Global oil and gas tax guide

2012

Ernst & Young

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Preface

The *Global oil and gas tax guide* summarizes the oil and gas corporate tax regimes in 70 countries and also provides a directory of Ernst & Young oil and gas tax contacts. The content is based on information current to 1 January 2012, unless otherwise indicated in the text of the chapter.

Tax information

This publication should not be regarded as offering a complete explanation of the tax matters referred to and is subject to changes in the law and other applicable rules. Local publications of a more detailed nature are frequently available, and readers are advised to consult their local Ernst & Young professionals for more information.

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Directory

Office addresses, telephone numbers and fax numbers, as well as names and email addresses of oil and gas tax contacts, are provided for the Ernst & Young member firms in each country. The listing for each tax contact includes a direct-dial office telephone number, if available.

The international telephone country code is listed in each country heading. Telephone and fax numbers are presented with the city or area code and without the domestic prefix (1, 9 or 0) sometimes used within a country.

Internet site

Further information concerning Ernst & Young's oil and gas services may be found at **www.ey.com/oilandgas.**

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A. At a glance

Fiscal regime

Depending on the date on which the petroleum contract was signed, the Algerian fiscal regime applicable to the oil and gas upstream industry is governed either by Law No. 86-14 dated 19 August 1986 or Law No. 05-07 dated 28 April 2005 (as amended by Ordinance No. 06-10 dated 19 July 2006), production sharing contract (PSC) or other similar contracts concluded between the Algerian authorities and the contractor.

The main taxes applicable in this sector are the following:

Under Law No. 86-14:

- Royalties
- Income tax
- Tax on extraordinary profits (TEP) or windfall tax

Under Law No. 05-07:

- Royalties
- Petroleum income tax (PIT)
- Additional profits tax (APT)
- Surface tax

Legal regime

- Law No. 86-14 governs the legal regime applicable to the activities of appraisal, exploration, exploitation and transportation of hydrocarbons, as well as constructions and installations enabling the performance of these activities.
- The scope of Law No. 05-07 is broader as it also provides for the legal regime applicable to the refining of hydrocarbons and to the commercialization, storage and distribution of petroleum products, as well as constructions and installations enabling the performance of these activities.

The 2005 regime provides for the transfer of some rights and duties from the national oil company (NOC) Sonatrach back to the Algerian State, through the newly created national agency for hydrocarbons (ALNAFT). For instance, ALNAFT is the sole holder of the permit for the exploration and exploitation of hydrocarbons.

ALNAFT may enter into contracts with third parties to perform exploration or exploitation activities.

However, the NOC maintains a key role, as invitations to tender for the award of an exploration and exploitation contract must contain a clause that awards the NOC a 51% interest in the contract.

Under Law No 05-07, the exploration and exploitation period is 32 years and follows a two-period approach.

Exploration period

The exploration period lasts a maximum of seven years (with an initial exploration phase of three years, followed by two phases of two years each). The exploration area is reduced by 30% at the end of the initial exploration phase and by another 30% after the second exploration phase.

Once a field has been discovered, a declaration of commerciality (déclaration de commercialité) and a draft of the development plan must be sent to ALNAFT for approval. Expected costs of development and a description of the exploitation area must be attached to the project development plan and a budget must be delivered annually. The draft of the development plan must specify the agreed spot or location, as a basis for the royalties calculation.

If the development plan includes the use of water, the contracting party will have to pay for the water at a rate of DZD80 per cubic meter.

Exploitation period

The exploitation period lasts a maximum of 32 years minus the duration of the exploration period. For dry gas fields, there is an additional five-year exploitation period.

In the case of known fields, the exploitation period lasts 25 years with a five-year extension concerning dry gas fields.

B. Fiscal regime

Hydrocarbon contracts signed before the publication of Law No. 05-07 remain governed by Law No. 86-14.

Law No. 05-07 has reformed the tax regime applicable to petroleum activities. There are two fiscal regimes applicable: a specific regime for exploration and production activities, and a common law regime for downstream activities that will not be presented here.

Main taxes under the former regime (Law No. 86-14), which remain applicable for certain contracts

Royalties

Royalties are due on the gross income and are paid by the NOC for the total production. The normal rate is 20% and can be reduced to 16.25% for Zone A and 12.5% for Zone B (corresponding to different zones of the Algerian territory). The royalty rate can be reduced beyond these by order of the Ministry of Finance, to a limit of 10%.

Income tax

Income tax applies to the profit made by the foreign partner and is subject to a 38% tax payable by the NOC on behalf of the foreign partner.

In practice, the income tax is included in the profit oil received by the NOC.

This profit is calculated by subtracting from the gross income the royalties, transportation costs, amortization costs and exploitation costs.

TEP or windfall tax

TEP was introduced by the Ordinance No. 06-10 dated 29 July 2006 and only applies to contracts signed under Law No. 86-14.

TEP applies to the output share of foreign partners of the NOC when the arithmetic average price of oil exceeds US$30 per barrel.

TEP applies at rates ranging from 5% to 50%.

The decree provides for different rates depending on the type of contract signed with the foreign partner, including:

- Contracts in which there is production sharing without distinction between hydrocarbons for reimbursement and hydrocarbons as a profit for the foreign partner and without a "price cap" mechanism
- Contracts in which there is production sharing with a clause containing a specific formula for calculating the compensation of the foreign partner without a "price cap" mechanism
- Contracts in which there is production sharing with a clause containing a specific formula for calculating the compensation of the foreign partner with a "price cap" mechanism

Main taxes applicable under Law No. 05-07, as amended

Surface fee

The surface fee is an annual tax that is not deductible. The amount of this tax depends on the territorial zone in which the operations are carried out and the surface of the perimeter.

The rates of the surface fee per square kilometer are:

	Exploration period				
	Years 1–3 included	Years 4–5	Years 6–7	Retention period and exceptional period	Production period
Area A	4,000	6,000	8,000	400,000	16,000
Area B	4,800	8,000	12,000	560,000	24,000
Area C	6,000	10,000	14,000	720,000	28,000
Area D	8,000	12,000	16,000	800,000	32,000

Zones A, B, C and D correspond to areas of the territory of Algeria.

Royalty

Royalties are calculated on the amount of hydrocarbons extracted from each perimeter of exploitation multiplied by the average monthly fixed price. They must be paid monthly to ALNAFT.

Royalties are established on the basis of the quantity of hydrocarbon production at the agreed spot (point de measure), which is the location at which the measurement of the hydrocarbons production will take place (Art 5 and 26 L. 2005).

The fixed price is calculated by reference to published indexes, depending on the nature of hydrocarbons.

The rate of royalties is determined under the terms of each contract. Nevertheless, the law has fixed a minimum rate for each area of production:

Area	A	B	C	D
0–20,000 BOE/day	5.5%	8.0%	11.0%	12.5%
20,001–50,000 BOE/day	10.5%	13.0%	16.0%	20.0%
50,001–100,000 BOE/day	15.5%	18.0%	20.0%	23.0%
> 100,000 BOE/day	12.0%	14.5%	17.0%	20.0%

The royalty is deductible for APT purposes.

PIT

The taxable basis corresponds to the value of the production of each perimeter of exploitation during the year minus deductible expenses.

The PIT is deductible for APT purposes.

The tax must be paid monthly by the operator.

The following taxes and expenses are deductible:

- Royalties
- Annual investments for exploration and development
- Reserves for abandonment or restoration costs
- Training costs

The tax rate is calculated by taking into consideration the volume of production since the beginning of production (accrued production) and is determined as follows:

Accrued production in DZD10	First accrued production point (S1)	70
	Second accrued production point (S2)	385
PIT rate	First level	30 %
	Second level	70 %
	Level when PV is between S1 & S2	40/ (S2-S1)*(PV-S1) + 30

When the accrued production since the beginning of exploitation (PV) is under S1, the PIT is calculated by using the first level rate (30%).

When the accrued production since the beginning of exploitation (PV) is above S2, the PIT is calculated by using the second level rate (70%).

When the accrued production since the beginning of exploitation (PV) is between S1 and S2, PIT is calculated using the following formula:

PIT rate % = 40/(S2-S1)*(PV-S1) + 30

Example:

If the accrued production since the beginning of exploitation (PV) is 200 * DZD10, the PIT rate would be:

40/(385-70)*(200-70) + 30 = 40/315*130 + 30 = 46.5%

"Uplift" rules apply to the annual research and development investments applying the following rates:

Zones	Uplift rate	Depreciation rate
A and B	15%	20% (5 years)
C and D	20%	12.5% (8 years)

Additional profits tax

This tax is due by all entities in the exploration or production contract.

This tax is due on the annual profits after PIT.

The following expenses are deductible for the calculation of the taxable basis:

- Royalties
- PIT
- Depreciation
- Reserves for abandonment or restoration costs

There are two applicable rates for the additional tax on profits:

- 30%
- 15% (for profits that are reinvested)

This tax must be paid at the date on which the annual income tax return is filed at the latest.

For calculation of this tax, contractors can consolidate their activities in Algeria.

Ancillary taxes

Gas flaring tax

Gas flaring is forbidden; however, ALNAFT can give exceptional authorization for a period not exceeding 90 days. The contractor is liable for a tax of DZD8,000 per thousand normal cubic meters (nm3).

This tax is not deductible for tax purposes.

C. Capital allowances

Under Law No. 05-07, the depreciation rates of investments in exploration and development are subject to an uplift mechanism that increases them, depending on the nature of the works and the zone on which the works were performed:

	Research and development	
Area	A and B	C and D
Rate of depreciation	20%	12.5%
Rate of uplift	15%	20%

D. Incentives

As a general rule, operations conducted under the former law regime (1986) and the new regime (2005) are exempt from:

- VAT
- Customs duties
- Social contributions (foreign employees of petroleum companies are not subject to social security contributions in Algeria if they remain subject to social security protection in their home country)

An exemption from the tax on professional activity applies to contracts signed under Law No. 86-14.

E. Withholding taxes

Withholding taxes (WHT) are not dealt with under the Hydrocarbons Law.

F. Financing considerations

There are no specific issues or limitations concerning the financing of hydrocarbons activities in Algeria.

G. Transactions

The transfer of an interest in a PSC governed by Law No. 05-07 is subject to 1% tax on the value of the transaction. This tax is also applicable to the transfer of a PSC signed under Law No. 86-14.

H. Indirect taxes

Facilities and services that are directly allocated to research and exploitation activities are exempt from VAT and customs duties.

I. Other

Foreign exchange controls

If exploration expenses were paid with imported convertible currency, nonresidents are authorized:

- To keep abroad the product of hydrocarbons exportations acquired according to the contract
- To freely use the proceeds of sales, on the national market, of hydrocarbons acquired according to the contract, and transfer them abroad

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A. At a glance

Fiscal regime

There are three types of contracts, each with different tax regimes:

1. Production sharing agreement (PSA) – the most common form of arrangement
2. Partnership – applicable only to certain partnerships set up in the 1960s and 1970s, such as Block 0 and FS/FST
3. Risk service contract (RSC)

Taxes applicable to all oil tax regimes:

Petroleum income tax (PIT)	50% (PSA) and 65.75% (partnership and RSC)
Surface fee (SF)	US$300 per square kilometer (km²)
Training tax contribution (TTC)	US$0.15 per barrel/US$100,000 to US$300,000[1]

Taxes applicable exclusively to partnerships:

Petroleum production tax (PPT)	20%[2]
Petroleum transaction tax (PTT)	70%
Investment incentives	U[3]

1 *Annual contribution of US$100,000 to US$300,000 only applicable before production phase.*

2 *May be reduced to 10%.*

3 *U: uplift on development expenditure under investment allowance.*

Legislation changes[4] enacted in 2012 envisage a tax reduction for Angolan national oil and gas companies. Angolan national oil and gas companies are all public companies owned by the State and/or Angolan public companies or private owned companies held in 100% by Angolan nationals. Per the changes, PIT is reduced from 50% (PSA) and 65.75% (partnership and RSC) to the equivalent of the industrial tax standard rate which is 35%.[5]

B. Fiscal regime

The tax regime applies to all entities, whether Angolan or foreign, within the Angolan tax jurisdiction that perform exploration, development, production, storage, sale, exportation, processing and transportation of crude oil and natural gas, as well as of naphtha, paraffins, sulfur, helium, carbon dioxide and saline substances from petroleum operations.

The current oil and gas taxation regime applies to concessions granted on or after 1 January 2005, as well as to profits or capital gains from assignment of an interest in an earlier concession.

A PSA is a contract between a contracting group and the state concessionaire under which the contracting group bears all expenditures for exploration and extraction of substances in the contract area together with related losses and risks.

The state concessionaire is a distinct department of Sonangol (the Angolan national oil company (NOC)), through which the Government manages its oil and gas properties and its contractual relationships with other oil companies.

Profit oil, under a PSA, is the difference between the total oil produced and oil for cost recovery (cost oil). Cost oil is the share of oil produced that is allocated for recovery of exploration, development, production and administration and service expenditures.

Profit oil is shared between the state concessionaire and its partners based on the accumulated production or on the contracting group rate of return (preferred method).

The computation of tax charges for each petroleum concession is carried out on a completely independent basis.

In a PSA, the assessment of taxable income is independent for each area covered by the PSA, except for the expenses provided for in Article 23, subparagraph 2 (b) of Law No. 13/04, dated 24 December, to which the rules in the preceding paragraph apply (generally, exploration expenditure).

Common revenues and costs associated with distinct development areas and concessions are allocated proportionally based on the annual production.

For the purposes of assessing taxable income, crude oil is valued at the market price calculated on the free-on-board (FOB) price for an arm's-length sale to third parties.

Bonuses may be due from the contracting group to the state concessionaire in compliance with the Petroleum Activities Law and cannot be recovered or amortized. Furthermore, a price cap excess fee may also be payable under a PSA whenever the market price per oil barrel exceeds the price fixed by the minister of oil. In both cases, the amounts are ultimately due to the Angolan state.

A contracting group may also be requested to make contributions for social projects to improve community living conditions (such as hospitals, schools and social housing), which also cannot be recovered or amortized.

4 *Presidential Legal Decree No. 3/12, of 16 March 2012.*

5 *This rate will be reduced to 30% under the Angolan tax reform. At the date of printing, the law has not yet been published in the Angolan Official Gazette, hence changes may occur.*

Entities engaged in business activities in Angola and not subject to the oil and gas taxation regime are subject to industrial tax on business profits. This tax is not dealt with in this guide. Moreover, this guide does not cover the specific tax regimes that apply to mining activities, as well as the incentives available under private investment law, such as exemptions from customs duties, industrial tax, dividends withholding tax, (WHT) and property transfer tax. Since a special regime is in force for the LNG Project, we also outline below the main features of said regime.

Petroleum income tax

PIT is levied on the taxable income assessed in accordance with the tax law from any of the following activities:

- Exploration, development, production, storage, sale, exportation, processing and transportation of petroleum
- Wholesale trading of any other products resulting from the above operations
- Other activities of entities primarily engaged in carrying out the above operations, resulting from occasional or incidental activity, provided that such activities do not represent a business

PIT does not apply to the receipts of the state concessionaire, premiums, bonuses and the price cap excess fee received by the state concessionaire under the terms of the contracts.

PIT is computed on accounting net income adjusted in accordance with the tax law. Tax law provides detailed guidelines on taxable revenues, deductible costs and non-deductible costs.

Under a PSA, tax-deductible costs should comply with the following general rules:

- Cost oil is limited to a maximum percentage of the total amount of oil produced in each development area, in accordance with the respective PSA (generally 50%, but may be increased up to 65% if development expenditures are not recovered within four or five years from the beginning of commercial production or from the year costs are incurred, whichever occurs later).
- Exploration expenditures are capitalized and are recognized up to the amount of cost oil (limited as above) not utilized in the recovery of direct production and development expenses as well as indirect administration and service expenses.
- Development expenditures are capitalized, and the amount is increased by the investment allowance (uplift) defined in the respective PSA and amortized at an annual rate of 25% up to the cost oil amount, from the year incurred or upon commencement of oil exportation, whichever occurs later.
- Production expenditures are expensed up to the cost oil amount.
- Administration and service expenditures are either capitalized and amortized (similar to development expenses) or immediately expensed up to the cost oil amount being allocated to exploration, development and production expenses.
- Inventory is allocated to exploration, development, production and administration and service activities in proportion to its utilization or consumption within oil operations.
- Strategic spare parts are allocated to exploration, development, production and administration and service expenses in accordance with the respective PSA.
- Costs incurred in assignment of a participating interest (the difference between acquisition price and recoverable costs plus the net value of remaining assets – goodwill) are considered development expenses (but do not benefit from uplift), provided such difference has been taxed at the level of the transferor.

- Should the cost oil amount not be enough to recover allowable expenses, the balance can be carried forward within the same concession.

Taxable income is fixed by an assessment committee on the basis of the tax return submitted. The committee validates the amounts reported and determines the taxable income. The taxpayer may challenge the amount determined by the committee.

If the company operates under a PSA, the tax rate is 50%; otherwise, the tax rate is 65.75%.

For partnerships and RSC, tax-deductible costs should comply with the following general rules:

- Costs incurred in exploration operations, drilling costs of development wells, costs incurred for production, transportation and storage facilities, as well as costs incurred with the assignment of a participating interest (the difference between the acquisition price and the capitalized costs plus the net value of remaining assets – goodwill, provided this difference has been taxed at the level of the transferor), are recognized at an annual rate of 16.666% as of the beginning of the year in which they are incurred, or the year in which oil is first commercially produced, whichever occurs later.
- Costs incurred before production are capitalized and recognized over a four-year period (25% per year) from the first year of production.
- If the costs exceed the revenues in a given year, the excess can be carried forward up to five years.

Petroleum production tax

PPT is computed on the quantity of crude oil and natural gas measured at the wellhead and on other substances, less the oil used in production as approved by the state concessionaire.

The tax rate is 20%. This rate may be reduced by up to 10% by the Government and upon petition by the state concessionaire in specific situations, such as oil exploration in marginal fields, offshore depths exceeding 750 meters or onshore areas that the Government has previously defined as difficult to reach. This tax is deductible for the computation of PIT.

PPT is not imposed under a PSA.

Petroleum transaction tax

PTT is computed on taxable income, which takes into account several adjustments in accordance with the tax law. The tax rate is 70%. This tax is deductible for the computation of PIT.

Deduction of a production allowance and an investment allowance is possible on the basis of the concession agreement. PPT, SF, TTC and financing costs are not deductible to compute the taxable basis.

PTT is not imposed under a PSA.

Surface fee

SF is computed on the concession area or on the development areas whenever provided for in the application agreement of Decree-Law No. 13/04.

The surcharge is equivalent to US$300 per km² and is due by partners of the state concessionaire. This surcharge is deductible for PIT purposes.

Training tax contribution

This levy is imposed on oil and gas exploration companies as well as production companies, as follows:

- US$0.15 per barrel – for production companies as well as companies engaged in refinery and processing of petroleum
- US$100,000 a year – for companies owning a prospection license
- US$300,000 a year – for companies engaged in exploration

The levy is also imposed on service companies that contract with the above entities for more than one year.

The levy for service companies is computed on the gross revenue from any type of contract at the rate of 0.5%. If a clear distinction exists between goods and services it may be possible to exempt the portion relating to the goods and, in some circumstances, it may also be possible to exempt part of the services for work entirely performed abroad.

The same 0.5% also applies to the revenue obtained by entities engaged in the storage, transport, distribution and trading of petroleum.

Angolan companies with capital more than 50% owned by Angolan nationals are not subject to this levy. Also excluded from this levy are:

- Foreign companies that supply materials, equipment and any other products
- Services providers and entities engaged in the construction of structures (or similar), which execute all or most of the work outside Angola
- Entities engaged in a business not strictly connected with the oil industry

C. Capital allowances

Investment allowances (uplift on development expenses) may be granted by the Government upon request made to the ministers of oil and finance. The amount and conditions are described in the concession agreement. Uplift may range between 30% and 40%, based on the profitability of the block.

Production allowances exist for certain blocks, which allow for the tax deduction of a fixed US dollar amount per barrel produced in all development areas in commercial production from a predefined date. This deduction is available up to the unused balance of cost oil.

D. Incentives

The Government may grant an exemption from oil industry-related taxes, a reduction of the tax rate or any other modifications to the applicable rules, whenever justified by economic conditions. This provision may also be extended to customs duties and other taxes.

The PSA entered into between the Government and the oil company may override the general taxation regime and may set forth specific taxation rules and rates.

E. Withholding taxes

For companies operating in the oil and gas industry, no WHT is levied on dividends.

Interest is normally subject to 10% (shareholders loans) or 15% investment income WHT.

Royalties are subject to 10% investment income WHT.

Industrial WHT applies to service payments at the rate of 5.25%.[6]

No branch profits remittance tax applies in Angola.

F. Financing considerations

There are no thin capitalization rules in Angola. However, finance expenses are not deductible for PIT, except for borrowings with banks located in Angola upon authorization by the ministers of finance and oil.

G. Transactions

Profits or capital gains, whether accounted for or not, on the sale of oil and gas interests are included in the calculation of taxable profit.

No tax is levied on the share capital of oil and gas companies.

Other income is generally included in the taxable basis for the PIT computation.

6 *A 6.5% WHT rate is established in the draft of the new industrial tax code amended under the Angolan tax reform. At the time of printing the law has not yet been published in the Angolan Official Gazette, hence changes may occur.*

H. Indirect taxes

Consumption tax

Consumption tax is levied on goods produced in or imported into Angola, and also on the consumption of water, energy, telecommunication services and tourism industry services (hotels and restaurants). The general rate is 10%, but it may vary between 2% and 30%, depending on the nature of the goods or service. The rate is 5% for water, energy and telecommunication services.

With the amendments introduced to the Consumption Tax Code,[7] apart from the production of goods in Angola, importation of goods, goods sold by customs authorities or other public services, use of goods or raw materials outside the productive process that have benefited from a tax exemption, consumption of water and energy, telecommunication services and tourism services (including hotels and restaurants), the following services are subject to consumption tax:

Services	Rate
Lease of areas for parking of cars	5%
Lease of machinery or equipment, as well as work done on movable assets, excluding the lease of machinery and other equipments that for its nature originate the payment of royalties in accordance with the terms defined with the Investment Income Tax code	10%
Lease of areas prepared for conferences, exhibitions, publicity and other events	10%
Consulting services, including, legal, tax, financial, accounting, computer and information, engineering, architecture, economics, real estate, audit, statutory audit and lawyers' services	5%
Photographic services, film processing and image processing, informatics and website creation services	5%
Port and airport services and broker services	5%
Private security services	5%
Travel and tourism agency services promoted by tourism agencies or touristic operators	10%
Canteen, cafeteria, dormitory, real estate and condominium management services	5%
Access to cultural, artistic and sporting events	5%
Transportation services by water, air, land, cargo and containers, including storage related with these transportations, provided that exclusively rendered in Angola	5%

Consumption tax must be paid by the goods supplier or service provider. If certain services are rendered by a nonresident entity, a reverse charge mechanism applies where an Angolan acquirer must assess and pay the respective consumption tax.

Any consumption tax benefit or advantage granted to importation of certain type of goods must also be extended to its production.

Customs duties

Customs duties are levied on imported goods, including equipment. The rates vary between 2% and 30%, according to the goods tariff classification.

7 *The amendments to the Consumption Tax Code were made public on 28 February 2012 and, in practice, enacted as from 1 April 2012.*

The oil and gas industry has a special customs regime that provides an exemption from customs duties, consumption tax and general levies and taxes on the importation of goods to be used exclusively in oil and gas operations (although stamp duty and statistical tax still apply). The list of goods may be added to upon a petition to the minister of finance. The importer should present to the customs authorities a declaration stating that the goods are to be exclusively used in such operations.

A temporary import regime granting an exemption from customs duties and consumption tax is also available for goods that are exported within one year (general regime) or two years (oil and gas industry regime); this may be extended upon petition. A temporary exportation regime is also available for goods shipped abroad for repairs, provided the goods are re-imported within a one-year period.

The exportation of oil produced in each concession before or after processing is exempt from duties, except from stamp duty on customs clearance documents, the statistical tax of 0.1% ad valorem and other fees for services rendered.

Stamp duty

Stamp duty is levied on a wide range of operations, including:

- Acquisition and financial leasing of real estate at 0.3%
- Collection of payments as a result of transactions at 1%
- Real estate lease at 0.4%
- Lease of equipment at 0.4%
- Importation of goods and equipment at 1%
- Bank guarantees between 0.1% and 0.3%
- Insurance premiums between 0.1% and 0.4%
- Financial transactions between 0.01% and 0.5%

The transfer of shares in an oil company should not be subject to stamp duty; however, the transfer of oil and gas assets may be dutiable property.

The rates vary between 0.001% and 1%, but may also be a nominal amount, depending on the operation.

Some of the stamp duty rates apply starting from 1 April 2012.

Emoluments

General customs emoluments at the rate of 2% of the customs value of the goods are also chargeable on the importation of goods.

Transport expenses also apply and may vary, depending on the means of transport used and the weight of the goods.

Generally, goods used in the oil and gas industry may be exempt from tax and duties except from stamp tax at 1% and statistical tax at 0.1%.

I. LNG Project

The Angola LNG Project (the Project) — meaning all activities and installations aimed at receiving and processing associated gas in Angola, production in Angola of liquefied natural gas (LNG) and natural gas liquids (NGL), as well as respective commercialization — has been considered of public interest, hence special incentives for tax, customs and exchange controls have been granted under Decree-Law No. 10/07.

The Project is subject to the laws applicable to petroleum activities, namely, the Petroleum Activities Law, the Petroleum Activities Taxation Law and the customs regime law applicable to the oil sector, as complemented and amended by the mentioned Decree-Law.

Angola LNG Limited is the main entity responsible for executing the Project, through which the promoting companies hold their investment and rights. Other companies, such as Sociedade Operacional Angola LNG and Sociedade Operadora dos Gasodutos de Angola, act in representation of Angola LNG Limited. Promoting companies, which are the original shareholders of Angola

LNG Limited, include Cabinda Gulf Oil Company Limited, Sonangol – Gas Natural Limitada, BP Exploration (Angola) Limited and Total Angola LNG Limited.

Petroleum income tax

Taxable profit of Angola LNG Limited is subject to PIT computed considering the rules stated in Decree-Law No. 10/07 and other related legislation. Tax losses can be carried forward for five years.

Taxable profit is imputed to the promoting companies under a sort of tax transparency regime. The applicable PIT rate is 35%.

Promoting companies enjoy a tax credit for 144 months from the commercial production date, against the PIT liability, determined as per Decree-Law No. 10/07.

An exemption from PIT applies to interest and dividends obtained by affiliates (of promoting companies) that hold a participating interest in a block through which a production contract is entered into with Sonangol.

Training tax contribution

Angola LNG Limited is subject to TTC of US$0.15 per LNG barrel, increased by US$0.02 per each mmbtu of LNG sold.

Gas surcharge

Angola LNG Limited is subject to the payment of a gas surcharge, on a quarterly basis, as from the first LNG export.

Industrial tax

Any income obtained by Angola LNG Limited, the promoting companies and their affiliates, related to the commercial activities and transactions realized under the Project, benefits from an industrial tax exemption.

Profits obtained by Sociedade Operacional Angola LNG and Sociedade Operadora dos Gasodutos de Angola are subject to industrial tax, although specific rules apply.

Payments made by Angola LNG Limited to Sociedade Operacional Angola LNG and Sociedade Operadora dos Gasodutos de Angola, as well as the payments between Sociedade Operacional Angola LNG and Sociedade Operadora dos Gasodutos de Angola, concerning the execution of any service contract, are not subject to industrial tax withholdings.

Concerning service contracts (including the supply of materials) entered into by Angola LNG Limited, Sociedade Operacional Angola LNG and Sociedade Operadora dos Gasodutos de Angola, these companies are not required to perform industrial tax withholdings. This exemption only applies during a specific time frame. This is also applicable to the entities contracted and subcontracted and to the subcontracts aimed at the rendering of services or works (including the supply of materials) for the Project.

Investment income tax

Interest income derived from shareholder loans or other loans made by the promoting companies, respective affiliates and third parties, for the benefit of Angola LNG Limited, Sociedade Operacional Angola LNG, Sociedade Operadora dos Gasodutos de Angola or other companies they have incorporated, will be exempt from investment income tax. A similar exemption, under certain conditions, may apply on interest derived from loans made between the promoting companies.

Promoting companies and their affiliates are exempt from investment income tax on dividends received from Angola LNG Limited, Sociedade Operacional Angola LNG and Sociedade Operadora dos Gasodutos de Angola.

Angola LNG Limited, Sociedade Operacional Angola LNG, Sociedade Operadora dos Gasodutos de Angola or any other company incorporated by them are not required to withhold investment income tax in relation to payments under certain lease contracts, transfer of know-how, and intellectual and industrial property rights. This exemption only applies during a specific time frame.

Other tax exemptions

Income obtained by Sonangol from payments for the use of the associated gas pipelines network, made by Angola LNG Limited under the investment contract, is exempt from all taxes and levies. Angola LNG Limited should not perform any withholdings on such payments.

Angola LNG Limited, Sociedade Operacional Angola LNG, Sociedade Operadora dos Gasodutos de Angola, promoting companies and their affiliates are exempt from all other taxes and levies that are not specified in Decree-Law No. 10/07, namely: PPT, PTT, urban property tax, property transfer tax, investment income tax and stamp duty (under certain conditions). Notwithstanding, these companies are subject to the standard administrative surcharges or contributions due in relation to commercial activities and transactions associated with the Project, provided such surcharges and contributions are generically applicable to the remaining economic agents operating in Angola.

The transfer of shares in Angola LNG Limited, Sociedade Operacional Angola LNG and Sociedade Operadora dos Gasodutos de Angola, without a gain, should be exempt from all taxes and levies. Moreover, no taxes or levies are imposed on the shares of the mentioned companies, including increases and decreases of capital and stock splits.

No taxes or levies are imposed to the transfers or remittances of funds to make any payment to the promoting companies, their affiliates or third parties making loans that are exempt from income tax or WHT, as per Decree-Law No. 10/07, including the reimbursement of capital and payment of interest in relation to shareholder loans and other loans, as well as the distribution of dividends in accordance with the above Decree-Law.

Customs regime

In accordance with the Project's regime, the customs procedure applicable to the operations and activities is that established for companies in the customs regime law applicable to the oil industry, with the changes and adjustments stated in Decree-Law No. 10/07.

This customs regime is applicable to Angola LNG Limited, Sociedade Operacional Angola LNG, Sociedade Operadora dos Gasodutos de Angola and other entities that carry out operations or activities related to the Project on behalf of Angola LNG Limited, Sociedade Operacional Angola LNG or Sociedade Operadora dos Gasodutos de Angola.

In addition to the goods listed in the customs regime law applicable to the oil industry, also exempted from customs duties are various other products that are exclusively used for the purposes of the Project.

Angola LNG Limited, Sociedade Operacional Angola LNG and Sociedade Operadora dos Gasodutos de Angola are subject to surcharges on all acts of importation and exportation (up to the limit of 0.1%), a statistical surcharge on all acts of importation and exportation (0.1% ad valorem) and stamp duty on all acts of importation and exportation (1%).

J. Other

Personal income tax

Employees working in Angola are subject to personal income tax, which is charged under a progressive rate system up to 17%. Personal income tax is paid through the WHT mechanism operated by employers (PAYE system).

Social security

Nationals or foreign individuals working in Angola are subject to the local social security regime. Contributions are paid by the employer and are due at the rates of 8% for employers and 3% for employees. Individuals temporarily working in the country may be exempt from local contributions if they remain affiliated to a compulsory regime abroad.

Petroleum activities law main features

Concession rights and mineral rights are attributed to the state concessionaire. Foreign or local entities may contract with the state concessionaire as investors. Any company that wants to conduct oil and gas operations in Angola must do so in partnership with the state concessionaire – except for operations within the scope of an exploration license.

Partnership with the state concessionaire may take one of the following forms: a company, a consortium agreement or a PSA. The state concessionaire is also permitted to carry out oil and gas activities under RSCs. In some cases, an incorporated joint venture may also be put into place. As a general rule, if the joint venture takes the form of a company or a consortium agreement in which the state concessionaire has an interest, the state interest should be greater than 50% (although the percentage may be lower upon receiving Government authorization).

The partnership must be pre-approved by the Government. The operator, which may or may not be a partner, must be stated in the concession agreement following a proposal by the state concessionaire. The operator or the partner must be a commercial company.

The investment risk during the exploration phase is taken by the parties that have contracted with the state concessionaire, with no recovery of their investment if no economic discovery is made.

Borrowings for investments from third parties by the state concessionaire or its partners must be authorized by the Government if oil production is used as security.

An exploration license or an oil concession is required to carry out the activity.

Hiring of contractors by oil and gas companies

Local regulations provide for the following three regimes:

1. Limited free trade regime – certain services should only be provided by local companies (foreign contractors are excluded)
2. Semi-free trading regime – certain services may only be provided by local companies or foreign contractors when associated with local partners
3. Free trade regime – all services related to oil and gas activity (onshore and offshore) that are not within either of the two previous regimes, and that require a high level of industry expertise, may be freely provided by local companies or by foreign contractors, although joint ventures with local partners are possible

To be considered as a local company, the majority of the share capital must be owned by Angolan investors, and the company must be registered with the Ministry of Petroleum or the Angolan Chamber of Commerce and Industry.

Licensed entities, the state concessionaire and its partners, as well as all entities that participate in oil operations, must:

- Acquire materials, equipment, machinery and consumption goods produced locally, provided they are of equivalent quality and are available in reasonable time, at prices not exceeding more than 10% of the cost of imported items (including transportation, insurance and customs costs)
- Contract with local service providers if the services rendered are identical to those available in the international market and the price, when liable to the same level of tax, does not exceed the prices charged by foreign service providers for similar services by more than 10%
- Recruit local nationals, unless there are no locals with the required qualifications and experience

Foreign exchange controls

Legislation was approved in January 2012 to introduce new foreign exchange control regulations applicable only to the oil and gas sector.

The new rules aim primarily to establish a uniform treatment in this sector by replacing the multiple exchange regimes that have been applied to the oil and gas upstream companies operating in Angola, providing fair treatment to all investors.

These foreign exchange control rules cover the trade of goods and services and capital movements arising from the prospecting, exploration, evaluation, development and production of crude oil and natural gas.

For the purpose of the rules, exchange operations will encompass (i) the purchase and sale of foreign currency, (ii) the opening of foreign currency bank accounts in Angola by resident or nonresident entities and the transactions carried out through these bank accounts, (iii) the opening of national currency bank accounts in Angola by nonresident entities and the transactions carried out through these bank accounts, and (iv) the settlement of all transactions of goods, services and capital movements.

The state concessionaire and corporate investors, domestic or foreign, must carry out the settlement of foreign exchange transactions through bank institutions domiciled in the country and authorized to conduct foreign exchange business. This must be done by opening bank accounts, in the foreign currency, and depositing sufficient funds for tax payments and other mandatory payments for the settlement of goods and services provided by residents or nonresident entities.

The Angolan Central Bank (Banco Nacional de Angola (BNA)) will establish a phased implementation of the procedures and mechanisms to be adopted by the agents carrying out foreign exchange transactions and will ensure correct enforcement within a period not exceeding 24 months.

This legislation shall enter into force 120 days following its date of publication.

Other

The state concessionaire and its partners must adopt an accounting system in accordance with the rules and methods of the General Accounting Plan. The Ministry of Finance may issue rules to adjust the accounts if the currency devalues, using the US dollar as a benchmark. Accounting records must be maintained in Angola, and book entries should be made within 90 days.

The fiscal year is the calendar year. The time allowed in Article 179 of the Commercial Companies Code for the approval of the balance sheet and the report of the board of auditors is reduced to two months.

Documents must be submitted in Portuguese, using kwanza (the Angolan national currency), and these documents must be signed and stamped to indicate approval by a director. Oil tax returns are filled in thousand kwanza and US dollars.

Angola is undergoing a significant tax reform; hence, inter alia, WHT, indirect taxes and other taxes will be considerably impacted and amended during year 2012.

The new urban property tax, investment income tax, stamp tax and consumption tax codes have already been published. The remaining codes — personal income tax and industrial tax codes, large taxpayers regime, new transfer pricing regulations, tax consolidation regime and the new legal regime of invoices — will be published in the *Angolan Official Gazette* during the current year.

Argentina

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A. At a glance

Fiscal regime

Argentina is organized into federal, provincial and municipal Governments. The fiscal regime that applies to the petroleum industry principally consists of federal and provincial taxes.

Corporate income tax (CIT)	35%
Withholding tax (WHT)	Dividends 0% Interest 15.05%/35% Royalties 21%/28%/31.5%
Minimum presumed income tax (MPIT)	1%
VAT	21% (general rate)
Stamp tax	1% (general rate)
Turnover tax	2.5% (average rate)
Customs duties	Importation taxes (rates on cost, insurance and freight (CIF)), importation duty 0%/35.0%, statistical rate 0.5%, VAT 10.5%/21% and withholding on: income tax 0%/3%/11%, VAT 0%/5%/10% and turnover tax 0%/1.5%
Export taxes	General export duty (5% to 25% on free-on-board (FOB) price) plus an additional rate applicable to crude oil
Tax on debits and credits in checking accounts	0.6% (6‰)
Personal assets tax	Equity interest on local entities 0.5%
Social security tax	Employer 23% to 27%, employee 17%

B. Fiscal regime

Argentina is organized into federal, provincial and municipal Governments. The main taxes imposed on the petroleum industry by the National Government include income tax, VAT, minimum presumed income tax, personal assets tax, tax on debits and credits in checking accounts, custom duties and social security taxes.

Provincial taxes imposed on the petroleum industry are turnover tax, stamp tax and royalties (this applies to upstream companies only).

Municipalities may impose taxes within their jurisdictions.

Taxation powers are jointly exercised by the National and provincial Governments up to three nautical miles offshore, measured from the lowest tide line. However, the National Government has exclusive taxation power up to 200 nautical miles offshore.

Corporate income tax

Argentine resident corporations and branches are subject to income tax on their non-exempt, worldwide income at a rate of 35%.

Consolidation

No system of group taxation applies in Argentina. Members of a group must file separate tax returns. There are no provisions to offset the losses of group members against the profits of another group member.

Tax losses

Net operating losses arising from the transfer of shares or equity interests may only offset income of the same origin. The same applies to losses from activities that are not sourced in Argentina and from transactions under derivative agreements (except for hedging transactions). All tax losses generated in a tax period may be carried forward to the five periods following the period when the losses were incurred.

Thin capitalization

Thin capitalization rules require a debt-to-equity ratio of 2:1 for the deduction of interest derived from loans granted by foreign entities that control the Argentine borrower company (according to the definition provided for transfer pricing purposes), except when interest payments are subject to the maximum 35% withholding rate (according to conditions mentioned in Section C).

The rate that applies is the rate chargeable under the income tax law or that provided by the relevant treaty signed by Argentina to avoid international double taxation, whichever is less. If the treaty rate is less than 35%, thin capitalization rules must be observed by the local borrower to the extent that the above-mentioned control condition is satisfied.

Transfer pricing

Transfer pricing rules follow the Organization for Economic Cooperation and Development (OECD) guidelines (arm's-length principle).

Depreciation

The following depreciation principles apply:

- Intangible assets related to the oil and gas concession — depreciation based on units of production
- Wells, machinery, equipment and productive assets — depreciation based on units of production
- Other tangible assets (vehicles, computers) — straight-line, considering the useful lives of the assets

Minimum presumed income tax

MPIT is assessed at a rate of 1% on the value of the taxpayer's assets at the end of the taxpayer's accounting period. Value in this case excludes shares in Argentine companies. In addition, value excludes investments in new movable assets or infrastructure for the initial year of investment and the succeeding year.

MPIT is due to the extent that a taxpayer's MPIT liability exceeds its CIT. This excess is then treated as a tax credit that may be carried forward for the 10 years following the year the tax was paid. To the extent that the taxpayer's CIT exceeds MPIT during this 10-year period, the credit may be used to reduce the CIT payable, up to the amount of this excess.

C. Withholding taxes

Generally, no WHT applies to dividends. However, if the amount of a dividend distribution or a profit remittance exceeds the after-tax accumulated taxable income of the payer, a final WHT of 35% may be imposed on the excess.

A WHT rate of 15.05% applies on interest payments related to the following types of loans:

- Loans granted by foreign financial entities that are located in jurisdictions not listed as tax havens under the Argentine income tax regulations, or jurisdictions that have signed exchange of information agreements with Argentina (and have internal rules providing that no banking, stock market or other secrecy regulations can be applied to requests for information by the Argentine tax authorities)
- Loans for the importation of movable assets, except automobiles, if the loan is granted by the supplier of the goods

In general, the WHT rate for all other interest payments to nonresidents is 35%.

The general WHT rate for royalties is 31.5%. If certain requirements are met, a 21% rate may apply to technical assistance payments, and a 28% rate may apply to certain royalties (e.g., trademarks).

D. Indirect taxes

VAT

VAT is levied on the delivery of goods and the provision of services derived from an economic activity, on the import of goods and on the import of services to be used or exploited in Argentina.

The standard VAT rate is 21%. This rate is reduced for certain taxable events (e.g., sales, manufacturing, fabrication or construction and definitive imports of goods that qualify as "capital assets" according to a list included in the VAT law, and on interest, commissions and fees on loans granted by financial institutions, subject to certain conditions).

Exports are exempt from VAT. Taxpayers may claim a refund from the Government for VAT paid relating to exports.

The VAT that a company charges on sales or service provisions is known as "output VAT." The VAT paid by companies for goods or services purchases is called "input VAT." In general, companies deduct input VAT from output VAT every month, and pay the difference (if any). VAT returns are filed monthly.

If, in a given month, the input VAT exceeds the output VAT, the difference may be added to the input VAT for the next month. A taxpayer is not entitled to a refund unless the accumulated input VAT is related to exports.

Stamp tax

Stamp tax is a provincial tax levied on acts formalized in Argentina through public or private instruments. It is also levied on instruments formalized abroad when they produce effects in Argentina.

In general, effects are produced in Argentina when the following activities occur in its territory: acceptance, protest, execution, demand on compliance and payment. This list is not exhaustive.

Each province has its own stamp tax law, which is enforced within its territory.

The documents subject to stamp tax include agreements of any kind, deeds, acknowledged invoices, promissory notes and securities.

The general rate is approximately 1% but, in certain cases, for example, when real estate is sold, the rate may reach 4%. However, rates vary according to the jurisdiction.

Royalties

Royalties in Argentina amount to 12% of the wellhead value of the product. Royalties may be treated as an immediate deduction for CIT purposes.

Turnover tax

Provincial Governments apply a tax on the gross revenues (or turnover) of businesses. The rates are applied to the total amount of gross receipts accrued in the calendar year. The average rate is 2.5% (for upstream companies). The rate could be higher for service companies in the oil and gas industry.

Exports are exempt for turnover tax purposes for all activities without any formal procedure.

Customs duties

Argentina is a member of the World Trade Organization (WTO), the Latin American Integration Association (ALADI) and the MERCOSUR (South American trade block).

As a member of the WTO, Argentina has adopted, among other basic principles, the General Agreement on Tariffs and Trade (GATT) value code, which establishes the value guidelines for importing goods.

The ALADI is an intergovernmental agency that promotes the expansion of regional integration to ensure economic and social development, and its ultimate goal is to establish a common market. Its 12 member countries are Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela.

The MERCOSUR was created in 1991, when Argentina, Brazil, Uruguay and Paraguay signed the Treaty of Asunción. The basic purpose of the treaty is to integrate the four member countries through the free circulation of goods, services and productive factors, and establish a common external tariff. Chile and Bolivia are associated with MERCOSUR as acceding countries, and Venezuela is in the process of being incorporated as a full member.

The import of goods originating in any of the member countries is subject to a 0% import duty.

Importation taxes

In Argentina, importation duties are calculated on the CIF value of goods, valued using GATT valuation standards. The duty rate ranges from approximately 0% to 35%, according to the goods, which should be identified for duty purposes using common MERCOSUR nomenclature tariffs.

Additionally, the importation of goods is subject to the payment of a statistical rate, which is 0.5% of the CIF value of goods, with a US$500 cap and VAT (10.5%/21%, depending on the goods). VAT payable at importation may be treated as input VAT by the importer.

The definitive importation of goods is subject to an additional income tax withholding of 3%, 6% or 11% (depending on the classification of the imported goods), VAT withholding (5% or 10%) and turnover tax withholding (1.5%).

These tax withholdings constitute an advance tax payment for registered taxpayers of tax calculated in the tax return for the relevant tax period.

Export taxes

Export duty is levied on the export of goods for consumption, i.e., the definitive extraction of merchandise from Argentina. The duty is calculated based on the FOB value of the goods, using the Argentine Customs Code standards. Any other taxes and charges levied on exports and the CIF value of materials imported on a temporary basis are excluded from the taxable value, if they have been included in the value of goods.

The duty rate ranges from approximately 5% to 25%, according to the exported goods, which should be classified for duty purposes using the tariff of common MERCOSUR nomenclature.

In the case of the export of crude oil, an additional rate applies (described below).

Other taxes

Tax on debits and credits in checking accounts

The tax on debits and credits in checking accounts is assessed at a 6‰ rate, based on the amount of the credit or debit made in the checking account. The tax is determined and collected by the bank.

Additionally, 34% of the tax paid for bank account credits may be offset against income tax or MPIT returns and related tax advances.

Personal assets tax

Personal assets tax applies to individuals with assets owned as at 31 December each year. Taxpayers are required to pay the equivalent of 0.5% to 1.25% of the assets owned as at that date, depending on their global tax value if it exceeds a certain amount. For resident individuals, the tax applies on assets owned in Argentina and abroad. For nonresident individuals, the tax applies only on assets owned in Argentina.

The law presumes (without admitting evidence to rebut the presumption) that shares, quotas and other participation interests held in the capital of Argentine companies that are held by nonresident entities are indirectly owned by foreign individuals; thus, the tax applies to this type of ownership. The tax amounts to 0.5% annually (based on the equity value according to the financial statements), which must be paid by the Argentine companies as substitute taxpayers. The substitute taxpayer is consequently entitled to ask for the refund of the tax from its shareholders or partners.

Social security taxes

Salaries paid to employees are subject to employer and employee contributions to the social security system, which are withheld from the salary.

The percentages for employers and employees are 23% and 17%, respectively. The employee's tax must be withheld from the salary payment by the employer.

Additionally, if a company's main activity is commerce or the provision of services and its average sales for the last three fiscal years exceed ARS48 million (about US$11 million), the social security taxes borne by the company rise from 23% to 27%.

Province of Tierra del Fuego

A special tax regime currently applies to certain activities carried out in the Province of Tierra del Fuego. Law No. 19640 establishes that individuals, undivided estates and legal persons are exempt from any national tax that may apply to events, activities or transactions performed in the Province of Tierra del Fuego, Antarctica and the South Atlantic Islands, or that relate to assets located in Tierra del Fuego. As a result, activities carried out in the Province of Tierra del Fuego are exempt from CIT, VAT and MPIT. Furthermore, employees working in this province are exempt from income tax.

Oil prices (additional export tax)

- Local prices: the prices are regulated by the Government but must not exceed US$42 per barrel
- Export prices: West Texas Intermediate (WTI) less export tax (discussed below)

Method of calculation of export tax:

$$\% = \frac{IP - CV}{CV} \times 100$$

$$CV \times \% \Rightarrow W$$

$$IP - W \Rightarrow NP$$

IP	100	90	80	70
CV	42	42	42	42
%	138,10%	114,29%	90,48%	66,67%
W	58	48	38	28
NP	42	42	42	42

IP	International price (WTI)
CV	Cap value
%	% applicable over CV
W	Export withholding
NP	Net price (IP – W)

The net price (NP) is the maximum price that would be obtained by an oil and gas company based on the application of this calculation method (US$42 per barrel). This NP does not include the incidence of transportation, quality differential, federal and provincial taxes. These costs should be deducted from the NP.

E. Other

Business presence

In Argentina, forms of "business presence" typically include corporations, foreign branches and joint ventures (incorporated and unincorporated). In addition to commercial issues, the tax consequences of each form are important considerations when setting up a business in Argentina. Unincorporated joint ventures are commonly used by companies in the exploration and development of oil and gas projects.

Foreign exchange controls

The executive branch and the Central Bank have issued regulations that establish certain requirements for the transfer of funds abroad. Exporters must repatriate into Argentina the cash derived from the exports of goods and services within a specified time period. Funds derived from loans granted from abroad must be received in Argentina and remain in the country for a minimum term. In certain circumstances, 30% of the funds received from abroad must be held as foreign currency in a non-interest bearing deposit for a one-year period. Payments abroad of dividends, loans, interest, and principal and imports of goods are allowed if certain requirements are met.

Treaties to avoid international double taxation

Argentina has 17 treaties in effect to avoid double international taxation (the application of one of them is under discussion) and thus promote reciprocal investment and trade. In addition, a treaty with the Russian Federation that had been signed in October 2001 has been ratified by law (published in the Official Bulletin in January 2007), and it will become effective once the Governments have been mutually notified of the respective internal procedures required for its application.

Also, Argentina has entered into specific international transportation treaties with several nations.

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A. At a glance

Fiscal regime

The fiscal regime that applies in Australia to the petroleum industry consists of a combination of corporate income tax (CIT) and either a petroleum resource rent tax (PRRT) or royalty-based taxation.

Royalties[8]	0% to 12.50%
Income tax rate	CIT rate 30%
Resource rent tax	40%[9]
Capital allowances	D, E, O[10]
Investment incentives	L, RD[11]

B. Fiscal regime

The current fiscal regime that applies in Australia to the petroleum industry consists of a combination of CIT and either a PRRT or royalty-based taxation.

Corporate income tax

Australian resident corporations are subject to income tax on their non-exempt, worldwide income at a rate of 30%. The net income of nonresident corporations from Australian sources that is not subject to final withholding tax or treaty protection is also subject to tax at 30%. The 30% rate applies to income from Australian oil and gas activities.

8 *Under the current law, depending on the location of the production, either a PRRT or royalty will apply. PRRT is proposed to apply to all onshore projects from 1 July 2012.*

9 *PRRT paid is deductible for income tax purposes.*

10 *D: accelerated depreciation; E: immediate write-off for exploration costs and the cost of permits first used in exploration; O: PRRT expenditure uplift.*

11 *L: losses can be carried forward indefinitely; RD: R&D incentive.*

Australia does not apply project ring-fencing in the determination of corporate tax liability. Profits from one project can be offset against the losses from another project held by the same tax entity, and, similarly, profits and losses from upstream activities can be offset against downstream activities undertaken by the same entity.

Australia has tax consolidation rules whereby different Australian resident wholly owned legal entities may form a tax consolidated group and thereby be treated as a single tax entity.

CIT is levied on taxable income. Taxable income equals assessable income less deductions. Assessable income includes ordinary income (determined under common law) and statutory income (amounts specifically included under the Income Tax Act). Deductions include expenses, to the extent they are incurred in producing assessable income or are necessary in carrying on a business for the purpose of producing assessable income. However, an expenditure of a capital nature is not deductible.

Deductions for expenditures of a capital nature may be available under the "uniform capital allowance regime." This would most relevantly be in the form of a capital allowance for depreciating assets (see below). However, there may be deductions available for other types of capital expenditures (e.g., an expenditure incurred to establish an initial business structure is deductible over five years).

Profits from oil and gas activities undertaken by an Australian resident company in a foreign country are generally exempt from tax in Australia, provided they are undertaken through a foreign permanent establishment.

In 2010, following an extensive review of Australia's taxation system, the Australian Government announced a proposed reduction of the corporate tax rate from 30% to 29% from 2013–14. Small companies will benefit from an early cut to the company tax rate to 29% from 2012–13. These changes are yet to be legislated, and the Government announcement indicated that these reductions are dependent on the introduction of the proposed resources taxation regime for iron ore, coal and onshore oil and gas (see PRRT section).

Capital gains

Gains resulting from a capital gains tax (CGT) event may be subject to taxation. Gains arising for assets acquired prior to 20 September 1985 can be disregarded subject to the satisfaction of integrity measures. Capital gains or losses are determined by deducting the cost base of an asset from the proceeds (money received or receivable, or the market value of property received or receivable). For corporate taxpayers, the net capital gain is taxed at 30%.

Capital losses are deductible against capital gains and not against other taxable income. However, trading losses are deductible against net taxable capital gains, which are included in taxable income. Net capital losses can be carried forward indefinitely for use in subsequent years, subject to meeting loss carryforward rules.

Capital gains and losses on disposals of plant and depreciating assets acquired on or after 21 September 1999 are not subject to the CGT provisions. Instead, these amounts are treated as a balancing adjustment under the depreciation rules and are taxed on revenue account (see "Asset disposals" in Section G).

Oil and gas exploration permits, retention leases and production licenses acquired after 30 June 2001 are treated as depreciating assets and, therefore, are not subject to CGT. Permits, leases and licenses acquired on or before 30 June 2001 are subject to the CGT provisions.

For interests in foreign companies of 10% or more, capital gains or losses derived by an Australian resident company for the disposal of shares in a foreign company are reduced according to the proportion of active versus passive assets held by the foreign company. Foreign companies with at least 90% active assets can generally be disposed of free of tax.

Australian companies with foreign branch active businesses (which will generally include oil- and gas-producing assets) can also generally dispose of foreign branch assets free of CGT.

Nonresidents are only subject to CGT on taxable Australian property (TAP). TAP includes:

- Taxable Australian real property (e.g., real property or land in Australia and mining, quarrying or prospecting rights if the underlying minerals or materials are in Australia)
- Indirect Australian real property, comprising a membership interest in an entity, where, broadly speaking, the interest in the company is equal to or greater than 10% and more than 50% of the market value of the company's assets can be traced to taxable Australian real property. The residency of the entity is irrelevant, and this measure can apply to chains of entities (see Section G for an explanation of how this principle is applied in the context of nonresidents selling shares in an Australian company)
- Assets of a business conducted through a permanent establishment in Australia
- Rights or options to acquire the above-mentioned assets

Functional currency

Provided certain requirements are met, taxpayers may calculate their taxable income by reference to a functional currency (i.e., a particular foreign currency) if their accounts are solely or predominantly kept in that currency.

Transfer pricing

Australia's tax law includes measures to ensure that international related-party transactions are priced at arm's-length. The Australian Taxation Office (ATO) adopts Organization for Economic Cooperation and Development (OECD) principles in its transfer pricing rulings and has specific documentation requirements for compliance purposes. Further, specific disclosures in relation to international related-party transactions and their underlying pricing (including methodologies adopted and supporting documentation maintained) are required to be made as part of the income tax return process.

Dividends

Dividends paid by Australian resident companies are franked with an imputation credit to the extent that Australian income tax has been paid by the company at the full corporate tax rate on the income being distributed.

For resident corporate shareholders, to the extent the dividend has been franked, the amount of the dividend is grossed up by the amount of the franking credit and included in assessable income. The company is then entitled to:

- A credit or offset of an amount equal to the gross-up against income tax payable on the distribution
- Conversion of excess franking credits into carryforward trading losses
- A franking credit in its own franking account that can in turn be distributed to its shareholders

For resident individual shareholders, the shareholder includes the dividend received plus the full imputation credit in assessable income. The imputation credit can be offset against personal income tax assessed in that year. Excess credits are refundable.

Dividends paid or credited to nonresident shareholders are subject to a final 30% withholding tax (the rate is generally reduced by any applicable tax treaty) on the unfranked portion of a dividend. No dividend withholding tax applies to franked dividends. Subject to double tax treaty relief, the withholding tax is deducted at source on the gross amount of the dividend.

Special rules exempt withholding tax on dividends paid to foreign residents that are classed as "conduit foreign income." This term broadly means foreign-sourced income earned by an Australian company that is not subject to tax in Australia. In practice, this means non-Australian exploration and production (E&P) companies may consider using Australia as a regional holding company because:

- Profits from foreign operations (or foreign subsidiaries) can be passed through Australia free of tax
- CGT is not generally levied on the disposal of foreign subsidiaries or branch operations (provided they hold predominantly active assets)

Tax year

A company's tax year runs from 1 July to 30 June of each year. It is, however, possible to apply for a different accounting period to align a taxpayer's tax year with the financial accounting year.

PRRT

PRRT is a federal tax that applies to petroleum projects undertaken in certain offshore areas under the jurisdiction of the Commonwealth of Australia. Generally, PRRT applies to all production licenses issued under the Offshore Petroleum and Greenhouse Gas Storage Act 2006 (OPGGSA) (Commonwealth) or its predecessor Acts.

PRRT returns are due annually, for each year ending 30 June, if assessable receipts are derived in relation to a petroleum project. It is not possible to change the PRRT year-end to a date other than 30 June. Quarterly installments of PRRT must also be calculated and paid.

Currently, projects in the following areas are excluded from the PRRT regime:

- Certain specified projects located in the Northwest Shelf (related to exploration permits WA-1-P and WA-28-P), although it is proposed that PRRT will apply to these projects from 1 July 2012
- Projects within the Australia-East Timor Joint Petroleum Development Area (JPDA)

PRRT applies to the taxable profit of a project generated from a project's upstream activities. The taxable profit is calculated by reference to the following formula:

Taxable profit = assessable receipts — deductible expenditure

Generally, because PRRT is imposed on a project basis, the deductibility of an expenditure is limited to expenditures incurred for that project, and such expenditures cannot be deducted against other projects of the same entity. However, exploration expenditures may be transferred between projects in which the taxpayer or its wholly owned group of companies has an interest, subject to certain conditions.

A liability to pay PRRT exists where assessable receipts exceed deductible expenditures. PRRT applies at the rate of 40%.

PRRT is levied before income tax and is deductible for income tax purposes. A PRRT refund received is assessable for income tax purposes. Under the current law, projects subject to PRRT are generally not subject to excise tax or royalties. Under the proposed expanded PRRT regime, royalties paid are granted as a credit against the PRRT liability. From 1 July 2009, taxpayers can elect to calculate their PRRT liability by reference to a functional currency other than Australian dollars, provided certain requirements are met.

Assessable receipts include all receipts, whether of a capital or revenue nature, related to a petroleum project.

For projects involving the conversion of gas to liquids, special regulations apply to govern the calculation of the deemed sale price at the point of conversion. It is necessary to calculate a deemed price in terms of the regulations where no independent sale occurs at the gas-to-liquid conversion point. This price is then applied to determine the assessable receipts subject to PRRT. It is proposed in the current PRRT amendments that these regulations will apply to sales of gas for gas-to-liquid projects, even where an independent sale occurs.

Deductible expenditures include expenses of a capital or revenue nature. There are three categories of deductible expenditures: exploration expenditures (e.g., exploration drilling costs, seismic survey), general project expenditures (e.g., development expenditures, costs of production) and closing-down expenditures (e.g., environmental restoration, removal of production platforms).

Certain expenditures are not deductible for PRRT purposes, for example: financing type costs (principal, interest and borrowing costs); dividends; share issue costs; repayment of equity capital; private override royalties; payments to acquire an interest in permits, retention leases and licenses; payments of income tax or good and services tax (GST); indirect administrative or accounting type costs incurred in carrying on or providing operations or facilities; and hedge expenses. A number of these items are contentious and are subject to resolution with the Australian tax authorities.

Expenditures not deducted can be carried forward to be offset against future assessable receipts. Expenditures not deducted are deemed to be incurred each year and are compounded using one of a number of set rates ranging from a nominal inflation rate to the long-term bond rate plus 15%, depending on the nature of the expenditure (exploration or general) and the year the expenditure was incurred. Such a compounded expenditure is referred to as an "augmented" expenditure.

A 150% PRRT deduction can be available for qualifying expenditures in nominated deepwater areas.

Where closing-down expenditures and any other deductible expenditures incurred in a financial year exceed the assessable receipts, a taxpayer is entitled to a credit. The amount of this credit or PRRT refund is calculated in terms of specific rules.

Currently, it is proposed that PRRT will apply to onshore projects, and the Northwest Shelf, from 1 July 2012. The PRRT amendments were passed by the House of Representatives on 23 November 2011. As at 1 January 2012, the PRRT amendments had been referred to the Senate Economics Legislation Committee for enquiry and report by 14 March 2012.

To recognize existing investments, project interests that existed on 2 May 2010, and that transition into the PRRT on 1 July 2012, have the option of electing a "starting base" or taking into account expenditures incurred prior to 1 July 2012. The proposed changes also include a consolidation regime, which would be applicable to onshore project interests only. It is proposed that state and territory royalties and excise will be creditable against the liabilities of PRRT projects. Apart from these distinguishing features, it is expected that the proposed legislation for onshore projects and the Northwest Shelf will broadly follow the rules in the current PRRT legislation.

Royalty regimes

For onshore projects, wellhead royalties are applied and administered at the state level. Wellhead royalties are generally levied at a rate of between 10% and 12.5% of either the gross or net wellhead value of all the petroleum produced. In some states, the rate for the first five years is nil, increasing to 6% in year six and thereafter at 1% per annum up to a maximum of 10%.

Each state has its own rules for determining net wellhead value; however, it generally involves deducting deductible costs from the gross value of the petroleum recovered. Deductible costs are generally limited to the costs involved in processing, storing and transporting the petroleum recovered to the point of sale (i.e., a legislative net back).

For most offshore projects, federally administered PRRT is applied, rather than a royalty and excise regime. Royalties will continue to apply to onshore projects subject to the proposed expanded PRRT. See previous section on PRRT for details of the potential expansion.

C. Capital allowances

In calculating a company's CIT liability, tax depreciation deductions may be available.

Depreciating assets include assets that have a limited effective life and that decline in value over time. Examples of depreciating assets include plant and equipment, certain items of intellectual property, in-house proprietary software and acquisitions of exploration permits, retention leases, production licenses and mining or petroleum information, after 30 June 2001.

A capital allowance equal to the decline in the value of the asset may be determined on a diminishing value (DV) or a prime cost (PC) method. The DV method allows a taxpayer to claim a higher decline in value earlier in the effective life of a depreciating asset.

The formula under each method is as follows:

- DV = base value x days held/365 days x 200%/asset's effective life
- PC = asset's cost x days held/365 days x 100%/asset's effective life

A taxpayer can elect to use either the effective life determined by the Commissioner or to independently determine the effective life of an asset.

A specific concession under the capital allowance provisions relevant to the oil and gas industry is the immediate write-off available for costs incurred in undertaking exploration activities. For example, the cost of acquiring a permit or retention lease can be immediately deducted, provided it is first used for exploration.

To the extent the asset is first used for development drilling for petroleum or for operations in the course of working a petroleum field, an immediate deduction is not available and the cost may be claimed as a capital allowance over the effective life of the asset.

The effective life of certain tangible assets used in petroleum refining, oil and gas extraction and the gas supply industry is capped at between 15 and 20 years, with taxpayers able to self-assess a lower effective life.

D. Incentives

Exploration

An expenditure on exploration is immediately deductible for income tax purposes.

Tax losses

Income tax losses can be carried forward indefinitely; however, the utilization of a carried-forward loss is subject to meeting detailed "continuity of ownership" requirements (broadly, continuity in more than 50% of the voting, dividend and capital rights) or "same business test" requirements. Currently, tax losses may not be carried back.

Regional incentives

An immediate uplift to 150% on PRRT deductions has historically been available for exploration expenditures incurred in designated offshore frontier acreage areas released by the Australian Government between 2004 and 2009, where the purpose is not related to evaluating or delineating a previously discovered petroleum pool. There have been no further announcements or enacted incentives regarding acreage releases beyond 2009.

Research and development

The new research and development (R&D) Tax Incentive replaces the existing R&D Tax Concession for all income years starting on or after 1 July 2011.

A non-refundable 40% tax credit is available to eligible R&D entities with a turnover greater than A$20 million. The 40% tax credit can be used to offset the company's income tax liability to reduce the amount of tax payable. If the company is in a tax loss position, the tax credit can be carried forward indefinitely, subject to ownership and same business requirement tests.

Eligible R&D activities are categorized as either "core" or "supporting" R&D activities. Generally, only R&D activities undertaken in Australia qualify for the new R&D Tax Incentive. Core R&D activities are broadly defined as experimental activities whose outcome cannot be known and which are conducted for the purpose of acquiring new knowledge. Supporting activities may also qualify if they are undertaken in supporting the core R&D activities, as long as they are not an excluded activity or produce goods or services.

Software-related projects may also be core or supporting R&D activities unless their dominant purpose is for internal administration, in which case they will be classified as an excluded activity. An additional eligibility test may apply.

Eligibility criteria

Eligible expenditure is defined as expenditure incurred by an eligible company during an income year, including contracted expenditure, salary expenditure and other expenditure directly related to R&D.

Eligible companies are those incorporated in Australia or foreign branches that have a permanent establishment in Australia. An entity whose entire income is exempt from income tax is not an eligible entity.

Generally, a company must demonstrate the R&D activities are undertaken on its own behalf in order to claim the R&D Tax Incentive.

Foreign-owned R&D

Where intellectual property (IP) formally resides in a foreign jurisdiction of the Australian R&D entity (e.g., overseas parent company level), the Australia-based R&D activities may qualify for the 40% R&D Tax Incentive provided the R&D contract arrangement is undertaken with a country with which Australia has a double tax treaty agreement.

E. Withholding taxes

Interest, dividends and royalties

Interest, dividends and royalties paid to nonresidents are subject to a final Australian withholding tax of 10%, 30% (on the unfranked portion of the dividend (see Section B for a discussion on dividends)) and 30%, respectively, unless altered by a relevant double tax agreement. Australia has a comprehensive tax treaty network that can significantly reduce these taxes.

In addition, some recent double tax agreements specifically exclude payments for the use of substantial equipment from the definition of royalty.

Natural resource payments made to nonresidents are subject to a non-final withholding tax. Natural resource payments are payments calculated by reference to the value or quantity of natural resources produced or recovered in Australia. Entities receiving natural resource payments are required to lodge an income tax return in Australia, which includes the non-final withholding tax paid.

Branch remittance tax

Branch remittance tax does not generally apply in Australia.

Foreign resident withholding tax and foreign contractor withholding tax

Foreign resident withholding tax and foreign contractor withholding tax (FRWT) of 5% must be withheld from payments made to foreign residents for certain "works" and for related activities in connection with such works in Australia.

Works include the construction, installation and upgrade of buildings, plant and fixtures, and include such works where they relate to natural gas field development and oilfield development and pipelines. Related activities cover associated activities, such as administration, installation, supply of equipment and project management.

A variation of, or exemption from, the FRWT rate of 5% may be sought from the Australian tax authorities in certain circumstances: for example, if the relevant income is not assessable in Australia, or if the rate of 5% is excessive in comparison to the amount of tax that would ultimately be payable or if the foreign entity has an established history of tax compliance in Australia.

Examples of payments that are not subject to FRWT include:

- Payments that constitute a royalty (a royalty withholding tax may apply depending on the circumstances)
- Payments for activities relating purely to exploration-related activities
- Payments for services performed entirely outside of Australia

Withholding tax from clients of nonresidents doing business in Australia without an Australian Business Number

An entity is required to withhold 45%[12] from a payment it makes to another entity if the payment is for a supply made in the course or furtherance of an enterprise carried on in Australia and the other entity does not correctly quote its Australian Business Number (ABN).

The 45% need not be withheld if the ABN is correctly quoted or if the taxpayer has evidence that the payment is being made to a nonresident for a supply that is not made in carrying on an enterprise in Australia, or if it will be exempt from income tax.

F. Financing considerations

Australia's income tax system contains significant rules regarding the classification of debt and equity instruments and, depending on the level of funding, rules that have an impact on the deductibility of interest.

Thin capitalization measures apply to the total debt of Australian operations on multinational groups (including foreign and domestic related-party debt and third-party debt). The measures apply to the following entities:

- Australian entities that are foreign-controlled and foreign entities that either invest directly into Australia or operate a business through an Australian branch
- Australian entities that control foreign entities or operate a business through an overseas branch

The measures provide for a safe harbor based on 75% of net assets (+/- some adjustments). This largely approximates to a debt-to-equity ratio of 3:1. Interest deductions are denied for interest payments on the portion of the company's debt that exceeds the safe harbor ratio. Separate rules apply to financial institutions.

If the entity's debt-to-equity ratio exceeds the safe harbor ratio, interest is still fully deductible, provided the entity can satisfy the arm's-length test. Under this test, the company must establish that the level of debt could be obtained under arm's-length arrangements, taking into account industry practice and specific assumptions required under the tax law.

The debt/equity classification of financial instruments for tax purposes is subject to prescribed tests under law. These measures focus on economic substance rather than on legal form. If the debt test is satisfied, a financing arrangement is generally treated as debt, even if the arrangement could also satisfy the test for equity.

12 *The tax is 46.5% if the recipient is not a "prescribed foreign resident."*

The debt/equity measures are relevant to the taxation of dividends (including imputation requirements), the characterization of payments to and from nonresident entities, the thin capitalization regime and the dividend and interest withholding taxes and related measures.

Australia does not impose interest quarantining. Generally, corporate-level debt deductions may be used to offset all assessable income derived by the borrowing entity, regardless of the source or type of assessable income. However, interest deductions may be disallowed if the related borrowing is directly related to the derivation of foreign income by a foreign branch.

G. Transactions

Asset disposals

The disposal of a petroleum permit, retention lease or production license acquired on or after 1 July 2001 results in an assessable or deductible balancing adjustment under the Uniform Capital Allowance provisions. Depreciation is recaptured if the proceeds received on disposal exceed the asset's adjustable value (written-down tax value). The full gain is assessable and included in taxable income — not just the depreciation previously claimed (i.e., sales proceeds less the written-down tax value). If the sales proceeds are less than the adjustable value, a deductible balancing adjustment is allowed.

The transfer or disposal of an interest in a petroleum permit does not in itself trigger PRRT consequences — a transferor is not subject to PRRT on any consideration received and the transferee is not entitled to any deduction for PRRT purposes for any consideration given. However, generally, the purchaser inherits the vendor's PRRT profile, including undeducted expenditure.

Farm-in and farm-out

It is common in the Australian oil and gas industry for entities to enter into farm-in arrangements.

The taxation implications for a farmee who enters into a farm-in arrangement on or after 1 July 2001 are determined under the Uniform Capital Allowance provisions. A farmee is deemed to hold a depreciating asset, being the interest in the petroleum permit, from the time the interest is acquired (this can be up front or deferred depending on the terms of the particular arrangement). The farmee can generally deduct the acquisition cost of the depreciating asset over its effective life from the time it is held by the farmee (note that assets first used for exploration purposes are immediately deductible). The cost is the amount the farmee has paid for the interest.

Future commitments (e.g., free carry) incurred by the farmee for its interest are generally deductible for the farmee (either outright or over the asset's effective life) if the farmee holds an interest in the permit.

The tax consequences for the farmor depend on whether the interest was acquired by the farmor prior to 1 July 2001, in which case the disposal is taxed under the CGT regime (see page 24), or on or after 1 July 2001, in which case the disposal is taxed under the Uniform Capital Allowance provisions (see above).

Acquisition costs of a farmee are not deductible for PRRT purposes and, similarly, consideration received by a farmor for the farm-out is not assessable for PRRT purposes.

Selling shares in a company (consequences for resident and nonresident shareholders)

A share disposal is generally subject to the CGT regime. Nonresidents who dispose of shares in an Australian or nonresident company are subject to tax in Australia only if the shares are considered to be taxable Australian property (see Section B for a discussion of CGT and taxable Australian property). Entities that hold, directly or indirectly (via interposed subsidiaries), assets comprising primarily Australian oil and gas exploration permits and production licenses are generally classed as having taxable Australian property. However, exceptions to this provision may apply depending on the company's asset mix.

H. Indirect taxes

Goods and services tax

Introduction

A GST regime applies in Australia. All transactions that take place within Australia (and some from offshore) are subject to GST. This tax, which was introduced in July 2000, is a multi-staged VAT that applies at each point of sale or lease. It is applied at a standard rate of 10%, with GST-free rates for qualifying exported products and services and other transactions, and input tax rates generally apply to financial services and residential housing.

Both Australian resident and nonresident entities engaged in the oil and gas industry may be subject to GST on services and products supplied. All commercial transactions have a GST impact, and this should be considered prior to entering into any negotiation or arrangement.

Imports and exports

The importation of products and equipment into Australia is subject to GST. It is payable at the time of importation and in a similar manner to a customs duty (see below). Customs may not release goods until such time as GST has been paid. To alleviate the cash flow impact that may arise, entities may register for the GST deferral scheme. This scheme allows the payment of GST on imports to coincide with the GST return filing (and possible recovery of the GST on imports).

If products and equipment are exported, GST-free status may be obtained. To qualify as GST-free, goods must generally be exported within 60 days, although this period can be extended by the ATO in certain circumstances. Exports must also be supported by evidence that indicates the goods have left Australia within the required time.

Registration

The GST registration threshold is A$75,000; however, entities below this threshold can choose to register voluntarily for GST.

Nonresident entities are able to register for GST, and GST will apply to taxable supplies and taxable imports made by them. A nonresident may appoint a tax or fiscal representative in Australia (but is not required to do so).

A registered entity may recover input tax on "creditable acquisitions," that is, the GST charged on goods and services that a registered entity acquires for creditable purposes. Input tax is generally recovered by being offset against the GST payable on taxable supplies.

There are both voluntary and compulsory reverse charge provisions that may apply to both resident and nonresident entities.

Nonresidents

From 1 July 2012, a number of changes are proposed to simplify the application of GST on cross-border transactions. These proposed reforms include the following:

- Making GST-registered entities with a presence in Australia responsible for the GST consequences of supplies of goods, services and intangibles supplied to them by nonresidents who do not carry on an enterprise in Australia (or have one and do not use it)
- Changes to the voluntary and compulsory reverse charge provisions to alleviate the requirements of nonresidents to register for Australian GST in some circumstances
- Changes to the agency provisions to apply more broadly and limit the circumstances in which a nonresident is required to register for Australian GST
- Removing the requirement for nonresidents to register for Australian GST when they only make GST-free supplies

Disposal of assets or shares

The disposal of an asset, such as a petroleum permit, retention lease or production license, will ordinarily be a taxable supply upon which GST is payable. However, an entity can usually claim input tax credits for acquisitions made in connection with the sale and/or acquisition of the asset(s). Such transactions can also be treated as GST-free going concerns in qualifying circumstances. A share disposal is ordinarily treated as an input-taxed supply under the Australian GST regime. Thus, although no GST will be payable on the sale of the shares, an entity will generally be restricted from claiming input tax credits on acquisitions made in connection with the disposal or acquisition of those shares.

Farm-in and farm-out

Under farm-in arrangements that involve the up front transfer of an interest, the farmor makes a taxable supply of the interest in the tenement or license to the farmee and has a GST liability. The farmee makes a creditable acquisition of the interest and is entitled to an input tax credit. Likewise, the farmee makes a taxable supply of exploration benefits to the farmor and has a GST liability. The farmor makes a creditable acquisition of the benefits and is entitled to an input tax credit. If there is separate consideration for the exchange of project information, this will be a separate taxable supply by the farmor for which the farmee is entitled to input tax credits. Note that the GST going concern provisions can also apply and the up front transfer of an interest can be GST-free in certain cases.

Under a deferred transfer farm-in arrangement, the farmor makes a taxable supply when it grants the farmee the right to acquire an interest in the tenement or license and has a GST liability. In relation to the grant of exclusive use and access rights, the farmor makes a taxable supply and the farmee makes a corresponding creditable acquisition to which input tax credit entitlements apply. In the event that the percentage interest is transferred, the farmor will make a taxable supply and the farmee will make a creditable acquisition. However, if the farmee withdraws from the arrangement without earning an interest in the tenement or license, there will be no taxable supply of the interest in the tenement or license by the farmor, and the farmee will not make a creditable acquisition of this interest. Likewise, the farmee will not make a supply of exploration benefits, and the farmor will not be making a creditable acquisition of the exploration benefits. If there is separate consideration for the exchange of project information, this will be a separate taxable supply by the farmor for which the farmee is entitled to input tax credits.

Import duties

All goods, equipment and materials that enter Australia from overseas are subject to customs import duties. The general rate of customs duty applied to the customs value of imported goods is 5%; however, this rate may vary depending on several variables, including the type of commodity, its end use, the constituent material and country of origin.

As an example, goods such as vessels in excess of 150 gross tons are generally "free" of duty, whereas some petroleum products, including marine diesel fuel, attract duty of A$0.38143 per liter. Upon importation into Australia, goods are reported to customs using an import declaration, and they are classified in the customs tariff to identify the appropriate duty rate and duty is paid (if applicable).

Fuel tax credits

Fuel imported or sourced locally in Australia and used in a qualifying activity may be eligible for fuel tax credits (FTCs). FTCs are a rebate of the Federal Government fuel tax component embedded in the cost of fuel and may be claimed on an entity's Business Activity Statement (BAS).

Fuel consumed in offshore oil and gas is generally eligible for FTCs as a marine transport or mining activity pursuant to the Fuel Tax Act. As not all consumption of fuels is eligible, claiming of FTCs should be considered on a case-by-case basis.

The current fuel tax rate is A$0.38143 per liter for most fuels including diesel, petrol and fuel oils. However, the introduction of a price on carbon emissions in Australia from 1 July 2012 will have an impact on the rate of FTCs available for each type of eligible fuel. While fuels are not covered directly under the carbon price mechanism, an effective carbon price will be imposed through changes in fuel tax credits or changes in excise.

The following table lists the relevant FTC impact for each fuel type over the three-year fixed price period, and the figures are based on the emissions rate of the various fuels. The amounts shown for each financial year period are subtracted from the 100% rate. Therefore, in FY2014–15, FTCs for diesel fuel consumed in an eligible activity will be available at 31.285 c/L (38.143–6.858).

Fuel	100% Rate c/L	2012–13	2013–14	2014–15
Petrol	38.143	5.52	5.796	6.096
Diesel	38.143	6.21	6.521	6.858
LPG*	2.5–12.5	3.68	3.864	4.064
LNG / CNG*	5.22–26.13 (c/kg)	6.67	7.004	7.366

**Duty rate increases over transitional period to reach full rate on 1 July 2015.*

The financial impact of the reduction in FTCs will be reduced by the fact that, as of 1 July 2012, those activities currently eligible for FTC at the 50% rate will become eligible for credits at the full rate.

Export duties

There are no duties applied to goods exported from Australia.

Excise duty

Excise duty is applied to some goods manufactured in Australia, including petroleum products, alcohol and tobacco. In the case of petroleum, the rate of excise depends on annual production rates, the reservoir date of discovery and the date production commenced. Excise does not generally apply to exported oil or condensate sourced from an area currently subject to PRRT. Excise will potentially continue to apply to those projects that are subject to the proposed expansion of the PRRT; however, it is proposed that excise will be creditable against the project PRRT liability.

Excise duty on most refined petroleum products is A$0.38143, but it is not generally levied on goods bound for export.

Stamp duty and registration fees

Stamp duty is a state-and territory-based tax that is generally imposed on specified transactions. Each state and territory has its own stamp duty legislation as well as a Taxation Administration Act, which deals with tax administration.

Generally, stamp duty is imposed under different heads of duty. The most significant is conveyance duty on the transfer of property (e.g., land, tenements, certain rights including rights to extract and business assets). Plant and equipment may also be subject to duty if they are conveyed with other dutiable property.

A transfer of shares in a company that predominantly holds land interests may also require a stamp duty on the underlying land interests.

State and territory stamp duty legislation can differ in relation to the types of instruments or transactions on which duty is imposed, the rates of duty, the parties liable to pay duty and the timing for lodgment and payment of duty. The top marginal conveyance duty rates range from 4% to 6.75%.

The stamp duty treatment of dealings in Australian onshore tenements (i.e., tenements situated within an Australian state or territory or within three nautical miles of the coastline of the state or territory) varies between the Australian states and territories.

For onshore petroleum permits, any transfers or dealings in such tenements may be subject to stamp duty or a registration fee, depending on the relevant jurisdiction. For example, Western Australia (WA) exempts from stamp duty any dealings in onshore petroleum tenements. However, WA imposes a registration fee on dealings in onshore petroleum tenements, calculated as 1.5% of the greater of the consideration or the value of the petroleum permit or license. We note that WA specifically includes onshore pipelines and pipeline licenses within its definition of "land" and that any dealings in these items would be subject to duty in WA. In other Australian jurisdictions, stamp duty may apply to dealings in onshore petroleum tenements, depending on the legislation of the relevant jurisdiction.

For offshore petroleum tenements (i.e., tenements situated outside three nautical miles of the coastline of a state or territory, but within Australian Commonwealth waters), any transfers or dealings in such tenements are generally subject to a 1.5% registration fee based on the higher of the consideration paid or the value of the petroleum tenements. We note that the registration fee is only payable on the transfer of the petroleum tenements and, as such, it may be useful to identify separately and allocate value to other items of property if they are being acquired together with the tenements (e.g., mining information, plant and equipment). This would ensure that the registration fee is solely imposed on the transfer of the petroleum tenements and not the other items of property that are being acquired.

Other taxes

Other significant taxes include fringe benefits tax on non-cash employee benefits of 46.5% and payroll taxes paid by employers of 4.75% to 6.85% (the rates vary by state). Although not a tax in itself, it is important to note that a statutory contribution of 9% applies to superannuation. The Australian Government has announced a proposal to increase this contribution progressively to 12% by 2019–20. Australia also has compulsory workers' insurance requirements.

I. Other

Joint petroleum development area

In general, the taxing rights for operations in the JPDA are split between Timor-Leste and Australia on a 90:10 basis (i.e., 90% is taxed in Timor-Leste, and 10% is taxed in Australia). This guide does not deal with the tax implications of operating in the JPDA.

Foreign Investment Review Board

The Australian Government monitors investment into Australia through the Foreign Investment Review Board (FIRB). Government policy generally is to encourage foreign investment, although there are strict controls regarding the purchase of real estate. There are notification and approval requirements depending on the level of investment and the assets in which the investment is being made.

Acquisitions of greater than 15% of a company's share capital are also subject to review.

Domestic production requirements

There has been significant discussion regarding minimum domestic production requirements, particularly in the context of domestic gas. This landscape is continuing to evolve, and companies that seek to invest in Australia should be aware of the possibility that a minimum domestic production commitment may be imposed, depending on the location of the project.

Foreign exchange controls

There are no active exchange control restrictions on the flow of funds. However, the Financial Transaction Reports Act of 1988 requires each currency transaction involving the physical transfer of notes and coins in excess of A$10,000 (or foreign currency equivalent) between Australian residents and overseas residents, as well as all international telegraphic and electronic fund transfers, to be reported to the Australian Transaction Reports and Analysis Centre (AUSTRAC). This information is then available to the Commissioner of Taxation, federal police, Australian Customs Service and other prescribed law enforcement agencies.

Business presence

Forms of "business presence" in Australia typically include companies, foreign branches and joint ventures (incorporated and unincorporated). In addition to commercial considerations, the tax consequences of each business are important to consider when setting up a business in Australia. Unincorporated joint ventures are commonly used by companies in the exploration and development of oil and gas projects.

Visas

Australia has very strict immigration rules, and it is critical that anyone coming to Australia, whether short term or long term, enters using the correct visa.

Carbon pricing mechanism

From 1 July 2012, Australia will implement a carbon pricing mechanism. The Government's Clean Energy Legislative Package comprises 18 bills passed through Parliament on 18 November 2011. Under the carbon pricing mechanism, Australia's largest greenhouse gas emitters (an estimated 500 entities whose facilities emit greater than 25,000 tonnes of CO2-e) will be directly liable to buy and surrender to the Government a permit for every tonne of carbon pollution they produce.

Under the first three years of the carbon pricing mechanism, the price on carbon will be fixed, before moving to a floating emissions trading scheme on 1 July 2015. During the fixed price period (starting on 1 July 2012), the carbon price will start at A$23 per tonne, rising at 2.5% a year in real terms. From 1 July 2015, the carbon price will be set by the market (within certain boundaries) via a cap-and-trade emissions trading scheme dependent on the supply of permits by the Government.

In addition to this direct liability on large emitters, an effective carbon cost in the form of a reduction in the fuel tax credit (or an additional price imposed on gas retailers) will be also be imposed on emissions from liquid fuels (other than for individual and light commercial vehicles). Modes of transportation of liquefied natural gas (LNG) and petroleum products that may be covered by the equivalent carbon cost include rail, shipping, off-road transport and on-road transport (from 2014).

Levels of assistance by way of free permits will be provided to emissions-intensive, trade-exposed (EITE) industries. Between 40–50 activities will be eligible to receive either 94.5%, 66% or possibly 50% (reducing over time) shielding of their carbon liability, depending on the level of emissions intensity.

The refining of petroleum is considered an EITE activity. It is sufficiently trade-exposed and emissions-intensive to fall into the "highly emissions-intensive" assistance category. Entities conducting this activity may be eligible to receive 94.5% shielding of their direct carbon liability.

The production of LNG is currently not considered an EITE activity; however, an LNG project may receive an allocation of carbon permits to ensure an effective assistance rate of 50% for its entirety. It should be noted that an LNG project may consist of many "activities", some of which will not be eligible EITE activities.

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A. At a glance

Fiscal regime

Azerbaijan's fiscal regime consists of a combination of production sharing agreements (PSAs) and host government agreements (HGAs). In addition, the Law on Application of Special Economic Regime for Export-Oriented Oil and Gas Operations (the Law) came into force on 17 April 2009. The Law applies to export-oriented oil and gas operations carried out by contractors, as well as by subcontractors, as defined in the Law. The Law will be effective for 15 years but may be further extended once this period is over.

Bonuses	Negotiated bonuses and acreage fees are applicable to PSAs.
PSA	PSA partner contractors are subject to a profit tax (at a negotiated rate that varies from 20% to 32%) and social fund contributions for local employees. Other potential major payments include bonuses, acreage fees and social fund payments. The PSA partners are exempt from all other taxes, including royalties. PSA subcontractors are deemed to earn taxable profit of 20% to 25%, depending on the particular PSA, of the payments received for transactions performed in Azerbaijan. These subcontractors are subject to tax on such profit at the rate of 20% to 32%, resulting in a total withholding tax (WHT) obligation at rates between 5% and 8%. Subcontractors are also liable for social fund payments.
HGA	Participants are only subject to a profit tax of 27% and social fund contributions for local employees. The participants are exempt from all other taxes. Registered contractors (subcontractors in common terms) are exempt from all types of taxes, except for social fund payments.
Income tax rate	Tax rates range from 14% (up to AZN2,000) to 30% (after AZN2,000) – the same as in domestic legislation.
Capital allowances	Capital allowances are calculated in accordance with the tax rules prescribed in the Tax Code of the Republic of Azerbaijan (TCA).

B. Fiscal regime

Azerbaijan's fiscal regime consists of a combination of PSAs and HGAs. To become entitled to a special economic regime introduced by the Law, contractors and subcontractors, except for foreign subcontractors that do not have a permanent taxable presence (i.e., a permanent establishment) in Azerbaijan, should obtain a special certificate that will be issued for each contract separately. The certificate will be granted by the respective state authority, generally for a period specified in the contractor's or subcontractor's contract (or an alternative document). However, the period may not be longer than the validity period of the Law. The legislation in Azerbaijan applies to ownership of all petroleum resources existing in a natural state in underground and surface strata, including the portion of the Caspian Sea within the jurisdiction of the state that vested with Azerbaijan.

The State Oil Company of the Azerbaijan Republic (SOCAR) has been given the authority to control and manage the country's petroleum resources. Several oil consortia, with participation from a number of major oil companies, are engaged in exploration and production activities in the Azerbaijani sector of the Caspian Sea and in onshore exploration. All consortia were created on the basis of PSAs.

Currently, HGAs apply to oil and gas pipeline projects. The Main Export Pipeline (Baku-Tbilisi-Ceyhan) (MEP) and the South Caucasus Pipeline (SCP) activities are governed by the respective HGAs.

There are substantial differences between the general tax legislation and the tax regimes of the existing PSAs, HGAs and the Law. Generally speaking, PSAs, HGAs and the Law have negotiated taxes that provide for substantial relief to investors, while those operating outside the above-mentioned agreements must pay the whole range of standard Azerbaijani taxes under the statutory tax regime.

Production sharing agreements

A range of taxes, duties and bonuses are applicable to PSAs. The taxation of contractor parties and subcontractors are considered separately below.

Contractor parties

Oil and gas contractors (PSA partners) are subject to profit tax and social fund contributions for local employees. Other major payments include bonuses and acreage fees. The PSA parties are exempt from all other taxes, including royalties.

Profit tax

Under the PSAs currently in effect, contractor parties carrying out business in Azerbaijan in connection with petroleum operations are subject to tax on profit. The profit tax rate is negotiated and varies from 20% to 32%.

Taxable income is calculated in accordance with internationally accepted accounting practices in the petroleum industry, rather than in accordance with Azerbaijani statutory accounting procedures. In calculating taxable income, contractors get a capital allowance for capital expenditure based on the tax depreciation rules prescribed by PSAs.

Losses incurred by contractor parties to PSAs during the period of exploration are deductible once production starts. Loss carryforward provisions (including how long losses may be carried forward) vary between different PSAs.

Activities that are not connected with hydrocarbon activities in Azerbaijan or relevant contract areas are deemed to be outside the scope of PSAs and the related protocol tax regimes. If a company is engaged in both hydrocarbon and non-hydrocarbon activities, separate accounting books in accordance with statutory rules must be maintained to reflect income and losses generated from the non-hydrocarbon activities. The operating companies under the PSAs are not taxable and allocate income and expenses to contractor parties in proportion to their participating interests in the PSAs.

Social charges

Under the PSAs, contractor parties are permitted to employ personnel as required for the purpose of carrying out their operations. There may be requirements to give preferences, as far as they are consistent with the operations, to employ citizens of Azerbaijan within the framework of the overall quotas.

Contractor parties are required to make contributions to the Social Insurance Fund of 22% of the gross local payroll. These contributions are made at the expense of the employer. A further 3% of employees' salaries is withheld from local employees and paid to the same Social Insurance Fund.

Bonus payment and acreage fees

The terms of the bonus payment and the size of the bonus are negotiated and vary for each individual PSA. Existing PSAs call for the bonus to be paid in three installments, connected with the stages of the agreements.

Starting with the second consortium agreement signed, an acreage fee is payable for the contract area during the exploration period and an additional exploration period. For some PSAs, the range of the acreage fee is US$1,200 to US$2,000 per square kilometer (km^2).

Royalties

Under the existing PSAs, the contractor parties are not subject to royalties for extraction of hydrocarbon resources in Azerbaijan.

Subcontractors

Both Azerbaijani legal entities and foreign legal entities are treated as subcontractors to PSAs. Azerbaijani legal entities are subject to tax in accordance with the general taxation rules. Registered foreign subcontractors, on the other hand, are generally subject to WHT (as described below), as well as social fund payments in the same manner as contracting parties. The sale of goods or equipment to which title is transferred outside Azerbaijan, and the provision of services outside of Azerbaijan, should not be subject to the WHT.

Withholding taxes

Foreign subcontractors that carry on business in Azerbaijan in connection with hydrocarbon activities are deemed to earn a taxable profit of 20% to 25% of the payments received in respect of transactions performed in Azerbaijan (depending on the particular PSA). These subcontractors are subject to tax on profits at a rate of 20% to 32%, resulting in a total WHT obligation at the rates of 5%, 6.25%, 7.5% or 8% (depending on the particular PSA) of the gross contractual payment.

WHT on foreign subcontractors that sell goods should only apply to a mark-up charged on such goods. Under certain PSAs, in the case that no mark-up is indicated, the tax may apply to the gross sales price.

However, under some of the existing PSAs, certain foreign subcontractors are subject to profit taxation under the domestic law. Such foreign subcontractors include those working after approval of the development and production stage of the agreement or those selling goods without indicating a mark-up on their sales.

Social charges

Similar to the contracting parties, subcontractors are allowed to employ personnel as required for the purpose of carrying out their operations. There may be requirements to give preferences, as far as they are consistent with the operations, to employ citizens of Azerbaijan within the framework of the overall quotas.

Subcontractors are required to make contributions to the Social Insurance Fund of 22% of the gross local payroll. These contributions are made at the expense of the employer. A further 3% of employees' salaries is withheld from local employees and paid to the same Social Insurance Fund.

Other benefits

Export and import regulations

Each contractor or subcontractor is entitled to import and re-export (free of any taxes) machinery, equipment, fixed assets, goods, works and services for use in petroleum operations. However, customs processing fees are payable. A customs duty exemption certificate must be obtained from the customs authority in connection with the PSA.

VAT

Contractors and subcontractors are "exempt with credit" from value added tax (VAT) (i.e., a 0% rate is applied) in connection with petroleum activities on all:

- Goods, works and services supplied to or by them
- Exports of petroleum
- Imports of goods, works and services

Any supplier of works and services (including subcontractors) to each contractor may treat these supplies as being exempt from VAT with credit.

A VAT exemption certificate must be obtained from the relevant tax authority in connection with the PSA.

Tax residency rules for individuals

Local employees are generally subject to taxation under the Azerbaijani domestic tax regime, whereas most existing PSAs separately address the issue of expatriate taxation.

Normally, an expatriate employee of an operating company, a contractor party, an affiliate of a contractor party or a foreign subcontractor who is present in Azerbaijan on "ordinary business" becomes a tax resident in the event that they spend more than 30 consecutive days in Azerbaijan in a calendar year. Income earned after the 30th day is taxable in Azerbaijan. Individuals spending fewer than 30 consecutive days but more than 90 cumulative days in Azerbaijan in a calendar year are also treated as tax residents, and income earned after the 90th day becomes taxable. Rotating employees and foreign employees who have a primary place of employment in Azerbaijan qualify as tax residents if they spend more than 90 cumulative days in Azerbaijan in a calendar year, and they are taxable from the first day of their presence in Azerbaijan.

Penalties

In general, penalties applicable to contractor parties and subcontractors under the PSAs tend to be less strict than those provided for by the general domestic legislation. One of the typical penalties applied is interest for late tax payments at the rate of London Interbank Offered Rate (LIBOR) plus 4%.

Host government agreements

Currently, HGAs apply exclusively to oil and gas pipeline projects. MEP and SCP activities are governed by the respective HGAs.

A range of taxes and duties is applicable to HGAs. The taxation of participants and contractors is considered separately below and on the next page.

Participants

Participants (the HGAs' partners) are subject to a profit tax at 27% and social fund contributions for local employees. The participants are exempt from all other taxes.

Profit tax

Profit tax may apply to all participants (i.e., companies investing in the pipelines), although actual or deemed tax treaty relief may protect the parties from taxation in Azerbaijan. Profit tax applies individually to each participant.

The profit tax rate is fixed at 27% in the Azerbaijan HGA and is based on the prevailing statutory rate in effect on the date of signature of the agreement.

Tax depreciation is available for expenditure of a capital nature. In addition, tax losses of a MEP and SCP participant may be carried forward without limitation to the subsequent years of assessment.

Social charges

The participants (HGAs' partners) are allowed to employ personnel as required for the purpose of carrying out their operations.

Participants are required to make contributions to the Social Insurance Fund of 22% of the gross local payroll. These contributions are made at the expense of the employer. A further 3% of the employees' salaries is withheld from local employees and paid to the same Social Insurance Fund.

Contractors

Both Azerbaijani legal entities and foreign legal entities are considered as contractors (subcontractors) to the HGAs. The registered contractors are exempt from all types of taxes except for social fund payments (which apply in a similar manner as for the participants).

Social charges

Similar to the participants, the contractors are allowed to employ personnel as required for the purpose of carrying out their operations.

Contractors are required to make contributions to the Social Insurance Fund of 22% of the gross local payroll. These contributions are made at the expense of the employer. A further 3% of the employees' salaries is withheld from local employees and paid to the same Social Insurance Fund.

Other benefits

Export and import regulations

The HGAs allow for import and re-export (free of any taxes) of machinery, equipment, fixed assets, goods, works and services for use in HGAs' operations. However, customs processing fees are payable. A customs duty exemption certificate must be obtained from the customs authority in connection with the HGAs' operations.

VAT

Participants and contractors are exempt with credit from VAT (i.e., a 0% rate is applied) in connection with the HGAs' activities on all:

- Goods, works and services supplied to or by them
- Imports of goods, works and services

Additionally, any supplier of works and services (including contractors) to each participant may treat those supplies as being exempt with credit from VAT.

A VAT exemption certificate must be obtained from the relevant tax authority in connection with the HGAs' operations.

Tax residency rules for individuals

Special residency rules apply for expatriate employees of the participants and contractors. Specifically, a foreign individual who spends more than 182 days in a calendar year in Azerbaijan is considered to be a tax resident. Residents are liable to pay personal income tax exclusively on income received from Azerbaijani sources.

The Law

The following privileges are envisaged under the special economic regime established by the Law:

Profit tax

Contractors have an option of paying profit tax at 5% of total payments (without any expense deductions) received from the qualifying activity. Alternatively, contractors may choose to be subject to profit tax on such activity under the basic rules established by the TCA. If a contractor chooses to pay profit tax specified by the TCA, any future increases in the tax rate will have no effect on the contractor, as it will continue paying the tax at the rate valid on the date when the aforesaid certificate was issued.

All payments made to foreign subcontractors (legal entities only) by contractors or other subcontractors will be subject to WHT at a rate of 5%.

Payments made to foreign subcontractors that are physical persons are subject to WHT in the manner specified by the TCA. Local subcontractors (both legal entities and physical persons) shall also pay their respective taxes in accordance with the TCA.

Withholding tax

No WHT applies to the payments made by contractors and foreign subcontractors for dividends and interests.

Nonresident subcontractors are not subject to the net profit repatriation tax at the source of payment by their permanent establishments.

VAT

Goods (works and services) exported by contractors from Azerbaijan are subject to VAT at a 0% rate.

Income tax

Regarding contractors' and subcontractors' employees, foreign and stateless persons directly employed in Azerbaijan, as well as Azerbaijani citizens, shall be subject to income tax in accordance with the TCA.

Property tax and land tax

Contractors are exempted from both property tax and land tax.

Any other taxes envisaged by the TCA but not covered by the Law should be applied in a way specified by the TCA.

Customs regime

Contractors and subcontractors are exempt from customs duties and VAT on goods (works and services) imported to, or exported from, Azerbaijan. Irrespective of the value of imported or exported equipment and materials, contractors and subcontractors shall pay AZN275 of customs collections for each customs declaration.

Currency regulation regime

Contractors and subcontractors may open, keep and use AZN and foreign currency accounts at banks within as well as outside Azerbaijan. Contractors must inform the relevant Azerbaijani authorities about opening and closing of bank accounts outside Azerbaijan. Moreover, contractors and subcontractors may convert funds received in AZN into foreign currency, and, as such, freely transfer these funds outside Azerbaijan, subject to making tax and other mandatory payments.

The Law also imposes the following "local content" type requirement:

Use of local manpower regime

Unless export-oriented oil and gas operations are to last for less than six months, within one year from the day of obtaining the certificate, at least 80% of contractors' and subcontractors' employees represented at all organizational hierarchies and management bodies shall be Azerbaijani citizens. However, in certain cases, a relevant state authority shall grant permission to contractors and subcontractors to employ Azerbaijani citizens in different proportions.

C. Capital allowances

Capital allowances are available to contractors (PSAs) and participants (HGAs). Allowances are calculated in accordance with the tax rules prescribed by the relevant agreements.

D. Incentives

Not applicable.

E. Withholding taxes

WHTs are specific to PSAs. The details are given in Section B.

F. Financing considerations

There are no specific issues related to financing.

G. Transactions

Participation interests in PSAs and HGAs and shares in companies that hold an interest in PSAs and HGAs may be sold. The transaction mechanisms and the tax consequences of any sales depend on the provisions of the particular PSA or HGA.

H. Indirect taxes

Import duties and export duties

Each contractor or subcontractor under a PSA or participant or contractor under an HGA is entitled to import and re-export (free of any taxes) machinery, equipment, fixed assets, goods, works and services for use in respect of petroleum operations. A customs duty exemption certificate must be obtained from the customs authority.

VAT

Contractors and subcontractors are exempt with credit from VAT (i.e., a 0% rate is applied) in connection with petroleum activities on all:

- Goods, works and services supplied to or by them
- Exports of petroleum
- Imports of goods, works and services

Additionally, any supplier of works and services (including subcontractors) to each contractor may treat those supplies as being exempt with credit from VAT. A VAT exemption certificate must be obtained from the relevant tax authority in connection with the PSA.

I. Other

Issues relevant to PSAs, HGAs and the Law are discussed in Section B.

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A. At a glance

Corporate income tax (CIT) rate	46%[(a)]
Capital gains tax (CGT) rate	n/a
Branch tax rate	n/a
Withholding tax (WHT):	
Dividends	n/a
Interest	n/a
Royalties	n/a
Management fees	n/a
Branch remittance tax	n/a
Net operating losses (years):	
Carryback	n/a
Carryforward	indefinitely[(a)]

(a) Only applicable to oil companies obliged to pay tax in Bahrain

Bahrain provides a free, open and transparent environment for businesses and has a globally competitive, value-creation story that focuses on sustainability, skills and good governance.

Although major industries such as oil, gas, aluminum and others connected with the infrastructure are usually majority-owned by the Government, there is an increasing trend toward privatization and no industry is closed to foreign investors.

To carry out any commercial activity in the Kingdom of Bahrain, a legal vehicle should be established in accordance with the Bahrain Commercial Companies Law No. 21 of 2001.

Foreign investors are able to establish a 100% foreign-owned entity in Bahrain under certain conditions.

B. Fiscal system

Corporate tax

There are no corporate taxes in Bahrain except for the levy of income tax on the profits of companies engaged in the exploration, production or refining of crude oil and other natural hydrocarbons in Bahrain (this is levied at a rate of 46%).

The tax basis for oil companies is net profits generated in Bahrain. Taxable income for oil companies is net profits, which consist of business income less business expenses.

Reasonable expenses will be deductible for tax purposes, including administrative, overhead and establishment expenses, interest, royalties, rental, contributions, remunerations, rewards for services rendered by others and pension or other plans established for the benefit of the persons rendering the services.

Capital expenditures will be depreciated over five years (i.e., 20% per annum).

Trading losses of oil companies may be carried forward indefinitely. Loss carryback is not permitted.

Personal income tax

There are no personal income taxes in Bahrain.

Capital gains tax

There is no CGT in Bahrain.

VAT and GST

There is no VAT and goods and services tax (GST) in Bahrain except for the following:

- Sales tax of 12% on gasoline
- Persons using hotel facilities are charged a government levy of 5% (there is also a 15% service charge that is added to the bill amount by a hotel or restaurant)

Withholding tax

There are no WHT taxes in Bahrain.

Zakat (religious wealth tax)

Zakat is not levied in Bahrain.

Land registration tax

There is a land registration fee payable to the Government on the transfer of real property.

Payroll tax

There is no payroll tax in Bahrain.

Advance tax ruling

Advance tax rulings are not applicable in Bahrain.

Transfer pricing

Bahrain does not have any transfer pricing rules. However, in principle, transactions between related parties should be at arm's-length.

Customs duties

The Gulf Cooperation Council (GCC) countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) announced the unification of customs duties, effective from 1 January 2003.

There are no customs tariffs on financial transactions or trade in locally manufactured goods between GCC member states where the local shareholding is 51% and if products have at least 40% local value-added content.

Bahrain has been a member of the World Trade Organization (WTO) since December 1993. Bahrain applies its customs tariff according to the codes issued by the World Customs Organization (WCO). The following are the broad categories of the customs duty:

- Free duty – vegetable, fruits, fresh and frozen fish, meat, books, magazines and catalogs
- 5% duty – all other imported items such as clothes, cars, electronics and perfumes
- 100% duty – tobacco and tobacco-related products; these are also evaluated based on the quantity or weight and the higher value is taken into consideration for duty
- 125% duty – alcohols

Municipal tax

A municipal tax is payable by individuals or companies renting property in Bahrain. The rate of the tax varies according to the nature of the property, as summarized below:

- Rented commercial building – 10% of rent
- Rented unfurnished residential building – 10% of rent
- Rented furnished residential building:
  - Owner pays electricity, water and municipal tax – 7% of rent
  - Tenant pays electricity, water and municipal tax – 7.5% of rent

Some landlords when quoting the rental amount include the tax and utilities.

C. Social insurance

The social insurance scheme is governed by the Social Insurance Organization (SIO).

It is mandatory to register all employees, once employed by a Bahraini entity, with the SIO and pay social contributions.

Every January, the employer is required to update salary records for employees registered with the SIO. When an employee joins or leaves an entity, the entity must update SIO records. The SIO will calculate the amount to be remitted monthly, and the employer is required to remit the same by the stipulated date.

The deduction is made from basic wages and recurring constant allowances as a percentage, and this is then appropriated for social insurance and pension.

The base for the calculation of social insurance contributions cannot exceed BHD4,000 per month (i.e., if the salary exceeds BHD4,000 per month, the contributions will be calculated only on BHD4,000).

Provided below is an overview of social security contributions and benefits applicable in Bahrain.

Old age pension fund

Employer contribution: 9%

Employee contribution: 6%

Only applicable to Bahraini nationals

Insurance against employment injuries

Employer contribution: 3%

Applicable to both Bahraini nationals and expatriates

Unemployment insurance

Employee contribution: 1%

Applicable to both Bahraini nationals and expatriates

Some employers pay this amount without deduction from the employee's wages.

End-of-service benefit

At the completion of their employment contract in Bahrain, expatriate employees are entitled to an end-of-service benefit that is calculated on the following basis:

- Fifteen days' salary for every year of service for the first three years of continuous service
- One month's salary for every year of service thereafter

The end-of-service benefit is only payable on completion of three years of continuous service.

D. Other levies

Training levy

Employer contribution: 4% (for organizations with 50 or more employees not providing training to their employees). Only applicable to expatriates.

E. Foreign exchange controls

There are no exchange control restrictions on converting or transferring funds. Furthermore, Bahrain has no withholding or thin capitalization rules in relation to the financing arrangements in Bahrain.

F. Double tax treaties

To date, Bahrain has signed double tax treaties with 36 countries, 24 of which are in force. The following table lists the most current information as provided by the Bahrain Ministry of Finance.

Bahrain double tax treaties

Country	Signed	In force	Dividends	Interest	Royalties
Algeria	Yes	Yes	0%	0%	24% / 4.8%
Austria	Yes	Yes	0%	0%	0%
Belarus	Yes	Yes	5%	5%	5%
Belgium	Yes	No	10%	5%	0%
Bermuda	Yes	No	0%	0%	0%
Brunei	Yes	Yes	0%	5%	5%
Bulgaria	Yes	Yes	5%	5%	5%
China	Yes	Yes	5%	10%	10%
Czech Republic	Yes	No	5%	0%	10%
Egypt	Yes	Yes	n/a	0%	0%
France	Yes	Yes	0%	0%	0%
Georgia	Yes	No	0%	0%	0%
Iran	Yes	Yes	5%	5%	5%
Ireland	Yes	Yes	0%	0%	0%
Isle of Man	Yes	No	0%	0%	0%
Jordan	Yes	Yes	n/a	10%	10%
Lebanon	Yes	Yes	0%	0%	0%

Country	Signed	In force	Dividends	Interest	Royalties
Luxembourg	Yes	Yes	0% / 10%	0%	0%
Malaysia	Yes	Yes	n/a	5%	8%
Malta	Yes	No	0%	0%	0%
Mexico	Yes	No	0%	4.9%/10%	10%
Morocco	Yes	Yes	5% / 10%	10%	10%
Netherlands	Yes	Yes	0% / 10%	0%	0%
Pakistan	Yes	Yes	10%	10%	10%
Philippines	Yes	Yes	10% / 15%	10%	10% / 15%
Seychelles	Yes	No	0%	0%	0% / 5%
Singapore	Yes	Yes	n/a	5%	5%
Sri Lanka	Yes	No	5% / 7.5% / 10%	10%	10%
Sudan	Yes	No	0%	0%	0%
Syria	Yes	Yes	0%	10%	18%
Thailand	Yes	Yes	10%	15%	15%
Turkey	Yes	Yes	10% / 15%	10%	10%
Turkmenistan	Yes	No	10%	10%	10%
UK	Yes	No	0%/15%	0%	0%
Uzbekistan	Yes	Yes	8%	8%	8%
Yemen	Yes	Yes	n/a	0%	0%

Benin

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A. At a glance

The tax and legal regime applicable to oil companies operating in Benin depends on the date on which the petroleum contract was signed. Petroleum contracts signed with the Beninese authorities before 17 October 2006 are governed by the Petroleum Code dated 13 April 1973 (Order No. 73-33). This Code only provides for a concession regime. Oil companies operating under the 1973 regime had the opportunity to opt into the new 2006 regime (this option expired in November 2007).

On 17 October 2006, a new Petroleum Code was issued by the Beninese authorities (Law No. 2006-18). In addition to the existing 1973 concession regime, this new Petroleum Code introduces production sharing contracts (PSCs) and other types of contracts used in the petroleum sector.

Fiscal regime

The fiscal regime applicable to the petroleum industry is provided for by the Beninese Tax Code, the 2006 Petroleum Code or the 1973 Petroleum Code (as applicable) and the agreement concluded between the hydrocarbons contractor and the Beninese authorities.

The main taxes applicable in the petroleum sector are:

- Under the Petroleum Code of 1973:
  - Fixed fees depending on the type of agreement concluded with the Beninese authorities
  - Royalty
  - Surface fees
  - Income tax on gross profit at a rate between 50% and 55%
- Under the Petroleum Code of 2006:
  - Fixed fees depending on the type of agreement concluded with the Beninese authorities
  - Royalty
  - Surface fees
  - Income tax with a cap of 45%, the tax rate will depend on the categories of hydrocarbon and operating conditions

Legal regime

Under the Petroleum Code of 1973, hydrocarbon contractors are required to set up a Benin subsidiary in order to hold the petroleum title.

The Petroleum Code also provides that the exploitation of hydrocarbons is based on a concession regime. Under this regime, the Beninese authorities grant to a hydrocarbon contractor or a consortium the exclusive right to prospect or research for a maximum of nine years. Where there is a discovery, the Beninese authorities may grant an exploitation permit for production. In return, the hydrocarbon contractor or the consortium pays royalties and taxes to the state of Benin.

Three types of permits are provided for under the Petroleum Code of 1973:

- A prospecting authorization: this allows its owner to perform investigations from the surface with potential use of geophysical and geochemical methods to obtain evidence of hydrocarbons. The prospecting period is nine years, with an initial period of three years and two renewals of three years each.
- A permit of research (also called "H permit"): this allows its owner to perform surface or deep work to obtain further evidence regarding the operating conditions and industrial use and to conclude on the existence of exploitable deposits. The permit of research has a maximum term of nine years, with an initial period of three years and two renewals of three years each.
- A concession of hydrocarbon exploitation: only the holder of a valid research permit can obtain this. It allows its owner to extract hydrocarbons. The concession period is 25 years, which may be extended for an additional 10-year period.

The Petroleum Code of 2006 has introduced the possibility of using PSCs. The Code also provides that the state of Benin can conclude all kinds of contracts in use in the international oil industry.

The 2006 Code supersedes the 1973 Code provisions concerning prospecting, research and exploitation of hydrocarbons, but prospecting authorization is now limited to three years.

The obligation to establish a Beninese subsidiary to hold the petroleum title is enforced by the new Code.

B. Fiscal regime

Hydrocarbon contracts signed before the publication of the Petroleum Code of 2006 remain governed by the Petroleum Code of 1973. Until November 2007, oil companies under the 1973 regime could opt for the new regime provided by the Petroleum Code of 2006.

Main taxes under the Petroleum Code of 1973

Fixed fees

The following table indicates the fixed fees due depending on the petroleum license required:

Hydrocarbons prospecting authorization	XOF2.5m
Issuance of an H permit	XOF4m
Renewal of an H permit	XOF4m
Provisional authorization for exploiting hydrocarbons	XOF5m
Issuance or renewal of petroleum concession	XOF10m
Authorization of hydrocarbon pipeline transportation	XOF2m

Surface fees

The surface fee is an annual tax based on the surface allocated to perform petroleum activities. The following table summarizes the surface fees applicable:

H permit	XOF12.5 per hectare during the first period XOF25 per hectare for the following periods
Concession of hydrocarbons exploitation	XOF375 per hectare during the first three years XOF750 per hectare for the following years

The surface fee for temporary exploitation of an oil field is XOF300 per hectare.

Proportional royalty on hydrocarbons

This royalty is proportional to the initial value of the hydrocarbon fields and is determined as follows:

- 12.5% for liquid hydrocarbons
- 10% for gas hydrocarbons

The value used is the price set at oil wells, after their cleaning out. Oil used by the producing company, gas flaring and reinjected gas are not subject to this royalty.

Income tax

Hydrocarbon contractors are subject to income tax on research and exploitation activities. The income tax rate is negotiated in the convention concluded between the contractor and Beninese authorities. However, for the holders of a concession of hydrocarbon exploitation, the income tax rate must be between 50% and 55% of the gross profit.

The Benin Financial Act of 1999 has fixed the income tax rate at 55% for research, exploitation, production and sale of hydrocarbons. In principle, the taxable gross profit is defined as total revenues less total expenses. In the case where special conditions on the determination of the taxable gross profit and its basis are specified in the petroleum concession agreement (PCA), the provisions of the Tax Code should be applied only if these provisions are not changed by the PCA. Moreover, the Petroleum Code of 1973 obligates the hydrocarbon contractor to provide annually two certified copies of its balance sheet, profit and loss account, auditor's report and board meeting report to the director of mines, geology and hydrocarbons.

Main taxes under the Petroleum Code of 2006

The Petroleum Code of 2006 has modified the tax legislation of petroleum contracts as follows:

Fixed fees

Fixed fees are due on the following:

- Granting of a prospecting authorization
- Issuance and renewal of an H permit
- Issuance and renewal of an exploitation permit
- Provisional authorization for exploiting hydrocarbons
- Authorization of hydrocarbon pipeline transportation

Annual surface fees

A fixed surface fee is due for research and exploitation permits.

Royalty ad valorem

This royalty is proportional to the value of the hydrocarbons at the point of exit from the oil field. The rate of this royalty is negotiated in the petroleum contract and will depend on the nature of hydrocarbons and the operating conditions. However, the minimum rate is 8%.

Oil and gas that are either consumed for direct production needs or reinjected into the field or lost and related substances are excluded from the calculation of the taxable basis of the ad valorem royalty.

Income tax

Hydrocarbon contractors are subject to income tax on research and exploitation activities. The income tax rate is negotiated in the convention concluded between the contractor and Beninese authorities. However, this rate is capped at 45%.

For the holders of concessions of hydrocarbon exploitation, the income tax rate is between 35% and 45%.

In the case of a PSC, the income tax due by the contractor is deemed to be included in the profit oil received by the state (which will pay the income tax).

C. Incentives

Taxes incentives

Article 106 of the Petroleum Code of 2006 provides that the permit holders and their subcontractors are exempt from all duties and taxes during:

- The research period, except for property taxes on residential premises, surface fees, road tax and the fixed fees on granting authorizations and permits
- The exploitation period, except for the ad valorem royalty and income tax

Moreover, hydrocarbon contractors are exempted from paying the "patente," a specific business tax, the value of which depends on the location and the activities of the taxpayer.

Custom incentives

Pursuant to Article 7 of Order No. 73-34 and Article 108 of the Petroleum Code of 2006, concessible mineral substances are exempt from custom duties. The petroleum agreement provides that hydrocarbon contractors and their subcontractors may benefit from exemptions of duties and taxes on imported equipment, exploitation materials and machines.

These exemptions are negotiated by the hydrocarbon contractor while concluding the agreement with the Beninese authorities.

VAT

VAT is not included in the Petroleum Code of 2006. However, in practice, hydrocarbon contractors may benefit from VAT exemptions on activities strictly related to petroleum operations. This exemption is negotiated by the hydrocarbon contractor while concluding the petroleum agreement with the Beninese authorities.

D. Withholding taxes

Withholding taxes (WHT) are not dealt with under the Petroleum Code. Amounts paid to a nonresident as compensation for services of any kind provided or used in Benin are subject to WHT at a rate of 12%.

E. Registration duties

The Petroleum Codes do not provide for specific rules on registration duties.

F. Capital allowances

The Petroleum Codes do not include capital allowances. These are taken into account while negotiating the petroleum agreement with the Beninese authorities.

G. Financing considerations

There is no specific issue or limitation concerning the financing of hydrocarbon activities.

H. Transactions

The Petroleum Codes do not include any specific taxation on the transfer of an interest in petroleum contracts. However, registration duties may apply.

I. Foreign exchange controls

According to Article 109 of the Petroleum Code of 2006, the permit holders and their subcontractors are allowed to:

- Pay in foreign currency, in full or in part, the wages, reimbursements and other indemnities
- Open, keep and use bank accounts in foreign currencies in Benin and abroad and accounts in local currency in Benin
- Directly pay abroad, in foreign currency, foreign subcontractors for the acquisition of equipment and supplies of services related to the petroleum operations
- Receive, transfer and keep abroad and freely dispose of all funds, including but not limited to, all payments received for the exportation of hydrocarbons and any payment received from the Government
- Obtain from abroad all financing required for the petroleum operations
- Buy the local currencies required for the petroleum operations and convert into foreign currency all local currencies in excess of the immediate domestic needs in accredited banks or exchange offices

Compliance requirements

The holder of the petroleum title is required to keep, in French and in conformity with local legislation, accounting information separated from any other activity not covered by the petroleum contract.

Brazil

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A. At a glance

Fiscal regime

The Brazilian fiscal regime that applies to the oil and gas industry consists of corporate income tax (CIT) and government and third-party takes. Government and third-party takes vary depending on the type of contract.

As from 2011, there are two types of contracts:

1. Concession contract (CC) – under this contract, the winner of the bid is the entity that offers the greater signature bonus to the Government for the block. More recently, the level of local purchases offered (local content) has also been considered as a component of the bid offer. This was the model adopted on the 10 bidding rounds already tendered by the National Agency of Petroleum (Agência Nacional do Petróleo, Gás Natural e Biocombustíveis or ANP).
2. Production sharing contract (PSC) – under this contract, the winner of the bid is the entity that offers the greater volume of oil to the Government, that is, the National Oil Company (NOC), the exclusive operator of the fields. Introduced in 2010, this model is meant to be used in future bidding rounds for the exploitation of the pre-salt and other strategic areas.

Current pre-salt areas, already granted, are being governed by a special concession contract model (onerous concession), which basically follows the CC rules.

Government and third-party takes include:

1. Signature bonus – one-time amount (not less than the minimum price established by the ANP) paid by the winning bidder in the proposal for the CC or the PSC to explore and produce crude oil and natural gas
2. Royalty percentage – under the CC, it varies from 5% to 10% of the oil and gas production reference price. Under the PSC, it corresponds to a percentage of the volume of produced oil, to be determined in the bid procedure

3. Special participation percentage — applies only under the CC in a percentage that varies from 10% to 40%, based on progressive tables, on net production revenues adjusted for royalties, exploration investments, operating costs, depreciation and taxes.
4. Occupation or retention of area — applies only under the CC for large production volumes and corresponds to BRL10–BRL5,000 per km² based on a progressive table
5. Landlord cost percentage — under a CC, it varies from 0.5% to 1% of the oil and gas production reference price. Under a PSC, it applies only to onshore oil fields and corresponds to a percentage up to 1% of the value of the oil and gas production

Income tax rate	34%
Resource rent tax	None
Capital allowances	D[13], U[14]
Investment incentives	L[15], RD[16]

B. Fiscal regime

Corporate income tax

Brazilian resident legal entities are subject to income tax on their worldwide income at a rate of 15%, with a surtax of 10% for profits exceeding BRL240,000 a year. In addition, Brazil imposes a social contribution tax on corporate net profits at a rate of 9%. Therefore, the combined CIT rate generally used is approximately 34%. Taxation is the same for entities bearing CC or PSC contracts, or both.

Brazil does not apply ring-fencing in the determination of the CIT liability. Profits from one project can be offset against the losses from another project conducted by the same legal entity and, similarly, profits and losses from upstream activities can be offset against profits and losses from downstream or other activities undertaken by the same legal entity. Brazil has no tax consolidation rules. Each legal entity is subject to its own CIT.

Brazilian resident legal entities may elect to pay CIT based on taxable profits determined as either:

- A percentage of gross revenues (*lucro presumido*)
- Per their actual income under accounting records (*lucro real*)

This election is made annually, and it is usually driven by the company's profitability and future investment plans. In general, the taxation regime based on a percentage of gross revenues is limited to companies with annual gross revenues that do not exceed BRL48 million. Accordingly, upstream companies that operate in Brazil generally pay CIT based on taxable profits determined per their actual income according to their accounting records.

Under the taxation regime based on taxable profits determined by accounting records, the tax is charged on the company's accounting profit and adjusted for non-deductible expenses and non-taxable revenues. CIT may be calculated and paid on a quarterly or annual basis (with prepayments during the calendar year). In general, operating expenses are deductible for CIT purposes, provided they are "necessary and usual" to the company's activity.

13 *D: accelerated depreciation.*

14 *U: capital uplift.*

15 *L: tax losses can be carried forward indefinitely.*

16 *RD: research and development (R&D) incentives.*

Royalties on oil and gas production are fully deductible. Other types of royalties, in general, may be deducted from taxable income limited to 1% to 5% of the net sales derived from the activity on which royalties are paid, depending on the business activities of the payor entity. For trademark royalties, the limit is 1%. For royalty payments to be treated as tax-deductible expenses, the underlying contracts must be approved by the Brazilian Intellectual Property Agency (*Instituto Nacional de Propriedade Industrial* or the INPI), and they must be registered with the Brazilian Central Bank (BACEN) to allow foreign remittances.

Capital expenditures are normally deducted in the form of depreciation of fixed assets or amortization of costs incurred and capitalized during the exploration and development stages. Depreciation and amortization criteria as well as specific rules related to the oil and gas industry are described in Section C.

Profits generated by a foreign subsidiary of a Brazilian entity are subject to Brazilian CIT. These profits are taxed at standard CIT rates. Under the Brazilian regulations related to controlled foreign corporations (CFCs), income from CFCs must be included in the parent company's taxable income at the end of each calendar year, regardless of its availability or classification of the income for the Brazilian shareholder. Losses incurred abroad cannot offset profits generated in Brazil. The amount of foreign tax paid by a CFC may be used to offset Brazilian CIT (subject to limitations).

Carryforward tax losses

Tax losses may be carried forward indefinitely. No carryback or inflation adjustments are permitted. Tax losses that are carried forward may be used to offset up to 30% of a company's taxable income in a tax period. Restrictions on the offsetting of carried forward tax losses may be imposed if there is a change of ownership control and a change of the business activity between the period when the losses were generated and the period when the losses will be effectively used.

Capital gains

Capital gains recognized by Brazilian resident entities are included as ordinary income, and they are taxed at the standard rates of CIT. In general, capital losses incurred in a calendar year may offset operating profits or capital gains generated in the same year. Excess capital losses may be carried forward indefinitely, but limited, however, to 30% of future capital gains only.

Capital gains recognized by nonresidents from the disposal of assets located in Brazil, regardless of whether the buyer is located in Brazil or abroad, are also subject to taxation in Brazil at a general rate of 15%. The capital gains taxation rate increases to 25% when the beneficiary is domiciled in a low-tax jurisdiction (i.e., any country where income is not taxed or the maximum income tax rate is less than 20% or residents of jurisdictions in which information on the company's owner or economic transactions is confidential). Indirect dispositions of Brazilian assets are not taxable.

Transfer pricing

A Brazilian entity that computes taxable profits based on actual accounting records is required to comply with Brazilian transfer pricing rules, which differ in several aspects from the arm's-length principle adopted under the Organization for Economic Cooperation and Development´s (OECD) guidelines and from the majority of the countries with transfer pricing regulations. For example, unless expressly agreed to otherwise with the Brazilian tax authorities, Brazilian taxpayers are required to adopt fixed profit margins to indicate compliance with transfer pricing regulations under one of the available methods, which may not necessarily mean an acceptable profit margin under arm's-length conditions.

The legislation contains a very broad definition of related parties involving concepts of direct and indirect control utilizing voting power and business control criteria. This includes companies associated in joint ventures, consortia and other forms of joint ownership. In addition, there are rules whereby exclusive distributors and interposed parties are also considered related parties for the purposes of Brazilian transfer pricing regulations.

Brazilian transfer pricing rules also apply to residents of low-tax jurisdictions, regardless of a corporate relationship with the Brazilian company, as defined under Brazilian tax legislation. In June 2010, a new blacklist of low-tax jurisdictions was issued by the tax authorities, increasing the number of jurisdictions from 51 to 65. Note, however, that, as of June 2010, the effects that may derive from the inclusion of Switzerland on this list are currently suspended.

The application of transfer pricing rules has recently been extended to cover transactions with any individual or company, even if not a related party, under a preferential tax regime (PTR). A PTR is defined as any tax regime where one or more of the following is present:

- Income is not taxed or the maximum income tax rate is less than 20%
- Tax advantages are granted to nonresidents without an obligation of having substantive economic activity in the country
- Tax advantages are granted to nonresidents conditioned to the non-conduction of substantive economic activity in the country
- Income generated abroad is not taxed or the maximum income tax rate is less than 20%
- Information on the company's owners, ownership of assets or rights or economic transactions performed is confidential

Together with the new blacklist, the Brazilian tax authorities also included a list of regimes that should be considered as a PTR under Brazilian tax rules (grey list). This PTR, in March 2011, was amended, excluding Luxembourg from the list. Now, this list includes the Uruguayan Sociedad Anonima Financieira de Inversion (SAFIS), the Spanish Entidad de Tenencia de Valores Estranjeros (ETVEs), Dutch and Danish holding companies without substantive economic activity, the American Limited Liability Companies (LLCs) with some specific characteristics, among other entities. These inclusions have been much debated and changes are expected in the near future. Note that the effects that may derive from the inclusion of Dutch holding companies and Spanish ETVEs on this list are currently suspended.

Prices on importation and exportation are generally based on the following transfer pricing methods:

- Cost plus
- Resale minus
- Use of comparables

No "best method" rule applies; instead, a Brazilian taxpayer may demonstrate compliance with the transfer pricing rules by choosing the method that best fits the transaction and that provides the most efficient tax consequences.

Although crucial for the oil and gas industry, the leasing of equipment and charter of vessels are transactions that are not under a mature legislative framework consensus and, thus, should be deeply and carefully analyzed by taxpayers.

Regarding exportation, transfer pricing rules apply exclusively to transactions entered into with related parties if the average price used for the transaction is less than 90% of the average price for identical or similar goods, services or rights traded in Brazil during the same period and under similar payment terms (the "absolute safe harbor" provision).

Brazilian transfer pricing regulations also provide for two safe harbor provisions on exportation, which allow the Brazilian entity to demonstrate the adequacy of the adopted export price by disclosing regular commercial documents that support the export transaction. Under such provisions, the burden of proof is shifted to the Brazilian tax authorities in the case of a subsequent tax audit. The safe harbor provisions apply in the following situations:

- The taxpayer's net export revenues do not exceed 5% of the total net revenues during the fiscal year
- The taxpayer demonstrates that a minimum pretax profit of 5% is reached on the export transaction (for the analyzed fiscal year and the two preceding years)

Interest paid or credited to related parties abroad, associated with loan agreements not registered with the BACEN, is also subject to Brazilian transfer pricing rules. Interest expense is tax deductible if the amount does not exceed an amount based on the London Interbank Offered Rate (LIBOR) for six-month US dollar deposits, plus a spread of 3% per year, proportional to the period for which the interest is charged. If the lender is the Brazilian legal entity, interest income must be at least the LIBOR for six-month US dollar deposits, plus a spread of 3% per year, proportional to the period for which the interest is charged.

The Brazilian transfer pricing rules do not apply to royalty payments associated with agreements registered with the INPI, to the extent that the deductibility of these payments for CIT in Brazil is subject to limitations based on domestic legislation.

Dividends

No currency exchange restrictions are imposed on dividends distributed to shareholders domiciled abroad, provided the foreign investment into Brazil is properly registered with the BACEN.

A Brazilian entity may calculate notional interest on the net equity value (adjusted by the deduction of certain accounts) payable to both resident and nonresident shareholders. Notional interest on equity is a hybrid mechanism to remunerate the capital of shareholders and create a deductible expense for purposes of Brazilian CIT.

Interest on equity is calculated by applying the official long-term interest rate (TJLP) on net equity, but it is limited to 50% of the greater of the current earnings or accumulated profits. Interest on equity paid to a foreign beneficiary is subject to withholding tax (WHT) in Brazil charged at a general rate of 15% (25% if payment is made to a low-tax jurisdiction).

Interest on equity payments tend to be advantageous to profitable Brazilian subsidiaries, to the extent that the interest generates tax-deductible expenses at 34% with the cost of the 15% WHT, although the overall tax benefit should be evaluated in light of the country of residence of the foreign shareholder.

Deduction of payments to an individual or company resident in a low-tax jurisdiction or under a PTR

Any payment made, direct or indirectly, to an individual or company resident in a low-tax jurisdiction or under a PTR is not deductible for income tax purposes, unless the following requirements are met:

- Identification of the effective beneficiary of the income
- Evidence of the operating capacity of the recipient
- Supporting documentation regarding the price paid for rights, goods and services

Further, it is also established that the effective beneficiaries will be deemed to be those entities to which the income can be attributable, not created with the sole purpose of avoiding taxes.

Government and third-party takes

Government and third-party takes vary depending on the contractual regime to which the Brazilian entity is subject.

Concession contracts

In 1997, with the end of the monopoly of Petróleo Brasileiro S/A (Petrobras) in the Brazilian oil and gas sector, a concession regime was introduced in Brazilian legislation to grant licenses to private players to perform oil and gas activities in Brazil. Under the concession regime, the concessionaire is authorized to explore oil and gas activities within a certain area, at its own cost and risk, and must compensate the Brazilian Government for this right.

More than one company may exploit a concession. Partners on a joint venture shall organize themselves under a consortium agreement. Specific provisions between the partners can be set up through a joint operation agreement (JOA) for each concession granted.

In this context, upstream concession holders are subject to the payment of four government and one third-party takes, as described below.

Signature bonus (Government)

The signature bonus reflects the amount offered by the winning bidder in the proposal for the concession to explore and produce crude oil and natural gas. It is a one-time payment, and it may not be less than the minimum price established by the ANP in the bid notice. It must be paid entirely at the date of the signature of the respective concession agreement.

Royalties (Government)

The amount of petroleum royalties to be paid monthly for a field is equivalent to 10% of the total production volume of crude oil and natural gas of the field during that month, multiplied by the relevant reference prices (determined by the ANP), beginning in the month of the relevant production start-up date, with no deductions allowed. Royalty payments are due on the last working day of the month following the month of their computation.

The ANP may, in the bid notice for a given block, reduce the percentage of 10% to a minimum of 5% of the total production volume, considering geological risks, production expectations and other factors pertaining to the block. In the 10 bidding rounds conducted by the ANP (note that round 8 is suspended), only part of auctioned blocks had their royalties reduced from 10% to 5%. This decrease applied to auctioned blocks classified as inactive marginal fields for evaluation, rehabilitation and production of oil and natural gas.

Special participation (Government)

The special participation represents an extraordinary financial compensation payable by crude oil and natural gas exploration and production concessionaires for large volumes of production or high earnings. It must be paid in relation to each field in a given concession area from the quarter when the relevant production start-up date occurs. Special participation payments are due on the last working day of the month following the quarter of computation.

Computation of special participation is based on net production revenues adjusted for royalties, exploration investments, operating costs, depreciation and taxes. The special participation rates are based on progressive tables that range from 10% to 40% and consider:

- Reservoir location (onshore, lakes, rivers, river islands, lake islands and continental shelf within bathymetric depths of up to and more than 400 meters)
- Years of production (one, two, three and more than three years)
- The inspected quarterly production volume, measured in thousands of cubic meters of equivalent oil, for each field

The current CC provides that, in fields where the special participation is due, concessionaires must invest an amount equivalent to 1% of the gross revenue of the oil field in expenses that qualify as R&D.

Occupation or retention of areas (Government)

Both the bid notice and the concession agreement include payment provisions for the occupation or retention of the area. The amount is to be computed each calendar year, beginning from the date of execution of the concession agreement. It is payable on 15 January of the following year.

The amount due for the occupation or retention of an area is set by the ANP and considers the block location and other pertinent factors. The calculation is based on a progressive table that ranges from BRL10 to BRL5,000 per square kilometer (km²), based on the location of the block and its development stage.

Landlord cost (third party)

Landlord cost is not a government take because it is due to the owner of the land as a monthly rental payment for access to and use of the land. For the onshore blocks, the ANP sets the amount from 0.5% to 1% of the oil and gas production reference price. In the 10 bidding rounds conducted by the ANP (note that round 8 is suspended), only part of auctioned blocks had their landlord cost reduced from 1% to 0.5%. This decrease applied to blocks auctioned that were classified as inactive marginal fields for evaluation, rehabilitation and production of oil and natural gas.

Production sharing contracts

After significant debate, Law 12,351 was published on 23 December 2010, introducing a production sharing regime for the pre-salt area and other strategic areas, which include regions of interest for national development, characterized by low exploration risk and high production potential.

In summary, the production sharing contracts (PSC) is a regime in which the contracted company will execute, at its own cost and risk, exploration, development and production activities and, in case of commercial discovery, it will have the right to recover, in oil, the operational costs incurred during the exploration and development stages (cost of oil) and receive the volume correspondent to the oil surplus (the difference between the total oil produced and royalties paid plus recovered cost) relating to its participation in the venture.

Under a PSC, Petrobras (NOC) must be the exclusive operator and leader of the consortium established for such venture and shall have a minimum 30% participation in all ventures. Under certain circumstances, Petrobras may be directly hired to explore and produce the remaining 70%, which shall otherwise be offered to private oil companies under a bid process, in which Petrobras may also participate in equal conditions.

The consortium to explore and produce oil and gas in these strategic areas must be set up by:

- The Government-owned company, *Empresa Brasileira de Administração de Petróleo e Gás Natural S.A. – Pré-Sal Petróleo S.A.* (PPSA), to be incorporated with the specific purpose of managing the PSC. PPSA will not bear any risks or cost associated with the exploration, development and production activities
- Petrobras
- The bid winner, if applicable, which shall have joint liability for the execution of the contract with Petrobras

Under Brazilian oil and gas legislation, upstream PSC holders are subject to the payment of two government and one third-party takes, as described below.

Signature bonus (Government)

The signature bonus, which does not integrate the cost of oil, corresponds to a one-time fixed amount payment, and it may not be less than the minimum price established by ANP in the bid notice. It must be paid entirely at the date of the signature of the PSC.

Royalties (Government)

The royalties, which do not integrate the cost of oil, correspond to a percentage of the oil surplus. The minimum percentage, terms, conditions and calculus criteria should be determined in the bid procedure according to the Mining and Energy Ministry parameters. There is a current discussion on the recoverability of such royalties by the associated partners in a joint venture.

Landlord cost (third party)

In case of an onshore block, the landlord cost, which does not integrate the cost of oil, will correspond to up to 1% of the production value and is due to the owner of the land.

C. Capital allowances

As a general rule, fixed assets may be depreciated based on their "useful life." Documentation is required to support the useful life when it differs from the useful life provided by the Brazilian Internal Revenue Service (*Receita Federal do Brasil,* or the RFB). This supporting documentation should be issued by the Brazilian National Institute of Technology or other similar institute.

Examples of RFB ordinarily used rates include:

- Buildings – 25 years
- Machinery and equipment – 10 years
- Vehicles, computer hardware and software – 5 years

A company that works two shifts per day may depreciate machinery and equipment at 1.5 times the normal rate. If it operates three shifts, it may double the normal rate.

Oil and gas upstream companies may depreciate fixed assets directly connected with upstream operations based on the concession term or on the produced volume in relation to the total crude oil or gas in the reservoir when the useful lives are shorter than those defined by the RFB.

Currently, some tax incentives apply to specific industries and also to companies located in developing areas, such as the north and northeast regions of Brazil. An R&D incentive was enacted in 2006 that introduces an accelerated depreciation program and capital uplifts. For further information, see Section D.

The capital expenditures for the acquisition of rights, which are expected to exist or be exercised within a limited period of time, may be amortized. This amortization can be calculated based on the remaining life of the right or on the number of accrual periods for which the legal entity expects to enjoy the benefits, originating from the expenses registered as deferred charges.

For the depletion of mineral resources (including oil and gas reservoirs), a Brazilian legal entity can opt to calculate the exhaustion of the mineral resource based on the concession term or on the produced volume in relation to the total crude oil or gas in the reservoir.

Upstream companies have generally accounted for costs incurred on exploration and development activities as permanent assets. Under the successful efforts method, costs are written off when wells are not considered viable. The only exception is for geological and geophysical costs, which are not capitalized but are generally expensed when incurred.

D. Incentives

Tax holiday

Brazil does not have a tax holiday regime.

Regional incentives

Apart from the special customs regimes (see below), REPENEC *(Regime especial de incentivos para o desenvolvimento de infraestrutura da indústria petrolífera nas regiões Norte, Nordeste e Centro-Oeste)* is the only specific tax incentive for the oil and gas industry.

REPENEC

On 14 June 2010, Law 12,249/2010, which is the conversion of Provisional Measure 472/09, was published in the Official Gazette. Among other matters, such Law (i) created a new special regime for the oil and gas industry (REPENEC), (ii) included thin capitalization rules in the Brazilian legislation, and (iii) established additional rules for the deduction of payments, direct or indirectly, to an individual or company resident in low-tax jurisdictions or under a PTR.

REPENEC relates to infrastructure projects in the oil and gas industry approved by the Federal Government by 31 December 2010, when the applicant is incorporated in the north, northeastern or mid-western regions of Brazil.

In summary, in the event of local sales or importation of new machinery, instruments and equipment, and of construction materials for use or integration into infrastructure projects classified as fixed assets, REPENEC provides for the suspension of social contribution taxes (PIS and COFINS), federal VAT (IPI) and import duty (II) that would otherwise apply (please see Section H for further explanations on these taxes). PIS and COFINS are suspended on the importation or acquisition of local services for these projects.

Other regional tax incentives

Besides REPENEC, Brazil offers, in general, a variety of tax incentives intended to attract businesses of particular importance and foster the development of certain underdeveloped regions in the country.

The following incentives are offered to entities located in the area of the Agency for the Development of the Northeastern States (*Agência de Desenvolvimento o Nordeste*, or the ADENE) and the Agency for the Development of the Amazon (Agência de Desenvolvimento da Amazônia, or the ADA):

- A reduction of 75% of the 25% CIT due calculated on profits from activities covered by the incentive tax treatment (*lucro da exploração*) for projects considered to be vital for development of the ADA and ADENE regions or for modernization, expansion or diversification of existing projects considered to be vital for the development of the ADA and ADENE regions. This incentive is granted until 31 December 2013. Companies may benefit from this incentive for a maximum period of 10 years.
- From 1 January 2009 to 31 December 2013, a reduction of 12.5% of the 25% CIT due calculated on profits from activities covered by the incentive tax treatment (*lucro da exploração*) for new ventures considered to be a priority for the development of the regions covered by the ADA and ADENE.

Until 2013, companies that undertake projects of particular importance for the development of the region are entitled to reinvest up to 30% of the income tax due at 15% on their ADENE and ADA projects.

Research and development (Law 11.196/05)

Companies that invest in technological innovation are entitled to this R&D federal tax incentive. The definition of technological innovation is "the design of a new product or manufacturing process, as well as new functionalities or characteristics added to products or to processes, which results in incremental improvements and an actual gain in quality or productivity, thus leading to increased market competitiveness."

Based on the qualifying conditions, the application of this tax incentive is associated with the design of new manufacturing processes or products or with new functionalities or characteristics being added to existing processes or products.

In summary, the tax incentives offered include:

- Deduction of total expenditures made during the computation period in connection with technological R&D of technological innovation, which are classifiable as operating expenses pursuant to Brazilian tax legislation
- Deduction for purposes of CIT of 60% to 100% of total expenditures made during the computation period in connection with R&D of technological innovation, which are classifiable as operating expenses by Brazilian tax legislation
- Reduction by 50% of IPI levied on equipment, machinery, devices and instruments, as well as on their related spare accessories and accompanying tools that were intended for use in technological R&D
- Accelerated depreciation by deduction, in the acquisition year, of the total cost of new machinery, equipment, devices and instruments intended for use in activities regarding R&D of technological innovation
- Accelerated amortization by deduction (only for CIT purposes), in the computation year in which they are incurred, of the expenditures classifiable as deferred assets relating to the acquisition of intangible assets associated exclusively with R&D of technological innovation activities
- Reduction to zero of the WHT rate applicable to foreign remittances for purposes of registration and retention of trademarks, patents and cultivars (variety of cultivated plants)

No prior approval is necessary to take advantage of this tax incentive. However, the taxpayer is required to provide information to the Science and Technology Ministry (*Ministério da Ciência e Tecnologia*) on its technological research programs by 31 July of each subsequent year and must have a regular status, in both semesters of the year, regarding its federal tax liabilities. Under Brazilian tax legislation, all documentation related to the use of these tax incentives must be available for tax inspectors during the open period under the statute of limitation.

Exportation incentives

A relevant incentive for exporters that can be used by the oil and gas industry in Brazil is the *Regime Especial de Aquisição de Bens de Capital para Empresas Exportadoras* (RECAP), which is a special tax regime for the acquisition of capital goods by export companies. To benefit from the RECAP, a company must have recognized gross revenues derived from exports in the prior year equal to or greater than 70% of its total annual gross income, and it must maintain a minimum of 70% of export revenues for the following two calendar years (or the following three years, if the company does not comply with the first requirement).

The RECAP regime applies to certain equipment, instruments and machinery imported directly by the RECAP beneficiary to be used as fixed assets. Under the RECAP regime, the social contribution taxes on gross revenues triggered upon the importation, namely PIS and COFINS, are suspended and converted into a zero tax rate after the incentive conditions are fulfilled. The regime also provides for the suspension of PIS and COFINS on local acquisitions made by the beneficiary of the RECAP regime.

In addition to the conditions outlined above, the Brazilian legal entity must not have any past-due federal tax liabilities to benefit from the RECAP regime. Benefits are also canceled if the legal entity does not comply with the minimum export revenues requirement of 70%, if the beneficiary does not comply with the other requirements for the RECAP regime to apply or at the beneficiary's own request. A legal entity excluded from the RECAP regime must pay interest and penalties on the taxes suspended, calculated from the date of acquisition of the imported assets and services or the registration of the import transaction with the electronic customs system (SISCOMEX).

The RECAP tax incentive is not available to Brazilian companies subject to PIS and COFINS under the cumulative tax regime.

Apart from the RECAP tax incentive, Brazilian legal entities may also qualify for the IPI, PIS and COFINS suspension upon a local purchase or importation of raw materials, intermediary products and package materials if they meet, among other conditions, the 70% threshold outlined above. Some Brazilian states provide a similar tax incentive for state VAT (ICMS) tax purposes.

E. WHT and other taxes on imported services

Dividends

Dividends paid from profits accrued as of 1 January 1996 are not subject to WHT in Brazil, regardless of whether the beneficiary is a resident or a nonresident shareholder.

Interest

Interest remitted abroad is generally subject to WHT at a rate of 15% (unless a tax treaty provides otherwise). Interest paid to residents of low-tax jurisdictions is subject to WHT at a rate of 25%.

Royalties and technical services

Royalties and technical assistance fees remitted abroad are generally subject to WHT at a rate of 15% (unless a tax treaty provides otherwise) when the special contribution (CIDE) tax is due on this remittance (see below). Royalties and technical assistance fees paid to residents of low-tax jurisdictions are subject to WHT at a rate of 25%.

Administrative and similar services

Administrative and similar service fees remitted abroad are generally subject to WHT at a rate of 15% (unless a tax treaty provides otherwise) when the CIDE tax is due on this remittance (see below). Administrative service fees paid to residents of low-tax jurisdictions are subject to WHT at a rate of 25%.

Other services

For the remittance of fees for other services, the WHT rate is 25%, even if the payment is not made to a low-tax jurisdiction. This rate applies because CIDE is not due on these remittances.

Rental

Rental payments made to a nonresident are generally subject to WHT at a rate of 15%. Rental payments made to residents of low-tax jurisdictions are subject to WHT at a rate of 25%.

Payments for charter of vessels with no service components are subject to WHT at a rate of 0%, provided that the entry of the vessel into Brazilian waters is approved by the competent authority. This reduced rate does not apply if the beneficiary is domiciled in a low-tax jurisdiction, in which case taxation will be at the rate of 25%.

Branch remittance tax

A foreign company may not operate through a branch in Brazil unless it submits a special request to the Ministry of Industry and Commerce (*Ministério da Indústria e Comércio*) and receives prior authorization through a presidential decree. In practice, due to the bureaucratic difficulties in obtaining such authorization, few branches of foreign companies operate in Brazil.

A branch must be registered with the commercial register and adopt the same name as its head office. A permanent representative of any nationality who is fully authorized to act on behalf of the branch must be a resident in Brazil. No minimum capital requirement is imposed. Liability is not limited to the capital of the branch but extends to the head office.

Branches of foreign companies must publish their annual financial statements, and they are subject to the requirements similar to those that apply to Brazilian resident legal entities.

Special contribution

CIDE tax is charged at a rate of 10% on royalty payments, including fees for technical assistance, technical services, administrative services and similar services. The Brazilian payor that makes the remittance to the foreign beneficiary is considered to be the taxpayer for purposes of the CIDE tax. A CIDE tax credit system in Brazil is available for trademark royalty payments only.

Social contribution taxes on importation

PIS and COFINS are both social contribution taxes charged on the importation of assets, products and services and are usually charged at a combined nominal rate of 9.25%. The Brazilian importer under the non-cumulative PIS and COFINS regime may compute a PIS and COFINS tax credit for certain inputs and services acquired (for more details, see Section G). PIS and COFINS are not due on certain imports (e.g., imports under the Repetro and RECAP regimes). As the right for tax credits has been strongly debated within the oil and gas industry and it is not under a mature legislative consensus, it should be deeply and carefully analyzed by taxpayers.

Service tax on importation

The municipal tax on services (ISS) is charged on the importation of services. ISS applies at rates that vary from 2% to 5%, depending on the nature of the service and the municipality where the Brazilian payor is domiciled.

Tax on financial operations on import of services

The federal tax on financial operations (*Imposto sobre Operações de Crédito, Câmbio E Seguro, ou Relativas A Valores, Mobiliários,* or IOF) is currently charged at 0.38% on the amount of Brazilian currency exchanged into foreign currency for the payment of imported services. Most currency exchange transactions are subject to IOF at a rate of 0.38%. This tax may be altered by the executive branch with immediate effect.

F. Financing considerations

Thin capitalization

Thin capitalization rules were introduced into the Brazilian CIT system to apply to inbound and outbound transactions performed either with related parties or with unrelated parties resident in low-tax jurisdictions or under a PTR.

Under the new rules, irrespective of whether the intercompany loans are compliant with the general rules governing the deduction of expenses and Brazilian transfer pricing rules, interest expenses are only deductible if the related Brazilian borrower does not have a debt-to-equity ratio greater than 2:1. Any excess interest is not deductible for purposes of Brazilian CIT.

Additionally, interest expenses deriving from financing arrangements executed with a contracting party established in a low-tax jurisdiction or under a PTR, irrespective of whether related or not to the Brazilian borrower, are only deductible if the debt-to-equity ratio of the Brazilian borrower does not exceed 0.3:1.

Debt versus equity

Brazilian operations can be financed by debt, equity or a combination of both. By capitalizing the Brazilian entity with equity, the parent company bears the risk of the currency exchange fluctuation. On the other hand, if the Brazilian entity is financed through debt, the exchange risk is shifted to the Brazilian subsidiary, which may accrue a currency exchange loss or gain for book and tax purposes, even if unrealized. At the election of the Brazilian payor, currency exchange gains or losses may be recognized on a cash basis for Brazilian tax purposes. Debt may also be interest bearing, which triggers a deductible interest expense for Brazilian tax purposes. Brazilian corporate borrowers cannot lend funds to others on conditions that are more favorable when compared with their own debt liabilities. With the recent introduction of thin capitalization rules in Brazil, restrictions are applicable to interest deduction on loans (see above).

To foster Brazilian exports, the Government has reduced the WHT on export financing loans to 0%. Therefore, if the upstream company intends to export its production, either totally or partially, this instrument may be tax-efficient because it triggers a local tax deduction at the rate of 34% with the cost of the 0% WHT.

IOF on loans

Under certain circumstances, an IOF is imposed by the Federal Government at rates varying from 0% to 25%.

Domestic loans between legal entities, including related parties, are subject to IOF, on the credit transaction, at a maximum rate of 1.88% per year.

Foreign loans are subject to IOF on the foreign currency exchange transaction, but not on the lending (foreign credit) transaction itself. As a general rule, a 0% rate applies, but foreign loans with average maturity terms of up to 720 days are subject to IOF at a rate of 6%.

G. Transactions

Under Brazilian oil and gas legislation, it is possible to transfer concession agreements to third parties, provided that the transfer is pre-approved by the ANP.

Asset disposals

Concession costs, including exploration and development costs, are classified as permanent assets. Disposals of permanent assets are treated as non-operating transactions, which trigger capital gains or losses. Capital gains are taxed at the same CIT rates as ordinary income (see Section B).

Farm-in and farm-out

Brazilian tax legislation does not have a special tax treatment for farm-in and farm-out transactions; accordingly, general Brazilian tax rules on asset disposals apply.

Selling shares in a Brazilian company

Investments not for sale in subsidiaries either in Brazil or abroad are classified as permanent assets. Disposals of permanent assets by Brazilian legal entities are treated as non-operating transactions, which trigger capital gains or losses. Capital gains are taxed at the same CIT rates as ordinary income (see Section B).

The gain on a sale of a Brazilian asset by a nonresident shareholder is taxable in Brazil at the rate of 15%. If the beneficiary of the capital gain is resident in a low-tax jurisdiction, the WHT rate is increased to 25%. Indirect dispositions of Brazilian assets are not taxable in Brazil (see Section B).

State VAT

ICMS is due on the local sale of oil and gas, based on the sale price, including the ICMS itself (built-in calculation). For intrastate operations (carried out by a seller and buyer located in the same Brazilian state), the ICMS rate is determined by the legislation of the state where the sale is made, which generally varies from 17% to 19%.

Because of a specific provision under the Brazilian federal constitution, ICMS is not due on interstate oil operations (carried out by a seller and buyer located in different Brazilian states).

On other interstate operations, ICMS rates are reduced and will vary depending on the location of the seller and buyer. In the case of consumables or fixed assets, the buyer must pay, to the state where it is located, an additional ICMS tax calculated based on the difference between the reduced interstate rate and its own internal ICMS rate.

Federal VAT

As a general rule, the IPI is charged on transactions involving manufactured goods by a manufacturing plant, or on the first sale in Brazil of an imported asset, as defined in the legislation in force. According to the Brazilian federal constitution, local sales, intrastate sales or importation of oil products, including crude oil and its by-products, are not subject to the IPI tax. IPI rates vary from zero to 365%.

Social contribution taxes on gross revenue

PIS and COFINS are social contribution taxes charged on gross revenues earned by a Brazilian legal entity under one of two different regimes of calculation: non-cumulative and cumulative.

Under the non-cumulative regime, PIS and COFINS are generally charged at a combined nominal rate of 9.25% (1.65% PIS and 7.6% COFINS) on revenues earned by a legal entity. Certain business costs result in tax credits to offset PIS and COFINS liabilities (e.g., depreciation of machinery, equipment and other fixed assets acquired to be directly used in the manufacturing of a product or rendering of a service). PIS and COFINS paid upon importation of certain assets and services are also creditable. Upstream companies are generally subject to this regime.

Brazilian taxpayers subject to the cumulative regime must calculate PIS and COFINS at a combined rate of 3.65% (0.65% PIS and 3% COFINS). No tax credits are provided under this regime. It applies to some industries (not including oil and gas) and also to companies that compute taxable profits as a percentage of gross sales. For further information, please see Section B.

Exportation of oil

Oil export transactions are exempt from ICMS, IPI, PIS and COFINS.

H. Indirect taxes

Importation of equipment and other

In Brazil, companies that intend to operate with foreign trade transactions must be registered within the SISCOMEX electronic system, an integrated computerized system through which all international trade transactions are electronically processed. Through this system, an import declaration (*Declaração de Importação*, or DI) is issued and registered for each import operation.

In a few cases, the importation of goods, including machines and equipment, also requires an import license (*Licença de Importação*, or LI), which is a type of previous authorization for the import procedure. The need for a prior import license is determined based on the tariff classification of the goods to be imported and some other specific conditions.

The licensing procedure may be automatic or non-automatic, depending on the product. In most cases, the import license is obtained automatically during the filing of the DI in the SISCOMEX system. Certain products, however, are subject to the non-automatic licensing process, which means that, it is important to check if the import license must be obtained before shipment of goods to Brazil. In some other listed circumstances, the import license may be obtained after the shipment of the goods, but before the registration of the DI (at the beginning of the customs clearance process).

The importation of certain goods, such as petrochemicals, crude oil and natural gas, requires authorization from special regulatory agencies as a condition for the issuance of the import license.

Import duty (*Imposto de Importação*, or II) is due over the customs value of imported goods, composed the cost of the product, the international insurance and freight (CIF value). The customs value may vary depending on specified price elements, as defined by the customs valuation rules.

II is a non-recoverable tax, which means that no credits are available against it, and always represent a cost to the importer (as II is not a creditable tax and, consequently, II paid upon importation cannot be deducted from any subsequent import transaction taxed by the II).

The II rate varies depending on the tariff classification of the imported goods, as per the MERCOSUR tariff code system, which is based on the Harmonized System. The average rate for machines and equipment is 14%.

Capital goods and data processing and telecommunications goods may benefit from an II reduction to 2% (*Ex-Tarifário Special Program*) if the importer is able to attest and demonstrate that no similar goods are manufactured in Brazil.

In addition to II, import transactions are also subject to the following taxes: IPI and ICMS and PIS and COFINS.

For import transactions, the IPI is calculated on the customs value of the imported item, plus II. The rate also depends on the respective tariff classification. The average IPI rate ranges between 10% and 20%. However, for machines and equipment, it generally ranges from 0% to 5%.

IPI is a recoverable tax, which means that, in principle, the amount paid upon the import transaction may be offset in the future, provided some requirements are met.

ICMS is charged on the customs value of the imported goods, plus II, IPI, ICMS itself, PIS and COFINS and other smaller customs charges.

ICMS rates vary depending on the state where the importer is located, which means that, unlike II and IPI, the ICMS applicable rate does not relate to the product itself, but to the state where the importation takes place. The ICMS rates range from 17% to 19% and may be lower in some cases, depending on:

- The nature of the goods being imported
- Eventual application of state tax benefits

As with IPI, if the imported item is either used in a manufacturing process in Brazil or resold, the Brazilian importer may recover the ICMS paid upon the import transaction.

PIS and COFINS contributions are also levied on the import of goods and services at a combined rate of 9.25%. On import transactions, the taxable amount is the customs value of the goods, plus ICMS, grossed-up by PIS and COFINS. The effective tax rate is approximately 13.45%.

Freight surcharge for renovation of the merchant marine fleet

Maritime transportation is subject to a freight surcharge for renovation of the merchant marine fleet (*Adicional ao Frete para Renovação da Marinha Mercante*, or AFRMM), which is an extra freight charged by Brazilian and foreign shipping companies operating in Brazilian ports. AFRMM is charged at a rate of 25% on the international freight value and at 10% on the coastal navigation freight (based on the bill of lading and the cargo manifest).

The AFRMM does not apply to the transportation of goods in connection with exploration activities of hydrocarbons and other underwater minerals in the Brazilian Exclusive Economic Zone. In addition, goods imported by autarchies and other entities directly connected to federal, state and municipal governments, such as Petrobras, are not subject to the AFRMM.

Similarly, AFRMM is suspended for assets imported under a special customs regime up to the term granted by the Ministry of Transportation (*Ministério dos Transportes*) or under DI registration, such as under the drawback or the temporary admission regime with suspension of taxes. The exemption or suspension of AFRMM depends on a previous analysis and approval by the Ministry of Transportation.

The main fees applicable to the customs clearance of imported equipment or goods are storage fees, demurrage, terminal handling charges (*capatazias*), unstuffing and cargo handling fees and deconsolidation of bill-of-lading fees. Rates and amounts vary.

Main special customs regimes related to oil and gas activities

Special bonded warehouse for oil and gas platforms

The special bonded warehouse for oil and gas platforms is a customs regime specifically targeted to cover bonded areas located in oil and gas platforms contracted by companies located abroad for research and drilling purposes. In summary, this special bonded warehouse may be operated and located in construction or conversion platforms, shipyards or other manufacturing establishments located by the sea and destined for the construction of marine structures, oil platforms and modules for such platforms.

This regime applies to materials, parts, pieces and components to be used in the construction or conversion of such facilities and allows manufacturing processes and testing activities to be performed inside the bonded facility.

It grants full suspension of federal taxes otherwise due on imports (II, IPI, PIS, and COFINS) and full suspension of federal taxes otherwise due on local purchases (IPI, PIS and COFINS). Some states also extend the benefits to ICMS.

Temporary admission

The temporary admission is a special customs regime that grants total or partial suspension of federal and state import taxes (II, IPI, PIS, COFINS and ICMS) on the importation of equipment and general products, provided that the imported items are re-exported within a stipulated term. Failure to re-export the products results in a tax liability for the previously suspended taxes, increased by fines and interest.

The temporary admission that allows total suspension of the applicable import taxes is generally granted for a maximum period of three months, with a possible extension for the same period.

Equipment and products imported for economic applications, such as those imported to be used or applied on the provision of services, fall under the temporary admission regime with partial suspension of the import taxes. In this case, they may remain in the country for the duration of the underlying contract (operational lease, rental, loan, loan agreements, etc.).

Under the current calculation rules, II, IPI, PIS and COFINS and ICMS will be partially paid and calculated at 1% per month of permanency of the imported goods in Brazil, of the total amount of taxes that otherwise would be due upon nationalization. Some restrictions on the proportional ICMS exist, depending on the state.

Drawback

The Brazilian customs legislation provides for different types of drawback regimes:

Integrated drawback suspension

Regulated by the Foreign Trade Operations Department (DECEX), the integrated drawback suspension *(Drawback Integrado Suspensão)* is a special customs regime that allows the importation and local acquisition of goods to be applied or consumed in the manufacturing process for export purposes, with total suspension of federal taxes (i.e., II, IPI and PIS/COFINS-Import). These items must be industrialized and composed or be consumed in the industrialization of a product to be further exported.

As a general rule, integrated drawback suspension only allows the suspension of ICMS over imported items. There is no similar benefit for goods purchased locally under the regime.

The regime also provides for the suspension of the freight surcharge for AFRMM, when applicable.

For goods purchased locally under the regime, the local invoice issued by the local supplier must be registered by the beneficiary company within the SISCOMEX system.

Internal and strict controls over the inventory of goods imported and locally acquired for industrialization and exportation under the drawback regime are required.

A Brazilian company that requests drawback suspension must comply with certain requirements to obtain approval. As a general rule, taxes may be suspended on regular imports for one year, extendable for another year. With long production cycles, the suspension may reach five years.

Integrated drawback exemption

The integrated drawback exemption *(Drawback Integrado Isenção)* is a variation of the drawback regime. The main difference from the suspension type consists of exempting imported or locally purchased items from regular taxation when similar and fully taxed items were already used in the manufacturing process of exported final goods.

It is a type of retroactive applicability of the drawback rules. It works as a replacement for benefited items that could have been covered by integrated drawback suspension in the past but were not.

This regime involves an exemption from II, IPI, PIS, COFINS and, possibly, an exemption of ICMS, depending on the state.

It applies to the importation of raw materials and goods in equal quantity and quality as the ones once used in the prior manufacturing process in Brazil of a final product that was already exported.

The company benefited by the drawback exemption must prove that the goods have been exported to obtain the tax exemption.

Certified bonded warehouse

The certified bonded warehouse (DAC) is a special export system under which goods are deemed exported but physically remain within a bonded warehouse in Brazil.

Goods remitted to a DAC facility are subject to certain export customs clearance procedures and shall be considered as legally exported for all fiscal, administrative and foreign exchange purposes.

Remittances to DAC are exempted from all federal taxes (IPI and PIS/COFINS). As ICMS is a state tax, each Brazilian state establishes its own legislation and decides whether ICMS shall be levied.

Goods may remain stored in this special regime for no longer than one year.

Repetro

Repetro is the most relevant tax incentive for the oil and gas industry. Repetro is a special customs regime available in Brazil for the importation and exportation of equipment and other qualifying assets for the oil and gas industry. It consists of a combination of three different customs regimes: temporary admission, drawback (under the drawback suspension type) and fictitious exportation.

This regime is applicable to companies that hold an authorization or concession to exploit oil and gas in Brazil and to its subcontractors. The importation process under Repetro is complex and attracts specific requirements, such as an electronic inventory control with the tax authorities.

ICMS tax consequences of Repetro are defined by *Convênio* ICMS 130, as discussed below.

Temporary admission under Repetro

As per the above-mentioned comments on the temporary admission regime, under such regime, Repetro grants total suspension of federal taxes (II, IPI, PIS and COFINS) that otherwise would be due upon the importation of equipment and other qualifying assets in connection with oil and gas exploration, development and production activities.

Under temporary admission, the assets may remain in Brazil for a determined period of time, for the purposes they were imported for and must return abroad with no significant modifications, while ownership is kept abroad.

Drawback under Repetro

Under the drawback regime, Repetro grants full suspension of taxes for the manufacturer in Brazil for parts, pieces or complete equipment and other qualifying assets imported, under the condition that they are re-exported to an owner established outside Brazil.

Fictitious exportation under Repetro

The fictitious exportation is a legal fiction aimed at creating fair competition among foreign and Brazilian suppliers, under which equipment and other qualifying assets supplied locally to foreign purchases are considered commercially exported, despite their delivery within the Brazilian territory (no actual remittance abroad). These sales are treated as exportation for the purpose of federal taxes and, thus, are exempt from IPI, PIS and COFINS taxes.

Convênio ICMS 130

Convênio ICMS 130 establishes that taxpayers may elect to import equipment and qualifying assets used for the production of oil and gas under a cumulative or a non-cumulative ICMS regime at rates of 3.0% and 7.5%, respectively.

The non-cumulative method allows the appropriation of ICMS tax credits at 1/48th monthly, after the 24th month of the actual ICMS collection.

The Brazilian states may also exempt, or reduce to 1.5%, the cumulative ICMS on the temporary admission of equipment and other Repetro-qualifying assets used for the exploration of oil and gas fields and may either exempt from ICMS or apply non-cumulative and cumulative regimes at the rates of 7.5% and 3.0%, respectively.

In addition, the Brazilian states may exempt from taxation locally manufactured equipment and Repetro-qualifying assets used for the exploration of oil and gas fields, or used for the production of oil and gas, as long as they are fictitiously exported and are subsequently temporarily imported under the Repetro rules. ICMS credits for the exporter in these cases are not allowed.

Finally, ICMS exemption may apply to:

(i) Equipment and Repetro-qualifying assets exclusively used in exploration activities

(ii) Production platforms in transit for repair or maintenance

(iii) Equipment and Repetro-qualifying assets used in exploration and production activities that remain in Brazil for less than 24 months

Instead of granting ICMS tax exemption, states may opt to tax equipment and Repetro-qualifying assets within (i) and (iii) above at the cumulative rate of 1.5%.

Taxpayers must formally opt for taxation under the *Convênio* ICMS 130 regime. As of the current date, not all Brazilian states have regulated this matter.

I. Other

Brazilian tax reform

In March 2008, the Brazilian Government submitted a tax reform proposal to be voted on and approved by the federal congress. The main goals of the proposal included simplifying the national tax system, and eliminating gaps that forestall the growth of the Brazilian economy, as well as alleviating interstate competition, especially with regard to the "fiscal war" among Brazilian states. Additionally, the proposal increased the amount of resources devoted to the National Policy on Regional Development (*Política Nacional de Desenvolvimento Regional*) and introduced significant modifications to the implementation of such policy.

One of the items in the proposal addressed the unification of a group of VAT levied on the production and trading of goods and services. To this effect, COFINS, PIS and the special social contribution on fuel products (CIDE-Combustível) would be consolidated into a new tax to be levied on operations involving goods and services, referred to as federal VAT (*Imposto sobre Valor Agregado Federal*, or IVA-F). Under the proposals, the constitutional provisions that created the COFINS, PIS and CIDE-Combustível taxes would be repealed.

Two other important modifications proposed were the consolidation of federal income taxes into a single income tax and payroll distressing measures.

There has been a general consensus that the tax reform would be positive for Brazil; however, it is also expected that it would undergo significant changes before it passes into law. Nevertheless, the proposal has been in Congress since March 2009.

International Financial Reporting Standards and Law 11638/07

In the process of aligning Brazilian accounting standards with International Financial Reporting Standards (IFRS), Law 11638 was enacted on 28 December 2007. It amended the Brazilian Corporation Law (Law 6404, dated 15 December 1976), in order to allow international accounting convergence, as well as to increase the transparency level of the overall financial statements, including those of large companies not organized as corporations (*sociedades anônimas*).

Effective 1 January 2008, the law prescribed, among other accounting changes, that accounting standards issued by the Brazilian Securities Commission (CVM) must be aligned with international accounting standards adopted in the main security markets, i.e., standards issued by the International Accounting Standards Board (the IASB), which is currently considered the international reference for accounting standards.

Privately held companies may now elect to adopt the standards issued by the CVM for publicly held corporations, which allows them to participate in the accounting convergence process.

Large companies, construed to be those that individually or under common control have total assets in excess of BRL240 million or gross revenues of more than BRL300 million, must be audited by independent auditors registered with the CVM.

Transitional tax regime

Effective as of its publication date (converted into Law 11.941/09), Provisional Measure (MP) 449, of 3 December 2008, is the existing instrument that aims to achieve the intended tax neutrality upon the conversion into IFRS. It has created a transitional tax regime (RTT), under which, for income taxes and PIS and COFINS purposes, the accounting methods and criteria as of 31 December 2007 shall be considered for the recognition of revenues, costs and expenses.

The RTT was optional for the years 2008 and 2009, and it has created the necessity for off-book controls for the different accounting methods and criteria for the determination of the computation basis of such taxes, thus leading to the existence of deferred taxes. As from 2010, the RTT became mandatory, until a new piece of legislation determines otherwise.

Concession participant or PSC consortium member

Foreign companies may participate in the block concession or PSC bidding rounds held by the ANP. However, a foreign company must commit to incorporating a company in Brazil under Brazilian law, with its headquarters and administration in Brazil, to hold the concession rights or to be a partner in the PSC if it wins the bid.

National content

The national content rule was created to foster national industry. Under this rule, a certain percentage of goods, equipment and services must be purchased from Brazilian suppliers.

Up to ANP round 4, there were no minimum national content requirements.

As from ANP round 5, the agency has established minimum national content requirements for the exploration and development phases. The percentages indicated below varied depending on the ANP round.

Round Number							
Commitment of acquiring local services and resources (minimum value)		5	6 Min	7, 8, 9		10	
				Max	Min	Max	
Exploration	Deep water	30%	30%	37%	55%	–	–
	Shallow water	50%	50%	37%	55%	–	–
	Shallow water <100m	–	–	51%	60%	–	–
	Land	70%	70%	70%	80%	70%	80%
Development	Deep water	30%	30%	55%	65%	–	–
	Shallow water	60%	60%	55%	65%	–	–
	Shallow water <100m	–	–	63%	70%	–	–
	Land	70%	70%	77%	85%	77%	85%

The minimum national content is 70% for the auctioned blocks classified as inactive marginal fields for evaluation, rehabilitation and production of oil and natural gas.

For PSC, the minimum national content shall be established by the bid procedure.

Repatriation of capital

Repatriation of share capital is generally not restricted if the foreign investor has registered its foreign direct original investment and subsequent capital increases or capitalization of earnings with BACEN.

Repatriation of capital may be accomplished by the sale of the Brazilian shares to a local resident by a capital reduction, redemption of shares or liquidation of the Brazilian company. Commercial law contains specific rules on redemption of shares and on companies repurchasing their own shares.

Cameroon

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A. At a glance

Fiscal regime

Cameroon's fiscal regime applicable to the upstream petroleum industry consists of Cameroon's General Tax Code, the Cameroonian Petroleum Code and the production sharing contracts (PSC) or concession agreements (CA) concluded between the State of Cameroon and the contractor.

The main taxes applicable in this sector are:

- Corporate tax
- Annual surface rent
- Royalty on the production
- Additional petroleum tax
- Bonuses
- Stamp and registration duties

Royalties (only applicable to CA holders)

The tax base and royalty rate are provided for by the CA.

Royalties are payable on a monthly basis.

Bonuses

There are typically two sorts of bonuses — signature and production:

- Lump sum in US$ to be paid on the effective date of signature
- Lump sum in US$ to be paid at the start of the production of hydrocarbon
- Lump sum in US$ to be paid when the cumulative amount of production since the start of the exploitation phase reaches a cap (as provided by the PSC)

Production sharing contract

The state has an option to participate directly or indirectly through a public entity in the joint venture agreement with the consortium. Usually, this participation will range from 5% to 25%.

The state's share should equal a percentage of output as reduced by petroleum costs incurred by the contractor, i.e., a percentage of oil production profit.

This share will vary in accordance with the daily average of the total available production.

Income tax rate

The income tax rate is provided for in the PSC. It may vary from 38.5% up to a maximum of 50%.

Surface rent tax (only applicable to PSC holders)

An annual surface rent tax is levied in Cameroon.

This tax is payable in cash each calendar year before 31 January, based on the surface area on 1 January each year or, for the first year, on the surface area on the effective date.

The relevant rates are:

- The first year – XAF1,750/m²
- The second year – XAF2,000/m²
- The third year – XAF3,500/m²
- The following years – XAF5,500/m²

Capital allowances[17]

Investment incentives[18]

B. Fiscal regime

Corporate tax

Corporate tax is levied on the taxable profits of the contractor.

Taxable profits amount to net profits arising from all upstream activities performed in Cameroon during the taxable period.

Net profits represent the difference between the opening and closing value of net assets for the relevant year of assessment, less extra contributions, plus any amounts taken by associated companies during this period.

Net profits are computed after deduction of all expenses that are necessary to perform upstream operations (as supported by relevant invoices), depreciation, and reserves and losses, as applicable.

Corporate income tax (CIT) is payable in cash, except where the state expressly requests settlement by means of a corresponding quantity of hydrocarbon.

Except as otherwise provided for by the PSC, up-front CIT, equal to 1.1% of the turnover of the previous month, is due monthly. Any remaining balance is due before 15 March.

The Cameroon's General Tax Code does not provide for profits from one project to be offset against losses from another project held by the same tax entity. Accordingly, each petroleum project should be accounted for separately.

Comment on characteristics of PSC or CA

The PSC and CA are concluded between the contractor and the state of Cameroon and are signed by the minister in charge of petroleum activities, following approval of the minister of finance.

They are approved by the president of Cameroon, published in the Official Journal, and registered in accordance with the conditions provided by the law.

Government share of profit oil

The remaining production after deduction of cost oil (see page 76) is shared between the state and the contractor according to the value of the ratio "R" defined as follows:

Value of "R"	Government share %	Contractor share %
Less than 1	.....%	.....%
From 1 to 2	.....%	.....%
From 2 to 3	.....%	.....%
Over 3	.....%	.....%

17 *See Section C*

18 *See Section D*

"R" is the ratio "net cumulated revenue" to "cumulated investments," which are determined in accordance with the cumulated amounts from the effective date until the end of the calendar year.

- Net cumulated revenue is the cumulative of the benefit after the assessment of the corporation tax
- Cumulated investments is the cumulative amount of expenditure on research, evaluation and development

Non-recoverable expenditures

Non-recoverable expenditures are those considered by the PSC to be non-recoverable. They notably include payments made for the settlement of fees, charges or expenses not directly related to the petroleum operations or not necessary for the undertaking of these operations.

They include, for instance, payments made for:

- Signature bonuses
- Costs relating to the period prior to the effective date
- External auditing costs paid by the contractor within the framework of the particular relationship between the companies constituting the contractor
- Penalties

Calculating cost oil

Cost oil or reimbursement oil is the portion of the available production applied to reimbursement of petroleum costs. Petroleum costs are all expenses borne by the contractor in the framework of the PSC and determined in accordance with accounting principles.

Annual surface rent

The payment of an annual surface rent is due as of the signature of the PSC or service contract. Based on a typical PSC, the annual surface rent is determined as follows:

- The first year – XAF1,750/m²
- The second year – XAF2,000/m²
- The third year – XAF3,500/m²
- The following years – XAF5,500/m²

This tax is payable in cash each calendar year on or before 31 January, based on the surface area on 1 January each year or, for the first year, on the surface area on the effective date.

Royalty regimes and additional petroleum tax

Contractors under a CA are subject to payment of a monthly royalty on the free-on-board (FOB) value of hydrocarbons produced, to be paid in cash or in kind, at the state's option. The rate, basis of calculation, declaration, settlement and recovery of this royalty are specified in the CA.

Contractors can be subject to an additional petroleum tax that is based on the profitability of the petroleum operations. The rate, basis of calculation, declaration, settlement and recovery of this additional tax are specified in the CA.

C. Capital allowances

Land and intangible assets are not depreciable for tax purposes. Other fixed assets may be depreciated on a straight-line basis at rates provided for under the PSC and the General Tax Code. The following are some of the applicable straight-line rates.

Asset	Rate (%)
Buildings	5 to 20
Plant and machinery and transport equipment	7.5 to 33
Office equipment	10 to 20

D. Incentives

Ability to carry forward losses

Under the General Tax Code, losses arising from petroleum operations may be carried forward for up to four income tax years, but the PSC may provide for a longer period. Losses may not be carried back.

VAT incentives

The supply of goods and services of any kind that are directly linked to petroleum operations are exempt from VAT.

Contractors' suppliers, subcontractors, services providers and affiliates are also exempt from VAT otherwise due on account of sales made, services rendered and work performed in connection with the contract.

E. Withholding taxes

Dividends

Dividends paid by a company incorporated in Cameroon to a nonresident are exempt from tax on dividends, as provided for by the Petroleum Code.

Interest

A 16.5% withholding taxes (WHT) is imposed on interest paid on debt claims, bank deposits and guarantees to corporations that do not have their head office in Cameroon or to nonresident individuals.

Royalties

A WHT will be levied on remuneration paid to foreign companies or individuals providing services to the local company if the services are used in Cameroon and if the foreigners have no professional installation in Cameroon. The rate of WHT is 15% of the gross amount. Companies engaged in drilling, research or assistance work on behalf of oil companies whose activity is deemed to constitute a permanent establishment may opt for this 15% deemed-profit tax. In this respect, they must first obtain authorization from the director general of taxation.

Branch remittance tax

Except as otherwise provided for by international tax treaties, profits made by companies that do not have their head office in Cameroon are deemed to be distributed to foreigners (individual or corporate) that are not resident or do not have their head office in Cameroon. However, under the Petroleum Code, contractors are exempt from any tax on profits or income distributed.

F. Financing considerations

Thin capitalization limits

Interest paid to the partners for funds made available to the company, in addition to their capital contributions, no matter the form of the company, are deductible, but subject to a maximum rate of interest, i.e., no more than two points above the advance rate of the Central Bank.

G. Transactions

Asset disposals

The PSC may be terminated if all the assets are transferred.

Income realized through the transfer of certain classes of asset of the holder is offset against the balance of petroleum costs to be recovered.

Capital gains are taxed at the regular corporate rate, which may vary from 38.5% up to a maximum of 50%. The tax, however, can be deferred in the event of a merger.

If the business is totally or partially transferred or discontinued, only one-half of the net capital gain is taxable, provided the event occurs less than five years after the start-up or purchase of the business, and only one-third of the gain is taxable when the event occurs five years or more after the business is begun or purchased.

The registration fees to be paid are:

- Transfer of exploration permit – XAF6 million
- Transfer of production permit – XAF250 million

H. Indirect taxes

Import duties

Provisions relating to customs duties are identical for most contracts (PSC or CA). They usually provide that the designated contractor and its subcontractors are allowed to import into Cameroon any goods, materials, machinery, equipment and consumer goods that are necessary to carry out qualifying operations, in its own name or in the name of its subcontractors, as follows:

- The contractor or third parties acting on its behalf or its subcontractors may import without restriction all materials, products, machinery, equipment and tools under regulations of temporary admission (AT) or temporary imports (IT) regulations, either normal or special, on condition that these goods are to be used exclusively for qualifying operations and that they can be re-exported at the end of their use.
- The contractor or third parties acting on its behalf or its subcontractors are allowed to import, without payment of duty, materials, products, machinery, equipment and tools to be used exclusively for oil prospecting and exploration in the specified area, provided these are listed in Annex of Act Number 2/92-UDEAC-556 dated 30 April 1992.
- The contractor or third parties acting on its behalf or its subcontractors may be granted permission by the Ministry of Economy and Finance to import, at a reduced rate of duty of 5%, materials, products, machinery, tools and equipment that, although they do not meet the above criteria, are necessary and required for production, storage, treatment, transport, shipment and transformation of hydrocarbons.

Export duties

There is no export duty applicable.

VAT

The supply of goods and services of all kinds that are directly linked to petroleum operations are exempt from VAT.

Ancillary activities that are not linked to petroleum operations will be subject to VAT at a rate of 19.25%.

Stamp duties

Stamp duties may be payable on the registration of various contracts concluded by an oil company.

Registration fees

Registration fees depend on the type of agreement concluded.

I. Other

Exchange controls

The Economic and Monetary Community of Central Africa Countries (CEMAC) Act, dated 29 April 2000, provides exchange control regulations that apply to financial transfers outside the franc zone, which is a monetary zone including France and mostly French-speaking African countries. However, for the duration of the PSC, Cameroon authorities provide certain guarantees to the contractor for the operations carried out within the framework of the PSC or CA, especially:

- The right to open a local or foreign bank account in local or foreign currencies
- The right to collect, and maintain offshore, all funds acquired or borrowed abroad, including sales receipts, and to freely dispose thereof, to the extent these exceed the requirements of its operations in Cameroon
- The right to repatriate capital invested under the PSC and to transfer proceeds relating to the capital, in particular, interest and dividends
- The right to provide offshore payment to nonresident suppliers

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A. At a glance

Fiscal regime

The fiscal regime that applies to the oil and gas industry in Canada consists of a combination of royalties and income taxation.

Royalties	Crown royalties 10% to 45%, special regime for oil sands production
	Freehold royalties and gross overriding royalties vary from lease to lease
Income tax rate	Federal corporate tax is 15% in 2012 for income subject to tax in a province
	Provincial corporate tax rates vary from 10% to 16%
Investment IC	R&D[19] 20%

B. Fiscal regime

Corporate tax

For Canadian income tax purposes, a corporation's worldwide taxable income is computed in accordance with the common principles of business (or accounting) practice, modified by certain statutory provisions in the Canadian Income Tax Act. In general, no special tax regime applies to oil and gas producers.

Depreciation, depletion or amortization recorded for financial statement purposes is not deductible; rather, tax-deductible capital allowances specified in the Income Tax Act are allowed.

Oil and gas corporations are taxed at the same rate as other corporations. Corporations are taxed by the Federal Government and by one or more provinces or territories. The basic rate of federal corporate tax is 25%[20], but it is reduced to 15% by an abatement of 10% on a corporation's taxable income earned in a province or territory. Provincial or territorial tax rates are added to the federal tax, and they generally vary between 10% and 16% of taxable income.

19 *IC: investment credit, research and development (R&D).*

20 *The 2011 general federal corporate tax rate is 26.50% (before abatement). It is reduced to 25% for 2012 and onward.*

No tax consolidation, group relief or profit transfer system applies in Canada. Each corporation computes and pays tax on a separate legal entity basis. Business losses referred to as non-capital losses may be carried backward 3 years and forward 20 years.

Gains resulting from a disposal of capital property are subject to tax. Capital gains or losses are determined by deducting the adjusted cost base of an asset from the proceeds of disposition. For corporate taxpayers, one-half of the capital gain (taxable capital gain) is taxed at normal income tax rates.

Capital losses are exclusively deductible against capital gains and not against any other income. However, non-capital losses are deductible against taxable capital gains, which are included in taxable income. Capital losses can be carried back three years and forward indefinitely for use in future years, provided an acquisition of control has not occurred.

Oil and gas rights are not capital properties.

Royalties

Oil and gas producers are required to make royalty payments to the holder of the mineral rights. In Canada, the majority of the mineral rights are owned by the Crown (the Government). Royalty payments to the Government are referred to as "Crown royalties." The computation of Crown royalties is very complex and it varies from province to province because each province or territory has its own royalty regime. In general, computations are based on a function of well productivity and the wellhead price. Crown royalty rates typically range from 10% to 45%. Special tax and royalty regimes apply to oil sands, the Arctic and Atlantic offshore production.

Royalties paid on mineral rights that are not held by the Government are called "freehold royalties." These royalties are typically based on production, and the royalty percentage varies according to the freehold lease. Because the Crown does not receive royalties on freehold leases, "freehold mineral taxes" are levied by the Crown on freehold leases, and the tax is based on production.

Royalties are deductible in determining taxable income.

C. Capital allowances

Oil and gas rights

The cost of oil and gas rights is accumulated in a pool called Canadian Oil and Gas Property Expense (COGPE). Each year, the pool is increased by the cost of the new acquisitions and reduced by the proceeds of the disposition of oil and gas rights and by deductions claimed from the pool. COGPE does not include the cost of any tangible or depreciable property, such as oil and gas machinery or equipment.

Deductions in computing income for income tax purposes for a taxation year may be claimed up to a maximum amount of 10% of the unclaimed COGPE balance. The deduction is discretionary, and unclaimed COGPE may be carried forward indefinitely to be claimed in future years.

Oil and gas exploration

The costs incurred to determine the existence, extent and location of oil and gas (such as seismic, geological, geophysical and geochemical expenses) and the cost of drilling a well that results in the discovery of a new oil and gas reservoir are accumulated in a pool called the Canadian Exploration Expense (CEE). Each year, the CEE pool is increased by the new expenditures and reduced by the proceeds of the disposition and by the deductions claimed from the pool. CEE does not include the cost of any tangible or depreciable property, such as oil and gas well machinery or equipment.

Deductions in computing income for income tax purposes for a taxation year may be claimed up to a maximum amount of 100% of the unclaimed CEE balance. The deduction is discretionary, and unclaimed CEE may be carried forward indefinitely to be claimed in future years. A corporation that carries on an oil and gas business cannot claim a CEE deduction in a taxation year if the deduction would create or increase a loss for tax purposes for that year.

Oil and gas development

The costs incurred to drill and complete an oil or gas well for the production of oil and gas are accumulated in a pool called the Canadian Development Expense (CDE). Each year, the CDE pool is increased by new drilling and completion expenditures and reduced by deductions claimed from the pool. The CDE does not include the cost of any tangible or depreciable property, such as oil and gas well machinery or equipment.

Deductions in computing income for income tax purposes for a taxation year may be claimed to a maximum amount of 30% of the unclaimed CDE balance. The deduction is discretionary, and the unclaimed CDE may be carried forward indefinitely to be claimed in future years.

Foreign exploration and development

The costs incurred to acquire foreign oil and gas rights and the expenses incurred to explore or develop a foreign oil and gas property are accumulated in a pool called the Foreign Resource Expense (FRE). A separate FRE pool must be maintained for all FRE expenditures for each individual country. FRE does not include the cost of any tangible or depreciable property, such as oil and gas well machinery or equipment.

A corporation that carries on an oil and gas business is permitted to claim a minimum 10% FRE deduction in a taxation year, regardless of whether it has any income from the foreign resource property for the year. The deduction for a particular taxation year may be increased to the lesser of 30% of the FRE pool for a particular country or the income for the year from the foreign resource property in that country. Unclaimed FRE may be carried forward indefinitely to be claimed in future years.

Well equipment

The acquisition cost for oil and gas well equipment used for exploration, development and production of oil and gas is accumulated in a pool called Class 41.

Each year, the Class 41 pool is increased by the cost of the acquisition of oil and gas well equipment. It is reduced by deductions claimed from the pool (capital cost allowances) and by the proceeds of disposition (up to the original cost) of the oil and gas machinery or equipment that was previously added to the pool.

Deductions in computing income for income tax purposes for a taxation year may be claimed up to a maximum amount of 25% on the unclaimed Class 41 pool balance. The deduction is discretionary, and the unclaimed Class 41 pool may be carried forward indefinitely to be claimed in future years. Only one-half of the normal 25% deduction is allowed in respect of the net additions in the year. Special available-for-use rules determine when the cost of oil and gas equipment is first available for the purposes of claiming a deduction.

D. Oil sands operations

The Canadian tax rules do not have one specific section that covers the taxation of oil sands operations. The tax treatment of oil sands project expenditures depends on a number of determinations, which are affected by factors such as the material being extracted and the type of operations involved. The two most common types of oil sands operations are in open-pit mining and in situ projects. In situ operations involve oil wells that can generally be compared with the oil wells used for conventional oil production. Open-pit mining is used to remove and process oil sands (to extract bitumen) at surface level, whereas in situ techniques are used when the oil sands are located at depths that are not economical to reach through surface mining.

The acquisition cost of an oil sands right may be either a COGPE or CDE amount, depending on whether the underlying properties to be extracted under the right satisfy the requirements for treatment as bituminous sands.

Expenses incurred for performing geological, geophysical or geochemical activities and for trenching, prospecting, digging test pits and preliminary sampling for an oil sands project may be eligible for treatment as CEE.

Costs incurred during oil sands development using an open pit mine or an in situ project for production may constitute CEE or CDE, depending on the circumstances. The legislative criteria for CEE treatment vary according to whether the operation is related to a mine or an oil well.

Capital cost allowance (CCA) deductions are generally available for equipment acquired for oil sands operations at 25% on a declining-balance basis. Additional CCA (up to 100%) may be available for equipment acquired for an oil sands operation that constitutes a mine. This accelerated CCA (ACCA) is available to both open-pit mining and in situ projects. The Government announced on 19 March 2007 that ACCA for oil sands projects — both mining and in situ — will be phased out; that is, the current ACCA system will continue to be available in full for assets acquired before 19 March 2007, and assets acquired before 2012 that are part of a project phase on which major construction commenced by 19 March 2007. For assets that do not meet these criteria, the current ACCA will be progressively phased out until it is completely eliminated in 2015. Draft legislation to implement the phase-out of this ACCA has not been enacted as yet.

E. Incentives

Atlantic investment tax credits

Federal income tax payable may be reduced by investment tax credits (ITC) of 10% of the qualifying expenditures in the Canadian Atlantic (including the offshore area of the Canadian Atlantic).

Qualifying expenditures include, among other things, the acquisition of machinery, equipment and buildings primarily for use in oil and gas exploration or production.

Unused ITC may be carried forward for up to 20 years or backward for up to three years to reduce the federal income taxes payable for those years.

The effect of the ITC is a reduction in the amount of income tax payable, as well as a reduction in the cost of machinery, equipment or buildings, thereby reducing the amount of the cost available for the CCA.

Scientific research and experimental development

Scientific research and experimental development (SR&ED) generally refers to systematic investigation or research carried out in a field of science or technology by means of experiment or analysis.

The treatment of SR&ED expenditures has the following special features:

- Current and capital expenditures are accumulated in a special pool that can be deducted at a rate of 100% in the current year or in any subsequent year. No time limit applies for deductibility of these amounts.
- SR&ED expenditures are also eligible for federal ITC of 20%. For qualifying Canadian-controlled private corporations (CCPCs), the 20% rate is increased to 35% on up to CAD$3 million of annual SR&ED expenditures.

If these expenditures are carried out in the course of carrying on an oil and gas business in Canada, they are deductible when computing the income from that oil and gas business for income tax purposes.

Generally, SR&ED ITC are used to offset taxes otherwise payable.

Unused SR&ED ITC may be carried backward for up to three years and forward for up to 20 years. Some or all of the ITC earned by a qualifying CCPC in a year that are not required to offset taxes otherwise payable may be refundable.

In addition to the federal SR&ED ITC, most provinces offer similar incentives on current and capital expenditures with ITC rates varying from 10% to 20% and, in many cases, the ITC that are not required to offset taxes otherwise payable are refundable. The province of Quebec provides for a 17.5% ITC on SR&ED wages and a portion of the amount paid to subcontractors for qualifying work, with an enhanced 35% ITC rate for qualifying CCPCs on up to CAD$3 million of annual SR&ED expenditures.

F. Withholding taxes

Under the Income Tax Act, withholding taxes (WHT) are imposed at a rate of 25% on interest, dividends, royalties and certain other payments; however, such rates may be reduced under a tax treaty.

Interest

Interest paid to arm's-length, nonresident persons is exempt from WHT (other than in respect of participating debt). Interest paid to non- arm's-length nonresident persons is subject to 25% WHT, unless the rate is reduced by an applicable treaty. Generally, the reduced treaty rate is either 10% or 15%; however, the Canada-US Income Tax Convention provides for a 0% WHT rate for interest paid to non- arm's-length US residents.

Dividends

Dividends paid to nonresidents are subject to 25% WHT, unless the rate is reduced by an applicable treaty. Generally, the reduced treaty rate is 15%. If the nonresident shareholder is a corporation that has a substantial interest in the payer (usually defined as 10% of the votes), the dividend WHT rate is reduced to either 5% or 10%, depending on the applicable treaty.

Oil and gas royalties

Oil and gas royalties paid are generally subject to 25% WHT and not usually reduced under the applicable treaty.

Branch remittance tax

In general, repatriated branch profits (i.e., after-tax income subject to an allowance for investment in Canadian property) are subject to an additional 25% tax. If a nonresident corporation that carries on business in Canada is resident in a treaty country, in most cases, the branch profits tax rate is reduced by the applicable treaty to either 5% or 10%.

G. Financing considerations

Interest expense is generally deductible, provided that the interest is a reasonable amount and it is incurred pursuant to a legal obligation to pay interest on borrowed money or on an amount payable for property and it is used for the purpose of earning income from a business or property. Canadian transfer pricing rules apply to the interest rate on a debt owed to a non- arm's-length nonresident.

Canada has thin capitalization rules that can disallow a deduction for interest payable by a Canadian corporation on debts owed to "specified nonresidents." These rules generally disallow a deduction for interest on the portion of the affected debt that exceeds two times the corporation's equity. The calculation is determined using the monthly average of the greatest amount of the debts outstanding at any time in each calendar month in the relevant taxation year. A corporation's equity for this purpose is basically the aggregate of its retained earnings at the beginning of the year and the monthly average of each of its contributed surplus and paid-up capital in respect of shares owned by specified nonresidents at the beginning of each calendar month.

Generally, if the debt is not denominated in Canadian dollars, there may be tax consequences for the borrower from any foreign exchange fluctuations (e.g., a gain or loss on the repayment of the principal amount of the debt).

H. Transactions

Many transactions in Canada involve the acquisition of shares of a corporation or interests in a partnership, as opposed to a direct acquisition of operating assets. This trend is generally driven by the differing tax consequences of each type of transaction for the vendor. On the sale of a capital property (such as shares or partnership interests), only one-half of the capital gain is included in taxable income in Canada. However, the sale of operating assets can give rise to income, 100% of which is included in taxable income in Canada and capital gains (as discussed in further detail below). Having a mix of income and capital gains on a sale of assets generally results in a higher effective tax rate on an asset sale versus a sale of capital property.

Share acquisitions

There are no stamp duties or similar taxes payable in Canada on the acquisition of shares.

Since there are no tax consolidation rules in Canada, most share acquisitions are completed using a special-purpose Canadian acquisition company, which is formed by the purchaser to acquire the shares of the target company.

The purchaser capitalizes the acquisition company with debt (subject to the thin capitalization restrictions noted) and equity. Subsequent to the acquisition of the shares of the target company, the acquisition company and the target company are amalgamated. The purpose of the amalgamation is to ensure that the interest expense paid on the debt incurred by the acquisition company is deductible against the income of the target company. Since there are no tax consolidation rules in Canada, if the amalgamation is not completed, the interest expense incurred by the acquisition company would not be available to offset the income of the target company.

Generally, no rules allow for a step-up of the inside tax basis of the assets of the target company upon acquisition of the target company's shares. However, when the acquisition company and the target company amalgamate, an opportunity arises to step up to fair market value the tax cost of non-depreciable capital property owned by the target company at the date of the acquisition (usually shares of subsidiaries or partnership interests), provided that certain qualifying conditions are met.

Shares in a private corporation and any other shares not listed on a designated stock exchange are taxable Canadian property, including shares of nonresident companies whose value is more than 50% attributable to Canadian oil and gas properties and other Canadian real property. The sale of this type of share can give rise to a Canadian income tax liability for a nonresident vendor. To ensure that nonresidents pay any taxes owed in respect of a sale of taxable Canadian property, the nonresident vendor must provide the purchaser with a certificate issued by the tax authorities. The certificate is granted when appropriate arrangements are made to ensure payment of any tax liability. If the certificate is not provided, the purchaser must withhold and remit to the tax authorities 25% of the purchase price, whether or not any tax would be payable by the vendor on the sale. It is not necessary to obtain a certificate with respect to shares that are listed on a recognized stock exchange. Generally, for dispositions after 2008, a nonresident vendor will not be required to obtain a certificate if it holds shares on which the gain is exempt from Canadian income tax by virtue of an income tax treaty (treaty-protected property).

If a share purchase results in an acquisition of control, certain tax consequences apply for the acquired company, including a deemed tax year-end and restrictions on the availability of tax losses and the deductibility of FRE, CEE, CDE and COGPE.

Asset acquisitions

Generally, no land transfer taxes are imposed on the purchase of oil and gas assets.

The allocation of the purchase price among the various assets acquired has Canadian tax implications for both the vendor and the purchaser. For the vendor, the manner in which the purchase price is allocated may result in the recapture of CCA claimed in prior years, the realization of income upon the sale of intangible oil and gas rights (see above) and, in some cases, capital gains on the sale of capital property. For the purchaser, the value attributed to the various assets forms the cost of such assets. Therefore, to accelerate deductions from the taxable income that will be generated from the business in future years, the purchaser may wish to allocate as much of the purchase price as possible to depreciable property (in most cases, eligible for Class 41, which is a 25% declining-balance pool) rather than to oil and gas rights (in most cases, classified as COGPE, a 10% declining-balance pool). The allocation is a matter of negotiation between the parties, and the values attributed to the assets should generally form part of the purchase agreement.

Most assets used by a nonresident vendor in a Canadian oil and gas business are taxable Canadian property and are usually not treaty-protected property. Therefore, in these circumstances, the purchaser is generally required to withhold and remit to the tax authorities 50% of the purchase price if the nonresident vendor does not have a certificate from the tax authorities authorizing a lesser withholding rate.

I. Indirect taxes

Goods and services tax and harmonized sales tax

Supplies made in the provinces of Newfoundland, New Brunswick and Ontario are subject to harmonized sales tax (HST) at a rate of 13%. Supplies made in the provinces of Nova Scotia and British Columbia are subject to HST at a rate of 15% and 12%, respectively. Supplies made in all other parts of Canada are subject to GST at a rate of 5% and the applicable provincial sales tax rate. In 2013,[21] supplies made in British Columbia will be subject to good and services tax (GST) at the rate of 5% and the applicable provincial sales tax instead of an HST at the rate of 12%.

The importation of products and equipment into Canada is subject to GST, which is payable by the importer of record to the Canada Border Services Agency.

The GST/HST is a multi-staged tax, applying at each point of sale or lease. Certain supplies, such as goods sold for subsequent export and services provided to nonresidents of Canada, are zero-rated. This means that GST/HST applies to the transaction, but at a rate of 0%. Documentation that evidences the export, and in some situations a declaration letter provided by a GST-registered exporter, is required to support the zero-rating.

Other goods and services are exempt from GST, such as most supplies made by charities and financial institutions. Oil and gas businesses are not typically involved in making exempt supplies.

GST/HST paid on purchases and imports is recoverable by a registrant that purchases the goods or services for use in commercial activities. Commercial activities include business carried on by a registrant, other than to the extent to which the business involves making exempt supplies. Oil and gas businesses are typically engaged in commercial activities.

21 *The current target date is 1 April 2013 for the reinstatement of the provincial sales tax at the rate of 7% in British Columbia. However, the date of the reinstatement may change.*

A nonresident is required to register for GST/HST if it makes taxable supplies in Canada and carries on business in Canada. The term "carrying on business" is not defined under the Excise Tax Act.[22] Several factors are considered in determining whether a nonresident carries on business in Canada. Generally, a nonresident must have a significant presence in Canada to be considered to be carrying on business in Canada. Even if a nonresident does not carry on business in Canada, it may choose to register voluntarily if it expects to pay GST/HST to its suppliers or on importation (please note that the nonresident must meet certain conditions to register voluntarily). A voluntary registration will allow a nonresident person to recover the GST/HST paid. If a nonresident does not have a permanent establishment in Canada through which it makes supplies, it will be required to post security with the Canada Revenue Agency in order to register for GST/HST. The security amount ranges from CAD$5,000 to CAD$1 million. The security is based on 50% of the absolute value of the expected net GST/HST payable or recoverable over the course of the first year of registration.

Except for rights supplied to consumers[23] and to non-registrants that acquire the right in the course of the business of supplying these rights to consumers, the supply of the natural resources property rights is not deemed to be a supply. Therefore, any consideration paid or due, or any fee or royalty charged or reserved in respect of these rights, is not deemed to be consideration for GST/HST purposes and thus does not attract GST/HST. This provision applies to most (but not all) property interests that form the legal basis of Canada's major resource industries (i.e., oil and gas, mining, forestry). For all practical purposes, this treatment has the same effect as zero-rating. The rights covered by this provision include:

- A right to explore for or exploit a mineral deposit (including oil and gas); a peat bog or deposit of peat; or a forestry, water or fishery resource
- A right of entry or use relating to the right to explore
- A right to an amount computed by reference to the production (including profit) from, or to the value of production from, any such deposit, bog or resource

Oil and gas businesses often explore for and operate oil and gas resource properties as joint ventures with other oil and gas companies. If a written joint venture agreement exists between the joint venture participants, and the participants complete an election, the operator can account for the GST collected on the sales and paid on the purchases on its GST return. Furthermore, where the election is in place, the operator does not charge GST to the other participants on the joint interest billings.

Quebec sales tax

Quebec sales tax (QST) is a value added tax (VAT) and operates similarly to GST/HST, except that it is imposed exclusively on supplies of goods and services made in the province of Quebec. In addition, QST is generally imposed on goods and equipment imported into Quebec for consumption or use, unless the person importing the goods is a registrant and will use the goods exclusively in commercial activities. In addition, QST will apply to goods and equipment imported for supply in the province of Quebec, where the importer is a small supplier that is not a QST registrant. In Quebec, QST applies at a rate of 9.5% on the GST-inclusive price and is in addition to GST at the rate of 5%.

Quebec is planning to harmonize its sales tax with the QST, effective from 1 January 2013. In addition, QST will no longer be calculated on the GST-inclusive price. As a result, the QST rate will increase on 1 January 2013 to 9.975% from 9.5% to maintain the effective combined GST/QST rate of 14.975%.

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22 *The Excise Tax Act is the statute that governs GST/HST.*

23 *Consumer is defined by the Excise Tax Act as a "particular individual who acquires or imports the property or service for the particular individual's personal consumption, use or enjoyment or the personal consumption, use or enjoyment of any other individual at the particular individual's expense… "*

Provincial sales taxes

Saskatchewan, Manitoba and Prince Edward Island impose provincial sales tax (PST) on sales and imports of tangible goods and some services for consumption in those provinces. In those provinces, PST will apply in addition to the federal GST. Alberta does not have a sales tax, so only GST at the rate of 5% applies to supplies made in that province. As discussed previously, British Columbia will reinstate its provincial sales tax in 2013.

PST is imposed on the purchaser. Therefore, even if PST is not charged by the vendor, it must be self-assessed by the purchaser on any taxable purchases.

Goods acquired for the purpose of resale are not subject to PST.

Each province also provides various exemptions in respect of certain goods and services. Saskatchewan provides exemptions or rebates for certain oil and gas exploration and production equipment, certain processing materials and certain services in respect of oil and gas exploration and well servicing.

In general, persons are required to register for PST if they make regular supplies of taxable goods or services in a province. Once registered, persons must collect PST on all taxable goods and services they deliver in that province.

PST is non-recoverable unless it is paid in error. The rates as of 1 January 2012 are (applied net of GST, except for Prince Edward Island where PST applies to the GST-inclusive price): Saskatchewan at 5%, Manitoba at 7% and Prince Edward Island at 10%. It is expected that the PST rate in British Columbia will be 7% after it is reinstated in 2013.

Some goods are conditionally exempt (e.g., where exemption is based on the person's use, status or intent to resupply the goods rather than the nature of the goods themselves). In these circumstances, the vendor is required to obtain certain documents from the purchaser. The documents required to satisfy this condition vary by province.

Other indirect taxes

If a business imports, refines or sells refined fuel products, it may be required to register for and remit federal excise tax and provincial fuel taxes. In many provinces, businesses that use natural gas they produce to power their own compressors are required to self-assess fuel tax on their consumption of natural gas.

Effective from 1 July 2008, British Columbia imposed a carbon tax on various fossil fuels consumed in the province, including natural gas that is flared or used to power compressors. The carbon tax rate varies based on the type of fossil fuel used.

Some of the other provinces also levy a carbon tax in certain circumstances on certain fossil fuels.

J. Other

Canada has a concessionary type fiscal regime whereby private ownership of resources is permitted. Oil and gas in Canada typically belong to the province in which the resource is located. Rights to explore, develop or produce oil and gas in a province are obtained by acquiring a petroleum or natural gas lease or license from the province or from another party that holds such a lease or license. As is typical with most concessionary fiscal regimes, the initial owner of the resource (usually a government) leases or licenses the right to take petroleum or natural gas from the lands but retains a royalty interest in the production.

Chad

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A. At a glance

Fiscal regime

Chad's fiscal regime applicable to the upstream petroleum industry consists of: i) the Chadian Petroleum Code (Law no. 006/PR/2007 dated 2 May 2007 pertaining to hydrocarbons and Ordinance No. 001/PR/2010 dated 30 September 2010, which approves the standard production sharing contract (PSC) and modifies and completes the provisions of the above-mentioned Law regarding petroleum operations); ii) the standard production contract (hereafter referred to as the Model PSC); iii) the PSC and concession agreements (CA) concluded between the state of Chad and the contractors (the oil companies), and iii) the Chadian Tax Code.

Fiscal regime under a PSC

Corporate income tax (CIT)	Non-applicable
Royalties on crude oil	Rate set by the PSC, provided that it cannot be less than 14.25% nor exceed 16.5%
Royalties on natural gas production	Rate set by the PSC, provided that it cannot be less than 5% nor exceed 10%
Cost stop (as defined below)	70%
Cost recovery principles	Ring-fence according to the Model PSC (negotiable) and LIFO (last in, first out)
Tax oil (as defined below)	Cannot be less than 40% and varies according to a profitability ratio (R factor)
Surface rent tax	Annual contribution as agreed in the PSC (non-recoverable cost)
Exceptional tax on capital gains resulting from assets assignments	25%
Withholding tax (WHT)	On payments made abroad for services provided in the country as described below
Dividends	Exempt
Interest	Exemption for interest paid to nonresident lenders incentives
L[24], VAT exemption	
Signature bonus	As agreed in the PSC

24 *L: Ability to carry forward losses.*

Bonus for the awarding of an exclusive exploitation authorization	As agreed in the PSC

Fiscal regime under CA (in practice, such contracts are no longer concluded)

Legal regime

The Chadian Petroleum Code provides for two types of regimes: i) the concession regime and ii) the PSC regime. However, since the issuance of Ordinance No. 001/PR/2010 dated 30 September 2010, all of the conventions and agreements concluded between the state and the contractors follow the PSC regime, based on the Model PSC approved by this Ordinance. Under this regime, the contractor undertakes petroleum activities on behalf of the state but at its sole and full risk. The contractor is not entitled to be granted a mining title. Exploration operations are undertaken pursuant to an exclusive exploration authorization granted to the contractor for a maximum period of five years renewable once for three years. The exclusive exploration authorization provides exclusive rights to undertake exploration activities within the contractual zone. In case of a commercial discovery, the state grants, to the contractor or the consortium, an exclusive exploitation authorization for a maximum period of 25 years that is renewable once for 10 years.

Upon the award of any exclusive exploitation authorization, the state is entitled to require the assignment of a stake up to a maximum of 25% of the rights and obligations attached to the exclusive exploitation authorization. Pursuant to Article 16 of the Ordinance of 30 September 2010, the participation of the state is fully carried by the oil company for a threshold of 10% of the participation. The state is co-owner of the exclusive exploitation authorization to the extent of its participation.

The contractor is responsible for financing all petroleum costs. In return, as from the date of the production start-up, the contractor is entitled to recover these petroleum costs by receiving a quantity of hydrocarbons known as "cost oil" that cannot exceed a maximum of 70% of the production per year. The remaining production, known as "profit oil", is shared between the state and the contractor. The share of the state in the profit oil, referred to as "tax oil," cannot be less than 40% of the profit oil and varies according to a profitability ratio (the R factor).

The ownership of any property purchased or acquired by the contractor for the purpose of carrying out petroleum operations is transferred to the state free of charges. However, the contractor is reimbursed through the cost recovery mechanism discussed below.

PSCs are negotiated with reference to the Model PSC approved by the Law. They are signed by the minister in charge of petroleum activities, approved by an Act of Parliament and published in the Official Gazette.

B. Fiscal regime (under a PSC)

Corporate income tax

Chadian CIT rate is 40%.

Pursuant to Article 15 of the Ordinance of 30 September 2010, the contractor is not subject to any other taxation other than the taxation that is provided by the Ordinance and the Model PSC.

According to Article 47.1.2.d of the Model PSC, the contractor (the oil company or the consortium which jointly holds the exclusive exploitation authorization) is exempt from CIT. Article 47.2.1 of the Model PSC provided that the share of the state via the tax oil mechanism is the equivalent of CIT. A tax clearance is delivered to the contractor upon payment of the tax oil to certify that this tax oil is the equivalent of the CIT and that there is no need for the contractor to pay any additional CIT or direct tax on profits.

The contractor shall nevertheless file a yearly tax return for its petroleum operations within three months following the end of the tax year (i.e., before 1 April).

Furthermore, the net profits arising from the operations carried out by the contractor in Chad, apart from petroleum operations, are subject to CIT in accordance with the common law and shall be held in a separate accounting from the petroleum operations accounting.

Royalty regime

Contractors are subject to a monthly royalty on the production at a rate agreed in the PSC. The Model PSC provides that the rate ranges from 14.25% to 16.5% for crude oil and from 5% to 10% for natural gas.

The royalty on crude hydrocarbon shall be payable at the state's option, either in cash or in-kind.

Contractors shall file a monthly production statement, together with supporting documents, that sums up the total production of the previous month, including, but not exhaustively:

- The net hydrocarbon production (total hydrocarbon production minus water, sediment and the quantities of hydrocarbons used for petroleum operations)
- The quantity of hydrocarbons allocated to the payment of the royalty as measured at the measurement point, regardless whether such royalty is paid in cash or in-kind
- The quantity of hydrocarbons allocated for the reimbursement of the petroleum costs
- The quantity of hydrocarbons delivered at the delivery point, which is the quantity of hydrocarbons to be exported

The summary should mention separately the quantity of crude hydrocarbons and the quantity of natural gas.

The royalty is required to be paid by the 15th day of the month following the relevant month. When the royalty is paid in cash, the amount is assessed based on the ex-field market price.

Royalty is not a recoverable cost under the PSC.

Cost recovery

Contractors are entitled to receive a part of the net production (after deduction of the royalty) for the purpose of recovery of their petroleum costs. The production to be allocated to the recovery or the reimbursement of the petroleum costs cannot exceed 70% of the net production (after deduction of the royalty).

The petroleum costs shall be reimbursed in the following order of priority:

- Exploitation costs (opex)
- Development costs
- Exploration costs
- Provisions that are determined to cover abandonment operations

Non-recoverable expenditures

Some expenditures or costs are not recoverable. Examples include:

- Expenses relating to the marketing and transportation of the hydrocarbons beyond the delivery point
- Gifts, donations and subsidies, except those approved by the Chadian state
- Gifts and discounts granted to suppliers, as well as gifts and discounts granted to intermediaries used in the frame of supplies or services contracts
- Fines, confiscations and penalties of all kinds arising from consortium transactions in contravention of the legal, economic or fiscal provisions of the convention

- Any other expenses that are not necessary for the performance of petroleum operations or are considered indirect, unreasonable or excessive
- The surface rent tax
- The signature bonus and the bonus for the award of an exclusive exploitation authorization (in certain contracts, however, these are recoverable)

Surface rent tax

Contractors are liable to the payment of an annual surface rent tax on the basis of the surface area as provided in the PSC.

The surface rent tax shall be payable annually and in advance, based on the situation as at January of the current year and shall be paid to the Public Treasury by 31 March of the relevant year.

Exceptional tax on capital gains relating to assignments of interests

Pursuant to Article 17 of the Ordinance of 30 September 2010, capital gains resulting from any assignment by the contractor of any authorization to undertake petroleum operations under the PSC and related assets shall be subject to a special 25% tax, which shall be payable by the assignor pursuant to the terms and conditions set forth in the Model PSC. In practice, however, the special tax applies only to assignments of exclusive exploration authorizations or assets and interests deriving from such authorizations. In many PSCs, there is an exemption for capital gains resulting from the transfer of assets under an exclusive exploitation authorization (farm-in and farm-out during the exploitation period). Inter-affiliated companies' assignments are also exempt from this tax.

This special tax is levied on the difference between the sale price of the assets and the cost price of the relevant assets. The tax is payable within 30 days from the issuance of the assignment authorization by the state.

C. Incentives

VAT incentives

The supply of goods and services of all kinds that are directly linked to petroleum operations are exempt from VAT. A list of exempted goods and services is included in the PSC.

D. Withholding taxes

Dividends

Dividends paid by a company incorporated in Chad to a nonresident are exempt from taxation as provided by the Petroleum Code.

Interest

Any interest paid to lenders that are nonresident, from a Chadian fiscal point of view, shall be exempt from any WHT.

Payments made abroad

The WHT shall apply to the following types of services provided in Chad but only insofar as such withholding is prescribed by the Chadian General Tax Code: technical, financial and accounting services; share of general and administrative expenses related to operations carried out in Chad; equipment or material rental; supplying information of an industrial, commercial, scientific or technical nature; and any services provided to the contractor by any contractor, subcontractor or affiliate. For the purposes of the application of the relevant withholding rules, technical, financial and accounting services, as well as general and administrative expenses, shall have their respective common law meanings.

E. Financing considerations

Thin capitalization limits

Interest paid to shareholders for funds made available to the company, in addition to their capital contributions, regardless of the type of the company, is fully deductible to the extent that the rate applied does not exceed the Chadian Central Bank's rate plus two points.

F. Indirect taxes

Import duties

Provisions regarding customs duties are identical for most contracts. They usually provide that the person designated as the "contractor," as well as its subcontractors, are allowed to import into Chad any goods, materials, machinery, equipment and consumer goods that are necessary to carry out qualifying operations in their own name or in the name of their subcontractors. The following rules apply:

- The material intended exclusively for petroleum exploration and exploitation will be exempt from all taxes and customs duties.
- Equipment, merchandise and appliances intended for the petroleum exploration and exploitation work sites will be placed under the normal temporary admission regime.
- Work site vehicles, specialized or not, will be placed under the temporary admission regime; company vehicles and vehicles for personal use will be subject to the general legal regime without exemption; airplanes and their spare parts and consumable materials required for petroleum exploration and exploitation, as listed in the appendix of the PSC, will be exempt from all taxes and customs duties.

Export duties

The Chadian Petroleum Code provides that contractors will be exempt from any taxes and duties while exporting.

VAT

As noted above, the supply of goods and services of all kinds that are directly linked to petroleum operations is exempt from VAT. A list of exempted goods and services is usually enclosed with the CA. Ancillary activities that are not linked to petroleum operations will be subject to VAT at a rate of 18%. No separate registration process is necessary for VAT purposes. VAT registration will be included in the registration for tax purposes with the Chadian tax administration. There is no threshold minimum value of supplies. Registration for tax purposes will be required for all resident entities.

Registration fees

Registration fees depend on the type of the agreement concluded. Contractors are exempt from registration fees relating to the incorporation of any company in Chad and from any capital increase.

G. Other

Exchange control

The Economic and Monetary Community of Central Africa Countries (CEMAC) Act (Act No. 02/00/CEMAC/UMAC/CM), dated 29 April 2000, provides for exchange control regulation that applies to financial transfers outside the franc zone, which is a monetary zone including France and mostly French-speaking African countries. However, for the duration of the CA, Chadian authorities provide certain guarantees to the contractor for the operations carried out within the framework of the CA, notably:

- The right to obtain financing from abroad necessary for the conduct of the petroleum operations; to receive and to maintain abroad all funds acquired or borrowed abroad, including income from sales; and to dispose of them freely insofar as funds exceed the requirements of their operations in Chad and of their fiscal and contractual obligations
- Free movement of funds belonging to it, free of all taxes and duties, between Chad and any other countries
- The right to repatriate the capital invested within the framework of the CA and to transfer income from such capital, in particular interest and dividends, although the state shall have no obligation to provide foreign currency
- Free transfer of amounts payable, as well as the right to receive amounts of any nature that are payable to them, subject to making the necessary declarations required by the regulations
- The right to direct payments abroad to foreign suppliers and services required for the petroleum operations

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A. At a glance

Fiscal regime

As a general rule, the oil and gas industry is subject to the same general tax regime and tax regulations as any other industry in Chile.[25] However, pursuant to Article 19, No. 24, Subsection 10 of the Political Constitution, the exploration, exploitation or benefits arising from deposits or oil fields that contain substances that are not freely traded may be carried out by means of administrative concessions or through special operating contracts or agreements. According to the foregoing, there is a special regime applicable to the exploitation of hydrocarbons, being an exception to the above-mentioned general rule.
This special regime is contained in Decree Law No. 1.089 of 1975, which regulates the granting, subscription, rights, obligations and tax treatment of the operating agreements (Contrato Especial de Operaciones para la Exploración y Explotación de Hidrocarburos, or special operating agreements for the exploration and exploitation of hydrocarbons, also known as CEOP) by means of which private contractors may carry out the exploitation of hydrocarbons.

Corporate income tax (CIT) rate (standard regime)	18.5%[26]
Special tax regime applicable to CEOP	50% of gross revenues
Tax on capital gains	20%–35%
Withholding tax (WHT):	
Dividends	35%
Interests	35%
Royalties (patents, trademarks, formulas and similar items)	30%
Technical services and professional services	15%–20%
Other fees and compensation for services rendered abroad	35%
Net operating losses (years):	
Carryback	Unlimited
Carryforward	Unlimited
VAT	19%

25 *In general terms, Chile does not impose special regimes by industry.*

26 *The standard CIT rate of 17% is temporarily increased to 18.5% for 2012. The 17% rate will be reinstated in 2013.*

B. Fiscal regime

Special operating agreements for the exploration and exploitation of hydrocarbons

These agreements may be subject to the standard income tax regime or to a special regime, under which a 50% tax is assessed on gross revenues for the relevant CEOP. Notwithstanding the foregoing, regardless of the tax regime applicable to the CEOP, the president of Chile may grant several tax reductions to all or some of the taxes contained in the Income Tax Law, equivalent to 10%, 20%, 30%, 40%, 50%, 60%, 70%, 80%, 90% or 100% of the taxes imposed, in particular circumstances (i.e., if the exploration or exploitation areas are difficult to access, if there are no double taxation agreements in force between Chile and the country from which the investment comes from or when the other terms of the CEOP are too burdensome for the contractor).

When hydrocarbons are transferred to the contractor under the respective CEOP, they are exempt from all taxes and duties, including export taxes. However, according to Decree Law 1.089, the remuneration of foreign subcontractors that are domiciled abroad and that have entered into a CEOP will be subject to a 20% tax rate, applied to the total amount of the remuneration, and will substitute any other direct or indirect tax that may be levied upon the remuneration of the subcontractor. The president of Chile may grant a reduction of the above-mentioned tax equivalent to 10%, 20%, 30%, 40%, 50%, 60%, 70% or 75% of the same.

Finally, under the provisions of Decree Law No. 1.089, companies engaged in oil exploration or exploitation activities are eligible for VAT and customs reductions ranging from 10% to 100% on certain items, including imported machines, materials and spare parts. These reductions are granted by the president of Chile by means of enacting a Supreme Decree.

Notwithstanding the foregoing, in practice, almost all of the companies acting as contractors or subcontractors in a CEOP are subject to the standard tax regime.

Specific oil and gas tax

According to Law No. 18.502, a specific tax is applied to natural compressed gas and liquefied gas used in vehicular consumption, automotive gasoline and diesel.

With respect to natural compressed gas and liquefied gas, this tax will be levied upon its sale in Chilean territory. The same tax will be applicable when the distributor, producer or importer of these gases sells them directly for vehicular consumption or in order to supply fuels to vehicles exploited by them.

With regard to automotive gasoline and diesel, the tax will be accrued when they are sold for the first time or when imported into the country, and it will be levied upon the producer or the importer.

C. Corporate tax

General considerations

CIT is imposed on accrued net income. Chilean resident companies are subject to CIT (first category tax) on their worldwide income. Companies are considered resident if they are incorporated in Chile. A Chilean branch of a foreign corporation is taxed solely on the basis of its Chilean source income.

The income of corporations, limited liability companies and foreign branches is assessed in two stages: first, when the income is accrued and second, when the profits are distributed to shareholders or partners, and in the case of branches, when they are withdrawn or remitted abroad. The corporate tax is credited against the tax on profits distributed to partners or shareholders.

Tax rates

The current CIT rate for profits generated in the calendar year 2012 is 18.5%. The standard CIT rate is 17%; however, in order to finance reconstruction efforts after the earthquake in 2010, the Chilean Congress approved provisional increases of the CIT to 20% for the calendar year 2011 and 18.5% for the calendar year 2012. The standard CIT rate of 17% will be re-instated in 2013.

In addition, a WHT of 35% applies to profits distributed to nonresident individuals and corporations; however, CIT paid by the distributing entity is creditable against the WHT.

D. Tax payments and income tax return

Financial statements must be prepared as of 31 December of each year for income tax purposes. Income tax returns must be filed in April of the following year.

Provisional monthly payments (PPM) with respect to the final annual income tax liability must be made on a monthly basis. The amount payable is determined as a percentage of gross receipts accumulated during the corresponding month. If the company has losses in a given year, PPM can be suspended during the following quarter. PPM will continue to be suspended if losses continue in the quarters thereafter.

E. Foreign tax relief

Income tax paid in other countries may be credited against Chilean CIT liabilities up to an amount equivalent to the lower of:

i. the taxes paid abroad
ii. 18.5% or 30% of the foreign source income (depending on the type of income received). In any case, the total foreign tax credit can never exceed 30% of the Chilean company's net foreign source income

Foreign tax relief may also be available under double tax treaties currently in force in Chile with the following countries: Argentina, Belgium, Brazil, Canada, Colombia, Croatia, Denmark, Ecuador, France, Ireland, Malaysia, Mexico, New Zealand, Norway, Paraguay, Peru, Poland, Portugal, South Korea, Spain, Sweden, Switzerland, Thailand and the United Kingdom.

Chile has signed tax treaties with Australia, the Russian Federation and the United States, which are awaiting ratification by the Chilean Congress.

Under the tax treaty concluded with Argentina, income tax is levied in the source country and not in the country of the investor's residency. The rest of the tax treaties mentioned above are based on the OECD Model; they generally eliminate double taxation by allowing a credit system for Chile and a deduction mechanism for the other party involved.

F. Determination of taxable income

Taxable income, determined in accordance with generally accepted accounting principles, includes all profits, with the exception of specified items that are not considered income for tax purposes. Dividends received by resident companies from other resident companies are exempt from tax.

Taxable income is determined on the basis of profits or losses disclosed in the financial statements prepared at the company's year-end.

Inventories

For inventory valuation, the first in, first out (FIFO) method and the weighted-average cost method are accepted by law.

Expenses

As a general rule, all necessary expenses for producing income, duly proven and justified, may be deducted in determining taxable income.

Likewise, Chilean taxes, except for those contained in the Income Tax Law, are deductible. Foreign taxes that are not creditable in Chile are not treated as deductible expenses. For the case of VAT, whenever VAT cannot be reclaimed, it is a deductible cost or expense.

Depreciation and amortization allowances

Depreciation of tangible fixed assets is tax deductible. Depreciation is calculated using the straight-line method on the estimated useful life of the assets, without considering a residual value.

The tax authority has established the following normal periods of depreciation:

Assets	Years
Solid buildings	40 to 80
Semisolid buildings	20 to 40
Buildings of light materials	10
General installations	10
Machinery and equipment	15
Cars, pickups, station wagons and buses	7
Trucks	7

Taxpayers may apply the accelerated-depreciation method. This allows the calculation of depreciation as straight-line depreciation based on a useful life for an asset equivalent to one-third of the normal useful life established by the Chilean tax authorities. Accelerated depreciation can be applied to new goods acquired locally or imported goods, provided that the useful life exceeds three years.

The difference between normal and accelerated depreciation must be recaptured on any profits distributed to nonresidents.

Goods that become unusable before the end of their expected useful life may be depreciated at twice the rate as originally expected.

Research and development (R&D) expenses may be deducted entirely in the year they are owed or paid or can be amortized over six consecutive years.

Annual depreciation rates must be applied after the revaluation of fixed assets according to the monetary restatement rules (see below).

Monetary restatement

The Income Tax Law contains provisions designed to prevent the taxation of profits created by inflation. These provisions, known as monetary restatement, require taxpayers to revalue certain assets and liabilities annually based on changes reflected in the consumer price index (CPI)[27] and the foreign exchange rates.

In order to make an inflation adjustment, a distinction is made between monetary and non-monetary assets and liabilities. Only non-monetary assets and liabilities in existence at the balance sheet date are adjustable by inflation. Equity is considered non-monetary.

Relief for losses

Losses must first be carried back to offset undistributed profits of prior years and then may be carried forward indefinitely.

However, where there is a change in ownership, tax losses may not be deducted from the company's taxable income.

27 *The National Statistics Institute fixes the monthly CPI.*

G. Issues related to foreign companies

International loans and thin capitalization rules

The overall tax burden on repatriation of equity is 35%. Yet foreign investors frequently use thin capitalization financing for their Chilean projects to benefit from a reduced 4% WHT on qualifying interest payments (provided that the interest was paid to a foreign bank or to a foreign financial institution). Nevertheless, a change in the Income Tax Law provided that, from 1 January 2003, a 31% rate would be applied in addition to the 4% rate on those interests that arise from "excess indebtedness" in related-party transactions.

A company is in an "excess indebtedness" position when its related-party debt is greater than three times its equity (3:1 ratio). The company's equity is calculated as of 1 January of the fiscal year when the debt was contracted, or the date the activities commenced, as the case might be, adjusted by the increases (or decreases) in equity capital. The share in the income of subsidiaries or affiliates by the company paying the interest is also added to (or deducted from) this calculation. A debtor and a creditor are deemed to be "related parties" when one entity has an interest of 10% or more in the capital or profits of the other. Companies are also considered as being related when they have a common partner or shareholder who, directly or indirectly, has an interest of 10% or more in the capital or profits of the other. A relationship is also presumed in the case of a debt guaranteed by third parties with money or securities (back-to-back structures).

Services, duties, patents and technical assistance

In general, payments for services provided abroad made to entities not domiciled in Chile are subject to a 35% WHT.

The payment of duties, patents and assistance is subject to a 15% or 30% WHT depending on the specific nature of the service. However, the 15% rate is only available if the service is not provided between related parties or if the payment is not made to a tax haven, in which case, the rate is 30%.

Also, a 15% rate applies for technical assistance, engineering and professional services, whether provided in Chile or abroad, unless the service is provided between related parties or payment is made to a tax haven, in which case, the rate is 20%.

The tax treaties subscribed by Chile under the OECD Model establish reduced rates for services provided by an entity of a contracting state or even exemption if the income qualifies as a business profit.

Capital gains

Capital gains derived by foreign investors are taxed at the standard corporate rate of 35% if the capital gains relate to the disposal of a local entity other than a local corporation. Capital gains derived from the sale of shares of a Chilean corporation are subject to corporate tax as a sole tax if the following conditions are met:

- The shares were owned for at least one year.
- The seller is not habitually engaged in the sale of shares.
- The parties to the transaction are not related.

If any of these conditions is not met, the 35% general rate applies to the amount of capital gain.

Sales of shares of companies listed on the stock exchange are exempt from income tax under certain conditions. In addition, under certain double tax treaties, the general rate may be reduced.

H. Transfer pricing

Under the Chilean tax legislation, if values of goods and services differ significantly from similar transactions conducted between independent parties, the tax authorities may adjust the prices for tax purposes, particularly if the transactions are conducted between related parties.

In the case of related loans, the tax authority may challenge interest being paid out of Chile to a related entity. Under the current wording of Chilean law, it is not clear if transfer pricing regulation authorizes the Chilean tax authority to challenge interest payments to be paid to Chile.

Charges between companies

The reimbursement of specific expenses incurred by a foreign company in relation to activities of a Chilean agency can be deducted from taxes by the agency. General unspecified charges are unacceptable.

I. Taxation on payments to persons or entities not domiciled in Chile

Chilean source income, which is not specifically taxed as profits, services or royalties, either received or accrued by a taxpayer without residency or domicile in Chile, is subject to WHT (additional tax) at a standard tax rate of 35% or 42% if it is under the invariable tax regime established in the D.L. 600.

J. Special additional tax rates

- Interest payments on loans paid to foreign banks or financial institutions: 4%
- Payments for the use of trademarks, patents, formulas, assistance and other similar services: 15%/30%
- Payments for engineering services, technical assistance and professional services rendered in Chile or abroad: 15%/20%
- Fees paid for ocean freight to or from Chilean ports: 5%
- Payments for leases, lease purchases, charter parties or any other contract that contemplates the use of foreign vessels for coastal trading: 20%

Foreign taxpayers who suffer WHT on profit and dividend distribution are entitled to a tax credit equal to the first category tax rate paid on income withdrawn, distributed or remitted. This credit must be added in the calculation of the tax base for the WHT.

The following examples illustrate the above:

Chilean company's income	100
Corporate tax (first category tax)	(18.5)
Income distributed to foreign parent company	81.5
WHT base (additional tax)	100
WHT determined	(35)
Corporate tax credit	18.5
WHT payable	(16.5)
Available to foreign parent company	65

K. Indirect taxes

VAT

VAT applies to sales and other transactions regarding tangible personal property, as well as to payments for certain services. It also applies to certain real estate transactions. The standard tax rate is 19%. VAT is imposed under a debit-credit system.

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A. At a glance

Fiscal regime

The fiscal regime that applies to the petroleum industry in China mainly consists of production sharing contracts (PSC), special oil gain levies, VAT, resource tax and corporate income tax (CIT).

Special oil gain levy	Calculated in accordance with a formula in circumstances where the monthly average weighted price per barrel of crude oil sold is greater than US$40 per barrel before 1 November 2011 and US$55 per barrel from 1 November 2011
Royalties	0% to 12.5%, not applicable to PSCs concluded after 1 November 2011
Bonuses	Signature bonuses are defined in the PSC and take into account the volume of petroleum resources and the economic value of the field

Production sharing	Based on production volumes
Income tax rate	25%
VAT	17% (general rate)
Resource tax	5% of the sales price, where sales revenue is collected after 1 November 2011
Investment incentives	Qualified research and development (R&D) expenditure can be deducted at 150% of the actual expenses

B. Fiscal regime

Foreign petroleum companies are permitted to participate in and operate the exploration, development and production of petroleum resources in China by entering into PSCs with the Chinese Government or its designated Chinese national petroleum companies.

Special oil gain levy

As of 26 March 2006, a revenue windfall levy is charged on all oil production enterprises (both domestic and foreign) that sell crude oil produced in China. According to the Ministry of Finance, the revenue windfall levy applies regardless of whether the crude oil is sold within or outside China. The revenue windfall levy is charged whenever the weighted-average price of crude oil sold in any month exceeds US$40 per barrel for months before 1 November 2011 and US$55 per barrel for months after 1 November 2011.

The revenue windfall levy, if applicable, is calculated monthly and paid quarterly. Essentially, the amount of revenue windfall levy payable per barrel is calculated as follows: Monthly weighted-average price per barrel of crude oil sold minus US$40 or US$55 multiplied by the rate minus the quick calculation deduction

The relevant "rate" and quick calculation deduction amounts are as follows:

US$40 per barrel for months ending before 1 November 2011 (these rates no longer apply after 1 November 2011)

Crude oil price (US$/barrel)	Rate of levy	Quick calculation deduction (US$/barrel)
40-45 (inclusive)	20%	0.00
45-50 (inclusive)	25%	0.25
50-55 (inclusive)	30%	0.75
55-60 (inclusive)	35%	1.50
Above 60	40%	2.50

US$55 per barrel for months ending after 1 November 2011

Crude oil price (US$/barrel)	Rate of levy	Quick calculation deduction (US$/barrel)
55-60 (inclusive)	20%	0.00
60-65 (inclusive)	25%	0.25
65-70 (inclusive)	30%	0.75
70-75 (inclusive)	35%	1.50
Above 75	40%	2.50

Petroleum royalties

Petroleum royalties are administered and collected by the taxing authorities under the relevant rules pronounced by the Ministry of Finance. Payments are made in-kind with the crude oil and natural gas produced.

Sino-foreign[28] PSC onshore petroleum operations in Qinghai, Tibet and Xinjiang provinces and Sino-foreign PSC offshore petroleum operations are subject to petroleum royalties as shown below:

Annual gross output of crude oil (thousand metric tons)	Royalty rate
Portion not exceeding 1,000	0.0%
Portion between 1,000 and 1,500	4.0%
Portion between 1,500 and 2,000	6.0%
Portion between 2,000 and 3,000	8.0%
Portion between 3,000 and 4,000	10.0%
Portion exceeding 4,000	12.5%

Annual gross output of natural gas (cubic meters)	Royalty rate
Portion not exceeding 2 billion	0%
Portion between 2 billion and 3.5 billion	1%
Portion between 3.5 billion and 5 billion	2%
Portion exceeding 5 billion	3%

Sino-foreign PSC onshore petroleum operations, other than those located in Qinghai, Tibet and Xinjiang provinces, are subject to a different set of petroleum royalties as shown below:

Annual gross output of crude oil (thousand metric tons)	Royalty rate
Portion not exceeding 500	0.0%
Portion between 500 and 1,000	2.0%
Portion between 1,000 and 1,500	4.0%
Portion between 1,500 and 2,000	6.0%
Portion between 2,000 and 3,000	8.0%
Portion between 3,000 and 4,000	10.0%
Portion exceeding 4,000	12.5%

Annual gross output of natural gas (cubic meters)	Royalty rate
Portion not exceeding 1 billion	0%
Portion between 1 billion and 2.5 billion	1%
Portion between 2.5 billion and 5 billion	2%
Portion exceeding 5 billion	3%

Pursuant to the new resource tax regulations issued in 2011, Chinese and foreign parties to onshore/offshore PSCs shall pay resource tax instead of royalties. Where a PSC for oil and gas exploitation is concluded before

28 *Involving collaboration between a Chinese state-owned oil company and a foreign oil company*

1 November 2011, the taxpayers shall still follow the existing petroleum royalties regime during the effective period of the PSC. The taxpayers, who are mainly Chinese and foreign parties on cooperative upstream oil and gas projects, shall start to pay resource tax upon expiry of the PSC.

Signature bonus

A signature bonus is a lump-sum payment made by a petroleum entity to the Government for the right to exploit the petroleum resource. The amount may be defined by the Government based on the volume of petroleum resources and economic value of the field. It would be payable on the signing of a PSC.

Resource tax

According to the new regulations on resource tax issued by the State Council on 30 September 2011, companies engaged in the exploitation of natural resources in China are liable to pay resource tax. The tax rate for crude oil and natural gas is 5%, based on the sales price. The sales price shall be determined on the same basis as that for VAT purposes, i.e., the total consideration plus any other charges. However, the sales price shall not include the output VAT collected. Oil and gas used by taxpayers in the continuous production of oil and gas are not subject to resource tax. Tax exemption and reductions are also available in the following situations, subject to the approval of the tax authorities:

- Full exemption for oil and gas extracted and used in heating the heavy oil in transporting heavy oil inside the oil fields
- 40% exemption for the extraction of heavy oil, high pour point oil and high sulfur gas
- 30% exemption for tertiary recovery
- 20% exemption for oil and gas extracted from low abundance oil (gas) field
- 30% exemption for deepwater oil (gas) field

Production sharing

Production sharing is based on the production volume that is termed "annual gross production." A PSC defines the percentage of total production to be used for cost recovery and the sharing of the Government and the PSC participants in the "profit production."

Annual gross production net of all revenue levies and revenue taxes (such as special oil gain levy, resource tax and VAT) is used for calculating "cost recovery" and profit production. In general, cost recovery for offshore PSCs and onshore PSCs is from 50% to 62.5% and 60%, respectively (with deemed interest cost recovery on development costs).

The cost recovery mainly involves the recovery of the following expenses and expenditure in the sequence below:

- Petroleum royalties (replaced by resource tax for PSCs concluded after 1 November 2011)
- Production and operating expenses
- Exploration expenditure
- Development expenditure
- Deemed interest cost recovery on development costs currently 9%

The remainder is automatically added to the pool for profit production. Profit production is shared between the Government and the PSC participants based on the allocation factor stipulated in the PSC.

Corporate income tax

Petroleum companies are taxed at the rate of 25% on their taxable income according to the Enterprise Income Tax Law. Taxable income equals assessable income less deductions. A petroleum company is permitted to report income tax on a consolidation basis for all the PSC participations that it directly owns in China. Net operating tax losses may be carried forward for five years to offset future taxable income. Carryback of losses is not allowed.

Taxable income is defined as total revenues less non-taxable income, tax-exempt income, deductible expenses and tax losses. No major differences exist between tax and accounting methods for income computation purposes. Dividends, bonuses, interest, royalties or resource tax, rent and other income are included in taxable income.

All necessary and reasonable expenses incurred in carrying on a business are deductible for tax purposes, except for advertisement and sales promotion expenses, entertainment expenses, union fees, employee welfare costs and employee education expenses, which are subject to specified deduction thresholds. Qualified R&D expenditure may be deducted at 150% of the actual expenses. Charitable donations within 12% of the total annual profit are deductible.

Reasonable expenses allocated from the overseas head office may be deductible for an establishment of a non-tax resident enterprise in China, provided these expenses are incurred by the head office for the production or business operations of the establishment, and they are supported by proper documents issued by the head office. The competent tax authorities may apply certain deduction thresholds to be determined by reference to the head office overhead percentage as agreed upon by participants in a PSC.

Provisions that have not been approved by the tax authorities are in general not deductible, such as various provisions and allowances for asset impairment and risk reserves.

For PSC petroleum operations in China, deductions may typically include payments of revenue taxes and levies (including special oil gain levies and VAT levied at a rate of 5%), petroleum royalties or resource tax, deductible production and operating expenses, tax amortization of exploration expenditure and tax amortization of development expenditure.

Foreign tax credit

A foreign tax credit (FTC) is allowed for foreign income taxes paid, or indirectly borne, by PRC resident enterprises, but the credit is generally limited to the amount of PRC CIT payable on the foreign-sourced portion of an enterprise's worldwide taxable income and must be calculated on a country-by-country basis. For dividend income derived from overseas subsidiaries, FTCs would be allowed within three tiers, provided the qualified shareholding percentage requirement is met.

Special FTC treatment has been granted to Chinese oil companies under Caishui [2011] No. 23, which extends the FTCs from dividend income derived by Chinese oil companies up to five tiers (for foreign-sourced income derived from the investment activities, construction service and technical service of oil and gas exploration projects overseas). In addition, Chinese oil companies are able to select either the country-by-country method or general deduction method. The general deduction method (or combined method) only applies to a specific class of worldwide income, i.e., foreign-sourced income relating to the exploration of crude oil and relevant technical services (upstream-related activities).

Once a calculation method is adopted, no changes can be made for five years. The balance of creditable foreign tax and FTC limit calculated for prior years can be carried forward and credited in the remaining years, according to the PRC CIT Law.

Oil and gas companies taxation developments

In 2011, there were a series of circulars issued by Chinese tax authorities governing oil and gas exploration and production in China. The main tax circulars include the following:

- The new resource tax regulations were issued in 2011 and require that companies engaged in the exploitation of natural resources in China pay a resource tax. The tax base for crude oil and natural gas was changed from sales volume to sales price. The applicable tax rate for crude oil and natural

gas is 5% of sales price. Effective from 1 November 2011, Chinese and foreign parties to onshore/offshore PSCs shall pay resource tax instead of royalties.

- The new regulation of Guojiashuiwuzongju (2011) No. 22 was issued to clarify the deduction of abandonment expense for CIT purposes. The operator of an oil field should prepare and register the provisional abandonment plan with the competent tax authority before it starts deducting a provision for abandonment expenses. The actual abandonment expense incurred would be netted against the provision made.
- A special FTC treatment was granted to Chinese oil companies under Caishui [2011] No. 23, which extends the FTC of dividend income derived by Chinese oil companies up to five tiers in relation to their foreign-sourced income derived from the upstream-related activities.

Amortization of expenditure on acquisition of oil (gas) field interests and exploration expenditure

Under Circular 49, a qualified expenditure on acquisition of oil (gas) field interests and exploration expenditure incurred by a petroleum company can either be expensed against production income generated from other oil (gas) fields that the company owns in China or be capitalized and amortized on a straight-line basis against production income generated from the oil (gas) field for which the expenditure was incurred. The minimum amortization period of the exploration expenditure is three years, starting from the month during which commercial production commenced.

Expenditure on the acquisition of an oil (gas) field (oilfield acquisition expenditure) includes all necessary expenditures incurred in obtaining the exploration right.

Exploration expenditure may include the drilling of appraisal wells, feasibility studies and the preparation of an overall petroleum development program and other work to identify petroleum reserves and to determine whether the reserves have commercial value. Exploration expenditures may also include expenses incurred for scientific research and training for the development of petroleum resources in China.

Any remaining oilfield acquisition expenditure and exploration expenditure balance that are not yet amortized can be expensed if the operations are ceased due to failure in discovering any commercial oil (gas) structure. Net operating tax losses may be carried forward for five years to offset against future taxable income. Carryback of losses is not allowed.

If the exploration drilling expenses incurred result in fixed assets and the relevant oil field enters into commercial production, the unamortized exploration drilling expenses should be reclassified as development expenditures for depreciation purposes.

Depreciation of development expenditure

Under Circular 49, qualified development expenditures may be depreciated on a straight-line basis against production income generated from the oil (gas) field for which the expenditure was incurred, subject to a minimum period of not less than eight years starting from the month during which commercial production commenced. If the operation of an oil (gas) field is terminated, the residual value of the development assets would be recognized as a loss and be deductible for CIT purposes in the year of termination. Net operating tax losses may be carried forward for five years to offset against future taxable income. Carryback of losses is not allowed.

Development expenditures are expenditures incurred for development operations, including activities such as design, construction, installation, drilling and the corresponding research work, performed during the period starting from the approval date for the overall petroleum development program up until the commencement date for commercial production. Expenditures, including all investments, either tangible or intangible (and including fixed assets acquired), made during the period of development operations and should be capitalized based on each individual oil (gas) field.

Abandonment expenses

The actual incurred abandonment expense is deductible for PRC CIT purposes, but it should be netted against the provision made. The new regulation of Guojiashuiwuzongju (2011) No. 22 (Notice 22) issued by the State Administration of Taxation (SAT) provides the following detailed regulations, which were effective from 22 April 2011.

Registration of abandonment plan

Expenses incurred on abandonment of offshore oil and gas production facilities cover expenditure on disposal, removal and environment restoration of offshore oil fields and the related preparatory works. According to Notice 22, an operator of the oil field should prepare and register the detailed provisional abandonment plan for offshore oil and gas production facilities with its competent tax bureau before it starts deducting the provision for abandonment expenses.[29] The provisional abandonment plan should cover an estimation of abandonment costs, funding arrangements and methods to dispose of the facilities.

Before the company implements the abandonment of the oil field, the implementation plan for the abandonment should be registered with the competent tax bureau.

Provision for abandonment expenses and tax treatment

Provision for abandonment expenses should be made on a monthly basis in the month after the relevant oil field enters into commercial production. The provision should be made based on the "production method" or "straight-line method" in accordance with the proposed abandonment plan. Such provisions would be managed as a special fund and would be deductible for CIT purposes.

Under the straight-line method, the formula would be:

Monthly provision for abandonment expenses = (total estimated abandonment expenses – accumulated provision for abandonment expenses) / PSC contract production period (in months) – gain or losses of designated account for abandonment expenses for current month

Under the production method, the formula would be:

Monthly provision for abandonment expenses = (total estimated abandonment expenses – accumulated provision for abandonment expenses) x current month's provision ratio – gain or losses of designated account for abandonment expenses for current month

Current month's provision ratio = current month's actual production / (current month's actual production + closing proved exploitation reserves) where "gain or losses of designated account for abandonment expenses" includes interest income and foreign exchange gain or loss in relation to the designated account

Use of abandonment expenses provision

Upon implementation of the abandonment plan, the actual incurred abandonment expenses would be netted against the provision made. If there is any unused provision after completion of the abandonment plan, the provision balance should be added back to the taxable income of that year. However, any abandonment expenses incurred in excess of the provision made would be deductible from the taxable income of that year.

Management of abandonment expenses provision

The provision and use of abandonment expenses should be accounted for in RMB. Any foreign exchange gain or loss should be taken into account in calculating the provision to be made.

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29 *According to Circular [2010] No. 1305 jointly issued by the Ministry of Finance and other authorities, provision for abandonment expenses should start to be made in the month following the month in which the oil field commenced commercial production.*

The provision for abandonment expenses should not be used for other purposes. Otherwise, the amount used for other purposes where a tax deduction has been claimed should be added back for income tax purposes.

Service contracts

Foreign contractors that provide services to a petroleum company in China are liable to pay Chinese taxes, including business tax, income tax and some other local levies.

Business tax is a type of cumulative revenue tax payable on gross amounts of revenues generated from the provision of services, the transfer of immovable properties and intangible property, so long as the service provider or the recipient of the service is an individual or an entity situated in China. Supply of industrial processing services and repair and replacement services are not chargeable to business tax, but they are subject to VAT. The tax rate ranges from 3% to 20%, determined by the nature of the activities performed.

Income taxes are payable at the standard tax rate of 25% of the actual profits derived by a foreign contractor or on the imputed profits agreed upon between a foreign contractor and the taxing authorities.

The petroleum company that receives the services is deemed to be the tax withholding agent.

Tax on engineering, procurement and construction contract in China

Under the PRC turnover tax regime, an engineering, procurement and construction (EPC) contract is not administered as one single contract. The engineering and construction parts of the contract will be taxed as business tax liable activities at 5% and 3% of the gross contract portion, respectively. The procurement part of the contract will be taxed as the sale of goods under PRC VAT at 17%, allowing the input VAT to be offset against the output VAT. It is worth noting that the ongoing VAT reform may change the status in the future, and the whole contract could become subject to VAT once the reform is fully implemented across China. In terms of income tax, the cost/expense incurred for the implementation of the EPC contract is an allowable deduction for CIT purposes.

C. Capital allowances

The detailed provisions relating to capital allowances are set out in Section B.

D. Investment incentives

Petroleum companies that are engaged in the exploration, development and production of crude oil and natural gas may be eligible for customs duty and VAT exemptions in importing certain qualified equipment and materials into China, subject to the approval of the relevant governmental authorities.

As of 1 January 2009, the revamped Chinese VAT regime removed the exemption from VAT on imported machinery and equipment, which was applicable to companies in certain encouraged industries (as specified by the relevant PRC regulations).

For the purpose of supporting the exploration and development of petroleum (natural gas) in China, special VAT treatment applies to petroleum (natural gas) exploration and development offshore projects and onshore projects in designated areas (i.e., the desert, including Gobi desert) of China.

During China's 12th Five-Year Period, which starts on 1 January 2011 and ends on 31 December 2015, import duties and import VAT shall be exempted to the extent of a specified duty-free import quota on equipment, instruments, parts and accessories and special tools, which are unavailable domestically or for which the performance cannot be matched by domestic products. To qualify for the exemption, the products must be imported for the exploitation of petroleum (natural gas) and the development of projects in the aforementioned areas.

E. Withholding taxes and double tax treaties

Remittance of dividends, interest, royalties and rental is subject to withholding taxes (WHT) at a rate of 10%. WHT is due at the time the remittance is made or at the time the relevant transaction and costs are recorded in the accounting books of the Chinese payer, whichever is the earlier.

The treaty WHT rates for dividends, interest and royalties varies depending on the particular country. Generally speaking, dividend, interest and royalty WHT rates vary between 5% to 10%.

F. Financing considerations

According to the new income tax regime, interest expense paid on bank loans used to finance taxable operations is generally deductible. Interest expense paid on loans borrowed from related parties other than a financial institution is also deductible. The deduction is subject to the arm's-length principle and generally should be subject to a debt-to-equity ratio of 2:1. Please note that PSCs are not subject to the thin capitalization regime (i.e., the deductibility of interest is not subject to a 2:1 debt-to-equity ratio).

Deemed interest cost recovery on development costs is not deductible for income tax purposes.

G. Transactions

Disposal of PSC interest

Gains, if any, derived from the disposal of an interest in a PSC are taxable in China. Taxable gains are equal to the disposal proceeds less the remaining balance of exploration and development expenditure that has yet to be amortized for tax purposes. Costs incurred for acquiring an interest in a PSC may be claimed as qualified exploration and development expenditure and are eligible for tax amortization according to the relevant tax rules.

H. Indirect taxes

Customs duties

The importation of tangible goods (including equipment and materials) into China for the purpose of petroleum exploration, development and production is subject to customs duties (however, this is subject to the availability of special import incentives as discussed in Section D).

VAT

VAT is payable at a rate of 5% on the crude oil and natural gas produced from an oil (gas) field operated under a Sino-foreign PSC.

The purchase of goods (including equipment and materials) supplied in China is subject to VAT, generally at the standard rate of 17%. After the full implementation of VAT reform on 1 January 2009, input VAT associated with the purchase of fixed assets is now deductible against output VAT, unless the taxpayer is subject to the special VAT exemption regime as discussed in Section D.

Local levies

To unify the city construction tax (CCT) and education surcharge (ES) treatments applicable to foreign enterprises (FEs), foreign investment enterprises (FIEs), domestic enterprises and individuals, on 18 October 2010, the State Council announced circular Guofa [2010] No. 35 to resume the collection of CCT and ES from FEs, FIEs and foreign individuals from 1 December 2010 who have been exempted from these local levies for more than 20 years. On 7 November 2010, the Ministry of Finance released another circular, Caizong [2010] No. 98, regarding the unification of the local education surcharge (LES) on all parties subject to turnover tax in China. LES is a separate local levy from CCT and ES, but these three levies share the same tax base, i.e., the turnover taxes (VAT, business tax and consumption tax) actually paid by the taxpayers.

The applicable rates of the local levies:

- CCT: 7% of the PRC turnover taxes for a taxpayer in a city; 5% of the PRC turnover taxes for a taxpayer in a country town or town; 1% of the PRC turnover taxes for a taxpayer in a place other than a city, country town or town
- ES: standardized as 3% of the PRC turnover taxes
- LES: standardized as 2% of the PRC turnover taxes

SAT issued a special tax circular (SAT circular [2010] No. 31) on 30 December 2010 to reconfirm that foreign oil companies participating in upstream petroleum production are liable to pay CCT as well as ES. CCT and ES are to be levied at their respective applicable rates on the 5% flat rate VAT payment made by the foreign oil company.

The applicable CCT rate is 1% for a foreign oil company participating in an offshore oil production project.

Circular 31 does not clarify whether a foreign oil company would also be liable to pay LES.

Assuming that LES would also be payable, extra indirect tax costs to an offshore oil production project would be equivalent to 6% of the VAT payments, adding CCT, ES and LES together, whereas the extra indirect tax costs to an onshore oil production project could be equivalent to 12% of the VAT payments should the project be located in a city.

I. Other

Transfer pricing

China has introduced transfer pricing rules that require all fees paid or charged in business transactions between related parties to be determined based on an arm's-length standard. If the parties fail to meet this requirement, the tax bureau may make reasonable adjustments by using one of the following methods:

- Comparable uncontrolled price (CUP)
- Resale price method (RPM)
- Cost plus method (CPM)
- Transactional net margin method (TNMM)
- Profit split method (PSM)
- Other methods that are consistent with the arm's-length principle

The new income tax regime also recognizes the concept of cost-sharing arrangements. Taxpayers may also apply for advance pricing agreements (APAs) in China.

General anti-avoidance rules

The new income tax regime has introduced general anti-avoidance rules that require any tax planning to have a "business purpose."

The controlled foreign corporation (CFC) rules have also been introduced to counter planning based on income deferral. Under the new rules, a CFC's retained earnings are subject to current Chinese taxation if the earnings are retained overseas without a reasonable business purpose.

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A. At a glance

Fiscal regime

The fiscal regime that applies in Colombia to the petroleum industry consists of a combination of corporate income tax (CIT) and royalty-based taxation.

Royalties

New oil and gas discoveries after Law 756 issued in 2002[30]: field daily production (monthly average in barrels of crude per day)	Percentage
Up to 5,000	8
5,001 to 125,000	8 + (production – 5,000)*0.10
125,001 to 400,000	20
400,001 to 600,000	20 + (production – 400,000)*0.025
More than 600,000	25

Royalties for gas exploitation are obtained by applying the following percentages on oil royalties:

Location	Percentage
Onshore and offshore below 1,000 ft depth	80
Offshore more than a 1,000 ft depth	60

30 *The law entered into force on 25 July 2002 (Official Diary No. 44.878).*

Bonuses

Economic rights to be paid to the National Hydrocarbon Agency (ANH[31]) are applicable[32] as follows. Further details are included in the section on "Royalty regimes":

Rights for the use of the subsoil and subsurface	An amount in US dollars per hectare depending on the location and area of the block and the duration of the phase
Rights for the exploitation (even in the evaluation phase)	An amount in US dollars per barrel
Participation rights[33]	A percentage of the production (after royalties) to the extent agreed in the contract.
Rights for high prices	Agreed in the contract as explained below.

Production sharing contract

It is no longer possible to execute new production sharing contracts (PSCs) in Colombia. PSC was the type of contract used until Decree 1760 of 2003 came into effect.

PSCs executed before Decree 1760 of 2003 may still be in force. Therefore, it is possible to become an associate of a PSC if an associate of one of the contracts in force assigns the economic rights in the contract, totally or partially.

Exploration and production

The oil and gas contract model was changed, from PSC to an exploration and production (E&P) contract, which is a type of contract similar to a concession contract (royalty and tax system), entered by the ANH. The contractor explores and produces with autonomy at its own risk and cost. The length of time in each phase of the E&P contract is as follows:[34]

- Exploration: 6 years
- Evaluation: 1–2 years
- Exploitation: 24 years (+ extensions of 10-year periods until final depletion)

The contractor has all the production rights, after a sliding scale royalty, and makes conditional payments to the ANH to share surplus income in case of high crude prices. Natural gas and heavy crude have special incentives:

- Income tax rate: CIT rate 33%
- Resource rent tax: Not applicable
- Capital allowances: D, A, 30%[35]
- Investment incentives: L, Don, Env, R&D[36]

31 *Agencia Nacional de Hidrocarburos (ANH).*

32 *Included in the E&P contract versions of 2009, 2010 and 2011.*

33 *Under the 2011 versions of the E&P contract applicable for those contracts entered into on 2011, extensions can be granted under certain conditions. In the current version of the E&P contract the participation right is also applicable.*

34 *Under the 2009, 2010 and 2011 versions of the E&P contract, extensions can be granted under certain conditions for contracts entered into in 2009, 2010 and 2011.*

35 *D: depreciation, A: amortization, 30%: 30% capital allowance for investment in real productive fixed assets, except for free trade zone taxpayers, since this benefit does not apply to them. As of FY2011, 30% applies only for taxpayers with legal stability agreements filed before 1 November 2010 and signed in 2011.*

36 *L: losses can be carried forward indefinitely; Don: donations; Env: special deduction for investments in the environment; R&D: special deduction for investments in scientific or technological development.*

B. Fiscal regime

Corporate tax

Corporate taxpayers

Companies that are domiciled in Colombia (i.e., incorporated under Colombian law) are taxed on their worldwide income (subject to review in detail, with a corresponding tax credit). Colombian registered branches of foreign corporations are taxed only on their Colombian source income (as defined).

Permanent establishment — permanent activity

Colombian tax law does not provide a definition of "permanent establishment" (PE).

However, Colombia's Code of Commerce does provide a list of activities that qualify as a "permanent activity." The Code provides that, if a foreign company undertakes a permanent activity in Colombian territory, it must incorporate a branch in Colombia to carry out those activities.

Although Colombia's tax laws do not provide a definition of permanent activities, the tax laws state that branches are subject to taxes in Colombia as corporations, but limited, for income tax purposes, to their Colombian source income.

It should be noted that, if a nonresident company earns Colombian source income, the income is taxable in Colombia, regardless of whether the nonresident company has a branch in Colombia. A nonresident company that is in this position may be required to file an income tax return in Colombia depending on the income tax withholding that applies to the income (see Section E below).

Corporate income tax

Currently, the Colombian CIT rate is 33%. Tax credits are provided for foreign taxes paid by Colombian corporations.

Law 1004 of 2005 (Free Trade Zone Regime) established a reduced income tax rate of 15% for legal entities that perform activities in the industrial free trade zones that are qualified as "manufacturing users"[37] or "users that provide services."[38] The reduced income tax rate does not apply to commercial users. However, it is important to note that Subsection 2(1) of Decree 4051 of 2007 forbids the establishment of permanent free trade zones in areas of "exploration, exploitation or extraction of non-renewable natural resources."

Tax year and due dates for corporations

The tax year is the calendar year. The Government sets the due dates for filing income tax returns and making tax payments annually. Income tax is paid in three installments by large taxpayers and in two installments by all other corporate taxpayers. Each year, the tax authorities identify and list the companies that they will consider to be large taxpayers as of that year, as well as the companies that will be removed from the list.

Taxable income

The basis for the calculation of the annual income tax payment is the higher of ordinary taxable income and presumptive income.

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37 *Manufacturing users is the entity authorized to produce, transform or assemble goods through the processing of raw materials or semi-manufactured products.*

38 *Users that provide services is the entity authorized to develop the following activities exclusively in one or more free trade zones: (i) logistics, transportation, handling, distribution, shipping, labeling and classification of goods; (ii) communications and data processing; (iii) science and technologic research; (iv) medical assistance and health services; (v) tourism; (vi) maintenance of goods; (vii) technical support maintenance of aircrafts and related equipment; (viii) auditing, administration, consulting and others.*

Ordinary taxable income

Ordinary taxable income is calculated by subtracting deductible costs and expenses from net revenues (taxed revenues minus rebates and discounts). If this calculation results in a loss (NOL), the loss may be carried forward. From tax year 2007, tax losses may be carried forward with no limitation.

Additional restrictions apply to the transfer of tax losses in mergers or spin-offs (which are tax-free events for Colombia tax purposes). The transfer of tax losses in mergers and spin-offs is applied exclusively if the economic activity of the companies involved (which generate the losses) remains the same after the merger or spin-off occurs.

Presumptive income

Presumptive income is calculated as 3% of the prior fiscal year's net tax equity.

For tax purposes, net tax equity is tax assets minus tax liabilities. However, liabilities held with related parties abroad are not accepted as debt for local tax purposes (which will be deemed as tax equity), except those related to short-term importations (up to 12 months).

Some assets may be excluded from the taxable basis — for example, the net equity value of assets during non-productive periods of an enterprise.[39]

The amount of income tax payable after tax credits may not be less than 75% of the income determined under the presumptive income rules, before taking into account tax credits.

The excess of presumptive income adjusted with inflation over ordinary income may be carried forward as a compensation for five years.

Costs and expenses

Costs and expenses may generally be deducted from income tax, provided that they are necessary, related to the generation of taxable income and proportional, and the expenditure is not limited or forbidden by the law.

Payments abroad

In general, taxpayers may deduct expenses incurred abroad, if they are related to national source income, if:

- The applicable tax withholdings are made on the payments, when applicable
- The amounts charged comply with transfer pricing rules
- Exchange regulations are fulfilled[40]

If tax withholdings are not required, deductibility of costs and expenses abroad are limited to 15% of the net taxable income before such payment. Compliance with transfer pricing rules is mandatory, where applicable.[41]

Accruals

As a general rule, accruals are not deductible, except for those related to receivable accounts and, subject to special rules, accruals for the payment of pensions.

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39 *On 21 January 2009, a decision issued by a law tax court (Tribunal Administrativo de Cundinamarca — file 00242-01) has provided that a well might be seen as a separate enterprise. Thus, to the extent it can be demonstrated by the taxpayer, an exploration well might be seen as a separate enterprise, notwithstanding the taxpayer has other productive wells. The decision is not legally binding in Colombia, but provides auxiliary criteria that might be observed by the Colombian judges. This decision was confirmed in May 2011 by the Council of State (maximum court for tax matters).*

40 *Sections 123 and 419 of the Colombian Tax Code.*

41 *Sections 121 and 122 of the Colombian Tax Code include some exceptions to this 15% limitation, also Sections 124 and 260-7.*

Capital gains tax

Gains on sales of assets considered fixed assets[42] and owned for more than two years are subject to capital gains tax (CGT). Capital losses may be offset only with capital gains. The part of the capital gains that corresponds to previous depreciation deductions must be treated as a deduction recapture, which means that the amount is treated as ordinary income.

Functional currency

Pursuant to accounting local provisions, COLGAP, in Colombia, the functional currency is Colombian pesos (COP).

Transfer pricing

Transfer pricing regulations are included in Sections 260-1 to 260-10 of the Colombian Tax Code. These rules were introduced by Law 863 of 2003, and they basically follow Organization for Economic Cooperation and Development (OECD) principles. The transfer pricing regulations establish that Colombian taxpayers must apply the arm's-length principle to cross-border related-party transactions.

A taxpayer with gross equity that equals or exceeds 100,000 times the Colombian tax value unit (UVT)[43] (approximately US$1,340,866), or with gross income that equals or exceeds 61,000 times the UVT (approximately US$817,928), must prepare transfer pricing documentation for each type of cross-border related-party transaction that exceeds 10,000 times the UVT (approximately US$134,087), and it must prepare a disclosure related to these transactions.

A taxpayer whose gross equity or gross income does not exceed the following amounts must prepare transfer pricing documentation and a disclosure form if it undertakes a transaction with a tax haven jurisdiction with a value exceeding 10,000 times the UVT (approximately US$134,087), regardless of whether the transaction is with a related party. This type of transaction is not considered to be at arm's-length unless proven otherwise. To date, there is no list of tax havens in Colombia.

Dividends

Colombia applies an imputation system to dividends. Thus, dividends paid by Colombian companies to other Colombian or foreign corporations are not subject to dividend tax if the company generating the profits was taxed on the profits distributed as dividends (timing differences may affect this calculation). Otherwise, dividends are subject to 20% income tax withholding if the recipient is a Colombian company or 33% if the recipient is a foreign corporation or an individual who is not obliged to file an income tax return for the corresponding year.

Royalty regimes

Royalties

In Colombia, ownership of minerals found beneath the surface, including oil and gas, is vested in the national Government. Therefore, companies engaged in the exploration and extraction of non-renewable resources (i.e., oil and gas) must pay the ANH (which represents the Government) a royalty at the production field, determined by the Ministry of Mining as follows:

- New oil discoveries following the introduction of Law 756 issued in 2002 (E&P contracts):

42 *Section 60 of the Colombian Tax Code defines it as those assets which are not sold or changed in the regular course of business.*

43 *For 2012, UVT is COP26,049, approximately equal to US$12,566 (based on an exchange rate of COP1,942 to the US dollar).*

Field daily production (monthly average in barrels of crude per day)	Percentage (%)
Up to 5,000	8
5,001 to 125,000	8 + (production – 5,000) * 0.10
125,001 to 400,000	20
400,001 to 600,000	20 + (production – 400,000) * 0.025
More than 600,000	25

- Prior to the introduction of Law 756 issued in 2002, two other royalties regimes applied: 20%, and sliding scale (5% to 25%).

Colombian Congress is considering a new royalty sliding scale table, keeping the same top rate of 25% applicable to lower average daily production. This proposal, submitted under Project of Law Number 191 of 2010, may be approved during 2012; however, any final conclusion about this change will be known during 2012.

Royalties for gas exploitation are obtained by applying the following percentages to oil royalties:

Location	Percentage (%)
Onshore and offshore below 1,000 ft depth	80
Offshore more than 1,000 ft depth	60

Economic rights of the ANH[44]

Contracts for the exploration and exploitation of oil and gas have the following economic rights:[45]

Right for the use of the subsoil and subsurface

Beginning with the second exploration phase, the contracting party pays a fee in US dollars as follows:[46]

Monthly amount per phase in US$/hectares on exploration areas				
Size of contract area	First 100,000 hectares		Each hectare in addition to first 100,000	
Duration of the phase	<= 18 months	>18 months	< = 18 months	>18 months
Within polygons A and B	2.38	3.17	3.17	4.75
Outside polygons A and B	1.59	2.38	2.38	3.17
Offshore	0.79			

Please note that the values can change depending on the negotiation of the contract.

44 *Latest contract model that appears on the ANH website: www.anh.gov.co (latest version for contracts entered into in 2011). The figures have been established by the administrative act Circular 02 of 24 January 2011.*

45 *Established within the E&P contract (2011 model contract for E&P).*

46 *Annex D of the latest version of the E&P contract (2011 model contract for E&P).*

Rights for the exploitation

The contracting party pays ANH the resulting value of multiplying US$0.1204[47] by the number of barrels of liquid hydrocarbon owned by the contracting party. This amount increases annually, based on the terms of the contract.

Rights for high prices

From the time when the accumulated production of the exploitation area, including the volume of royalties, exceeds five million barrels of liquid hydrocarbon, and in the event that the international oil reference price is higher than the price determined in the contract (PO), the contracting party shall pay, at an agreed delivery point, a participation within the production net of royalties according to the following formula:

$$\text{ANH payment} \quad \left[\frac{P - PO}{P}\right] \times S$$

Notes:

1. For gas, the rule applies five years after commencement of the exploitation field, instead of observing accumulated production.
2. The ANH may ask to receive this right in cash rather than in kind, according to certain rules set up in the E&P contract.
3. P: for liquid hydrocarbon, P is the average benchmark of the West Texas Intermediate index (WTI) in US dollars per barrel. For natural gas, P is the average benchmark of the US Gulf Coast Henry Hub natural gas in US dollars per million British thermal units (BTU).
4. PO: for liquid hydrocarbon, PO is the base price of benchmark crude oil expressed in US dollars per barrel, and for natural gas, it is the average natural gas price in US dollars per million BTU, according to a table included in the contract. The table varies depending on (i) American Petroleum Institute (API) gravity of crude oil (starting from 15° API) – for heavy crude oil, the rights for high prices are triggered if API gravity is higher than 10°; or (ii) discoveries more than 300 meters offshore; or (iii) amount of natural gas produced and exported. However, if the API gravity is 10% or less, the rights for high prices are not triggered.
5. Almost all the amounts are subject to a readjustment formula already set up in the E&P model contract.

Rights of participation in the exploitation phase

If the exploitation phase of an exploitation area is extended from the initial exploitation phase subscribed in the E&P contract, the contracting party pays the ANH a sum equivalent to 10% of the production (for light hydrocarbon), or 5% in the case of heavy hydrocarbon.

Other participation rights

The E&P model contract applicable for those submitted in 2009, 2010 and 2011, allows the ANH to agree a percentage of the production with the contractor, subject to negotiation.

C. Capital allowances

Depreciation

Fixed assets (other than land) are depreciable under the following useful lives:[48]

Computers and vehicles	5 years
Machinery and equipment	10 years
Real estate (e.g., pipeline, buildings)	20 years

47 *Amounts applicable for year 2012.*

48 *Section 2 of Regulatory Decree 3019 of 1989*

However, taxpayers may apply a different useful life (lower or higher) after requesting authorization from the national tax authority (DIAN). This request must be submitted not less than three months prior to the start of the relevant taxable period. This means that, for example, a request for authorization to use a different useful life for 2012 has to be filed before 30 September 2011.

Generally, the depreciation deduction may be calculated using any of the following methods:

- The straight-line method
- The declining-balance method[49] or any other method of recognized technical value authorized by the DIAN

These methods follow international accounting principles. For instance, in the declining-balance method, the assets are depreciated annually at a fixed rate. This method requires the taxpayer to set a salvage or residual value; otherwise, a balance would remain, making the depreciation period infinite. Under this method, the annual fixed depreciation rate is calculated using the following formula:

$$\text{Depreciation rate} = 1 - \sqrt[n]{\frac{\text{Salvage}}{\text{Initial cost}}}$$

For assets acquired during the taxable year or period, the depreciation amount is calculated in proportion to the number of months (or fraction of months) that the assets (or improvements) were in service.

The salvage value is related to the realization amount at the time that the asset's useful life ends. The tax law has not established special rules with mandatory rates for setting the salvage value. Accordingly, taxpayers may determine the value themselves. However, taxpayers must be able to demonstrate to the tax authorities, if required, the procedures, techniques and evidence that prove how the salvage value was determined.

Likewise, if the assets are to be used for a term exceeding eight hours daily, the company may depreciate additional shifts (25% per each eight additional hours). This method could significantly increase the depreciation rate to be used in the year, by allowing the taxpayer to take an accelerated depreciation for additional shifts.

Amortization of investments

Investments or disbursements made for business purposes[50] and intangibles feasible of impairment are amortized.

For hydrocarbon activity, the following values may be treated as deferred amortizable assets:

- Initial preoperative installation, organization and development expenses
- Acquisition costs or well production
- Exploration and production costs of natural, non-renewable natural resources, production facilities

For tax purposes, the general rule is to amortize all investments over a minimum of five years, except where it can be demonstrated that it should be done over a shorter term, as a result of the nature or duration of the business. However, for hydrocarbon activity, if it is determined that investments made in exploration are unsuccessful, the activated values should be amortized in full in the same year that the condition is determined and, in any case, no later than within the following two years. The amortization of investments for the oil and gas industry may be summarized as follows:

49 *This method is not allowed for assets that were considered for the benefit of the 30% capital allowance.*

50 *In accordance with the accounting method used, they are to be recorded for their amortization as deferred assets.*

Amortization of investments	Method	Period
E&P costs	Technical units of operation or straight-line method	Five years straight-line method for 2002 onward
Other investments (preoperative)	Straight-line method	Five years or less if the business ends before such period of time
Unsuccessful investments	When investments in exploration are unsuccessful, amounts may be amortized in the year such condition is determined or in either of the following two years	

30% capital allowance

Pursuant to Law 1430 of 2010, this special benefit was repealed as of tax year 2011. However, for those companies that submitted a new legal stability contract application before 1 November 2010, the special deduction benefit can be extended for a three-year period counted from the date of signature of the contract.

D. Incentives

Exploration

During a non-productive period, an exploration company is not required to calculate income tax under the presumptive income system (explained in Section B).

A taxpayer is entitled to ask for 30% of the capital allowance to be carried forward if the company generates tax losses.

Tax holiday

Colombia does not have any tax holiday regime.

Tax losses

Effective from tax year 2007, tax losses may be carried forward with no time limit or limitation on the amount. Additionally, the tax regulations provide no limitations to the amount of tax losses available to offset against taxable income each tax year. According to the tax authorities, tax losses available before 31 December 2006, however, are covered by the prior rules. These rules provide that losses may be carried forward for a limited term of eight years and that only 25% of tax losses is available to offset each tax year.

Additional restrictions apply to the transfer of losses in mergers or spin-offs (which are tax-free events for Colombian tax purposes).

In mergers, the surviving entity may offset losses originating in the merged entities, limited to the percentage of its equity participation in the merged entity's equity.

In spin-offs, the new company (or companies) or the resulting companies may offset losses originating in the spun-off entity, limited to the participation percentage of the new companies in the equity of the spun-off company. Tax losses generated do not affect the entity's presumptive income for the relevant tax year.

To have the right to offset tax losses, companies involved in mergers or spin-offs are required to carry on the same economic activity as they did before the merger or spin-off process.[51]

51 *Section 147 of the Colombian Tax Code.*

Regional incentives

Section 16 of the Decree 1056 of 1953 (Oil Code) states that "oil exploration and exploitation, the extracted crude oil, its derivatives and its transportation, machines and elements used on its benefit, and in the construction and maintenance of refineries and pipelines" are exempt from departmental or municipal taxes. In these circumstances, the taxpayer may be required to file a local tax return with assessment of no taxes.

In addition, another incentive exists for oil and gas activities under the industry and commerce tax (ICA).[52] The ICA tax regime does not assess tax for the exploitation of oil and gas if the amount received by the municipality as royalties and contributions is equal to, or greater than, the amount it would have received otherwise as a tax under the ICA.[53] In these circumstances, the taxpayer is not required to file an ICA return (the case must be analyzed when the taxpayer obtains financial revenues).

Donations

Donations effectively made during the tax period are deductible by the beneficiary if one of the following is true:

- The entity is deemed to be a non-taxpayer under Section 22 of the Colombian Tax Code.[54]
- The entity is an association, corporation or foundation whose object and activity correspond to the development of health, education, culture, religion, sports, technological and scientific research, ecology and environmental protection, defense, protection and promotion of human rights and access to justice or social development programs, provided they are of general interest.

Deductibility for donations is limited to 30% of the net taxable income calculated before subtracting the investment value. Nonetheless, the 30% limitation does not apply in some special cases.

Section 125 of the Colombian Tax Code states that a certificate issued by the beneficiary of the donation, signed by the statutory auditor or accountant, is required in order to treat donations as an income tax deduction. The certificate must include details of the form, amount and destination of the donation, and it must state that the requirements listed above are fulfilled.

Special deduction for environmental investments

Taxpayers that make voluntary investments for the control and improvement of the environment are entitled to deduct the value of the investments made during the relevant tax year from their income. Mandatory investments are excluded from this deduction. The total value of the deduction may not exceed 20% of the taxpayer's net income, calculated before subtracting the investment value.

The law establishes several additional requirements for this deduction to apply.

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52 *The triggering event is the exercise or undertaking, directly or indirectly, of commercial, industrial or service activities within the jurisdiction of a municipality or district, either permanently or occasionally, in a certain property, with or without a commercial establishment.*

53 *Section 39 Law 14, 1983.*

54 *Section 22 of the Colombian Tax Code lists as non-taxpayers: the nation, department and its associations, the districts, the indigenous territories, the municipalities and other territorial entities, regional autonomous corporations, metropolitan areas, associations, superintendencies, special administrative units, federations, indigenous entities, public establishments, decentralized official establishments, and when the law does not state that they are taxpayers.*

Special deduction for investments in scientific or technological development

Investments in projects qualified by Consejo Nacional de Beneficios Tributarios en Ciencia (The National Council of Tax Benefits in Science) as technological investigation and development are deductible to the extent of 175% of the investment value of the technological project executed in the relevant tax year. The law establishes several requirements for this deduction to apply — among others, that the special deduction excludes a deduction for amortization or depreciation of assets.

The total annual value of the deduction may not exceed 40% of the taxpayer's net income, calculated before subtracting the investment value. The qualified investments exceeding this limitation can be carried forward for four years.

> The utilization of this deduction does not generate taxable profits for partners or shareholders in case of distribution.

In order to obtain the qualification and acquire the special deduction in scientific or technological development, a specific process has to be followed and official authorizations need to be obtained. For the qualification of special deduction for tax year 2012, a petition must be submitted before the competent authority by 28 February 2012.[55]

Income tax discount for VAT paid on heavy machinery for basic industries

The VAT paid on the importation of heavy machinery for use by basic industries may be used as a tax credit (discount) for income tax purposes. The hydrocarbon industry is considered to be a basic industry for these purposes.[56]

E. Withholding taxes

Colombia has a withholding tax (WHT) regime that is intended to secure the collection of taxes and make the system more efficient by providing for the advance collection of tax. The most important taxes subject to this procedure are income tax, VAT and ICA (a municipal tax described below).

Self-income tax withholding for exports of hydrocarbons

From 1 January 2011, exportation of hydrocarbons must be subject to "self-income tax withholding" by the exporter and paid over to the authorities through the corresponding WHT return. The rate of the self-income tax withholding is 1% over the exportation amount. This income tax withholding is creditable against the year-end income tax due.

Note that the rate of 1% may vary if another regulatory decree regarding the self-withholding is established. The maximum withholding rate authorized by law cannot exceed of 10%.

Payments made abroad

Generally, services rendered abroad generate foreign source income, and, therefore, no Colombian WHT applies. This provision does not apply to services rendered abroad that are, by legal provision, considered to be generators of national source income. For example, this service includes payments or credits to accounts related to consulting, technical services and technical assistance services,[57] which are subject to WHT at the rate of 10%, irrespective of whether they are rendered in the country or abroad.

55 *Administrative Act 01427 of 2011. Departamento Administrativo de Ciencia, Tecnología e Innovación.*

56 *Section 258-2 of the Colombian Tax Code.*

57 *Section 408 of the Colombian Tax Code.*

Unless modified by a treaty,[58] the following table contains a list of the most relevant items subject to WHT, together with the relevant withholding rates on payments made to beneficiaries abroad. This list is not exhaustive:

Items	Income tax withholding	Deductibility (income tax)	VAT***
Payment for technical assistance services and consulting (rendered in Colombia or abroad)*	10%	15% limit does not apply	16%
Payment for technical services (rendered in Colombia)*	10%	15% limit does not apply	16%
Payment for technical services (rendered abroad)*	10%	15% limit does not apply	0%
Overhead expenses for general services rendered abroad and charged to the home office	0%	Non-deductible**	0%
Royalties in acquisition and exploitation of intangibles	33%	100%	16%
Payments for services rendered in Colombia (other than those mentioned above)	33%	15% limit does not apply	16%
Payments for services rendered abroad as a general rule (other than those mentioned above)	0%	Limitation of 15% of net taxable income	0%

Notes:

* For these types of services, the supplier must be a nonresident in Colombia (paragraph 2, Section 408 of the Tax Code).

** Payments are deductible if the transaction is structured as a service and pursuant to the arm's-length principle, supported by a transfer pricing study, regardless of whether it is subject to WHT. The 15% limitation applies if no WHT applies.

*** In order to expedite the tax collection system, the withholding rate is 100% for those who contract with people resident or are domiciled abroad but who render the services in the national territory. In this case, a special withholding method is applied, whereby the Colombian resident who requests the service must withhold the total VAT generated, using a reverse charge mechanism. If the VAT paid is creditable, the resident computes the self-accounted VAT amount from its bimonthly VAT return for the period when the payment was made.

Profits remitted overseas

With effect from 1 January 2007, profits remitted abroad by branches of foreign corporations are not subject to income tax withholding, regardless of whether the branch has paid taxes on the profits. This modification was introduced by Law 111 of 2006, which repealed the branch remittance tax (formerly 7%).

58 *Treaty to prevent double taxation with Spain is applicable as of 2009. Treaty with Chile is applicable as of 2010 and treaty with Switzerland is applicable as of 2012.*

Profits generated prior to 1 January 2007 were taxed 7%, unless the profits were reinvested for five years.

As explained, if the company operates in a legal form that is different from a branch (the traditional entity), the distribution of dividends or profits to shareholders or partners not domiciled in Colombia is not subject to income tax when the dividends or profits have been taxed at the corporate level. Otherwise, dividends or profits distributed abroad are subject to income tax at the general rate of 33%.

The amounts taxed are withheld by the legal entity when the dividends are credited to shareholders' accounts.[59]

The following table sets out the WHT treatment of dividends and profits.

	Income tax withholding
Profits that paid taxes in the name of the corporation	0% (*)
Profits that did not pay taxes in the name of the corporation	33% for nonresidents (**) 20% for resident taxpayers obliged by law to present an income tax return

Note:

* As a result of the tax reform of 2006, effective from fiscal year 2007, the income tax rate applied to dividends or participation received by corporations or other entities domiciled in the country changed from 7% to 0%.[60]

** Current treaties enforced with Spain and Chile do not provide relief to this rate. Some relief is provided, but only when income is exempted at the corporate level, subject to certain conditions. The Switzerland current tax treaty provides a lower withholding rate of 15% under certain conditions.

Interest on credit obtained abroad

Generally, payments or credits to account made by legal entities relating to interest are subject to WHT, at the rates of 14% if the loan payment length is longer than one year or 33% if the loan term is less than one year for 2011 onward (unless modified by a treaty[61]). Nevertheless, the following credits obtained abroad (among others) are not considered as national source[62] income and, therefore, they are not subject to WHT:

- Short-term credits originating from imports of goods and banks overseas
- Credits for foreign trade operations obtained through financial corporations and banks incorporated pursuant to the Colombian laws in effect

Please note that foreign indebtedness is not allowed for branches belonging to the special exchange regime.

F. Financing considerations

Colombia does not apply any capitalization rules. Therefore, there are no limitations on the ratio of debt to equity.

59 *Subsection 27 (B of the Colombian Tax Code).*

60 *Section 13 Law 1111 of 2006.*

61 *Treaties to prevent double taxation entered into with Spain, Switzerland and Chile are applicable for 2012.*

62 *Section 25 of the Colombian Tax Code.*

G. Transactions

Farm-in and farm-out

Farm-in arrangements are commonly used in Colombia in the oil and gas industry. A farm-in typically involves the transfer of part of an oil and gas interest in consideration for an agreement by the transferee (the farmee) to make certain expenditures that would otherwise have to be undertaken by the owner (the farmor). For tax purposes, the local selling price cannot be lower than 75% of the fair market value of the rights. Transactions with foreign-related parties must comply with transfer pricing provisions.

Selling shares in a company (consequences for resident and nonresident shareholders)

A share disposal is generally subject to CGT or income tax regime. The taxable capital gain or taxable net income is equal to the positive difference between the sale price of the asset and its tax basis (fiscal cost). Sales to foreign-related parties must comply with transfer pricing provisions. Unrelated sales or sales between resident-related parties cannot be performed for less than 75% of the fair market value of the assets sold.

Nonresidents that dispose of shares held directly in a Colombian company are subject to tax in Colombia. Assets owned in Colombia for two years or more are liable to tax as capital gains on sales. Assets owned for less than two years are liable to income tax upon sale. In both cases, the tax rate is 33%.

H. Indirect taxes

VAT and GST

Colombian VAT is triggered by the following transactions:[63]

- The sale of movable tangible assets (sales of fixed assets are not taxed with VAT)
- The importation of goods
- The provision of services in the national territory

In some cases specified in the tax laws, the importation of services (that is, services rendered abroad and used in Colombia) is subject to VAT if the recipient of the service is located in Colombia. The services subject to this provision include the following (this list is not exhaustive):

- Licenses and authorizations for the use of intangible assets
- Consulting and advisory (including technical assistance services) and audit services; technical services are not included under this provision
- Rental of corporate movable assets
- Insurance and reinsurance services

Crude oil to be refined, natural gas, butane and natural gasoline are excluded from VAT under Section 425 of the Colombian Tax Code. Other excluded products include goods that are basic necessities and services, such as health, transportation, education and public services. Excluded supplies are not subject to VAT and, therefore, the VAT paid to suppliers of goods and services cannot be credited in the VAT return and should be accounted for as an increase in the cost or expense of the goods or service. If a company exclusively makes excluded supplies, the VAT paid on its supplies cannot be recovered through the VAT credit system; thus, VAT paid becomes an additional cost or expense for the company.

In Colombia, the term "exempt supplies" is used for supplies of goods and services that are liable to VAT but have a zero rate (taxed at 0%). Exported goods and services are included within this category. In this case, the VAT paid to suppliers of goods and services may be recovered through the VAT credited system. If, as a result of making exempt supplies, the taxpayer has paid more VAT to its suppliers than it has charged, the credit balance may be requested as a refund from the tax authorities.

63 *Section 420 of the Colombian Tax Code.*

To improve the tax collection system, the Colombian Government has introduced a VAT withholding mechanism and has designated certain entities as VAT withholding agents (including government departments, large taxpayers, Colombian payers to nonresident entities and VAT taxpayers that qualify under the VAT common regime). These agents are responsible for withholding 50% of the tax due on any payment or accounting accrual related to taxable goods or services. In case of transactions with nonresidents (both entities and individuals), the withholding rate is 100%.

The general VAT rate is 16%. This rate applies to all goods and services, unless specific provision allows a reduced rate.

The VAT rate on imported goods for the oil and gas sector is generally 16%. However, the Colombian Tax Code offers the following VAT benefits for imported goods:

- Subsection 428 (e) of the Colombian Tax Code establishes a VAT exclusion for the temporary importation of heavy machinery for use by basic industries (the hydrocarbon sector is regarded as a basic industry) to the extent that those goods are not produced in the country (subject to the opinion given by the Ministry of Commerce, Industry and Tourism). Any request for VAT exclusion must be submitted at the time of the importation.
- Subsection 428 (f) of the Colombian Tax Code establishes a VAT exclusion for importation of machinery or equipment for treatment of residues when this machinery is not produced in the country.
- Subsection 428 (g) of the Colombian Tax Code establishes a VAT exclusion for ordinary imports of industrial machinery made by high export users (Usuarios Altamente Exportadores) to the extent that the machinery is used to transform raw materials and does not have local production (according to the opinion given by the Ministry of Commerce, Industry and Tourism). Any such request for exclusion should be submitted at the time of the importation.

Import duties

Goods imported by oil and gas sector companies on a permanent basis are generally subject to customs taxes (customs duties and VAT), even if they are imported on a non-reimbursable license basis.

Decree 562 of 2011 (added by Decree 1570 of 2011) establishes a specific list of subheadings (including machinery, equipment and spare parts) that are partially exempted from customs duties if the goods are imported by companies devoted to the exploitation, transformation and transportation of the mining industry or the exploitation, refinement and transportation (by pipes) of hydrocarbons. Exemption is for 50% of the custom duty applicable. This customs duty benefit applies until 16 August 2015.

Additionally, Decrees 492, 511, 2916 and 2917 of 2011 established a reduction or a 0% custom duty rate for specific subheadings listed in such regulations (i.e., some rigs and pipeline). In the case of Decrees 492 and 511, the reduction in the rate is permanent, while the exemption of Decrees 2916 and 2917 is available until 16 August 2012.

In light of the above, prior to the importation of any goods to Colombia, those decrees should be consulted to determine whether the imported goods qualify for an exemption or a reduction in customs duties.

Export duties

No duties apply to goods or services exported from Colombia.

Excise duties

Excise duties do not apply to upstream oil and gas.

Registration tax

The registration tax is levied on documents or contracts that must be registered with the Chamber of Commerce or with the public instrument office.

As explained below, a branch is the most common and convenient legal structure for oil and gas companies. Companies that operate using other legal structures must register with the authorities (e.g., a notary) if they decide to increase their patrimony by funding, and they must pay registration taxes, whereas branches do not have these obligations. Instead, a branch maintains a special account called the "supplementary investment to the assigned capital," in which it registers capital differences after funding, as if the account was a current account held with the head office.

I. Other

Equity tax

Law 1370 of 2009, and Decree 4825 of 2010, provided for an equity tax with the following characteristics:

- It was an instantaneous tax accrued on 1 January 2011, to be paid in eight equal installments during four years.
- Therefore, for fiscal years 2012 to 2014, taxpayers have to pay the equity tax liquidated and declared in 2011 in two equal installments each year.

Tax on financial transactions

The tax on financial transactions (TFT) applies to any financial debit transactions involving a withdrawal of deposited resources in checking or savings bank accounts opened in financial entities. Exemptions apply, but none apply specifically to the oil and gas sector.

The current tax rate is 0.4%. The TFT applies to the total amount of the transaction. In general, the withholding agents of TFT are financial entities and the Central Bank.

In agreement with Law 1430 of 2010, the tax rate will decrease as follows:

- As of 2014, the rate will be 0.2%
- As of 2016, the rate will be 0.1%
- As of 2018, the rate will be 0%

For tax years 2011 and 2012, 25% of the tax actually paid during the year will be deductible[64] for income tax purposes. As of tax year 2013, 50% of the amount paid will be deductible for income tax purposes.

Foreign exchange regime

As a general rule, all business entities that undertake business operations in Colombia are subject to Colombia's exchange control regime provisions. Colombian incorporated legal entities qualify as "residents" for exchange control purposes and are subject to what is referred to as the "general foreign exchange control regime." Colombian registered branches of foreign legal entities also qualify as residents and are, therefore, subject to this same regime. However, if the purpose of the business of a branch of a foreign entity is exclusively to enter into hydrocarbon exploration and exploitation activities, or the exclusive provision of technical services to the hydrocarbon sector (as a "qualified branch"), the branch may apply and qualify for treatment under the "special exchange regime."

The most notable differences between the two regimes are related to the way that businesses may handle their foreign currency resources and deal with "exchange operations" as follows:[65]

64 *Section 115 of the Colombian Tax Code and Ruling 025808 of 2011, DIAN.*

65 *Decree 2058 of 1991.*

General regime	Special regime
Scope	
Applies to all Colombian incorporated legal entities (including those undertaking exploration and exploitation of oil and gas) and non-qualifying branches of foreign legal entities.	Applies to branches of foreign companies exclusively devoted to the exploration and exploitation of hydrocarbons and the mining industry (limited to coal, ferronickel and uranium), as well as the exclusive provision of technical services to the hydrocarbon sector.

General regime	Special regime
Regime election	
Applies by default to the companies referenced above.	This regime is optional. Branches of foreign companies that do not wish to follow the special provisions stipulated in the special exchange control regime must report their decision to the Central Bank, and they shall be exonerated from applying such rules for 10 years, counted from the date of submitting the respective communication. Accordingly, all foreign exchange operations carried out shall be subject to the common regulations provided for in the exchange regime (Section 50 of Resolution 8 of 2000), as explained below.

General regime	Special regime
Characteristics	
It is mandatory to repatriate to the exchange market all foreign currency received from sales abroad (i.e., it is mandatory to bring it into Colombia and convert it into local currency through a financial institution). However, Colombian regulations include an exception for entities under the general regime to use properly registered foreign-currency-based bank accounts (cuentas de compensación).	It is not mandatory to repatriate the foreign currency received from sales (i.e., bring it into Colombia and convert it into local currency). Branches are only required to repatriate into the Colombian exchange market the foreign currency needed to cover expenses in Colombian currency.

General regime	Special regime
Characteristics	
The acquisition of foreign currency from the Colombian regulated foreign currency market is permitted. An entity covered by this regime should undertake all its exchange control operations through Colombian qualified foreign exchange intermediaries or their foreign-currency-based bank accounts (cuentas de compensación).	In general, qualifying branches do not have access to the regulated foreign exchange market. As a result, qualifying branches are not allowed to purchase foreign currency from the Colombian foreign currency market. Therefore, the execution of determined exchange operations is limited, and most business must be attended to by the head office. By way of exception, qualifying branches may remit abroad through the exchange market (with the certification of the entity's statutory auditor or accountant) any proceeds received in Colombian pesos for internal sales of oil, natural gas or services to the hydrocarbon sector and the foreign capital amount to be reimbursed to the head office in the event of the liquidation of the branch.
	All expenses incurred by the branch in Colombia should be paid in Colombian legal currency, except for payments to companies in the same business sector, which may be performed in foreign currency.

General regime	Special regime
Characteristics	
	Considering that the importation of goods is an exchange operation mandatory to channel through the foreign exchange market, all imports of goods must be paid in full by the head office with its own resources. The importation of goods by these types of branch must be filed for customs purposes as non-reimbursable importations. Payment of services (which is a free market operation not mandatorily channeled through the foreign exchange market) must be made abroad by the head office on behalf of the branch. These payments are considered to be capital contributions when made abroad by the head office. Payments must be managed as supplementary investments to the assigned capital. Additionally, non-reimbursable importations treated as contributions to the supplementary investment account are subject to securing a previous license before the Ministry of Commerce, Industry and Tourism. This license is required as a supporting document for filing the importation return before Colombian tax authorities and thus must be obtained before filing this return.

General regime	Special regime
Characteristics	
Colombian incorporated legal entities may receive investments in cash and in kind from foreign shareholders (whereas non-qualifying branches may only receive cash contributions) in the form of capital investments.	The receipt by a branch of an investment in cash or in kind from its head office must be accounted under the supplementary investment to the assigned capital account (SIACA). The SIACA is a special account that, even though it forms an integral part of the equity accounts of the qualified branch, is a separate account from the assigned capital account. This allows the flow of investment funds in and out of the branch's equity account without entailing a change to the assigned capital account, thus allowing the branch to increase or reduce the SIACA balance without requiring the formality of a corporate resolution, or prior authorization by Colombian supervisory entities (e.g., Superintendence of Corporations). Therefore, the SIACA can be managed, in effect, as a "current account" of the branch with its home office.

General regime	Special regime
Foreign currency movements	
These entities may carry out all operations that are typical of the foreign exchange market. Some of the exchange control operations are: ‣ Foreign capital investments in Colombia and related yields ‣ Colombian capital investments abroad and related yields ‣ Financial investments in securities issued abroad, investments in assets located abroad and related yields, unless the investment is made with foreign currency from transactions that are not required to be channeled through the exchange market ‣ Endorsements and warranty bonds in foreign currency ‣ Derivative transactions ‣ Foreign indebtedness	These entities may: ‣ Receive foreign investments into their assigned capital or SIACA ‣ Receive the necessary foreign currency for their expenses in the country ‣ Voluntarily repatriate the proceeds of their exportations to pay local expenses only ‣ Remit abroad the proceeds of the branch's final liquidation Considering that the head office receives the proceeds abroad, it may not: ‣ Carry out operations that are typical of the exchange market ‣ Remit profits ‣ Carry out foreign indebtedness operations ‣ Purchase foreign currency for the payment of obligations ‣ Pay importation of goods

General regime	Special regime
Requirements	
Registration of foreign investment Automatic at the time of channeling the funds through the foreign exchange market, via presentation of Form No. 4. The capitalization of sums "with right of remittance," such as payable interest or dividends, are registered using Form No. 11. **Deadline** For registration of sums with right of remittance, up to one year following the investment.	**Registration of foreign investment** Capital: automatic at the time of channeling of the funds through the foreign exchange market, via presentation of Form No. 4. **Deadline** For registration of SIACA, up to 30 June of the year following the investment using Form No 13.
Annual foreign investment update Form No. 15 "Equity reconciliation – companies and branches of the general regime." The annual foreign investment update is not mandatory to entities supervised by the Superintendence of Corporations. **Deadline** On 30 June if transmitted electronically, or 30 April if presented in a physical document.	**Annual foreign investment update** Form No. 13 "Registration of SIACA and update of equity accounts – branches of the special regime." **Deadline** Up to 30 June of the year following the corresponding year.

General regime	Special regime
Foreign trade operations	
Payment of imports must be channeled through the Colombian foreign exchange market. The proceeds of exports must be brought into the Colombian foreign exchange market.	Imports coming from their home office or from third parties must not be paid in foreign currency; therefore, all goods entering the country should come in as a contribution of their head office. Imports made, therefore, qualify as non-reimbursable imports and, thus, there is no access to foreign currency to pay for them. There is no obligation to reintegrate into the Colombian foreign exchange market the proceeds of their exports.

General regime	Special regime
Foreign indebtedness	
These entities may enter into passive and active foreign debt transactions. Also, indebtedness can be undertaken with any nonresident. Foreign currency originated in foreign indebtedness operations and its financial costs must be channeled through the Colombian foreign exchange market.	These entities may not enter into passive or active foreign indebtedness operations for any concept (i.e., all foreign indebtedness (including any international leasing) must be undertaken by the home office, as opposed to the branch).

General regime	Special regime
Foreign currency accounts	
These entities may have checking or savings bank accounts in foreign currency with foreign financial entities, and are not required to report or register them with the Central Bank. These accounts may only be used for handling operations not required to be channeled through the foreign exchange market (Section 55 Resolution 8 of 2000).	These entities may have current or savings accounts in foreign currency with foreign financial entities and are not required to report or register them with the Central Bank (Section 55 Resolution 8 of 2000). No operations, other than free operations, may be carried out in the exchange market.
They may have foreign-currency-based bank accounts (cuentas de compensación) registered before the Central Bank for handling operations mandatorily channeled through the foreign exchange market. (Section 56 Resolution 8 of 2000).	They cannot have foreign-currency-based bank accounts (cuentas de compensación). The last, due to the fact that accessing the exchange market is proscribed.

- The special regime for the investment of foreign capital for the hydrocarbon sector prevails over the regulations established for the general regime of foreign investment (Section 20 Decree 2080 of 2000).
- Branches of foreign companies that do not wish to follow the special provisions stipulated in the special exchange control regime must report their decision to the Central Bank, and they shall be exonerated from applying such rules for 10 years, counted from the date of submitting the respective communication. Accordingly, all foreign exchange operations carried out shall be subject to the common regulations provided for in the exchange regime (Section 50 of Resolution 8 of 2000).
- As an exception to the general prohibition established in the Colombian exchange regime to execute payments between Colombian residents in foreign currency, the companies (including companies and branches) that perform activities of exploration and exploitation of hydrocarbon or technical services for this sector are authorized to agree and to pay contracts between each other in foreign currency into the country whenever (i) this is made between companies with the same activity and (ii) the used currencies come from generated resources of their operation.

Legal stability agreements

To promote new investment in Colombia, Law 963 of 2005 allows investors to enter into legal stability agreements. Under this type of contract, an investor in Colombia can be guaranteed that, during the term of the contract (3 to 20 years), the investment will not be adversely affected by modifications made to existing laws, regulations or rulings. In consideration for such guarantee, the investor pays a contribution equal to 1% of the amount invested during the year. The rate of the contribution is reduced to 0.5% if the project is in the preoperational stage.

Law 1450 of 2011 modified the way in which the contribution has to be calculated by stating that the contribution should be determined taking into account the rules included as part of the stabilization agreement. This modification is not currently in force while a regulatory decree is issue to clarify the application.

In general, direct taxes (income tax) are covered by the agreement. However, VAT, taxes created under a state of emergency and territorial taxes (state and municipal taxes) may not be covered by the contract. The contract may also cover other measures, such as corporate laws, private laws and official doctrines issued by the tax authorities.

To enter into legal stability agreements, the investor must submit an application to a government committee for its approval, including a detailed list of the laws and regulations covered by the agreement, the description of the investment project and the term of the project. Additional requirements are provided by the law.

In the case of taxpayers with legal stability agreements applications filed before 1 November 2010, Law 1430 of 2010 allows the inclusion of a 30% capital allowance provision for the investment projects described in the agreement, with the clarification that this capital allowance will apply for a maximum term of three years from the year in which the legal stability agreement is signed.

J. Other tax compliance

The Colombian Tax Code states that taxpayers are required to provide information to the tax authorities. Based on that, the tax authorities (for the national and municipal levels) request every year from certain taxpayers detailed information (called "magnetic media," or "MM") to support the figures reported in their income tax returns, using a specific format provided by the tax authorities.

Individuals or corporations acting as "operator" in E&P oil and gas contracts are obliged to provide MM to the tax authority: a full set of information from their own operations information used in their own operation as well as other partner's operations engaged in the same E&P contract, in which they are involved.

Côte d'Ivoire

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A. At a glance

Fiscal regime

The fiscal regime applicable to the petroleum industry in Côte d'Ivoire consists of Ivorian tax law, the Ivorian petroleum code and the production sharing contracts (PSC), or the contract of service concluded between the Ivorian Government and the contractor (hereafter referred to as the Holder).

Corporate income tax (CIT)	25%
Surface rent tax	No specific legislated rate and depends on the terms of the PSC
Bonuses	Amount of bonus depends on the terms of the PSC
Royalties on production	Rate depends on the terms of the PSC[66]
Additional petroleum tax	No specific legislated rate and depends on the terms of the PSC
Capital allowances	D, E[67]
Incentives	L, RD[68]

B. Fiscal regime

There are two groups of petroleum companies in Côte d'Ivoire. The first group is composed of exploration and production (E&P) companies specializing in the exploration and the production of oil and gas (hereafter referred to as E&P companies or Holder). The second group consists of petroleum services contractors that specialize in the supply of petroleum services and are subcontracted by the Holder.

The fiscal regime that applies to E&P companies differs from that which applies to petroleum service contractors.

Corporate tax

E&P companies in Côte d'Ivoire are subject to CIT on their non-exempt income at the rate of 25% (rate applicable since 27 January 2008). Some Holders are exempt from corporate tax. These exemptions are specified in their respective contracts with the Government.

Other companies can be authorized to pay the income tax in the form of part of their petroleum production. In such cases, the national petroleum company (PETROCI) is designated to verify the quantities provided by E&P companies. This must be stipulated in the contract.

66 *Royalties are applicable to the Holder of the PSC.*

67 *D: accelerated depreciation; E: immediate write-off of exploration costs.*

68 *L: ability to carry forward losses; RD: R&D incentive.*

The CIT is calculated on the net taxable income of the Holder. The net profit is the difference between the value of the opening and closing balances of the net assets in the relevant year of assessment, less extra contributions, plus any amounts taken by associated companies during the said period.

Exploration and development costs are taken into account in determining the company's income.

The profit is calculated after deduction of all charges that meet the following conditions:

- Incurred in the direct interest of the company or related to the normal management of the company
- Correspond to actual charges and are supported by sufficient evidence
- Are reflected by a decrease in the net assets of the company
- Are included in the charges of the fiscal year during which they were incurred

Characteristics of the PSC

The PSC is concluded between the Holder and the Ivorian Government and is signed by both the minister in charge of petroleum activities and the minister of finance. It is one of the most common contracts used by the Government. The PSC is in principle published in the official journal and registered in accordance with the conditions provided by the law.

In terms of the PSC, an E&P company finances all exploration and development costs and bears all costs and risks of this operation in the event that no oil and gas is found.

The production is divided as follows: one part of the production (the cost oil) will be used to recover the exploration and development costs incurred by the company; the remaining part (the profit oil) is shared between the Government and the Holder.

Production sharing is calculated with reference to the production volume, and cash can be payable in lieu of oil, under certain circumstances.

Government share of profit oil

The government share of profit oil is determined in each PSC. There is no quantity required by law. The Government share depends on the terms of the PSC or the service contract and should be equal to a percentage of the production after the deduction of cost oil. Based on an example of a PSC, the Government share of profit oil is determined in this example:

Daily global oil production (barrels)	Government share of profit oil	Holder share of profit oil
From 0 to 100,000	45%	55%
From 100,001 to 200,000	47%	53%
From 200,001 to 300,000	55%	45%
Over 300,000	60%	40%

Cost oil

Recoverable expenditures

Exploration costs are recoverable by the Holder in the form of cost oil.

Non-recoverable expenditures

The following expenditures are not recoverable:

- Expenditures relating to the period before the effective date of the contract
- Expenses relating to the operations carried out beyond the point of delivery, such as marketing and transport charges

Determination of cost oil

Cost oil is all expense borne by the Holder in the performance of the PSC and determined in accordance with relevant accounting processes. Cost oil and profit oil are determined for each contract. There is no standard rate for all Holders, and each Holder agrees its share of cost oil with the Government.

Uplift available on recovered costs

The Holder can also claim a reasonable amount representing general expenses incurred abroad that are necessary for the performance of the petroleum operations and borne by the Holder and its affiliated companies. The amount claimable is determined with reference to the annual amount of petroleum costs (outside of financial charges and general expenses).

VAT

The Holder is exempt from VAT and tax on financial operations in Côte d'Ivoire for the purchase of goods and services related to its petroleum activities.

The availability of the exemption is subject to compliance with VAT exemption procedure established by Ivorian tax authorities.

The Holder will be liable for VAT at the rate of 18% on the purchase of certain goods and services not covered by the above exemption.

It is not necessary to register for VAT separately. As soon as a company is registered in Cote d'Ivoire, it is given a taxpayer number that covers all taxes, including VAT.

Bonuses

Each petroleum or gas agreement specifies the bonus payable to the Government. The amount is negotiated with the Government when the agreement is signed and therefore the amount of any bonus payable may differ in each contract. There are two main kinds of bonuses:

- The bonus due at the signing of the contract, payable 30 days after the signing of a gas or petroleum agreement
- The bonus related to quantities produced, payable 30 days after the last day of the test production

Bonuses vary according to the total cumulated oil production. Based on an example, the bonus will be due as follows:

- US$3 million when the net cumulated oil production reaches 50 million barrels
- US$6 million when the net cumulated oil production reaches 75 million barrels
- US$8 million when the net cumulated oil production reaches 100 million barrels
- US$12 million when the net cumulated oil production reaches 200 million barrels

Annual surface rent tax

The payment of an annual surface rent or other surface rent can be due according to the PSC or service contract. In this case, the payment must be made in the first 10 days of the year. In the case of annual surface rent tax, the amount due will be paid for the entire year, based on the area of the permit.

Additional petroleum tax

Holders can be subject to an additional petroleum tax that is calculated by reference to the profitability of the petroleum operations. The rate, conditions of calculation, declaration, liquidation and recovery of this additional tax are specified in each PSC or service contract.

Royalties

Royalty rates are determined by the PSC or service contract.

Holders are subject to the payment of a royalty on the value of the hydrocarbons produced. Royalties can be paid in cash or in kind. In this regard, royalties can be based on the estimated production value for the current year and must be amended on 1 February of the following year, once the real quantities of the production have been determined.

Royalties can also be determined with reference to a specified level of oil production and must be paid at the end of each quarter.

The royalty is calculated with reference to the total quantity of hydrocarbons produced in the concession and not used in the petroleum operations.

The amount of this royalty, and the rules relating to the basis and recovery thereof, are specified in the PSC.

Some contracts may provide a Holder with a full or partial exemption from the requirement to pay a royalty.

C. Capital allowances

Holders are subject to accounting rules known as SYSCOHADA, only in relation to their general activities.

In practice, each Holder, whether resident or not, must adopt two accounting systems: one for general activities and the other for petroleum costs. In this second system, the relevant company must have a special account per year where the production level, results and balance sheet of the company are set out.

However, some contracts give the right to the Holder not to be subject to SYSCOHADA.

Accelerated depreciation

According to SYSCOHADA, some assets may be subject to an accelerated depreciation. An E&P company can ask for authorization from the tax authorities if it wants to use this method for tax purposes. Such depreciation is deductible from the taxable income of the Holder.

Immediate write-off for exploration costs

The exploration expenses incurred by the Holder in the territory of Côte d'Ivoire, including, in particular, the cost of geological and geophysical surveys, and the cost of exploration wells, will be regarded as charges fully deductible as of the year during which they are incurred. Alternatively, these costs may be depreciated according to a method determined by the Holder.

D. Incentives

Research and development incentives

Holders of PSCs are exempt from any taxes, duties and fees as soon as they sign the PSC contract for the period in which they are conducting R&D during the E&P period up to the end of their activities in Cote d'Ivoire or at the end of the PSC. The main taxes exempted are:

- Tax on banking operations
- Tax on sales or similar tax (VAT)
- Taxes and duties applicable to petroleum products supplied to permanent facilities and drilling facilities

Any person or company working on behalf of the Holder may be exempt from tax on sales or a similar tax in respect of the petroleum operations performed.

During this period, equipment intended directly and exclusively for petroleum operations is exempt from any duties and taxes on its importation into Côte d'Ivoire by the Holder or by companies working on its behalf.

Ability to carry forward losses

The unverified amount of the loss is deductible from the taxable profits until the fifth fiscal year following the period in which the loss arose, unless the PSC or service contract authorizes the Holder to carry these losses forward beyond the five-year period.

However, the amount of loss relating to asset depreciation can be carried forward indefinitely.

E. Withholding taxes

Dividends

Dividends distributed by the Holder are exempt from taxation.

Interest

Interest related to petroleum activities paid by the Holder is not subject to withholding taxes (WHT).

Technical services

Nonresident contractors are subject to taxation on the wages they receive from a Holder based in Côte d'Ivoire. Generally, the rate is 25% of 30% of the wage amount, resulting in an effective rate of 7.5%.

Branch remittance tax

Branch remittance tax applies in general, but not to PSC Holders.

F. Thin capitalization limits

When a Holder borrows money from its holding or sister companies, the interest on this borrowing is a deductible charge for the Holder, provided the interest rate on the funds placed at the disposal of a company by the associated company does not exceed the prevalent interest rate in the national financial market.

G. Transactions

Asset disposals

The income that results from asset disposals is included in the corporate income of the company and is subject to taxation. In the case of a non-cash payment (such as check or bank transfers), the asset costs are deductible from the taxable income. However, they are not deductible in cash transactions, which are not encouraged in Cote d'Ivoire.

Capital gains

In principle, capital gains are taxed at the corporate tax rate of 25%. Exceptionally, transfer of assets without cash or payment – in kind or involving the resumption of the assets by the concessionary at the account value at the consignor – is exempt from tax.

H. Indirect taxes

Import duties

All goods and materials entering into Côte d'Ivoire from overseas are subject to customs import duties.

However, personal and domestic goods of nonresident workers of E&P companies are exempt from any customs duties. Also, all materials required to facilitate petroleum or gas activities are exempt.

VAT

See page 137.

Export duties

No duties are applied to goods exported from Côte d'Ivoire. E&P companies, which export petroleum product, are not subject to export duties.

Stamp duties

Stamp duties are due on transactions made by a Holder. These stamp duties are the same for all companies.

Registration fees

Upon company registration, Holders become taxable entities and must register with the tax authorities in order to obtain a tax identification number.

The registration fees for the creation of a company are:

- Up to XOF5 billion share capital 0.6%
- More than XOF5 billion share capital 0.2%

I. Other

Excise duties

Excise duties are applied to petroleum products that are imported or sold in Côte d'Ivoire. The following examples are considered to constitute a sale or import that is subject to excise duty:

- The sale of petroleum product by the Holder to its subsidiary company is considered to be a dutiable sale.
- The usage of petroleum product for its own use is considered to be a dutiable sale.
- The sale of petroleum products to distribution and supplying companies is considered an importation.

Some petroleum products are exempt from excise.

The amount of excise is determined as shown in the following table:

	Identification	Amount
Per liter at 15ºC	Super and special gasoline	XOF157.40
	Car gasoline	XOF141.20
	Diesel oil	XOF37.80
	Carbureactor	Exempt
	Lamp petroleum	XOF2.80
	Diesel oil for special planes	Exempt
	Mineral oils	XOF15
Per kilogram	Distillate diesel oil	XOF50.50
	Exempt distillate oil	XOF1.50
	Domestic fuel oil	XOF1.50
	Light fuel oil	XOF1.50
	Heavy fuel oil	XOF1.50
	Vegetable fats	XOF15

Other taxes and compliance issues

Other taxes include WHT on rental payments. Holders, in their capacity as Côte d'Ivoire companies, must submit their financial statements and income results of the same period to the tax authorities each year.

Recent legislative changes (tax appendix 2011)

- Arrangements relating to admission to simplified tax regime (STR):
- Receipt from Trade Register sufficient evidence to be admitted to STR regime (activities performed for less than 6 months in Ivory Coast)
- Tax registration and deregistration to be performed by a local representative of the subcontractor
- Compliance obligations falls under PSC holders (returns and payment)

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A. At a glance

Fiscal regime

The fiscal regime that applies in Cyprus to the oil and gas industry consists of a combination of corporate income tax (CIT), capital gains tax (CGT), immovable property tax (IPT), VAT and excise duty, whereby upstream oil and gas exploration and exploitation activities are to be undertaken under a production sharing contract (PSC).

CIT rate	10%
CGT rate	20%
IPT rate	0.4%–0.8%
Branch tax rate	10%
VAT rate	17%
Royalties	None
Bonuses	Yes
PSC	Yes

B. Fiscal regime

There are currently no specific tax laws on hydrocarbon exploration and exploitation activities in Cyprus, and the general (corporate) tax laws in force are applicable. As per the model exploration and production sharing contract (MEPSC), published as part of the second licensing round for offshore Cyprus concerning the authorization for hydrocarbons exploration, the intention of the Cyprus Government is to enter into a PSC with operators and contractors under which the Republic of Cyprus shall be entitled to a certain percentage of the profit hydrocarbon resulting from the hydrocarbon operations to be undertaken by the operator or contractor in Cyprus at its sole risk, cost and expense. Under the MEPSC, the applicable CIT shall be deemed to be included in the Republic's share of profit oil and profit gas and, therefore, the portion of the available hydrocarbons that the operator or contractor is entitled to shall be net of CIT.

Corporate income tax

Companies resident in Cyprus are subject to CIT on their worldwide income from business activities and certain other selected types of income. A company is resident in Cyprus if its management and control are exercised from Cyprus. Nonresident companies are taxed only on income derived from a permanent establishment in Cyprus and on rental income from property located in Cyprus.

Ring-fencing

Cyprus does not apply ring-fencing in determining an entity's corporate tax liability in relation to its oil and gas activities. Losses from one project (where, if such losses were profits, they would be subject to CIT) can be offset against profits of the same company from another project, and, similarly, profits and losses from upstream activities can potentially be offset against downstream activities undertaken by the same taxpayer. New oil and gas industry taxation rules in this respect may be introduced by regulations envisaged by the Government.

CIT is levied on taxable income

Taxable income is the difference between taxable revenues and tax-deductible expenses for the year of assessment. Expenses (including interest expenditure) are deductible for CIT purposes if they are incurred wholly and exclusively for the production of (taxable) income.

The determination of taxable income is generally based on accounts prepared in accordance with international financial reporting standards (IFRS), subject to certain adjustments and provisions.

Tax losses

Losses can be carried forward without any time restriction. Loss carrybacks are not allowed.

Groups of companies

Group loss relief for a loss incurred in an income year is allowed between resident group companies that meet certain conditions.

Capital gains tax and immovable property tax

Cypriot capital gains tax (CGT) is levied at a rate of 20% only with respect to profits realized upon a disposal of immovable property situated in Cyprus, as well as on the sale of shares of companies the property whereof consists partly or wholly of immovable property situated in Cyprus. Gains realized upon disposal of shares in companies that do not own Cypriot-based immovable property are not subject to CGT. Moreover, the disposal of a lease registered in accordance with the Immovable Property (Tenure, Registration and Valuation) Law constitutes a taxable event for Cypriot CGT purposes.

Cypriot IPT is imposed at rates in the range of 0.4% to 0.8% on the owner of an immovable property and is calculated on the market value of property as of 1 January 1980 as per the general revaluation.

Although not explicitly provided in the legislation, the term "immovable property" should be confined to include only immovable property physically situated on the mainland of Cyprus, as well as leases registered in accordance with the provisions of the Immovable Property Law, and should neither include the sea blocks or sea beds falling within the exclusive economic zone of the Republic of Cyprus, nor a right to a fixed or variable payment for the working of mineral deposits and other natural resources (e.g., the rights under the PSC).

C. Depreciation and amortization allowances

The general depreciation and amortization allowances rules are as follows:

Plant and machinery. A straight-line allowance of 10% a year is given on capital expenditures for plant and machinery.

Industrial buildings. A straight-line allowance of 4% a year is available for industrial buildings.

Commercial buildings. A straight-line allowance of 3% a year is available for commercial buildings.

Office equipment. A straight-line allowance of 20% a year is available for computers. Other office equipment is depreciated under the straight-line method at an annual rate of 10%.

Motor vehicles. In general, a straight-line allowance of 20% a year is available for motor vehicles (except for private saloon cars).

Sales of depreciable assets. On disposal of an asset, if sale proceeds are less than the remaining depreciable base, a further allowance is granted, up to the difference. If sale proceeds exceed the depreciable base, the excess (up to the amount of allowances received) is included in taxable income. This is done on an asset-by-asset basis.

New oil and gas industry depreciation and amortization allowance rules may be introduced by regulations envisaged by the Government.

D. Incentives/tax holidays

There are no specific incentives or tax holiday facilities in Cyprus.

E. Withholding taxes

Cyprus does not impose any withholding taxes (WHT) on payments of dividends and interest to nonresident shareholders or lenders.

A 5% or 10% WHT rate applies (subject to double tax treaty relief or absence of WHT based on European Union related party Interest and Royalties Directive) to royalty payments for the economic utilization of licensing rights and provision of technical assistance services within Cyprus.

F. Financing considerations

Thin capitalization

There are no thin capitalization rules or debt-to-equity ratios in Cyprus.

The arm's-length principle is codified in the CIT law in a wording similar to that of Article 9 of the OECD Model Tax Convention. Consequently, all transactions entered into with related parties should be concluded on an arm's-length basis in order to avoid adjustments of the taxable profit by the Cypriot tax authorities. However, there are no specific rules regarding transfer pricing or transfer pricing documentation requirements in Cyprus.

In terms of intragroup loans, this means that the interest rate applicable on such loan(s) should be based on market terms and conditions (irrespective of the tax-residency status of the related counterparty of the Cypriot tax-resident company).

G. Transactions

Asset disposals

The MEPSC provides for assignment of the PSC (subject to conditions) as well as a change of control of the contractor.

If the contractor (Cyprus tax-resident company) is to realize a gain from disposal of assets, such gain shall not be subject to CIT in Cyprus if not realized in the course of conducting the business and being capital in nature (i.e., if such transactions are not of a repetitive character) and shall not be subject to CGT in Cyprus (unless Cyprus-based immovable property is disposed of).

Farm-in and farm-out

No specific provision applies for the tax treatment of farm-in and farm-out consideration, and its treatment is determined on the basis of general taxation principles and provisions of the PSC.

Joint operations

There are currently no specific rules in Cyprus on allocation of profits (i.e., revenues and costs) applicable to joint undertakings.

H. Indirect taxes

VAT

In Cyprus, the following rates of VAT currently apply: the standard rate at 17% (as of 1 March 2012); the reduced rates at 5% and 8%; and the zero rate (0%). The standard rate of VAT applies to all supplies of goods or services, unless a specific provision allows a reduced rate, zero rate or exemption.

Excise duties

In accordance with the EU Acquis, Cyprus has adopted special excise duties rates in the following categories of products known as "harmonized," irrespective of whether they are produced in Cyprus, imported from other EU Member States or imported from non-EU countries:

Energy products and electricity, e.g., petroleum oil, gas oil, kerosene, natural gas, coal and coke

Alcohol and alcoholic beverages, e.g., ethyl alcohol, beer, still wine and fermented beverages

Tobacco products, e.g., cigarettes, and cigars

Transfer tax

There are no specific transfer taxes in Cyprus other than Land Registry Office fees when transferring immovable property.

Stamp duties

Cyprus levies stamp duty on every instrument (i.e., agreement or contract) if it relates to any property situated in Cyprus, or it relates to any matter or thing that is performed or carried out in Cyprus (e.g., sale or purchase of Cypriot-based assets, i.e., immovable property, shares in a Cypriot company). There are instruments that are subject to Cypriot stamp duty at a fixed fee (ranging from 3 cents to €34, e.g., agreements without consideration) and instruments that are subject to stamp duty based on the value of the instrument (0.15% for amounts up to €170,860 and 0.2% for sums exceeding €170,860 plus €256) with a maximum stamp duty payable of €17,086 per instrument.

Registration fees

Registration fees are payable to the Registrar of Companies upon incorporation of a Cypriot company (fixed fee of €102 and an additional fee of 0.6% on every euro of registered nominal or authorized capital), upon every further increase of registered nominal or authorized capital (fee of 0.6% on every euro of registered nominal or authorized capital) and upon every further issue of shares (fixed fee of €17).

Other significant taxes

The following table summarizes other significant taxes.

Nature of tax	*Rate (%)*
Special contribution for the Defence Fund of the Republic	
On rents received	3
On interest received or credited (except for interest earned in the ordinary course of business)	15
On dividend received or deemed to be received from a nonresident company (if exemption under the Cyprus domestic tax laws does not apply)	20
Special contribution	2.5–3.5

(levied for the years 2012–13 on salaries, income of the self-employed and pensions in the private sector)

Payroll taxes

Social insurance contribution, levied on each employee's gross salary, up to €4,342 a month; payable by both employer and employee	6.8
Special Cohesion Fund, levied on gross salary; payable by employer	2
Human Resource Development Authority and Redundancy Fund, levied on gross salary, up to €4,442 a month; paid by employer	1.7
Leave Fund, levied on gross salary, up to €4,442 a month; paid by employer in lieu of holiday pay (employer may obtain exemption from contribution to this fund)	8

I. Other

Foreign exchange controls

Cyprus does not impose foreign exchange controls.

Gas to liquids

There is no special regime for gas to liquids conversion.

Mergers and demergers

No taxes arise on mergers and demergers with respect to transfers of businesses, assets or shares provided they qualify as company reorganization transactions.

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A. At a glance

Fiscal regime

The fiscal regime applicable to the petroleum industry in the Democratic Republic of Congo (DRC) consists of the Congolese Tax Law, the General Tax Code dated March 2003, the Reform of Tax procedures book dated 13 March 2003, the Hydrocarbon Ordinance-Law n°81-013 dated 2 April 1981, customs code and customs tariff, the relevant production sharing contract (PSC) or other similar contract concluded between the Government and the oil company, and the provincial legislation.

The rules for taxation rate, control, sanctions, prescription and tax litigation in relation to corporate tax and mineral fees (*redevance minière proportionnelle*) are contained within the general tax rules and the Hydrocarbon Code.

Corporate income tax (CIT)	40%
Surface rent[69]	US$2/km² and US$500/km² per permit
Bonuses	Various amount applicable
Royalties	Rate depends on the terms of the PSC
Mineral fee	Rate depends on the terms of the PSC

B. Fiscal regime

Corporate income tax

Corporate income tax is applied to the net profit of oil companies at the rate of 40%. The net profit is the difference between the net asset value at the end of a fiscal year and other definite charges, such as cost oil (see below) and provision for recovery of oil field.

CIT is paid by way of apportionment of profit oil (see below) from the relevant field to the DRC Government.

Petroleum contracts

The main petroleum contract under which the DRC Government gives a right to an oil company to exploit a specific area is a production sharing contract (PSC).

69 *Annual surface rent is applicable to the PSC holder or participants.*

Production sharing contract

Usually, under the terms of a PSC, to the extent oil is discovered by a company undertaking exploration and development activities in the DRC, the exploitation is made in the name of the DRC Government. If oil is not discovered, all the costs of exploration are assumed by the company.

CIT is paid by way of apportionment of profit oil from the relevant field to the DRC Government and is calculated by applying the CIT rate to the net profit of oil companies.

The principles of deductibility of expenditure under the General Tax Code similarly apply to PSCs.

Tax depreciation rules are provided by the General Tax Code, although a relevant PSC can provide further specific rules. Expenditure in respect of restoration works is deductible as and when it is incurred.

Certain costs are not deductible for tax purposes under the General Tax Code, such as fines, penalties and provisions.

The indirect transfer of profits by a DRC company to an affiliated non-DRC tax-resident company is likely to be regarded as non-deductible under the General Tax Code. Amounts paid by a DRC tax-resident company to an affiliated non-DRC tax-resident company should only be deductible if:

- The substance of the service is clearly demonstrated
- The service in question cannot be made in the DRC
- The amount corresponds to the actual value of the service

The law does not prescribe any quantitative consideration for sharing of profit oil between the company and the DRC Government. Accordingly, the government share of profit oil is determined by the relevant PSC in place. In general, the portion of production allocable to each party depends on net production of the year and is re-examined each year to ensure compliance with the terms of the PSC.

The accounting system for a PSC is specified in the contract itself.

Bonuses

A bonus is paid to the DRC Government for granting a prospecting permit or exploitation permit. The fixed amount is paid as follows:

- Bonus at the signing of the contract: US$500,000
- Bonus for exploration permit: US$250,000
- Bonus for the renewal of exploration permit: US$125,000
- Bonus for first production: US$1 million
- Bonus of production of the 10 millionth barrel: US$5 million

Annual surface rent

An annual surface rent (redevance superficiaire) is due by the company to the DRC Government. The amount per square kilometer is equal to US$2 per square kilometer and US$500 per square kilometer per license.

Royalty regimes

Royalty regimes are determined by the PSC, if the contract provides for payment of royalty. There is no difference in the royalty rates between onshore and offshore production.

Mineral fee

Rate depends on the terms of the PSC.

C. Capital allowances

The tax depreciation rules for the petroleum sector are provided in the PSC according to the straight-line method of deprecation. The depreciation rates are fixed by the Hydrocarbon Code as follows:

- Cost incurred for exploration can be depreciated at the rate of 100%
- All other capital expenditure is depreciated over a period of five years at the rate of 20% from the beginning of commercial production of each deposit
- The Congolese Hydrocarbon Code does not provide any accelerated depreciation for the assets of the petroleum company.

D. Incentives

There are usually various tax incentives that would be specified within any negotiated PSC. These potential incentives are listed below.

Research and development

A permit can support losses from another permit regarding the cost of R&D. That is, R&D expenditure can be transferred between permits.

Ability to carry forward losses

In principle, losses can be carried forward for a period of five years. The amount of losses related to depreciation (*Amortissement Réputé Différé,* or ARD) can be carried forward indefinitely.

E. Withholding taxes

Interest and technical services

Generally, there is no withholding taxes (WHT) on services rendered by local or foreign subcontractors. However, there is an ICA (see below) paid by the beneficiary of services at the rate of 30% on services rendered by foreign subcontractors.

Dividends

Dividend payments made by a DRC tax-resident company are subject to WHT at the rate of 20%.

Branch remittance tax

There is no concept of branch remittance taxes for overseas tax-resident companies performing activities in the oil and gas sector in DRC.

F. Indirect taxes

VAT/ICA

VAT was introduced in the DRC by the Ordinance-Law n°10/001 of 20 August 2010, replacing ICA. This regulation will come into force in principle on 1 January 2012.

The VAT principles laid down by the Ordinance-Law are quite similar to those applicable in other French-speaking African countries, including the scope of this tax, the exemptions, the rating of taxable operations, the rules of deduction, the treatment of export and the form and date of declarations.

The Ordinance-Law provides that a VAT credit cannot be refunded, but it can be imputed on VAT due over the following months until the total amortization of such. However, there are exceptions relating to exporters or companies in the process of ceasing to carry on business in DRC, on specific request to the DRC tax administration. The rate of VAT will be 16%, except for exports, which are at the rate of 0%.

Where a company exports all its production, it should be able to recover all of its input VAT. The period for obtaining this VAT refund is not specified by the Law. The practical arrangements of the VAT refund will be determined by regulation.

Import duties

Depending on the nature of equipment, import duty is usually applied at a rate of between 5% and 20%, although the applicable PSC can provide exemptions.

Export duties

Export duties depend on the nature of the equipment. The PSC can provide exemptions.

Stamp duties

Stamp duties are not applicable

Registration fees

Registration fees are not applicable

However, registration fees at the rate of 1% of the amount of the capital are due for the incorporation of a company or the increase of capital.

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A. At a glance[70]

Fiscal regime

The tax regime that applies to hydrocarbon exploration and production (E&P) companies in Denmark consists of a combination of corporate income tax (CIT) and hydrocarbon tax. The hydrocarbon tax rate and rules applicable depend on whether the license is granted before or after 1 January 2004.

Royalties	None[71]
Bonuses	None
Production sharing contract (PSC)	None[72]
Income tax rate	Chapter 2 corporate tax rate 25%
	Chapter 3 hydrocarbon tax rate 70%
	Chapter 3A hydrocarbon tax rate 52%
Resource rent tax	None
Capital allowances	D, U, E[73]
Investment incentives	L

70 *A Danish tax reform was adopted in May 2010. No changes concerning hydrocarbon taxation were made. However, the reform has, among other things, eased the taxation of capital gains on shares and dividends (abolishing ownership period requirements), introduced taxation on capital gains and dividends where the ownership percentage is lower than 10%, irrespective of ownership period, and introduced new excise duties. The new rules were effective as of 1 January 2011. Further, the new elected Government (2011) has proposed certain new bills regarding limitations on the utilization of tax loss carry forwards and joint and several liability for corporate tax in joint taxation arrangements. The exact wording of the proposed regulations are uncertain at this stage; however, it is expected that the rules will be proposed in 2012 and will be effective from 1 January 2013.*

71 *Only a small number of licenses are subject to royalty obligations.*

72 *A pipeline duty is payable. Besides this, Denmark does not have a PSC regime, except for the fact that the Danish Government holds a 20% interest in the 1962 Sole Concession.*

73 *D: accelerated depreciation; U: capital uplift; E: immediate write-off for exploration costs and the cost of permits first used in exploration; L: losses can be carried forward indefinitely.*

B. Fiscal regime

Danish resident companies are subject to tax in accordance with a modified territoriality principle, which means that income and expenses from foreign permanent establishments (PEs) and real estate outside Denmark are not included in the income of a Danish resident company. Branches of foreign companies located in Denmark, as a general rule, are taxed exclusively on trading income and on chargeable capital gains derived from the disposal of trading assets that are located in Denmark and related to a PE.

The Danish hydrocarbon tax rules, however, contain a broader definition of when a Danish tax limited liability is created for a foreign company or person compared with the ordinary PE test.

Foreign persons and companies that engage in hydrocarbon feasibility studies, exploration activities, production of hydrocarbons and related business, including construction of pipelines, supply services and transportation of hydrocarbons by ship or pipeline, are subject to taxation in Denmark on the income from the time the activity commences in Denmark. If Denmark has entered into a double tax treaty with the country where the foreign company is a tax resident, the treaty may modify the Danish tax liability.

The Danish taxation regime that applies to hydrocarbon E&P companies consists of a combination of CIT and hydrocarbon tax. The hydrocarbon tax rate depends on whether the license was granted before or after 1 January 2004.

The Danish hydrocarbon tax system is a two-string system combining CIT at the standard rate of 25% (Chapter 2 income) and a special hydrocarbon tax at a rate of 70% (Chapter 3 income) or 52% (Chapter 3A income).

The income covered by Chapters 2, 3 and 3A includes first-time sales of hydrocarbons, gains and losses from disposal of licenses, exploration rights, gains and losses from the disposal of assets used in E&P activities and financial income directly related to the hydrocarbon activities.

Income related to hydrocarbon feasibility studies, providing services to E&P companies, construction of pipelines, supply services and transportation of hydrocarbons by ship or pipeline, is not covered by Chapters 2, 3 or 3A, but is subject to ordinary CIT (the tax rate is 25%).

The income taxed under Chapters 2, 3 and 3A is calculated according to the ordinary tax rules that apply to Danish companies and branches, with the adjustments provided in the Danish Hydrocarbon Tax Act. In general, due to the hydrocarbon tax uplift (see Section C "Capital uplift"), hydrocarbon tax is levied exclusively on extraordinarily profitable oilfield production. Chapter 2 tax is allowed as a deduction against the tax basis for hydrocarbon tax (Chapters 3 and 3A).

Separate tax returns must be filed each year for each income stream (Chapters 2, 3 and 3A tax returns), and all companies involved in oil and gas exploration in Denmark are required to file a Danish tax return from the year when they commence their exploration activities. The filing deadline is 1 May the following year. The financial period must follow the calendar year.

Besides hydrocarbon income, the company may have ordinary corporate income (income not covered by the hydrocarbon tax rules). Such income is taxed at a rate of 25%. The filing deadline for the tax return is 30 June the following year. A company is required to file two or more returns if they have different streams of income.

Licenses granted after 1 January 2004 are covered by a specific chapter in the Danish hydrocarbon tax system (Chapter 3A). Chapter 3A taxable income is taxed at 52%. Special, less favorable hydrocarbon tax relief rules apply to income covered by this chapter compared with Chapter 3 income. The income and expenses are ring-fenced (but there is no field ring-fence if there is more than one field or exploration site).

Companies may have both old and new licenses (some covered by Chapter 3 and some covered by Chapter 3A). For licenses covered by Chapter 3, the overall combined tax rate for Chapters 2 and 3 is 77.5%. The overall combined tax rate for Chapters 2 and 3A is 64%. The combined rates are applicable irrespective of the proportion of income from the respective chapters.

A pipeline duty of approximately 5% of the value of the hydrocarbons produced is payable. However, the duty is deductible against Chapters 2 and 3 income, but not against Chapter 3A income.

A royalty is payable on very few licenses.

Ring-fencing and losses

As a general principle, expenses and tax losses on transactions not related to Danish oil and gas E&P may not be offset against oil- and gas-related taxable income, neither for company tax purposes (Chapter 2) nor for hydrocarbon tax purposes (Chapters 3 and 3A). For example, financing expenses are deductible against the oil- and gas-related income only to the extent that the loan proceeds have been used in an oil and gas business. When a field is commercialized and put into production, the field is treated as a separate taxable source of income (field ring-fence) for Chapter 3 hydrocarbon tax purposes (but not for company tax purposes in Chapter 2 or for Chapter 3A purposes). This means that Chapter 3 losses on a loss-making field cannot be offset against profits on a profitable field. Exclusively, the income from profitable fields is included in the computation of taxable income according to Chapter 3.

Expenses (losses) incurred before a field is commercialized are deductible (Chapter 3) outside the field ring-fence. This means that, to the extent the field net income is positive (after deduction of expenses and uplift), these costs can be offset against the net positive field income. For Chapters 2 and 3A purposes, these costs are directly deductible in the Chapters 2 and 3A income calculation (because no field ring-fence exists).

However, exceptions apply to the Chapter 3 field ring-fence rule. These include the following:

- When a loss-making field is closed down, any tax losses carried forward from that field may be offset against a profitable field
- Capitalized exploration costs (including hydrocarbon tax relief) and tax losses carried forward from the exploration phase can also be offset against profits from any field

It is not possible to utilize tax losses realized under one chapter against income covered by another chapter (e.g., tax losses covered by Chapter 3 cannot be utilized against Chapter 3A income or vice versa, and Chapter 2 losses cannot be utilized against Chapters 3 or 3A income or vice versa).

Chapter 2 losses may, however, be offset against ordinary corporate income (income not covered by the hydrocarbon tax law), but this does not apply the other way around.

Dismantlement costs

Expenses related to closing down a field are tax deductible under Chapters 2, 3 and 3A. Companies and persons that are taxed according to Chapter 3A receive a tax refund equal to the tax value of the tax losses remaining at the time of closing a Danish hydrocarbon business. The refund is limited to the amount of Chapter 3A taxes paid plus Chapter 3 taxes paid, before the 2004 income year.

The expenses are deductible when they have been incurred. Provisions for dismantlement costs are not deductible.

Mandatory joint taxation

Danish companies, branches of foreign companies and real property in Denmark that belong to the same corporate group are subject to mandatory joint taxation. The mandatory joint taxation also applies if a group has two entities in Denmark involved with hydrocarbon activities, e.g., the Chapter 3 incomes in these two entities must be taxed jointly (but only income and losses covered by the same chapter are included).

Functional currency

Provided that certain requirements are met, taxpayers may calculate their taxable income by reference to a functional currency (i.e., a particular foreign currency other than the Danish kroner). The election must be made before the beginning of the income year.

Transfer pricing

Transactions between affiliated entities must be determined on an arm's-length basis. In addition, Danish companies and Danish PEs must report summary information about transactions with affiliated companies when filing their tax returns.

Danish tax law requires entities to prepare and maintain written transfer pricing documentation for transactions that are not considered insignificant. The documentation does not need to be filed with the tax authorities but, on request, it must be filed within 60 days. For income years beginning on or after 2 April 2006, enterprises can be fined if they have not prepared any transfer pricing documentation or if the documentation prepared is considered to be insufficient.

The Government has proposed a new bill defining the fine to be a fixed penalty of DKK250,000 plus 10% of the increased income; however, the bill has not yet been finalized.

The documentation requirements for small and medium-sized enterprises apply exclusively to transactions with affiliated entities in non-treaty countries that are not members of the European Union (EU) or the European Economic Area (EEA). To qualify as a small or medium-sized enterprise, companies must satisfy the following conditions:

- They must have less than 250 employees.
- They must have an annual balance sheet total of less than DKK125 million or annual revenues of less than DKK250 million.

The above amounts are calculated on a consolidated basis (i.e., all group companies must be taken into account).

C. Capital allowances

Capital uplift

To enable companies engaged in oil and gas E&P activities to earn an attractive rate of return after taxes, the hydrocarbon tax relief (uplift) was introduced to ensure that the 70% Chapter 3 and 52% Chapter 3A hydrocarbon taxes are levied exclusively when production from a field is extraordinarily profitable. No uplift is available under Chapter 2. The Chapter 3 hydrocarbon tax relief is an uplift of 250% on qualifying expenditures, which includes capitalized exploration costs (incurred before any fields owned by the company were classified as commercial) and investments made in drilling rigs, ships, pipelines and other production plant and equipment. The relief is available for the tax basis for hydrocarbon tax only. The uplift is allowed as a 25% deduction over a 10-year period and is granted in addition to the normal tax depreciation of plant and machinery and amortization of capitalized exploration costs over a 5-year period. The uplift is not available for lease payments, interest and production and administration expenses. The uplift on exploration expenses

is made outside the field ring-fence and it may be deducted from positive hydrocarbon income from other fields, while uplift on investments in drilling rigs, ships, pipelines and other production plant and equipment is made inside the ring-fence for the field in question.

The Chapter 3A uplift is 30%. The uplift is allowed as a 5% deduction over a six-year period.

Depreciation

An acquired oil license right may be amortized at an equal rate per year over the term of the license.

The main rule is that fixed assets (machinery, production equipment, etc.) may be depreciated according to the reducing-balance method by up to 25% a year. However, a number of large assets with a long economic life are depreciated on a separate balance by up to 15% annually, according to the reducing-balance method. This group of assets includes, for example, fixed plants such as drilling rigs.

The rate of 15% is introduced gradually during the period until 2016 as follows:

Income year	Depreciation of fixed plants, aircraft, ships, etc., according to the reducing-balance method
2011	21%
2012–13	19%
2014–15	17%
2016	15%

Exploration costs

All costs related to oil and gas exploration in Denmark are allowed as a deduction (inside the ring-fence) for the purposes of Chapters 2, 3 and 3A when they are incurred. For Chapter 3, the deduction is available within the hydrocarbon ring-fence, but not outside the field ring-fence.

As an alternative to expensing the costs when they are incurred, exploration costs may be capitalized and then deferred for amortization over five years when the oil production is commenced or for write-off if the exploration is stopped altogether. No time limits apply to capitalized exploration costs.

A company may choose to expense costs when they are incurred for the purposes of Chapter 2 while, at the same time, capitalizing them for the purposes of hydrocarbon tax (Chapters 3 and 3A). Capitalization of exploration costs is particularly advantageous in relation to the 70%/52% hydrocarbon tax and, unlike non-capitalized costs, capitalized exploration costs qualify for an uplift of 250%/30% by way of the hydrocarbon tax relief (see comments above). For Chapter 3, the uplift is available within the hydrocarbon ring-fence, but not outside the field ring-fence.

No capitalization of exploration expenses can be made by a company from the time the company has classified one field as "commercial." To the extent the company has some costs that do not relate to the oil and gas business in Denmark, these costs are only deductible outside the ring-fence (only against ordinary business income).

D. Incentives

Tax losses

Tax losses (Chapters 2, 3 and 3A tax losses) may be carried forward indefinitely. Hydrocarbon tax losses realized before the 2002 income year may be carried forward for 15 years. If a change of control occurs, certain loss carryforward restrictions may apply for ordinary tax losses. It is likely that the change of ownership rules does not apply to Chapters 2, 3 and 3A tax losses. However, this issue has not specifically been dealt with in the law or in practice.

E. Withholding taxes

Dividends paid

In general, dividends paid are subject to withholding taxes (WHT) at a rate of 27%. However, no WHT is imposed on dividends paid to companies if the Danish shares qualify as subsidiary shares, provided that the WHT has to be reduced or eliminated due to the EU Parent-Subsidiary Directive or a double tax treaty. For a company owning Danish shares, which are not subsidiary shares but group shares, it is a requirement that the WHT should be reduced or eliminated due to the EU Parent-Subsidiary Directive or a double tax treaty if the shares were subsidiary shares. Furthermore, it is, in both cases, a condition that the recipient of the dividends is the beneficial owner of them and thus is entitled to benefits under the EU Parent-Subsidiary Directive or a double tax treaty.

Dividends received

Dividends from group shares or subsidiary shares are tax exempt if the dividend has to be reduced or eliminated according to the EU Parent-Subsidiary Directive or a double tax treaty. Dividends for which the dividend-paying company has made a tax deduction in its taxable income are not tax exempt for the Danish dividend-receiving company, unless taxation in the source country is reduced or eliminated according to the EU Parent-Subsidiary Directive.

Dividends received by a Danish PE may also be tax exempt if the PE is owned by a foreign company that is tax resident within the EU, EEA or in a country that has concluded a double tax treaty with Denmark.

Dividends received on a company's own shares are tax exempt.

Dividends that are not covered by the tax exemption (see above), such as dividends from portfolio shares, must be included in the taxable income of the dividend-receiving company. Such dividends are thus taxed at a rate of 25%. A tax credit may be available for the dividend-receiving company for foreign WHT paid by the dividend-distributing company.

Classification of shares

Subsidiary shares can generally be defined as shares in a company in which the shareholder directly owns at least 10% of the share capital (other conditions apply).

Group shares are shares in a company that is subject to mandatory joint taxation under Danish rules with the shareholder, or is eligible to be comprised by international joint taxation under Danish rules with the shareholder.[74]

Portfolio shares are shares that are not subsidiary shares or group shares.

Interest

In general, interest paid to foreign group companies is subject to WHT at a rate of 25%. The WHT is eliminated if any of the following requirements are satisfied:

- The interest is not subject to tax or taxed at a reduced rate under the provisions of a double tax treaty. For example, if WHT on interest is reduced to 10% under a double tax treaty, the WHT is eliminated completely.
- The interest is not subject to tax in accordance with the EU Interest and Royalties Directive. Under the Directive, interest is not subject to tax if both of the following conditions are satisfied:
  - The debtor company and the creditor company fall within the definition of a company under Article 3 in the EU Interest and Royalties Directive (2003/49/EC)
  - The companies have been associated as stated in the Directive for a period of at least 12 months (Danish domestic law has reduced the requirement from a 24-month period to a 12-month period)

74 *See Section C on "Group of companies" in the Ernst & Young Worldwide Corporate Tax Guide.*

- The interest accrues to a foreign company's PE in Denmark.
- The interest accrues to a foreign company in which the Danish company, indirectly or directly, is able to exercise control (for example, by holding more than 50% of the voting rights).
- The interest is paid to a recipient that is controlled by a foreign parent company resident in a country that has entered into a double tax treaty with Denmark and has controlled foreign corporation (CFC) rules and if under these foreign CFC rules, the recipient may be subject to CFC taxation.
- The recipient company can prove that the foreign taxation of the interest income amounts to at least three-quarters of the Danish CIT and that it will not in turn pay the interest to another foreign company that is subject to CIT amounting to less than three-quarters of the Danish CIT.

Furthermore, it is a condition that the recipient of the interest is a beneficial owner of the interest and thus is entitled to benefits under the EU Interest and Royalties Directive or a double tax treaty. The above measures and exceptions also apply to non-interest-bearing loans that must be repaid with a premium by the Danish debtor company.

Royalties

Royalty payments are subject to a 25% WHT. The WHT rate may be reduced under a double tax treaty or taxed in accordance with the EU Interest and Royalties Directive. Royalty payments are subject to WHT if the payments are remunerated for the use of, or the right to use, any patent, trademark, brand, brand name, design, model, pattern, drawing, secret formula or manufacturing or production method, or for information on industrial, commercial or scientific experiences (know-how). The rules apply both to lump-sum payments and to current payments. Under Danish tax law, the qualification of royalty income is based on the substance of the agreement between the parties rather than on how the payments are "named" (form).

Technical services and nonresident contractors, as a general rule, are not subject to WHT, unless the payment falls within the definition of royalty as defined above. These services may, however, be subject to taxation under Chapter 2 (corporate taxation of hydrocarbon income).

Branch remittance tax

Branch remittance tax is not applicable in Denmark.

Income tax withholding and reporting obligations

A foreign company that is engaged in oil and gas exploration or production activities in Denmark is required to withhold a 30% flat-rate income tax from salaries paid to nonresident employees working in Denmark. If Denmark has entered into a double tax treaty with the country where the foreign company is a tax resident, the treaty may modify the Danish tax liability.

Withholding and payment of taxes withheld are required on a monthly basis, and reports must be filed with the Danish tax administration on an annual basis.

F. Financing considerations

Interest expenses

Interest expenses and capital losses (e.g., due to foreign exchange) on debts incurred for financing oil and gas E&P in Denmark are allowed as a deduction against both tax bases (Chapters 2, 3 and 3A). The interest or loss must be related to the Danish oil and gas activity.

However, a branch of a foreign company cannot deduct interest on loans from its principal (the head office); there must be an "outside" lender (e.g., a sister company).

Capital losses are generally deductible according to the realization principle, but it is possible to opt for the mark-to-market principle on currency fluctuations.

Debt to equity and other interest limitation rules

Under the thin capitalization rules, interest paid and capital losses realized by a Danish company, or by a branch of a foreign group company, are partly deductible to the extent that the Danish company's debt-to-equity ratio exceeds 4:1 at the end of the debtor's income year and the amount of controlled debt exceeds DKK10 million.

Denied deductibility applies exclusively to interest expenses related to the part of the controlled debt that needs to be converted to equity in order to satisfy the debt-to-equity rate of 4:1 (a minimum of 20% equity). The thin capitalization rules also apply to third-party debt if the third party has received guarantees or similar assistance from a foreign group company.

The Danish thin capitalization rules have been supplemented by an "interest ceiling" rule and an "earnings before income tax" (EBIT) rule. These rules cover both controlled and non-controlled debt. Only companies with net financial expenses exceeding DKK21.3 million are affected by these supplementary rules. For jointly taxed companies, the DKK21.3 million threshold applies to all group companies together.

As a result of the interest ceiling, deduction for net financial expenses is restricted to 3.5% (2012) of the taxable value of certain qualified assets. Any net financial expenses that exceed this amount are lost, except for capital and exchange losses, which may be carried forward for three years.

Under the EBIT rule, a company may only reduce its taxable income (due to financial expenses) by 80% of the EBIT. Net financial expenses in excess of this amount are non-deductible, but, in contrast to the net financial expenses restricted under the interest ceiling rule, these amounts can be carried forward to be used in future years (if they are not restricted once again by the EBIT rule in that year). The calculation must be made after a possible restriction due to the interest ceiling.

If a company establishes that it could obtain third-party financing on similar terms, it may be permitted to deduct the interest that would normally be disallowed under the ordinary thin capitalization rules described above. No arm's-length principle can be applied to help the company avoid the interest ceiling or the EBIT rule.

Danish tax law does not re-characterize or impose WHT on the disallowed interest.

G. Transactions

Asset disposals

The disposal of assets is a taxable event; gains and losses are generally taxable or deductible. As a rule, sales proceeds from fixed assets are deducted from the depreciation pool.

As an alternative, it is also possible to take the loss deduction directly in the taxable income computation. However, this requires that the written-down tax value of the asset is deducted from the depreciation pool and that no depreciation on the asset is available in the year of sale. A further requirement is that the depreciation pool does not become a negative amount as a result of deducting the written-down tax value of the asset from the pool.

Farm-in and farm-out

It is common in the Danish hydrocarbon production industry for entities to enter into farm-in arrangements. However, the tax consequences of the farm-in and farm-out must be considered on a case-by-case basis, depending on how the agreement is structured.

The farmee (the party entering into a farm-in arrangement) is subject to taxation according to the hydrocarbon taxation rules. A farmee is deemed to hold a depreciating asset, the interest in the hydrocarbon license, from the time the interest is acquired (this can be up-front or deferred depending on the terms of the particular arrangement). The farmee can deduct the cost of the depreciating asset. The "cost" is the amount that the farmee is considered to have paid for the interest, and it can include the value of non-cash benefits. Future commitments incurred by the farmee in respect of interest are generally deductible for the farmee (either outright or over the asset's effective life) if the farmee holds an interest in the permit.

The farmor, i.e., the person farming out, is deemed to have disposed of an interest in the license, production equipment, etc. The tax treatment of the farmor is described above under "Asset disposals."

Selling shares in a company

From 2010, taxation of a company's dividends received and realized capital gains on the sale of shares will depend solely on whether the shares qualify as subsidiary shares, group company shares, own shares or portfolio shares. The ownership period will, from the 2010 income year onward, be irrelevant.

H. Indirect taxes

VAT

Since Denmark is part of the EU, the EU common system of VAT has been implemented. VAT is a general value added tax on consumption, which is based on transactions. VAT applies to all supplies of goods and services at every stage of the supply chain, up to and including the retail stage. A deduction is granted for VAT on purchases for use in a business subject to VAT, making the VAT neutral to the business and industrial structure. The place of taxation depends on the place of supply. However, there are specific rules concerning the place of supply where a distinction between supply of goods and services must be made. Gas, water, electricity and heat are considered supply of goods.

The VAT system was introduced in Denmark in July 1967. Danish VAT is now applied at a standard rate of 25%; however, some transactions are zero-rated, and other transactions and entities are exempt from VAT.

Danish VAT applies exclusively within the Danish territory, which is made up of landmasses, internal territorial waters, up to 12 nautical miles into the outer territorial waters from the shore or base line and the airspace above. The territory does not include the Faroe Islands or Greenland.

VAT applies to the supply of goods or services made in Denmark by a taxable person; the acquisition of goods from another EU Member State (intra-Community acquisition) by a taxable person; reverse-charge services received by a taxable person and the importation of goods from outside the EU, regardless of the status of the importer. A taxable person is anyone who independently carries out an economic activity. Furthermore it is a prerequisite for applying VAT that the supply of goods or services is made for a consideration.

Examples of common transactions and arrangements (this list is not exhaustive):

Subject to VAT	Zero-rated	Exemption
Selling goods and services	Export	Letting of real estate
Leasing goods	Intra-Community trade	Financial transactions
Importing goods		Conveyance of passengers

If goods are exported or sold to a VAT-registered entity in another EU Member State (intra-Community supply), the supplies may qualify as free of VAT if they are supported by evidence that the goods have left Denmark.

Non-established businesses must also register for VAT in Denmark if any of the following apply: goods are located in Denmark at the time of supply; the business acquires goods into Denmark from other EU-countries; import goods from outside of the EU; distance sales are in excess of the annual threshold or services that are taxable in Denmark, and to which the reverse-charge mechanism is not applicable.

The VAT registration threshold is DKK50,000 (approximately €6,700); however, entities trading below this threshold can choose to register voluntarily for VAT. There is no registration threshold for foreign businesses.

A registered entity must state the output VAT it has charged on its sales in its periodic VAT returns (monthly, quarterly or biannual, depending on the taxable person's total annual turnover). From the output VAT, the registered entity may deduct input VAT on purchases and costs related to its activities subject to VAT. Non-established businesses may apply for reimbursement on costs incurred in Denmark.

Import duties

Denmark is part of the EU. The EU is a customs union with a common market; goods that circulate within the EU are deemed to be "in free circulation" and the transfer of goods between Member States is exempt from customs duty. However, the importation of goods from outside the EU may be subject to customs duty (depending on the nature of the goods). The EU, therefore, is considered one country from a customs point of view. The duty rate on imported goods is regulated by the customs tariff, which is based on information from the World Customs Organization (WCO). Furthermore, the EU has entered into several agreements with developing countries. According to these agreements, under certain circumstances, goods from the developing countries may be subject to a reduced or zero customs duty rate.

Goods are reported to the Danish tax authorities on importation into Denmark and, thus, to the EU Customs Union. In general, all duties (including customs duty, excise duties and VAT) must be paid to the authorities before the goods are in free circulation in Denmark and the EU. However, most companies are granted a credit.

Export duties

The export of goods or services is not subject to any duties.

Excise duties

Excise duties are levied on a number of goods manufactured in Denmark or imported into Denmark. Excisable goods include mineral oil products, natural gas, coal and electricity. All these energy products are covered by an energy tax, a carbon dioxide tax and a sulfur tax. The rates for the most common products in 2012 are as follows (exchange rate from DKK to €744):

Energy product	Energy tax	Carbon dioxide tax	Sulfur tax(es)	Nitrogen oxide tax[75]
Gasoline	€0.54/liter	€0.05/liter	€2.93/kg content of sulfur	€0.001/liter
Diesel oil	€0.39/liter	€0.058/liter	€2.93/kg content of sulfur	€0.001/liter
Heating oil	€0.29/liter	€0.058/liter	€2.93/kg content of sulfur	€0.001/liter
Heavy fuel oil	€0.32/kg	€0.069/kg	€2.93/kg content of sulfur	€0.004/kg
Natural gas	€0.32/m^3	€0.049/m^3	0	€0.001/ m3

Energy product	Energy tax	Carbon dioxide tax	Sulfur tax(es)	Nitrogen oxide tax[75]
Coal	€8.0/GJ	€2.1/GJ	€2.93/kg content of sulfur	€0.067/ GJ
Electricity	€0.10/kWh	€0.009/kWh	0	0

For certain purposes, companies that are registered for VAT can get a refund on energy taxes and carbon dioxide taxes.

The energy tax on electricity for oil and gas drilling purposes in Danish territory is refundable. The carbon dioxide tax on electricity is also refundable if it is used for refining.

If certain conditions are met, energy tax, carbon dioxide tax and sulfur tax on heating oil, heavy fuel oil, natural gas and coal for oil and gas drilling and refining purposes are refundable.

Taxes on gasoline and diesel oil (for engines) are not refundable.

Offshore oil and gas drilling takes place outside the Danish territory and, therefore, is outside the scope of energy taxation. However offshore oil and gas drilling activities are liable for the nitrogen oxide tax.

Stamp duty and registration fee

The Stamp Duty Act was amended in 1999. As a result, only "insurance against loss or damage" is subject to stamp duty. However, at the same time, a registration fee was implemented. The Registration Fee Act is a revamped version of the older Stamp Duty Act. This fee should not be confused with the registration fee on cars (car tax).

The main items subject to the registration fee are the registrations of ownership of immovable property, boats and aircrafts (generally, when ownership changes). The registration fee is fixed. However, the basis of the fee calculation is subject to specific regulations. As a general rule, the fee on immovable property is DKK1,400 plus 0.6% of the amount payable for the change in ownership. It should be noted that it is possible to avoid the 0.6% registration fee on immovable property in connection with an ownership change as a result of certain transactions (such as mergers, demergers and the conveyance of assets).

I. Other

Business presence

Forms of business presence in Denmark typically include companies, foreign branches and joint ventures (incorporated and unincorporated). In addition to commercial considerations, it is important to consider the tax consequences of each form when setting up a business in Denmark. Unincorporated joint ventures are commonly used by companies in the exploration and development of oil and gas projects.

Tax treaty protection

In general, oil and gas production constitutes a permanent establishment under most tax treaties; therefore, treaty protection cannot generally be expected for a foreign company. For individual income tax liability, tax treaty provisions vary from country to country, and protection against Danish taxation may be available in specific cases.

Other reporting obligations

Entities involved in E&P, that engage foreign (non-Danish) contractors to provide services, have a reporting obligation to the Danish tax authorities. The Danish tax authorities use this information to determine whether the contractor has a Danish limited tax liability arising from the services provided.

75 *From 1 July 2012 the tax rate will be multiplied by five.*

Ecuador

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A. At a glance

Corporate income tax (CIT) rate	23%[76]
Royalties	12.5% to 18.5%[77]
Bonuses	None
Production sharing contract (PSC)	81.5% to 87.5%[78]
Exploration and exploitation service fee	1% of the services fee amount after determination of profit sharing and income tax
Sovereignty margin	25% of gross income of the field production
Exploration and exploitation service contract	Only contracting structure currently applied

Capital allowances

Immediate write-off for exploration costs is not a common practice. However, these costs can be subject to write-off when the operation is finished. See amortization of exploration costs in the following sections.

Investment incentives

Loss carryforward: net operating losses may be carried forward and offset against profits in the following five years, provided that the amount offset does not exceed 25% of the year's profits. Loss carrybacks are not permitted.

Depreciation and amortization expenses can be deducted on a double base (twice the expense), to the extent they are related to acquisition of machinery, equipment and technologies for the implementation of cleaner production mechanisms, energy generation projects from renewable sources or reduction of environmental impact productive activities, and reducing emissions of greenhouse gases.

Reinvestment of profits result in a 10% reduction on the corporate income tax rate.

76 *A 44.4% income tax rate applies for service contracts.*

77 *Royalties paid to the Government for petroleum exploitation might go from 12.5% to 18.5% depending on the barrels produced, and calculated upon the gross monthly income.*
For gas exploitation, there is a minimum rate of 16% over the monthly income.

78 *Once production begins, the contractor has the right to share in the production of the area of the contract, which is calculated based on the percentages offered in the proposal and agreed in the contract.*

B. Fiscal regime

Corporate income tax

The Ecuadorian tax system is based on the "worldwide principle," whereby all income, both foreign and Ecuadorian-sourced, is subject to income tax.

Oil and gas companies are subject to the general rules that apply to all industries. Oil and gas entities that operate through a locally incorporated company, a branch or a consortium are obligated to file and pay annual income tax for the net profit of the year.

Income tax has to be paid on an annual basis, in April, for the preceding calendar year.

Corporate tax rate

Due to recent legislation changes, the CIT tariff has been modified in accordance with the following chart:

Year	Tariff
2011	24%
2012	23%
2013	22%

However, companies that reinvest their profits are entitled to a 10% reduction in the income tax rate, provided that they use those profits for the acquisition of new machinery or equipment to be used in production activities or for the purchase of goods related to research and technology applied to production. That is, the reinvested profits are taxed at a 15% rate, provided that the reinvested amount has been used for the acquisition of machinery for purposes of the business.

Further, the rate for companies that have entered into exploration and exploitation contracts with the Government of Ecuador is 44%.

General deductibility rules

Resident taxpayers are taxed on their net income: taxable income less deductible costs and expenses.

In this manner, all the expenses that are directly related to the main course of the business, and necessary to obtain, maintain or improve taxable income, might be considered as deductible expenses on production of duly supported valid invoices and receipts.

Withholding taxes

According to the local legislation, withholding taxes (WHT) is triggered upon payment or crediting on account, whether directly or through any other intermediary, to the extent it constitutes taxable income for the receiver. In this sense, remittances of Ecuadorian sourced income to nonresidents are subject to WHT. The tax is withheld on the gross amounts remitted with no deductions allowed. The taxpayer of this WHT is the nonresident beneficiary of the Ecuadorian-sourced income. However, the local payer is considered a withholding agent and, as such, jointly and severally liable.

Generally, almost all types of cross-border payments are subject to income tax withholding, at a rate of 24% for the year 2011 (23% for the year 2012 and 22% for the year 2013).

It is noteworthy that all incomes are deemed taxable except those expressly listed as exempt. The list of exemptions does not include items such as royalties, rendering of services, expenses reimbursement, nor payments made to nonresidents or importation of goods. However, this percentage can be reduced under the application of double taxation treaty benefits.

Income generated from the non-monetary investments, performed by companies that have contracts with the Ecuadorian Government, for the rendering of oil and gas exploration and exploitation, are considered as exempted income; provided that such investments have been charged to related companies as a cost, in order to render these services. In addition, such investments shall be registered before the Ecuadorian Central Bank as non-monetary investments to be reimbursed.

A 2% WHT applies on payments made to local beneficiaries for the provision of services, and a 1% WHT is applied to the acquisition of goods.

Dividends

Dividends paid after determination and payment of annual income tax also exempt, provided that the beneficiary is a company non-domiciled in a tax haven or lower tax jurisdiction. Dividend recipients domiciled in a tax haven or lower tax jurisdiction shall be subject to an additional income tax withholding as follows:

- Year 2011: 11%
- Year 2012: 12%
- Year 2013: 13%

Dividends received by Ecuadorian corporations from foreign corporations are considered to be tax-exempt income, provided that those foreign-sourced incomes have already been subject to taxation in the origin country.

Dividends paid to individuals (tax residents) are subject to an income tax withholding at a rate that varies from 1% to 10% depending on the amount distributed.

Interests

Interest payments and financial fees are generally subject to 24% income tax withholding (5% locally); however, if the loan has been granted by a foreign financial institution or by an international organization (e.g., the World Bank), no income tax withholding should apply on such interest payments.

In addition, for interest expenses on foreign loans to be deductible, the following conditions should be met:

- The economic substance over form condition should be met.
- The loan must be registered with the Ecuadorian Central Bank.
- The interest rate should not exceed the maximum rate set up by the Ecuadorian Central Bank at the date of registration of the loan.
- The income tax withholding on the payment should be made (excepting for the above-mentioned case, in which, if the interest rate exceeds the maximum rate set up by the Ecuadorian Central Bank, the 24% income tax withholding should be made over the excess).
- When the transaction is performed between related parties, the 3:1 debt-to-equity ratio should be applied.

Excess on sale price

With respect to the units sold, the Government is entitled to at least 50% (currently 70%) of the difference between the sale price and the base price established in the contract. If the base price has not been established in the contract, it is determined by the president of Ecuador through a decree. In no case will the decreed price be less than the international price in force at the contract subscription date. For newly signed PSCs, the applicable rate on the excess sales price shall be 99%.

Foreign tax relief

Ecuador does not grant relief from foreign taxes for companies domiciled in Ecuador. However, apart from countries considered to be tax havens, income sourced from other countries received by Ecuadorian corporations is considered to be tax exempt, provided that the income was subject to tax in that foreign country. This exemption does not apply when the foreign income comes from a tax haven jurisdiction.

Income tax advance payments

Companies that have signed an oil and gas exploration and exploitation services contract with the Ecuadorian Government shall make income tax advance payments. Income tax advance payment consists of an amount equal to 50% of the income tax amount triggered and paid in the previous fiscal year, less the amounts paid by the company via income tax withholdings. The income tax advance payment is liquidated in two installments: one in July and the other in September of the corresponding fiscal year.

If the triggered income tax for the current fiscal year, payable in April of the following year, is lower than the income tax advance payment, this latter one shall constitute a minimum tax, and no refund is available.

Other

There is no Branch remittance tax in Ecuador.

In Ecuador, exploitation companies might be granted with one or more fields, which could be negotiated in one or more exploitation service contracts. Ecuadorian laws state that each contract shall be considered as a single and separate business unit; and therefore, consolidation of financial statements of contract units is not permitted.

C. Contracts

In Ecuador, a variety of contracts can be signed with the Government in order to invest and produce in the oil and gas sector: joint contracts, shared management contracts, specific services provision or specific goods acquisition contracts and participation contracts. However, due to recent changes made by the current Government, participation contracts are no longer being signed; instead, the oil and gas exploration and exploitation service contract is now being strictly enforced.

In order to sign an oil and gas exploration and exploitation service contract, companies must be domiciled in Ecuador through a local branch or a subsidiary company, and must participate in a public open bidding.

In addition, companies that have signed an oil exploration and exploitation service contract may sign an additional contract in order to explore and exploit natural gas within the same field.

Exploration phase

The oil and gas exploration phase can last four years and can be extended for two years with prior approval by the hydrocarbons secretary.

Production sharing contracts

The participation of the contractor is based on production volume. It is calculated using the terms and parameters offered and agreed upon in the contract, in accordance with the following formula:

$$PC = X * Q$$

Where:

PC = Participation of the contractor

X = Average factor, in decimals, corresponding to the participation of the contractor

Q = Audited annual production in the area of the contract

Gross proceeds

In a PSC, income corresponds to the participation of the contractor based on the sales price; however, the sales price cannot be less than the reference price set by the Government petroleum entity (EP PETROECUADOR).

According to the regulations applicable to hydrocarbons, the reference price is the average price for the previous month's external sales of hydrocarbons made by EP PETROECUADOR of equivalent quality, based on the contractual bases. If there are no external sales by EP PETROECUADOR, the reference price is calculated based on the crude proportion negotiated by the parties, obtained from specialized and recognized publications.

For natural gas, the reference price is the same as for renewable energy. In PSCs, the reference price is calculated as follows:

- For free natural gas: the reference price for each unit is calculated by multiplying the calorific power (in BTU) by the BTU price of fuel oil no. 6.
- For condensed gas: the reference price of a metric ton is the same for the average volume price of liquefied petroleum gas sold by EP PETROECUADOR under cost, insurance and freight (CIF) conditions.

Therefore, the reference prices may be verified with the production companies to analyze new conditions regarding this issue.

Pre-production costs

Generally, pre-production costs include exploration costs, development costs and financial costs. If reserves are found, these costs are amortized equally over a five-year period starting from the date production begins. If no reserves are found, these costs may be deducted in the year that this is recognized.

Payments to related parties that exceed 5% of the taxable basis are not deductible for income tax purposes. Amortization of pre-production costs attributable to administrative expenses may not exceed 15% of the total amount of such costs.

Funding from the headquarters shall be registered as a long-term liability. No income statements shall be presented.

Exploration costs

For PCS, exploration costs may be assigned within the duration of the exploration period, which might range from four to six years, starting from the date that the contract is registered in the National Agency for Control and Regulation of Hydrocarbons (Agencia Nacional para Control y Regulación de Hidrocarburos).

Exploration costs generally include depreciation of fixed assets (support equipment). Excluded from exploration costs are those that are incurred by the contractor before the date of registration of the contract in the Hydrocarbons Directory, and interest from financing.

Development costs

These costs can be registered from the date on which the development plan is approved.

Production costs

These costs should be registered from the date on which the first barrel is available for commercialization or industrialization and should be amortized based on the units of production. During this period, funding from the headquarters is registered as a short-term liability. Income statements are presented.

Depreciation, depletion and amortization calculation

Depreciation, depletion and amortization (DD&A) of the exploration, development and production costs are calculated as follows:

- Pre-production costs are amortized on a straight-line method over a five-year period, starting from the production phase.
  - Production costs are amortized over the life of the contract using the units-of-production method based on proven crude oil reserves. See formula below:

$$\text{DD\&A:} \quad \frac{\text{Unamortized cost at beginning of period}}{\text{Proven reserves at beginning of period}} \times \text{production of the period}$$

If the proven reserves change during the fiscal year, the applicable formula is as follows:

$$\text{DD\&A:} \quad \frac{\text{Unamortized cost at beginning of period}}{\text{Proven reserves at beginning of period}} \times \text{production of the period}$$

- Transportation and storage costs are amortized on the straight-line method over a 10-year period beginning with operations.
- Support equipment is depreciated using the straight-line method, according to general percentages of annual depreciation as follows:

Buildings, aircraft and ships	5.00%
Facilities, machinery, equipment and furniture	10.00%
Vehicles and other transportation equipment	20.00%
Hardware and software	33.33%

Transport and storage costs

Amortization of transport and storage costs will be carried out in 10 years from the moment the transport system enters in operation, duly authorized by the National Agency for Control and Regulation of Hydrocarbons.

Oil production

To determine oil production, it is necessary to measure the crude oil kept in the warehouse tanks at the collecting centers, after separating water and ware materials. The resulting oil is measured in barrels.

Fiscal uncertainty

Oil and gas companies must adapt to the fiscal regime in force. However, fiscal uncertainty clauses are included in oil and gas transportation contracts.

Marginal field contracts

With low operational and economic priority, marginal field contracts are intended for low-quality crude. They represent less than 1% of the national production.

Under these contracts, all production belongs to the estate. Exploration costs under these contracts are capitalized annually. The tax basis for these costs (adjusted for amortization) is considered an asset of the contractor.

For the development of the contract, the contractor receives reimbursement for operation costs of the base curve of production, in dollars, and participation in the volume of the crude resulting from the increase over the base production. The base curve is estimated on future production from developed, proven reserves using mathematical simulation and studies of the wells; it is specifically detailed in the contract.

Service contracts for exploration and exploitation of hydrocarbons

In service contracts for exploration and exploitation of hydrocarbons, the contractor commits to EP PETROECUADOR to provide exploration and exploitation services in the areas previously determined. The contractor uses its own economic resources. Accordingly, the contractor has to invest the necessary capital and use the equipment, machinery and technology required for such contracts.

Transportation, commercialization and production costs (including reimbursements and payments made by EP PETROECUADOR in favor of the contractor) are deducted from income. Further, the contractor secures the right to a refund of its investments, costs and expenses, as well as the payment for services provided, when it finds hydrocarbons that may be commercialized.

Farm-in and farm-out

Farm-in and farm-out are permissible; however, before any agreement is entered into, it is mandatory that the contractor obtain the written authorization of EP PETROECUADOR and the Ministry of Mines and Petroleum. If the authorization is not duly obtained, the agreement is invalid, resulting in the termination of the contract with the Government. The Government is not only in charge of authorizing this type of agreement, but also in charge of qualifying the entity entitled to the rights, through the corresponding transfer. Transfer fees apply and vary depending on the type of the transfer.

D. Royalties

As a general rule, royalties to be paid to the Ecuadorian Government range from 12.5% to 18.5%. To determine the amount of royalties, the oil production has to be efficiently determined once the water and ware have been previously separated from the oil. A measurement will then be taken in the collection tank centers. The corresponding royalties will be paid on a monthly basis.

Royalties for the PSCs are generally calculated as follows:

Production (P)	Monthly maximum contractor sharing	Monthly minimum estate sharing
P < 30,000 daily barrels	87.5%	12.0%
30,000< = P < 60,000 daily barrels	86.0%	14.0%
P => 60,000	81.5%	18.5%

F. Financing considerations

Effective from 1 January 2008, thin capitalization rules are in force, establishing a ratio of 3:1 foreign debt to paid common stock capital.

G. Transactions

Capital gains

Capital gains derived from the sales of shares are exempt from tax if the sales qualify as "occasional" sales. Occasional sales are those that are not made in the ordinary course of the company's business. Losses on sales between related parties are not deductible.

Asset disposals

All assets are generally the property of the Government, except for those acquired under specific service contracts.

With respect to all contracts, assets from foreign investments can enter the country under a special custom regime known as temporary importation with re-exportation. Under this regime, there is no income tax effect or VAT effect (provided the goods are not "nationalized").

Currency exportation tax

All Ecuadorian taxpayers that remit currency abroad are subject to 5% tax on the amount of the transfer, regardless of whether the transaction is made through a financial institution.

All payments made abroad by Ecuadorian tax-resident companies shall pay currency exportation tax independently, if the financial resources are not located in Ecuador.

Additionally, exportation cash in amounts (incomes) also triggered currency exportation tax, regardless of whether the corresponding payments were made in Ecuador. In this case, the value of currency exportation tax payments generated abroad may be deducted.

Dividends distributed to foreign residents shall be exempt from currency exportation tax to the extent that the recipients of the dividends are not domiciled in a tax haven or lower minor jurisdictions. Currency exportation tax payments could be considered as income tax credit, for four fiscal years.

H. Indirect taxes

Import taxes

Import taxes are paid based on the custom return (generally based on the description of goods, including origin, cost and quantity) and on "auto-liquidation" (generally, the self-assessment of taxes) performed by the taxpayer. The taxable base for customs taxes is the CIF value.

The direct importation of machinery, tools and other materials for the exploitation and exploration of hydrocarbons, by companies that have entered into exploration and exploitation contracts with the Ecuadorian Government, is not subject to import taxes during the period of exploration or in the first 10 years of exploitation, provided that the imported machines are not made in Ecuador.

Importation of equipment, machinery, implements and other materials are exonerated from customs taxes within the exploration phase and within 10 years of the exploitation phase, provided that such products are not, and could not, be produced in Ecuador.

VAT

VAT is based on the value of imported goods, the acquisition of goods and the provision of services. The VAT rate is 12%; however, certain transfers of goods or services are specifically zero-rated. Imported services are taxed with 12% VAT.

Local taxpayers must file monthly VAT returns. VAT amounts paid in the local acquisitions of goods or services, importation of goods or services, and acquisition of intellectual property rights, could be offset with the VAT amounts levied on sales, to the extent sales are taxed with 12% VAT.

VAT paid on the purchase of goods or services, for the production of exported goods, may be recovered. In addition, companies may receive tax credit regarding all VAT payments for the purchase of goods or services, in order to render services levied with 12% VAT.

Export duties

The tax basis for customs duties is based on the freight on-board value. Export duties depend on this item.

I. Other considerations

Employee profit sharing

In general, all employers must distribute 15% of their annual profit to their employees; however, with respect to the hydrocarbon industry, the employees receive only 3% of the 15%, and the remaining 12% goes to the Government.

Other specific requirements

For all contracts:

- Compensation for public construction – the contractor is required to compensate public construction at the beginning of the production period in accordance with government plans, the size of the contracted area and the proximity of the findings. The amount of this compensation is determined by the Government.
- Water and materials contribution – this is an annual fixed contribution of at least US$60,000.
- Provinces contribution – it is necessary to make a monthly auto-liquidation; the amount is based on the transported barrels through the SOTE (state pipeline for export of oil), except for any that are not destined for sale.
- Fund for the development of Amazon provinces – the taxable base is the value of the EP PETROECUADOR bill for the services performed.
- Fund for the development of the ecosystem of the Amazon region – the taxable base is the commercialization value of the petroleum.
- Environmental warranties – the amount depends on the basis for contracting.

For specific services provision or specific goods acquisition contracts:

- Honor of offer warranty – a minimum of 2% of the amount of the offer. This warranty is recoverable once the contract is signed.
- Proper compliance warranty – 5% of the amount of the contract. This warranty is recoverable once the documentation of termination or delivery is registered.
- Proper performance of work – 5% of the amount of the contract. This warranty is recoverable once there is evidence of the quality of the well's materials and whether the development work is considered highly effective.
- Investment warranty – before the inscription of the contract, the contractor or its associate shall pay a guarantee in an equivalent quantity to 20% of the compromised investments detailed for the contractor during the exploration period. This guarantee may be paid in cash or government bonds. This warranty is recoverable once the exploitation period concludes and all exploration obligations have been accomplished.

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A. At a glance

Fiscal regime

Egypt's fiscal regime that applies to the petroleum industry consists of a combination of corporate income tax (CIT) and royalty-based taxation.

Bonuses	Signature and production bonuses are stipulated in the particular Petroleum Concession Agreement (PCA)
Production sharing agreement (PSA)	The PSA is the basic document signed with the Egyptian General Petroleum Corporation (EGPC)
Income tax rate:	
General rate	20%
For taxable income (portion exceeding 10,000,000 EGP)	25%
Oil exploration and production	40.55%
EGPC, Suez Canal Authority and Central Bank of Egypt	40%
Capital allowances	D[79]
Investment incentives	L, RD[80]

B. Fiscal regime

Egypt's fiscal regime for the petroleum industry consists of a combination of CIT and royalty-based taxation as follows.

Corporate tax

On 9 June 2005, the president of Egypt approved Income Tax Law no. 91, which was published on 10 June 2005. The new law introduced new tax measures, including tax consequences for related-party transactions and withholding tax on payments to nonresident companies.

The corporate tax applies to:

- Companies that are resident in Egypt, on profits generated inside or outside Egypt
- Companies that are not resident in Egypt, only on profits generated inside Egypt

79 *D: accelerated depreciation — based on the provisions of the concession agreement and pending approval of the EGPC, capitalized exploration expenses are amortized over the lifetime of the concession.*

80 *L: losses can be carried forward for five years; RD: R&D incentive.*

Egypt does not apply ring-fencing in the determination of corporate tax liability. Profits arising from one project may be offset against the losses from another project, provided it is held by the same tax entity; similarly, profits and losses from upstream activities may be offset against downstream activities undertaken by the same entity. Egypt does not apply tax consolidation rules.

Corporate tax is levied on taxable income. The general rate of corporate tax is 20%. However, taxable income from oil exploration and production is subject to a corporate tax rate of 40.55% on all profits.

The EGPC, the Suez Canal Authority and the Central Bank of Egypt are subject to a tax rate of 40%.

Taxable income equals assessable income less deductions. Assessable income includes ordinary income (determined under common law) and statutory income (amounts specifically included under the Income Tax Act). Deductions include expenses, to the extent they are incurred in producing assessable income or are necessary in carrying on a business for the purpose of producing assessable income. However, an expenditure of a capital nature is not deductible.

The EGPC is the final tax bearer (under the concession agreements; the corporate tax due is paid by the EGPC after grossing up the taxable base). Exploration entities calculate the CIT due on EGPC's assessable income, and they have the calculation reviewed and confirmed by the EGPC. The EGPC then pays the taxes directly to the tax authority. This is also the case for all active concession agreements. Accordingly, the tax return prepared by the exploration entity should be reviewed, approved and signed by the EGPC.

Grossing up means maximizing the assessable income as follows:

- Assessable base x 100/tax rate. The tax due is then calculated on the new grossed-up amount.
- An exploration entity is generally entitled to sell its share of the oil to whomever it chooses, subject to approval by the EGPC (in some circumstances, the EGPC may elect to purchase the oil itself). The sales income from its share of the oil and deductible expenses (which may be recoverable and non-recoverable expenses) is included as part of the entity's tax return and is subject to tax.
- Based on the provisions of the concession agreement, deductions for an expenditure of a capital nature may be available under the "uniform capital allowance regime." In the context of the oil and gas industry, this would generally be in the form of a capital allowance available in respect of depreciating assets (see discussion below). However, deductions may be available for other types of capital expenditures; for example, an expenditure incurred to establish an initial business structure is deductible over five years.
- Profits from oil and gas activities undertaken by an Egyptian resident company in a foreign country are generally not subject to tax in Egypt, provided they are undertaken through a foreign permanent establishment or legal entity, not a branch.

Capital gains tax

Gains resulting from a capital gains tax (CGT) event may be subject to tax. The Income Tax Law provides for CGT events, including the disposal of assets. Capital gains or losses are determined by deducting the cost base of an asset from its proceeds (money received or receivable or the market value of property received or receivable). For corporate taxpayers, the net capital gain is taxed at 20% + 25 respectively.

Capital losses are deductible exclusively against capital gains and not against ordinary income. However, trading losses are also deductible against net taxable capital gains, which are included in taxable income.

Capital gains derived by an Egyptian resident company in respect to the disposal of shares in a foreign company are subject to tax in Egypt, with the entitlement to offset the foreign paid taxes against the Egyptian taxes. However, losses are not offset against Egyptian profits.

Capital gains resulting from the disposal of active foreign branch operations by an Egyptian company (which generally include oil- and gas-producing assets) are subject to tax in Egypt.

In summary, CGT is generally levied on the disposal of foreign subsidiaries or branch operations.

Nonresidents are only subject to CGT on taxable Egyptian property.

Functional currency

Provided certain requirements are met under Egyptian Income Tax Law, taxpayers may calculate their taxable income by reference to a functional currency (i.e., a particular foreign currency) if their accounts are solely or predominantly kept in that currency. The election of a functional currency is an approach sometimes applied by oil and gas companies if most of their transactions are denominated in, for example, US dollars or British pounds. Election of a functional currency generally reduces compliance costs and, depending on foreign currency movements, may shield the company from unexpected taxable foreign currency gains (although it could deny a deduction for foreign currency losses).

Transfer pricing

Egyptian tax law includes measures to ensure that the Egyptian taxable income base associated with cross-border transactions is based on arm's-length prices. Several methods for determining the arm's-length price are available, and strict documentation requirements apply to support the method chosen and the prices reached. This is particularly relevant to the sale of commodities, intercompany services, intercompany funding arrangements and bareboat and time charter leases.

Dividends

Dividends paid by Egyptian resident companies are franked with an imputation credit to the extent that Egyptian income tax has been paid by the company at the full corporate rate on the income being distributed.

No withholding tax is calculated on dividends paid either to resident or nonresident corporate shareholders.

Bonuses

Signature bonuses and production bonuses are generally considered deductible according to the concession agreement.

Direct instructions were issued by EGPC in this regard, stressing the deductibility of such bonuses for corporate tax purposes. However, having such bonuses as deductible costs in the corporate tax return is still debatable and challenged with the Egyptian tax authorities which, in return, issued instructions contradicting EGPC instructions and stressing the fact that such costs should not be considered deductible.

C. Capital allowances

Capital allowances are based on the provisions of the concession agreement.

D. Incentives

Exploration

Expenditures on exploration are capitalized and are deductible for income tax purposes. Based on the provisions of the concession agreement and pending approval of the EGPC, capitalized exploration expenses are amortized over the lifetime of the concession agreement.

Tax losses

Income tax losses may be carried forward for five years.

R&D

R&D incentives are based on the provisions of the concession agreement.

E. Withholding taxes

Interest, dividends and royalties

The new Income Tax Law has introduced new tax rules in Egypt, including the tax consequences for related-party transactions and withholding tax on payments to nonresident companies.

According to Article 56 of Income Tax Law No. 91 of 2005, a tax rate of 20% is applied to amounts paid by individual companies or any legal entities resident in Egypt to nonresidents, without any deductions. These amounts include interest, royalties (except those related to manufacturing) and services. The rate may be reduced according to the double tax treaties with other countries.

Payments to nonresident entities should be listed in the tax return, including the country, the type of deal and the tax withheld, if any (see below for further detail).

As noted above, payments to nonresident entities or individuals are subject to tax at the rate of 20%, without any deductions. This applies as follows:

- Royalties:
  - Except the amounts paid abroad against design or know-how for serving the industry. The minister, in agreement with the minister concerned with industry, shall determine the cases in which the know-how is for serving the industry.
- Interest:
  - Except for loan agreements of three years or more
  - Reduced tax rate per the tax treaty (if applicable)
- Services fees:
  - Except for the following:
    - Transport or freight
    - Shipping
    - Insurance
    - Training
    - Participation in exhibitions and conferences
    - Listing fees of the Egypt Stock Exchange
    - Direct advertising and promotion

Foreign contractor withholding tax

Foreign contractor withholding tax (FRWT) ranges between 0.5% and 5%. It must be withheld from payments made to foreign residents in respect of certain works in Egypt and for related activities in connection with such works in Egypt.

F. Financing considerations

The Egyptian income tax system contains significant rules regarding the classification of debt and equity instruments and, depending on the level of funding, rules that have an impact on the deductibility of interest. These rules can have a significant impact on decisions regarding the financing of oil and gas projects.

The measures provide for a safe harbor debt-to-equity ratio of 4:1. Interest deductions are denied for interest payments on the portion of the company's debt that exceeds the safe harbor ratio.

G. Transactions

Asset disposals

In general, a gain resulting from disposing of, or the transfer of, an interest in a petroleum permit does not in itself trigger any corporate tax consequences because it is not considered to be a disposal of fixed assets. In addition, most of the concession agreements include specific articles exempting such gains from Egyptian taxes.

Farm-in and farm-out

It is common in the Egyptian oil and gas industry for entities to enter into farm-in arrangements.

A farmee is deemed to hold a depreciating asset, the interest in the petroleum permit, from the time the interest is acquired (this can be up-front or deferred depending on the terms of the particular arrangement). The farmee can deduct the cost of the depreciating asset over its effective life from the time it is held by the farmee. The cost is the amount the farmee paid for the interest and can include the value of non-cash benefits.

Future commitments incurred by the farmee in respect of its interest will generally be deductible for the farmee (either outright or over the asset's effective life) if the farmee holds an interest in the permit.

Acquisition costs of a farmee are deductible for corporate tax purposes and, similarly, consideration received by a farmor in respect of the farm-out are not assessable for tax purposes, provided a formal agreement (recommended to be within a concession agreement) is approved by the EGPC. EGPC approval for the transfer of an interest is mandatory.

Selling shares in a company (consequences for resident and nonresident shareholders)

A share disposal is generally subject to the CGT regime. Nonresidents that dispose of shares in an Egyptian company are not subject to tax in Egypt if the owner of the shares does not have a permanent establishment in Egypt.

H. Indirect taxes

Goods and services tax

A goods and services tax (GST) regime applies in Egypt to ensure that all transactions that take place within Egypt (and some from offshore) are subject to GST. The tax, introduced in 1991, is a multi-staged tax that applies at each point of sale or lease. GST is applied at a standard rate of 10%, with GST-free ratings for qualifying exported products and services and other transactions, and input tax ratings for financial services and residential housing.

Only Egyptian residents may be subject to GST on services and products supplied. All sales within Egypt are subject to GST at the rate of 10% (known as taxable supplies). All commercial transactions have a GST impact, and this should be considered prior to entering into any negotiation or arrangement.

Common transactions or arrangements that have GST implications include:

- Importation of equipment and vessels
- Sale or lease of equipment in Egypt
- Sale of products in Egypt
- Asset disposals

If products are exported, a GST-free status may be obtained. Exports must also be supported by evidence that indicates the goods have left Egypt.

The GST registration threshold is EGP150,000 for resident entities. However, entities below this threshold can choose to register voluntarily for GST.

Nonresidents are not required to register for GST.

Input tax is generally recovered by being offset against GST payable on taxable supplies.

In general (and according to the standard concession agreements), oil and gas exploration entities working in Egypt are exempt from being subject to GST on supplies made for them by other suppliers (except for passenger cars). It is mandated that such supplies are used for exploration and development purposes.

Import and export restrictions

The Government is revising Egypt's customs and trade systems to eliminate certain bureaucratic obstacles confronting importers. Egyptians must handle all imports. Although an Egyptian agent is not required for exports, such an agent is often used. Certain goods, such as cotton, wheat, rice, cement and oil, may only be handled by the public sector.

Import restrictions

The Government imposes import controls to improve Egypt's balance of payments. Importers must obtain approval to open a letter of credit. A cash deposit ranging from 15% to 100% is also required, depending on the type of goods imported. The origin of goods must be certified in order to enter Egypt.

Travelers entering Egypt may import modest quantities of alcohol, cigarettes and perfumes free of duty. Visitors may also purchase certain quantities of duty-free liquor using foreign currency after passing through customs. Valuable personal effects may be declared to permit them to be taken out of the country on departure.

Export restrictions

Most goods may be exported free of duty. Certain items must be inspected before an export license is granted.

Stamp duty

Stamp duty is a state and territory-based tax that is usually imposed on specified transactions but, in general, is very minor.

Other significant taxes

Other significant taxes include cash remuneration or fringe benefits tax on non-cash employee benefits of 10% to 20%, and payroll taxes paid by employees of 10% to 20%.

I. Other

Foreign direct investment

The Government sets a high priority on attracting foreign direct investment (FDI) into the country. FDI helps improve technological innovations, creates more jobs and expands the country's ability to compete in international markets. Equally important, FDI opens the Egyptian economy to trade in semifinished products and other intermediate goods, which are increasingly becoming the mainstream of international trade.

As part of the economic reform program, and in an effort to attract foreign investors, changes were made in various areas, such as corporate tax reform, lowered customs duties and streamlined investment procedures. Changes have also affected the system of national accounting, the modernization of Egyptian insurance supervision and intellectual property rights. These measures make Egypt an attractive destination for investors seeking to enter the Middle East and North Africa (MENA) marketplace.

The opportunities in Egypt are open in all sectors, including energy, banking and finance and information technology.

FDI statistics

Net FDI:

Net FDI increased from US$509.4 million in FY 2000–01 to US$13.2 billion in 2007–08, falling to US$8.1 billion in 2008–09, US$6.8 billion in 2009–10 and US$1.6 billion in Q1 of FY 2010–11.

Egypt ranked first among North African countries and second in the African continent as an attractor of FDI, according to the World Investment Report 2010 by the United Nations Conference on Trade and Development (UNCTAD).

FDI distribution by sector:

Petroleum accounted for 53.1% of net FDI (US$3,589.4 million) in FY 2009–10, compared with 66% (US$5,356.6 million) in FY 2008–09. Net FDI in non-petroleum sectors amounted to US$3,168.8 million in FY 2009–10 as opposed to US$2,756.8 million in the previous fiscal year.

Furthermore, the petroleum sector attracted US$575.7 million in FDI (36%) during Q1 of FY 2010–11 against US$1,344.3 million (77.7%) in Q1 of FY 2009–10.

Exchange control regulations

Because of the economic reforms and agreements reached with the International Monetary Fund (the IMF), exchange controls have been canceled in Egypt. The Foreign Exchange Law of May 1994 allows individuals and legal entities to retain and transfer foreign exchange in Egypt and abroad. Nevertheless, as a result of the current economic downturn in Egypt, transfers of foreign exchange (e.g., US dollars) abroad are unlikely to continue by companies and individuals. This is because financial institutions usually have a severe deficit in the procurement of foreign exchanges to be repatriated abroad.

Based on the above, no exchange control regulations affect the transfer abroad of funds or profits generated in Egypt. Noting that, only Egyptian banks (authorized by the Central Bank of Egypt) are used for such purpose.

Repatriation of profits abroad

There is no restriction on the repatriation of profits abroad.

Dividends paid by an Egyptian company are not subject to withholding taxes on the basis that they have been paid from profits that have been subjected to corporate tax, or they are specifically exempt.

Business presence

Forms of business presence in Egypt typically include companies, foreign branches and joint ventures (incorporated and unincorporated). In addition to commercial considerations, the tax consequences of each business are important to consider when setting up a business in Egypt.

Unincorporated joint ventures are commonly used by companies in the exploration and development of oil and gas projects.

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A. At a glance

Fiscal regime

The fiscal regime that applies to the oil and gas industry is provided by the EG Tax Code (EGTC) dated 28 October 2004, the EG Hydrocarbon Law No. 8/2006 dated 3 November 2006, the production sharing contract (PSC) or other similar contract concluded between the Equatorial Guinea (EG) Government and the contractor.

The main taxes applicable in this sector are:

Corporate income tax (CIT)	35%
Taxes on transfer and assignment	If transaction generates capital gains not invested in EG, it is subject to CIT
Export duties	Generally exempt subject to conditions[81]
Royalties	Not less than 13%
Bonuses	Determined under the terms of each PSC
Surface premiums on rental rates	Determined under the terms of each PSC
Discovery, production and marketing bonds	Determined under the terms of marketing bonds of each PSC[82]
Urban property tax	1% of tax base
PSC	State is entitled to a percentage of all hydrocarbons[83]

81 *Materials and equipment directly related to petroleum operations and imported under the temporary import regime may be exported from EG free of all export duties.*

82 *Discovery means the finding by the contractor of hydrocarbons whose existence within the contract area was not known prior to the effective date or hydrocarbons within the contract area that had not been declared a commercial discovery prior to the effective date, and that are measurable by generally accepted international petroleum industry practices.*

83 *The state is entitled to a percentage of all hydrocarbons won and saved from a contract area, based on the terms agreed in each contract and after deduction of royalties and investment recovery oil. The participation of the state should not be less than 20%.*

Capital allowances	Straight-line depreciation[84]
Investment incentives	RD[85], L[86]

B. Fiscal regime

Corporate tax

EG companies are subject to CIT of 35% on the territorial principle. EG companies are those registered in EG regardless of the nationality of the shareholders or where the companies are managed and controlled. Foreign companies engaged in business in EG are subject to CIT on EG-sourced profits.

The net profit will be determined by deducting from the gross income or gross profit all expenses tied to the performance of the taxable activities in EG.

Operations carried out offshore (i.e., outside the international boundaries of EG) shall not fall within the scope of EG corporate tax. However, please note that EG tax authorities may try to attract profits from operations carried out outside EG when they could be linked to the branch or company in EG.

Ring-fencing

EG law does not provide that the profit from one project can be offset against the losses from another project held by the same tax entity. Accordingly, the petroleum operations should be accounted for separately.

Production sharing contract

The main type of oil contract in EG is a PSC. The contract is concluded either by international public invitation to tender in order to guarantee competition between the potential contractors or by direct adjudication.

Each contract shall come into force only after it has been ratified by the president of the Republic and on the date of the delivery to the contractor of a written notice of this ratification.

Government share of profit oil

In addition to royalties, the state is entitled to a percentage of all hydrocarbons that have been extracted and kept from a contract area based on the terms agreed in each contract and after deduction of royalties and investment recovery oil.

Non-recoverable expenditures

The following expenditures are not recoverable:

a. Interest on loans obtained by the contractor from any affiliated company, or the parent company or non-affiliated third parties, that exceed the commercial rates charged by official banks
b. Expenses incurred by the contractor prior to and during contract negotiations, and any expense incurred prior to the effective date of the contract
c. Bonus paid by the contractor upon execution of the contract
d. Discovery bonus paid by the contractor
e. Annual surface rental rate paid to the state
f. Amounts in excess of 7.5% of the annual budget approved by the appropriate Branch Ministry during the initial exploration period; and over 5% of the annual budget approved by the Ministry during the development and exploitation phase

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84 *The EGTC provides the straight-line system of depreciation: all assets are depreciated in a uniform manner over a period representing the probable useful life of the assets in question.*

85 *The EG investment regulations provide financial and fiscal advantages for companies that create jobs and offer professional training for nationals and for research and development (R&D).*

86 *Net operating losses incurred during the previous year are deductible up to a maximum of five years.*

g. Any payment made to the Government as a result of failure to comply with minimal exploration work obligations as agreed upon in the contract
h. Any sanction imposed by the Government on the contractor as a result of environmental contamination (oil spills, etc.)
i. Fines or sanctions that may be levied as a result of violation of the laws, regulations and other legal provisions in EG
j. Audit and inspection expenses incurred by the Government at the contractor's headquarters, as a result of the absence of original documents in the contractor's office in the Republic of EG
k. Contractor's expert's expenses according to the contract

Determination of cost oil

Cost oil is the sum of all expenses borne by the holder in the framework of the PSC, determined in accordance with accounting methods. All costs related to petroleum operations shall be classified in accordance with their end use.[87] Classification criteria shall be included in the approved annual work program and annual budget for the calendar year in which the expenditure is made.

Uplift available on recovered costs

With the exception of general and administration costs incurred in EG directly assignable to the annual budget, an uplift is available on the general and administration expenditures incurred by the contractor outside of national territory with respect to petroleum operations. The uplift should be determined with the sliding scale set out in the PSC, based on total petroleum operations costs incurred during the year and duly justified by the contractor and approved by the Ministry.

Annual surface rent

An annual surface rent is due when the PSC or service contract is signed. The surface rental shall be prorated from the effective date through to 31 December of such year and shall be paid within 30 days after the effective date.

Surface rentals shall be calculated based on the surface of the contract area and, where applicable, of a development and production area occupied by the contractor on the date of payment of such surface rentals.

Royalty regimes

Contractors are subject to the payment of a royalty on the value of the hydrocarbon produced (including the government share of the production) and this payment is due from the first day of production based on the total disposable production from a development and production area.

C. Capital allowances

Tax depreciation rules

Depreciation will be estimated from the calendar year in which the asset is placed into service, with a full year's depreciation allowed for the initial calendar year. Depreciation shall be determined using the straight-line method. The following rates are some of those applicable:

- Developed land 5%
- Housing 5%
- Temporary buildings 20%
- Light vehicles 25%
- Heavy vehicles 33.33%
- Office furniture 20%
- Naval and air material 20%

87 *Exploration costs, development and production costs, operating or production costs, commercialization costs, allocation of general and administrative costs.*

EG law does not provide for any accelerated depreciation for the assets of a petroleum company.

D. Incentives

Carryforward losses

Net operating losses incurred during the previous year are deductible up to a maximum of five years. As discussed in Section B, ring-fencing applies. EG law does not provide that the profit from one project can be offset against the losses from another project held by the same tax entity. Accordingly, the petroleum operations should be accounted for separately.

Research and development incentives

R&D incentives are determined according to each PSC.

E. Withholding taxes

Dividends

Dividends paid by an EG company to a nonresident are subject to withholding taxes (WHT) at the rate of 25%.

Interest

Interest paid by an EG company to a nonresident is subject to WHT at the rate of 25%. However, the bank interest rate is 4%.[88]

WHT on resident and nonresident income

Gross income obtained in EG for any kind of commercial or industrial activity, services, manpower supply and analogous services are subject to WHT at the rate of 6.25% when the economic activities are performed and invoiced by the resident, while the rate is fixed at 10% for nonresidents.

Amounts paid for mobilization, demobilization and transportation services in EG in the petroleum sector shall be subject to WHT at the rate of 5% for nonresident entities.

Branch remittance tax

There is no branch remittance tax in EG.

F. Financing considerations

Interest on loans will be deductible only when they do not exceed the interest invoiced by the banks, authorized by the Bank Commission.

G. Transactions

The assignment, transfer or other disposition of the right granted by any contract shall require prior written authorization from the Ministry. Such assignment, transfer or other disposition shall be subject to the payment of a non-recoverable, non-deductible fee and other requirements that shall be established in the authorization granted by the Ministry.

The transfer of the ownership of more than 50% of the shares in capital of any person making up a contractor, that affects the ownership of the rights under the relevant contract, shall be deemed to be an assignment of contractual rights under a contract. All profits resulting from any assignment, transfer or other disposition of rights under a contract, regardless of the beneficiary, type or location of the transaction, shall be subject to taxes in accordance with the laws of EG.

Capital gains will be included in the taxable profit calculation for CIT purposes, in accordance with the provisions of the EG tax law.

88 *This rate may be changed at any time by the Central Bank.*

The registration fees to be paid depend on the kind of asset, for example:

- Shares 2%
- Transferable bonds 2%

These registration fees are paid by the assignee.

H. Indirect taxes

Import duties

Provisions of customs duties are identical for most of EG production sharing agreements (PSAs). They usually provide that the person designated as a contractor under a PSA, as well as its subcontractors, are allowed to import into EG without restrictions and without payment of duties, on goods, materials, machinery, equipment and consumer goods that are necessary to carry out qualifying operations under a PSA, in its own name or in the name of its subcontractors under regulations of temporary admission (AT) or temporary imports (IT), either normal or special, on condition that these goods are going to be used exclusively for qualifying operations and will be re-exported at the end of their use.

Export duties

The materials and equipment directly related to petroleum operations and imported under the IT regime may be exported from EG free of all export duties, provided that the ownership of such materials and equipment has not been transferred to the state.

Stamp duties and registration fees

Registration fees are based on a percentage of the foreign company's share capital for a branch registration and of the share capital for a subsidiary registration. Registration costs pertaining to a subsidiary or to a branch are similar.

Provided that the share capital for a subsidiary or for the foreign company's share capital is not higher than XAF10 million (which is the legal minimum share capital for any public limited company (PLC) under the OHADA regulations), registration costs may be estimated at XAF8 million as of today.

Registrations have to be renewed every year at different administrations (mines, trade, promotion of small and medium-sized businesses and city council).

I. Other

Urban property tax

All owners, holders and equitable owners of the assets will be required to pay this tax, including heirs, joint owners and other entities that, while lacking their own legal status, constitute an economic unit and are the owners of record of assets that are urban in nature.

The tax base for urban property tax, which will coincide with the net base, will be constituted by 40% of the sum of the value of the land and the construction.

It will enter into effect for taxation purposes on the fiscal year immediately following its notification.

The tax debt will be the result of applying 1% to the tax base. This tax will be due per complete six months and its amount paid in the second quarter of the respective fiscal year.

Personal income tax

Employers are liable to personal income tax (as a payroll deduction) on behalf of their employees and shall pay it back to the tax administration no later than 15 days after the beginning of the following month:

Taxable basis: previous month's gross salary

Rate: 0% to 35% (progressive scale)

Professional expenses deduction amounts to 20% of gross salary, after social contributions have been deducted, up to XAF1 million a year.

Employers are also liable to the following withholding individual contributions, (as a payroll deduction) on behalf of their employees, and shall pay it to the tax administration no later than 15 days after the beginning of the following month.

a. Social security contribution
   - Taxable basis: previous month's gross salary
   - Employers' rate: 21.5%
   - Employees' rate: 4.5%

b. Work Protection Fund (WPF) contribution and Professional Training Fund (PTF) contribution:
   - Employers' rate: 1%; taxable basis: gross salary
   - Employees' rate: 0.5%; taxable basis: net salary

c. Applicable domestic production requirements

All contractors are obliged to sell and transfer to the state, upon written request of the Ministry, any amounts of hydrocarbon of a contract area and any amounts of natural gas processed in EG by a contractor or its associate that the state shall deem necessary to meet domestic consumption requirements.

Tax treaties

EG has entered into the Central African Economic and Customs Union (UDEAC)[89] tax treaty.

89 *Now called CEMAC, whose member states are: Cameroon, the Central African Republic, Congo, Gabon, Equatorial Guinea and Chad.*

Gabon

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A. At a glance

Fiscal regime

A draft Hydrocarbon Code is under consideration by the Government.

Currently, the fiscal regime that applies in Gabon to the upstream petroleum industry consists of the Gabonese Tax Code, the Gabonese petroleum laws, and the production sharing contract (PSC) or service contract between the Gabonese Government and the contractor.

The main taxes applicable in the oil and gas industry are the following:

- Corporate tax
- Annual surface rent
- Royalty on production

Royalties	Between 6% and 12% of total production
Bonuses	On production: between US$1 million to US$2 million depending on the volume of production
	On signature: US$215/km² minimum (from US$0.5 million to US$1 million depending on the area)
PSC[90]	Between two-thirds and four-fifths in favor of the state
Corporate tax:	
Common tax regime	35% for holder under the exploitation and production sharing contract (CEPP): 35% to 40% at least for holder under concession: 73%
Annual surface rent	On exploration: US$3 to US$6/km²
	On production: US$4 to US$8/hectare
Resource rent tax	None
Investment incentives	D[91], L[92]
Additional petroleum levies:	
Contribution to petroleum support fund:	On exploration: US$200,000/year (included in cost oil)
On production:	US$0.05/barrel (not included in cost oil)

90 *PSC government share is based on production. A service contract regime is in place called CEPP.*

91 *D: Accelerated depreciation for capital goods.*

92 *L: Losses can be carried forward until the third fiscal year following the deficit period.*

Contribution to the fund of reconstruction of deposit:	Around US$200,000/year (depending on the value of equipment removed or upgraded) For the restoration of site: maximum amount of 0.5%/year of the value of original equipment and facilities involved
Contribution to training:	On exploration: paid three times (US$50K, US$100K, US$100K per year) On production: US$200,000/year.

B. Fiscal regime

Corporate tax

Tax rate

For oil and gas net profits, the common tax rate is 35%. With the introduction of the CEPP[93] regime, companies are subject to different tax rates. Companies following this regime are exempt from corporate tax or any other tax, except for those taxes that are expressly stated in the CEPP. The minimum rate is usually around 35% to 40%. For companies that follow the concession regime, the tax rate is 73%. Under this regime, the tax can be paid either in kind or in cash.

Ring-fencing

In principle, ring-fencing is limited to the exploitation zone. However, the contract can plan to extend it to the area covered by the contract.

Treatment of exploration and development costs

The depreciation deductions applicable in the petroleum industry are calculated by the operator in accordance with the rate defined in the CEPP. In practice, this mostly concerns companies operating under a concession agreement that has this specificity in the agreement. In such a case, rates depend on the time period for depreciation, which in turn depends on whether expenses are exploration expenses or development and exploitation expenses. The rates can be readjusted if the actual time period for utilization is shorter (particularly in the case of an accidental loss or if the material wears out more quickly than expected).

However, in the frame of a PSC, depreciation follows a special treatment. It is excluded from cost oil and does not impact corporate income tax as this is paid in kind. In practice, development and exploitation costs shall be recovered first, and exploration costs are recovered after.

Production sharing contract (PSC)

The PSC is an agreement between the state and a company. It is a type of service contract where a company is viewed as a service provider and the state is considered a master builder. All the operations are realized by the company in favor of the state, which is the owner of the resources and investment.

Determination of the cost oil and profit oil

Once production has started, it is divided into two parts: cost oil and profit oil. These are divided pursuant to the terms of the service contract between the service provider and the state.

a. Cost oil

Cost oil is the part of oil that serves to recover the exploration expenses, the operating expenses and the development expenses. Cost oil is calculated using an annual base but can be recovered monthly. The calculation is based on net production (total production available of hydrocarbons less royalty payments made).

93 *Gabonese Law No. 14/82 of 24 January 1983.*

b. Profit oil

Profit oil, or the remaining production, is the net production less the cost oil. The contractor and the state share the profit oil according to a rate specified in the contract. Depending on the contract, the rate in favor of the state can be two-thirds (2/3), three-quarters (3/4) or four-fifths (4/5). The rate is progressive and depends on the volume of production. The law does not define the minimum share that must be allocated to the company or to the state.

Based on production volume or production value

a. Corporate tax

Under the model of the CEPP that has been in place since 1998, companies must pay corporate tax in kind. Corporate tax is not based on annual sales, but on the level of production. The companies give the state a quantity of petrol that corresponds to the amount of tax owed (i.e., the quantity of petrol given is equivalent to the amount of corporate tax that companies would otherwise pay in cash). This amount is included into the profit oil as part of the state's entitlement.

For accounting purposes, the amount of corporate tax is calculated according to a special method called a "gross-up" method (which is not planned in the contract). The amount of corporate tax of the company is calculated as follows:

$$\textbf{Amount of corporate tax} = \frac{\textbf{Profit oil x tax rate}}{\textbf{1 - tax rate}}$$

In addition to their operating accounts, companies have to establish special petrol cost accounts. The amount of corporate tax calculated should normally correspond to the amount calculated in the operating account. However, as the expenditures differ between the operating account and the petrol cost account, there could be a discrepancy between these numbers. Currently, the minister of mines, energy and petroleum in Gabon is considering a re-examination of the model of the CEPP published in 1998.

b. Royalties

The CEPP generates a royalty that is calculated at the production stage. The rate of royalty depends on the daily average of the total production (for a limited zone and for one month). This rate is proportional to the total production and is not progressive. The rate can be fixed or variable within a production bracket (as determined in the contract) and is generally between 6% and 12% of the total production.

The rate is determined according to the following formula:

$$\textbf{Amount of royalty} = \textbf{official price of sale/transfer x the contract rate x gross production}$$

Expenditure recovery

a. Non-recoverable expenses

The following expenditures are non-recoverable:

- Expenses that are not tax-deductible
- Bonuses
- Expenses related to the period before the effective date of the contract
- Expenses related to operations carried out for commercialization
- Taxes, duties and royalties which the tax legislation does not authorize as deductible expense or for which the recovery is excluded by a provision of the contract

b. Caps that apply to expenditure recovery

The contractor reports to the state the amount of expenses incurred during the exploration according to the terms of the contract. Those expenses are refunded by the state at a later time, but are limited by a "cost stop." The amount of a cost stop is determined in the contract and is generally around 60% to 70% of net production. If the costs incurred in a particular year are higher than this limit, they can be deducted in the next year.

c. Uplift available on recovered cost

Uplift is available on recovered costs but overhead costs are limited to 3%.

d. Fiscal uncertainty clauses

Fiscal uncertainty clauses are generally included in the contract.

e. VAT treatment

During the exploration phase and until the quantity produced is sufficient for commercialization, the contractor is exempt from paying VAT. Suppliers, subcontractors, service providers and affiliated companies are exempt from paying VAT as well.

However, during the production phase, contractors, suppliers, subcontractors, service providers and affiliated companies are required to pay VAT at the rate in force (normally 18%, or 10% to 25% for certain products[94]), but can recover these payments later. For operations between companies on the UPEGA list,[95] the rate is 0%.

Resource rent tax

Generally, a resource rent tax is imposed only if the accumulated cash flow from the project is positive (i.e., based on the profitability of the petroleum operations). Gabon does not have a resource rent tax.

Annual surface rent

An annual surface rent is due in the calendar year following the grant of title to a parcel of land. This fee is based on the surface of the site:

- On exploration, the annual surface rent is US$3 to US$6/km²
- On production, the annual surface rent is US$4 to US$8/hectare

Royalty regimes

Royalty regimes are not affected by the characterization of production as onshore or offshore.

C. Incentives

Accelerated depreciation

The tax depreciation rules are provided for in the applicable CEPP contract. Depreciation can be calculated using either the straight-line method or the declining-balance method. The Financial Law of 1998 allows the use of the declining-balance method of depreciation for capital goods. Before 1998, the calculation of depreciation for capital goods was only possible through the straight-line method of depreciation or, after authorization from the general director of the indirect and direct contributions, through an accelerated method of depreciation. The declining-balance method is only possible for goods that are part of a list of enumerated goods made by a joined order of the minister of finance and the minister of the concerned activity sector.

According to this law, only goods that are necessary to the production, transformation or development of petroleum, and those companies that participate in the industrial development of the country, can benefit from the use of the declining-balance method.

The Gabonese Tax Code[96] allows accelerated depreciation for certain fixed assets. The list of fixed assets eligible for accelerated depreciation is made available by the minister of finance and the minister of mines but this list has not yet been released. All the fixed assets of the company that are eligible for accelerated depreciation are specified in the applicable CEPP contract.

94 *I.e., custom rate.*

95 *Gabonese Petroleum Union.*

96 *Art.11-V-b of the Gabonese Tax Code.*

In order to use the accelerated-depreciation method, a letter must be sent to the director of the tax office within three months of the acquisition of the fixed asset. The director must then consent within three months after the date of the return receipt. If no answer is received within those three months, the request is presumed as accepted by the tax office.

Carryforward losses

Losses can be carried forward until the third fiscal year following the deficit period.

D. Withholding taxes

A 20% withholding tax (WHT) is levied on capital gains (e.g., dividends, attendance fees and bondholder fees) paid by a resident company to a physical person.

A 15% (WHT) is levied on capital gains (e.g., dividends, attendance fees and bondholder fees) paid by a resident company to another resident company.

A 10% (WHT) is levied on most other payments made to a nonresident or a foreign company. This withholding tax applies to services, industrial property, royalties or interest. This rate also applies to the branch remittance tax.

E. Indirect taxes

Import duties

Exploration and production (E&P) companies are subject to the Customs Code of the Customs & Economic Union of Central Africa (UDEAC) and its regulations.

Products, materials and equipment exclusively related to the prospecting and researching of petroleum are exempt from customs duties. Contractors, subcontractors or others related to the contractors have to produce a final certificate of utilization. For the custom administration, the exploration period ends when the production reaches 10,000 barrels per day and night.

The same exemption exists for the personal belongings of the company's foreign employees who are engaged in the prospecting, researching or exploitation of petroleum.

Products, materials and equipment related to the production, storage, treatment, transport, expedition and transformation of hydrocarbons are subject to a reduced rate of 5%. A contractor must request the general director of customs to grant permission for this reduced rate to be applicable. The reduced rate is not applicable after five years following the beginning of exploitation.

Products, materials and equipment exclusively related to the activity of a petroleum company, that are destined to be "re-exported" at the end of their utilization, can be imported under the normal temporary regime. Under the normal temporary regime, customs duties on imports for certain goods that are destined to be re-exported are suspended. Such materials must be necessary to the petroleum company's activities and should not belong to the state.

For all other goods, normal custom rules are applicable.

Export duties

Materials and equipment that are destined to be re-exported at the end of their utilization will be exempt from customs duties.

Focus on the draft Hydrocarbons Code

The main changes provided by the draft Hydrocarbons Code will include the following topics:

- The length of the foreign branch after which it shall be converted into a local company will be limited (four years including one renewal)
- Setting up of a minimum participation of the state into the PSC
- Creation of additional bonuses
- Fixation of conditions for recovery
- Cost stop of minimum 60% to a maximum of 80% or 85% (for ultra-deep work), adjustable depending on the profitability
- Setting up of thresholds for the proportional royalty fee (depending on whether it is deep or ultra deep)
- Fixation of duration of exploration and exploitation phases
- Strengthening the obligation to contribute to the promotion of national employment (by the submission of the realization of efforts in hiring nationals, including advertisement of vacancies in local newspapers and through firm recruitment)
- Priority in awarding a subcontract to companies incorporated in Gabon (80% national participation)
- Creating a real industrial responsibility to repair damages caused to persons, property and environment from industrial activities
- Framing of the activity of gas flaring

Finally, kindly note that, at this stage, this Hydrocarbons Code only consists of governmental discussions and that there is still no text to enact it.

Ghana

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A. At a glance

Fiscal regime

The fiscal regime that applies to the petroleum industry consists of the combined use of two basic tax laws – the Internal Revenue Act[97] (the IRA) and the Petroleum Income Tax Law[98] (PITL) – and the Petroleum Agreement (PA).

PAs are signed between the Government of Ghana (GoG), the Ghana National Petroleum Corporation (GNPC) and the respective petroleum company or contractor.

Royalties	Royalty rates are not fixed. The PAs signed so far prescribe royalty rates ranging from 3% to 12.5% for gas and crude production.
Production sharing contract (PSC)	The PA deals with specific PSC issues that exist between the petroleum company, the GNPC and the GoG. Generally, the PA indicates that the GoG's share may be taken in cash or in petroleum lift. An initial carried interest of at least 10% is provided in the PA for the Republic (acting through the GNPC). Additional interest, which is a paying interest, may be acquired by GoG through the GNPC.
Income tax rate	The income tax rate for upstream petroleum activities is 50% (per the PITL) or an alternative rate as specified in the PA. The PAs signed so far prescribe a rate of 35%. For downstream petroleum activities, the applicable income tax rate is 25%.
Capital allowances	D[99]
Investment incentives	L, R&D[100]

97 *(2000) Act 592 as amended.*

98 *(1987) PNDCL 188, yet to be amended; to be repealed and replaced soon*

99 *D: accelerated depreciation.*

100 *L: losses can be carried forward indefinitely. RD: R&D incentive.*

B. Fiscal regime

Corporate tax

Ghana's petroleum fiscal regime is governed by two basic tax laws – the IRA[101] and the PITL[102] – and the PA. The commissioner-general of the Ghana Revenue Authority (GRA) administers the IRA, the PITL and the tax portions of the PA.

The IRA is the main tax law covering downstream petroleum activities, whereas the PA and the PITL are the main instruments covering upstream petroleum activities.

The corporate tax rate provided in the PITL is 50%, but the PAs signed to date prescribe an overriding tax rate of 35%.

The corporate tax rate is applied on the chargeable income derived by the Petroleum Contractor. The chargeable income is arrived at after deducting all expenditures "wholly, exclusively and necessarily" expended and specified expenditures, including prior-year losses, and permitted capital allowances for the year, from the gross income from petroleum operations. Expenditures of a capital nature, private outgoings and costs paid in respect of taxes, however, are not deductible.

Ghana applies ring-fencing. Profits from one project cannot be used to offset the losses of another project unless both projects are of the same type (i.e., downstream profits or losses can be offset against downstream projects, and upstream profits or losses can be offset against upstream projects). Downstream petroleum activities are governed by the IRA, while upstream oil activities are governed by the PITL and the PA. The different tax laws apply different tax rates of 25% to downstream petroleum activities, and 50% or 35% to taxable income from upstream petroleum activities. It has been proposed to amend this to preclude companies from setting off costs in one contract area or site against profits in another area or site.

Annual and quarterly tax returns must be filed by the contractor or the petroleum operator. Annual corporate tax returns must be filed within four months after the financial year-end of the contractor. In addition, within 30 days after the end of every quarterly period, the contractor must submit a quarterly tax return to the commissioner-general. The quarterly return must disclose an estimate of taxable income from petroleum operations for the quarter, an estimate of the tax due and a remittance in settlement of the tax due on that income. The commissioner-general has the power to grant a further 14-day extension for the contractor to meet the quarterly return requirement.

The PITL grants the Commissioner-General the power to assess the contractor provisionally to tax in respect of any quarterly period after receipt of the quarterly return, or after the expiry of the periods allowed for the submission of the returns.

Capital gains tax

No capital gains tax (CGT) applies on gains derived from the disposal of depreciable assets, such as plant or machinery. CGT, however, is payable on the gains made on the sale of chargeable assets (e.g., goodwill or technical know-how). The gain or loss made on the disposal of depreciable assets is included in the normal income tax calculation. It has been proposed to amend this provision.

It is important to note that the rate of capital gains tax is 15%, whereas the rate for income tax can be 25%, 35% or 50% depending on the particular circumstances (see above).

Capital losses are not carried forward and are not allowed as a deduction against any other gains made on other chargeable assets. In addition, capital losses cannot be recouped or offset against taxable income.

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101 (2000) Act 592 as amended.

102 (1987) PNDCL 188, yet to be amended.

Functional currency

The primary and functional currency in Ghana is the Ghana cedi. All monetary transactions in Ghana, therefore, are expected to be conducted in the Ghana cedi. However, under specified conditions, the Ghana fiscal authorities permit companies that have strong reasons to report their business activities in another currency. The PA permits oil and gas companies to transact business in a currency of their choice. However, for tax purposes, the commissioner-general must give approval for the oil and gas company to report in any other currency apart from the Ghana cedi.

Transfer pricing

Ghana's tax laws include measures to ensure that cross-border trading does not unnecessarily erode local taxable profits of companies in their dealings with their parent or related entities. The commissioner-general has wide powers to disallow expenses or make adjustments if it is believed that an attempt is being made by the taxpayer, in dealing with the parent or any other related entity, to reduce the tax payable in Ghana. The commissioner-general has the power to determine the acceptability and taxability or otherwise of any pricing module that exists between related parties. A technology transfer regulation (LI 1547) also attempts to ensure that the transfer of technology between an entity and its parent or other related persons is uniformly regulated in Ghana.

The GoG, with the assistance of the African Tax Administrators Forum, is preparing regulations to govern transfer pricing transactions in the near future. It is envisaged that the draft Bill will be ready by the end of the first quarter of 2012. It is, however, not certain when the Bill will be passed into law.

Management and technical services

The Ghana Investment Promotion Centre (GIPC) is the manager of all technical service transfer agreements that an entity incorporated or registered in Ghana can have with its parent, affiliate or other unrelated persons.

The Technology Transfer Regulation (LI 1547) regulates the types of technology that can be transferred for a fee in Ghana. The fee ranges between 0% and 8% of the net sales or 0% to 2% of profit before tax (PBT).

Dividends

Ordinarily, dividend income is taxable under the IRA. However, dividend income paid out from the gross income that has been subject to tax under the PITL is not a taxable income under the PITL. Further, the PA exempts contractors from the payment of dividend tax. This means that dividend income earned by investors in a company carrying on upstream petroleum operations in Ghana is not subject to any tax.

Royalties

Petroleum royalties are administered and collected by the commissioner-general and, like all taxes, are paid into the state's consolidated fund. The royalty rate is not fixed. In the PAs signed so far, it ranges from 3% to 12.5% of the gross production of crude oil and natural gas.

Royalty payments are based on the gross value of oil or gas lifting. The GoG and GNPC have the right to elect to choose oil and gas lift as payment for the royalty, or to receive a cash payment in lieu of petroleum lift.

Additional oil entitlement

The GoG and GNPC have the right to receive an additional oil entitlement (AOE), which is taken out of the contractor's share of the petroleum. The GoG and GNPC also have the right to elect that the AOE receivable be settled in cash or petroleum lift.

The AOE calculation is very complex. Broadly, it is based on the after-tax, inflation-adjusted rate of return that the contractor has achieved with respect to the development and production area at that time. The contractor's rate of return is calculated on the contractor's net cash flow and is determined separately for each development and production area at the end of each quarter, in accordance with an agreed formula.

C. Capital allowances for petroleum capital expenditure

A petroleum capital expenditure is depreciated for tax purposes over a period of five years in equal installments.

A preoperational petroleum capital expenditure incurred by a person carrying on petroleum operations is divided into five equal parts and claimed as a capital allowance in each of the first five years (from the year of commencement, in which the contractor first produces oil under a program of continuous production for sale).

Capital expenditure incurred after the year of commencement is also claimed equally over a five-year period.

Accordingly, the capital allowance for any year of assessment after the year of commencement is, therefore, the sum of:

- The annual capital allowance for that year
- The sum of:
  - The capital allowance for the year of commencement (see below) as long as that allowance subsists (i.e., there is a carried forward, undeducted balance)
  - The capital allowance in respect of the subsisting annual capital allowances for previous years (i.e., where there are carried forward, undeducted balances)

To calculate the capital allowance for the year of commencement, the sum of petroleum capital expenditure incurred in the year of commencement and in previous years is taken and the following deductions are made:

- Consideration received in respect of any interest acquisition
- Sales of any asset in respect of which a petroleum capital expenditure has been incurred
- Insurance monies received in respect of the loss of an asset
- Monies received in respect of the sole risk of operations (SRO)
- Any other amount received in respect of petroleum operations in or before the year of commencement

D. Incentives

Exploration

Exploration costs incurred prior to commencement of drilling operations are capitalized and a capital allowance claimed equally in the first five years of commercial operations. Similarly, exploration costs incurred after commencement of drilling operations may be capitalized and a capital allowance claimed equally over a five-year period.

Tax losses

Tax losses incurred in any year of assessment can be deducted from the subsequent year's profit. If the subsequent year's income is not enough to recoup the loss, the loss can be carried forward until it is eventually recouped. Under no circumstances may the aggregate deduction in respect of any such loss exceed the amount of the loss.

As noted previously, ring-fencing applies and, accordingly, losses from upstream petroleum activities cannot be used to offset profits from downstream or other unrelated business activities.

Research and development

No special incentives for R&D costs are available in the PITL or the PA. However, the IRA ordinarily permits the deduction of R&D expenditure. The IRA indicates that, for the purposes of ascertaining the income of a person for a period from any business, the R&D expenditure incurred by that person during the period in the production of income is deducted. The IRA further defines R&D as "any outgoing or expense incurred by a person for the purposes of developing that person's business and improving business products or processes but does not include any outgoing or expense incurred for the acquisition of an asset in relation to which that person is entitled to a capital allowance."

E. Withholding taxes

Branch remittance tax

The PITL and the PA do not tax branch profit remittances. The IRA, however, imposes tax on branch profit remittances at 10%. However, since the PA indicates that no tax, duty or other impost shall be imposed by the state (Ghana) or any political subdivision on the contractor, its subcontractors or its affiliates in respect to the activities relating to petroleum operations and to the sale and export of petroleum other than as provided for in the PA, branch remittances are not captured as taxable transactions.

Therefore, unless the PITL is amended, branch remittances relating to upstream activities are not subject to branch remittance tax, but remittances relating to downstream activities are subject to branch remittance tax of 10%.

Foreign resident withholding tax/foreign contractors withholding tax

Subcontractors to a PA suffer a final withholding tax (WHT) of 5% on gross payments received from the contractor who is a party to the PA. It has been proposed to classify third-party lenders as subcontractors, in which case interest payments made to them will be subject to 5% final WHT.

A contractor, as defined by the PITL, means any person who is a party to a PA with the GoG and GNPC. A subcontractor is also defined as any person who enters into a contract with a contractor for the provision of work or services (including rental of plant and equipment) in Ghana for, or in connection with, the PA.

Generally, no variation of, or exemption from, the 5% WHT payable is available in respect of payments to subcontractors. However, WHT in respect of services provided to the contractor by an affiliate is waived, as long as such services are charged at cost.

Although the commissioner-general cannot grant any exemptions from the payment of WHT, Ghana's Parliament may grant an exemption.

Ghanaian registered or incorporated companies are required to file annual returns with the GRA. However, for a nonresident company, no returns need to be filed.

F. Financing considerations

Ghana's tax system has significant rules governing the tax impact that the degree of debt and equity mix could have on a company. These rules should be taken into account by petroleum companies in evaluating any planning options.

Thin capitalization rules restrict the total debt and equity mix in a foreign-controlled entity for tax purposes. The permitted debt-to-equity ratio for tax purposes is 2:1. Any excess interest payment or foreign exchange loss incurred in respect of the fall in the value of the debt obligation over and above this ratio is not tax deductible. It has been proposed that the prior approval of the sector minister be required with regard to the capital mix, in which case all interests relating to loans forming part of this pre-approved capital mix shall be allowed as deductible expenses.

The rule applies to the following entities:

- Ghanaian entities that are foreign-controlled or foreign entities that operate locally registered entities in Ghana
- Ghanaian entities that are locally controlled by other Ghanaian parent entities

The thin capitalization rule governs the extent of debt that an exempt-controlled entity can obtain from the parent. An exempt-controlled entity is a company with 50% or more of its shares owned or controlled by the parent entity or a related entity. The deductibility of interest payments and foreign exchange losses for tax purposes in any particular year is restricted to a debt-to-equity ratio of 2:1.

Financial institutions are excluded from the debt-to-equity rules.

Proposed changes that may affect the financing of oil and gas companies include:

- Interest on loans from third parties are not to exceed the lowest market interest rates for similar loans.
- Debt in excess of debt to equity mix approved by the Minister shall have the interests thereon disallowed.

Most investments are inbound and, therefore, it is not common for Ghanaian entities to have controlling interests in other Ghanaian entities such that they could be caught by the thin capitalization rules. In the majority of instances, thin capitalization rules have been applied to Ghanaian resident companies with parents domiciled elsewhere. Such parent companies generally prefer not to tie down funds in equity. Instead, they prefer to have a mechanism to allow for quicker repatriation of funds invested in Ghana and, thus, tend to invest in debt rather than equity.

G. Transactions

Asset disposal

The disposal of an asset can have two effects, depending on whether it was sold before or after the year in which petroleum operations commenced.

If an asset is sold before the year in which petroleum operations commence, its sale has an impact on the quantity of capital allowances that may be claimed when operations commence. For the purposes of calculating the capital allowance for the year of commencement of commercial operations, the full proceeds of the sale are deducted from the accumulated petroleum capital expenditure incurred up to the year of commencement. The net expenditure, after deducting the proceeds of the sale, is treated as the petroleum capital expenditure at commencement and it is subject to a capital allowance in equal installments over a period of five years.

In the case of the disposal or the loss or destruction of a petroleum capital asset in any year after the year of commencement of operations by a person carrying on petroleum operations, the full proceeds of the sale or insurance monies, compensation or damages received by the person must be divided into five equal amounts. The resulting amount is added to the gross income of the person arising from petroleum operations, for the purpose of calculating the taxable income in that year and in each of the immediately succeeding four years.

Farm-in and farm-out

Farm-in arrangements are a common practice within the petroleum extracting sector. A farmee entering into a farm-in arrangement is expected to be allocated the proportionate cost purchased in respect of the farm-in arrangement (that is, the cost of the interest purchased). The farmee is entitled to a deduction for the cost it incurs over a period of five years from the date of commencement of commercial operations (see the previous section on capital allowances for more detail).

For the farmor, if the farm-in occurs in or before the year of commencement of commercial operations, the petroleum capital expenditure incurred up to the date of commencement or in previous years is a net expenditure, after deducting the consideration received in respect of the acquisition by the farmee of an interest or proportionate part of the petroleum interest or in the related assets.

Any sums received after the year of commencement as a reimbursement of cost are treated as proceeds from the sale of an asset and they are divided by five. The resulting amount is added to the gross income from the operations for the purpose of calculating the income that would be subject to tax in that year, and in each of the immediately succeeding four years.

Selling shares in a company (consequences for resident and nonresident shareholders)

Gains made on the sale of shares ordinarily attract CGT. However, to encourage listing and trading of shares on the Ghana Stock Exchange, gains made from the sale of shares listed and traded on the Ghana Stock Exchange are tax exempt. Gains made on shares not listed on the Ghana Stock Exchange, however, attract a 15% tax. The tax treatment is the same for resident and nonresident shareholders. No CGT is payable on gains derived from the sale of upstream petroleum shares.

It has been proposed that the written approval of the sector minister be required prior to the transfer to a third party of ownership, directly or indirectly, in a company, if the effect is to give the third party control of the company or enable the third party to take over the shares of another shareholder.

H. Indirect taxes

Import duties

Goods imported for upstream petroleum operations are exempt from import duties. The sale of an exempt item by a contractor to another petroleum contractor remains exempt. However, the sale of an exempt item by a contractor to a non-petroleum contractor attracts duty if the item is ordinarily dutiable. The duty is assessed at the duty rate prevailing on the date the asset is transferred.

VAT

The VAT regime came into effect in 1998. VAT applies in Ghana to all transactions conducted in Ghana, except for transactions that are exempt. The VAT rate is 12.5%. There is a National Health Insurance Levy (NHIL) of 2.5%. The NHIL is collected by the VAT service. When combined with the VAT, it effectively makes the VAT rate 15%.

The PA basically exempts upstream petroleum activities from VAT (both the 12.5% VAT and the 2.5% NHIL). However, VAT applies to goods and services supplied to companies that undertake petroleum activities. To effect the exemption, the VAT office issues a VAT Relief Purchase Order (VRPO) to the petroleum company whose activities are VAT exempt so that it may "pay" any VAT assessed on goods and services with the VRPO. This means that the petroleum entity is still charged VAT on supplies to it, but it uses the VRPO instead of cash to pay the VAT element. Also, it does not charge VAT on its sales and transactions.

In general, exports of goods and services are zero-rated. That means that petroleum exports by a contractor attract VAT on exports at a zero rate.

However, imports of equipment (machinery) and vessels are exempt from VAT. In addition, the sale of equipment (machinery, including items that constitute apparatus appliances and parts thereof) designed for use in the industry is exempt.

The sale of crude oil and hydrocarbon products is exempt from VAT.

An asset disposal is exempt from VAT if the asset is not subject to VAT under Schedule 1 of Ghana's VAT Act. However, if the asset is ordinarily subject to VAT, a disposal of the asset to an entity that is not a petroleum company is subject to VAT.

The VAT registration threshold is currently GHS10,000. Every person who expects to earn revenue in excess of the threshold in a year, or a proportionate amount thereof in a quarter, is required to register for VAT. Persons with an annual business turnover between GHS10,000 and GHS90,000 are required to register under the VAT Flat Rate Scheme and charge VAT and NHIL at 3%. Persons with annual turnover exceeding GHS90,000 are required to register as standard-rated suppliers and charge VAT and NHIL at 12.5% and 2.5%, respectively. It has been proposed to increase this amount to GHS120,000.

Export duties

No export duties apply to the export of upstream petroleum products. Ghana does not usually charge duty on the export of goods. This is probably because the Government wants to encourage exports.

Stamp duties

The PA exempts upstream petroleum companies from the payment of stamp duties.

Registration fees

A variety of registration fees are payable at the local Government level.

I. Other

The Government's approach is toward taking equity ownership of projects and the maximum equity limits that apply, with interest of the parties.

In order to encourage prospecting and the development of oil and gas in Ghana, pioneer oil and gas corporate entities received very generous fiscal incentives. The GoG has become less and less generous following the oil find in 2007.

The PA signed by the GoG and GNPC and the petroleum contractor requires the establishment of a joint management committee (JMC) to conduct and manage the petroleum operations.

However, in relation to all exploration and development, the GNPC is expected to take (at no cost) a 10% to 12.5% initial interest in respect of crude oil and a 10% initial interest in respect of natural gas. The GNPC has an interest in all exploration and development operations.

The GNPC also has the option to acquire an additional interest in every commercial petroleum discovery. However, to acquire the additional interest, the GNPC must notify the contractor within 90 days after the contractor's notice to the minister of the discovery. If the GNPC does not give the required notice, its interest shall remain as described above. If the GNPC decides to acquire the additional interest, it will be responsible for paying for its proportionate share in all future petroleum costs, including development and production costs approved by the JMC.

Domestic production requirements

The GoG has a 5% to 12.5% royalty take in the petroleum production and a 3% royalty in gas production. The GoG can elect to take a cash settlement for its 3% and 5% to 12.5% royalty, or it may have it settled with the supply of gas and crude petroleum, respectively. In addition to the 5% to 12.5% royalty take in oil and the 3% in gas, the GoG (through its equity interest) has a 12.5% initial interest take in oil and a 10% interest in gas, or their cash equivalents. Any additional interest that the Government has in petroleum production is taken in oil and/or gas or their cash equivalent.

Crude oil for domestic consumption, therefore, is expected to be met by the royalty and government share in the petroleum production. However, if domestic consumption exceeds the state's share of oil and gas the GoG is expected to inform the other partners about the additional local need three months in advance, and the contractor is expected to oblige and meet local production requirements.

The state, however, must pay for the additional supply required at the ruling market price.

Proposed changes

The proposed changes are summarized as follows:

- Interest on loans from third parties not to exceed the lowest market interest rates for similar loans
- Third-party lenders to be considered subcontractors; interests payable to them to be subject to WHT (presently 5% and final)
- Percentage of loans to total capital to receive the prior approval of the minister
- Interests on "unapproved" loans to be disallowed
- Profits from direct or indirect assignment, transfer or disposal of rights regardless of beneficiary, type or location of the transaction to be subject to CGT
- Written approval of the minister to be sought by a contractor before direct or indirect transfer of shares to a third party
- Offset of VAT credit against corporate tax outstanding a possibility
- No less than 5% of contractor's entitled petroleum to be supplied to the domestic market at a negotiated price
- Contractors obliged to meet domestic supply requirements (pro rata but not to exceed total entitlement)
- Contractors and subcontractors in petroleum operations to be required to consider Ghanaian companies and operators first in awarding contracts

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A. At a glance

Fiscal regime

There are no separate tax laws or regulations in Greenland governing the oil and gas sector. Companies are therefore subject to the general Corporate Income Tax Act.

Royalties	Yes
Bonuses	None
Production sharing contract (PSC)	Yes
Income tax rate	31.8%[103]
Capital allowances	E[104]
Investment incentives	L[105]

B. Fiscal regime

Greenland tax-resident companies are subject to corporation tax on their worldwide profits, including chargeable gains, with credit for any creditable foreign taxes. The taxable income of companies is stated as their gross income net of operating expenses, i.e., expenses incurred during the year in acquiring, securing and maintaining the income. The tax assessment is based on the net income or loss, adjusted for tax-free income, non-deductible expenses, amortization and depreciation, and tax loss carryforwards.

The taxable income must be stated for one income year at a time. The income year generally corresponds to the calendar year. However, companies may, upon request to the tax authorities, be allowed to apply a staggered income year. The area covered, generally, is activities undertaken within Greenland territorial borders, its territorial sea or continental shelf area.

Foreign persons and companies that engage in hydrocarbon prospecting activities, exploration activities, exploitation of hydrocarbons and related business, including construction of pipelines, supply services and transportation of hydrocarbons by ship or pipeline, are in general subject to taxation in Greenland on the income from the time the activity is commenced in Greenland. If Greenland has entered into a double tax treaty with the country where the foreign person or company is a tax resident, the treaty may modify the Greenland tax liability.

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103 Companies subject to full and limited tax liability (including companies subject to the Act on Mineral Resources) must pay tax at a rate of 30% on their round-off income plus a charge of 6%, which adds up to an effective tax rate of 31.8%. In practice, licensees do not pay the 6% tax charge and, thus, pay tax at a rate of 30%.

104 E: immediate write-off for exploration costs.

105 L: losses can be carried forward indefinitely.

Prospection and exploration for mineral resources may be carried out by either a branch (permanent establishment for tax purposes) or a company, whereas a license to exploit mineral resources can only be granted to public limited companies that are domiciled in Greenland, that exclusively carry out business under licenses granted pursuant to the Mineral Resources Act and that are not taxed jointly with other companies. In addition, the company cannot be more thinly capitalized than the group to which it belongs; however, the company's debt-to-equity ratio may go as far as 2:1. Furthermore, the licensee must command adequate technical knowledge and financial resources to carry out the exploitation activities in question. If the exploration for mineral resources has been carried out by a branch, it may be necessary to convert the branch into a public limited company in connection with the transition from exploration to exploitation activities (subject to a license granted for such activities). Such conversion generally will be considered a taxable transaction, and any gains arising in connection with the transfer will be subject to tax. However, provided certain conditions are fulfilled, it is possible to transfer all assets and liabilities related to the Greenland branch to the new Greenland public limited liability company on a tax-exempt basis. One of the conditions that must be fulfilled is that the public limited company — in all relations — must succeed to the rights and obligations of the branch as far as the Corporate Income Tax Act and the Greenland Home Rule Act on tax administration are concerned.

Production sharing contract

Under the Mineral Resources Act, the publicly owned company NUNAOIL A/S must be part of a license. Oil and gas companies undertaking oil and gas operations in Greenland will enter into a PSC with NUNAOIL A/S according to which NUNAOIL A/S will participate in the license with a specified share (determined on a license-by-license basis). The contractor will provide financing and bears all the risks of exploration, development and exploitation activities in exchange for a share of the total production.

Royalties

Royalties are calculated on a license-by-license basis. Royalties may be levied by way of area fees, production fees, volume fees, application fees and output fees, etc. Royalties are dependent on the concession agreement between the company and the Greenland Bureau of Minerals and Petroleum.

Ring-fencing and losses

As a general principle, expenses and tax losses on transactions related to Greenland oil and gas exploration and exploitation activities may not be offset against non-oil- and gas-related taxable income. For example, exploration costs are deductible against the oil- and gas-related income only to the extent that the costs de facto have been used in an oil and gas business.

However, exceptions apply to this general ring-fence rule. Exceptions include the following:

- When a loss-making field is closed down, any tax loss carryforward from that field may be offset against a profitable field.
- Capitalized exploration costs and tax loss carryforwards from the exploration phase can also be offset against profits from any field.

Shutdown provision

Upon the granting of a license for exploration for, and exploitation of, mineral resources, a plan must, pursuant to the Mineral Resources Act, be drawn up detailing the licensee's obligations to remove installations, etc., upon termination of the activities and clear out the areas concerned. Companies that have been granted an exploitation license pursuant to the Act may, in their statement of taxable income, deduct any amounts set aside to ensure that an approved shutdown plan can be implemented. The right to deduct such amounts presupposes that the terms relating to security, etc., stipulated in the license are fulfilled.

Tax consolidation

Joint taxation and other forms of tax consolidation are, in general, not allowed in Greenland. However, companies granted a license to explore for mineral resources in Greenland pursuant to the Mineral Resources Act are allowed to compute their taxable income on an aggregate basis if, for instance, they have more than one permanent establishment at the same time or carry on other activity that is subject to limited tax liability.

Functional currency

Provided that certain requirements are met, taxpayers may calculate their taxable income by reference to a functional currency (i.e., a particular foreign currency other than the Danish kroner). The election must be made before the beginning of the income year.

Transfer pricing

Transactions between affiliated entities must be determined on an arm's-length basis. In addition, Greenland companies and Greenland permanent establishments must report summary information about transactions with affiliated companies when filing their tax returns.

Greenland tax law requires entities to prepare and maintain written transfer pricing documentation for transactions that are not considered insignificant. The documentation does not need to be filed with the tax authorities but, on request, it must be filed within 60 days.

The fine is set as a minimum penalty corresponding to twice the expenses (e.g., internal staff costs and fees to tax advisors) saved for not having drawn up, or partially omitted to draw up, transfer pricing documentation. In addition, if the income is increased because the arm's-length criterion is not met, the minimum penalty can be increased by an amount corresponding to 10% of the increase.

C. Capital allowances

Depreciations

An acquired license right may be amortized on a straight-line restricted basis over a 10-year period. Licenses with a remaining term shorter than 10 years at the time of acquisition are amortized at a rate resulting in equal annual amounts over the remaining term.

The main rule is that fixed assets (e.g., machinery, production equipment) may be depreciated according to the reducing-balance method by up to 30% a year. Included is fixed onshore plant, etc., fixed and mobile platforms and associated equipment and machinery, pipelines, pumps, storage tanks and other equipment, and any independent accommodation platforms.

For purposes of the liquidity in the companies disposing of depreciable assets (in this respect, assets only covers buildings and installations as well as ships and aircraft), companies can, further, increase the depreciation for tax purposes through "gains depreciation," following which the company can provide depreciation for tax purposes corresponding to the taxable gain (gains depreciation) on disposal of the assets in question.

The depreciation provided by the company (ordinary depreciation and gains depreciation) can furthermore be increased by depreciation corresponding to half the company's pre-tax profit — the "profit depreciation." The company may allocate profit depreciation to buildings, ships and aircraft and the balance on the operating equipment account at its own discretion.

To prevent speculative trading in companies with unutilized depreciation allowances, the Greenland tax rules states that, where a company provides for depreciation at rates below 30%, the company's depreciation balance is reduced to the amount to which the company's assets could have been depreciated in the following cases:

- 30% or more of the share capital is owned by other shareholders or owners at the end of the income year compared with the beginning of the income year.
- The distribution of shares or voting rights in the company changes significantly during the income year compared with the distribution in the previous income year.
- The company's activities change significantly during the income year compared with the activities in the previous income year.
- The company is a party to a merger, a demerger or a similar reconstruction.

A "significant change" in relation to the distribution of shares or voting rights is, as a general rule, defined as 30% or more. In relation to the company's activities, a significant change takes place if 30% or more of the company's income or net profit in the income year in question stems from other activities as compared with the company's income in the preceding income year.

Exploration costs

All costs related to oil and gas exploration in Greenland are allowed as a deduction for the purposes of the statement of taxable income.

D. Incentives

Tax losses

Tax losses may be carried forward indefinitely. However, there is a requirement that there is no significant change of ownership during an income year. The right to carry forward tax losses may be restricted in connection with a significant change in the company's ownership structure or activities. Losses are forfeited if the composition of the group of shareholders is significantly changed. A group of shareholders is deemed to have been significantly changed where more than one-third of the capital has changed hands. This is established by comparing the group of shareholders at the beginning of the income year showing a loss with the group of shareholders at the end of the income year in which the company wishes to deduct the loss.

Tax exemption

The Greenland tax authorities may exempt companies with a license to exploit mineral resources from taxation if this is stipulated in the license granted to the licensee.

E. Withholding taxes

Greenland companies paying dividends and royalties must withhold tax at source. Greenland distributing companies must withhold dividend tax at the rate fixed by the tax municipality of the company in question (currently 37% to 44%). Dividend tax is a final tax that must be withheld only on declared dividends. Companies with a license to explore for and exploit hydrocarbons and minerals pay withholding tax at a rate of 37%.

Royalty tax at a rate of 30% must be withheld on royalty payments to foreign companies.

Dividend and royalty tax may be reduced or eliminated under an income tax convention if the receiving company is able to document that it is domiciled in a foreign state with which Greenland has concluded such a convention.

Under Greenland law, interest and capital gains are not subject to tax at source.

Branch remittance tax

Branch remittance tax is not applicable in Greenland.

Income tax withholding and reporting obligations

A foreign company that is engaged in oil and gas exploration or exploitation activities in Greenland is required to withhold income tax from salaries paid to nonresident employees working in Greenland. If Greenland has entered into a double tax treaty with the country where the foreign company is a tax resident, the treaty may modify the Greenland tax liability.

Withholding and payment of taxes withheld are required on a monthly basis, and reports must be filed with the Greenland tax administration on an annual basis.

F. Financing considerations

Interest expenses

Interest expenses and capital losses (e.g., due to foreign exchange) on debts incurred for financing oil and gas exploration and exploitation in Greenland are allowed as a deduction against the tax base. The interest or loss must be related to the Greenland oil and gas activity.

However, a branch of a foreign company cannot deduct interest on loans from its principal (the head office); there must be an "outside" lender (e.g., a sister company).

Capital losses are generally deductible according to the realization principle, but it is possible to opt for the mark-to-market principle on currency fluctuations.

Debt-to-equity limitation rules

Under the thin capitalization rules, interest paid and capital losses realized by a Greenland company or by a branch of a foreign group company are partly deductible, to the extent that the Greenland company's debt-to-equity ratio exceeds 2:1 at the end of the debtor's income year and the amount of controlled debt exceeds DKK5 million.

Denied deductibility applies exclusively to interest expenses related to the part of the controlled debt that needs to be converted to equity in order to satisfy the debt-to-equity rate of 2:1 (a minimum of 33.3% equity). The thin capitalization rules also apply to third-party debt if the third party has received guarantees or similar assistance from a foreign group company.

Greenland tax law does not recharacterize or impose withholding tax on the disallowed interest.

G. Transactions

Asset disposals

The disposal of assets is a taxable event; gains and losses are generally taxable or deductible for tax purposes. As detailed above, provided certain conditions are fulfilled, it may be possible to transfer assets and liabilities on a tax-exempt basis (see Section B).

Transfer of license interests

All transfers of licenses (including farm-ins and farm-outs) require approval from the Greenland Bureau of Minerals and Petroleum.

It is common in the Greenland oil and gas business for entities to enter into farm-in and farm-out arrangements. However, the tax consequences of this farm-in or farm-out must be considered on a case-by-case basis, depending on how the agreement is structured.

Provided certain conditions are fulfilled, it is possible to farm-out (i.e., transfer part of a license to another company in return for this other company's defrayment of part of the exploration costs to be paid by the seller regarding their remaining interest) a license on a tax-exempt basis for the farmor. The company farming in can deduct its share of the exploration costs against its taxable income. The farmee cannot amortize the acquired license interest.

The Greenland farm-out provision does not apply to the transfer of exploitation licenses but only for the transfer of prospecting or exploration licenses. Furthermore, intragroup transfers are not covered by the Greenland farm-out provision, so it only applies to the transfer of license interest to independent third parties.

Selling shares in a company

Gains and losses arising on the disposal of shares are included in the taxable income irrespective of the percentage interest and period of ownership.

H. Indirect taxes

In Greenland, there is no general VAT system and hence no sales taxes. Also, in general, there are no specific duties, energy taxes or similar. However, for a number of specific products, such as motor vehicles, meat products, alcohol and cigarettes, there are import duties.

I. Other

Business presence

Forms of business presence in Greenland typically include companies, foreign branches and joint ventures (incorporated and unincorporated). In addition to commercial considerations, it is important to consider the tax consequences of each form when setting up a business in Greenland. Unincorporated joint ventures are commonly used by companies in the exploration and development of oil and gas projects.

Tax treaty protection

In general, oil and gas activities constitute a permanent establishment under most tax treaties; therefore, treaty protection cannot generally be expected for a foreign company. For individual income tax liability, tax treaty provisions vary from country to country, and protection against Greenland taxation may be available in specific cases.

Tax return and tax assessment

Foreign companies subject to limited tax liability and Greenland domestic limited liability companies must submit an annual tax return to the Greenland tax authorities, but they are not required to prepare separate financial statements. Tax returns must be prepared and filed with the Greenland tax authorities no later than 1 May in the income year following the income year it concerns. Tax is due 11 months and 20 days after the end of the income year.

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A. At a glance

General corporate income tax (CIT)	20%
Production levy	D, 5%
Special hydrocarbon tax	E, progressive

B. Fiscal regime

Exploration for oil and gas in Icelandic waters is regulated by Act No. 13/2001 on prospecting, exploration and production (E&P) of hydrocarbons (Hydrocarbons Act). Accompanying the Act are Regulation No. 884/2011 and Regulation No. 39/2009. The Act applies to the Icelandic territorial sea and exclusive economic zone and the Icelandic continental shelf. In addition, the Agreement of 22 October 1981 between Norway and Iceland on the Continental Shelf Between Iceland and Jan Mayen, the Agreement of 3 November 2008 between Norway and Iceland concerning transboundary hydrocarbon deposits and the Agreed Minutes of 3 November 2008, concerning the Right of Participation pursuant to Articles 5 and 6 of the Agreement from 1981, apply to the relevant parts of the continental shelf between Iceland and Norway.

Petroleum activities are subject to general Icelandic laws and regulations on taxation, environmental protection, health and safety. Hydrocarbon accumulations are owned by the Icelandic state, and a license from the National Energy Authority (Orkustofnun, or NEA) is required for prospecting, E&P of hydrocarbons. The NEA is also responsible for monitoring hydrocarbon prospecting, E&P activities, and archiving the data generated by such activities. The NEA coordinates the response of Icelandic authorities to requests from oil companies for information regarding petroleum activities.

Iceland is a member of the European Economic Area. The European Union Directive on the conditions for granting and using authorizations for the prospecting, E&P of hydrocarbons (Directive 94/22/EC), and other relevant EU legislation, therefore applies to petroleum activities in Icelandic waters.

C. The scope and parties liable for taxation

Hydrocarbon extraction activities are subject to CIT of 20%, a production levy (see Section D) and a special hydrocarbon tax (see Section E).

Act No. 109/2011 on the taxation of hydrocarbon production extends the territorial scope of Icelandic CIT to all income derived from exploration, production and sales of hydrocarbons, including all derived activities, such as transportation in pipelines or by ships and other work and services provided:

- In Iceland's territorial waters, its exclusive economic zone and on its continental shelf
- In the adjacent ocean region where hydrocarbon resources extend across the center line with another state, when entitlement to the hydrocarbons falls to Iceland under an agreement with the other state

- Outside Iceland's territorial waters, exclusive economic zone and continental shelf provided that Iceland has the right to tax the activity and work in accordance with ordinary law or a special agreement with a foreign state

An obligation to pay taxes and levies lies with those parties who have received licenses for exploration or production of hydrocarbons, and also all other parties who participate, directly or indirectly, in the exploration, production and distribution of hydrocarbon products and other related activities. Thus, liability of taxation, also with reference to Act No. 90/2003 on income tax, rests with legal persons, self-employed individuals and wage-earners who earn income through activities that take place in the above listed areas.

D. Production levy

A licensee who is liable for taxation shall pay a special production levy of 5% of the value of the quantity of hydrocarbons that they produce each year on the basis of their activities for which a license is required. Production refers to all the hydrocarbons that are delivered from the resource, including those destined for further processing and for the licensee's own use.

The value of the hydrocarbons is based on a reference price determined at the beginning of each month in respect of the month that has just passed. The reference price is based on the average price of hydrocarbons on a recognized international market trading in comparable hydrocarbon products, also taking into account the cost of sales and the point of delivery.

The production levy is a part of operational expenses and is therefore deductible for Icelandic corporation income and special hydrocarbon tax purposes.

E. Special hydrocarbon tax

Taxable licensees having income from exploration, production, distribution or sale of hydrocarbons, as well as other parties receiving a part of this income, are obliged to pay a special hydrocarbon tax.

The tax base for the special hydrocarbon tax for a taxable entity shall include all operating revenue and capital gains, with certain costs restricted or excluded as set out in Section F. If sales of hydrocarbons during any period have been made at a price lower than the reference price for the production levy, the reference price shall be used when the tax base is calculated.

The tax rate of the special hydrocarbon tax is the company's profit rate multiplied by 0.45. The profit rate as a percentage is the ratio of the special hydrocarbon tax base to total income. For example, if a company's profit ratio is 40%, the special hydrocarbon tax rate is 18% (40%*0.45).

Special hydrocarbon tax is not deductible for CIT purposes.

F. Deductions from taxable income

When determining the base of the hydrocarbon tax, deductions for the following costs may be restricted:

1. Financial costs deducted from the year's income may not exceed 5% of the company's balance sheet liability position, less financial assets, including receivables and inventory, at the end of the relevant financial year.

   Financial costs shall include all interest costs, indexation adjustments, depreciation and exchange rate gains or losses on the book value of liabilities, after interest earnings, indexation adjustments, depreciation and exchange rate gains or losses on the book value of assets have been deducted from them. If such financial costs arise in connection with the acquisition of assets other than those that are used in the operations for which the license is required, it shall be divided in direct proportion to the outstanding balance of the depreciated value, for tax purposes, of all depreciable assets at the end of the year. That part of the financial costs which pertains to assets that are not used in connection with hydrocarbon production shall not be deductible from income when the tax base is determined.

The minister may raise or lower the reference percentage, taking into account the currency used in the licensee's operations and financing, and the general rate of interest in the currency involved. When calculating this base, unpaid income tax or calculated unpaid hydrocarbon tax shall not be included among liabilities. The same shall apply to calculated tax commitments and tax credits arising from a permanent incongruity in the timing of compilation of annual accounts and the payment of tax.

2. Rent paid for structures or equipment used for exploration or extracting hydrocarbons, which exceeds normal depreciation and interest on the assets involved, based on the utilization time each year, may not be deducted from income. If equipment is rented by an associated party, the Icelandic tax authorities may disallow the entry of the rental as a cost item, unless the lessee submits information and materials demonstrating the cost price and accrued depreciation of the equipment in the ownership of the lessor, so that it is possible to establish that certain conditions have been met.
3. The cost of the hire of labor may only be deducted from income if the work agency has registered itself in Iceland. Insurance fees, distribution costs and all service fees to related parties can only be deducted from income if the taxable entity can demonstrate that these costs are no higher than would apply in arm's-length transactions. In the year in which a production area is closed, 20% of operating income for the preceding year may be entered as income for that year.

In calculating the tax base for the special hydrocarbon tax, it is not permitted to deduct the following items:

- Losses incurred on sales of assets to related parties
- Any gifts or contributions to charities, cultural activities, political organizations and sports clubs
- Depreciation of receivables and inventories
- Losses or expenses in activities not covered by Act No. 109/2011, including places of business onshore
- Losses or expenses incurred by a taxable entity before the issuing of a license

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A. At a glance

Fiscal regime

India has a hybrid system of production sharing contracts (PSCs) containing elements of royalty, as well as sharing of production with the Government.

Royalties (under New Exploration Licensing Policy)

Onshore areas:	
Crude oil	12.5%
Natural gas	10%
Shallow water offshore areas:	
Crude oil and natural gas	10%
Deepwater offshore areas:	
Crude oil and natural gas	For the first seven years of commercial production 5% and thereafter 10%
Bonuses	None as per the New Exploration Licensing Policy
Income tax rate:	
Domestic companies	30%[106]
Foreign companies	40%[106]

106 *In addition, a surcharge (5% on tax for a domestic company and 2% on tax for a foreign company) must be paid if income of the company is in excess of INR10 million. An education levy of 3% on the tax and surcharge is also applicable.*

Resource rent tax	None
Capital allowances	D, E[107]
Investment incentives	TH, RD[108]

B. Fiscal regime

India has a hybrid system of PSCs containing elements of royalty, as well as sharing of production with the Government.

Companies enter into a PSC with the Government of India to undertake exploration and production (E&P) activities.

Income from E&P operations is taxable on a net income basis (i.e., gross revenue less allowable expenses). Special allowances are permitted to E&P companies (in addition to allowances permitted under the domestic tax laws) for:

- Unfruitful or abortive exploration expenses in respect of any area surrendered prior to the beginning of commercial production; after the beginning of commercial production; expenditure incurred, whether before or after such commercial production, in respect of drilling or exploration activities or services or in respect of physical assets used in that connection
- Depletion of mineral oil in the mining area post-commercial production

Domestic companies are subject to tax at a rate of 30% and foreign companies at a rate of 40%. In addition, a surcharge (5% on tax for a domestic company and 2% on tax for a foreign company) must be paid if income is in excess of INR10 million. An education levy of 3% also applies. The effective corporate tax rates are as follows:

Domestic company		Foreign company	
For net income up to and including INR10 million	For net income exceeding INR10 million	For net income up to and including INR10 million	For net income exceeding INR10 million
30.9%	32.45%	41.2%	42.02%

Minimum alternate tax

Minimum alternate tax (MAT) applies to a company if the tax payable on its total income as computed under the tax laws is less than 18.5% of its book profit (accounting profits subject to certain adjustments). If MAT applies, the tax on total income is deemed to equal 18.5% of the company's book profit.

Credit for MAT paid by a company can be carried forward for 10 years and it may be offset against income tax payable under domestic tax provisions. Due to the MAT regime, a company may be required to pay some tax, even during the tax holiday period.

Ring-fencing

No ring-fencing applies from a tax perspective; therefore, it is possible to offset the exploration costs of one block against the income arising from another block.

Treatment of exploration and development costs

All exploration and drilling costs are 100% tax deductible. Such costs are aggregated till the year of commencement of commercial production.

They can be either fully claimed in the year of commercial production or amortized equally over a period of 10 years from the date of first commercial production.

Development costs (other than drilling expenditure) are allowable under the normal provisions under the domestic tax law.

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107 *D: accelerated depreciation; E: immediate write-off for exploration costs and the cost of permits first used in exploration.*

108 *TH: tax holiday; RD: research and development incentive.*

Production sharing contract regime

India has a hybrid system of PSCs containing elements of royalty as well as sharing of production with the Government. E&P companies (contractors) that are awarded the exploration blocks enter into a PSC with the Government for undertaking the E&P of mineral oil. The PSC sets forth the rights and duties of the contractor.

The PSC regime is based on production value.

Cost petroleum or cost oil

Cost petroleum is the portion of the total value of crude oil and natural gas produced (and saved) that is allocated toward recovery of costs. The costs that are eligible for cost recovery are:

- Exploration costs incurred before and after the commencement of commercial production
- Development costs incurred before and after the commencement of commercial production
- Production costs
- Royalties

The unrecovered portion of the costs can be carried forward to subsequent years until full cost recovery is achieved.

Profit petroleum or profit oil

Profit petroleum means the total value of crude oil and natural gas produced and saved, as reduced by cost petroleum. The profit petroleum share of the Government is biddable by the contractor. The blocks are auctioned by the Government. The bids from companies are evaluated based on various parameters including the share of profit percentage offered by the companies.

The law has no caps on expenditure recovery. The percentage of recovery of expense incurred in any year is as per the bids submitted by the companies. Further, no uplift is available on recovered costs.

The costs that are not eligible for cost recovery[109] are as follows:

- Costs incurred before the effective date[110] including costs of preparation, signature or ratification of the PSC
- Expenses in relation to any financial transaction to negotiate, obtain or secure funds for petroleum operation. For example, interest, commission, brokerage, fees and exchange losses
- Marketing or transportation costs
- Expenditure incurred in obtaining, furnishing and maintaining guarantees under the contract
- Attorney's fees and other costs of arbitration proceedings
- Fines, interests and penalties imposed by courts
- Donations and contributions
- Expenditure on creating partnership or joint venture arrangement
- Amounts paid for non-fulfillment of contractual obligations
- Costs incurred as a result of misconduct or negligence of the contractor
- Costs for financing and disposal of inventory

The PSC provides protection in case changes in Indian law result in a material change to the economic benefits accruing to the parties after the date of execution of the contract.

109 *Without prejudice to their allowability under domestic tax laws.*

110 *Effective date means the date when the contract is executed by the parties or the date from which the license is made effective, whichever is later.*

Royalties

- Land areas – payable at the rate of 12.5% for crude oil and 10% for natural gas
- Shallow water offshore areas – payable at the rate of 10% for crude oil and natural gas
- Deepwater offshore areas (beyond 400m isobath) – payable at the rate of 5% for the first seven years of commercial production and thereafter at a rate of 10% for crude oil and natural gas

The wellhead value is calculated by reducing the marketing and transportation costs from the sale price of crude oil and natural gas.

C. Capital allowances

Accelerated depreciation

Depreciation is calculated using the declining-balance method and is allowed on a class of assets. For field operations carried out by mineral oil concerns, the depreciation rate is 60% for specified assets[111] while the generic rate of depreciation on the written-down basis is 15% (majority of the assets fall within the generic rate). Further, additional depreciation of 20% is available on the actual cost of new machinery or plant[112] in the first year.

D. Incentives

Tax holiday

A seven-year tax holiday equal to 100% of taxable profits is available for an undertaking engaged in the business of commercial production of mineral oil or natural gas or refining of mineral oil.

Carryforward losses

Business losses can be carried forward and set off against business income for eight consecutive years, provided the income tax return for the year of loss is filed on time. For closely held corporations, a 51% continuity of ownership test must also be satisfied.

Unabsorbed depreciation can be carried forward indefinitely.

Research and development

Expenditures on scientific research incurred for the purposes of the business are tax deductible.

Deduction for site restoration expenses

A special deduction is available for provisions made for site restoration expenses if the amount is deposited in a designated bank account.
The deduction is the lower of the following amounts:

- The amount deposited in a separate bank account or "site restoration account"
- Twenty percent of the profits of the business of the relevant financial year

E. Withholding taxes

The following withholding tax (WHT) rates apply to payments made to domestic and foreign companies in India:

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111 *Mineral oil concerns:*
(a) Plant used in field operations (above ground) distribution – returnable packages
(b) Plant used in field operations (below ground), not including curbside pumps but including underground tanks and fittings used in field operations (distribution) by mineral oil concerns.

112 *Additional depreciation is permitted for all persons engaged in the business of manufacturing or producing any article or thing for new plant and machinery acquired after 31 March 2005.*

Nature of income	Rate (%)	
	Domestic company	Foreign* company
Dividends**	0%	0%
Interest	20%	20%***
Fees for professional or technical fees	10%	10%
Royalty	10%	10%
Nonresident contractor		Maximum 40%****
Branch remittance tax	0%	

For countries with which India has entered into a tax treaty, the WHT rate is the lower of the treaty rate and the rate under the domestic tax laws on outbound payments.

* The rates are to be further enhanced by the surcharge and education levy.

** Dividends paid by domestic companies are exempt from tax in the hands of the recipient. Domestic companies are required to pay dividend distribution tax (DDT) at 16.22% on dividends paid by them.

*** This rate applies to interest from foreign currency loans. Other interest is subject to tax at the rate of 40% (plus applicable surcharge and education levy).

**** Subject to treaty benefits. If a permanent establishment is constituted in India, the lower WHT rate depends on profitability.

F. Financing considerations

Thin capitalization limits

There are no thin capitalization rules under the Indian tax regulations.

Under the exchange control regulations, commercial loans obtained by an Indian company from outside India are referred to as external commercial borrowings (ECBs). ECBs are permitted for capital expansion purposes. ECBs can be raised from internationally recognized sources such as international banks, international capital markets and multilateral finance institutions, export credit agencies, suppliers of equipment, foreign collaborators and foreign equity holders (subject to certain prescribed conditions, including debt-to-equity ratio).

Interest quarantining

Interest quarantining is possible, subject to the exact fact pattern.

G. Transactions

Asset disposals

A capital gain arising on transfer of capital assets (other than securities) situated in India is taxable in India (sale proceeds less cost of acquisition). Capital gains can either be long term (capital assets held for more than three years, except for securities where it is required to be held for more than one year) or short term. The rate of capital gains tax (CGT) is as follows: [113, 114]

113 *The rates are further enhanced by the applicable surcharge and levy.*

114 *The cost of capital assets is adjusted for inflation (indexation) to arrive at the indexed cost (the benefit of indexation is not available to nonresidents), which is allowed as a deduction while computing the long-term capital gains.*

Particulars	Rate (%)*	
	Short-term capital gains	Long-term capital gains
Resident companies	30%	20%
Nonresidents	40%	20%

* The rates are to be further enhanced by the surcharge and education levy.

A short-term capital gain on transfer of depreciable assets is computed by deducting the declining-balance value of the classes of assets (including additions) from the sale proceeds.

Farm-in and farm-out

No specific provision applies for the tax treatment of farm-in consideration, and its treatment is determined on the basis of general taxation principles and provisions of the PSC. However, special provisions do determine the taxability of farm-out transactions in certain situations.

Selling shares in a company (consequences for resident and nonresident shareholders)

Listed securities on a stock exchange

The transfer of listed securities is exempt from long-term CGT provided that securities transaction tax is paid. Short-term capital gains are taxable at a reduced rate of 15%.

Transfer of listed securities outside a stock exchange

Long-term capital gains derived from the transfer of listed securities are taxed at the rate of 10% (without allowing for indexation adjustments) or at the rate of 20% with indexation benefits. Short-term capital gains are taxable at the rate of 30% and 40% for resident companies and nonresident companies, respectively.

Unlisted securities

The CGT rate applicable to transfers of unlisted securities is as follows:

Particulars	Rate (%)*	
	Short-term capital gains	Long-term capital gains
Resident companies	30%	20%
Nonresidents	40%	20%

* The rates are to be further enhanced by the surcharge and education levy.

H. Transfer pricing

The Income Tax Act includes detailed transfer pricing regulations. Under these regulations, income and expenses, including interest payments, with respect to international transactions between two or more associated enterprises (including permanent establishments) must be determined using arm's-length prices. The transfer pricing regulations also apply to cost-sharing arrangements.

The Act specifies methods for determining the arm's-length price:

- Comparable uncontrolled price method
- Resale price method
- Cost plus method
- Profit split method
- Transactional net margin method
- Any other method prescribed by the Central Board of Direct Taxes (CBDT)

The CBDT has issued the regulations for applying these methods to determine the arm's-length price.

The transfer pricing regulations require each person entering into an international transaction to maintain prescribed documents and information regarding a transaction. Each person entering into an international transaction must arrange for an accountant to prepare a report and furnish it to the tax officer by the due date for filing the corporate tax return, which is 30 November. The due date for corporate tax return filing for taxpayers not subject to the transfer pricing provisions is 30 September.

A tax officer may make an adjustment with respect to an international transaction, if the officer determines that certain conditions exist, including any of the following:

- The price is not at arm's-length.
- The prescribed documents and information have not been maintained.
- The information or data on the basis of which the price was determined is not reliable.
- Information or documents requested by the tax officer have not been furnished.

Stringent penalties (up to 2% of transaction value) are imposed for non-compliance with the procedural requirements and for understatement of profits.

I. Other

There is a special tax regime for foreign companies that are engaged in the business of providing services or facilities, or supplying plant or machinery or hire used in connection with prospecting, extraction or production of mineral oils.

Important note

Please note that the Indian Finance Ministry has proposed to release a new direct tax code (DTC). As yet, the date of the introduction of DTC is unconfirmed. Once enacted, it would replace the existing income tax and, therefore, it is likely that the discussions above may undergo significant changes upon its enforcement.

J. Indirect taxes

Indirect taxes are applicable to activities that span from manufacturing to final consumption, and include within their scope distribution, trading and imports, as well as services. Therefore, indirect taxes impact almost all transactions.

In India, indirect taxes are multiple, multi-rate and multi-tier (i.e., levied at the central, state and local levels). The principal indirect taxes are central excise, customs duty, service tax, central sales tax and VAT. Additionally, other indirect taxes such as entry tax are also levied by state governments and municipalities.

Customs duty

Customs duty is levied on the import of goods into India and is payable by the importer. The customs duty on imports comprises the following:

- Basic customs duty (BCD)
- Additional duty of customs (ADC), levied in lieu of excise on goods manufactured in India
- Special additional duty of customs (SAD), levied in lieu of VAT on the sale of similar goods in India
- Education levy

The rate of customs duty is based on the classification of imported goods. The classification is aligned to the Harmonized System of Nomenclature (HSN).

The rates of BCD vary across goods and range from 0% to 10%, except for certain specified items that attract higher rates.

ADC is levied in lieu of excise duty that applies to similar goods manufactured in India. It is generally 10.3% (including education levy). SAD is levied in lieu of central sales tax or VAT payable on the sale of similar goods at 4%. In addition, education tax at 3% is charged on the aggregate customs duty.

Thus, the general effective customs duty rate for most imported goods is 26.85%. Further, certain exemptions or concessions are provided on the basis of classification, location or usage of the imported products. In addition, the Government of India has entered into several free or preferential trade agreements with trade partners, such as Thailand, Sri Lanka, the South Asian Association for Regional Cooperation (SAARC) countries, Singapore, and the Association of South East Asian Nations (ASEAN) countries. To promote trade-in terms, preferential tariff rates have been extended for certain identified goods traded with these countries. Similar trade agreements with the European Union countries and others are also currently being negotiated.

Subject to conditions, an importer using imported goods in the manufacture of goods may obtain a credit for ADC and SAD, whereas a service provider using imported goods may obtain a credit exclusively for ADC.

Notable issues for the oil and gas sector

Several concessions or exemptions have been provided for import of goods for specified contracts for exploration, development and production of petroleum goods. Further, concessions or exemptions have been provided for the import of crude and other petroleum products.

Further, import of certain petroleum products also attracts other customs duties, in addition to the duties discussed above, such as additional duty on import of motor spirit and high-speed diesel, and national calamity contingent duty on import of crude oil.

Excise duty

Excise duty applies to the manufacture of goods in India. Most products attract a uniform rate of excise duty of 10% and education tax at a rate of 3%. Accordingly, the effective excise duty rate on most products is 10.3%.

Excise duty is mostly levied as a percentage of the value of goods sold. However, for certain goods, the excise duty is on the basis of the maximum retail price, reduced by a prescribed abatement.

The Cenvat credit rules of 2004 allow a manufacturer to obtain and use the credit of excise duty, ADC, SAD and service tax paid on procurement of goods and services toward payment of excise duty on manufactured goods.

Notable issues for the oil and gas sector

No excise duty is levied on domestic production of crude oil, but it attracts national calamity contingent duty as well as oil tax. On certain petroleum products, excise duty is levied both on the basis of value and quantity. Certain petroleum products also attract other excise duties such as additional duty (on motor spirit and high-speed diesel) and special additional excise duty (on motor spirit).

Cenvat credit is not available in respect of excise duty paid on motor spirit, light diesel oil and high-speed diesel oil used in the manufacture of goods. Manufacturers of certain products now have the option to pay excise duty at a reduced rate of 1%, provided the manufacturer does not claim Cenvat credit on goods and services used for such manufacture.

Service tax

Service tax is levied on certain identified taxable services provided in India at the rate of 10.30% (inclusive of a 3% education tax). The liability to pay the service tax is on the service provider, except in the case of a goods transport agency service or a sponsorship service, where the liability to pay the service tax rests with the service recipient.

Service tax is applied on the basis of the destination principle. Thus, export of services is not subject to tax. On the other hand, import of services is taxable in India and the liability to pay the tax is on the recipient of the service (under the reverse-charge mechanism). Specific rules have been promulgated to determine the conditions under which a specific service would qualify as an export or an import. The Point of Taxation Rules have been introduced to determine the point of time at which the liability of service tax shall arise.

Similar to the manufacture of goods, the Cenvat credit rules allow a service provider to obtain a credit of the ADC and excise duty paid on the procurement of inputs or capital goods. Further, service tax paid on the input services used in rendering output services is also available as credit toward payment of the output service tax liability. However, credit of SAD is not available to a service provider.

Notable issues for the oil and gas sector

Service tax is levied on services provided in relation to the mining of minerals, oil and gas and also on the survey and exploration of minerals, oil and gas.

Previously, the application of service tax extended to the Indian landmass, territorial waters (up to 12 nautical miles) and designated coordinates in the continental shelf (CS) and exclusive economic zone (EEZ). Further, there was an amendment in the law (with effect from 7 July 2009) whereby the application of service tax was extended to installations, structures and vessels in the CS and EEZ of India.

Subsequently, a new notification (with effect from 27 February 2010) was issued, superseding an earlier notification, which stipulates that the service tax provisions would extend to:

- Any service provided in the CS and EEZ of India for all activities pertaining to construction of installations, structures and vessels for the purposes of prospecting or extraction or production of mineral oil and natural gas and supply thereof
- Any service provided, or to be provided, by or to installations, structures and vessels (and supply of goods connected with the said activity) within the CS and EEZ of India that have been constructed for the purpose of prospecting or extraction or production of mineral oil and natural gas and supply thereof

VAT or central sales tax

VAT or central sales tax (CST) is levied on the sale of goods. VAT is levied on sale of goods within a state and CST is levied on a sale occasioning movement of goods from one state to another.

VAT is levied at two prime rates of 4%–5% and 12.5%–15%. However, certain essential items are exempt from VAT. CST is levied either at the rate of 2% (subject to the provision of declaration forms prescribed under the CST Act) or at a rate equivalent to the local VAT rate in the dispatching state.

A VAT or CST registered dealer is eligible for credit for the VAT paid on the procurement of goods from within the state and to utilize it toward payment of the VAT and CST liability on sale of goods made by the dealer. CST paid on procurement of goods from outside the state is not available as a credit.

Notable issues for the oil and gas sector

Petroleum products — petrol, diesel, naphtha, aviation turbine fuel, natural gas etc. — are subject to VAT at higher rates, which range from 4% to 33%, depending on the nature of product and the state where they are sold. VAT credit on petroleum products is generally not allowed as a credit against output VAT or CST liability, except in the case of the resale of such products. Since crude oil has been declared under the CST Act as being goods of "special importance" in the interstate trade or commerce, it cannot be sold at a VAT or CST rate higher than 4%.

GST

The current scheme of indirect taxes is being considered to be replaced by GST. GST was expected to be introduced with effect from April 2011, which was extended to April 2012 (however, the implementation will be delayed further as no consensus has been reached between the Government of India and the state governments on certain key aspects of GST) and shall replace central taxes such as service tax, excise and CST as well as state taxes such as VAT and entry tax.

GST would be a dual GST, consisting of a central GST and a state GST. The tax would be levied concurrently by the center as well as the states, i.e., both goods and services would be subject to concurrent taxation by the center and the states. An assessee can claim credit of central GST on inputs and input services and offset it against output central GST. Similarly, credit of state GST can be set off against output state GST. However, specific details regarding the implementation of GST are still awaited.

Currently, the inclusion of the petroleum sector under GST is not certain, since there are varied views within the Government.

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A. At a glance

The fiscal regime applicable to oil and gas companies consists of product sharing contracts (PSCs) that are entered into between contractors and BPMIGAS, the Indonesian executive body for oil and gas upstream activities (previously Pertamina on behalf of the Government).

Corporate income tax (CIT)	Tax rate depends on the PSC generation entered into; the current rate is 25%
Branch profits tax (BPT)	Current rate is 20%
Royalties on production	None
Bonuses	Amount varies depending on PSC terms
Resource rent tax	None
Surface rent tax	None
Withholding tax:	
‣ Dividends	Depends on the generation of contract
‣ Branch remittance	Depends on the generation of contract
‣ Other withholding tax	Follows general tax law
Capital allowances	Declining-balance depreciation
Incentives	L[115]

Legal regime

The existing contractual arrangements between the foreign oil and gas contractors and BPMIGAS are mainly in the form of a PSC. The other types of agreement between the contractors and BPMIGAS are joint operating contracts (JOC), technical assistance agreements (TAA) and enhanced oil recovery (EOR).

Article 33 of the 1945 Indonesian Constitution is the fundamental philosophy underlying the taxation of the oil and gas industry in Indonesia. It stipulates that "all the natural wealth on land and in the water is under the jurisdiction of the State and should be used for the greatest benefit and welfare of the people." The law of Pertamina, Law No. 8 of 1971, is based on this fundamental philosophy. In accordance with Article 12 of Law No. 8 of 1971, the authority to administer, control the work and carry out the mining operation in the field of oil, natural gas and geothermal energy is vested in Pertamina. Pertamina is authorized to cooperate with other parties in the form of a PSC in carrying out its regulatory duties and functions.

115 *L: ability to carryforward losses.*

With the introduction of Oil and Gas Law, Law No. 22 of 2001, Law No. 8 of 1971 was revoked. Unlike Law No. 8 of 1971, Law No. 22 of 2001 differentiates between upstream (exploration and exploitation) and downstream (refining, transport, storage and trading) activities. The upstream and downstream activities have to be undertaken by separate legal entities. Law No. 22 of 2001 provides the authority for the Government to establish BPMIGAS, an executive agency for upstream activities, and BPHMIGAS, a regulatory agency for downstream activities, to assume Pertamina's regulatory functions.

Law No. 22 of 2001 also stipulates that BPMIGAS or BPHMIGAS will replace Pertamina (Persero) as the contractual party representing the Indonesian Government. Pertamina will no longer have the same function as in the past and it is transformed from a state-owned enterprise governed by Law No. 8 of 1971 into a state-owned limited liability company, PT Pertamina (Persero). PT Pertamina is now similar to other oil and gas companies in Indonesia. However, PT Pertamina has the authority to supply for domestic consumption. The previous contractual agreements entered with the Indonesian Government have also changed and are now structured as cooperation contracts. The contractor may now enter into cooperation or service agreements that are similar to the previous PSC terms and conditions.

Government Regulation No. 79, issued 20 December 2010, provides rules on cost recovery claims and Indonesian tax related the oil and gas industry. This regulation, known as GR 79/2010, is effective from the date of issuance and applies to cooperation contracts signed or extended after that date.

The terms and conditions of cooperation contracts signed before 20 December 2010 are still respected, except where the cooperation contracts do not clearly define certain specific areas covered by the regulation. Taxpayers covered by such cooperation contracts have been given a transitional time frame of three months to comply with the rules provided by GR 79/2010 in those specific areas.

B. Fiscal regime

Corporate and general tax rules

By regulation, each interest holder, including the operator of the work area, has to register with the Indonesian tax office from the moment it obtains an interest in the work area.

The income tax rates, consisting of the corporate income tax (CIT) and the dividend tax or branch profits tax (BPT) for branch operations, vary depending on the year the contract was entered into.

The contractor's taxable income is broadly calculated as gross income less tax deductions. The calculation embraces the "uniformity concept" as the basis for determining which costs are recoverable and which are tax deductible. Under this concept, very broadly, costs that are recoverable are tax deductible.

Ring-fencing

The Government applies the tax ring-fencing rule, meaning that costs incurred by the contractor in one working interest are not allowed to be offset by income of another working area. As a result, an entity is likely to hold working interest in only one contract area.

GR 79/2010 specifically also requires costs relating to gas activities and oil activities in the contract area to be separated and provides rules on how to offset and recover the costs from the different products.

There are no tax consolidation or other group relief facilities available in Indonesia.

General terms of a PSC

The general concept of the PSC is that contractors bear all risks and costs of exploration until production. If production does not proceed, these costs are not recoverable. If production does proceed, the contractor can receive the following:

- A share of production to meet its recoverable costs
- Investment credit (refer below)
- An equity interest of the remaining production (also called equity oil)

Generally, the following points are included as part of the PSC agreement:

- Management responsibility rests with BPMIGAS.
- The contractor pays a bonus at the time the contract is signed, which, based on GR 79/010, is not cost recoverable and not tax deductible.
- The contractor agrees to a work program with minimum exploration expenditures for a 3- to 10-year period.
- Exploration expenses are only recoverable from commercial production.
- The contractor is reimbursed for the recoverable cost in the form of crude oil called cost oil.
- The contractor's profit share oil is called equity oil and is taken in the form of crude oil.
- The contractor has to settle its taxation obligations separately on a monthly basis.

Relinquishment

Each PSC also stipulates the requirements for part of the working area to be relinquished during the exploration period. The PSCs can vary in the timing and percentage to be relinquished. 15% to 25% of the contract is typically relinquished after three years and 30% to 35% by the end of five years.

Calculation of equity oil and sharing of production

The following simplified example may serve to illustrate the amount of equity oil to be shared. Broadly, it is crude oil production in excess of the amounts received for first tranche production (FTP), cost recovery and investment credit adjusted with the contractor obligation to supply domestic market obligation (DMO). These terms are further explained below.

First tranche production

Usually, FTP equal to 20% of the production each year (before any deduction of cost recovery) is split between the Government and the contractor according to their equity oil share as stipulated in the agreement with the Indonesian Government.

FTP is taxable income.

Domestic market obligation

Broadly, after commencement of commercial production from the contract area, a contractor is required to supply a specific portion of the crude oil to the domestic market in Indonesia from its equity share. A DMO can also apply to gas production.

The DMO is negotiated for each agreement and usually ranges from 15% to 25%. GR 79/2010 requires that the DMO for oil and gas is 25% of their production.

Usually, the quantity of DMO that is required to be supplied under the PSC will be limited by the quantity of equity oil or gas to which they are entitled. Any difference between the maximum DMO to be supplied and the DMO to be supplied based on the equity share usually will not be carried forward to subsequent years.

The compensation to be received for the DMO by the contractor is governed by the agreement signed with the Indonesian Government. Usually, the contractor is compensated by BPMIGAS for the DMO at the prevailing market price for the initial five years of commercial production.

The difference between the DMO costs and the DMO fee received is subject to tax.

Cost recovery

Cost recovery is usually stipulated in Exhibit C of the agreement with the Indonesian Government and is the reimbursement of PSC cost (through cost oil) prior to the determination of the profit oil. GR 79/2010 reconfirms the uniformity concept of operating expenses (i.e., costs that are recoverable are also deductible for tax purposes). The basic principles for operating expenses to be recoverable and tax deductible are:

- The costs are incurred to earn, collect and maintain income and have a direct connection with operation of the production block of the respective contractor.
- The costs are at arm's-length and are not influenced by a special relationship.
- The petroleum operation is conducted is conducted in accordance with accepted business and technical practice.
- The operation is in accordance with a work program and budget approved by the Indonesian regulatory body.

GR 79/2010 provides that direct and indirect allocation of expenses from a head office can only be charged to an Indonesian project and is cost recoverable and tax deductible if certain conditions are met.

GR 79/2010 further defines costs that cannot be claimed as cost recoverable or tax deductible. In total, there are 29 items listed as non-cost recoverable and non-tax deductible.

Capital allowances

The depreciation and amortization of assets are usually stipulated in Exhibit C of the agreement with the Indonesian Government.

All equipment purchased by the contractors becomes the property of BPMIGAS once the equipment is in Indonesia. The contractors have the rights to use and depreciate such property until it is abandoned or for the life of the work area, subject to approval by BPMIGAS.

Depreciation will be calculated at the beginning of the calendar year in which the asset is placed into service, with a full year's depreciation allowed for the initial calendar year. The method used to calculate each year's allowable recovery of capital costs is the declining-balance depreciation method. An asset falls into one of three groups, and calculation of each year's allowance recovery of capital costs should be based on the individual asset's capital cost at the beginning of that year multiplied by the depreciation factor as follows:

- Group 1 – 50%
- Group 2 – 25%
- Group 3 – 10%

The balance of unrecovered capital costs is eligible for full depreciation at the end of the individual asset's useful life.

GR 79/2010 provides a list of assets, useful life and depreciation rates. The regulation also provides for a declining-balance depreciation method. However, depreciation only starts from the month the asset is placed into service. The assets are also grouped into three groups with the depreciation factors as follows:

- Group 1 – 50%
- Group 2 – 25%
- Group 3 – 12.5%

C. Incentives

Several incentives are available to the oil and gas companies, e.g., investment credit, indefinite carryforward of prior year unrecovered costs, interest recovery and exemption from importation tax and duties on certain equipment and assets. The availability of the incentives depends on the agreement with the Indonesian Government.

Investment credit

Usually, the contractor will be permitted an investment credit of 8.8% net after tax on the capital investment cost directly required for developing production facilities out of new oil fields.

This investment credit is allowed for capital investment on production facilities, including pipeline and terminal facilities, and the investment credit must be claimed in the first or second production year after the expenditure has been incurred. The investment credit is treated as taxable income as it is considered additional contractor lifting.

The investment credit rules that apply can depend on the year the agreement was signed and the types of fields.

Oil fields entitled to the incentive must meet the following criteria:

- Located in the production working area
- Having an estimated rate of return based on the terms and conditions in the contract and other prevailing intensive package regulations of less than 15%

Interest recovery

The interest costs on loans do not normally form part of the cost recovery, irrespective of whether the loans are internal or third-party 'loans', unless specifically approved by BPMIGAS. Approval is not common, and there are certain conditions that must be satisfied for the recovery of interest on loans.

The claim for interest recovery must be included in the financing plan, and the amount must be included in each year's budget for the approval of BPMIGAS.

The interest rate should not exceed the prevailing commercial rates. Subject to tax treaty relief, the interest is subject to withholding tax of 20% of the gross amount if it is provided by a non-Indonesian lender. The contractors can gross up the interest amount to reflect the withholding tax amount.

Based on GR 79/2010, interest costs or interest cost recovery is not a cost recoverable expense and is not tax deductible.

Loss carryforward and unrecovered cost

The contractors are allowed to carryforward for tax purposes the pre-production expenses to offset against production revenues. However, these capital and non-capital costs incurred during the pre-production stage are not expensed and, accordingly, no tax loss originates from these costs. Generally, these pre-production costs may be carried forward indefinitely to future years. The tax loss carryforward limitation outlined in the tax laws is not applicable to the pre-production costs.

D. Withholding taxes

The rate of dividend withholding tax and the rate of branch profits tax depend on the year that the PSC was entered into.

Withholding tax on all other amounts follows the general tax law. For example:

Interest	15%/20%[116]

116 *A final withholding tax of 20% is imposed on payment to nonresidents. Tax treaties may reduce the tax rate. A 15% withholding tax is imposed on interest paid by non-financial institutions to residents.*

Royalties from patents, know-how, etc.	15/20[117]
Fees for services paid to residents:	
▸ Technical, management and consultant services	2[118]
▸ Construction contracting services	2/3/4[119]
▸ Construction planning and supervision	4/6[120]
▸ Other services	2
Fees for services paid to nonresidents	20[121]

E. Financing considerations

Refer to Section C for interest recovery.

F. Indirect taxes

Generally, PSCs are VAT collectors and are required to collect the VAT and remit it to the Indonesian Government on a monthly basis.

Generally, for PSCs that are signed under the law prior to Law No. 22/2001, the import duty, VAT on importation and import withholding tax on importation of capital goods and equipment are exempted by the Indonesian Government through the use of a "master list" arrangement.

For PSCs that are signed under Law No. 22/2001, the import duty is exempt, and VAT on importation is borne by the Indonesian Government relating to import of capital goods and equipment used in exploration activities through the use of a master list arrangement. The import withholding tax may also be exempt but it will require separate approval from the Indonesian tax office.

G. Other

Disposal of PSC interest

Generally, under the terms of most agreements, the contractor has the right to transfer the interest under the contract to a related party or other parties with either written notification or prior written consent of BPMIGAS.

The income tax laws provide that the transfer of assets is subject to income tax.

GR 79/2010 provides that the transfer of a direct or indirect participating interest in the exploration stage is subject to a final tax of 5% of gross transaction proceeds. However, the final rate is 7% if the transfer is conducted when the participating interest is in the exploitation stage. Transfers of participating interest to domestic companies, as required by the cooperation contract, are exempt from tax. In addition, the transfer of participating interests in the exploration stage with the intention to share risks is not considered taxable income if all of the following conditions can be satisfied:

- The transfer is not of the entire participating interest owned.
- The participating interest is owned for more than three years.
- Exploration activities have been conducted (i.e., working capital has been spent).
- The transfer is not intended to generate profit.

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117 *A final withholding tax of 20% is imposed on payment to nonresidents. Tax treaties may reduce the tax rate.*

118 *This tax is considered a prepayment of income tax. It is imposed on the gross amount paid to residents. An increase of 100% of the normal withholding tax rate is imposed on taxpayers subject to this withholding tax that do not possess a tax identification number.*

119 *A final tax. The applicable tax rate depends on the type of services provided and the qualification of the construction company.*

120 *The applicable tax rate depends on the type of services provided and the qualification of the construction company.*

121 *This is a final tax on gross amounts paid to nonresidents. The withholding tax rate on certain types of income may be reduced under double tax treaties.*

The implementing regulation to GR 79/2010, which was issued in December 2011, further outlines the mechanism for the reporting, withholding and remittance of the final tax. It also provides transitional rules in relation to the transfer of participation interests that occurred between the date of issue of GR 79/2010 (i.e., 20 December 2010) and the date of the implementing regulation.

The implementing regulation also outlines the requirement to pay profit remittance tax on the after-tax income from the sale of the participating interest.

CIT rate

GR 79/2010 provides that taxpayers can choose to adopt the prevailing CIT rate for PSCs, cooperation contracts and service contracts at the time of signing, or it can be subject to the CIT rate applicable over time.

Uplift income

Income received by a participating interest holder in relation to funding support provided to other participating interest holders for operational expenses for the contract area is uplift income. Uplift or other income of a similar nature is subject to final tax of 20% of gross transaction value.

The implementing regulation to GR 79/2010, which was issued in December 2011, also outlines the requirements for the reporting, withholding and remittance of the final tax of 20% and provides transitional rules in relation to uplift payments that occurred between the date of issue of GR 79/2010 (20 December 2010) and the date of the implementing regulation.

The implementing regulation also outlines the requirement to pay profit remittance tax on the after-tax income from the uplift payments.

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A. At a glance

Corporate income tax (CIT) rate	15%
CIT rate of upstream oil and gas activities	35% [122]
Capital gains tax rate	15%
Capital gains tax rate of upstream oil and gas activities	35% [122]
Branch tax rate	15%
Branch tax rate of upstream oil and gas activities	35% [122]
Withholding tax:	
Dividends	0%
Interest	15% [123]
Royalties	15% [123]
Branch remittance tax	0%
Net operating losses (years):	
Carryback	0
Carryforward	5 [124]

122 *In 2010, the Iraqi Parliament ratified a new tax law for foreign oil and gas companies. The income tax rate applicable to income earned in Iraq from contracts undertaken by foreign oil and gas companies and by contractors working in the fields of production and extraction of oil and gas and related industries will be 35%. Companies, branches or offices of oil and gas companies and service companies, and subcontractors working in fields of production and extraction of oil and gas and related industries are all subject to the law. In late December 2011, the Ministry of Finance finalized instructions aimed at clarifying the applicability of this law. The Iraqi tax authority will deem a minimum taxable income percentage; a taxable income percentage of 20% was deemed upon the oil and gas sector, which will be subject to the tax rate of 35%, resulting in a deemed income tax liability of 7% of revenues.*

123 *This withholding tax is imposed on payments to nonresidents.*

124 *See Section C.*

B. Taxes on corporate income and gains

Corporate income tax

In general, income tax is imposed on corporate entities and foreign branches with respect to taxable profit from all sources arising or deemed to arise in Iraq. Income is deemed to arise in Iraq if either of the following is located there:

- The place of performance of work
- The place of delivery of work
- The place of signing the contract
- The place of payment for the work

Tax rate

The general CIT rate applicable to all companies (except upstream oil and gas activities) is a unified flat rate of 15% of taxable income. Activities that relate to upstream oil and gas activities will be subject to income tax at the rate of 35% of taxable income.

Capital gains

Capital gains derived from the sale of fixed assets are taxable at the normal CIT rate. Capital gains derived from the sale of shares and bonds not in the course of a trading activity are exempt from tax. Capital gains derived from the sale of shares and bonds in the course of a trading activity are taxable at the normal CIT rate.

Administration

Tax returns for all corporate entities must be filed in Arabic within five months after the end of the fiscal year, together with payment of the total amount of taxes due according to the final tax declaration. If the tax return is not submitted within the statutory time limit (21 days from the due date specified by the tax authorities), delay fines of 5% are imposed for the first 21-day period. Penalties are doubled after the 21-day period. The total amount of the penalty may not exceed IQD500,000.

In addition to the penalties above, foreign branches are subject to a penalty of IQD10,000 if they do not submit financial statements by the tax return's due date.

A taxpayer may be subject to imprisonment for a period ranging from three months to two years if convicted of, among other crimes, fraudulently evading tax liability or purposefully manipulating books and records.

Dividends

In general, dividends received are exempt from tax.

Interest

Interest is subject to income tax at the normal CIT rate.

Foreign tax relief

A foreign tax credit is available to Iraqi companies on income taxes paid abroad. In general, the foreign tax credit is limited to the amount of an Iraqi company's CIT on the foreign income, calculated on a country-by-country basis. Any excess foreign tax credits may be carried forward for five years.

C. Determination of trading income

General

All income earned in Iraq from trading or any other source is taxable in Iraq, except for income exempted by the income tax law, the industrial investment law or the investment law.

All business expenses incurred to generate income are allowable, with limitations on certain items such as entertainment and donations. However, provisions and reserves are not deductible for tax purposes.

Tax depreciation

The Iraqi Depreciation Committee sets the maximum depreciation rates for various types of fixed assets. If the depreciation rates used for accounting purposes are greater than the ones computed under the prescribed rates, the excess is disallowed. The tax regulations provide for straight-line depreciation rates for the financial sector (banks and insurance companies) and other sectors. The following are the depreciation rates set by the Iraqi Depreciation Committee.

Asset	Financial sector (%)	Other sectors (%)
Buildings	2 to 5	2 to 5
Office equipment	20	15 to 25
Motor vehicles	20	15
Plant and machinery	20	15
Other assets	20	20

Used assets are depreciated at statutory rates established by the tax authorities, calculated on the purchase price.

Depreciation percentages applicable to selected oil and gas companies' assets

Pure butane production unit	6.5%
Gas drying and cooling units	5%
Electrical system technology	5%
High-pressure vessels	8%
Machinery and equipment	20%
Electrical air compressors	8%
Cranes and rollers	7.5%
Liquid gas tanks	4%
Bulldozers and shovels	20%
Precision machinery and equipment	10%

Relief for losses

Taxpayers may carryforward unabsorbed losses for five years to offset profits in future years. However, the amount of losses carried forward that may be used to offset taxable income is limited to 50% of each year's taxable income. Losses may not be carried back. Losses incurred outside Iraq cannot be offset against taxable profit in Iraq. The availability of losses carried forward can be severely limited: if the Iraqi tax authority applies a deemed profit percentage to a book loss year, the losses with respect to that year will be lost forever.

Groups of companies

Iraqi law does not contain any provisions for filing consolidated returns or for relieving losses within a group of companies.

D. Other significant taxes

The following table summarizes other significant taxes.

Nature of tax	Rate (%)
Stamp fees; imposed on the total contract value	0.2
Property tax; imposed on the annual rent	
From buildings	9
From land	2
Social security contributions; imposed on salaries and benefits of local and expatriate employees; a portion of employee allowances up to an amount equaling 30% of the base salary is not subject to social security contributions	
Employer	12
Employee	5
Social security (oil and gas companies.)	
Employer	25
Employee	5

E. Miscellaneous matters

Foreign exchange controls

The currency in Iraq is the Iraqi dinar (IQD). Iraq does not impose any foreign exchange controls.

Debt-to-equity rules

The only restrictions on debt-to-equity ratios are those stated in the articles and memoranda of association.

F. Tax treaties

Iraq has entered into a bilateral double taxation treaty with Egypt and a multilateral double taxation treaty with the states of the Arab Economic Union Council.

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A. At a glance

Fiscal regime

Ireland's fiscal regime that applies to the petroleum industry consists of a combination of corporation tax and a profit resource rent tax (PRRT) based on field profitability.

Royalties	None
Bonuses	None
Production sharing contract (PSC)	Not applicable
Income tax rate	Corporation tax rate 25%
Resource rent tax	PRRT rate between of 5% to 15%, depending on field profitability relative to capital investment[125]
Capital allowances	D, E[126]
Investment incentives	L, RD[127]

B. Fiscal regime

Ireland's fiscal regime that applies to the petroleum industry consists of a combination of a corporation tax and a PRRT.

Corporation tax

Irish resident companies are subject to corporation tax on their worldwide profits (i.e., income and gains). Income from an Irish trade is subject to corporation tax at a rate of 12.5%; however, certain "excepted trades" are subject to corporation tax at a rate of 25%. The definition of excepted trades includes dealing in land, working minerals and petroleum activities.

Nonresident companies are also subject to Irish corporation tax if they carry on a trade in Ireland through a branch or agency. Profits or gains arising for a nonresident person from exploration or exploitation activities carried on in Ireland or in a "designated area," or from exploration or exploitation rights, are regarded for tax purposes as profits or gains of a trade carried on by that person in Ireland through a branch or agency. A designated area is an area designated by order under the Continental Shelf Act 1968. Accordingly, income arising for a nonresident company from petroleum activities is regarded as arising from an excepted trade and is subject to corporation tax at a rate of 25%.

125 *PRRT is not deductible for corporation tax purposes.*

126 *D: accelerated depreciation; E: immediate write-off for exploration costs.*

127 *L: losses can be carried forward indefinitely; RD: research and development incentive.*

Chargeable gains accruing from the disposal of "petroleum-related assets" are subject to tax at a rate of 30%.[128] Petroleum-related assets include any petroleum rights, any assets representing exploration expenditures or development expenditures and shares deriving their value or the greater part of their value, whether directly or indirectly, from petroleum activities, other than shares quoted on a stock exchange.

Corporation tax is charged on taxable income. This is determined by starting with income according to accounting principles and then adjusting it for certain add-backs and deductions required under the tax legislation. Expenses are generally allowed if they are incurred "wholly and exclusively" for the purposes of the trade, but certain expenses are not permitted under the legislation, such as capital expenditure.

Deductions for expenditure of a capital nature may be available under the capital allowances regime. For the petroleum industry, this is in the form of a 100% deduction for both exploration expenditures and development expenditures that become available when petroleum extraction activities commence (in the case of petroleum exploration expenditures) and when production in commercial quantities commences (in the case of development expenditures). In addition to allowing full write-offs against petroleum profits for exploration and development expenditures, a provision allows for a deduction for expenditures that companies may incur in withdrawing from or shutting down an oil or gas field (see further discussion on exploration, development and abandonment expenditures in section C below).

Ring-fencing

Petroleum activities are ring-fenced for tax purposes so that losses from petroleum activities may not be set off against profits from other activities. Similarly, there are restrictions on the group relief of petroleum losses and charges on income incurred in petroleum activities. The ring-fencing also prevents losses from other sectors of the economy being applied against petroleum profits. This two-way ring-fencing recognizes the unique potential of the petroleum exploration and production industry for exceptionally large costs and losses and for exceptionally large profits.

Profits from oil and gas activities undertaken by an Irish resident company in a foreign country are subject to tax in Ireland.

Profit resource rent tax

Irish tax legislation contains provisions for PRRT that apply to petroleum activities. Under these provisions, companies carrying on Irish petroleum activities will be subject to an additional charge to tax depending on the profitability of the fields affected.

The PRRT rate varies from 5% to 15%, depending on the profitability of the field, measured by reference to the capital investment required for that field. PRRT is not deductible for corporate tax purposes.

PRRT only applies to exploration licenses and reserved area licenses awarded on or after 1 January 2007 and licensing options. PRRT operates on a graded basis by reference to profitability and, in particular, by reference to the profit ratio achieved on the specific field for which a license has been granted. The profit ratio is defined as the cumulative after-tax profits on the specific field divided by the cumulative level of capital investments on the specific field.

128 *As announced in the Irish Budget 2012 and effective for disposals that occur after 6 December 2011. However, this change in the capital gains tax rate has not yet been recognized in primary legislation.*

Each field that falls within the scope of the regime is treated as a separate trade for the purposes of the new tax and is effectively ring-fenced, with the result that a company would not be entitled to offset losses from any other activities against the profits of a taxable field for the purposes of calculating the PRRT. It is possible for capital expenditures incurred by one company to be deemed to have been incurred by another group company (with the necessary relationship to the first company) for the purposes of calculating the level of capital investments used in determining the profit ratio. For this provision to apply, an election must be made by the company that originally incurred the expenditure.

PRRT is calculated as follows:

Profit ratio	<1.5	>1.5 but <3.0	>3.0 but <4.5	>4.5
Additional tax	0%	5%	10%	15%

PRRT applies to taxable field profits, which are defined as the amount of the petroleum profits of the taxable field for the accounting period after making all deductions for, and giving or allowing all reliefs for, corporate tax purposes. The one exception is if, in a particular accounting period, the profit ratio for a specific field is in excess of 1.5 and was less than 1.5 in the immediately preceding accounting period with respect to that field. In such a situation, the profits to which the PRRT applies are calculated by reference to the following formula:

$$\{A - (B \times 1.5)\} \times 100/(100 - R)$$

In this formula, A is the cumulative field profits on the field from 1 January 2007, B is the cumulative field expenditure on the field from 1 January 2007 and R is the general rate of tax for Irish petroleum activities (currently 25%). The purpose of this formula is to reduce the quantum of profits to which the PRRT applies in the period immediately following a period for which the PRRT did not apply as a result of the profit ratio being less than 1.5.

PRRT is collected in the same manner as corporation tax, and returns for PRRT are submitted with the annual corporate tax return.

C. Capital allowances

Development expenditure

Irish tax legislation provides for a 100% allowance for capital expenditures incurred for production and development in connection with a relevant field being worked in the course of carrying on a petroleum trade. The allowance is available for the period when the asset represented by the expenditure is brought into use for the purposes of the trade. The allowance is subject to production in commercial quantities, having started in the field for which the assets were provided.

Assets leased to a person for the purposes of a petroleum trade are treated in a broadly similar manner. The allowance is available to the lessor, provided the burden of wear and tear falls directly on the lessor. The legislation excludes from development expenditure amounts expended on vehicles, land and buildings, machinery or plant or structures for processing or storing petroleum won (other than initial treatment or storage) and the acquisition of, or rights in or over, deposits of petroleum. Interest payments are also excluded.

Exploration expenditure

Irish tax legislation provides for a 100% allowance for exploration expenditures against the profits of a petroleum trade. The allowance is due when petroleum extraction activities begin. Exploration expenditure is defined as a capital expenditure on petroleum exploration activities, but excludes any interest payments. If expenditure qualifies as a development expenditure, it cannot also be an exploration expenditure. To the extent that a loss is created by the exploration allowance, this can be carried forward against future profits of the same petroleum trade.

An allowance is given for successful and abortive exploration expenditures, subject to the abortive expenditure having been incurred not more than 25 years before the commencement of the petroleum trade, against which the profits of such allowance are claimed. However, an abortive expenditure incurred more than 25 years ago on a field that subsequently begins production may still be claimed upon commencement of production.

No allowance for exploration expenditure will be made, to the extent that the exploration expenditure is reimbursed to the claimant. A clawback provision applies (by way of a balancing charge on the amounts previously allowed) if a disposal or part disposal takes place of the asset representing the amount of the expenditure with respect to which the allowance was originally made. The maximum balancing charge is limited to the amount of the allowances made or the appropriate part of that amount, in the case of a partial disposal.

A person who buys assets representing exploration expenditures connected with a relevant field may claim an allowance if that person carries on a trade that consists of or includes working that field or part of the field. The allowance cannot exceed the exploration expenditure originally incurred or, if less, the price paid for the assets representing that expenditure.

If there is a sale or transfer of assets representing an exploration expenditure before a petroleum trade commences, the allowance due to the claimant is reduced by the proceeds of the sale or transfer.

A provision applies for granting an allowance for an exploration expenditure against the profits of a petroleum trade carried on by one company if the exploration expenditure was incurred by another company and one company is a wholly owned subsidiary of the other company, or both are wholly owned subsidiaries of a third company. A transferred expenditure is treated as incurred by the transferee company at the time it was actually incurred by the transferor, thus preventing an old abortive exploration expenditure from being used by the transferee any later than it could have been used by the transferor. A provision also applies to avoid duplication of allowances.

Abandonment expenditure

An abandonment expenditure is an expenditure incurred on abandonment activities in relation to a field or part of a field. Abandonment activities in relation to a field or part of a field are activities of a company that comply with the requirements of a petroleum lease held by the company with respect to closing down, decommissioning or abandoning the field or part of it. This provision includes dismantling and removing pipelines used to bring petroleum to dry land.

A 100% allowance applies for an abandonment expenditure for the chargeable period when the expenditure is incurred. If a loss arises due to an insufficiency of income to absorb the allowance, the loss may be carried back to offset the income from the petroleum activities of the three previous years. An offset is made against later periods in priority to the earlier periods.

A provision is made for a carryforward of unused abandonment losses if a company permanently discontinues one petroleum trade and subsequently commences a new petroleum trade. In these circumstances, the losses are deductible in the first chargeable period of a new petroleum trade carried on by the company.

An abandonment expenditure incurred after a petroleum trade has ceased is brought back into the final period of trading. If this creates a loss, that loss may be carried back for the three years preceding the final year of trading.

D. Incentives

Losses

Tax losses may be carried forward indefinitely against profits of the same petroleum trade. However, if, within a three-year period, there is both a change in ownership (effectively more than 50%) and a major change in the nature or conduct of the trade, relief for losses carried forward may be denied.

Research and development

To encourage expenditure on R&D, a tax credit of 25% of the incremental expenditure incurred by a company over the base year R&D expenditure in 2003 may be offset against its corporate tax liability for the accounting period when the expenditure is incurred. The Irish Budget for 2012 announced intentions that relief will be available on the first €100,000 of R&D spend on a volume basis (rather than an incremental basis), but this legislation is yet to be published and the effective date of this change is not yet known. However, it is anticipated that this change would come into effect in 2012.

Any excess R&D credits may be carried back against corporate tax of the preceding accounting period. Any remaining excess R&D credits may be refunded by the Irish tax authorities (Revenue) over a three-year period.

A limit is placed on the amount of the refund available to a company, which is the greater of:

(i) The corporation tax payable by the company in the previous 10 years

(ii) The payroll tax liabilities (including employers' social insurance) for the period in which the expenditure giving rise to the claim is incurred

In the case of a company, expenditures on R&D are expenditures that have been incurred on R&D activities carried on by that company in the European Economic Area (EEA) in a relevant period. The expenditure must qualify for tax relief in Ireland and, in the case of an Irish resident company, it must not qualify for tax relief in any jurisdiction other than Ireland. The R&D credit is in addition to any tax relief that may be available by way of a deduction in computing trading income, or by way of capital allowances.

R&D activities mean systematic, investigative or experimental activities in a field of science or technology and being one or more of basic research, applied research or experimental development. Activities do not qualify as R&D activities unless they seek to achieve scientific or technological advancement and involve resolution of scientific or technological uncertainty.

E. Withholding taxes

Dividends, interest and royalties

Under Irish domestic law, dividends, interest and royalties are, prima facie, subject to a withholding tax (WHT) of 20%. However, interest paid by a company in the course of a trade or business to a company resident in an EU Member State, or in a country with which Ireland has a double taxation agreement, is exempt from withholding tax provided the recipient country generally imposes tax on such interest receivable. Furthermore, under Irish domestic law, WHT on royalties applies only to certain patent royalties (where Revenue clearance is obtained) and to other payments regarded as "annual payments."

In relation to dividends, exemptions from dividend withholding tax (DWT) are provided for certain nonresidents. The principal exemptions are for:

- Nonresident companies under the control of persons resident in an EU Member State or in a country with which Ireland has a double taxation agreement (provided these persons are not under the control of persons not resident in such countries)
- Nonresident companies, or 75% parent companies of nonresident companies, the principal class of shares of which is substantially and regularly traded on a recognized stock exchange
- Companies not controlled by Irish residents that are resident in an EU Member State or a tax treaty country

Third-party declarations are no longer required to obtain this exemption. Instead, a self-assessment system applies whereby the nonresident company declares that it meets one of the conditions above. DWT does not apply to dividends covered by the EU Parent-Subsidiary Directive (subject to compliance with a bona fide parent test).

Branch remittance tax

Branch remittance tax does not apply in Ireland.

Relevant contracts tax

Relevant contracts tax (RCT) is a withholding tax under Irish domestic law that applies to persons engaged in the construction, meat processing and forestry industries. Unfortunately, the RCT provisions are very widely drawn and the definition of "construction operations" brings "operations which form an integral part of, or are preparatory to, or are for rendering complete, the drilling for or extraction of minerals, oil, natural gas or the exploration for, or exploitation of, natural resources" within the ambit of RCT.

Effective from 1 January 2012, the administration and compliance aspects of the RCT regime have moved to an electronic platform (from the previous paper-based system), with principal contractors required to communicate electronically with the Revenue via the Revenue On-Line Service (ROS) or other approved software system. Under the new system, the Revenue will issue an electronic deduction authorization to the principal contractor stating the withholding tax rate to be applied to the specific subcontractor (i.e., 0%, 20% or 35%). By improving their tax compliance position, subcontractors can reduce the withholding rate assigned by the Revenue. Principal contractors are exposed to tax, interest and penalties where they are found not to be compliant with the RCT regime.

The Revenue will automatically credit any RCT deducted to the subcontractor's tax record. This credit will be available for offset against other tax liabilities of the subcontractor as they arise or for repayment annually. The RCT regime extends to nonresident principals and subcontractors.

F. Financing considerations

Thin capitalization and interest quarantining

At present, Ireland does not have legislation dealing with thin capitalization and interest quarantining.

G. Transactions

Asset disposals

If a company that carries on a petroleum trade disposes of an asset representing an exploration expenditure, it is subject to a balancing charge calculated by reference to the proceeds received for the disposal. If the disposal takes place prior to the commencement of a petroleum trade, the exploration allowance to be made to the company when it commences its petroleum trade is reduced by the amount of any consideration in money or money's worth received on the disposal.

A disposal of an asset representing a development expenditure is similarly subject to a balancing charge calculated by reference to the proceeds received for the disposal.

Farm-in and farm-out

The legislation provides that changes in license interests at the pre-production stage that are approved by the minister for communications, energy and natural resources do not give rise to chargeable gains if their sole purpose is the furtherance of exploration, delineation or development of a licensed area (i.e., an area licensed under the 1975 or 1992 licensing terms or subsequent licensing terms).

The legislation operates by defining a "relevant period" in relation to a disposal as being a period beginning 12 months before and 3 years after the disposal. If the consideration received on a disposal is wholly and exclusively applied within the relevant period for the purposes of either or both petroleum exploration activities, and searching for and winning access to petroleum in a relevant field, the disposal is not treated as a disposal for the purposes of capital gains tax (CGT). Therefore, no chargeable gain (or allowable loss) can arise. On a subsequent disposal of an asset acquired, brought into being or enhanced in value by the application of the consideration received, the consideration is not deductible in calculating the gain on the subsequent disposal (i.e., it does not form part of the base cost).

The legislation also treats the exchange of license interests as not involving any disposal or acquisition. It treats the asset given and the asset received as the same asset acquired, in the same manner as the asset given was acquired.

For an exchange of license interests where one party receives consideration in addition to the license interest taken by that party, the exchange rule set out above does not apply to that party unless the additional consideration is applied in full in the same manner as set out above. In this way, the disposal of the portion of the license interest that is represented by the consideration received is treated as a partial disposal for which the disposal provisions set out above apply.

If a party to an exchange of license interests gives consideration in addition to the license interest, the portion of the license interest received represented by the additional consideration is regarded as an asset that has a basis equal to the consideration given.

Selling shares in a company (consequences for resident and nonresident shareholders)

Irish tax legislation contains substantial shareholding exemption provisions. However, they do not apply where the shares being sold derive the greater part of their value from exploration or exploitation rights in a designated area. In the absence of being able to avail of the substantial shareholding exemption, a resident shareholder company is liable for CGT on the disposal of shares in a company that holds exploration or exploitation rights in a designated area.

A nonresident shareholder company is also liable for CGT on a disposal of shares in a company that holds exploration or exploitation rights in a designated area. This is because Irish domestic law deems a gain on a disposal of shares that derive their value, or the greater part of their value, directly or indirectly from exploration or exploitation rights in Irish designated waters to be a gain accruing on the disposal of assets situated in Ireland. This has the effect of bringing the gain into the charge to CGT at a rate of 30%.

H. Indirect taxes

Import duties

Duties apply to the importation of goods. If goods are imported directly to a rig that is located outside Irish territorial waters, there are no Irish customs duty issues.

However, if goods are brought to the rig via Ireland, Irish customs duties issues arise (end-use authorizations). On the assumption that correct procedures are put in place, Irish customs duty should not be a cost.

Excise duties

A Community excise regime governs the production, processing and holding of excisable products under duty-suspension, within each Member State of the Community (including Ireland) as well as all intra-Community movement of excisable products. The rates of excise duty on mineral oils in Ireland (known as mineral oil tax) vary depending on the type of oil.

Excise duty on direct imports into Ireland of most excisable products from outside the fiscal territory of the Community is payable at import unless the products are removed to a tax warehouse. In the case of excisable products dispatched to or received from other Member States, an intra-Community warehousing network allows duty-suspended movement of products to the premises of receipt, with excise duty being subsequently paid on release in the Member State of destination. Excisable products on which duty has already been paid and that move to another Member State are liable to excise duty in the Member State of destination. In such cases, the excise duty paid in the Member State of dispatch may be reclaimed.

Carbon tax

Carbon tax at a rate of €15 per metric ton of carbon dioxide (CO_2) emitted was introduced in Ireland in 2009. Budget 2012 increased the rate to €20 per metric ton of carbon dioxide. This change applied from 7 December 2011 to petrol and auto-diesel, and will apply from May 2012 to other fossil fuels (excluding solid fuels such as peat and coal). However, persons who receive, either from a tax warehouse or directly by importation, mineral oils that are exclusively for a use covered by their greenhouse emissions permit can obtain oils free of the carbon charge.

VAT

VAT applies to the supply of goods and services, the importation of goods and intra-Community acquisitions made in the territory of Ireland.

If a company is not established in Ireland and it undertakes activities outside the 12-nautical-mile limit from the shore of Ireland (and thus outside the EU), the supply of those activities is deemed to occur outside the jurisdiction. In these circumstances, the company is not entitled to register for Irish VAT. The supply of goods from Ireland to the offshore location is charged at a zero rate because they are effectively exports.

If goods or services supplied to an offshore company are liable to Irish VAT, VAT reclaims may be made through the electronic VAT refund (EVR) procedure (if the claimant company is established in the EU) or the EU 13th Directive reclaim process (if the claimant is established outside the EU). Alternatively, if an offshore company has an administrative office in Ireland that would constitute an establishment for VAT purposes, it may be allowed to register for VAT in Ireland in order to recover any Irish VAT incurred through its Irish VAT returns.

An offshore company that operates outside the Irish jurisdiction makes supplies that are outside the scope of Irish VAT and, accordingly, any invoices raised by the company are also outside the scope of Irish VAT.

Stamp duty

Stamp duty applies to certain documents that are executed in Ireland or relate to Irish property or to something done or to be done in Ireland. Stamp duty is chargeable under different heads, with the most significant related to the conveyance or transfer of property on a sale. Stamp duty can represent a significant cost. The rate applicable to transfers of nonresidential property is 2%. The rate of stamp duty applicable to transfers of Irish registered shares is 1%. Stamp duty is payable by the purchaser.

As stamp duty is a tax on documents, if assets such as plant and machinery pass by delivery, and no document evidences the transfer, no stamp duty should arise.

Also, full relief from stamp duty can apply to the transfer of property between companies that are 90% associated. The relief must be claimed.

An exemption from stamp duty is provided for the sale, assignment or transfer of licenses and leases granted under the Petroleum and Other Minerals Development Act 1960. The exemption extends to the sale, assignment or transfer of any right or interest in any such license or lease.

I. Other

Rules for valuation of petroleum in certain circumstances

For accounting periods commencing on or after 1 January 2011, Irish transfer pricing regulations now apply. These regulations apply to intercompany trading transactions to impose the arm's-length principle and documentation requirements.

Irish legislation provides rules for the valuation of petroleum disposed of other than by way of sale at arm's-length or appropriated to use in activities that fall outside the ring-fence (e.g., if the oil is appropriated by a production company for use in its own refinery).

Petroleum disposed of other than by way of sale at arm's-length is treated as disposed of for a consideration equal to the market value at the time of disposal. Petroleum that is "relevantly appropriated" for use in activities outside the company's ring-fence activities without being disposed of is treated, for the purposes of the ring-fence activities and the activities to which it is appropriated, as having been sold and bought, respectively, for a price equal to its market value at the time it is appropriated.

The market value of petroleum at any time is the price that the petroleum could be expected to fetch in a sale on the open market at that time.

Employee taxation

Income tax

Irish tax legislation brings into charge income arising from the exercise of employment in Ireland, whether or not an individual is tax resident in Ireland. This charge extends to both income tax and the universal social charge (USC). The legislation provides that duties performed in a designated area in connection with exploration or exploitation activities are treated as performed in Ireland. Income tax and the USC, therefore, arise on an individual under domestic legislation that may be mitigated or exempted under a relevant double tax treaty.

While not provided for in the legislation, the tax authorities generally ignore a charge if an individual spends less than 30 working days in Ireland (which, for this purpose, includes a designated area of the Continental Shelf) in a fiscal (calendar) year. There will, therefore, not be any income tax, USC liability or withholding requirement if the individual spends fewer than 30 working days in Ireland. See the discussion below, however, regarding the social insurance liability (PRSI).

An obligation arises on a foreign employer to withhold income tax, PRSI (where applicable) and the USC under the Pay As You Earn (PAYE) system from individuals that exercise duties in Ireland, regardless of whether those individuals ultimately have a tax liability in Ireland. If the employer is a nonresident and does not comply with this obligation, the entity benefiting from the services in Ireland may be held liable. However, two exemptions from the requirement for the employer to operate Irish PAYE exist.

The first exemption states that PAYE withholding will not be required if:

1. The individual is resident in a country with which Ireland has a double taxation agreement and is not resident in Ireland for tax purposes for the relevant tax year.
2. There is a genuine foreign office or employment.
3. The individual is not paid by, or on behalf of, an employer resident in Ireland.
4. The cost of the office or employment is not borne, directly or indirectly, by a permanent establishment in Ireland of the foreign employer.
5. The duties of that office or employment are performed in Ireland for not more than 60 total working days in a year of assessment and, in any event, for a continuous period of not more than 60 working days.

The second exemption states that condition 5 above may be extended to 183 days, but only if conditions 1 through 4 above are satisfied, in addition to a number of other conditions imposed on the employees and foreign employers.

Social insurance

Pay-related social insurance (PRSI) is payable with respect to every individual who exercises duties of employment in Ireland, regardless of the duration. Various classes of contribution apply, depending on the nature of the employment and the level of the emoluments. The most common class is A1, which imposes a charge of 10.75% on the gross earnings (including benefits) of the employer and 4% on the employee. The first €127 per week is exempt from the employee contribution. There is no ceiling on the earnings liable to the employer or employee contributions.

A charge to PRSI can be avoided only if the employer provides an appropriate authorization from the employee's home country to remain within the home country's social insurance regime. The authorization may be either an E101/A1 form (for EU countries, Iceland, Liechtenstein, Switzerland and Norway) or a Certificate of Coverage (for Australia, Canada (including Quebec), New Zealand, the United States, Japan and the Republic of Korea).

In respect to the countries not covered by the E10/A1 or Certificate of Coverage provisions, there may be an entitlement to an exemption from PRSI for the first 52 weeks of a posting in Ireland. Advice should be sought on the specific conditions applicable to this exemption.

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A. At a glance

Israel has an income tax regime that is applicable across all industries, and a windfall tax for oil and gas activities.

Windfall profits tax	0%–50%
Corporate income tax (CIT) rate	25%
Capital gains tax (CGT) rate	25%
VAT rate	16%
Incentives	Large number of incentives offered
	Losses may be carried forward indefinitely

B. Fiscal regime

Corporate income tax

The income tax regime is applicable across all industries. Resident companies are subject to Israeli tax on their worldwide income. Nonresident companies are subject to Israeli tax on income accrued or derived in Israel, unless otherwise provided for in an applicable tax treaty.

A company is considered resident in Israel for Israeli tax purposes if either of the following applies:

- It is incorporated in Israel.
- Its business is controlled and managed in Israel.

The regular rate of company tax is 25% for 2012. The combined Israel taxes on profits for 2012, taking into account the 30% withholding tax (WHT) on dividends paid to shareholders holding 10% or more of the company (material shareholders) and the 25% WHT imposed on shareholders holding less than 10% of the company, are:

- Material shareholders – 47.5%
- Other shareholders – 43.75%

The dividend WHT rates mentioned above may be reduced based on applicable tax treaties.

Determination of trading income

Taxable income is based on financial statements that are prepared in accordance with generally accepted accounting principles and are derived from acceptable accounting records. In principle, expenses are deductible if they are wholly and exclusively incurred in the production of taxable income. Various items may require adjustment for tax purposes, including depreciation, research and development (R&D) expenses, and vehicle and travel expenses.

Payments subject to WHT, such as salaries, interest and royalties, are not deductible unless the requisite tax is withheld and paid to the tax authorities.

Provisions

Bad debts are deductible in the year they become irrecoverable. Special rules apply to employee-related provisions, such as severance pay, vacation pay, recreation pay and sick pay.

Tax consolidation

Subject to certain conditions, consolidated returns are permissible for a holding company and its industrial subsidiaries if the subsidiaries are all engaged in the same line of production. For this purpose, a holding company is a company that has invested at least 80% of its fixed assets in the industrial subsidiaries and controls at least 50% (or two-thirds in certain cases) of various rights in those subsidiaries. For a diversified operation, a holding company may file a consolidated return with the subsidiaries that share the common line of production in which the largest amount has been invested.

Group returns may also be filed by an industrial company and industrial subsidiary companies if the subsidiaries are at least two-thirds controlled (in terms of voting power and appointment of directors) by the industrial company and if the industrial company and the subsidiaries are in the same line of production.

Detailed rules concerning the deferral of CGT apply to certain types of reorganizations, including corporate mergers, divisions and shares-for-assets exchanges. In many cases, an advance ruling is necessary.

Holding companies and participation exemption

To qualify for the participation exemption, an Israeli holding company must satisfy various conditions, including the following:

- It must be incorporated in Israel.
- Its business is controlled and managed in Israel only.
- It may not be a public company or a financial institution.
- It must not have been formed in a tax-deferred reorganization.
- For 300 days or more in the year, beginning in the year after incorporation, the holding company must have an investment of at least NIS50 million in the equity of, or as loans to, the investee companies, and at least 75% of the holding company's assets must consist of such equity investments and loans.

Specific conditions should be satisfied by a foreign investee.

An Israeli holding company is exempt from tax on the following types of income:

- Capital gains derived from the sale of an entitling shareholding in an investee company
- Dividends distributed during the 12-month minimum shareholding period with respect to an entitling shareholding in an investee company
- Interest, dividends and capital gains derived from securities traded on the Tel Aviv Stock Exchange
- Interest and indexation amounts received from Israeli financial institutions

In addition, dividends paid by Israeli holding companies to foreign resident shareholders are subject to a reduced rate of dividend WHT of 5%.

Capital gains and losses

Resident companies are taxable on worldwide capital gains. Capital gains are divided into real and inflationary components. The following are descriptions of the taxation of these components:

- For 2012, the tax rate on real capital gains is 25%.
- The inflationary component of capital gains is exempt from tax to the extent that it accrued on or after 1 January 1994, and is generally taxable at a rate of 10% to the extent that it accrued before that date.

Unless a tax treaty provides otherwise, in principle, nonresident companies are subject to Israeli tax on their capital gains relating to Israeli assets. Exemptions are available for disposals of certain types of Israeli securities and subject to certain conditions. Foreign resident companies pay CGT in accordance with the rules and rates applicable to residents, as described above. However, nonresidents investing with foreign currency may elect to apply the relevant exchange rate rather than the inflation rate to compute the inflationary amount.

Windfall tax

According to the Windfall Profits Tax Law, in effect from 10 April 2011, oil profits from an oil project will be levied in the relevant tax year. The levy is designed to capitalize on the economic dividend arising from each individual reservoir. The levy will be imposed only after the investments in exploration, development and construction are fully returned plus a yield that reflects, among other things, the developer's risks and required financial expenses. The levy is progressive and will be relatively lower in rate when first collected; it will increase as the project's profit margins grow.

The basic economic unit used to calculate the collection of the levy is an oil project, based on a single oil right that is an early permit, license or stake, according to the oil project's current development stage.

According to the Law, the levy rates will be determined using the R factor. The R factor establishes the project's profitability. Oil profits from an oil project will be calculated for every individual tax year at the end of that year as the difference between total current receipts in the tax year and total current payments in that year. The R factor formula takes into consideration the levy on oil and gas profits in the early years, timing of discovery and production, investments, interest and certain expenditures including royalties paid to the Government. The R factor will be calculated for each tax year and a relative levy factor will be calculated for each month in an amount equal to retained profits divided by accrued investments. The levy rate will be 0% as long as the relative levy factor is less than 1.5. Once a project's relative levy factor reaches 1.5, the levy rate will be 20%. This rate will increase linearly as the relative levy factor increases up to a maximum of 50% (imposed when the relative levy factor is 2.3).

In order to allow tax benefits arising from the allocation of taxable income or losses to the qualifying holders and to allow effective tax assessment and collection procedures, specific provisions regarding the taxation of oil partnerships were determined, that will apply to the taxable income or losses of the oil partnership in the tax year 2011 onward.

It is determined that the owner of the oil right will have a special deduction from the base price of the "deductible asset" in their possession, effective from the tax year in which commercial production commences. This special deduction of 10% annually will replace the depreciation of the deductible asset pursuant to the provisions of Section 21 to the ITO for each of the holders of the oil right, pro rata to their share in the project. The Law states that the depreciation provisions applicable pursuant to the ITO apply to such deduction as if it were depreciation, under the necessary adjustments.

The Law prescribes transitional provisions that allow a gradual transition to the determined system in order to prevent any impairment to the construction of the oil projects that are in planning and construction stages and that are designed to supply oil to the Israeli market in the coming years.

C. Depreciation

Depreciation at prescribed rates, based on the type of asset and the number of shifts the asset is used, may be claimed with respect to fixed assets used in the production of taxable income.

Accelerated depreciation may be claimed in certain instances. For example, under the Inflationary Adjustments Regulations (Accelerated Depreciation), for assets first used in Israel between 1 June 1989 and 31 December 2013, industrial enterprises may depreciate equipment using the straight-line method at annual rates ranging from 20% to 40%. Alternatively, they may depreciate equipment using the declining-balance method at rates ranging from 30% to 50%.

The following are some of the standard straight-line rates that apply primarily to nonindustrial companies:

Asset	Rate (%)
Mechanical equipment	7-10
Electronic equipment	15
Personal computers and peripheral equipment	33
Buildings (depending on quality)	1.5-4
Goodwill	10
Solar energy-producing plant	25

D. Incentives

Capital Investment Encouragement Law

An amendment to the Law is effective from 1 January 2011. Significant aspects of the amended law are summarized below.

The law has the following objectives:

- Achieving of enhanced growth targets in the business sector
- Improving the competitiveness of Israeli industries in international markets
- Creating employment and development opportunities in outlying areas

Precedence is granted to innovation and development areas.

The country is divided into national priority areas, which benefit from several reduced tax rates and benefits based on the location of the enterprise.

A reduced uniform corporate tax rate for exporting industrial enterprises (over 25% of turnover from export activity) is established. The reduced tax rate does not depend on a program and applies to the industrial enterprise's entire income.

The tax rates for industrial enterprises will be reduced gradually over a period of five years according to the following schedule:

- For 2012, the reduced tax rate is 10% for Development Area A and 15% for the rest of the country.
- For 2013 and 2014, the reduced tax rate will be 7% for Development Area A and 12.5% for the rest of the country.
- For 2015 and future years, the reduced tax rate is 6% for Development Area A and 12% for the rest of the country.

The reduced tax rate is contingent on making a qualifying investment in productive assets.

A reduced tax on dividends of 15% is imposed without distinction between foreign and local investors. On the distribution of a dividend to an Israeli company, no WHT is imposed.

A unique tax benefit is granted to certain large industrial enterprises. This entitles such companies to a reduced tax rate of 5% in Development Area A and 8% in the rest of the country.

Fixed asset grants of 20% to 32% of the investment cost of fixed assets may be granted to enterprises in Development Area A.

Some of Israel's tax treaties include tax-sparing clauses under which regular Israeli taxes, rather than reduced Israeli taxes, may be credited against tax imposed on dividends received from an Israeli company in the investor's country of residence. As a result, the Israeli tax benefits may be partially or fully preserved for an investor in an Israeli company enjoying the benefits of the Law.

Eilat free port

Corporate tax exemptions and other benefits are granted to authorized enterprises in the Eilat free port and free trade area.

Other incentives

Approved industrial, commercial and residential rental properties qualify for reduced company tax rates on rental income (and on gains derived from sales of certain buildings that have a residential element; a building has a residential element if at least 50% of the floor space is rented for residential purposes for a prescribed number of years, according to detailed rules). The reduced rates range from 10% to 18%. A tax holiday or grants may be available to approved industrial properties, depending on their location.

Preferential tax treatment may also be allowed with respect to the following activities:

- Real estate investment trust (REIT) companies
- Oil
- International trading
- R&D financing
- Nonresidents' bank accounts

Significant non-tax incentives include financial support for the following activities:

- R&D
- Development of production prototypes
- Investment in new facilities or products to promote competition with foreign companies (trade exposure fund)
- Exporters
- Export agents
- Equipment leasing to approved enterprises

Foreign resident investors may qualify for exemption from CGT in certain circumstances.

Relief for losses

In general, business losses may be offset against income from any source in the same year. Unrelieved business losses may be carried forward for an unlimited number of years to offset business income, capital gains derived from business activities or business-related gains subject to the land appreciation tax (see Section B). According to case law, the offset of losses may be disallowed after a change of ownership and activity of a company, except in certain bona fide circumstances.

Special rules govern the offset of foreign losses incurred by Israeli residents. Passive foreign losses (for example, relating to income from dividends, interest, rent or royalties) may be offset against current or future foreign passive income. Passive foreign rental losses arising from depreciation may also be offset against capital gains from the sale of the relevant foreign real property.

Active foreign losses (relating to a business or profession) may be offset against the following:

- Passive foreign income in the current year
- Active Israeli income in the current year if the taxpayer so elects and if the foreign business is controlled and managed in Israel, however, in the preceding two years and in the following five years, foreign-sourced income is taxable up to the amount of the foreign loss
- Active foreign income and business-related capital gains in future years

E. Withholding taxes

Dividends

A 30% WHT is generally imposed on dividends paid to individual shareholders holding 10% or more of the shares in an Israeli company (material shareholders). A 25% WHT is imposed on dividends paid to individual shareholders holding less than 10% of the shares in an Israeli company. However, resident companies are exempt from company tax on dividends paid out of regular income that was accrued or derived from sources within Israel. Companies are generally subject to tax at a rate of 25% on foreign dividend income that is paid from a foreign source or from income accrued or derived abroad (foreign-sourced income that is passed up a chain of companies).

A reduced WHT of 15% is imposed on dividends paid out of the income of a company enjoying the benefits of the Capital Investment Encouragement Law.

Interest

An exemption from Israeli tax is available to foreign investors that receive interest income on bonds issued by companies traded on the Israeli stock exchange.

Overseas remittances

Israeli banks must withhold tax, generally at a rate of 25%, from most overseas remittances unless the remittances relate to imported goods. An exemption or a reduced withholding rate may be obtained from the Israeli tax authorities in certain circumstances, such as when a treaty applies or when the payments are for services that are rendered entirely abroad. A 30% WHT rate applies to dividends payments to recipients who hold 10% or more of the payer entity.

F. Other significant taxes

Other significant taxes are the following:

Nature of tax	Rate (%)
VAT, standard rate	16
Wage and profit tax, imposed on financial institutions instead of VAT; this tax is imposed in addition to company tax	16
National insurance contributions on monthly employment income (subject to an upper income limit that fluctuates periodically)	Various
Payroll levy on salaries of foreign employee (levy does not apply if monthly salary exceeds twice the average monthly salary)	20
Acquisition tax, imposed on purchasers of real estate rights; maximum rate	5-7
Annual municipal taxes on property	Various

G. Other

Foreign-exchange controls

The Israeli currency is the new Israel shekel (NIS). On 14 May 1998, exchange control restrictions were abolished. However, transactional and periodic reporting requirements apply in certain circumstances, principally to Israeli residents if the amounts involved or overseas assets total over US$5 million. In certain circumstances, shekel–foreign currency swap transactions and foreign residents' transactions in short-term government bonds are also subject to reporting requirement. These reports are filed with the Bank of Israel.

Debt-to-equity rules

No thin capitalization rules are imposed in Israel. However, approved enterprises and approved properties (see Section B) must be at least 30% equity-financed if they received their approval before 1 April 2005.

Transfer pricing

Transactions between related parties should be at arm's-length. Detailed transfer pricing regulations apply. An Israeli taxpayer must report on each international transaction undertaken with a related party and indicate the arm's-length amount for such transaction. Advance rulings may be requested regarding transfer pricing.

Free-trade agreements

Israel has entered into free-trade agreements with Bulgaria, Canada, the European Free Trade Association, the European Union, Mexico, Romania, Turkey and the United States.

Foreign tax relief

A credit for foreign taxes is available for federal and state taxes but not municipal taxes. Any excess foreign tax credit may be offset against Israeli tax on income from the same type in the following five tax years.

Foreign residents that receive little or no relief for Israeli taxes in their home countries may be granted a reduced Israeli tax rate by the minister of finance.

Administration

The Israeli tax year is normally the calendar year. However, subsidiaries of foreign publicly traded companies may sometimes be allowed to use a different fiscal year.

Companies are generally required to file audited annual tax returns and financial statements within five months after the end of their fiscal year, but extensions may be obtained.

Companies must normally file monthly or bimonthly reports and make payments with respect to the following taxes:

- Company tax advances, which are typically computed as a percentage of a company's sales revenues
- Supplementary company tax advances with respect to certain non-deductible expenses
- Tax withheld from salaries and remittances to certain suppliers
- VAT

Nonresidents are required to appoint an Israeli tax representative and VAT representative if any part of their activities is conducted in Israel. The VAT representative is deemed to be the tax representative if no other tax representative is appointed. The tax representative is empowered to pay tax out of the foreign resident's assets.

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A. At a glance

Fiscal regime

This article describes the fiscal regime in force for almost all existing and all new contracts from 1 January 2009. This regime is applicable to all contracts except production sharing agreements that became effective prior to 1 January 2009 and contracts specifically approved by the president of Kazakhstan.

The generally applicable fiscal regime that applies in Kazakhstan to exploration and production (E&P) contracts in the petroleum industry consists of a combination of corporate income tax (CIT), rent tax on export, bonuses and royalty-type taxation. Oil and gas production activities are ring-fenced from downstream activities and from each other (i.e., contract by contract) for tax purposes.

Mineral extraction tax

Mineral extraction tax (MET) is a volume-based, royalty-type tax applicable to crude oil, gas condensate and natural gas. Rates escalate depending on volume. Different tables of rates apply, depending on what is produced and whether it is exported or sold domestically. The rates are applied to production valued at world prices for export sale.

Bonuses

Subsurface users are expected to pay a signature bonus and a commercial discovery bonus.

Corporate income tax

CIT is applied to all companies at a rate of 20% of taxable income in 2010.

Rent tax on export

The tax base is determined as the value of the exported crude oil and gas condensate based on the same tax valuation as for MET. The tax rate ranges from 0% to 32%.

Excess profit tax

Excess profit tax (EPT) is calculated annually. The tax is paid at progressive rates on tranches of income that remain after deduction of CIT. The taxable tranches are derived by applying percentages of the deductible expenses.

Capital allowances

Capital allowances are available for CIT and EPT.

Investment incentives

Losses relating to subsurface use contracts can be carried forward for up to 10 years.

Crude oil export duty

Crude oil export duty is currently charged at a rate of US$40 per ton and could further be revised depending on the oil price volatility.

B. Fiscal regime

In Kazakhstan, oil and gas E&P concessions are referred to as "subsurface use contract."

The taxes applicable to subsurface users are as follows:

Applicable taxes	
Bonuses	Variable
MET	0.5% to 18%
EPT	0% to 60%
Payment for compensation of historical costs	Variable
Rent tax on export	0% to 32%
Excise on crude oil and gas condensate	Variable
Land tax	Generally immaterial
Asset tax	1.5%
Environmental fees	Variable
Other fees (e.g., fee for the use of radio frequency spectrum, fee for the use of navigable waterways)	Variable
Other taxes and payments	Variable
VAT	12%
Crude oil export duty	US$40 per ton

Excess profit tax

EPT is calculated annually. The taxable object is the portion of net income (if any) that exceeds 25% of "deductions." The net income is calculated as aggregate annual income less deductions less CIT and branch profits tax, if any. For EPT purposes, deductions is the expenditure deductible for CIT purposes plus certain modifications such as the right to take accelerated depreciation for fixed assets. The tax is calculated by applying the following rates to the tranches of excess income, each tranche being allocated the marginal net income determined as a percentage of deductions until the limit of net income is reached.

Net income allocation schedule for EPT, % of deductions	% for calculating marginal net income allocation for EPT	EPT rate (%)
Less than or equal to 25%	25	Not set
From 26% to 30% inclusively	5	10
From 31% to 40% inclusively	10	20
From 41% to 50% inclusively	10	30
From 51% to 60% inclusively	10	40
From 61% to 70% inclusively	10	50
Over 70%	Any excess	60

Special rules apply to determine the taxable object if the hydrocarbon production is processed prior to sale, for example, by refining crude oil into gasoline or diesel. In such cases, it is unlikely that an EPT liability would actually arise.

Payment for compensation of historical costs

From 2009, the payment for compensation of historical costs is included in the list of obligatory payments of a subsurface user and is a fixed payment of the subsurface user to compensate the state for geological survey and development costs of the contract territory incurred before the subsurface use contract is concluded.

The obligation to compensate historical costs arises from the date when the confidentiality agreement is concluded between the subsurface user and authorized state body on subsurface study and usage.

Mineral extraction tax

MET applies to crude oil, gas condensate and natural gas. The taxable object is the value of production. For export sale, the value is based on world prices without deductions. The world price of crude oil and gas condensate is determined as the arithmetic mean of daily quotations for each of the Urals Mediterranean (Urals Med) or Dated Brent (Brent Dtd) brands in the tax period on the basis of information published in the *Platts Crude Oil Marketwire* issued by The McGraw-Hill Companies or, if that source does not provide price information for those brands, using the Petroleum Argus source. The world price for natural gas is determined as the arithmetic mean of daily quotations in the tax period on the basis of information published in the *Platts Crude Oil Marketwire*. If that source does not provide price information for natural gas, the Petroleum Argus source should be used.

The rates of tax are determined by the annual volume of production at the following rates. Different rates apply to crude oil and gas condensate on the one hand and natural gas on the other, as follows:

Volume of annual oil production, including gas condensate, for each calendar year (thousand tons)	MET
	2012
Up to 250 inclusively	5%
Up to 500 inclusively	7%
Up to 1,000 inclusively	8%
Up to 2,000 inclusively	9%
Up to 3,000 inclusively	10%
Up to 4,000 inclusively	11%
Up to 5,000 inclusively	12%
Up to 7,000 inclusively	13%
Up to 10,000 inclusively	15%
Over 10,000	18%

These rates are reduced by 50% if the production is processed domestically in Kazakhstan either by the producer or by a purchaser. There are special rules for the calculation of tax bases in such cases.

In the case of natural gas that is exported, a flat rate of 10% applies. If the gas is sold to the domestic Kazakhstan market, rates are reduced to between 0.5% and 1.5% depending on the annual production.

Bonuses

Subsurface users are expected to pay two types of bonuses:

- Signature bonus
- Commercial discovery bonus

Signature bonus

The signature bonus is a lump-sum amount paid by a subsurface user for the right to use the subsurface.

For oil exploration contracts, the bonus is a fixed amount of 2,800 MCI,[129] which is equivalent to KZT4,530,400.

For oil production contracts, where reserves have not been approved, the bonus is a fixed amount of 3,000 MCI, which is equivalent to KZT4,854,000.

Where reserves have been approved, the bonus is calculated by a formula that applies a rate of 0.04% to the approved reserves and 0.01% to the provisionally approved reserves but not less than 3,000 MCI.

For production contracts, the signature bonus should not be less than the amount of the commercial discovery bonus.

Commercial discovery bonus

The commercial discovery bonus is a fixed payment paid by subsurface users when a commercial discovery is made on the contract territory.

The base for calculation of the commercial discovery bonus is defined as the value of the extractable minerals duly approved by the competent state authorities. The value of the mineral resources is determined using the market price established at the International (London) Petroleum Exchange in Platts. The rate of the commercial discovery bonus is fixed at 0.1% of the value of proven extractable resources.

Corporate income tax

CIT is applied to all companies at the rate of 20% of taxable income in 2011. Taxable income is calculated as the difference between aggregate annual income (after certain adjustments) and statutory deductions.

Deductions

All expenses incurred by a taxpayer in carrying out activities that are directed at the receipt of income are deductible for the purpose of determining taxable income. Examples of expenses that are allowed for deduction can be found below (this list is not exhaustive):

- Interest expense (within limits)
- Contributions to the decommissioning fund, the procedure for making such contributions and the amount are to be established in the subsurface use contract
- Expenditure on geological studies and exploration and preparatory operations for extraction of mineral resources
- Expenditures on R&D and scientific and technological works

Geological studies and exploration, and preparatory operations for production of useful minerals, include the following: appraisal, preparatory work, general and administrative expenses, and costs associated with the payment of the bonuses. These costs, together with expenditure on the purchase of fixed assets and intangible assets (expenditure incurred by a taxpayer while acquiring the right to geological exploration, development or extraction of mineral resources), form a depreciation group separate from fixed assets for tax purposes. These costs may be deducted by declining-balance depreciation at a rate not exceeding 25%. Similar expenses incurred after the separate depreciation group has been formed (such as expenses incurred after

129 The monthly calculation index (MCI) is KZT1,618 as of 1 January 2012.

depreciation starts) are included into the group to increase its balance value if, under International Financial Reporting Standards IFRS, such expenses are capitalized into the value of assets already included in the group.

Depreciation of the pool of such expenses begins when production commences, after the commercial discovery. In the case of a farm-in, the subsurface user is allowed to capitalize the cost of acquiring a subsurface use right. Upon farm-out, the subsurface user is liable for tax on capital gains.

The following are examples of other deductible expenses:

- Expenses incurred under a joint operating agreement based on information provided by the operator
- Business trip and representative expenses (per diems are deducted in full based on taxpayers' internal policy, whereas representative expenses are deductible in the amount up to 1% of payroll)
- Foreign exchange losses when a foreign exchange loss exceeds a foreign exchange gain
- Expenses on social payments to employees
- Insurance premiums, except for insurance premiums paid according to accumulative insurance contracts
- Amounts paid as redemption of doubtful payables previously written off as income
- Doubtful receivables not redeemed within three years
- Taxes paid (except for the taxes already excluded prior to determining aggregate annual income, income tax paid in Kazakhstan and in any other states, and EPT)
- Fines and penalties, except for those payable to the state budget
- Maintenance or current repair expenses
- Capital repair (within the statutory limits)
- Expenditure actually incurred by a subsurface user with respect to training Kazakhstan personnel and the development of the social sphere of rural areas, within amounts stipulated in subsurface use contracts
- The Tax Code also provides for certain expenses to be deducted directly from taxable income up to 3% of the taxable income, such as sponsorship aid and charitable contributions (subject to certain conditions)

The depreciation regime for fixed assets is discussed in Section C.

Dividends

Dividends distributed domestically (i.e., by a local subsidiary to a local parent company) are tax exempt. Dividends paid abroad are subject to 15% withholding tax (WHT), usually reduced by tax treaties to 5%. Branches are subject to an equivalent branch profit tax at the same rates but applied to undistributed profit after deduction of CIT.

Rent tax on export

The rent tax on export is paid by legal entities and individuals that export crude oil and gas condensate. The tax base is calculated as the volume of the exported crude oil multiplied by the world price of crude oil and gas condensate. The world price is determined as the arithmetic mean of daily quotations for each of the Urals Med or Brent Dtd brands in the tax period on the basis of information published in the *Platts Crude Oil Marketwire* issued by The McGraw-Hill Companies or, if that source does not provide price information for those brands, using the Petroleum Argus source. The tax rates applied to exported crude oil and gas condensate vary as follows:

Market price (US$/bbl)	Rate
US$20/bbl inclusively	0
US$30/bbl inclusively	0
US$40/bbl inclusively	0
US$50/bbl inclusively	7
US$60/bbl inclusively	11
US$70/bbl inclusively	14
US$80/bbl inclusively	16
US$90/bbl inclusively	17
US$100/bbl inclusively	19
US$110/bbl inclusively	21
US$120/bbl inclusively	22
US$130/bbl inclusively	23
US$140/bbl inclusively	25
US$150/bbl inclusively	26
US$160/bbl inclusively	27
US$170/bbl inclusively	29
US$180/bbl inclusively	30
US$190/bbl inclusively	32
US$200/bbl inclusively	32

The tax period for rent tax on export is a calendar quarter.

C. Capital allowances

For tax depreciation purposes, fixed assets are split into four groups. Assets are depreciated at the maximum depreciation rates set out in the following table:

Group number	Type of fixed assets	Maximum depreciation rate (%)
I	Buildings, structures (except for oil and gas wells and transmission devices)	10
II	Machinery and equipment, except for machinery and equipment of oil and gas production	25
III	Office machinery and computers	40
IV	Fixed assets not included in other groups, including oil and gas wells, transmission devices, machinery and equipment of oil and gas production	15

Fixed assets, among other things, include:

- Fixed assets, investments in real estate, intangible assets and biological assets recorded in accordance with IFRS and Kazakhstan accounting standards
- Assets with a useful life exceeding one year, manufactured and (or) acquired by concessionaires under concession agreements
- Assets with a useful life exceeding one year that are objects of social infrastructure projects
- Assets with a useful life exceeding one year that are intended for use in activities directed at the receipt of income and received by a fiduciary for fiduciary management under a fiduciary management agreement, or on the basis of another document, which is a basis on which fiduciary management arises

The following items are not considered fixed assets:

- Intangible assets with an indefinite useful life
- Assets commissioned under investment contracts concluded before 1 January 2009

Subsurface users have the right to use double depreciation rates in the year of commissioning "newly created" fixed assets, provided they will be used in their contract activities for three years.

Expenses actually incurred on use, repair, maintenance and liquidation of fixed assets are defined as "subsequent costs" and are deductible in the tax period when they are actually incurred.

D. Investment incentives

Losses

Losses pertaining to subsurface use contracts may be carried forward for up to 10 years. Tax losses may not be carried back.

Tax holiday

Kazakhstan does not have a tax holiday regime for subsurface users.

Investment tax preferences

Certain tax preferences are available for subsurface users subject to the Government's approval and limited to contracts concluded between 2009 and 2012.

E. Withholding taxes

In the absence of a permanent establishment (PE) in Kazakhstan of a nonresident company, Kazakhstan withholding tax (WHT) applies to a nonresident's income derived from Kazakhstan sources. The general WHT rate is 20%, except for dividends, capital gains and interest income (15%), income from international transportation services and insurance premiums payable in accordance with reinsurance risk agreements (5%) and insurance premiums (10%).

Further, double tax treaties provide for either an exemption from Kazakhstan WHT or application of reduced WHT rates. Generally, interest and royalty rates in treaties are 10%, and dividends 5%, provided conditions are met.

Any type of income payable to a nonresident registered in a country with a preferential tax regime is subject to WHT at a rate of 20%. The list of such countries is approved by the Governmental Decree.

F. Financing considerations

From 2009 to 2011, a 6:1 debt-to-equity limit applied (4:1 from 2012) on both Kazakhstan and non-Kazakhstan sourced financing obtained from, or guaranteed by, a related party or obtained from an entity registered in a tax haven. Interest on debt-to-finance construction should be capitalized.

G. Transactions

Any capital gains derived from a sale of an equity interest in a subsurface use contract, or in a Kazakhstan resident company or a nonresident company may give rise to Kazakhstan sourced income. From 2012, the capital gain from the sale of shares or participating interests in a resident or nonresident legal entity or consortium may be exempt from Kazakhstan taxation provided that the following conditions are simultaneously met:

1. The shares or participating interests have been owned by the taxpayer for more than three years
2. The legal entity (consortium) in which the shares or participating interests are being sold is not a subsurface user
3. No more than 50% of the asset value of the legal entity (or consortium) in which the shares or participating interests are being sold consists of the property of an entity that is a subsurface user

The gains realized by nonresidents and not associated with a PE in Kazakhstan are subject to WHT in Kazakhstan at 15%, unless specifically exempt from tax according to Kazakhstan domestic tax law or by virtue of an applicable double taxation treaty. The above exemption is inapplicable if the capital gain is made by a nonresident registered in a country with a preferential tax regime and without a registered presence in Kazakhstan. Such capital gains are subject to WHT at a rate of 20%, unless the applicable double tax treaty provides for an exemption.

In the case of a farm-in, the subsurface user may capitalize the cost of acquiring a subsurface use right. Upon farm-out, the subsurface user is liable for tax on capital gains.

H. Indirect taxes

Import duties

Some old contracts benefit from grandfathered customs exemptions; however, new contracts do not. Imports from Customs Union countries (Russia and Belarus) are exempt from import duties, and imports are not subject to customs clearance.

The customs legislation provides for a temporary import regime for goods that will be re-exported. It either exempts goods and equipment from customs duties and import VAT or it allows for partial payment provided the goods and equipment are re-exported.

VAT

An EU-style VAT applies in Kazakhstan. The VAT rate has reduced from 20% in the late 1990s to 12% currently.

Crude oil, natural gas and gas condensate sold in the territory of Kazakhstan are subject to 12% VAT. Export sales of crude oil, natural gas and gas condensate are subject to zero-rated VAT.

Under the Tax Code, international transportation services (including transportation of oil and gas via trunk pipelines) are subject to zero-rated VAT.

Imports of goods and equipment from Customs Union countries and other countries are subject to 12% import VAT. Special tax administration rules apply to import VAT.

Place of supply rule

The applicability of Kazakhstan VAT is determined based on the deemed place of supply of a given supply. It is important to note that, under the place of supply rules, a service may be physically performed outside Kazakhstan, but deemed to be supplied inside Kazakhstan for VAT purposes. Examples of services taxed in this way include a supply of a service related to immovable property located in Kazakhstan, or a consulting service performed outside Kazakhstan for a customer inside Kazakhstan. If the place of supply is deemed to be outside Kazakhstan, the underlying supply is not subject to Kazakhstan VAT. The rules determining the place of supply are generally as follows:

For goods:

- The place where transportation commences if goods are transported or mailed
- Otherwise, the place where goods are transferred to the purchaser (it is not clear whether this involves a physical transfer or a transfer of rights)

For works and services:

- The place where immovable property is located for works and services directly related to such property
- The place where works and services are actually carried out for works and services related to movable property
- The place of business or any other activity of the customer for the following works and services: transfer of rights to use intellectual property, consulting services, audit services, engineering services, design services, marketing services, legal services, accounting services, attorney's services, advertising services, data provision and processing services, rent of movable property (except for rent of motor vehicles), supply of personnel, communication services and others
- Otherwise, the place of business or any other activity of the service provider
- Sales of goods or services that are merely auxiliary to a principal sale are deemed to take place wherever the principal sale takes place. No definition of auxiliary sales is provided in the tax legislation

Export duties

In May 2008, Kazakhstan introduced a new customs export duty on crude oil at the rate of US$109.91 per ton. It is intended that the rate will be adjusted periodically in line with movements in world market prices. At the present time, the rate is US$40 per ton effective from 1 January 2011.

Stamp duties

No stamp duty applies in Kazakhstan.

Registration fees

Insignificant fixed fees apply.

I. Other

Social tax

The social tax is paid by employers for each employee at the rate of 11% on the total cost of employing the individual (including benefits in kind).

Individual income tax

Employees pay individual income tax at 10% on practically all income.

Contract transfers

The Kazakhstan state has a preemption right on transfers of subsurface use contracts or entities that own them directly or indirectly, which it frequently exercises, often taking 50% of the interest transferred.

Transfer pricing

From 2009, a new transfer pricing law was introduced and is expected to be aggressively applied.

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A. At a glance

Corporate income tax (CIT)	30%
Capital gains tax rate	n/a
Branch tax rate	37.5%
Tax loss carryback	n/a (this applies only to a petroleum company that has permanently ceased to produce petroleum, and the losses cannot be carried back for more than three years)
Tax loss carryforward	Five years

Withholding tax

Description	Resident %	Nonresident %	Note
Dividends	5	10	
Interest – government bonds and other sources	15	15	i
Insurance commissions – brokers	5	20	
Insurance commissions – others	10	20	
Royalties	5	20	
Real estate rent	–	30	
Pension and retirement annuities	0-30	5	ii
Management, consultancy, professional and training fees	10	20	iii
Contractual	3	20	
Telecommunication service fees	–	5	

Notes

i. The withholding tax (WHT) rate in respect of interest arising from bearer bonds with a maturity of 10 years for residents is 10%. With respect to interest arising from bearer instruments other than a government bearer bond of at least two years' duration, the WHT rate is 25% of the gross amount payable. Interest income accruing from all listed bonds used to raise funds for infrastructure and social services is exempt from tax, provided that the bonds have a maturity of at least three years.

ii. Tax deducted at source on withdrawals from provident and pension schemes in excess of the tax-free amounts made after 15 years, on reaching the age of 50 years or upon earlier retirement on health grounds, is final.

iii. WHT on payments to residents for management, professional and training fees applies to payments of KES24,000 or more in a month to both registered and non-registered businesses. The nonresident rate in respect of consultancy fees payable to citizens of the East African Community Partner States is 15%.

Lower rates for WHT are applicable on some payments to residents of countries that have double tax agreements with Kenya. The treaty rates are as follows:

No.	Payee resident in	Dividends %	Interest %	Royalties/management and professional %
1	Canada	10	15	15
2	Denmark	10	20	20
3	Germany	10	15	15
4	India	10	15	17.5/20[(b)]
5	Norway	10	15	20
6	Sweden	10	15	20
7	UK	10	15	12.5/15[(c)]
8	Zambia	0[(a)]	15	15

(a) No Kenyan tax is due if the dividend is subject to tax in Zambia. (b) The rate is 17.5% for management and professional fees. (c) The rate is 12.5% for management and professional fees paid to the UK. Where the treaty rate is higher than the non-treaty rate, the lower rate applies.

B. Fiscal regime

The fiscal regime that applies in Kenya to the petroleum industry is the same regime that applies to other industries. It consists of CIT, VAT, import duty and royalties. It includes some tax exemptions on import duties and relief on VAT for exploration companies.

The National Oil Corporation of Kenya (NOCK) is a limited liability company incorporated by the Government of Kenya for the development of the exploration, prospecting and production of oil and gas. The company acts on behalf of the Government in the coordination of exploration activities. It operates both upstream and downstream. The minister for energy is mandated to sign production sharing contracts (PSCs).

Corporate income tax

A resident corporation is subject to CIT on its worldwide income at the rate of 30%. A nonresident corporation is taxed on income derived or accrued from Kenya at the rate of 37.5%. However, a new company is taxed at a reduced rate of 20% or 25% for a period of five years, or 27% for a period of three years if it is listed on the Nairobi Stock Exchange (if 40%, 30% or 20% of the issued share capital is listed on the Nairobi Stock Exchange respectively).

CIT is imposed on net taxable income. Taxable income is determined based on audited financial statements and is calculated as gross revenue less tax-deductible expenses allowable and other qualifying expenditures under the Income Tax Act Cap. 470. Allowable deductions include expenses incurred wholly and exclusively in the production of income.

Ring-fencing

There is no ring-fencing.

Deemed interest

Interest-free loans by a nonresident to a thinly capitalized resident company are deemed to earn interest at an average of the 91-day Treasury bill rate. This deemed interest is liable to WHT at the applicable rate as of June 2011.

Insurance compensation

Amounts received under an insurance against loss or damage of property shall now be deemed to be gains or profits for the year of income in which the insurance compensation is received.

Previously, it was deemed as gains or profits for the year of income in which the loss occurred as of June 2011 fiscal year.

Capital gains or losses

Capital gains on the disposal of depreciable assets are treated as business income for the corporate entity and are taxed at the normal corporate tax rate of 30% for resident corporations and 37.5% for nonresident corporations. Consideration for an assignment is treated as a receipt of a petroleum company and taxed accordingly.

Functional currency

Accounting income must be reported in the local currency, Kenyan shillings (KES).

Transfer pricing

There are transfer pricing rules and guidelines that should be adhered to by all companies that have nonresident related-party transactions.

Other petroleum taxes

The following taxes are payable under the PSCs, with the applicable rates negotiated at the time of signing the PSCs:

- Signature bonus
- Surface fees
- Training fee
- Windfall profits
- Profit oil – to be shared, taken and disposed of separately by the Government and contractor according to increments of profit oil

C. Capital allowances

For a petroleum company, capital expenditures incurred with respect to each development area shall be deductible at a rate of 20% per annum, based on amortization at that rate starting either in the fiscal year in which such capital expenditures are incurred and paid, or in the fiscal year in which commercial production from that development area commences, whichever is the later. "Capital expenditures" shall mean the qualifying expenditures, other than "intangible drilling costs," that are expenditures that have no salvage value, including expenditures on labor, fuel, repairs, maintenance, hauling, mobilization and supplies and materials, other than supplies and materials for well casings or other well fixtures that are for, or incidental to, drilling, cleaning, deepening, completing or abandoning wells.

Other capital expenditures are pooled into classes and granted wear and tear allowance at the applicable rates.

D. Incentives

Exploration

Expenditures of a capital nature on exploration qualifies for deduction on a straight-line basis at a rate of 20% per annum.

Tax holiday

Kenya does not have a tax holiday regime, other than for companies operating in the export processing zones.

Tax losses

Income tax losses can be carried forward for a period of five years but may be carried forward indefinitely subject to prior approval by the commissioner.

Tax losses cannot be carried back. However, there is an exception for a petroleum company that has permanently ceased operations. It can carryback tax losses incurred in one year to not more than three previous years.

E. Withholding taxes

Dividends

Dividends paid by a Kenyan entity are subject to WHT at a rate of 5% and 10% when made to a resident and nonresident, respectively.

Interest and royalties

Interest and royalties paid to nonresidents are subject to a final Kenyan WHT of 15% and 20%, respectively, unless altered by a relevant double tax agreement.

Branch remittance tax

A branch remittance tax (repatriated income of a domestic permanent establishment (PE)) is applicable at a rate of 10%. No exchange control regulations apply. Repatriation of branch profits can be effected freely after payment of statutory taxes.

F. Financing considerations

Thin capitalization

A foreign-owned entity is deemed be thinly capitalized where the debt-to-equity ratio exceeds 3:1. The consequences of thin capitalization include a restriction on deducting interest expense and deferral of foreign exchange losses.

G. Transactions

Books, accounts and audits

- The contractor shall keep books and accounts in accordance with the accounting procedures and shall submit to the minister a statement of those accounts not more than three months after the end of each calendar year.
- At the request of the minister, the contractor shall appoint an independent auditor of international standing, approved by the Government, to audit the books and accounts of the contractor annually and report thereon; and the cost of such audit shall be borne by the contractor.
- The Government may audit the books and accounts within two calendar years of the period to which they relate and shall complete that audit within one calendar year.

Asset disposals

The disposal of natural resources, exploration and production (E&P) rights and assets in respect of natural resource prospecting, exploration and development expenditures is regarded as a disposal of a depreciable asset. The difference between the written-down value and the consideration price is treated as business income and taxed at a corporate tax rate of 30% for resident corporations and 37.5% for nonresidents.

Farm-in and farm-out

Under the PSC, an entity may assign or transfer to a corporation, or firm, any of its rights, privileges or obligations, provided that the Government is notified and given written copies of the assignments and agreements, and any assignment shall be binding to the assignee.

H. Indirect taxes

VAT

All persons who deal with taxable supplies whose turnover in any given year is KES5 million or more must register for VAT. The standard rate of VAT is 16%.

Exports are zero-rated. Companies engaged in exploring and prospecting for oil are VAT exempt on importation of capital goods and professional services.

Excise duties

Excise duty is levied on some goods manufactured in Kenya, including petroleum products.

Stamp duty

Stamp duty applies to specified transactions. It is imposed under different heads of duty, the most significant of which is a conveyance duty on a transfer of property (e.g., land, buildings, certain rights, goodwill).

I. Other

Pay as you earn

Resident individuals, including expatriates, are taxed on their worldwide income based on the resident tax rates, while nonresidents pay tax on Kenyan-sourced income only. The resident minimum tax rate is 10%, and the maximum rate is 30%. Employers have the responsibility to withhold and pay the tax due from employees' entire remuneration on a monthly basis.

It is no longer mandatory for employees to file tax returns if their only source of income is from employment, with effect from June 2011.

National Social Security Fund

NSSF is a statutory contribution for both the employee (including expatriates) and the employer. Each contributes KES200 per month.

National Health Insurance Fund

This is a statutory health insurance for which employees are required to contribute. Depending on the salary scale, contributions range from KES80 to KES320 per month.

Double tax treaties

Kenya has double tax treaties with Canada, Denmark, Germany, India, Norway, Sweden, UK and Zambia.

Taxation of petroleum service subcontractors

A petroleum service subcontractor is a nonresident entity that provides services to a petroleum company in Kenya.

The companies are deemed to have made a taxable profit equal to 15% (assumed profit rate) of all the money paid by a petroleum company for the services rendered. However, reimbursement of expenses is exempt. The assumed profit is taxed at a rate of 37.5%.

A petroleum company is required to withhold this tax and remit it to the commissioner. The tax withheld is a final tax.

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A. At a glance

Fiscal regime

There are no separate tax laws or regulations in Kuwait governing the oil and gas sector. Foreign (non-Gulf Cooperation Council (GCC) companies, therefore, are subject to the corporate income tax (CIT) law as amended by Law No. 2 of 2008 (Law No. 2) and Executive Bylaws (the Bylaws) thereto. For fiscal periods commencing after 3 February 2008, the CIT rates are as follows:

Royalties	15%[(a)]
Bonuses	None
Production Sharing Contract	None
Income tax rate	15%
Resource rent tax	None
Investment incentives	A number of incentives are offered.

(a) Royalties are considered in the same manner as normal business income and subject to tax at 15%.

B. Fiscal regime

Corporate income tax

There are no separate tax laws or regulations in Kuwait governing the oil and gas sector.

Foreign "bodies corporate" are subject to tax in Kuwait if they carry on a trade or business in Kuwait, directly or through an "agent" (see below), in the islands of Kubr, Qaru and Umm al Maradim or in the offshore area of the partitioned neutral zone under the control and administration of Saudi Arabia.

Kuwaiti-registered companies wholly owned by Kuwaitis, and companies incorporated in GCC countries that are wholly owned by GCC citizens, are not subject to income tax. The members of the GCC are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates.

The term "body corporate" refers to an association that is formed and registered under the laws of any country or state and is recognized as having a legal existence entirely separate from that of its individual members. Partnerships fall within this definition.

Law No. 2 includes a definition of an "agent." Under this definition, an "agent" is a person authorized by the principal to carry out business, trade or any activities stipulated in Article 1 of the law or to enter into binding agreements with third parties on behalf and for the account of the person's principal. A foreign principal conducting business in Kuwait through an agent (as defined in the preceding sentence) is subject to tax in Kuwait.

Foreign companies conducting a trade or business in Kuwait are subject to income tax under Amiri Decree No. 3 of 1955.

Foreign companies conducting a trade or business in the islands of Kubr, Qaru and Umm al Maradim are subject to tax in Kuwait under Law No. 23 of 1961.

Foreign companies conducting a trade or business in the offshore area of the partitioned neutral zone under the control and administration of Saudi Arabia are subject to tax in Kuwait on 50% of the taxable profit under Law No. 23 of 1961. In practice, the tax department computes the tax on the total income of the taxpayer and expects that 50% of such tax should be settled in Kuwait. Many taxpayers are currently contesting this practice. Amiri Decree No. 3 of 1955 and Law No. 23 of 1961 differ primarily with respect to tax rates.

Foreign companies can operate in Kuwait either through an agent or as a minority shareholder in a locally registered company. In principle, the method of calculating tax is the same for companies operating through an agent and for minority shareholders. For minority shareholders, tax is levied on the foreign company's share of profits (whether or not distributed by the Kuwaiti company) plus any amounts receivable for interest, royalties, technical services and management fees.

Tax rates

Under Law No. 2, the tax rate is reduced to a flat rate of 15%, effective for fiscal years beginning after 3 February 2008. Consequently, the new law does not apply to a company with a fiscal year beginning 1 January 2008 and ending on 31 December 2008. For such companies, the new law is effective for the fiscal year beginning on 1 January 2009 and ending on 31 December 2009.

For the fiscal years commencing prior to 3 February 2008, the following tax rates were applicable under Amiri Decree No. 3 of 1955:

Taxable profits		
Exceeding (KWD)	Not exceeding (KWD)	Rate (%)
0	5,250	0
5,250	18,750	5
18,750	37,500	10
37,500	56,250	15
56,250	75,000	20
75,000	112,500	25
112,500	150,000	30
150,000	225,000	35
225,000	300,000	40
300,000	375,000	45
375,000	0	55

The following are the tax rates under Law No. 23 of 1961:

Taxable profits		
Exceeding (KWD)	Not exceeding (KWD)	Rate (%)
0	500,000	20

Taxable profits		
Exceeding (KWD)	Not exceeding (KWD)	Rate (%)
500,000	-	57

Kuwaiti income tax is not progressive; consequently, total profit is taxed at the appropriate rate from the above table. If taxable profit is only marginally higher than the previous limit, tax is calculated by adding the actual excess to the amount payable on the previous limit.

For example, on KWD38,000 of taxable income derived in Kuwait, the tax is KWD37,500 at 10% = KWD3,750, plus KWD500, resulting in total tax of KD4,250.

Capital gains

Capital gains on the sale of assets and shares by foreign shareholders are treated as normal business profits and are subject to tax at the rates stated above.

Article 1 of Law No. 2 and Article 8 of the Bylaws provide for a possible tax exemption for profits generated from dealing in securities on the Kuwait Stock Exchange (KSE), whether directly or through investment portfolios. However, no further clarifications have been provided regarding the definitions of "profits" and "dealing."

Administration

The calendar year is generally used for Kuwaiti tax purposes, but a taxpayer may ask in writing for permission to prepare financial statements for a year ending on a date other than 31 December. For the first or last period of trading or conducting a business, a taxpayer may be allowed to file a tax declaration covering up to 18 months.

Accounting records should be kept in Kuwait, and it is normal practice for the tax authorities to insist on inspecting the books of account (which may be in English) and supporting documentation before agreeing to the tax liability.

The tax authorities also have issued notifications restating the requirement for taxpayers to abide by Article 13 and Article 15 of the Executive Bylaws of Law No. 2 of 2008, which relate to the preparation of books and accounting records and submission of information along with the tax declaration.

Article 13 requires the taxpayer to enclose the prescribed documents, e.g., trial balance, list of subcontractors, list of fixed assets, inventory register along with the tax declaration.

Article 15 requires the preparation of prescribed books of accounts including general ledger and stock list.

In the case of noncompliance with the above regulations, the Department of Inspections and Tax Claims (DIT) may finalize an assessment on the basis deemed reasonable by the DIT.

The Bylaws provide that a taxpayer must register with the DIT within 30 days after signing its first contract in Kuwait. The prior tax law did not specify a period.

Under the Bylaws, a new system of tax cards has been introduced. All taxpayers will be issued tax cards that will be renewed annually. All government departments and public authorities will be prohibited from dealing with companies that do not hold an active tax card. At the time of writing, the tax card had not yet been issued for any company.

A tax declaration must be filed on or before the 15th day of the 4th month following the end of the tax period (for example, 15 April in the case of a 31 December year-end). Tax is payable in four equal installments on the 15th day of the 4th, 6th, 9th and 12th months following the end of the tax period provided the tax declaration is submitted on or before the due date for filing. The Bylaws provide that a request for extension in time for filing the tax

declaration must be submitted to the DIT by the 15th day of the 2nd month (the 3rd month under the prior law) after the fiscal year-end. The maximum extension of time that may be granted is 60 days (75 days under the prior law).

In the event of a failure to file a tax declaration by the due date, a penalty is imposed, equal to 1% of the tax for each 30 days or fraction thereof during which the failure continues. In addition, in the event of a failure to pay tax by the due date, a penalty is imposed, equal to 1% of the tax payment for each period of 30 days or fraction thereof from the due date to the date of the settlement of the tax due.

Article 24 to 27 of the Bylaws provides for the filing of objections and appeals against tax assessments.

As per Article 24 of the Bylaws, an objection may be filed against the assessment within 60 days from the date of assessment. The tax department has to consider and issue the revised assessment within 90 days from the date of filing the objection. If the department fails to pass a revised assessment during this period, the objection is considered as rejected.

The Bylaws allow companies to submit a revised tax declaration if an assessment of tax has not yet been issued by the DIT.

If the DIT accepts the amended tax declaration, the date of filing of the revised tax declaration is considered for the purpose of imposing delay fines.

Law No. 2 introduced a statute of limitations period of five years into the tax law. The prior Kuwait tax law did not provide a statute of limitations for tax. However, under Article No. 441 of the Kuwait Civil Law, any claims for taxes due to Kuwait or applications for tax refunds may not be made after the lapse of five years from the date on which the taxpayer is notified that tax or a refund is due.

Article 13 of the Bylaws provides that companies that may not be subject to tax based on the application of any tax laws, other statutes or double tax treaties, must submit tax declarations in Kuwait.

Determination of trading income

General

Tax liabilities are generally computed on the basis of profits disclosed in audited financial statements and adjusted for tax depreciation and any items disallowed by the tax inspector on review.

The tax declaration and supporting schedules and financial statements, all of which must be in Arabic, are to be certified by an accountant practicing in Kuwait who is registered with the Ministry of Commerce and Industry.

Design expenses

Under Executive Rule No. 25 of 2010, costs incurred for engineering and design services provided by third parties are restricted to the following percentages:

- If design work is carried out in the head office, 75% to 80% of the design revenue is allowed as costs.
- If design work is carried out by an associated company, 80% to 85% of the design revenue is allowed as costs.
- If design work is carried out by a third party, 85% to 90% of the design revenue is allowed as costs.
- If the design revenue is not specified in the contract, but design work needs to be executed outside Kuwait, the following formula may be used by the tax authorities to determine the revenue:

$$\textbf{Design revenue for the year} = \frac{\textbf{Design costs for the year x annual contract revenue}}{\textbf{Total direct costs for the year}}$$

Consultancy costs

Under Executive Rule No. 25 of 2010, costs incurred for consultancy services provided by various parties are restricted to the following percentages:

- If consultancy work is carried out in the head office, 70% to 75% of the consultancy revenue is allowed as costs.
- If consultancy work is carried out by an associated company, 75% to 80% of the consultancy revenue is allowed as costs.
- If consultancy work is carried out by a third party, 80% to 85% of the consultancy revenue is allowed as costs.
- If the consultancy revenue is not specified in the contract, but design work needs to be executed outside Kuwait, the following formula may be used by the tax authorities to determine the revenue:

$$\textbf{Consultancy revenue for the year} = \frac{\textbf{Consultancy costs for the year x annual contract revenue}}{\textbf{Total direct costs for the year}}$$

Interest paid to banks

Interest paid to local banks relating to amounts borrowed for operations (working capital) in Kuwait may normally be deducted. Interest paid to banks or financial institutions outside Kuwait is disallowed unless it is proven that the funds were specifically borrowed to finance the working capital needs of operations in Kuwait. In practice, it is difficult to claim deductions for interest expenses incurred outside Kuwait. Interest paid to the head office or agent is disallowed. Interest that is directly attributable to the acquisition, construction or production of an asset is capitalized as part of the cost of the asset if it is paid to a local bank.

Leasing expenses

The Kuwait tax authorities may allow the deduction of rents paid under leases after inspection of the supporting documents. The deduction of rent for assets leased from related parties is restricted to the amount of depreciation charged on those assets, as specified in the Kuwait Income Tax Decree. The asset value for the purpose of determining depreciation is based upon the supplier's invoices and customs documents. If the asset value cannot be determined based on these items, the value is determined by reference to the amounts recorded in the books of the related party.

Agency commissions

The tax deduction for commissions paid to a local agent is limited to 2% of revenue, net of any subcontractors' costs if paid to the agent and reimbursement costs.

Head office overhead

Article 5 of the Bylaws provides that the following head office expenses are allowed as deductions:

- Companies operating through an agent: 1.5% (previously 3.5%) of the direct revenue
- Companies participating with Kuwaiti companies: 1% (previously 2%) of the foreign company's portion of the direct revenue generated from its participation in a Kuwaiti company
- Insurance companies: 1.5% (previously 2%) of the company's direct revenue
- Banks: 1.5% (previously 2%) of the foreign company's portion of the bank's direct revenue

Article 5 of the Bylaws also provides that, for the purpose of computation of head office overheads, direct revenue equals the following:

- For companies operating through an agent, companies participating with Kuwaiti companies, and banks: gross revenue less subcontract costs, reimbursed expenses and design costs (except for design costs incurred by the head office)
- For insurance companies: direct premium net of share of reinsurance premium plus insurance commission collected

Inventory

Inventory is normally valued at the lower of cost or net realizable value, on a first-in, first-out (FIFO) or average basis.

Provisions

Provisions, as opposed to accruals, are not accepted for tax purposes.

Tax depreciation

Tax depreciation is calculated using the straight-line method. The following are some of the permissible annual depreciation rates:

Asset	Rate (%)
Buildings	4
Furniture and office tools	15
Drilling equipment	25
Computer equipment and accessories	33.3
Vehicles	20
Software	25
Electrical equipment and electronics	15

Relief for losses

Article 7 of the Bylaws provides that approved losses may be carried forward for a maximum of three years. The prior tax law provided that losses could be carried forward and deducted from subsequent profits without limit if no cessation of activities occurred.

Aggregation of income

If a foreign company has more than one activity in Kuwait, one tax declaration aggregating the income from all activities is required.

Foreign currency exchange gains and losses

As per Executive Rule No. 36 of 2010, gains and losses on foreign currency conversion would be classified into realized gain or loss and unrealized gain or loss.

Realized gains and losses resulting from fluctuation of exchange rates shall be allowed as a deduction (for losses) and taxable (for gains) provided the taxpayer would be able to substantiate the basis of calculations and documents in support of such transactions.

Unrealized losses are not allowed as deductible expenses and unrealized gains are not considered as taxable income.

Reimbursed costs

In case of deemed profit filings, reimbursed costs will be allowed as a deductible expense subject to the following:

- Such costs are necessary and explicitly mentioned in the contract
- Such costs shall not exceed 30% of gross revenues
- Supporting documentation is available for such costs

Furthermore, in cases where the reimbursable costs exceed 30%, the taxpayer would be required to file its tax declaration on accounts basis instead of deemed profit.

Miscellaneous matters

Foreign exchange controls

No foreign exchange restrictions exist. Equity capital, loan capital, interest, dividends, branch profits, royalties, management and technical services fees, and personal savings are freely remittable.

Imported material costs

The Kuwaiti tax authorities deem the following profit margins for imported materials and equipment:

- Imports from head office: 10% to 15% of related revenue
- Imports from related parties: 6.5% to 10% of related revenue
- Imports from third parties: 3.5% to 6.5% of related revenue

The imputed profit described above is normally subtracted from the cost of materials and equipment claimed in the tax declaration. If the revenue from the materials and equipment supplied is identifiable, the DIT normally reduces the cost of such items to show a profit on such materials and equipment in accordance with the percentages described above. If the related revenue from the materials and equipment supplied is not identifiable or not stated in the contract, the following formula may be applied to determine the related revenue:

Material and equipment revenue for the year	**=**	**(Contract revenue for the year/ total direct cost for the year)**	**x**	**Material and equipment costs for the year**

Supply and installation contracts

In supply and installation contracts, a taxpayer is required to account to the tax authorities for the full amount received under the contract, including the offshore supply element, which is the part of the contract (cost, insurance and freight to the applicable port) pertaining to the supply of goods.

Contractors' revenue recognition

Tax is assessed on progress billings (excluding advances) for work performed during an accounting period, less the cost of work incurred. The authorities generally do not accept the completed contract or percentage of completion methods of accounting.

Subcontractors' costs

The Kuwait tax authorities are normally stringent in allowing subcontractors' costs, particularly subcontractors' costs incurred outside Kuwait. Subcontractors' costs are normally allowed if the taxpayer provides the related supporting documentation (contract, invoices, settlement evidence and other documents), complies with Article 37 of the Bylaws and Executive Rule No. 6 of 2010 (see Tax retention) and fulfills certain other conditions.

Tax retention

Under Articles 37 and 38 of the Bylaws and Executive Rule No. 6 of 2010, all government departments, privately owned companies and government-owned companies are required to withhold final payments due to entities until such entities present a tax clearance from the DIT. In addition, the following rules must be followed:

- Local and foreign establishments, authorities and companies conducting a trade or business in Kuwait are required to give the director of income taxes details of the companies with which they are doing business as contractors, subcontractors or in any other form. Information to be provided should include the name and address of the company together with a photocopy of the contract.
- The final payment due to the contractor or subcontractor is to be withheld until the contractor or subcontractor presents a certificate from the DIT confirming that all tax liabilities have been settled. The final payment should not be less than 5% of the total contract value.
- When inspecting the tax declaration filed with the DIT, the DIT will disallow all payments made to subcontractors if the rules described above and on the previous page are not observed.

Article 39 of the Bylaws of Law No. 2 of 2008, empowers the Ministry of Finance to demand payment of the 5% retained amount withheld by subcontracting entities if the concerned contractors or subcontractors fail to settle their taxes due in Kuwait.

Work in progress

Costs incurred but not billed by an entity at the end of the fiscal year may be carried forward to the subsequent year as work in progress. Alternatively, revenue relating to the costs incurred but not billed may be estimated on a reasonable basis and reported for tax purposes if the estimated revenue is not less than the cost incurred. In general, if less than 20% of the contract is executed in a fiscal year, both income and expenses relating to the contract may be carried forward.

Salaries paid to expatriates

In a press release issued on 23 September 2003, the Ministry of Social Affairs and Labour announced that it would impose stiff penalties if companies fail to pay salaries to employees in their local bank accounts in Kuwait. These penalties apply from 1 October 2003. The release also stated that the DIT may disallow payroll costs if employees do not receive their salaries in their bank accounts in Kuwait.

Offset Program

The Ministry of Finance issued Ministerial Order 13 of 2005 to reactivate the Offset Program. In 2006, the National Offset Company (NOC) was formed to manage and administer the implementation of the Offset Program on behalf of the Kuwait Government and Ministry of Finance.

The following are significant aspects of the program:

- All civil contracts with a value of KWD10 million or more and defense contracts with a value of KWD3 million or more attract the offset obligations for contractors. The obligations become effective on the signing date of the contract.
- Contractors subject to the offset obligation must invest 35% of the value of the contract with Kuwaiti government bodies.
- Contractors subject to the offset obligation may take any of the following actions to fulfill their offset obligation:
  1. Equity participation in an approved offset business venture (direct participation in a project company)
  2. Contribution of cash and/or in-kind technical support

3. Investment in an offset fund managed by certain banks or investment companies in Kuwait
4. Procurement of the products that are manufactured in Kuwait (petrochemical products such as paraxylene)

- Contractors covered by the offset obligation must provide unconditional, irrevocable bank guarantees issued by Kuwaiti banks to the Ministry of Finance equal to 6% of the contract price. The value of the bank guarantee is gradually reduced based on the actual execution by the foreign contractor or supplier of its work. The Ministry of Finance may cash in the bank guarantee if the company subject to the offset obligation fails to fulfill such obligation.

In practice:

- Option 3 is currently not a viable option as the NOC has indicated that investment in funds would not be considered for the completion of offset obligations.
- The NOC is currently insisting that every offset venture should have a local equity partner and has also issued guidelines in this respect.
- A combination of options 1, 2 and 4 is being used.

The Offset Program is likely to be implemented through the inclusion of clauses in supply contracts that refer to an offset obligation of the foreign contractor. Unlike other Offset Programs in the Arabian Gulf, the Kuwaiti program allows foreign contractors to fulfill their offset obligations by investing in projects outside Kuwait if these investments add value to Kuwaiti products. For example, a joint venture between Kuwaitis and foreigners to refine Kuwaiti crude oil may qualify as an offset obligation. Most investments that benefit the Kuwaiti economy may qualify under the program.

Tax treaty withholding tax rates

Kuwait has entered into tax treaties with several countries for the avoidance of double taxation. Treaties with several other countries are at various stages of negotiation or ratification.

Disputes about the interpretation of various clauses of tax treaties between taxpayers and the DIT are not uncommon. Disputes with the DIT regarding tax treaties normally arise with respect to the following issues:

- Existence of a permanent establishment
- Income attributable to a permanent establishment
- Tax deductibility of costs incurred outside Kuwait

Kuwait has also entered into treaties with several countries relating solely to international air or sea transport. Kuwait is also a signatory to the Arab Tax Treaty and the GCC Joint Agreement, both of which provide for the avoidance of double taxation in most areas. The other signatories to the Arab Tax Treaty are Egypt, Iraq, Jordan, Sudan, Syria and Yemen.

The domestic tax law in Kuwait does not provide for withholding taxes except for the distribution of the dividend by the companies listed on the KSE. As a result, it is not yet known how the Kuwaiti Government will apply the withholding tax procedures included in the treaties listed in the table below. The withholding rates listed in the table are for illustrative purposes only.

Country	Dividends %	Interest %	Royalties %
Austria	0	0	10
Belarus	5 [c]	5 [c]	10
Belgium	10	0	10
Bulgaria	5 [j]	5 [f]	10
Canada	5% / 15% [m]	10	10
China	5 [a]	5 [a]	10

Country	Dividends %	Interest %	Royalties %
Croatia	0	0	10
Cyprus	10	10 [b]	5
Czech Republic	5 [j]	0	10
Ethiopia	5 [c]	5 [b]	30
France	0	0	0
Germany	15 [e]	0	10
Greece	5 [c]	5 [c]	15
Hungary	0	0	10
India	10 [n]	10 [n]	10
Indonesia	10 [c]	5 [b]	20
Italy	5	0	10
Jordan	5 [c]	5 [b]	30
Korea (South)	5	5	15
Lebanon	0	0	30
Malaysia	0	10	15 [q]
Malta	10/15 [d]	0	10
Mauritius	0	0 [f]	10
Mongolia	5 [h]	5 [h]	10
Netherlands	10 [i]	0	5
Pakistan	10	10 [g]	10
Poland	5 [j]	5 [j]	15
Romania	1	1	20
Russian Federation	5 [c]	0	10
Singapore	0	7 [b]	10
South Africa	0	0	0
Sri Lanka	5/10	10	20
Sudan	5 [h]	5 [h]	10
Switzerland	15	10	10
Syria	0	10 [k]	20
Thailand	10	10/15 [o]	20
Tunisia	10 [c]	2.5 [b]	5
Turkey	10	10	10
Ukraine	5 [f]	0	10
United Kingdom	5/15	0 [e]	10
Venezuela	5/10 [p]	5	20
Yugoslavia	5/10 [l]	10	10
Non-treaty countries	0	0	0

(a) The rate is 0% for amounts paid to a company of which the government owns at least 20% of the equity.

(b) The rate is 0% for interest paid to the government of the other contracting state. Under the Ethiopia treaty, the rate is also 0% for interest paid to entities in which the Government owns a specified percentage of the equity and for interest paid on loans guaranteed by the government.

(c) The rate is 0% for dividends and interest paid to the government of the other contracting state. Under the Ethiopia treaty, the rate is also 0% for dividends paid to entities in which the government owns a specified percentage of the equity.

(d) The rate is 10% for dividends paid to the government of Kuwait or any of its institutions or any intergovernmental entities. The rate is 15% for other dividends.

(e) The 5% rate applies if the recipient of the dividends owns directly or indirectly at least 10% of the payer. The 15% rate applies to other dividends.

(f) The rate is increased to 5% if the beneficial owner of the interest carries on business in the other contracting state through a permanent establishment and the debt on which the interest is paid is connected to such permanent establishment.

(g) The rate is 0% for amounts paid to the government of the other contracting state and to entities of which the government owns at least 51% of the paid in capital.

(h) For dividends and interest, the rate is 0% if the payments are made to the government, a governmental institution of the other contracting state or to a company that is a resident of the other contracting state and is controlled by, or at least 49% of the capital is owned directly or indirectly by, the government or a governmental institution. A 0% rate also applies to interest arising on loans guaranteed by the government of the other contracting state or by a governmental institution or other governmental entity of the other contracting state.

(i) A 0% rate applies if the beneficial owner of the dividends is a company that holds directly at least 10% of the capital of the company paying the dividends.

(j) The rate is 0% if the payments are made to the government, a governmental institution of the other contracting state or to a company that is a resident of the other contracting state and is controlled by, or at least 25% of the capital is owned directly or indirectly by, the government or a governmental institution of the other contracting state.

(k) The rate is 0% if the beneficial owner of the interest is a resident in the other contracting state and the loan is secured or financed directly or indirectly by a financial entity or other local body wholly owned by the government of the other contracting state.

(l) The 5% rate applies if the recipient of the dividends owns directly or indirectly at least 25% of the payer. The 10% rate applies to other dividends.

(m) The rate is 5% if the beneficial owner of the dividends is a company that owns 10% or more of the issued and outstanding voting shares or 25% or more of the value of all of the issued and outstanding shares. The 15% rate applies to other dividends.

(n) Dividends or interest paid by a company that is a resident of a contracting state is not taxable in that contracting state if the beneficial owner of the dividends or interest is one of the following:

- The government
- A political subdivision or a local authority of the other contracting state
- The central bank of the other contracting state
- Other governmental agencies or governmental financial institutions as may be specified and agreed to in an exchange of notes between the competent authorities of the contracting states

(o) The rate is 10% in the case of financial institutions (including insurance companies) and 15% in all other cases.

(p) The rate is 5% if the beneficial owner is a company that holds directly at least 10% of the capital of the company paying dividends. The rate is 10% in all other cases.

(q) The rate is 15% for the use of, or the right to use, cinematograph films, tapes for radio or television broadcasting and any copyright of literary or artistic work. The rate may be reduced to 10% for the right to use any patent, trademark, design, model, plan, secret formula process or any copy.

C. Incentives

Kuwait offers the following investment incentives:

Industry Law. To encourage investments in local industrial undertakings, Industry Law No. 56 of 1996 offers:

- Reduced import duties on equipment and raw materials
- Protective tariffs against competing imported goods
- Low-interest loans from local banks
- Export assistance
- Preferential treatment on government supply contracts

Direct Foreign Capital Investment Law (DFCIL; Law No. 8 of 2001). This Law provides the following benefits to new and existing foreign capital investment projects:

- Opportunity for investment in excess of 50% (up to 100%) in Kuwaiti companies by non-Kuwaitis
- Full or partial exemption from customs duties on certain imports and other government charges for approved projects
- A tax holiday of up to 10 years with respect to non-Kuwaiti shareholders' shares of the profits from qualifying projects (an additional tax holiday for a similar period is granted for further investment in an already approved project)
- A guarantee of repatriation of profits and capital invested in the project
- Double tax treaties and investment promotion and protection agreements
- Long-term leases of land in industrial estates at low rents
- Employment of required foreign manpower without being subject to the restriction contained in the Labor Law concerning employment of Kuwaiti manpower

The Ministry of Commerce and Industry has issued Bylaws to the DFCIL. These explain the application of the Law and the procedures for approval of projects, including procedures for obtaining applications for investment licenses and details about guarantees, advantages, facilities and exemptions to be offered to foreign investors. The Kuwait Government also has issued a list of categories of projects that qualify for approval under the DFCIL.

Licenses under the DFCIL are awarded for projects of strategic importance to Kuwait that are undertaken in Kuwait. These include projects involving the transfer of technology or technical expertise and projects creating job opportunities for Kuwaiti nationals and contributing to their training. It appears that very few projects have been approved so far under DFCIL.

Kuwait Free Trade Zone (KFTZ). To encourage exporting and re-exporting, the Government has established KFTZ in the vicinity of the Shuwaikh port. The KFTZ offers the following benefits:

- Up to 100% foreign ownership is allowed and encouraged.
- All corporate and personal income is exempt from tax.
- All imports into and exports from the KFTZ are exempt from tax.
- Capital and profits are freely transferable outside the KFTZ and are not subject to any foreign-exchange controls.

D. Withholding taxes

The domestic tax law in Kuwait does not provide for withholding taxes except in the case of dividend income received by the investors in companies listed on the KSE as mentioned above. However, please refer to the comments in Section B in respect of tax retention regulations.

E. Financing considerations

There are currently no thin capitalization rules currently imposed in Kuwait. Please, however, refer to Section B for our comments on the deductibility of interest charges.

F. Indirect taxes

Import duties

The six member States of the GCC have entered into a GCC Customs Union. Under the terms of the Customs Union, member states have agreed to unify the regional customs tariffs at 5% on all taxable foreign imports, down from individual country rates that ranged between 4% and 15%, as of 1 January 2003.

In general, after landing in Kuwait, goods may be cleared through customs within two weeks if documentation is completely in order. Customs examination is rigorous for all imported goods. This also applies to containerized cargoes arriving at the two main ports, Shuwaikh and Shuaiba. Lorries may be off-loaded on a random basis at a special inspection point in Kuwait City. Customs accepts no responsibility for damage, delays or losses. The Department of Standards and Metrology has established a large number of minimum-quality standards, based on a combination of American, British, German and other national standards.

VAT

Kuwait currently does not impose any VAT or other sales taxes.

Export duties

Kuwait currently does not impose any export duties.

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A. At a glance

Fiscal regime

In Libya, the fiscal regime that applies to the petroleum industry consists of a combination of corporate income tax (CIT) and a surtax.

Under the production sharing contract (PSC) regime, taxes are deemed to be paid by the This is National Oil Company (NOC), and the tax computation is notional.

Royalty	The royalty is 16.67% of production
Bonuses	Signature bonuses are payable under the bid process. Subsequent bonuses are payable upon declaration of a commercial discovery, upon reaching production of 100 million barrels and upon subsequent milestone production of each additional 30 million barrels
PSC	Libya has a PSC regime and is presently contracting under the fourth generation of exploration and PSAs (EPSA IV), though there have been no new agreements since 2007.

Income tax rate

CIT rate of 20% plus jihad tax	If these taxes, plus an adjustment for 4% royalty, are less than 65% of profits, a surtax is payable so that tax, other deductions and a surtax combine to produce a composite 65% rate
Resource rent tax	Not applicable
Capital allowances	All capital expenditures are recoverable from cost oil through depreciation or amortization
Investment incentives	Not applicable to oil companies

B. Fiscal regime

Corporate tax

Libyan corporations are subject to income tax on their non-exempt worldwide income. Foreign corporations, including international oil companies (IOCs), are taxable on income arising in Libya.

Oil companies

Petroleum exploration and production in Libya is governed by Petroleum Law 25 of 1955, as amended (principally by Regulation 9 of 1973). Until the 1970s, oil licenses were granted via deeds of concession, and Libya received remuneration through royalties and taxes. The royalty was 16.67% of production. A combination of a royalty adjustment, rents, income taxes and a surtax combined to create a deduction of 65% on profits. The amount paid by IOCs, therefore, was not a single petroleum tax but a payment comprised of a variety of elements. With one exception, these concession agreements have been renegotiated into EPSA IV.

In 1974, the first EPSA contract was introduced, and succeeding generations of EPSA contracts have introduced a variety of changes and refinements. IOCs and the National Oil Corporation of Libya (NOC of Libya) shared profit in a variety of percentages and in accordance with a number of formulas.

Under the current EPSA IV, introduced in 1999 but amended on an ongoing basis, there is an open and transparent bid process for new acreage. A share of production is bid for, and the lowest percentage bid wins the acreage. Percentage shares have been awarded for bids in the range of 7.5% to 25%. The agreement is usually for a period of 5 years, extendable by 25 years if oil is found in commercial quantities. The agreement contains a minimum exploration commitment, which may comprise, for example, the drilling of one to three wildcat wells and, for example, 3,000 kilometers of 2D seismic lines.

EPSA IV is a cost-recoverable agreement. If oil is discovered and produced, the NOC takes 100% less the share of the production bid by the IOC, until the IOC has recovered all exploration, appraisal, development and current annual production costs. Thereafter, any "excess petroleum" is allocated to the IOC based upon the following formula:

A factor x excess petroleum (barrels)

The "A" factor is the ratio of the cumulative value of production received by the IOC over the cumulative expenditure. The A factor is negotiable, but an example of a reasonable amount incurred is illustrated in the table below.

Ratio	A factor
Less than or equal to 1:5	0.90
More than 1:5 but less than or equal to 3:0	0.70
More than 3:0 but less than or equal to 4:0	0.50
More than 4:0	0.30

The crude oil value is used in determining the cumulative value of production received and is based on an average monthly international market price. The 2007 EPSA agreement values production at the monthly average price achieved by the NOC.

The terms of the current EPSA IV state that the taxation terms of the Petroleum Law apply and that the IOC should submit royalty and tax returns. Estimated returns must be submitted, and taxes and royalties must be paid quarterly. A final return (financial declaration) comprising actual amounts for the calendar tax year must be submitted no later than 31 March of the following year. Any additional tax due for the preceding year must be paid within 30 days, and any overpayment is treated as a credit against a future liability.

The Petroleum Law identifies that the 65% of profits paid by an IOC under the terms of a concession deed comprises a number of elements. However, under EPSA IV, a tax computation is prepared using the 65% rate as if it was a single rate.

Taxes are deemed to have been paid on behalf of the foreign IOC by the NOC and the amount of taxes paid on behalf of the IOC are grossed up. The gross-up amount is:

$$\frac{\textbf{Profit x 65\%}}{\textbf{100\% – 65\%}}$$

A tax receipt is issued for this amount.

The composite rate of 65% of profits payable by companies that are subject to Petroleum Law comprises:

1. Income tax due under Income Tax Law 7 of 2010
2. Jihad tax due under Law 44 of 1970
3. Surface rents due under Article 14(1)(a) of the Petroleum Law
4. A surtax so that the total deductions are 65% of taxable income

To date, 65% of the profit defined under the Petroleum Law has always exceeded the amount due in items 1., 2. and 3. above.

Income tax is computed per Libyan Income Tax Law (Law 7 of 2010) at the rate of 20% of profits.

The jihad tax is imposed by Law 44 of 1970 and is payable at the rate of 4% on profits. It is charged at sliding scales on both salaries and profits. Although it is assessed under different legislation, it is essentially another income tax.

The computation of revenue is generally defined in the applicable concession agreement or EPSA contract, and the EPSA tax computation is explained in Decision 394 of 2007 and Decision 96 of 2008.

Depreciation of tangible assets is allowed at 10% per year, and intangibles are amortized at 5% per year. Under Law 3 of 1983, the Secretary of Petroleum was given discretion to change these depreciation rates. The rate applied under the terms of the old concession agreements is 33.33%.

Interest is not deductible in determining profits.

Taxpayers from some countries do not have any objection to paying one undifferentiated amount that is labeled the petroleum tax. By comparison, tax authorities of some home countries of foreign investors require them to prove the specific amounts paid for the income tax, jihad tax and the petroleum surtax in order to calculate foreign tax credits or the amount that is eligible for a home-country exemption. For those taxpayers, it is important to calculate the various Libyan taxes provided in the income tax, jihad tax and Petroleum Law.

Ring-fencing

Historically, Libya applied the ring-fence principle in determining a petroleum tax liability. Profits from one project could not be offset against the losses from another project held by the same tax entity. Similarly, a non-associated gas project had to be accounted for separately from a crude oil project. Under the current EPSA IV, ring-fencing does not apply — revenue and costs may be pooled if the result is a commercially viable economic unit.

The Petroleum Law covers only upstream operations, although it includes rules relating to pipeline and terminal tariffs. Oil companies in Libya may acquire and build assets under their agreements but, in practice, downstream activities are usually undertaken by separate entities called oil service companies.

Oil service companies

An oil company may establish or have an interest in an oil service company, but such companies are subject to income tax law, not the Petroleum Law. Separate legal entities cannot form a tax consolidated group and, therefore, oil companies and oil service companies are taxed individually.

Corporate tax is levied on taxable income. Taxable income equals assessable income less any deductions. Deductions include expenses, to the extent they are incurred in producing assessable income or are necessary in carrying on a business for the purpose of producing assessable income. Assessable income generally comprises billings, capital gains and exchange rate gains.

Libyan tax law is straightforward, and the basis of determining taxable income, assessing and paying tax and the appeal process, as established in the income tax law, resembles tax laws in many countries. However, practice can differ from theory.

Although corporate tax law is based on the usual "add-back" basis, whereby a disallowed expenditure is added back to declared net profits or losses, the current practice is that the Libyan tax department usually raises assessments based on a percentage of turnover — the "deemed profit" basis of an assessment. Tax, therefore, is payable even when losses are declared.

The level of deemed profit applied to turnover varies according to the type of business activity, but it is likely to be in the range of 15% to 20% for an oil service company.

Capital gains

No separate schedule exists in the tax law under which capital gains are taxed in Libya. Gains are taxed as trading income at the tax rates discussed above.

Functional currency

With the exception of oil companies, the general rule is that the functional currency is the Libyan dinar, a currency that floats against the special drawing rights (SDR).

However, for oil companies, an EPSA requires that records are maintained in both Libyan dinars and US dollars and, for cost recovery and tax purposes, the US dollar records are used. Oil company tax liabilities are determined in US dollars, but paid in Libyan dinars.

Transfer pricing

Libya has no transfer pricing regulations. The Petroleum Law requires that charges from a parent company to its Libyan branch under the terms of a service agreement must be at cost.

There is no precedent, but transactions at arm's-length, which include a profit to comply with OECD regulations, should be identified and are subject to tax under the income tax law.

Dividends

Branches established in Libya by foreign oil companies do not declare and pay dividends.

Dividends declared and paid by an oil service company that has formed a Libyan joint stock company (JSC — which is the legal entity that a foreign company may establish) are payable gross, without withholding tax.

Royalty regime

A royalty is payable monthly under the terms of a concession agreement, at the same time as taxes, and computed at the rate of 16.67% of production and valued at the Libyan posted price applicable to liftings in the month that the royalty is paid. The Libyan posted price is an anachronism: it is US$27.75 at 40 degrees API.

C. Capital allowances

There is no capital allowances regime in Libya. Statutory rates of depreciation are chargeable and deductible.

Under the Petroleum Law, the rate may be determined by the NOC. Since 1983, it has been 33% for concession agreements. The rate for EPSA is 10%.

D. Incentives

Investment Law 9 of 2010

Investment Law 9 of 2010, together with the Implementing Regulations of 2010, offers:

- Exemption from company income tax on both retained and distributed profits for five years, with the possibility of an extension, and the carryforward of losses in exemption years to subsequent years
- Exempt from customs duty are machinery, tools, equipment, spare parts and primary materials, although this is now superfluous because customs duties are at a 0% rate (with the exception of tobacco)
- Exemption from stamp duties

There is flexibility as to the corporate form. That is, an investor may establish any legal entity allowed under business law — such as a branch or company with a majority or minority shareholding.

The NOC is in the process of negotiating with a number of oil companies and international industrial companies to refurbish and extend refineries and other downstream facilities under the terms of the Investment Law. The template is for joint ventures to be established (50/50), which will refurbish or build these facilities and subsequently operate them. Contracts are generally for 25 years, perhaps with an exclusive distribution agreement of 10 years.

After the expiration of the company income tax exemption period, these projects will be subject to tax under the income tax law.

Because NOC is a shareholder or owner in such an agreement, and because revenue will be based upon contracts with specific rates for throughput with defined costs, it is likely that any profit from these projects will subsequently be taxed on an add-back basis.

Exploration

As noted above, all capital expenditures and operating expenditures for exploration, appraisal, development and production are immediately cost recoverable if a commercial discovery is declared.

Tax losses

Tax losses can be carried forward for 10 years for an oil company under the Petroleum Law and for 5 years for an oil service company under the income tax law.

Regional incentives

Regional incentives are not applicable in Libya.

Research and development

There are no tax obligations on R&D in Libya'.

E. Withholding taxes

There are no formal withholding taxes established in the law.

Permanent establishment

There is no definition of permanent establishment (PE) in Libyan Tax Law 7 of 2010, but Libya has signed a number of double tax agreements in which the concept of a PE is recognized under the general provisions of the Model UN and OECD Tax Treaties.

The establishment of PE status in Libya, therefore, ought to be clear and in accordance with definitions contained in the Model Tax Treaties. However, in practice, it is a gray area.

Regardless of the definitions in the treaty, as a matter of practice on a day-to-day basis, the Libyan tax authorities work on the principle that de facto PE status is established if any work is undertaken, or service performed, in the Libyan jurisdiction. This is the case even if only a small proportion of a contract is undertaken in the Libyan jurisdiction (e.g., site visits), and regardless of the time spent in Libya.

Although it is a legal requirement for a foreign company to establish a corporate entity in Libya, in practice it is possible to pay taxes and register contracts without registering in a situation where a particular expertise is required, usually for a single, short-term contract. In such a case, the associated contract must be registered with the tax authorities, and income taxes and stamp duties on the full contract value must be paid in advance.

Interest and royalties

Libyan tax law taxes income specifically and only under the following headings:

- Pure agricultural income
- Income arising from commercial, industrial and craft activities
- Company income from national partners not wage workers' entities
- Income from the liberal professions
- Wages, salaries, etc.
- Residents' income from abroad
- Income from bank deposits
- Tax on companies

Tax law does not, therefore, directly deal with matters such as interest, royalty payments (except royalties under the Petroleum Law), leasing and payments for intellectual property rights, and much depends upon precedent.

All contracts for services to be performed in Libya should be registered with the tax department, and stamp duty should be paid on these contracts.

Thus, a foreign company registered in Libya that enters into an agreement with an overseas third party for the use of an asset or provision of a service in the Libyan jurisdiction that results in a payment, should require that the contract is registered by the supplier. In these circumstances, tax is payable on the profit deemed to result from the payment, and is payable even if the company to which the payment was paid is not registered in Libya.

The same position applies to interest payable on a loan to a Libyan-registered entity.

Branch remittance tax

Branch remittance tax is not applicable in Libya.

F. Financing considerations

Libya's tax system contains no significant rules regarding the classification of debt and equity instruments or the level of funding.

The Petroleum Law specifically prohibits interest paid to a parent to fund its Libyan operations, but agreements usually allow for the lesser of 2% or US$1 million of annual expenditures to be charged as the parent company's overhead (PCO).

Under the income tax law, PCO and interest and commissions are exclusively allowed, up to a maximum of 5% of administrative expenses included in the accounts.

There are no thin capitalization rules.

G. Transactions

Asset disposals

A profit resulting from the sale of a business, or from any of its tangible or intangible assets, is taxable income. The profit is the difference between the sale proceeds (or what is considered by the tax department to be the fair market value) and the cost or net book value.

Farm-in and farm-out

It is not common in the Libyan oil and gas industry for entities to enter into farm-in arrangements.

Selling shares in a company (consequences for resident and nonresident shareholders)

There is little precedent on this issue, but a share disposal is subject to the income tax law, and any gain on disposal is subject to tax as if it was trading income, for a transaction of this nature being concluded within the Libyan jurisdiction.

H. Indirect taxes

Stamp Duty Law 12 of 2004 (as amended by Stamp Duty Law 8/2010)

Stamp duty is applied to numerous documents, both to "papers" and "actions." There are 45 assessable schedules appended to the Law.

Stamp duty's most relevant impact on foreign companies arises from the requirement to register all contracts for work to be performed in Libya. Once a contract has been negotiated in Libya, if it is for anything other than a direct supply from abroad from an unregistered foreign company, it must be registered with the tax department within 60 days of the first date noted in the contract.

A 1% duty on the total contract value (plus 5/1,000 of the duty) is payable upon registration. Any invoice subsequently rendered against a registered contract must be taken to the tax department and stamped to confirm that the contract under which it is issued has been registered and the duty has been paid. Invoices should not be paid unless they are stamped as registered.

VAT and GST

There is no VAT or GST in Libya.

Import duties

With the exception of tobacco, there are no customs import duties in Libya.

A 6% service charge is assessed on the value of all imported equipment and materials to cover the administrative costs of the customs department. Some other immaterial fees apply.

Export duties

There are no duties applied to goods exported from Libya.

Excise duties

There are no duties applied to goods exported from Libya.

I. Other

Importation

Equipment may be imported either on a permanent or temporary basis. Equipment imported on a permanent basis cannot be reexported, whereas equipment imported on a temporary basis must be reexported.

The conditions associated with temporary importation are strict. Equipment may only be used for the contract for which it was imported and a deposit must be paid to the customs department.

Employment taxes

Other significant taxes include employer social security contributions of 11.25% of the gross salary, employee social security of 3.75% and taxes of 14% on all salary and benefits in kind paid to employees.

Foreign exchange controls

The Libyan dinar is not a convertible currency and contracts usually specify the proportion of the contract value that may be remitted abroad (the average is 80%). The balance of Libyan dinars is not transferable.

A foreign entity may hold only one Libyan dinar account at one bank. Different foreign currency accounts may be opened, but not multiple accounts in the same currency.

Branches of foreign companies may be paid directly offshore. JSCs may pay into foreign currency accounts held locally, and they may then remit the currency in accordance with the terms of their contracts, which should be deposited with the local bank.

Forms of business presence

A foreign oil company may establish a branch in Libya.

A foreign service company seeking to conduct a contract in the Libyan jurisdiction is required by law to establish either a branch (to undertake an "allowed activity" as listed by the authorities) or a Libyan JSC in which the foreign company may hold a maximum of 65% of the share capital.

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A. At a glance

Fiscal regime

The taxation of income from petroleum operations in Malaysia is governed by the Petroleum (Income Tax) Act (PITA) whereas income derived from nonpetroleum operations is subject to tax under the Income Tax Act.

Royalties	10% of gross production
Bonus	In practice, a bonus payment, such as a signature bonus, is normally waived

Production sharing contract

Under the Petroleum Development Act 1974, PETRONAS, the national oil corporation of Malaysia, is vested with the exclusive rights of exploring and exploitation of petroleum resources in Malaysia.

Oil and gas companies undertaking petroleum operations in Malaysia will enter into a PSC with PETRONAS where, generally, under each production sharing contract (PSC), the contractor provides the financing and bears all the risks of exploration, development and production activities in exchange for a share of the total production.

Tax rate

The petroleum income tax:

- Malaysia 38%
- Joint Development Area (JDA):
  - First eight years of production is 0%
  - Next seven years of production is 10%
  - Subsequent years of production are 20%

Income tax	25%[130]
Resource rent tax	None
Real property gains tax	5%[131]

130 *The Protocol to the Malaysia-Thailand Double Taxation Agreement provides for the tax chargeable to be reduced by 50% in respect of business income or profits derived from the Joint Development Area, which are taxable in both countries.*

131 *Disposal of real property or shares in real property companies from 1 January 2010 that have been held for more than five years will be exempted.*

B. Fiscal regime

Petroleum income tax is levied at the rate of 38% on the income of a chargeable person arising from "petroleum operations." The term "petroleum operations" refers to searching for and winning or obtaining petroleum in Malaysia and any sale or disposal of petroleum so won or obtained, and includes the transportation within Malaysia of the petroleum so won or obtained to any point of sale, delivery or export, but does not include:

- Any transportation of petroleum outside Malaysia
- Any process of refining or liquefying petroleum
- Any dealings with products so refined or liquefied
- Services involving the supply and use of rigs, derricks, ocean tankers and barges

Please note that information on the fiscal regime in this section relates to petroleum operations (upstream operations) only. Downstream operations are subject to separate income tax legislation (Income Tax Act) and the tax treatment may differ from that provided under the PITA.

Chargeable person

A chargeable person is any person conducting petroleum operations under each petroleum agreement (PSC) (i.e., each PSC effectively creates a separate chargeable person for PITA purposes).

A chargeable person includes a company, a partnership or other body of persons and a sole corporation.

Generally, an operator for the PSC is appointed and is responsible for keeping the books of the PSC, as well as filing the petroleum income tax return on behalf of the PSC. The individual partners of the PSC are not required to file a separate petroleum income tax return in respect of their share of income from the PSC.

Multiple agreements

If a person conducts petroleum operations under more than one PSC, each PSC will be treated as a separate chargeable person. Effectively, expenses incurred in respect of a PSC can only be offset against income from petroleum operations under the same PSC.

Contiguous agreement areas

If partners in a PSC carry on petroleum operations under two or more PSCs in contiguous areas, the petroleum operations in those areas are treated as being conducted under one PSC.

Succeeding partnerships

If, at any time during the period of the PSC, a partner in a PSC is succeeded by another, and at least one of the original parties to that PSC remains as a partner, both partnerships are treated as a continuing PSC partnership.

Unabsorbed losses and capital allowances

Any unabsorbed losses and capital allowances can be carried forward indefinitely to offset future business income.

Recovery of cost oil and profit oil

Generally, the gross production of crude oil in each quarter is divided as follows:

- A maximum of 10% is first taken by PETRONAS as royalty payments to the federal and state governments
- Next, cost oil recovery by contractors is determined by the "revenue over cost" (R/C) ratio
- The remaining portion, which is the profit oil, is split between PETRONAS and the contractors; the profit oil attributable to the contractors is shared, based on each party's participating interest

Cost oil recovery excludes nonrecoverable expenses such as:

- Costs incurred as a result of any proven negligent act or omission, or willful misconduct
- Replacement and/or repair costs in respect of assets or other property that is uninsured or underinsured
- Indemnity payments by contractors
- Expenses incurred in connection with the negotiation, signature or ratification of the PSC
- Expenses incurred in connection with raising money to finance petroleum operations, such as interest, bank charges and commissions
- Central administration and head office costs and charges that are not substantiated or are excessive
- All taxes and export duties
- Costs and expenses associated with local offices and local administration, including staff benefits that are excessive

Functional currency

Upon obtaining approval from the Ministry of Finance, oil and gas operators may opt to submit their petroleum income tax returns and calculate their taxable income by reference to a functional currency (i.e., a particular foreign currency) if their accounts are solely or predominantly kept in that currency.

Transfer pricing

The Inland Revenue Board Malaysia (IRB) has issued transfer pricing guidelines that apply to cross-border transactions and local transactions between associated enterprises. The guidelines are based on the arm's-length principle set forth in the OECD Transfer Pricing Guidelines and provide several methods for determining an arm's-length price. The guidelines also provide a detailed list of information, documentation and records that need to be maintained with respect to related-party transactions.

The anti-avoidance provision under PITA allows the MIRB to disregard or vary any transaction that is not made on an arm's-length basis.

Capital allowances

Qualifying plant expenditure		
	Initial allowance[(a)]	Annual allowance[(b)]
Plant		
Secondary recovery	40%	10%
Any other case	20%	8%
Fixed, offshore platform	–	10%
Environmental protection equipment and facilities	40%	20%
Computer software and hardware	20%	40%
Building		
Secondary recovery	20%	3%
Any other case	10%	3%

(a) Initial allowance is claimable in the year the expenditure was incurred.

(b) Annual allowance is claimable in each year, commencing from the year the expenditure was incurred.

The qualifying plant expenditure incurred during the exploration and development period is accumulated and carried forward to the commercial production period, and deemed to be incurred in the year of the first sale of petroleum (i.e., when commercial production begins).

Qualifying exploration expenditure

Qualifying exploration expenditure (QEE) incurred during the exploration and development period is accumulated and carried forward until the first sale of petroleum (i.e., when commercial production begins). QEE is allowed as a deduction gradually in the form of the initial allowance and annual allowances against the gross income for each year of assessment.

Initial allowance – 10%

Annual allowance – the greater of:

(a) 15% of residual expenditure;

or

(b)

$$\frac{\textbf{Output from petroleum operations for the basis period} \times \textbf{residual expenditure}}{\textbf{Output from petroleum operations for the basis period} + \textbf{total potential future output of the petroleum operations}}$$

Pursuant to the Gazette Order published on 18 August 2011, the QEE of a chargeable person incurred prior to the first sales of petroleum may be deducted against the gross income of another chargeable person in another petroleum agreement, provided that the original parties to the petroleum agreements are the same. Other rules and conditions apply (for example, this order is not applicable to the JDA). This Gazette Order is deemed to have come into operation on 30 November 2010.

Disposal of assets used in petroleum operations

If an asset (for which capital allowances have been claimed) is sold, discarded, destroyed or ceases to be used by the contractor for purposes of petroleum operations, a balancing allowance or a balancing charge is computed. A balancing allowance arises when the residual expenditure of the asset exceeds the disposal value of the asset. A balancing charge arises when the disposal value of the asset exceeds the residual expenditure of the asset.

Financing considerations

Upon commencement of commercial production, interest expense on borrowings utilized in the production of gross income or laid out on assets used or held for the production of gross income is deductible. The amount of the deduction may not exceed the fair amount of interest in a similar transaction between independent parties dealing at arm's-length.

C. Incentives

The Malaysian Government had announced the following incentives to promote upstream development and boost the commercialization of hard-to-reach oil fields:

- Investment tax allowance (ITA) for capital-intensive projects
- Reduced tax rate of 25% from 38% for marginal oil fields
- Accelerated capital allowances of up to five years
- QEE transfer between noncontiguous petroleum agreements
- Waiver of export duty on oil produced from marginal fields

However, the legislation and official guidelines on the above incentives are yet to be issued.

The above incentives are not expected to apply to petroleum operations in the JDA, which are taxed at a lower rate.

Downstream projects of national and strategic importance may apply for a prepackaged incentive (either pioneer status or ITA), subject to meeting certain conditions.

D. Withholding taxes

Dividends	0%
Interest	15%[a] [b]
Royalties	10%[b] [d]
Payments for specified services performed in Malaysia and for use of movable property	10%[b] [d]
Payments to nonresident contractors	13%[c] [d]
Other gains or profits (non-business) deemed to be derived from Malaysia (e.g., commissions, guarantee fees)	10%[b]

(a) Bank interest paid to nonresidents without a place of business in Malaysia is exempt from tax.

(b) This is a final tax applicable only to payments to a nonresident.

(c) The withholding tax is treated as a prepayment of tax of the final tax liability.

(d) The Protocol to the Malaysia–Thailand Double Taxation Agreement provides for the tax chargeable to be reduced by 50% in respect of royalties, technical fees and contract payment in connection with service contracts that is derived from the JDA, which are taxable in both countries.

E. Indirect taxes

VAT and GST

The GST bill was tabled for first reading in the Malaysian Parliament on 16 December 2009. However, the Malaysian Government has officially announced on 13 October 2010 the deferral of GST implementation. This is to enable the Government to engage actively with the public. The GST, when introduced, will replace the existing sales tax and service tax.

The Malaysian Government has announced that the GST may be introduced at a rate of 4%, but has yet to announce the date of introduction.

The proposed GST, which is similar in nature to VAT, would be a multistaged consumption tax applicable to every taxable supply of goods and services made in Malaysia, as well as to the importation of goods and services into Malaysia. A decision on the standard rate and registration threshold for GST is to be made closer to the time of the introduction of GST.

Import duty

All dutiable goods, equipment and materials that enter Malaysia from overseas are subject to customs import duty. The general rates of import duty applied to the customs value of imported goods are between 2% and 50%, depending on the types of goods imported. Goods under trade agreements are accorded the relevant preferential import duty rates. Certain classes of petroleum products under the HS code heading 27.10 are currently subject to import duty at rates ranging from zero to 5% and may require an import license.

The petroleum upstream industry (approved companies under the relevant order involving the exploration, development and production of crude oil, including condensate and gas) currently benefits from import duty and sales tax exemptions on all equipment and materials (listed in the master equipment list) used in such operations.

The petroleum downstream industry (involving refining of crude oil into petroleum products, manufacturing of petrochemical products, gas processing and distribution of processed gas) may apply for raw materials, components, packaging materials, machinery and equipment to be free of import duty if the goods are used in the manufacturing activity.

Export duty

Export duty at the rate of 10% applies to petroleum crude oil exported from Malaysia. Exportation of certain classes of petroleum products may require an export license.

Excise duty

Excise duty applies to a selected range of goods manufactured in Malaysia, as well as on selected goods imported into Malaysia. No excise duty is payable on dutiable goods that are exported.

Excise duty on petroleum has been abolished since 1 January 2000.

Sales tax

Sales tax is a single-staged consumption tax imposed on the domestic sale of taxable goods manufactured locally and on those goods imported into Malaysia. However, sales tax generally does not apply to goods manufactured in, or imported into, Labuan, Langkawi and Tioman Island, and in the Malaysia-Thailand JDA, free zones, licensed warehouses or licensed manufacturing warehouses.

Generally, the rates of sales tax for crude petroleum, its associated products and gas are as follows:

- Crude petroleum and natural gas (in a gaseous state) – 0% sales tax
- Refined petroleum – subject to sales tax at a specific rate, e.g., petrol is subject to sales tax at MYR.5862 per liter
- Lubricant oils – subject to 5% sales tax
- Liquefied natural gas – subject to sales tax at a specific rate (i.e., MYR.01 per kilogram)

All exports of crude petroleum, its associated products, and gas are exempt from sales tax.

Any company that undertakes manufacturing activity (of goods that are subject to sales tax), such as refining or compounding, and including the addition of any foreign substance, is required to register for sales tax, except any:

- Manufacturer whose taxable turnover does not exceed MYR100,000 (to apply for a Certificate of Exemption from sales tax licensing)
- Manufacturer that has been approved with licensed manufacturing warehouse (LMW) status
- Manufacturer that is located in a free zone

A company that is registered for sales tax, or is approved with an LMW status or is located in a free zone, is eligible to obtain tax-free raw materials, components, packaging materials, machinery and equipment for use in the manufacturing activity.

Service tax

Service tax is a single-staged consumption tax applicable on specified "taxable services." Services that are not included in the prescribed list are not taxable. Currently, there are nine major groupings of taxable services included in the prescribed list. Examples of taxable services include telecommunication services, employment services, consultancy services, management services, legal services, accounting services, advertising services, engineering services, surveying services, architectural services, insurance services and hired-car services. Generally, service tax is not applicable to the petroleum industry.

The service tax rate has been increased from 5% to 6% since 1 January 2011,.

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A. At a glance

Fiscal regime

The new Crude Hydrocarbons Code (new code) was voted and promulgated by the Mauritanian Parliament in 2010.

Please note that the new code has not been issued in the *Official Gazette*. The comments hereafter are based on the version passed by the Mauritanian Parliament.

The new code consolidates the preexisting legal framework applicable to the oil industry, namely Ordinance No. 88.151 of 1988 (Ordinance 1988), which pertains to the legal and fiscal regime applicable to exploration and exploitation of petroleum. The new code also includes the simplified tax regime (STR) introduced in 2004 by Law No. 2004-029.

Depending on the date on which the petroleum contract was signed, the Mauritanian fiscal regime applicable to the oil and gas upstream industry is governed either by Ordinance 1988 or the new code, the production sharing contract (PSC) and the General Tax Code.

Indeed, companies undertaking petroleum activities under a petroleum contract signed before 2010 remain subject to such contracts and to any noncontrary provisions of the new code.

A specific legal regime for downstream activities was introduced by Ordinance No. 2002-005 in 2002 and will not be presented here.

The main taxes applicable to the oil and gas upstream sector are the following:

- Under Ordinance 1988:
  - Corporate income tax (CIT)
  - Royalties
- Under the new code:
  - CIT
  - VAT
  - Surface fee

Legal regime

Ordinance 1988 governs the legal regime applicable to the exploration and exploitation of petroleum, whether solid, liquid or gaseous, as well as the transportation, storage and marketing thereof.

The scope of the new code is broader than Ordinance 1988 as it also provides the legal regime applicable to constructions and installations, enabling the exploration and exploitation of petroleum (as well as the associated transportation and storage). However, the new code does not cover the legal regime for petroleum marketing activities and does not cover the conduct of petroleum activities by individuals.

Under the new code, the state may carry out any petroleum activities either directly or through the national company. The state may also authorize one or more companies resident in Mauritania or with a branch there to carry out petroleum activities through:

A reconnaissance authorization

The initial duration of a reconnaissance authorization shall not exceed 12 months and may be renewed once for the same duration.

A reconnaissance authorization gives its holder the non-exclusive right, within a limited contractual perimeter, to conduct reconnaissance operations such as geological methods.

Exploration and production (E&P) activities

Research activities and exploitation of hydrocarbons are conducted on the basis of an E&P contract concluded with the state (PSC).

A PSC provides for the sharing of oilfield production between the state and the contractor and must be approved by a State Decree.

The PSC includes two phases:

1. An initial research phase that cannot exceed 10 years and that should include three phases defined by the PSC
2. An exploitation phase that cannot exceed 25 years if the exploitation concerns crude oil fields and 30 years for exploitation of dry gas fields

The PSC shall include a clause granting the state the option to participate in the rights and obligations of the contractor within the exploitation perimeter. This clause states that the maximum percentage of the state's participation in the E&P activities is 10%.

Transportation of hydrocarbons

A right to transport hydrocarbons is granted to the PSC holder. The new code provides, in particular, that holders of different PSCs may associate themselves to build and operate transportation systems.

B. Fiscal regime

Contracts signed before the new code came into force remain governed by any of its noncontrary provisions. This chapter, therefore, covers the main taxes applicable under both regimes (Ordinance 1988 and the new code).

Main taxes applicable under Ordinance 1988

Royalties

Under this regime, contractors holding a B-type exploitation permit are subject to a royalty on production, to be paid in cash or in kind. The amount of this royalty is determined by the total quantity of hydrocarbons produced from the exploitation permit (and not used in petroleum operations, excluding storage and marketing).

The amount of the royalty will be covered in the contract but should not be less than 10% of production. Royalties are deductible when determining taxable net profits.

The holder of an exclusive right of exploitation, excluding the holder of the B-type permit of exploitation, shall not be subject to royalties.

Corporate income tax

Companies conducting petroleum operations within the Mauritanian national territory are liable to CIT as provided in the General Tax Code. CIT is determined based on the net profit arising from such operations.

The applicable rate is provided by the contract. However, it must be at least equal to the common tax rate applicable at the time the contract was signed.

CIT is paid directly by the contractor. For CIT purposes, the contractor has to maintain separate accounts for its petroleum operations in each calendar year.

These accounts must include a profit and loss statement and a balance sheet that will show the results of the petroleum operations and the assets and liabilities assigned or directly related to the petroleum operations.

For the purpose of CIT, the following expenses are deductible:

- Petroleum costs, including costs of supplies, salaries and costs of services provided to the contractor in connection to the petroleum operations (the costs of supplies or services rendered by affiliated companies are deductible, provided that they do not exceed the arm's-length amount for identical or similar supplies of services)
- Depreciation of capital expenditure, in accordance with the rates applicable in the oil industry and covered by the contract
- Overheads related to petroleum operations performed under the contract, including rentals for movable and immovable property, and insurance premiums
- Interest paid to creditors of the contractor, subject to the limits stated in the contract
- Any accounting provisions made for clearly identified future losses, or liabilities for probable future events
- With respect to the holder of a B-type permit, the total amount of royalties paid in cash or in kind

The amount of prior-year losses that the company might have incurred during commercial production shall not be deducted from the taxable profit beyond the time limit allowed under the General Tax Code, unless otherwise provided for in the contract.

An additional petroleum tax may be incurred by the holder of a B-type exploitation permit. This tax is calculated on the profits arising from petroleum operations. The applicable rate is determined in the contract.

Main taxes applicable under the new code 2010

Corporate income tax

Similarly to Ordinance 1988, companies conducting petroleum operations within the Mauritanian national territory are liable to CIT as provided by the General Tax Code. CIT is determined based on the net profit arising from such operations.

The applicable rate is determined in the contract. However, it must be at least equal to the common tax rate applicable at the time the contract was signed. The current applicable rate is 25%.

From the first year of production and for each subsequent fiscal year, contractors must submit their annual tax return and financial statements to the Mauritanian tax authorities. The tax return and financial statements must be submitted before 31 March of the subsequent year.

The PSC may provide that the production sharing the state receives includes the CIT due by the contractor. In this case, the production sharing with the state will include the CIT.

The same deductible expenses as those provided in Ordinance 1988 are applicable under the new code, with the exception of royalties, as there are no royalties payable under the new code (see Section B).

Surface fee

The surface fee is an annual tax that is not deductible. The PSC determines the basis and the rate for each phase of the research period and for the exploitation period.

Bonuses

Contractors are required to pay a bonus upon signing the contract. They are also liable to pay a production bonus when the quantity of hydrocarbons produced has reached certain thresholds determined in the contract.

These bonuses are not deductible for CIT purposes.

C. Capital allowances

Capital allowances are governed by the General Tax Code and the PSC, and not by the hydrocarbons legislation.

Under the General Tax Code and the PSC, for the purposes of determining the taxable net profit arising from petroleum operations, capital expenditure incurred by the contractor that is necessary for the petroleum operations is depreciated on a straight-line basis. The following rates can be used as guidance, but the PSC may provide otherwise:

Nature of capital asset to be depreciated	Annual depreciation rate
Permanent buildings	5%
Temporary buildings	33.3%
Office and home furniture and fixtures	20%
Productive wells	20%
Production and delivery equipment	20%
Drilling equipment	33.3%
Pipelines	10%

D. Incentives

Under Ordinance 1988, contractors are exempt from any further tax on income that is in addition to royalties, CIT and the additional petroleum tax. Therefore, there is no additional tax on profits and the distribution of profits, nor is there any other levy, duty, tax or contribution on any transfer of funds or export of hydrocarbons. This exemption extends to income or activities of companies affiliated with companies holding exclusive petroleum exploration and exploitation rights, provided that such activities are directly related to petroleum operations.

In addition, as noted above, under Ordinance 1988, the holder of an exclusive right of exploitation is exempt from royalties.

The new code provides for an exemption from the following taxes:

- The minimum tax (impôt minimum forfaitaire)
- General income tax (impôt general sur le revenu, usually due by individuals) and any other tax on profits
- Tax on movable property, as well as any other withholding taxes (WHT) on profits distribution
- Any tax on turnover, including tax on services
- Patent fees
- Registration fees
- Learning fees
- Any other tax, duty or contribution related to petroleum activities

Operations conducted in Mauritania by foreign subcontracting companies might opt for the Simplified Tax Regime (STR), which provides for an exemption from all taxes, with the exception of CIT and tax on salaries (ITS).

E. Withholding taxes

Under the new code, contractors must withhold ITS at source and remit it to the Mauritanian tax authorities as provided by Article 84 of the General Tax Code. The ITS capped rate is 35% for expatriate employees in Mauritania.

As previously mentioned, similarly to other oil-producing countries, Mauritania introduced an optional STR in 2004 for foreign companies providing services to contractors in the oil industry. The STR has recently been integrated within the new code.

The STR is optional. It is based on a withholding system that transfers the tax collection burden from subcontractors to contractors. The STR covers taxes on salaries and CIT. As the STR regime is an optional regime, a contractor must confirm whether each subcontractor has elected for the STR to apply, prior to making any payments to the subcontractor.

If foreign subcontractors are taxable on their Mauritanian sourced income and do not opt for the STR, or if their application for the STR is rejected by the tax administration, they will be subject to the general tax regime. Under the new code, contractors must withhold the ITS at source and remit it to the tax authorities as provided by Article 84 of the General Tax Code. The ITS capped rate is 35% for expatriate employees in Mauritania.

F. Financing considerations

Under Ordinance 1988, interest paid to creditors of the contractor is treated as deductible, subject to the limits stated in the accounting procedure determined in the contract.

The new code provides for the same principles. However, its scope for deductibility is broader as it also includes interest paid to affiliated companies, provided they are related to financing petroleum activities and do not exceed the rates that would normally be charged in arm's-length transactions.

G. Transactions

There is no specific issue or limitation regarding petroleum transactions under both regimes.

H. Indirect taxes

Under Ordinance 1988, the holder of an exclusive petroleum exploration or exploitation right is exempt from any taxes on turnover.

Under the new code, contractors are subject to VAT under the common tax regime.

Local purchases of goods and services are subject to Mauritanian VAT.

Imports are subject to Mauritanian VAT at the normal rate (14%) or to the temporary import procedure (suspension of VAT).

As noted above, the export of hydrocarbons is exempt from VAT.

I. Other

Foreign exchange control

Contractors are subject to the exchange control legislation established by the Central Bank of Mauritania, in particular Law No. 2004-042 of 2004, which states the applicable regime for financial relations with foreign countries.

Expatriate employees of contractors have the right of free exchange and free transfer of their Mauritania sourced income to their country within the limits of the exchange control legislation.

Stability clauses

Under the former regime, and under the new code, the contract will provide for a "stability clause" stating that the contractor shall not be subject to any legislative provision that would disadvantage them when compared with the legislation and regulations in force on the date of signing the contract.

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A. At a glance

Fiscal regime

There are no special tax rules applicable to the petroleum industry. It should be noted that oil activities are reserved for the Mexican Government, and Petróleos Mexicanos (PEMEX) is the responsible agency. PEMEX, as a government agency, has a particular taxation regime, which is not covered by this guide. The intention of this guide is to provide an overview of the tax rules applicable to companies that provide services to PEMEX or are engaged in the oil industry in Mexico. However, PEMEX subcontracts an extensive variety of services to domestic and international providers, among them: drilling, supply, engineering and construction.

Royalties (withholding tax on payments abroad)

- For know-how and technical assistance, a 25% withholding tax (WHT) rate is applicable. However, payments for the use of patents, certificates of invention or improvements, trademarks and trade names are taxed at 30%.
- If a royalty is paid to a tax haven jurisdiction, the WHT rate will be 40%.
- Under most tax treaties, the maximum WHT rate is 10%.

Bonuses	Not applicable
Production sharing contract (PSC)	Not applicable
Income tax rate	Corporate income tax (CIT) rate was temporarily increased to 30% for 2010–12; the tax rate will be reduced to 29% for 2013 and return to 28% for 2014 and subsequent years

Single rate business tax (alternative minimum tax)

- General tax rate 17.5%

Branch tax rate	Same as corporate tax rates
Dividends	Not subject to WHT

Interest (WHT on payments abroad)

- Registered banks resident in a treaty country: 4.9%
- Registered banks not resident in a treaty country: 10%
- Qualified acquisitions of machinery and equipment: 21%
- General rate: 30%
- General rates under most tax treaties: 10% to 15%

Capital allowances

Refer to Section C.

Investment incentives

No investment incentives apply in Mexico.

B. Fiscal regime

Corporate income tax

From 2010 to 2012, the corporate tax rate has been increased from 28% to 30%. The rate will be reduced to 29% in 2013 and return to the current 28% as of 2014. Mexican resident companies are taxed at a rate of 30% (for 2012) on their worldwide earnings. A corporation is considered to be a Mexican resident if its "effective place of management" is located in Mexico. A permanent establishment (PE) of a foreign resident is generally taxed in the same manner as a Mexican resident, but it is taxed only on income attributable to the PE.

Deductibility requirements

In general, expenses related to the business activity of a taxpayer are deductible for income tax purposes. In addition, Mexico has formalistic documentation requirements that must be met to support the deduction, including requirements related to accounting records and invoices.

Instead of listing deductible expenses for tax purposes, the Mexican Income Tax Law (MITL) provides a list of the expenses that are treated as nondeductible items.

Consolidated returns

A group of Mexican companies that meet certain requirements may file an income tax return on a consolidated basis. The consolidation provisions are elective and require prior approval from the Mexican tax authorities (Hacienda). A group of companies can start filing consolidated tax returns at the beginning of the tax year following the year when permission to file on a consolidated basis is granted. Once the option to report tax results on a consolidated basis is elected, the holding company must consolidate its results for Mexican tax purposes for a minimum period of five years, unless Hacienda authorizes it to cease reporting on a consolidated basis. A group may be forced to stop calculating its income tax on a consolidated basis if the holding company no longer qualifies as a holding company for this purpose, or if it fails to comply with the provisions of the consolidation regime.

The 2010 reforms included significant changes to the tax consolidation regime. The new rules require the recapture of the benefits of the tax consolidation after a five-year period. Under these new rules, the benefits of consolidation are considered a deferred benefit, for which the tax must be paid beginning in the sixth subsequent year. The actual payment is made as follows: 25% in years 6 and 7, 20% in year 8 and 15% in years 9 and 10.

Example:

FY	Deferred tax (MXN)	2016	2017	2018	2019	2020	2021	2022	2023	Total (MXN)
2010	1,000	25%	25%	20%	15%	15%				
		250	250	200	150	150				1,000
2011	1,500		25%	25%	20%	15%	15%			
			375	375	300	225	225			1,500
2012	500			25%	25%	20%	15%	15%		
				125	125	100	75	75		500
2013	300				25%	25%	20%	15%	15%	
					75	75	60	45	45	300
Total (MXN)	3,300	250	625	700	650	550	360	120	45	3,300

The recapture of the benefits relates to net operating losses (NOLs) used in consolidation, excess dividend distributions between members of the group and cumulative differences between the net accumulated after-tax earnings accounts (i.e., Cuenta de Utilidad Fiscal Neta, or CUFIN) on an individual versus consolidated basis.

As a result of the 2010 reforms, recapture of the consolidation benefits begins in 2010 with benefits obtained from 2004. Some taxpayers challenged this retroactive application of the law, arguing that it is against the Mexican constitutional principles. The Mexican courts have not resolved these tax litigations yet.

In addition, beginning in 2010, the certified public accountant who prepares the tax audit report (dictamen fiscal) for the consolidated group must verify and report on the annual deferred income tax resulting from the consolidation.

Capital gains

Capital gains and losses are treated as ordinary income and deductions, except for most losses arising from the disposal of shares. Losses arising from the disposal of shares are generally not deductible against ordinary income. An exception exists for members of a consolidated group, whereby certain losses incurred on the sale of shares of a member of the consolidated group may be deducted against ordinary income of the group. Otherwise, losses from the disposal of shares may only be used to offset gains derived from the sale of stock or securities during the same tax year or the subsequent 10 tax years. It is important to note that the limitation on the use of these losses has been successfully challenged in Mexican courts.

A gain or loss is computed as the difference between the sale proceeds and the cost of the asset. The cost of the assets is adjusted for inflation using actualization factors based on the National Consumer Price Index. The tax basis of shares of a Mexican entity is also adjusted for changes in the CUFIN account of the company and the NOLs.

Single rate business tax

Since 1 January 2008, individuals and legal entities resident in Mexico, and PEs of nonresident entities, are subject to the single rate business tax (Impuesto Empresarial a Tasa Única, or IETU). The IETU replaced the asset tax in Mexico. The tax is imposed at a rate of 17.5% for the following activities:

- Selling goods
- Rendering independent services
- Granting temporary use or enjoyment of goods

Mexican resident entities are subject to tax on these activities on a worldwide basis. A PE is only subject to the tax on income attributable to the PE in Mexico. For purposes of the IETU, the determination of a PE and income attributable to a PE is based on the rules in the MITL or the applicable tax treaty.

In general terms, income is recognized on a cash or payment basis; however, an election can be made to recognize income based on the rules used for income tax purposes, which require that income is earned at the earlier of the sale of the goods or services and the payment being received, or a document is issued stating the price and object of the transaction. This election, once made, cannot be changed for future years and applies to income, not to deductions.

Excluded from the definition of the activities subject to the tax are, among others, dividends, most interest and royalties from related parties, except from the lease of commercial, scientific or industrial equipment.

In calculating the IETU tax base, deductions are allowed for certain expenses related to taxable activities. Deductions are also generally allowed on a cash basis, including when the payments are made for capital expenditures. If a net loss is incurred for IETU purposes, this loss creates a tax credit that may be used during the current year against future IETU liabilities. The carryforward period is 10 years. Although the IETU rules provide a series of credits against the tax, only the loss credit may be carried forward. This credit, however, is required to be used first.

Transitional rules provide limited credits for inventories and fixed assets acquired prior to 1 January 2008. Notably, expenditures for interest and other finance charges, royalties to related parties and salaries and benefits are not deductible for IETU purposes. Although compensation and fringe benefit payments are not deductible, a credit is allowed for IETU purposes for a taxpayer's income tax liability for the year is creditable against IETU, so that the greater of the income or IETU tax liability is paid each year. However, unlike other alternative minimum taxes, if IETU is paid in a given year, this amount is not recoverable.

Profit sharing

Employers in Mexico must pay profit sharing to employees each year equal to 10% of the adjusted taxable income of the business. The profit-sharing base is similar to taxable income for income tax purposes with certain exceptions, including:

- No carryforward of NOLs
- No inflation adjustments
- Timing of the recognition of exchange gains and losses

Other issues

Functional currency

The functional currency for Mexican tax purposes is always the peso (MXN). It is not possible to elect any other currency as the functional currency.

Transfer pricing

Mexican taxpayers are required to conduct transactions with related parties on an arm's-length basis. In addition to filing an annual informational return, taxpayers are required to produce and maintain contemporaneous documentation (i.e., a transfer pricing study) demonstrating that income and deductions arising from intercompany transactions are consistent with the amounts that would have resulted, had these transactions taken place with unrelated parties under similar conditions. Accordingly, Hacienda is entitled to make adjustments and to assess penalties if it determines that there is an underpayment of tax attributable to a misstatement resulting from intercompany prices charged or paid. In recent years, transactions between related parties have been subject to greater scrutiny.

Acceptable transfer pricing methods include the comparable uncontrolled price (CUP) method, the resale price method, the cost plus method, the profit split method, the residual profit split method and the transactional net margin method.

Recent modifications to the MITL require that taxpayers apply the best method rule, giving priority to the CUP method, and use the transactional methods as a last resort. A detailed explanation must be included in the contemporaneous documentation for the selection of a method other than the CUP method.

It may be possible to reach an Advance Pricing Agreement (APA) with Hacienda in order to obtain confirmation of a method used. These agreements may apply for a period of up to five years in the case of unilateral agreements, and for more years in the case of mutual agreements.

Dividends

Mexico has a semi-integrated system of corporate taxation under which the earnings of a Mexican company are generally taxed once at the corporate level. Dividends from a Mexican company are not subject to WHT.

Dividends in excess of previously taxed earnings, however, are subject to tax at the distributing company level at the corporate tax rate on a grossed-up basis. The effective rate after gross-up is 42.858% for 2012. This income tax is creditable against the annual income tax liability in the year in which the "excess" distribution is made, and the two subsequent years.

During the period from 1 January 1999 to 31 December 2001, a portion of corporate tax was allowed to be deferred, to the extent that the earnings remained invested by the taxpayer in Mexico. The portion of tax that was allowed to be deferred was equal to the difference between the net reinvested earnings of the company multiplied by a 35% tax rate with those earnings multiplied by a 30% tax rate. The latter rate was 32% in 1999.

Dividends that are distributed from previously taxed earnings in Mexico are not subject to further taxation upon distribution, except for the amount of deferred tax, if any, on earnings from 1999 to 2001. If the distributions are in excess of previously taxed earnings, CIT is imposed on a grossed-up basis. For this purpose, Mexican businesses must maintain a net accumulated after-tax earnings account (CUFIN). It should be noted that, for companies that deferred a portion of their income tax on earnings in the period from 1999 to 2001, these earnings must be distributed first, and the balance of these deferred earnings is monitored in a reinvested CUFIN account.

Branch remittance tax

There is no branch remittance tax in Mexico. However, distribution rules similar to those for dividends from resident entities apply to nonresident entities with a PE or branch in Mexico. For this purpose, the branch is required to keep an account for capital remittances made to the non-Mexican resident head office (Cuenta de Remesas de Capital del Residente en el Extranjero, or CURECARE). In general terms, the CURECARE balance shows the amount of earnings that have been subject to CIT by the PE. Additionally, Mexican branches are also required to record their previously taxed earnings through the CUFIN account. If a remittance is made to the head office of the Mexican PE, it is deemed to be a dividend distribution from previously taxed earnings. If the payment of the remittance exceeds the CURECARE and CUFIN balances, the excess dividend must be grossed up with a 1.4286 factor, with the result multiplied by the corporate tax rate.

Tax on cash deposits

There is a tax on cash deposits (IDE), which is applied on cash deposits into Mexican bank accounts.

The IDE is imposed at a rate of 3% on monthly cash deposits exceeding MXN15,000 (approx. US$1,135). Electronic transfers, transfers between different bank accounts, securities and any other instruments or systems agreed with the financial system, are not subject to IDE.

C. Capital allowances

Preoperating expenses

Preoperating expenses must be capitalized and amortized on a straight-line basis over a 10-year period. However, an election may be made to adopt a longer period for amortization of these costs. The preoperating period lasts until the company starts to sell its products or provides its services on a continuous basis.

Preoperating expenses are defined as expenses relating to "the design, improvement, packaging or distribution of a product, as well as the rendering of services, when these expenses are incurred prior to the time when the taxpayer sells its products or renders its services on a continuous basis. In the case of extractive industries, preoperating expenses relate to the exploration for location and quantification of new fields susceptible to exploitation." This limited definition allows significant costs incurred during the preoperating period to be deducted rather than capitalized, such as interest and general and administrative costs.

Depreciation of assets

Taxpayers are generally required to depreciate the costs of fixed assets using the straight-line method. The amount of the depreciation deduction is adjusted for inflation from the date of the acquisition until the tax year in which the deduction is taken. For this purpose, the MITL provides statutory depreciation rates; however, taxpayers may elect a lower rate than provided by law.

The deduction of investments in fixed assets, using the straight-line method, begins in the tax year when the investment is placed in service, or the following year.

Immediate depreciation

For certain new assets used in Mexico, an immediate, one-time deduction equal to the present value of the straight-line deduction is allowed (see rates below). The remaining balance of assets deducted under the immediate deduction regime is generally not deductible. However, if the asset is sold during the years immediately following the deduction, an additional deduction may be allowed as provided by the statutory tables in the MITL. The immediate deduction option is available for new assets used in Mexico but outside of the metropolitan areas of Mexico City, Guadalajara and Monterrey. Qualified investments outside metropolitan areas are entitled to the immediate deduction, if certain administrative requirements are met. Please note that immediate depreciation is not available for office furniture, automobiles, buses, trucks, tractors or trailers. Immediate depreciation may be taken in the year the investment is made, the year the asset is placed in service or the subsequent year.

For the immediate deduction, the MITL provides for certain rates, which were modified by a presidential decree issued in 2002. A summary of some of the depreciation rates is as follows:

Type of asset	Depreciation rate
a) Buildings and constructions	85%
b) Vessels	78%
c) Computers, servers, printers, optic scanners, digitizers, external storage units, etc.	94%
d) Telephone communication equipment	74%–85%
e) Dies, molds and tooling	95%
f) Machinery and equipment used in the following activities:	
1. Maritime, river and lake transport	74%
2. Production process of metal or natural carbon derivatives	78%

Type of asset	Depreciation rate
3. Crude petroleum or natural gas extraction and processing	80%
4. Processing of chemical, petrochemical and pharmacobiological products, manufacture of plastic products	84%
5. Electrical transport and manufacture of motor vehicles and parts therefor	85%
6. Construction industry	93%
7. Assets used directly to new product research or technological development in the country	95%
8. Others	85%

Since most companies in the oil industry operate under contracts to perform specific activities related to the overall objectives of PEMEX, the actual activities under the contract with PEMEX should be analyzed to determine the classification of the assets. For example, in some instances, drilling a well may be classified as a "construction" activity rather than assets used in the "extraction or processing of crude or natural gas."

D. Incentives

Exploration

Exploration incentives do not apply in Mexico.

Tax holiday

Mexico does not have a tax holiday regime.

Tax losses

NOLs may be carried forward for 10 years; no carryback is allowed. The amount of NOLs that may be used in a particular tax year is adjusted for inflation by multiplying the amount by the inflation factor for the period from the first month of the second half of the tax year when the loss was incurred until the last month of the first half of the tax year when the NOL is used.

In a merger, only the NOLs of the surviving company continue to exist after the merger. Further, the NOLs of the surviving entity may be used exclusively to offset income generated by operations of the same category as the operations that produced the losses. Thus, the merger of a profitable company into a loss company designed to use the latter's losses is effective only if the activities conducted by the profitable company prior to the merger are in the same line of business as the loss company.

The NOLs of a company that undergoes a corporate division (escisciсon) survive after the transaction. The NOL balance of the original company is allocated between the old and new entities based on the type of businesses in which the companies are engaged. The NOL allocation is based on inventory and accounts receivable balances if the entities are engaged in commercial activities and the allocation is based on the fixed asset balances if the entities are engaged in industrial activities.

In the case of a change, either direct or indirect, of the shareholders of a company that has tax losses, the usage of the NOLs may be restricted. This rule applies when the sum of the gross income in the three prior tax years is less than the amount of the available NOLs, adjusted for inflation. If this test is met, the tax losses may exclusively be used to offset income from the same business activity that generated the losses. A change in the controlling partner or shareholder is deemed to occur when there is a change of shareholders, either directly or indirectly, of more than 50% of the shares or social parts with voting rights of the company, in one or more transactions over a period of three years.

Regional incentives

Local governments may grant incentives related to payroll and property taxes for new businesses. These incentives must be negotiated locally.

Research and development

The R&D tax incentive, equal to a credit of 30% on qualifying expenses to stimulate investment in R&D of technology, was repealed as of 2010. However, transitional rules are contemplated to allow the use of any pending credit against the income tax liability of subsequent years to 2010.

Incentive for first-time employment

The incentive is available for employers that hire new employees who have never been registered with the social security authorities. This incentive is restricted to employees with less than eight minimum official salaries (i.e., approx. US$1,150). The incentive consists of an additional deduction for the employers equal to 40% for 2011, and 25% for 2012 and subsequent years of the salary paid to the employees, reduced by the income tax rate of 30%. This additional deduction will be available for a three-year period.

E. Withholding taxes

Oil and gas activities performed in Mexico by private companies must generally be performed under a contract with PEMEX or a PEMEX affiliate. For international investors, this requires either entry into a cross-border contract or the establishment of a local tax presence in Mexico. It is very important to understand in advance how PEMEX will treat the payments under the contract, since PEMEX will generally withhold payments to a nonresident at the highest possible rate. To qualify for a beneficial treaty rate, a certificate of tax residence is required. If a contract requires a foreign entity to provide services in Mexico, PEMEX may assert that there is a PE in Mexico and require an official invoice.

Planning should be considered to separate onshore (i.e., performed in Mexico) and offshore (i.e., performed outside of Mexico) services through a Mexican presence.

Royalties and technical assistance fees

The general rule is that royalty and technical assistance fees are deductible whether they are paid to a Mexican resident or to a nonresident. WHT is generally due on royalty payments to nonresidents, at the earlier of the date they are paid and the date they become payable. Under domestic law, the WHT rate for know-how is 25%, and for the use of patents, certificates of invention or improvements, trademarks and trade names is 30%. However, if the royalty is paid to a related-party resident of a tax haven jurisdiction (i.e., preferential tax regime as defined in the MITL), the rate is 40%.

Mexican tax law defines royalties as "payments of any kind for the temporary use or enjoyment of: patents; invention or improvement certificates; trademarks; trade names; rights with respect to literary, artistic or scientific works including movies, television or radio recordings; and computer software programs; drawings or models; plans; and formulas, commercial, scientific or industrial equipment; the transfer of technology and information related to industrial, scientific or commercial experience, as well as other similar rights and properties and the right to receive for retransmission visual images and/or audio sounds or both, or the right to allow the general public to access such images or sounds, when in both cases the transmission is made by way of satellite, cable, fiber optics or other similar means."

As noted previously, Mexico treats the lease of commercial, scientific or industrial equipment as a royalty. This definition is generally deemed to include the lease of most oil- and gas-related equipment. In this respect, PEMEX imposes the highest WHT rate on these payments if they are paid to a nonresident. The application of the lower rates for a treaty jurisdiction requires a certificate of residence.

The MITL specifically excludes technical assistance from the definition of royalties. For this purpose, technical assistance is defined as the rendering of independent personal services whereby the provider of the personal services is obliged to provide non-patentable knowledge that does not involve the transfer of confidential information related to industrial, commercial or scientific experience, and that requires the provider of the services to intervene in the application of this knowledge. Under this definition, most service arrangements, including management and other corporate service arrangements with related or unrelated parties, may be treated as technical assistance. Technical assistance under Mexican domestic law is generally subject to a WHT rate of 25%. However, under many tax treaties, the services should qualify as business profits not subject to WHT (assuming there is no PE).

In order to separate onshore and offshore components of contracts with PEMEX, many companies establish a local presence in Mexico in the form of a subsidiary or branch to enter into the contract with PEMEX. The local entity may then subcontract with a foreign affiliate for the offshore portion of the contract. If the offshore services performed are protected by a treaty, it may be possible to avoid WHT on the payment abroad.

Mexican companies may claim a tax deduction for payments related to royalties and technology transfers, and for technical assistance fees, paid to both residents and nonresidents provided the following requirements are satisfied:

- The provider possesses the appropriate technical expertise.
- The technical assistance is rendered directly by the contracting corporation and not through third parties, except for Mexican residents when the contract contemplates subcontracting.
- The technical assistance is actually rendered.

In the context of royalties paid abroad, the requirement that the service be rendered directly by the foreign recipient of the royalty payments could result in the non-deductibility of the royalties paid. For example, royalties paid to a nonresident that is the primary contractor in a technology transfer that subcontracts technical assistance services to a third party may be nondeductible. Because this rule specifically excludes payments made to Mexican residents, residents of certain tax treaty partner countries that are adversely affected by this rule may have grounds for arguing that it violates the applicable non-discrimination provisions.

Interest

Interest is considered to be Mexican sourced if the capital is issued or invested in Mexico or if the interest is paid by a Mexican resident or by the PE of a nonresident. Mexican sourced interest is subject to WHT when it is paid to a nonresident. Three factors must initially be considered in determining the WHT rate applicable to interest payments:

3 The type of entity that is providing the financing
4 The jurisdiction where the effective beneficiary of the interest resides for tax purposes (e.g., a treaty partner country, a non-treaty country or a tax haven)
5 The nature of the underlying instrument from which the interest is derived

WHT rates on interest payments to nonresidents

The general Mexican WHT rate on interest paid abroad is 30% for 2010 to 2012, unless an exception applies. Among others, the general exceptions include the following:

- 10% for interest paid to foreign banks, investment banks and certain limited-purpose financial companies that are the effective beneficiaries of the interest. To qualify, the institutions must be registered with Hacienda as authorized banks. It should be noted that the use of back-to-back loan arrangements as a means of obtaining reduced WHT rates is disallowed under Mexican domestic law. This rate is reduced to 4.9% with respect to interest paid to a registered financial institution that resides in a treaty partner country.

- 4.9% for interest paid on publicly traded securities or securities issued through a recognized stock exchange in a country with which Mexico has entered into a tax treaty, provided that the securities are registered with the National Registry of Securities and Intermediaries and certain information requirements are met. If the information requirements are not met, or the securities are issued through an exchange in a country with which Mexico does not have a tax treaty, the rate is 10%.
- 15% for interest paid to a nonresident lessor with respect to a financial lease. In this case, the interest is considered to be Mexican sourced if the assets are used in Mexico or if the payments made abroad are deducted in full or in part by a PE in Mexico, even if the payments are made through an establishment located abroad. The law presumes that the assets are used in Mexico when they are either used or enjoyed, or payment is made by a resident or a foreigner that has a PE in Mexico.

Most tax treaties provide for a 15% or 10% general rate. Currently, all registered banks resident in a treaty jurisdiction are entitled to a 4.9% rate under transitory domestic rules, which have been extended on an annual basis.

F. Financing considerations

Mexico's income tax system contains rules regarding thin capitalization of Mexican taxpayers, which have an impact on the deductibility of interest. These rules can have a significant impact on decisions made in respect of the financing of oil and gas projects in Mexico.

Thin capitalization rules

Beginning on 1 January 2005, Mexico adopted thin capitalization rules, which, as amended, deny the deduction of interest expense on loans with nonresident related parties when the company has a debt-to-equity ratio that exceeds 3:1.

The amount of excess debt for this purpose is calculated by subtracting the amount that results from multiplying by three the average balance of shareholder's equity of the taxpayer from the average annual balance of all interest-bearing debt. In certain instances, debt with unrelated parties may affect the deductibility of interest on related-party loans. Companies may also elect to determine the equity component of the ratio by using tax-basis equity (CUCA and CUFIN). If the debt is higher, a calculation is performed to determine the nondeductible interest. If the 3:1 debt-to-equity ratio is exceeded, the amount of nondeductible interest expense is calculated as follows:

- If the average balance of the taxpayer's debt with foreign related parties is less than the excess of the debt-to-equity ratio, all interest on the related-party debt is deemed nondeductible, taking into account monthly and annual balances. Further, if the average balance of the taxpayer's debt with foreign related parties is greater than the excess of the debt-to-equity ratio, the interest on related-party debt is deemed to be nondeductible, based on the proportion of the excess amount to the balance of the related-party debt. This should be evaluated based on the taxpayer's overall debt position.

The 2007 tax reform also provided that debt contracted for the construction, operation or maintenance of productive infrastructure related to strategic areas of the country is exempt from the 3:1 ratio requirement. These terms may apply to investments made under contracts with PEMEX. Furthermore, taxpayers may avoid being subject to the rules by obtaining a ruling from the tax authorities documenting that the taxpayer's business requires a higher debt-to-equity ratio.

Apart from the thin capitalization rules, interest expense incurred by a Mexican entity on loans is deductible, provided the funds are used to finance the entity's business operations. If debt is used to finance an investment or a cost that is either non-deductible or partly non-deductible, the deductibility of the interest expense relating to that debt is limited to the extent that the investment or the cost is deductible. This rule may have a significant impact on the manner in which certain investments and costs are financed.

Interest is generally deductible as it accrues, regardless of whether actual payment has been made.

Other restrictions

In addition, interest paid on a loan from a related party is treated as a nondeductible dividend if the loan has any of the following characteristics:

- The loan agreement provides that the debtor unconditionally promises to repay the loan at any time determined by the creditor.
- In the event of default, the creditor has the right to intervene in the administration of the debtor's business.
- The payment of interest is conditional on the availability of profits, or the amount of the interest is determined based on the profits.
- The interest rate is not stated at a fair market rate.
- The interest is derived from a back-to-back loan, including a back-to-back loan entered into with a financial institution.

Back-to-back loans for this purpose are defined as "operations in which one party provides directly or indirectly cash, goods or services to an intermediary which goes on to provide cash, goods or services to a related party or the original party. In addition, back-to-back loans include loans which are provided by a party and the loan is guaranteed by cash or cash deposits, shares or debt instruments of any type, of a party related to the borrower or by the borrower, to the extent the loan is guaranteed in this manner. In this respect, it is considered that the loan is guaranteed under this provision where the granting of the loan is conditioned on the execution of one or more contracts which provide an option right in favor of the lender or a related party to the lender, the exercise of which depends on partial or complete compliance with the payment of the loan or its accessories by the borrower. Loans which are not considered as back-to-back loans are those transactions in which financing is granted by a party and the loan is guaranteed by the shares or debt instruments, of any type, or property of the debtor or party related to the debtor which is resident in Mexico, when the lender does not have legal access to the instruments except in the event that the creditor does not comply with the terms of the debt."

If interest is paid on a loan made by a Mexican company to a nonresident shareholder and is deemed to be a dividend, it is treated as a dividend for Mexican WHT purposes.

A shareholder loan made to a nonresident that contains one of the provisions stated above has the following adverse consequences:

- The interest payment is non-deductible.
- The principal is not treated as equity, but rather as a liability subject to inflationary gains treatment.
- The excess of the interest on the loan over the lending company's CUFIN could be subject to the excess distribution tax.

With respect to the interest rate charged between related parties, Mexico's transfer pricing rules allow Hacienda to make an adjustment if the interest rate charged is determined to be at a rate that varies from the market rates. In the event that interest is charged to a related party at a rate that is less than an arm's-length rate, Hacienda may impute interest income to a Mexican lender using a market rate. Alternatively, if Hacienda determines that the interest charged on a related-party loan is in excess of the market rate, it may deny a deduction to the borrower for the amount of the interest in excess of the market rate.

Inflationary adjustments

Mexican companies must recognize, for tax purposes, the inflationary gains or losses attributable to their monetary liabilities and assets. Thus, in determining how to finance an investment in Mexico, consideration must be given to the income tax treatment of interest expense, whereby the inflationary gains arising from the debt may, in whole or in part, offset the interest expense and thereby erode the tax benefit from the interest expense deduction.

In broad terms, Mexico's system of tax accounting for inflation attempts to reflect in taxable income the effects of inflation on a company's monetary assets and liabilities. For this purpose, an inflation adjustment is required, which is closely linked to the treatment of interest and exchange gains and losses.

The inflationary adjustment is made once at the end of the year and is applied to the net monetary asset or liability balance of the taxpayer multiplied by the annual adjustment factor. Companies with a net monetary asset have a deductible inflationary loss, while companies with net monetary liabilities report a taxable inflationary gain.

Exchange gains and losses

In the case of financial assets and liabilities denominated in a foreign currency (i.e., any currency other than Mexican pesos), the resulting exchange gains and losses are treated in the same way as interest, and they are recognized on an accrual basis. If, for example, a Mexican company has US dollar-denominated liabilities, any exchange loss for the period resulting from a devaluation of the peso against the US dollar is added to the total interest expense for the period.

Exchange gains and losses are recognized as they accrue. The payment of a foreign currency liability before its maturity date, therefore, does not affect a resulting exchange loss deduction.

G. Transactions

Asset disposals

The transfer of assets in Mexico is generally a taxable transaction subject to the general CIT, unless the transfer occurs as a result of a qualified reorganization. Mergers and demergers can be done tax free between Mexican resident entities if certain conditions are met.

Farm-in and farm-out

Mexican tax legislation does not have a special tax treatment for farm-in and farm-out transactions.

Selling shares in a company (consequences for nonresident shareholders)

The MITL provides that a foreign resident is deemed to have Mexican-sourced income if it sells (transfers) shares of a Mexican resident company or if it transfers shares in a non-Mexican entity whose accounting value (more than 50%) is derived from real property located in Mexico. Under domestic rules, the seller has the option of being taxed at either 25% on gross proceeds or 30% on the net gain (the difference between the sales price and the tax basis of the shares). It should be noted that the net gain treatment is allowed exclusively for shareholders resident in countries that are not deemed to have a preferential tax regime or territorial tax jurisdiction. The tax basis is determined as the historical acquisition price of the shares, net of capital redemptions, adjusted for inflation, with the addition or subtraction of positive or negative fluctuations in the Mexican company's CUFIN account and an adjustment for the increase or decrease in the balance of NOLs during the period the shares were held. The 30% tax rate can only be elected if certain requirements are fulfilled. Note that sellers that are residents of tax havens are subject to tax on a gross basis at the rate of 40%.

Qualified sales of publicly traded shares on a recognized stock exchange by individuals or nonresidents are exempt from CGT.

In the case of a group restructuring, it is possible to transfer the shares and defer the income tax due until the shares leave the group (a group is considered to be a group of companies when at least 51% of the voting shares are directly or indirectly owned by the same corporate entity). Certain tax treaties entered into by Mexico provide an exemption for CGT or for tax-free corporate reorganizations.

H. Indirect taxes

VAT

Under the Mexican VAT Law (Ley del Impuesto al Valor Agregado), VAT is imposed on legal entities and individuals that conduct any of the following activities in Mexico: sell goods and property, render independent services, grant the temporary use or enjoyment of goods (e.g., leasing) and import goods or services.

As of 2010, the general VAT rate increased from 15% to 16% and for most transactions occurring within the "border zones" of the country, the rate increased from 10% to 11%. While the general VAT rate is applicable to most transactions, there is also a 0% rate applicable to certain transactions, such as exportation of goods and certain services, sales of foods, medicines, books and gold.

Generally, taxpayers subject to VAT shift the burden of the tax to the next stage, until it reaches the ultimate consumer. Taxpayers must add the VAT to the sales price of their products or services, collect it from their customers and, in turn, pay VAT to their own suppliers. The VAT that is paid to suppliers (input tax) is creditable against the VAT charged to customers (output tax). Consequently, the amount that companies must remit to Hacienda is the excess of the total VAT collected during the tax period from their customers over the VAT paid to suppliers. If, in a given period, VAT credits exceed VAT collected from customers, the excess may be carried forward to the following tax period or, alternatively, the taxpayer may obtain a refund for such excess; or offset the excess against other federal taxes.

A nonresident, in practice, is not able to register for VAT in Mexico, unless a PE exists. Therefore, for transactions or contracts in Mexico that may require local components of goods or services, it is wise to establish a Mexican entity in order to recover VAT on most contracts.

Import duties

All foreign goods, equipment and materials that enter Mexico are subject to customs and import duties as well as VAT. There are exemptions for import duties under certain free trade agreements.

Special preferential rates exist under the North American Free Trade Agreement (NAFTA) and the free trade agreements with Bolivia, Chile, Colombia, Costa Rica, the European Union (EU), Japan, Nicaragua and Venezuela. To qualify for these rates, the importer must present a certificate of origin at the time of customs clearance.

It is also possible to import certain equipment on a temporary basis thereby deferring, and in some cases avoiding, duties and VAT on importation if the equipment is re-exported within a certain period of time.

Export duties

In general, the export of goods is not subject to VAT or other duties. Note that only PEMEX is allowed to export oil and gas.

Excise tax

Under the Mexican Excise Tax Law (Ley del Impuesto Especial sobre Producción y Servicios, or LIEPS), the sale or importation of certain products, and the rendering of certain services, is subject to excise taxes, based on specific characteristics (e.g., alcoholic beverages, diesel).

As of 2010, certain telecommunications services became subject to excise tax at a rate of 3%. This tax will apply to cell phone and landline services, cable TV and satellite services. Exemptions have been provided for rural telephone services, public telephone services and internet services.

In general terms, the LIEPS provides a tax incentive that consists of a credit for excise taxes paid by taxpayers that acquire diesel destined for marine and other qualified activities and assets. Administrative requirements must be fulfilled in order to apply this provision.

Stamp duties

No stamp duty applies in Mexico.

Registration fees

No registration fees apply in Mexico.

I. Other

Restrictions on foreign investment

Generally, foreign participation in Mexican legal entities is unrestricted (i.e., foreigners may own 100% of a Mexican entity's stock), unless foreign investment in a particular economic activity is either prohibited or restricted by law. Restrictions on foreign investment fall into the following four categories:

1. Activities that may be exclusively carried out by the state, such as oil, certain areas of electricity, nuclear power, telegraph, postal service, and control and supervision of ports, airports and heliports. Nevertheless, foreign investment is allowed for the following activities, to the extent that it is authorized by the Government, in the oil and electricity industries: the transportation, storage and distribution of gas and the generation of electricity for purposes of co-generation, generation for self-use, imports, exports and sales to the state-owned electrical company.
2. Activities reserved for Mexicans, such as gas stations, radio and television (except cable television and certain satellite television activities), credit unions and land transportation within Mexico for passengers, tourism and cargo — excluding courier services. A Mexican legal entity that invests in these sectors must include a "foreign exclusion clause" in its bylaws, establishing that the company will not accept, directly or indirectly, foreign shareholders or companies without a similar provision.
3. Activities in which foreign participation is limited to the following minority equity holdings:
   - Up to 25% in airlines
   - Up to 10% in cooperative societies
   - Up to 49% in entities engaged in insurance, currency exchange, financial leasing and factoring, certain financial and investment institutions, newspapers, fishing, certain shipping activities and explosives and firearms, among others.
4. Prior approval from the National Commission of Foreign Investment is required for foreign ownership in excess of 49% in Mexican entities engaged in cellular phone systems, legal services, credit information, securities ratings, insurance entities, private education services, construction of oil and gas pipelines, oil and gas drilling, management of airports and port services and certain shipping activities. Advance approval is necessary for any investment in a Mexican entity if foreign investment is to exceed 49% of the Mexican company's capital.

Domestic production requirements

Mexico currently does not have domestic production requirements.

Foreign exchange controls

Mexico currently does not have foreign exchange controls.

Forms of "business presence" in Mexico

Please see information on PEs in Section B.

Temporary tax regulations

On 11 June 2010, the Mexican tax authorities issued their annual Temporary Tax Regulations (Resolución Miscelánea, or Miscelanea) that came into effect on 12 June 2010. One of the rules in the Miscelanea imposes a tougher compliance requirement for taxpayers that enter into contracts or provide services to the Mexican Government, and to companies owned by the Mexican Government (such as Mexico's oil company PEMEX), whereby they must obtain a certificate from the Mexican tax authorities stating that the taxpayer is in compliance with its tax-related obligations. This requirement will apply for taxpayers with contracts with the Mexican Government or state-owned companies that exceed MXN300,000 (approximately US$20,000). In the past, a similar requirement obliged companies to file a self-prepared declaration that they had complied with all their tax obligations. Now, taxpayers will have to request the certificate from the Mexican tax authorities through an electronic request.

Presidential Decree to alleviate compliance burden in Mexico

In an effort to simplify and alleviate the tax reporting burden on Mexican taxpayers, Mexico's President, Felipe Calderón, issued a Decree on 30 June 2010. Among other reduced compliance obligations, the Decree has established that the filing of the dictamen fiscal is optional for most taxpayers, provided that certain information is filed on a timely basis. It is important to note that the dictamen fiscal must be issued by the taxpayer's auditor and consists of an audit of the financial statements and an attestation as to compliance with tax obligations for the period, including certain aspects of transfer pricing and specific types of tax transactions.

The Decree also contemplates the elimination of certain filings of monthly informative returns of the single rate business tax and VAT to the extent that certain annual information is filed.

Energy reform

On 28 November 2008, after being approved by the Mexican Congress, several federal laws and regulations relating to the energy industry (energy reform) were published in the *Federal Official Gazette*. It is expected that the energy reform will encourage private participation in the energy sector and bring business opportunities for both domestic and international companies dealing with PEMEX. The Energy Reform also includes the enactment of new laws relating to the development of renewable sources and clean energies that will encourage the development of private power generation projects and energy efficiency in Mexico.

The energy reform includes changes aimed at creating a strong regulatory framework and giving PEMEX management an operational flexibility and efficiency. With respect to private investors, one of the most relevant aspects of the energy reform relates to the availability of joint investments with PEMEX (i.e., multiple services agreement) to the extent that PEMEX remains in control of the exploration and development activities.

On 6 January 2010, new administrative rules were published on contracting acquisitions, leases, constructions and services related to extractive activities to be provided to PEMEX. These new rules are extensive and include, among other provisions, general rules for various types of contract such as risk-based, for exploration and extraction activities.

Mozambique

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A. At a glance

Fiscal regime

The fiscal regime that applies to the petroleum industry in Mozambique consists of a combination of corporate income tax (CIT) and royalty-based taxation.

Royalties	From 6% to 10%
Bonuses	None – PPP law provides for signature bonus between 0.5% and 5% of fair value of assets
Production sharing contract (PSC)	None – production bonus in EPCC's but not based on law
Income tax rate	32%
Resource rent tax	None
Capital allowances	Not applicable
Investment incentives	Exemption from VAT and customs duties on importation of equipment, machinery and tools

B. Fiscal regime

Corporate income tax

Under the Corporate Income Tax (CIT) Code, companies and similar corporate entities (including oil and gas companies) are liable for CIT on income generated in Mozambique and abroad (worldwide income).

The standard corporate rate that applies to profits is 32%.

Companies that are tax resident in Mozambique or that are not a resident but have a permanent establishment (PE) in Mozambique and a turnover of more than MZN2.5 million (approximately US$80,000) are required to keep organized accounts for tax purposes.

The financial year is normally a calendar year, but taxpayers can apply for a different financial year if it is justified (e.g., for consolidation purposes).

Transfer pricing

Transfer pricing was introduced recently in Mozambique. No specific documented requirements apply, but transactions must be undertaken on an arm's-length basis.

Thin capitalization

The thin capitalization ratio is 2:1.

Dividends

Dividends distributed by Mozambican taxpayers are subject to a 20% withholding tax (WHT).

Dividends distributed by a resident company to resident corporate shareholders are not subject to WHT, provided that the beneficiary holds at least 20% of the share capital and the shares have been held for a minimum of two years. Dividends paid in these circumstances do not form part of the taxable income of the shareholder.

Losses can be carried forward for five years.

Ring-fencing

There is ring-fencing per concession.

However, if the taxpayer benefits from a partial exemption or a reduction in the tax rate, the losses of the activity that benefits from such incentives cannot be offset against the losses of the remaining activities.

Mozambique does not have tax consolidation rules.

Costs or losses confirmed as indispensable for the generation of profits or gains, or costs or losses relating to the maintenance of the production source, are tax deductible. These include:

- Costs related to the production or acquisition of goods or services, including the costs relating to the materials used, staff, electricity and other general expenses to manufacture, conserve and repair
- Costs of distribution and selling, such as for transporting, advertising and placing merchandise
- Financial costs, such as interests on loans, discounts, premiums, transfers, exchange rate differences, expenses of credit operations, debt collection and issuing bonds and other titles and reimbursement premiums
- Administrative costs, such as remuneration, allowances, current consumption materials, transports and communications, rent insurance
- Costs of analysis, rationalization, investigation and consultation
- Depreciation
- Provision
- Capital losses
- Any others that fall within the definition of costs mentioned above

The Mozambican tax system allows for the following deductions:

- Economic double taxation of distributed profits
- Credit for foreign tax paid (international double taxation)
- Tax benefits
- Provisional payments

Concession contracts

In Mozambique, oil operations are engaged based on concession contracts resulting from public tender, which can be for reconnaissance, research and production or construction and operation of pipelines. Such contracts determine, among others, the terms and conditions of state participation in the oil operations. All the terms and conditions of these concession contracts are agreed with the Mozambican state on a case-by-case basis.

However, such terms and conditions must be determined or agreed within the legal limits established. It is important to note that in 2010 a new legislation on public-private partnerships (PPPs) was introduced, which provides between 5% and 20% of local participation. Besides local participation, the new law foresees a signature bonus and an annual concession fee between 2% and 5% of the fair value of the assets made available by the Government.

Moreover, the Mozambican law states that no other tax benefits apply to oil operations other than the ones indicated in Section D. This means that the concession contracts effectively only formalize what is already foreseen in the law and determine which of these terms and conditions apply in each case.

Oil production tax (royalty)

An oil (including natural gas) production tax (royalty) is due on the value of the oil produced in Mozambique at the development and production site.

The rate is 10% for oil and 6% for natural gas.

The value of the tax is determined based on the average sales prices charged by the oil production company in the month corresponding to that in which the tax is assessed.

In addition, the above-mentioned prices refer to the main international oil export centers' prices.

The oil production tax is not considered a cost for CIT purposes.

C. Tax-deductible costs

Provisions created by companies involved in the petroleum-extracting industry related to the reconstruction of wells can be deducted for tax purposes, as well as those destined for the recovery of the landscape and environment of the exploration site after the conclusion of work.

Write-off of exploration costs

Exploration costs are considered to be a cost in the financial year in which the costs are incurred.

D. Incentives

Import duties, VAT and excise duties

- Exemption from import duties (e.g., for equipment destined to be used in the oil operations classified in Class K of the customs classification list, including explosives, detonators, igniting tubes, machines and explosives-blowing devices)
- Exemption from VAT and the special consumption tax (excise duties) on the imports mentioned above

E. Withholding taxes

WHT is due for both corporate and individual income tax.

Corporate Income Tax

The following income generated by nonresident entities in Mozambique is subject to a 20% WHT:

- Income generated from intellectual or industrial property (e.g., royalties), and the supply of information relating to experience acquired in the industrial, commercial or scientific sectors
- Income derived from the use or concession of use of agricultural, industrial, commercial or scientific equipment
- Income from technical assistance, management services and directors' fees
- Income derived from the application of capital (e.g., dividends, interests) and immovable property income

Telecommunications and international transportation services, and assembling and installation performed by nonresident entities, are subject to a 10% WHT.

Branch remittance tax

There is no branch remittance tax.

F. Financing considerations

Thin capitalization

Thin capitalization rules apply if a taxpayer's debt related to an entity that is not a resident in Mozambique, and with which it maintains "special relations," is excessive in relation to the equity of the taxpayer. The interest paid in respect of the excess is not deductible for purposes determining of the taxable income.

A special relationship is considered to exist between a taxpayer and a nonresident entity if:

- The nonresident entity holds, directly or indirectly, a shareholding of at least 25% of the share capital of the taxpayer
- The nonresident entity, not holding the above level of shareholding, has in fact a significant influence on management
- The nonresident entity and the taxpayer are under the control of the same entity, whether directly or indirectly

An excessive indebtedness is considered to exist if the value of the debt in respect to each of the entities involved, with reference to any date in the taxation period, is more than twice the value of the corresponding percentage held in the equity of the taxpayer.

G. Transactions

Asset disposals

The transfer of immovable property is subject to real estate tax at a rate of 2%.

Moreover, any gains or losses arising from the disposal of fixed assets of the company, and the gains and losses derived from the disposal of fixed assets permanently used for a purpose not related to the oil production activity, are considered to be capital gains or losses. The amount of such capital gains or losses is determined with reference to the difference between the realization value (proceeds) and the base cost, which is calculated in accordance with the Mozambican tax laws.

There is no specific tax on capital gains in Mozambique. In the case of resident taxpayers, the gain is included in the taxable income of the respective financial year and is taxed at a general rate of 32%.

Nonresidents must appoint a tax representative in Mozambique to comply with their tax obligations.

Farm-in and farm-out

In a farm-in transaction, the interest acquired is considered to be a depreciating asset, which is depreciated over the useful life of the asset.

In a farm-out transaction, a gain resulting from the transaction represents a capital gain that is included in the taxable income for the relevant financial year.

For nonresident entities, the capital gain is taxed for CIT at a rate of 32%. A nonresident entity must appoint a tax representative to comply with its tax obligations.

Transfer of shares

The gain resulting from the transfer of shares (i.e., the difference between the nominal value and the selling price) in a Mozambican company by a shareholder represents a capital gain and is taxed as:

- Extraordinary income if the shareholder is a company; the amount is included in the taxable income in the relevant financial year
- Capital gains income if the shareholder is an individual; the amount must be included in the individual's total taxable income for the relevant calendar year
- Capital gains for nonresident shareholders, tax must be paid within 30 days after the conclusion of a transaction

A nonresident shareholder must appoint a tax representative in Mozambique to comply with its tax obligations arising from the transfer of shares.

H. Indirect taxes

VAT

VAT is levied on the sale of goods and the rendering of services, and on imports, at a rate of 17%. Rendering of services related to exploration, drilling and construction of infrastructure to oil companies in the exploration phase are exempt from VAT.

As a tax incentive for the oil and gas sector, the importation of certain equipment destined to be used in oil operations (including explosives, detonators, igniting tubes, machines and explosives-blowing devices) is exempt from customs duties and VAT.

Exports are exempt from customs duties and VAT.

Stamp duty

Stamp duty is levied on all documents, books and acts listed in a table approved by the Council of Ministers.

Registration fees

Holders of the right to undertake oil operations are subject to the payment of the following fees:

- Application for granting oil operation rights (approximately US$20,000)
- Renewal of a concession contract (approximately US$5,000)
- Review of the development plan, except in cases of pipeline construction and operation contracts (approximately US$20,000)
- Authorization to commence oil operations (approximately US$5,000)
- Approval of the demobilization plan (approximately US$10,000)

I. Other

Social responsibility

A percentage of the income generated by an oil activity is allocated to the community in the area where the oil project is located.

The percentage payable is established by the state budget law in accordance with the estimated oil production income.

Exchange control regulations

Mozambique has strict exchange control regulations. Except for payment for services and importation of goods, which is qualified as current transactions, most payments such as repayments of loans, repatriation of capital invested and remittance of profits or dividends are subject to the prior approval of the Central Bank of Mozambique.

Service agreements require registration with the Central Bank. Loan agreements require the prior approval of the Central Bank.

Commercial banks require proof of payment of the relevant taxes prior to granting approval for overseas payments.

Oil and gas companies are normally authorized to open and keep offshore bank accounts for specific purposes.

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A. At a glance

Fiscal regime

The fiscal regime that applies to the petroleum industry in Namibia consists of a combination of petroleum income tax (PIT) under the Petroleum (Taxation) Act 3 of 1991 (the PTA), the administrative provisions as contained in the Income Tax Act 24 of 1981 (the Income Tax Act) and royalties levied on sales under the Petroleum (Exploration and Production) Act 2 of 1991 (the Petroleum Act).

Royalties	5% of gross revenues.[132] The value of the crude oil for royalty and tax purposes is the market value.
Production sharing (PSC)	No applicant is compelled to offer the contract National Petroleum Corporation of Namibia (NAMCOR) a share in a license, and no applicant is, therefore, penalized for not making an offer to NAMCOR. However, NAMCOR can participate in licenses if this is offered during negotiations and if NAMCOR decides to accept the invitation to participate. NAMCOR's interests are carried during the exploration phase, but it contributes fully from the development phase onward.
Income tax rate	35%, and additional profits tax (APT) levied on the after-tax net cash flows from petroleum operations (determined by deducting the exploration and development expenditure and the PIT from gross income). The first tranche of APT is only payable if operations in a license area earn an after-tax rate of return of at least 15%. If operations in the license area earn an after-tax rate of return of 20% to 25%, the second and third tranches of APT become payable.
Capital allowances	E[133]
Investment incentives	L[134]

132 *A rate of 12.5% applies to exploration licenses issued prior to the commencement of the Petroleum Laws Amendment Act of 1998 effective from 1 April 1999.*

133 *E: write-off of accumulated exploration costs in the year of first production (unless transferred to another field under circumstances prescribed in the PTA) and one-third of development expenditure. The rest of the development expenditure is written off in equal installments in the two subsequent years.*

134 *L: assessed losses can be carried forward indefinitely.*

B. Fiscal regime

The fiscal regime that applies in Namibia to the petroleum industry consists of a combination of PIT under the PTA, the administrative provisions as contained in the Income Tax Act and royalties levied on sales under the Petroleum Act.

Corporate tax

Corporate tax on petroleum operations is levied under the PTA and not under the Income Tax Act. Under Section 5 of the PTA, taxable income received by a person from a license area within the Namibian territorial sea is taxed at a rate of 35%, levied in respect of each license area. License areas are taxed separately even if the taxpayer has been granted the right of exploration in different license areas.

APT is levied on the after-tax net cash flows from petroleum operations, determined by deducting the exploration and development expenditure, and the PIT from gross income. The first tranche of APT is only payable if operations in a license area earn an after-tax rate of return of at least 15%. If operations in the license area earn an after-tax rate of return of 20% to 25%, the second and third tranches of APT become payable.

Gross income

Under Section 7 of the PTA, "gross income" is the total amount, in cash or otherwise, received by or accrued to, or in favor of, a person from a license area in connection with exploration operations, development operations or production operations, excluding amounts of a capital nature, but specifically including the following amounts, whether they are capital in nature or not:

- Amounts received or accrued in or outside Namibia, related to petroleum produced, saved or delivered and sold in an arm's-length sale
- The market value of petroleum produced, saved or delivered and sold in a non-arm's-length sale
- The market value of petroleum produced and saved in the license area and appropriated for refining purposes
- 50% of the market value of petroleum produced or saved, and which was not lost in any manner, not disposed of or acquired for refining purposes or disposed of but not delivered
- Insurance proceeds in respect of any loss of petroleum produced or saved or any income that would have been included in gross income had the loss not occurred
- Any income received or accrued to the person from the license area and deemed to form part of gross income under Section 12 of the PTA
- Any income received or accrued to a person from the sale of petroleum information in relation to such license area
- Any income received or accrued to a person under a condition of the license forms

Any amounts received or accrued to the license holder prior to the year of production in respect of these items are carried forward to the year of first production and are included in gross income in that year.

The share of petroleum in crude form produced and saved by a person in a license area is treated as all petroleum if that person is the sole holder of the license area, or as a contractually proportionate amount under any agreement if there are joint holders of a license. If no agreement was entered into, the petroleum is divided equally.

Deductible expenditure

Under Section 8 of the PTA, allowable deductions are expenses actually incurred, in respect of the particular license area, in the production of gross income. Other specific deductions, apart from the general deduction, include:

- Repairs and maintenance of premises occupied for exploration, development and production purposes and machinery used for these purposes
- Charges for rent of land or buildings occupied for exploration, development and production purposes
- Contributions to a fund or scheme approved by the permanent secretary in respect of a person employed in the production operations
- Interest on borrowings relating to exploration, development and production in respect of a license area
- Royalties paid under the Petroleum Act
- Education and training of Namibian citizens and educational or scientific materials and equipment
- Wages and salaries in connection with production operations in the license area
- Consumables in connection with production operations in the license area
- The right to use any plant, machinery or equipment in connection with exploration, development and production operations
- Customs duties in respect of plant, machinery or equipment imported in connection with production operations
- General administrative and management costs in connection with production operations
- Restoration costs after exploration operations cease
- Debts proven to be bad, provided that the amount is included in the income in the current tax year or was included in income but not deducted in any previous tax year
- Amounts included in the immediately preceding tax year under Section 7(1)(d) (i.e., amounts included in respect of petroleum produced or saved but not lost, not disposed of or acquired for refining purposes and not delivered)
- The amount determined in accordance with Section 68B(1)(a) of the Petroleum Act and deposited with reference to the trust fund and decommissioning shortfalls as referred to in Section 68D(3)(a)

Under Section 13 of the PTA, deductions are not allowed in respect of the following:

- Expenditures incurred in respect of improvements not specifically allowed under Section 8 of the PTA
- Rental or costs of acquisition of land and buildings not occupied for the purposes of production in the license area
- Contributions to a fund or scheme not approved by the permanent secretary
- Expenditures incurred in obtaining a loan or other debt not specifically allowed under Section 8 of the PTA
- Capital withdrawn or any sum used as capital
- Any royalty not levied under the Petroleum Act
- Expenses related to the purchase of an interest in petroleum
- Any tax payable within or outside of Namibia

Section 14 of the PTA provides that deductions for rent incurred outside Namibia in respect of the general administration and management of the business, as well as capital expenditures directly related to the general management and administration of the development operations, are only allowed to the extent that provision is made in the production license, or to the extent that the permanent secretary considers it "just and reasonable."

Section 17 of the PTA provides that excessive expenditures incurred under an arrangement between associated persons may be disallowed by the permanent secretary.

Each license area is assessed separately and losses incurred in one license area cannot be offset against profits earned in another, but losses resulting from allowable deductions are deductible as an allowable loss against the gross income from the license area in the following year. However, exploration expenditures from a license area without gross income may be deducted from license areas with gross income from production. The license holder is not required to have taxable income after deducting its expenses. Nor is it a requirement that the license area where the exploration expenditure arose has to be in production before the license holder is able to deduct exploration expenditures incurred in respect of a license area without gross income from a license area with gross income.

Section 9 of the PTA provides for an allowance for exploration expenditures and development expenditures incurred in the years before production commences. This allowance is discussed in more detail in Section C.

Capital gains tax

Namibia does not generally impose capital gains tax (CGT). In terms of recent amendments to the Income Tax Act, income from the sale of mining and exploration licenses and rights, and the shares in a company that owns these rights, will become taxable with effect from all years of assessment commencing 1 January 2012. The tax is payable on the sale of a mining or exploration license as defined in the Mineral (Prospecting and Mining) Act 33 of 1992. A mineral license is defined as "... a reconnaissance license, an exclusive prospecting license, a mining license or mineral deposit retention license and includes the renewal of any such license."

Based on the fact that petroleum is excluded from the definition of mineral in the Act, the proposed tax will not be imposed on the sale of petroleum licenses or rights, irrespective of where the licenses are located.

Under the definition of "gross income" in Section 7 of the PTA, the gross income is the total amount, in cash or otherwise, received by or accrued to, or in favor of, such person from a license area in connection with exploration operations, development operations or production operations, excluding amounts of a capital nature. However, certain amounts specifically listed (as detailed above) are included in the gross income, whether or not they are of a capital nature.

In addition, if the license holder receives an amount from the disposal, loss or destruction of any asset used in exploration and development operations, capital expenditure is only allowed to the extent that it does not exceed the amount received (see Section G for further information).

Section 12 effectively provides that capital gains arising on the disposal of assets are included in gross income and are taxable in the hands of the license holder.

These provisions, however, only apply to disposals after production has commenced, and any gain realized on a disposal prior to production will only be taxable when production commences. If production never commences, or the participant sells its entire interest prior to production, there will not be any tax on the gain.

Functional currency

Books of account must be kept in Namibian dollars (NAD). Even though taxpayers may invoice or be invoiced in other currencies, the invoices must be converted to Namibian dollars for VAT purposes at the ruling exchange rates of those transactions.

There are no special provisions in the PTA that deal with the exchange rates to be used for PIT purposes. However, under generally accepted accounting practice, income and expenses are converted to Namibian dollars when the transactions take place.

Transfer pricing

As the PTA specifically provides that no tax may be levied under the Income Tax Act, the transfer pricing provisions contained in that Act do not apply.

However, the PTA contains provisions that are similar in scope to the transfer pricing provisions in the Income Tax Act in respect of the determination of gross income. Under Section 7 of the PTA, a sale of petroleum is considered to be at arm's-length if the price provided for in the sale agreement is the only consideration, the sale is not affected by any relationships other than the sale relationship created in the sale agreement and the seller or any person associated with the seller has no interest in the subsequent resale of the petroleum. The market value of the petroleum produced and saved in the license area is determined in accordance with any of the terms or conditions of the license of that license area or, in the absence of such an agreement, an amount determined by the permanent secretary with regard to the amount that would be obtained between a willing buyer and a willing seller acting in good faith.

Further, Section 17 of the PTA provides that excessive expenditures incurred under an arrangement between associated persons may be disallowed.

Dividends

Petroleum companies are exempt from withholding taxes (WHT) on dividends, nonresident shareholders tax (NRST).

Royalties

Royalties are payable at a rate of 5% of gross revenues under the Petroleum Act. The value of the crude oil for royalty and tax purposes is the market value.

Royalties are generally payable quarterly. If the payer fails to remit payment, the Ministry of Mines and Energy may prohibit the removal of petroleum from the production area and any other dealings in respect of the petroleum.

Under the PTA, the royalty paid is deductible in the determination of the taxable income of the license holder.

C. Capital allowances

Capital allowances are divided into exploration expenditure and a development expenditure, both of which are defined in great detail in Section 1 of the PTA. However, no separate definition for production expenditure is provided.

An exploration expenditure is an expenditure actually incurred, whether directly or indirectly, in, or in connection with, carrying out exploration operations in, or in connection with, a license area, including, among other things, expenditures actually incurred in respect of:

- The acquisition of machinery, implements, utensils and other articles employed for purposes of such operations
- Labor, fuel, haulage, supplies, materials and repairs in connection with a survey or study, excluding drilling for appraisal purposes
- Contributions to a fund or scheme, approved by the permanent secretary, in respect of any person employed in, or in connection with, expiration operations
- The advancement of training and education of Namibian citizens at institutions approved by the permanent secretary
- Charges, fees or rent for, or in respect of, land or buildings occupied for purposes of carrying out exploration operations
- The general administration and management directly connected with exploration operations
- The restoration of a license area, or any part thereof, after cessation of exploration operations
- Customs duty in respect of importation for use in, or in connection with, exploration operations in such license areas as plant, equipment, spare parts, materials, supplies or consumable items

Under Section 1 of the PTA, development expenditures are actually incurred in, or in connection with, carrying out development operations in, or in connection with, a license area, including, among other things, expenditures actually incurred in respect of:

- The acquisition of machinery, implements, utensils and other articles used for purposes of such operations
- The acquisition of furniture, tools and equipment used in offices and accommodation and in warehouses, export terminals, harbors, piers, marine vessels, vehicles, motorized rolling equipment, aircraft, fire and security stations, water and sewage plants and power plants
- Labor, fuel, haulage, supplies, materials and repairs in connection with drilling, laying, installation and construction
- Contributions to a fund or scheme, approved by the permanent secretary, in respect of any person employed in, or in connection with, development operations
- The advancement of training and education of Namibian citizens at institutions approved by the permanent secretary
- Charges, fees or rent for, or in respect of, land or buildings occupied for purposes of carrying out development operations
- The general administration and management directly connected with development operations
- The restoration of such license area, or any part thereof, after cessation of development operations
- Customs duty in respect of the importation for use in, or in connection with, development operations in such license areas as plant, machinery, equipment, spare parts, materials, supplies or consumable items

Section 9 of the PTA provides an allowance for the exploration expenditure and development expenditure incurred in the years before production commences. These allowances can be carried forward to that year in the same way as income is carried forward. In the year when production commences, all the exploration expenditures can be deducted (unless they have already been transferred to another license area that has gross income from production), as well as one-third of the development expenditure. The rest of the development expenditures can be deducted in the two subsequent years in equal installments.

Section 10 of the PTA provides that exploration expenditures incurred after the year when production commenced are immediately deductible, while all other capital expenditures may be deducted in three equal installments commencing in the year they were incurred.

D. Incentives

Exploration expenditure

Accumulated exploration expenditures are deductible in full in the first year of production (unless they have already been transferred to another license area that has gross income from production). Exploration expenditures incurred after the year when production commences are immediately deductible.

Development expenditure

Accumulated development expenditures are deductible in three equal installments commencing in the first year of production.

Losses

Losses resulting from allowable deductions may be deducted as an allowable loss against the gross income from the license area in the next year. Losses may be carried forward without limitation. However, losses incurred in one license area may not be offset against income from another license area or other operations.

E. Withholding taxes

Dividends

Petroleum companies are exempt from withholding taxes (WHT) on dividends NRST.

Services

Payments for management or consultancy services as defined to nonresidents as defined are subject to WHT at a rate of 25% on the gross amount of the services fees, with effect from 30 December 2011. Payments to nonresidents for services rendered will be subject to WHT to be deducted and must be paid by the Namibian company or branch who pays the tax on behalf of the nonresident, unless the provisions of a double taxation agreement (DTA) provides relief.

Other

No WHT is payable on interest and royalties.

Branch remittance tax

There is currently no branch remittance tax in Namibia.

F. Financing considerations

Thin capitalization limits

There are no thin capitalization provisions in the PTA. However, exchange control rules may affect the choice of funding. The acceptance by a local entity of loan funds from abroad is subject to specific exchange control approval. The remittance of interest to nonresidents may be allowed upon provision of evidence of indebtedness, provided the rate is reasonable. Currently, a debt-to-equity ratio not exceeding 3:1 is required by the Bank of Namibia.

G. Transactions

Asset disposals

The license holder is not taxable on the proceeds from the sale of a share in physical assets. Section 7 of the PTA does not include capital receipts in taxable income, and even though Section 7(2) provides that an amount from the sale of an asset is deemed to have been received during the year of production, an amount received from the sale of an asset prior to the first year of production is not included in gross income. If, however, any portion of the amount received relates to prospecting information, it is taxable in the hands of the license holder in the year that production commences. Furthermore, although the license holder is not taxable on the amount received on the sale of the asset, the asset's capital expenditure is only allowed (or carried forward) to the extent that it exceeds the amount received (i.e., the amount received is "deducted" from the capital expenditure carried forward from that year).

Capital gains arising on the disposal of assets that are sold after the first year of production are included in gross income, and they are taxable in the hands of the license holder.

The purchaser is able to deduct the consideration in the year that production commences, provided that the amount paid relates to the transfer of part ownership in an asset and not to the right to participate in the petroleum produced under a production license.

Farm-in and farm-out

The recoupment provisions do not apply if an interest in a petroleum license is sold (e.g., where a disposal of part of an interest in a license area takes place in a year prior to the first year of production). As such, even if the consideration received, whether it is cash, an asset or a carryforward of an expenditure, exceeds the value of the share of the interest sold, it is not included in the license holder's gross income because there is no tax on the profits of the sale of capital assets in Namibia in the years prior to the first year of production.

The recoupment provisions do reduce the expenditure claimable in respect of the assets and reduce the capital expenditure claimable in the year that the consideration is received, whether the amount relates to an asset or to capital expenditures other than in respect of an asset.

The purchaser is able to deduct the consideration in the year that production commences, provided that the amount paid relates to the transfer of part ownership in an asset and not to the right to participate in the petroleum produced under the authority of a production license.

Selling shares in a company (resident and nonresident shareholders)

Namibia does not impose CGT, and as such, the sale of the shares in a Namibian company will not be subject to tax in Namibia. The sale of the shares will, however, be subject to stamp duties at a rate of NAD$2 for every NAD$1,000 transferred.

H. Indirect taxes

Import duties

License holders are exempt from paying import VAT under Schedule V of the Value-Added Tax Act 10 of 2000 (the VAT Act).

VAT

VAT is chargeable on the taxable supply of goods by every registered person under Section 6(1)(a) of the VAT Act. Taxable supplies are defined in Section 1 of the VAT Act as the supply of goods or services in the course or in the furtherance of a taxable activity. Namibia is defined for the purpose of the VAT Act as including the territorial sea, excluding the economic zone and the continental shelf. As such, for VAT purposes, goods or services supplied by a taxable person up to 200 nautical miles from the low watermark may be subject to VAT.

If taxable supplies exceed NAD$200,000, registration for VAT is obligatory.

For VAT purposes, taxable activity means any activity that is carried on continuously or regularly by any person in Namibia or partly in Namibia, whether or not for a pecuniary profit, that involves or is intended to involve, in whole or in part, the supply of goods or services to any other person for consideration. No guidelines define the terms "continuously" or "regularly" but, in practice, the Directorate of Inland Revenue views an uninterrupted presence in Namibia of four weeks or of three times in any 12-month period to be a sufficient presence to oblige the enterprise to register for VAT.

License holders must levy VAT at 15% on invoices for goods or services.

As VAT-registered persons, license holders are entitled to claim credit for VAT paid on invoices issued by Namibian suppliers against VAT charged on supplies made in Namibia.

Stamp duties

Stamp duties are payable at varying rates under the Stamp Duties Act 15 of 1993. Although there is no requirement to register the petroleum agreement, the stamping thereof ensures that the contract is valid for litigation purposes. Stamp duties on the contract are NAD$5.

Registration fees

License holders are required to pay annual charges for the benefit of the State Revenue Fund, calculated by multiplying the number of square kilometers included in the block or blocks by the amounts provided for in Section 67 of the Petroleum Act. In the case of exploration licenses, the charge is calculated as follows:

- During the first four years, NAD$60 per square kilometer
- During the next two years, NAD$90 per square kilometer
- During the subsequent two years, NAD$120 per square kilometer
- Thereafter, NAD$150 per square kilometer

In the case of the production licenses, the fee is NAD$1,500 per square kilometer.

I. Other

Government approach toward taking equity ownership of projects

No applicant is compelled to offer NAMCOR a share in a license, and no applicant, therefore, is penalized for not making an offer to NAMCOR. However, NAMCOR can participate in licenses if this is offered during negotiations, and if NAMCOR decides to accept the invitation to participate. NAMCOR's interests are carried out during the exploration phase, but it contributes fully from the development phase onward.

The Netherlands

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A. At a glance

Fiscal regime

The fiscal regime that applies in the Netherlands to the petroleum industry consists of a combination of corporate income tax (CIT), a surface rental tax, a state profit share (SPS) levy and royalty-based taxation.

Royalties	0% to 8%
Bonuses	None
Production sharing contract (PSC)	Not applicable
CIT	25%; 20% applies to the first €200,000
Surface rent tax:	
Production areas	€703 per km²
Reconnaissance areas	€235 to €703 per km²
SPS levy	50%[135]
Capital allowances	U, E[136]
Investment incentives	Research and development (R&D) credit, additional 25% deduction on capital invest on qualifying small fields (SPS)[137]

B. Fiscal regime

The fiscal regime that applies in the Netherlands to the petroleum industry consists of a combination of CIT, a surface rental tax, an SPS levy and royalty-based taxation.

Filing requirements (CIT/SPS)

The standard tax year, for CIT and SPS purposes, is the calendar year; however, a company may use its own accounting year as its tax year. A book year is established by the company's articles of incorporation and may end on any date during the year.

An annual CIT tax return must be filed within six months after the end of the year with the tax for corporate taxes, unless the company applies for extension (generally, an additional nine months). For SPS purposes, the license holder must file profit and loss statements made in accordance with the provisions of the Mining Act, together with a balance sheet showing the assets and liabilities relating to the production as of the financial year-end.

135 *The SPS levy is deductible for income tax purposes.*

136 *U: capital uplift or credit; E: immediate write-off for exploration costs.*

137 *Effective as of September 2010.*

This SPS information should be included as an appendix to the Dutch CIT return.

CIT and SPS are paid on an assessment basis. The competent authority for CIT and SPS assessments is the Dutch tax authorities (under the previous system of SPS, this was delegated to the Ministry of Economic Affairs).

Corporate income tax

CIT is levied on resident and nonresident companies. Resident companies are companies incorporated under civil law and companies that have their effective place of management and control in the Netherlands. Resident companies are taxable on their worldwide taxable income. Nonresident companies, primarily branch offices of foreign companies doing business in the Netherlands, are taxable only on specific income sources, such as business profits earned through a permanent establishment (PE) situated in the Netherlands.

It is important to note that the SPS due is deductible for Dutch CIT purposes.

Tax rates

For 2012, the statutory CIT rate is 25%. A rate of 20% applies to the first €200,000.

Determination of taxable income

The profit for tax purposes is not necessarily calculated on the basis of the annual financial statements. In the Netherlands, all commercial accounting methods must be reviewed to confirm that they are acceptable under the fiscal law. The primary feature of tax accounting is the legal concept of "sound business practice."

Expenses incurred in connection with the conduct of a business, in principle, are deductible. However, certain expenses are not deductible, such as fines and penalties and expenses incurred with respect to a crime. For companies that do not have shareholders with substantial interests, no other restrictions exist, except with respect to the deductibility of interest.

Functional currency

Taxpayers must calculate their taxable income in euros. On request, Dutch corporate tax returns may be filed in the functional currency of the taxpayer, provided the financial statements of the relevant financial year are prepared in that currency. The financial statements may be expressed in a foreign currency if this is justified by the company's business or by the international nature of the company's group. If this regime is applied, in principle, the functional currency must be used for at least 10 years.

Participation exemption

Generally, the Dutch participation exemption provides for a full exemption of Dutch CIT with regard to dividends derived from, and capital gains in relation to, a qualifying shareholding.

Since 1 January 2010, the following requirements must be satisfied to qualify for the participation exemption in the Netherlands:

- The taxpayer must hold at least 5% of the normal paid-up share capital of a company, with capital divided into shares
- One of the following tests is met:

  The participation is not held as a portfolio investment (the motive test)

  Or

  The subsidiary is not considered a low-taxed portfolio participation, which is determined by a two-pronged test: 1. an asset test and 2. an effective tax rate (ETR) test

Motive test

The motive test requires a determination as to the taxpayer's objective of owning the participation. The motive test is not satisfied if the taxpayer only aims at earning a yield that is similar to the yield that can be expected from normal, active portfolio asset management. If the taxpayer has more than one motive (e.g., the subsidiary is partly held as a portfolio investment and partly for business reason), the predominant motive is decisive.

The motive test is generally satisfied when the business carried on by the subsidiary is similar or complementary to the business conducted by the Dutch taxpayer. Further, the motive test is satisfied when the taxpayer plays an essential role in the business of the group because of its activities in terms of management, strategy or finance. The motive test is also satisfied if the Dutch taxpayer is an intermediary holding company that acted as a link between the ultimate parent and operating subsidiaries. In that case, the motive test is also met when the intermediate holding company is held by an intermediate holding company.

The motive test is deemed not to be met if (i) more than half of the subsidiary's consolidated assets consist of shareholding(s) of less than 5% or (ii) the predominant function of the subsidiary – together with the functions performed by its lower tier subsidiaries – is to put cash or assets at the disposal of other group entities, for example, to act as a group finance company.

Asset test

A participation is considered a "portfolio investment" if its assets consist, directly or indirectly, predominantly of (more than 50%) "free investments."

"Free investments" include portfolio investments other than those reasonably required within the scope of the business activities of the entity holding the investments. This also includes assets used for activities that predominantly consist of providing, directly or indirectly, financing to related entities or financing of assets of related entities, including making available assets or the right to use assets.

Examples of assets that could qualify as free investments are bank deposits, loan receivables, securities, real estate and bonds.

Group receivables are deemed to be free investments, unless (i) the participation qualifies as an active group finance company, (ii) the receivables are mainly financed (90% or more) from third-party debt or (iii) income of the receivables is subject to sufficient taxation (same meaning as for purposes of the ETR test – see below). As of 1 January 2010, assets used in active leasing business are no longer deemed to be portfolio investments.

Real estate is an asset that, in general, qualifies as a free investment, unless the real estate is used within the scope of the company's business activities (e.g., a hotel or cinema). However, if the assets of the company, on a consolidated basis, consist almost exclusively (i.e., 90% or more) of real estate that is not directly or indirectly held by an entity that is a Dutch mutual investment fund, the participation is qualified as a real estate participation. This type of participation qualifies for the participation exemption in any case. Only share interests of at least 5% are taken into consideration for consolidation purposes. The aforementioned 90% criterion is a strict one (i.e., receivables relating to the real estate owned do not qualify as real estate).

ETR test

If a participation does not meet the asset test, it must be subject to a certain level of taxation in order to enjoy the participation exemption regime (the ETR test). If the participation fails the required level of taxation, income derived from the participation could be subject to the credit system rather than the exemption. As of 2010, the ETR test is met when the participation is subject to a "realistic levy" of local taxation. An effective tax rate of at least 10% is sufficient for passing this test. As of 2010, a full recalculation to Dutch tax standards of the taxable profits of the participation should, in principle, no longer be required. It should still be considered whether the taxable basis of a participation is determined in a manner that does not differ too significantly from Dutch standards. Listed examples of regimes that would be significantly different from Dutch standards include, among others, cost-plus regimes if the basis is too limited, notional deductions or exemptions that substantially erode the taxable basis and too generous participation exemption regimes (i.e., certain imputation regimes).

Depreciation at will

In 2012, the Dutch Government abandoned the possibility for depreciation at will of qualifying new investment in business assets. Investments in qualifying assets in the periods 2009, 2010 and 2011 can benefit from the accelerated-depreciation rules.

Treatment of foreign branches

In 2012, the Dutch treatment of foreign branch results changed significantly. Until 2012, income from foreign branches was included in the worldwide income, followed by a reduction of allocable CIT. Foreign exploration losses were fully tax deductible, albeit subject to a recapture. Under the new rules, foreign results will be excluded from worldwide income, irrespective of whether the branch is subject to any tax. This treatment is effective for branches located in treaty and non-treaty countries.

These rules imply that foreign branch results cannot be deducted from the Dutch profit. However, if the branch is terminated, the ultimate loss will still be deductible, subject to certain deductions.

State profit share

The Mining Act provides for an SPS levy of 50% on income resulting from mineral production activities (the income relating to non-mineral production activities may be ignored). As such, the determination of the taxable basis for SPS is ring-fencing. The holder or coholder of a production license is subject to the levy of the SPS.

It is unlikely that gas storage activities fall within the realm of SPS. However, conversion of an upstream site into a storage facility may trigger "exit tax" discussions with the Dutch tax authorities.

Determination of the taxable basis for SPS purposes

A separate profit and loss account must be prepared for SPS purposes. If the taxpayer holds several licenses, it may consolidate the income derived from its licenses. It should be noted that no fiscal unity or group rules exist for SPS purposes.

The Mining Act specifically indicates that the determination of the taxable income for SPS purposes is based on the same principles as the Dutch Corporate Income Tax Act. For clarification, the Mining Act lists a number of income and expense items that are either included or excluded from the taxable basis.

Included income and expense components are:

- The movement of inventory
- The gain or loss realized in relation to the sale of a production license
- Costs pertaining to the exploration phase, to the extent that these have not already been deducted for SPS purposes

Excluded income and expense components include:

- Amortization of the purchase price of a reconnaissance license, to the extent that the purchase price exceeds costs that have not been deducted before for SPS purposes -- implying that a payment for a reconnaissance license is only deductible for SPS purposes, to the extent that this purchase price reflects costs that have not been deducted before for SPS purposes -- so goodwill paid in addition to the true costs of an exploration license are not deductible
- The value of extracted minerals that have been used for the upstream activity itself

The Mining Act provides for a 10% uplift of all costs, with the exception of:

- Any taxes and public levies that are borne by the license holder
- The amortization of the purchase price of a production license, unless the purchase price reflects costs that have not been deducted for SPS purposes already, so the uplift is only available for "truly incurred expenses" and not for a goodwill payment
- Donations to a dismantlement provision, to the extent that the transferor of the production license has already made donations to the obligation provision earlier (this prevents multiple uplifts)

Third-party income, such as income derived from the use of platforms or pipelines of the license holder, is excluded from the taxable basis for SPS purposes. As a consequence, costs relating to third-party income should also be excluded from the taxable basis.

SPS investment incentive for marginal gas fields

Since 16 September 2010, owners of Dutch gas exploration and production (E&P) licenses are allowed to claim an investment allowance of 25% with respect to certain capital investments relating to qualifying marginal gas fields for Dutch SPS purposes. Whether a (potential) gas field qualifies depends on a number of factors including the expected productivity of the gas well, the technical producible gas volume of the reservoir and the shortest distance to an existing platform. The additional allowance of 25% can be claimed in the SPS return for the year in which the license holder has entered into the obligation to purchase the capital asset or has incurred production costs in respect of the capital asset. If the asset is not yet in use at the end of the book year, and the amount of the investment allowance would exceed the amount that has been paid, only the amount that has been paid can be taken into account. The excess can be taken into account in following years to the extent payments have been made, but not later than in the year in which the capital asset is taken into use.

The investment allowance could effectively result in a subsidy of 12.5% of the amount of investments.

Tax rate and credits

The SPS rate is set at 50%. Based on current legislation, a loss may be carried back for three years and carried forward for an indefinite period of time. This provision differs from the CIT loss carryback (one year) and the carryforward (nine years) terms.

The Mining Act contains a credit for Dutch CIT that is borne on the mineral production activity. The credit is determined as follows:

- The SPS income is adjusted for the 10% uplift
- The adjusted SPS income is reduced by SPS that will be due after credits
- The number computed under the previous item is then multiplied with the Dutch CIT rate prevailing for the year

Excluded licenses

The Dutch Mining Act contains a number of transitional rules relating to some old licenses. From an SPS perspective, Article 147 of the Mining Act is of particular relevance. Under this provision, financial regulations embedded in production licenses that have been granted prior to 1965 will remain in force. As such, these financial provisions may overrule the current SPS provisions.

In addition, Article 149 contains a number of transitional rules for the taxation of storage activities that were previously not subject to a license.

Surface rental

Surface rental is a tax levied on each license holder that either has an offshore reconnaissance license or an offshore production license at 1 January of a calendar year. The 2011 rate amounts to €703 per km² for production areas and €235 to €703 per km² for offshore reconnaissance areas.[138]

The surface rental is paid on a "return" basis. The ultimate filing date is 1 April of the calendar year in question.

Royalty regimes

Royalties are calculated on a license-by-license basis by applying specified rates to the value of onshore oil and gas production. Production does not include oil and gas that are used for reconnaissance or exploration in the license area, or transport or treatment of the oil and gas.

The following rates apply for 2011:

Bracket	Oil (in thousand meters cubed)	Gas (in million meters cubed)
0–200 units	0%	0%
201–600 units	2%	2%
601–1,200 units	3%	3%
1,201–2,000 units	4%	4%
2,001–4,000 units	5%	5%
4,001–8,000 units	6%	6%
More than 8,000 units	7%	7%

The above rates increase by 25% in the event that the average price of an imported barrel of crude oil exceeds €25. A 100% increase applies in the event of an absence of state participation in the license.

The royalty is paid on a return basis. The ultimate filing date is 1 April of the year following the calendar year in question.

138 *The rates € per km² mentioned are 2011 rates. The 2012 applicable rates are likely to be confirmed mid-2012.*

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A. At a glance

Fiscal regime

New Zealand's fiscal regime applicable to the petroleum industry consists of a combination of corporate income tax (CIT) and royalty-based taxation.

Royalties	0% to 20%
Income tax rate	CIT rate: 28%
Capital allowances	D, E[139]
Investment incentives	L[140]

B. Fiscal regime

The fiscal regime that applies to the petroleum industry in New Zealand consists of a combination of CIT and royalty-based taxation.

Corporate tax

New Zealand resident corporations are subject to income tax on their worldwide income at the rate of 28%.

CIT is levied on taxable income. Taxable income is defined as assessable income less deductions, less any available net losses. Assessable income includes ordinary income (determined under common law) and statutory income (amounts specifically included in the Income Tax Act). In general, deductions include expenditures incurred in deriving assessable income or expenditures incurred in the course of conducting a business for the purpose of deriving assessable income.

An expenditure of a capital nature is generally not deductible when incurred, although depreciation deductions may be available (other than buildings with an estimated useful life of at least 50 years). However, deductions for certain oil and gas expenditures of a capital nature are available under a specific petroleum mining regime (refer to Section C for an outline of exploration and development costs).

Ring-fencing

New Zealand does not generally apply ring-fencing in the determination of corporate tax liability. However, expenditures on petroleum mining operations undertaken through a foreign branch of a New Zealand resident company cannot be offset against other New Zealand sourced income. Otherwise, the same tax entity may offset losses against any of its project profits (or other group companies with at least 66% of common ultimate ownership). New Zealand has tax consolidation rules under which various wholly owned New Zealand entities may form a tax consolidated group and thereby be treated as a single tax entity.

139 D: accelerated depreciation; E: immediate write-off for exploration costs.

140 L: losses can be carried forward indefinitely.

Capital gains tax

There is currently no comprehensive capital gains tax (CGT) in New Zealand. However, generally, all gains on financial arrangements are subject to tax. Further, gains on the sale of property that is purchased for the purpose of resale, or as part of a profit-making scheme, are taxable. An amount that has been derived from a business is also taxable, unless the amount is of a capital nature. The specific taxing provisions that apply to petroleum miners may override these general principles. For example, special provisions tax the proceeds from the sale of petroleum mining assets, such as license areas and geological information.

Dividends

New Zealand has a dividend imputation regime. The benefit of tax paid by a New Zealand company can be passed on to its New Zealand resident shareholders.

Fully imputed dividends (sourced from tax paid profits) are liable to a 0% rate of nonresident withholding tax (NRWT) if paid to a nonresident shareholder who holds at least a 10% direct voting interest in the company, or if less than a 10% direct voting interest, where the relevant tax treaty reduces the withholding rate to below 15% (none of the existing treaties allow for this second alternative to apply).

In other cases, a nonresident shareholder can receive a dividend that is fully imputed from a New Zealand company without further tax costs under the foreign investor tax credit (FITC) regime. However, the mechanism is somewhat complex. In brief, the New Zealand resident company can effectively compensate the foreign shareholder for the NRWT by paying an additional supplementary dividend. The supplementary dividend is funded through a FITC, as the company can claim a tax credit or refund equivalent to FITC.

Treaty relief may also be available.

Mineral royalties

The royalty regime applies to petroleum permits granted on or after 1 January 1995. The regime is set out in detail in the 2005 Minerals Program for Petroleum (as provided for under the Crown Minerals Act 1991). Royalties are payable if petroleum is discovered and sold, used in the production process as fuel, exchanged or transferred out of the permit boundaries without sale, or where petroleum remains unsold on the expiry of a permit. However, no royalty is payable in respect of:

- Petroleum flared or otherwise unavoidably lost
- Petroleum returned to a natural reservoir within the permit area (e.g., reinjected gas)
- Petroleum removed from an approved underground storage facility and upon which a royalty has previously been paid by the producer

Mining permits issued under the Crown Minerals Act 1991 prior to 1 January 1995, or mining licenses issued under the Petroleum Act 1937 prior to the passage of the Crown Minerals Act 1991, continue to pay the royalty specified at the time the permit or license was granted.

A company with a permit granted prior to 1 January 1995 may apply to the secretary of commerce to have the royalty calculated as if the permit was granted on or after 1 January 1995.

The Government announced on 16 December 2010 that it will review the Crown Minerals Act 1991 and the associated mineral programs as a single package. It is anticipated that a document discussing the proposed changes will be released for public consultation in 2012. In an initial review by the Government, the royalty and taxation regime was seen as generally fit for purpose. On that basis, it is not anticipated that the Government will introduce any major changes to the royalty regime when the proposals are released later this year.

Discoveries between 30 June 2004 and 31 December 2009

In summary, for any discoveries made under a mining permit between 30 June 2004 and 31 December 2009, the royalty regime is a hybrid regime that stipulates an annual payment of the greater of:

- An ad valorem royalty (AVR) which is levied on 1% of the net sales revenue on natural gas and 5% of the net sales revenue on oil
- An accounting profits royalty (APR) which is levied on:
  - 15% of accounting profits on the first NZ$750 million (cumulative) gross sales for an offshore discovery; or
  - 15% of accounting profits on the first NZ$250 million (cumulative) gross sales for an onshore discovery; and
  - 20% of accounting profits on additional production

Mining permit holders are required to pay the higher of the two royalties in any year.

Prospecting and exploration costs incurred anywhere in New Zealand between 30 June 2004 and 31 December 2009 are deductible for the purposes of calculating the APR.

The special royalty provisions applying to discoveries made, and prospecting and exploration costs incurred, between 30 June 2004 and 31 December 2009 are to encourage increased exploration to identify new gas discoveries, given the decline of existing fields.

All other petroleum production

For all other petroleum production, including any from a discovery made after 31 December 2009, the royalty regime comprises a 5% AVR or a 20% APR, whichever is the greater in any given year.

The APR deductions can only relate to the mining permit for which the royalty applies, not the activities of the permit holder overall.

Application of AVR and APR

Application of these royalties is determined by the net sales revenue earned in a period and the type of permit held.

If a mining permit has never had net sales revenue of more than NZ$1 million in a reporting period, the permit holder is liable to pay only the AVR. If the permit holder anticipates having revenue from a mining permit exceeding NZ$1 million, the royalty is payable at the higher of the APR and AVR.

Furthermore, where an exploration permit is held, the permit holders are only liable to pay the AVR.

Detailed records of allowable operating and capital expenses should be kept in order to claim allowable APR deductions.

Calculation of APR

The following deductions are permitted in calculating the APR:

- Production costs
- Capital costs, including exploration, development, permit consent and maintenance costs, and feasibility study costs (excluding permit purchase costs)
- Indirect costs
- Abandonment costs
- Operating and capital overhead allowance
- Operating losses and capital costs carried forward (including costs from previous permit holders that have not been deducted)
- Abandonment costs carried back

These costs are written off against sales revenues and any excess is carried forward to the succeeding reporting periods. Note that the costs are not amortized on a time or production basis.

Unfortunately, the prescription for calculating the accounting profit does not specify:

- The manner in which exploration costs are to be treated (successful method or unsuccessful method)
- Guidelines for associated products (which may have material value) and by-products (which have relatively insignificant value)

C. Capital allowances

Specific income tax provisions related to expenditures incurred in the course of petroleum mining operations.

Classification of petroleum expenditures

An expenditure on petroleum mining is categorized as either a petroleum exploration expenditure, a petroleum development expenditure or a residual expenditure.

The key features of the current petroleum regime are as follows:

- A petroleum exploration expenditure is allowed as a deduction in the year the expenditure is incurred
- Petroleum development expenditures must be capitalized and deducted over seven years or on a depletion basis

The various types of expenditures are defined below.

Petroleum exploration expenditure

The definition of a petroleum exploration expenditure encompasses:

- Exploratory well expenditures
- Prospecting expenditures
- Expenditures to acquire a prospecting license, a prospecting permit for petroleum or an exploration permit for petroleum

It does not include:

- Residual expenditures
- Expenditures on petroleum mining assets required to be treated as petroleum development expenditures

As discussed above, a petroleum exploration expenditure is fully deductible in the income year in which it was incurred.

Petroleum development expenditure

The definition of a petroleum development expenditure includes an expenditure incurred that:

- Directly concerns a permit area
- Is for acquiring, constructing or planning petroleum mining assets

It does not include:

- Residual expenditures
- Petroleum exploration expenditures
- Other expenditures otherwise allowed as a deduction elsewhere in the Income Tax Act

The term "petroleum mining asset" is defined as an interest in:

- A petroleum permit
- An asset that has an estimated life dependent on, and which is no longer than, the remaining life of the permit area, and is acquired by a petroleum miner for the purpose of carrying on in a permit area any activity in connection with:
  - Developing a permit area for producing petroleum
  - Producing petroleum
  - Processing, storing or transmitting petroleum before its dispatch to a buyer, consumer, processor, refinery or user
  - Removal or restoring operations

However, any asset acquired by a petroleum miner for the purposes of further treatment that takes place after the well stream has been separated and stabilized into crude oil, condensate or natural gas (by way of liquefaction or compression, the extraction of constituent products or the production of derivative products) is specifically excluded from the definition of a petroleum mining asset and is, therefore, not treated as a petroleum development expenditure. An exception applies if the treatment takes place at the production facilities.

Land is specifically excluded from the petroleum mining asset definition.

As discussed on the previous page, a petroleum development expenditure is treated as a deferred deduction that is currently deductible over seven years on a straight-line basis, or on a depletion basis.

Residual expenditure

An expenditure excluded from the definition of both petroleum exploration expenditures and petroleum development expenditures is a residual expenditure.

Residual expenditure consists of:

- An expenditure on scientific research, other than a capital expenditure
- An application fee paid to the Crown in respect of a petroleum permit
- An insurance premium or royalty paid under the Petroleum Act 1937 or the Crown Minerals Act 1991
- Land tax or rates, and interest
- Interest or an expenditure under a financial arrangement entered into prior to 20 May 1999
- Lease expenses in respect of land or buildings

A residual expenditure is deductible in the year it is incurred, subject to the general deductibility rules as discussed above.

D. Incentives

Exploration

A petroleum mining exploration expenditure is immediately deductible for income tax purposes.

Tax holiday

New Zealand does not have a tax holiday regime.

Ability to carry forward losses

Losses (including New Zealand branch losses of a nonresident company) can be carried forward indefinitely. However, there is a requirement that a company satisfies a 49% "continuity of ultimate shareholding" test from the period when the losses were incurred until the losses are used. This provision requires that there is a 49% shareholder continuity based on voting interests or, if applicable, based on the market value of shares and options.

Losses may also be offset against the income of other companies in the same group (the companies must be in the same group from the date the losses were incurred until the date they are offset). To be considered in the same group, the companies are required to have at least a 66% ultimate common ownership. Losses incurred by a dual resident company may not be offset in this manner.

Losses from foreign branches of New Zealand resident mining companies are ring-fenced against foreign income so that they cannot be used to shelter New Zealand sourced income.

Ability to carry back losses

Previously, under the Income Tax Act 2004, petroleum miners had the ability to carryback losses from unamortized development expenditure when a petroleum permit was relinquished. The loss was allowed as a deduction in the years preceding the year of relinquishment. This was effectively limited to four years because of the refund provisions in the Income Tax Act 2004. The Income Tax Act 2007 currently does not allow this. This appears to be a drafting error, and a submission has been made to the Inland Revenue to correct this.

Exemption for drilling rigs and seismic ships

Until 31 December 2014, income earned from the drilling of exploratory or petroleum development wells in New Zealand, and income earned from seismic survey work relating to petroleum in New Zealand, is exempt from tax. The activities must be carried out by nonresident companies and must be confined to offshore petroleum fields.

E. Withholding taxes

Nonresident withholding tax

The NRWT rules apply to dividends or royalties derived from New Zealand by a nonresident and to New Zealand sourced interest derived by a nonresident that is not engaged in business through a fixed establishment in New Zealand.

Dividends paid by a New Zealand resident company to a nonresident are subject to 30% NRWT, unless the dividends are paid from tax-paid profits or a double tax treaty applies (in which case, the rate is generally reduced to 15%, although some treaties may reduce the rate to either 5% or 0%). Further, a 0% NRWT rate may apply if the nonresident shareholder holds a 10% or more direct voting interest and the dividend is fully imputed (i.e., paid out of tax-paid profits), or if the nonresident shareholder holds less than a 10% direct voting interest, where the relevant tax treaty reduces the withholding rate to below 15%. Interest and royalties are subject to NRWT at a rate of 15% (reduced to 10% under most treaties). The approved issuer levy (AIL) regime (see below) may also apply to interest payments.

Interest

A resident petroleum mining company may deduct interest costs on an accrual basis (resident companies are generally allowed an automatic deduction for interest without establishing a nexus with assessable income), subject to thin capitalization and transfer pricing constraints (see Section F).

As noted above, interest payments to nonresidents are generally subject to 15% NRWT (reduced to 10% under most treaties). However, the tax treatment varies depending on the residence of the borrowing company and the source of the borrowings.

New Zealand has an AIL system that allows a company to pay interest to a nonassociated lender without having to deduct NRWT. The AIL is payable to the Inland Revenue at the rate of 2% (of the interest payable), which is generally tax deductible.

New Zealand has no restrictions on the repayment of loans or foreign currency transactions.

There is currently a proposal to apply a 0% AIL rate on New Zealand dollar denominated widely held bonds.

Royalties

Royalties are generally tax deductible if they are of a revenue nature and they are incurred in the production of assessable income. Royalty payments are generally subject to NRWT when paid offshore (see information about NRWT above).

Lease expenses

The tax treatment of lease payments is dependent on whether the lease in question is a finance lease. A finance lease includes the following:

- The ownership of the asset is transferred at the end of the lease term.
- The lessee has the option to buy the asset at a substantial discount.
- The term of the lease exceeds 75% of the asset's estimated useful life.

In the case of a finance lease, the lessee is treated as having purchased the asset, subject to a loan from the lessor. The lessee, therefore, is entitled to depreciation deductions on the leased asset and interest deductions in respect of the deemed loan.

If the lessor is not engaged in business through a fixed establishment in New Zealand, the lessor is potentially subject to NRWT on the deemed interest component of the lease payments. The amount of NRWT may be reduced under a relevant double tax agreement. Alternatively, a borrower may choose to pay a 2% AIL under the AIL regime (instead of NRWT) if the parties to the deemed loan are not associated.

If the lease is not a finance lease, the lessee is generally entitled to deduct the lease payments as they are incurred.

Nonresident contractors

Contract payments paid by a petroleum mining company to "nonresident contractors" for services performed in New Zealand are treated for tax purposes as payments liable for nonresident contractors tax (NRCT) deductions.

NRCT must be deducted from payments made to nonresidents in respect of any "contract activity." The definition of contract activity is very broad and includes:

- Performing any work in New Zealand
- Rendering a service of any kind in New Zealand
- Hiring personnel or equipment to be used in New Zealand

It should be noted that the work or services must be carried out in New Zealand. If the work or services are carried out in any other country, the contract payments are not liable for NRCT, even though they may relate to a New Zealand project. Some payments are expressly excluded from treatment as a contract payment to a nonresident contractor. These are:

- Royalty payments, which are subject to NRWT
- Cost reimbursing payment, which constitute a reimbursement of expenditures incurred by the nonresident contractor; this exclusion does not apply, however, if the parties to the cost reimbursement payment are associated persons
- Where the nonresident contractor has full New Zealand tax relief under a double tax agreement and is present in New Zealand for 92 days or less in a 12-month period
- When total payments do not exceed NZ$15,000 in a 12-month period
- Where the nonresident contractor has provided an exemption certificate to the payer

Branch remittance tax

Branch remittance tax does not apply in New Zealand.

F. Financing considerations

Thin capitalization

New Zealand's income tax system contains significant rules regarding the classification of debt and equity instruments and rules impacting the deductibility of interest.

New Zealand's thin capitalization rules also require the ratio of debt to assets to not exceed 60%. Interest deductions are not allowed, to the extent that the debt-to-asset ratio exceeds this ratio. However, the rules allow one exception: when the debt percentage of the New Zealand taxpayer is not more than 110% of the consolidated worldwide debt-to-asset ratio of the controlling nonresident group.

Transfer pricing

New Zealand also has a transfer pricing regime in respect of cross-border payments between associated parties. Broadly, the rules require the payments to be calculated on an arm's-length basis.

G. Transactions

Removal or restoration expenditure

An immediate deduction for removal or restoration operations is permitted in the year when the expenditure is incurred. It is recognized that these costs generally arise after the well has ceased production. Accordingly, any loss that cannot be offset can be carried back and offset against prior-year profits if necessary (limited to four years).

Relinquishment of petroleum license

If a petroleum permit or license is relinquished, any deferred deductions that have not been deducted previously are deductible in the year of relinquishment (or otherwise carried back and offset against prior-year profits if the Income Tax Act 2007 is amended to reflect the previous position under the Income Tax Act 2004).

Disposal of petroleum mining assets

Consideration received by a petroleum miner from the disposal of a petroleum mining asset is assessable income in the year the consideration is derived. Any deferred expenditure not yet deducted is deductible at that time, subject to the rule below in respect of associated person transactions.

If a petroleum mining asset is sold to an associated person, a petroleum miner's deduction for the balance of the deferred expenditure is limited to the amount of assessable income (i.e., consideration) the person derives from the disposal. This rule prevents a petroleum miner from claiming a loss on disposal by selling the assets below value to an associated person. The balance of any deferred expenditure can be claimed by the associated person if the asset subsequently is sold to a third party.

Use of exploratory well for commercial development

If an exploratory well is subsequently used for commercial production, the "exploratory well expenditure" that has been deducted in respect of that well must be added to the assessable income of the petroleum miner. The expenditure incurred is then treated as a petroleum development expenditure and deducted over seven years on a straight-line basis or on a depletion basis.

Dry well expenses

If a well that has commenced production subsequently becomes dry, the balance of any deferred expenditure is immediately deductible.

Farm-in and farm-out

Generally, the farm-in party's contribution to exploration or development work undertaken on a petroleum license area is deductible for the farm-in party according to whether it is a petroleum exploration or development expenditure. The farm-in party's contributions are specifically excluded from being assessable income for the farm-out party.

Disposal of petroleum mining shares

The proceeds from the sale of shares in any "controlled petroleum mining entity" are not taxable in New Zealand.

H. Indirect taxes

Import duties

Import duties are payable on the importation of some goods into New Zealand.

Import Goods and Services Tax (GST) at 15% may also be payable, but is refundable if the importer is GST registered.

Temporary import exemptions are available for goods that will be reexported within 12 months.

VAT and GST

GST is imposed under the Goods and Services Tax Act 1985 on the supply of goods and services in New Zealand.

From an economic perspective, GST is ultimately paid by the consumer or end user. The tax is paid (and reclaimed) at each step along the chain of ownership, until the goods or services reach the end user (who cannot reclaim the GST).

GST is charged at the rate of 15% on goods and services supplied by a registered person. The principal exemptions are for the supply of residential accommodations and financial services. Also, the sale of land or a business as a going concern may be zero-rated for GST purposes (i.e., GST charged at 0%).

Generally, GST is not imposed on goods exported from New Zealand (i.e., they are zero-rated for GST purposes).

The GST that a company pays when purchasing goods and services is called "input tax." Registration enables a company to claim this amount back from the Inland Revenue if the goods and services are purchased for the principal purpose of carrying on a "taxable activity."

The GST that the registered company is liable to charge on the supplies made is called "output tax." The company collects the output tax from the consumer and reports it to the Inland Revenue.

GST registration is compulsory if the total value of goods or services supplied exceeds (or will exceed) NZ$60,000 in any 12-month period.

Petroleum mining companies exploring in New Zealand may not make supplies and, therefore, are not required to register. However, they do have the option of voluntarily registering for GST, which then allows them to recover GST charged on supplies received.

Export duties

No duties apply to goods exported from New Zealand. However, a fee may be paid to the exporting company for the documentation necessary in the process of exporting goods.

Stamp duty

No stamp duty applies in New Zealand.

Local authority rates

Local authorities in New Zealand levy rates on land owners for the purpose of funding their activities. These are based on the Government's valuation of the property held. The amount charged varies from district to district.

Climate change emissions trading

Legislation has been enacted in New Zealand to introduce a carbon tax on greenhouse gases and an emissions trading scheme. The emissions trading scheme will enable organizations to manage their carbon tax obligations.

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A. At a glance

Fiscal regime

Companies carrying on petroleum operations are deemed to be in the upstream regime and taxed under the Petroleum Profits Tax Act (PPTA) 2004 (as amended). Petroleum operations are defined under the PPTA as winning or obtaining and transportation of chargeable oil in Nigeria by, or on behalf of, a company for its own account. Petroleum operations include any drilling, mining, extracting or other such operations or process (not including refining at a refinery) in the course of a business carried on by a company, including all operations incidental thereto and any sale of, or any disposal of, chargeable oil by, or on behalf of, the company.

Nigeria operates both a licensing and a contractual regime. Under the licensing regime, there are two arrangements. These are the joint ventures between the Federal Government of Nigeria and the international oil company (IOC) and the sole risk operator (SRO). The contractual regime arrangements are the risk service contracts (RSC) and the production sharing contracts (PSC).

It should be noted that, of the four arrangements, the RSC operators are not deemed to be carrying on petroleum operations but are placed under performance schemes with the Federal Government and are paid as service providers. Therefore, they are taxable under the Companies Income Tax Act at a far lower rate and not under the PPTA. The Federal Government of Nigeria, under all the arrangements, operates through the Nigerian National Petroleum Company (NNPC).

Royalties	0% to 20%
Bonuses	Yes[141]
PSC	Yes[142]

Income (profit) tax rate

Under Section 21 of the PPTA (Cap P13) LFN 2004, the rates apply as follows:

First five years (newcomers)	65.75%
First five years (existing companies)	85%
Subsequent years (all companies)	85%
Resource rent tax	Yes
Capital allowances	D[143]
Investment incentives	L[144]

141 *A company to which a concession has been granted to explore for and produce oil is liable to pay the signature bonus as consideration for the award of the concession. The amount payable is generally fixed at the absolute discretion of the Government and may not be determined in advance.*

142 *The PSC government share is based on production.*

143 *D: accelerated depreciation.*

144 *L: losses can be carried forward indefinitely.*

B. Fiscal regime

Petroleum profit tax

All companies liable to pay petroleum profit tax (PPT) are assessed tax on the current-year basis. As a result, the accounting period, which should cover the assessable profit, is from 1 January to 31 December of the relevant tax year, except in the year of commencement or cessation of business, when it may be shorter. For a company that is engaged in upstream crude oil operations, its profits for any accounting period are made up of the following:

- The proceeds from sales of all chargeable oil sold by the company in that period
- The value of all chargeable oil disposed of by the company in that period
- All income of the company during that period incidental to and arising from any one or more of its petroleum operations

In arriving at the taxable profits of the company, Section 10 of the PPTA provides for deductible expenses to include expenses "wholly, exclusively and necessarily" incurred in obtaining the profits.

To determine the assessable profits of an oil-producing company from its adjusted profits, the law allows all unrecouped losses suffered by the company during any previous accounting periods to be deducted from its adjusted profits. If all the losses cannot be relieved from the adjusted profits of any accounting period (e.g., because there is insufficient profit from which such losses could be offset), the PPTA allows the unrelieved losses to be carried forward to the succeeding accounting periods.

Production sharing contracts

PSCs have recently become the vehicle of choice for Nigeria in participating in the exploration of petroleum resources over time, particularly for the offshore acreages. A PSC is an agreement between the state oil company, the NNPC, and any other exploration and production company or companies for the purpose of exploration and production of oil in the deep offshore and inland basins. In Nigeria, the PSC is governed by The Deep Offshore and Inland Basin Production Sharing Contracts Decree No. 9 1999 Act Cap. D3 L.F.N. 2004, amended by the Deep Offshore and Inland Basin Production Sharing Contracts (Amendment) Decree No. 26 1999.

Under a PSC, the contractor funds exploration and production activities and recovers the cost of winning crude oil. A PSC is based on a production split, shared between the parties in agreed proportions. The contractor undertakes the initial exploration risks and recovers its costs if and when oil is discovered in commercial quantities. If no oil is found, the company receives no compensation. Under the PSC, the contractor has the full right to only cost oil (i.e., oil to recoup production costs) and equity oil (i.e., oil to guarantee a return on investment). The contractor can also dispose of tax oil (i.e., oil to defray tax and royalty obligations) on behalf of the NNPC.

The balance of the oil (if any) is shared between the parties. The contractor is subject to a petroleum profits tax at 50% of the chargeable profit.

Resource rent tax

These are annual or periodic charges made in respect of licenses granted under the Petroleum Act. The rent payable is determined as follows:

- NGN200.00 for each square kilometer or part thereof for an oil prospecting license (OPL)
- NGN300.00 for each square kilometer or part thereof for a nonproducing oil mining lease (OML)
- NGN500.00 for each square kilometer or part thereof of a producing OML

Royalty regimes

Any company engaged in upstream gas operations is required to pay royalties in accordance with the provisions of the Petroleum Act and the Petroleum Drilling Regulations 2004. This is usually in the form of monthly cash payments at an agreed percentage of the quantity of oil produced, after making adjustments for treatment, handling and related expenses. The royalty payable is dependent on the concession agreement between the company and the Federal Government.

Royalty rates for joint venture operations:

Onshore production	20%
Production in territorial waters and continental shelf up to 100 meters water depth	18.5%
Offshore production beyond 100 meters	16.67%

The Deep Offshore and Inland Basin Production Sharing Contracts Act specifies the royalty rates that apply to production from PSC fields beyond 200 meters as follows:

Area	Rate (%)
Up to 200 meters water depth	16.67
In areas from 201 to 500 meters water depth	12
In areas from 501 to 800 meters water depth	8
In areas from 801 to 1,000 meters water depth	4
In areas in excess of 1,000 meters water depth	0
Inland basin	10

C. Capital allowances

Under the PPTA, accounting depreciations are not allowable for tax calculations. Instead, the PPTA gives both petroleum investment allowance (PIA) and annual allowance (AA) to oil-producing companies that have incurred a "qualifying capital expenditure" (QCE). These allowances are allowed against the assessable profit to arrive at the chargeable profits. The relevant tax rate is applied to the chargeable profits to determine the amount of PPT payable.

Petroleum investment allowance

The PIA is an allowance granted to an exploration and production (E&P) company in the first year when it incurs QCE for the purpose of its operations. The rates depend on the fiscal regime (contract form) under which the E&P company operates. The following rates apply to companies in joint venture operations.

For the purpose of computing the PIA, the following rates apply, depending on location:

Onshore operations	5%
Operations in areas up to 100 meters water depth	10%
Operations in areas between 101 meters and 200 meters water depth	15%
Operations in areas beyond 200 meters water depth	20%

Annual allowance

The AA is an allowance granted annually at a flat rate of 20% on the original cost of an asset, subject to the requirement that the taxpayer retains 1% of the original cost in its books until the asset is finally disposed. The retention of the 1% cost in the books of the company means, effectively, the AA granted for the fifth (and last) year is 19% rather than 20%, as for the previous four years. For the ease of reference, the rates of AA are as follows:

First year	20%
Second year	20%
Third year	20%
Fourth year	20%
Fifth year	19%

The capital allowance for which relief may be claimed in any particular tax year is the sum of any PIA and AA.

QCE means capital expenditures incurred in an accounting year in respect of:

- Plant, machinery and fixtures
- Pipelines and storage tanks
- Construction of buildings, structures or works of a permanent nature
- Acquisition of rights in or over oil deposits, searching for, or discovering and testing, petroleum deposits or winning access thereto or construction of any work or buildings likely to be of little value when the petroleum operations for which they were constructed cease

No capital allowance is granted for any expenditure that would have been a qualifying expenditure, except in respect of deductions that have been made in arriving at the adjusted profit of the company pursuant to Section 10 of the PPTA.

Investment tax credits or investment tax allowances

A company engaged in petroleum operations in the deep offshore and inland basin, pursuant to a PSC executed in 1993, is allowed an investment tax credit (ITC) at the rate of 50% of the qualifying expenditure, in accordance with the terms of the PSC for the accounting period when the asset was first used for the purpose of its petroleum operations. In the same way, a company that has executed a PSC after 1 July 1998 is entitled to investment tax allowances (ITA) at a flat rate of 50% of the qualifying expenditure in the accounting year in which the relevant asset is first used in the business.

Restrictions on capital allowances

Under the PPTA, the capital allowance relief that can be claimed is the aggregate capital allowance for the relevant tax year. This, however, is subject to a limitation. Capital allowance relief is limited to the lower of either the aggregate capital allowance computed for the tax year or a sum equal to 85% of the assessable profits of the accounting period, less 170% of the total amount of the deduction allowed as PIA for that period. The purpose of this restriction is to ensure that the tax chargeable to the company is no less than 15% of the tax that would have been chargeable if no deduction had been made for capital allowances. Unrelieved capital allowances may be carried forward until they are finally relieved.

D. Incentives

In its bid to encourage the development and utilization of the country's gas resources, the following incentives are available:

- An investment required to separate crude oil and gas from the reservoir into usable products is considered part of the oilfield development
- A capital investment in facilities equipment to deliver associated gas in a usable form at utilization or the designated custody transfer point is treated, for tax purposes, as part of the capital investment for oil development

- Capital allowances, operating expenses and the basis for tax assessments are subject to the provisions of the PPTA and the tax incentives under the revised memorandum of understanding

Conditions for the incentives include:

- Condensates extracted and reinjected into the crude oil stream are treated as oil but those not reinjected are treated under the existing tax arrangement.
- The company pays the minimum amount charged by the minister of petroleum resources for any gas flared by the company, currently at US$3.50 per thousand standard cubic feet of gas flared. The company must, where practicable, keep the expenses incurred in the utilization of associated gas separate from those incurred in crude oil operation, and only expenses not able to be separated are allowable against the crude oil income of the company under the Act.
- Expenses identified as incurred exclusively in the utilization of associated gas are regarded as gas expenses and are allowable against the gas income and profit to be taxed under the Companies Income Tax Act.
- Only companies that invest in natural gas liquid extraction facilities to supply gas in usable form to downstream projects, including aluminum smelter and methanol, methyl tertiary-butyl ether and other associated gas utilization projects, benefit from the incentives.
- All capital investments relating to the gas-to-liquids facilities shall be treated as a chargeable capital allowance and recovered against the crude oil income.
- Gas transferred from the natural gas liquid facility to the gas-to-liquids facilities incurs 0% tax and 0% royalty.

The effect of these incentives is to give wider latitude to gas-producing companies on expenditures for which they can claim capital allowance relief.

E. Withholding taxes

Under Nigerian law, certain income is subject to withholding tax (WHT) regulations. Income subject to WHT includes rent, interest, dividends, fees, commissions and payments in respect of contracts. Thus, if a company makes a payment on one of these types of income, the payer company is required by law to deduct WHT from the payment at the applicable rate and remit the sum to the Federal Inland Revenue Service (FIRS) or the State Inland Revenue Service (SIRS). The relevant tax authority issues a receipt for the payment, which is forwarded to the payee as evidence of payment of the WHT on its behalf. However, WHT does not apply to dividends declared from profits that have suffered PPT.

The WHT rates are as follows:

Interest	10%
Royalties	10%
Technical services	10%
Nonresident contractors	5%
Branch remittance tax	Not applicable

The above withholding tax rates differ if paid to individuals.

Nigeria has treaty agreements with countries that include the UK, Northern Ireland, Canada, France, Belgium, Pakistan, Romania and the Netherlands. These countries are granted a reduced rate of WHT, usually at 75% of the generally applicable WHT rates. Thus, the applicable rate of WHT for treaty countries on interest, dividends and royalties is generally 7.5%.

F. Financing considerations

Thin capitalization

A company is thinly capitalized if its capital is made up of a much greater proportion of debt than equity. The tax authorities perceive that this situation creates problems because they are concerned about abuse through excessive interest deductions. Some tax authorities limit the application of thin capitalization rules to corporate groups with foreign entities to avoid "tax leakage" to lower tax jurisdictions. Nigeria does not have a specific thin capitalization rule, but it does apply general anti-tax avoidance rules. Under Section 15 of the PPTA 2004, if the tax authorities believe that any disposition is not, in fact, given effect to, or that any transaction that reduces or would reduce the amount of tax payable is artificial or fictitious, they may disregard the disposition or direct that adjustments be made in respect of the liability to tax as the authorities consider appropriate to counteract the reduction in the liability to tax, or the reduction that would otherwise apply, resulting from the transaction. The companies concerned are accordingly subject to tax. The expression "disposition" includes any trust, grant, covenant, agreement or arrangement. The following transaction is deemed to be artificial or fictitious: a transaction between persons if one of them has control over the other or between persons if both of them are controlled by another person if, in the opinion of the tax authorities, the transaction has not been made at arm's-length (i.e., on the terms that might have been fairly expected to be made by independent persons engaged in the same or similar activities dealing with one another at arm's-length).

It is understood that the FIRS is currently working on a draft transfer pricing regulation.

PSC expenditure recovery exclusions for financing costs

All the expenses incurred in respect of exploration activities prior to the effective date of the PSC are operating costs recoverable by the contractor from cost oil.

G. Transactions

Asset disposals

If a company disposes of a capital asset, capital gains accruing from the disposal are subject to tax under the Capital Gains Tax Act 2004 at the rate of 10%. The amount of capital gains is calculated after deducting expenses associated with the disposal of the assets. A company may claim rollover relief and, therefore, postpone the tax liability if the proceeds from the disposal are used to acquire an asset similar in nature to the one disposed.

Farm-in and farm-out

The Nigerian Petroleum (Amendment) Decree 1996 (Decree No. 23) provides that farm-out means "an agreement between the holder of an oil mining lease and a third party which permits the third party to explore, prospect, win, work and carry away any petroleum encountered in a specified area during the validity of the lease." Farming in is, therefore, a way of acquiring a license interest and, conversely, farming out is a way of disposing of a license interest. The terms "license interest" or "concession interest" are used in this chapter to include the bundle of rights owned by a participant in an oil or gas joint venture.

Selling shares in a company

The sale of shares does not attract capital gains tax (CGT) for resident and nonresident shareholders. A minimal stamp duty applies to the share transfer of documents. It is important to note that sales of interests in assets attract CGT.

H. Indirect taxes

Import duties

Generally, customs duties are payable on various goods, including plant, machinery and all equipment according to the provisions of the Customs, Excise Tariff (Consolidation) Act 2004.

The Act provides that any machinery, equipment or spare part imported into Nigeria by a company engaged in exploration, processing or power generation through utilization of Nigerian oil and gas is exempt from customs duties. Unlike the VAT exemption, the benefit for customs duty relief may be claimed by a company engaged in the upstream or downstream sector of the oil industry.

VAT

Under the Value Added Tax Act 2004, VAT is imposed at the rate of 5% on the supply of all goods and services, except the supply of any goods and services that have been exempted specifically under the Act. Taxable supplies include the sale, hire, lease and any other disposal of taxable goods. VAT charged by vendors in the oil and gas industry is deducted at the source and remitted to the FIRS.

VAT incentive for oil and gas businesses

VAT is not payable on the supply of plant, machinery and equipment imported or purchased locally for utilization of oil and gas businesses in downstream petroleum operations. In addition, VAT is not payable on supplies of exported goods and services, including oil and gas products.

The following transactions are placed on zero rate in line with the Value Added Tax Act 2007 (as amended):

- Non-oil export
- Goods and services purchased by diplomats
- Goods purchased for use in humanitarian donor projects

By virtue of the 2007 amendment to the VAT Act and guidelines, oil and gas companies are required to deduct VAT at source and remit the amount directly to the relevant VAT authority.

I. Other

Education tax

An education tax is assessed alongside the PPT or the income tax liability of a company. Education tax is assessed at 2% of the assessable profits of a company. For a company subject to tax under the PPTA, the education tax paid is an allowable deduction under Section 10 of the PPTA in arriving at the adjusted profits of the company for tax purposes.

Oil terminal dues

Subject to the provisions of the Terminal Dues Act and the Nigerian Ports Authority Act (the NPA Act), Section 1 of the Oil Terminal Dues Act stipulates that terminal dues may be levied on any ship evacuating oil at any oil terminal and in respect of any services or facilities provided under the Act. Under the Oil Terminals (Terminal Dues) Regulations, the amount payable as terminal dues is US$0.02 per barrel of oil loaded onto a ship.

Pursuant to the NPA Act, the Port Authority has the power to levy harbor dues on any ship. The harbor dues levied apply to all goods discharged or loaded within a harbor. The rate for a cargo of crude oil as specified under the NPA Act (Terminal Dues) Regulations is NGN0.1166 per ton.

Oil pipeline license fees

If a company seeks to construct and operate an oil pipeline for transportation of mineral oil or natural gas to any destination, it must obtain a license from the relevant authority. The application for, and the grant of, licenses attract separate fees under the Oil Pipelines Act. Annual fees, chargeable in accordance with the length of the pipelines, are also payable.

The application is made to the minister of petroleum resources through the Department of Petroleum Resources (the DPR). The fees are as follows:

Application for permit	NGN20 for submission
Grant of permit	NGN50
Application for license	NGN50 for submission of application
Grant of license	NGN200
Variation of permit	NGN50
Variation of license	NGN200
Annual fee on each license	NGN20 per mile of the length of the pipeline subject to a minimum of NGN200

It should be noted that a holder of a license is required to pay a fee of NGN100 upon submitting its application for an order restricting anyone from constructing any building or type of building or similar structures on lands adjoining pipelines. A maximum fee of NGN400 is payable upon the grant of this order.

State and local government rates

The Taxes and Levies (Approved List for Collection) Act 2004 sets out the various taxes and levies that may be collected by the three tiers of government in Nigeria. By virtue of the provisions of Section 10 of the PPTA, all these rates and levies are allowable as deductions in arriving at the adjusted profits of a company subject to tax under the PPTA. Some of the local taxes that may apply to oil and gas businesses are discussed below.

State government business registration fees

For a business located in an urban area, the maximum fee payable on registration is NGN10,000, while NGN5,000 is the maximum payable upon annual renewal of the registration. For a business located in a rural area, the maximum fees are NGN2,000 and NGN1,000 for initial registration and renewal, respectively.

Right of occupancy fees

Right of occupancy fees apply on lands in urban areas of a state. The rates vary from state to state.

Local government

Tenement rates

Tenement rates are rates chargeable on a building, payable by the occupier(s) of the building. The various state governments have enacted statutes under which tenement rates are imposed. The actual collection of the rates is done by the local authority for the area where the relevant building is situated. The tenement rate is usually assessed on the rental value of a building. In Lagos State, for example, the tenement rate is assessed at the rate of 10% of the rental value of a building.

Signboard and advertisement permit

The rate for a signboard and advertisement permit varies between different local governments.

Oil and Gas Export Processing Zone

Under the Oil and Gas Export Free Zone Act 2004, any approved enterprise established within Onne, the Oil and Gas Export Processing Zone, is exempted from all taxes, levies and rates imposed by the federal, state or local governments in Nigeria.

Service company taxation

Pursuant to the Companies Income Tax (Amendment) Act 2007, services companies are taxed at a rate of 30%, in addition to the 2% education tax assessed on the assessable profit of all Nigerian companies.

A deduction is available for capital allowances (CA) as follows:

	Table I: Initial allowances	Table II: Annual allowances	Rate %	Rate %
Building (industrial and non-industrial)	15	10		
Mining	95	0		
Plant: agricultural production	95	0		
Others	50	25		
Furniture and fittings	25	20		
Motor vehicles: public transportation	95	0		
Others	50	25		
Plantation equipment	95	0		
Housing estate	50	25		
Ranching and plantation	30	50		
Research and development	95	0		

The Petroleum Industry Bill

There is significant uncertainty as to when the Bill will be passed and what is going to be the content of the Act when passed into law.

Nigerian Oil and Gas Industry Content Act 2010 (NOGIC Act)

NOGIC Act was signed into law on 22 April 2010 and is effective from this date. The NOGIC Act is the legal framework and mechanism for the creation of an environment aimed at increasing indigenous capacity building. The implementation of the provisions is to be carried out by the Development and Monitoring Board. Every entity awarding a contract in the upstream sector of the Nigerian oil and gas industry should deduct and remit 1% to the National Content Development Fund. The 1% mandatory deduction is not applicable to contractual arrangements executed prior to 22 April 2010 and all ongoing projects that were awarded to contractors before the effective date of the Act (i.e., 22 April 2010). The 1% mandatory deduction applies to all contracts of any nature in the upstream sector and without any minimum limits.

IFRS conversion

The roadmap, which is in three phases, mandates publicly listed and significant public interest entities to prepare their financial statements based on IFRS by 1 January 2012 (i.e., full IFRS financial statements are required for accounting period to 31 December 2012). Other public interest entities are required to adopt IFRS for statutory purposes by 1 January 2013. The third phase requires small and medium-sized entities (SMEs) to adopt IFRS by 1 January 2014.

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A. At a glance

Royalties	None
Bonuses	None
Production sharing contracts (PSC)	None
Income tax rate	28%
Resource rent tax	50%
Capital allowances	O, E[145]
Investment incentives	L[146]

B. Fiscal regime

A company that is involved in extractive activities (i.e., upstream activities) within the geographic areas described in the Norwegian Petroleum Tax Act (PTA) Section 1 is subject to a marginal tax rate of 78% on its net operating profits (28% ordinary corporate tax and 50% special tax) derived from the extractive activities. The area covered, generally, is activities undertaken within Norwegian territorial borders or on the Norwegian continental shelf (NCS).

The tax basis for calculating taxes on extractive activities is essentially the same as for ordinary taxes except for the treatment of interest costs and uplift allowances.

	Oil and gas companies (offshore tax regime)	Other companies (onshore tax regime)
Ordinary tax	28%	28%
Special tax	50%	None
Total tax	78%	28%

145 *O, E: Offshore investments are depreciated over six years. An additional 30% uplift applies against the special tax for upstream activities*

146 *L: Losses from offshore activities may be carried forward indefinitely with interest*

Transportation and extractive activities (including related activities) performed outside the Norwegian territorial borders may be subject to Norwegian tax if the Norwegian authorities have secured the right to impose tax on these activities under international law or bilateral agreements.[147] In addition, support activities performed onshore (by oil and gas companies) are subject to the 78% tax rate.

The Norwegian petroleum tax system is based on the taxation of the entity rather than on specific assets and licenses. Therefore, there is no ring-fence between different licenses or fields on the NCS.

Income derived from offshore activities, in principle, may not be offset against losses incurred from onshore activities or vice versa. However, 50% of a company's onshore losses may be offset against income from offshore activities that are subject to the ordinary tax rate of 28%. Similarly, losses from offshore activities may be offset against income from onshore activities that are subject to the ordinary tax rate of 28%.

See Section C and D for an explanation of the treatment of both exploration costs and development costs.

See Section F for an explanation of the allocation of interest costs between the onshore and offshore activities.

Group relief

Norway does not have a "group relief regulation." However, under Section 10-4 of the General Tax Act (the GTA), if a company holds more than 90% of the shares in a subsidiary, each entity may contribute profits to the other company to offset losses incurred by the other company. With respect to oil and gas companies, such contributions are limited to distributions from onshore activities (e.g., an upstream company with onshore income, such as interest income or foreign exchange gains, may contribute this income to its 90% owned subsidiary to offset any losses from onshore activities incurred by that entity).

Norm price

A "norm price" or administratively determined price is used to calculate the taxable income derived from the sale of petroleum products (currently only crude oil and Propane from Karsto), regardless of the actual sales price obtained. If the sales price achieved is higher than the norm price, the additional amount is tax free. Correspondingly, if the price achieved is lower than the norm price, the seller is still taxed at the norm price. The norm price is published quarterly and is based on actual prices obtained, although the Norm Price Board sets the norm price for crude oil from each field or blend on a daily basis (changed from monthly to daily effective from Q4 2010).

C. Capital allowances

For taxable income subject to a total 78% tax, investments in production facilities, pipelines and installations (tangible assets) used in the extractive activity are depreciated over a six-year period beginning with the year of investment.

Additional allowances are permitted at a rate of 30% when calculating the special tax basis for the 50% tax rate (i.e., 7.5% each year over a four-year period). This means that 93% (i.e., 50% + 28% + (30% x 50%)) of offshore investments are eventually deductible.

Other investments and assets located onshore (e.g., buildings and office equipment) used in the extractive business are depreciated on a declining-balance method (from 2% to 30%) from when the assets are utilized; however, depreciation from such investments or assets are deductible in the offshore regime at the 78% tax rate.

147 *Cf. PTA Section 1.*

D. Incentives

Losses may be carried forward indefinitely for offshore activity. Interest on such losses is set by the Ministry of Finance annually; for 2011 the rate was 1.9%.

In addition, losses can be transferred in connection with the sale of the total activity, by a merger with another "upstream" company. The tax value of the losses can be refunded when the extractive activity on the NCS ceases. These rules apply for losses incurred effective from 1 January 2002 and for cessation of petroleum activity after 1 January 2005. Thus, a company subject to the offshore tax regime is guaranteed the full tax value of all costs incurred.

Effective from 1 January 2005, an upstream company may also be refunded the tax value of exploration expenses for each tax year loss, including direct and indirect expenses related to exploration activities on the NCS (except for financing costs). The refund is made on 22 December in the year following the tax year for which the expenses were incurred. For example, NOK100 million spent on exploration expenses in 2012 may result in a cash refund of NOK78 million on 22 December 2013.

The refund of exploration costs has opened up the opportunity for third parties to fund exploration activities. The claim on the state can also be pledged. In general, banks may typically be willing to fund 80% to 90% of the tax value of the exploration tax refund (i.e., 65% to 70% of the exploration cost basis).

E. Withholding taxes

Withholding tax (WHT) is not levied on distributions from offshore income. However, any onshore income part may be subject to a prorated dividend WHT, depending on where the parent company is located.

Dividend distributions from onshore activity are not subject to WHT if the shareholder is a company resident within the European Economic Area (EEA), the shareholder performs economic activity through an establishment in the EEA and Norway has entered into an agreement concerning the exchange of such information or the shareholder can provide such documentation from the tax authorities.

If the receiving company is situated outside the EU/EEA, WHT may be levied on dividend distributions pending further conditions.

F. Financing considerations

Thin capitalization

Effective from 1 January 2007, there are no thin capitalization rules. However, under Norwegian company law, a limited company must, as a general rule, have at least a 10% equity ratio to make dividend distributions.

If a company has entered into an internal funding agreement, the company may risk a discretionary deviation if the rates and terms agreed are not in compliance with the arm's-length principle (e.g., if the company exceeded its loan capacity compared with what it would have been able to obtain in the free market on a stand-alone basis).

Effective from 1 January 2007, only a portion of interest costs (and related foreign exchange) is deductible in the offshore tax regime. The remaining interest costs are subject to onshore taxation at the ordinary 28% tax rate.

The allocation of interest cost to the offshore district is calculated as follows:

$$\text{(Interest costs and related foreign exchange)} \times \frac{50\% \times \text{tax value offshore related assets per year-end}}{\text{Average interest-bearing debt}}$$

If the company has no investments or assets, all interest costs and related foreign exchange are allocated onshore. However, if the company has no other onshore income, the financial costs may be allocated back to the offshore regime for deduction against the 28% corporate tax rate (and it may be carried forward with interest).

The maximum amount of interest costs that are deductible in relation to an offshore activity is the company's total interest cost incurred.

G. Transactions

Asset disposals

In general, the disposal of assets is taxable or deductible at the 78% tax rate. Disposal of fixed assets offshore, such as platforms, will require a Section 10 approval.

Transfer of license interests

All transfers of production licenses (including farm-ins and farm-outs) require approval from the Ministry of Energy and Petroleum. The tax treatment must be approved by the Ministry of Finance; on 1 July 2009, a new administrative regulation was passed to simplify the Section 10 approval process. If the respective transaction is covered by the regulation, the approval from the Ministry of Finance is granted automatically.

If the transaction is not covered by the regulation, an application for a Section 10 ruling has to be submitted to the Ministry of Finance.

Section 10 rulings have been simplified compared with previous regulations. The standard conditions include:

- License sales are treated as nontaxable for the seller and as nondeductible for the buyer (after-tax basis)
- The buyer inherits the seller's basis for depreciation and uplift
- The carrying of costs is on a pretax basis
- All other costs or income (refunds) follow the normal rules

Reference is made here to the Section 10 guidelines issued by the Ministry of Finance on 1 July 2009, with subsequent updates.

From 1 January 2012, capital gains on the disposal of shares in Norwegian resident companies are exempt from taxation, provided that the owner is a Norwegian resident limited liability company (an AS or ASA).

H. Indirect taxes

VAT

Supplies of goods and services to drilling companies, license owners, and owners and lessees of platforms, rigs and specialized vessels for use in petroleum activities outside Norwegian territorial waters, are exempt from VAT. The exemption for supply of services applies regardless of whether the services are performed offshore or onshore, provided the services rendered are related to installations or equipment on these installations, for use in petroleum activities outside Norwegian territorial waters. There are certain documentation requirements to be maintained to comply with the rules.

Transportation between offshore facilities outside Norwegian territorial waters and onshore is also exempt from VAT.

From 1 January 2010, a new VAT Act came into force. According to the revised VAT Act, supplies of services "entirely for use outside Norwegian territorial waters" are now regarded as exports and consequently zero-rated or exempt from VAT. Before 2010, the export regulations were only applicable to supplies abroad and did not apply to supplies for use in the NCS. The export of goods to the NCS is also zero-rated or exempt from VAT, provided that the goods are exported directly by the supplier, and the supplier can prove the export.

Consequently, there is currently an overlap between the general export regulation and the special exemption for goods and services to be used in relation to petroleum activities on the NCS. Nevertheless, the special exemption, for goods and services used in relation to petroleum activities in the NCS, is wider and also includes intangible technical services, for instance computer services, relating to installations offshore. As a main rule, intangible services (services that can be delivered from a remote location) can only be zero-rated when a foreign company, not established in Norway, is the purchaser of the services.

Besides administrative changes regarding export and custom clearance, the revised VAT Act does not imply any material amendments for supplies of goods and services related to petroleum activities on the NCS. Imports to Norway from the NCS are liable to import VAT. However, this does not apply to, for example, import of petroleum products extracted on the NCS, platforms for use in petroleum activities offshore, and specialized ships for use in petroleum activities.

Environmental taxes

Upstream companies are subject to CO_2 tax, which is levied on gas consumed or flared on production installations offshore. The CO_2 tax for upstream companies is NOK0.49 effective from 1 January 2012.

A fee of NOK16.69 per kilogram per date is levied on NOx emissions for 2012. However, the Norwegian Oil Industry Association (the OLF) and several other industry associations reached an agreement with the Ministry of Environment in 2008 to establish a fund to reduce NOx emissions. Companies that endorsed the agreement were exempt from NOx tax for three years (i.e., 2008, 2009 and 2010); however, participating companies must commit to emission reductions, and a fee equal to approximately NOK11 per kilogram must be paid to the fund (a tax deduction of 78% is granted when the payment is made).

Subsequently, any contribution from the fund will be regarded as taxable income when the contribution is made. Investments made offshore in order to reduce the emissions will be subject to a six-year, straight-line deduction and uplift.

Based on the estimated costs to implement necessary measures, the shipping and fisheries sectors are expected to be the most cost-efficient sectors, where the greatest potential for reductions can be attained.

The Ministry of Environment and the industry associations agreed in 2010 to extend the NOx fund cooperation for seven years and further reduce the emissions by 16,000 tons by 2017. The new agreement for 2011–17 was approved by EFTA Surveillance Authority (ESA) on 19 May 2011.

Area fees

All production licenses are subject to an area fee that is paid after the initial exploration period has expired. The exploration period is normally four to six years. The annual area fee is increased from NOK30,000 per square meter in year one to a maximum of NOK120,000 per square meter in year three and thereafter. Special rules and exceptions apply for continued exploration activities beyond the initial period.

I. Other

Tax return and tax assessment

Companies involved in extractive activities must calculate and pay advanced tax. The first three installments are due on 1 August, 1 October and 1 December in the year of income. The remaining three installments are due on 1 February, 1 April and 1 June in the following year.

The tax return is due on 30 April in the year following the year of income.

A draft assessment from the Oil Taxation Office is available from mid-November, and the final assessment is published on 1 December. The taxpayer has three weeks from 1 December to file a complaint with the appeals board.

The tax exploration refund is made on 22 December following the year of income.

Transfer pricing reporting and documentation requirements

The Norwegian tax authorities have increased their focus on intragroup transactions and transfer pricing-related topics with the recent introduction of transfer pricing reporting and documentation obligations. Any legal entity that is obliged to file a tax return in Norway, and has transactions with related parties, is covered by the reporting and documentation requirements.

A company involved in extractive activities and subject to the PTA is only exempt from the reporting obligation (and subsequently the transfer pricing documentation obligation) provided that the total transactions are less than NOK10 million during the year and less than NOK25 million in receivables or debts at the end of the year (real values are based on arm's-length principles).

These reporting obligations entered into force on 1 January 2007 and require a standard form to be filed with the tax return on 30 April 2012. The purpose of the reporting form is to give the tax authorities an overview of the extent and nature of the taxpayer's intragroup transactions.

Effective from 1 January 2009, the tax authorities can request documentation to demonstrate that intragroup transactions are in compliance with the arm's-length principle as outlined in the OECD guidelines. The deadline for this documentation is 45 days from the date of the request. Norwegian authorities tend to have an aggressive approach when reviewing these reports. Even if the Norwegian documentation requirements are based on the OECD guidelines, the interpretation and implementation requirements may differ slightly from other countries' practices.

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A. At a glance

Fiscal regime

The fiscal regime that applies in Oman to the oil and gas exploration and production industry sector consists of corporate income tax (CIT) in accordance with the production sharing contract (PSC) arrangement.

Royalties	Not applicable
Bonuses	Applicable for PSC contracts only
PSC	Concession agreement on profit oil after allocating cost oil
Income tax rate	CIT rate is 55% (see Section B)
Resource rent tax	Not applicable
Capital allowances	Specific depreciation rates for specific types of assets, not applicable for PSC
Investment incentives	Dependent on the concession agreement

B. Fiscal regime

Corporate income tax

Oil and gas exploration and production companies are taxed at the rate of 55% on their taxable income. Taxable income is determined in accordance with the concession agreement to which the PSC applied. PSC arrangements generally involve the following elements:

- Expenditures for exploration, production and related activities are fully funded by the company (concession holder) (i.e., the Government does not fund any activity).
- The Government shares in production.
- Production sharing depends on production for the period valued at prices determined by the Government.
- From the production for the period, cost oil is first determined. Depending on the PSC, there may be a cap on the recovery of cost oil as a percentage of the total production for a given year. However, if the cost oil required to recover costs fully is less than the maximum cap allowed, cost oil is allocated only to the extent required for cost recovery. The remaining cost, not recovered, is carried forward for future recovery (no time limit is set under PSCs for carryforward of costs for future recovery). The remaining oil (i.e., after allocating cost oil) is profit oil. It is shared between the company and the Government in accordance with the sharing percentage agreed in the concession agreement. The Government generally takes a major share of the profit oil.

- The PSC does not involve royalty payments.
- The following payments may be made to the Government depending on the terms agreed in the concession agreement:
  - Annual rental payments
  - Signature bonus upon signing of agreement
  - A renewal bonus upon renewal of agreement
  - A one-time discovery bonus upon declaration of the first commercial discovery of oil or gas
  - A one-time anniversary bonus after the first anniversary of commercial production
- Expenditures qualifying for cost recovery. Generally, the PSC requires that costs and expenses of activities carried out by the company or its affiliates are to be included in recoverable costs only to the extent that such costs and expenses are directly or indirectly identifiable with such activities, and should be limited to the actual costs that are fair and reasonable. Certain costs are specifically prohibited for cost recovery. Excluded costs are bonus and rental payments made by the company to the Government in accordance with the PSC, the company's Omani income taxes paid in accordance with the PSC, foreign income taxes or other foreign taxes paid by the company, etc.
- A tax rate of 55% applies to taxable income, which is computed in accordance with the formula set out in the PSC. Taxable income is arrived at by applying the following formula:
  TI = NI + (55% x TI)
  TI = Taxable income
  NI = Net income determined as the market value of oil or gas lifted by the company, less recoverable costs
- The Government settles the company's tax liability from the Government's share of production. This implies that the company does not physically settle any taxes. The share of profit oil by the company is considered net of taxes. However, the tax authorities issue a tax receipt and a tax certificate for the taxes that apply to the company.

Service contracts

Effective from 1 January 2010, service contracts are taxed at 12%.

Resource rent tax

Resource rent tax does not currently apply in Oman.

Bonuses

Bonuses apply to PSCs only, as explained above. Otherwise, bonuses do not apply.

Royalty regimes

Royalty regimes do not currently apply in Oman.

C. Capital allowances

The tax law provides specific depreciation rates for specified types of assets; for example: pipelines 10%, vehicles and heavy equipment 33.33%. However, capital allowances do not apply in respect of PSCs because the entire capital expenditure qualifies as recoverable cost in accordance with the concession agreement.

D. Investment incentives

All incentives, such as tax holidays and R&D uplift, are dependent on the concession agreement.

Losses may be carried forward for five years but may not be carried back. Net losses incurred by companies benefiting from tax holidays may be carried forward without any time limit under certain circumstances. Loss carryforwards do not apply to PSCs because the entire cost is carried forward for future recovery.

E. Withholding tax and double tax treaties

The following payments made to foreign persons not having permanent establishments in Oman are subject to a final withholding tax (WHT) at the rate of 10%:

- Royalties
- Consideration for R&D
- Consideration for use or right to use computer software
- Management fees

WHT is also applicable where a foreign company has a permanent establishment but the permanent establishment does not account for income that is subject to WHT.

The tax is final, and foreign companies have no filing or other obligations in this regard.

The term "royalty" is defined to include payments for the use or right to use software, intellectual property rights, patents, trademarks, drawings, equipment rentals and consideration for information concerning industrial, commercial or scientific experience and concessions involving minerals.

WHT is not imposed on dividends or interests. The 10% WHT on royalties under Omani domestic law applies to royalties paid to companies resident in the other treaty countries. Under the France and Mauritius treaties, no WHT is imposed on royalties paid to a company resident in those countries, subject to the satisfaction of certain conditions.

Oman has entered into double tax treaties with Algeria, Belarus, Belgium, Brunei, Canada, China, France, India, Italy, Lebanon, Mauritius, Moldova, Netherlands, Pakistan, Seychelles, Singapore, South Africa, South Korea, Sudan, Syria, Thailand, Tunisia, Turkey, United Kingdom, Uzbekistan, Vietnam and Yemen. Oman has signed double tax treaties with Croatia, Egypt, Iran, Morocco, Russian Federation but these treaties are not yet in force. The double tax treaties with Bangladesh, Germany, Kazakhstan and Malta have not yet been ratified.

F. Financing considerations

Thin capitalization

The following deductions will be subject to executive regulations to be issued shortly:

- Interest paid to a sole proprietor or another person controlled by a sole proprietor
- Interest payable by an Omani company (other than banks and insurance companies)
- Interest paid by a PE to a head office or controlled entity
- Head office overheads

The thin capitalization rules are subject to the executive regulations to be issued.

In addition, individual PSCs may contain rules regarding deductibility of interest cost.

G. Transactions

An expenditure that qualifies for cost recovery (opex and capex) is explained in Section B. Other major transactions are explained below.

Asset disposals

Under the PSC, if the assets that qualify for cost recovery are sold, the proceeds are remitted to the Government (i.e., they are considered to be the Government's assets). A balancing charge or allowance does not apply, as explained in Section C.

Relinquishment

Generally, a PSC requires a specified percentage of the stake held by a company to be relinquished from time to time. For example, the PSC may state that the company should relinquish from time to time its stake in the contract to retain no more than 50% of the original contract area by a certain date. A PSC also allows a company to relinquish all or any part of the contract area at any time, as long as the company fulfills its obligation under the contract.

H. Indirect tax

Customs duty is the only indirect tax imposed in Oman.

Customs duty

The Government of the Sultanate of Oman, as a member of the Gulf Cooperation Council (GCC), follows the Unified Customs Act across the GCC; the uniform customs duty of 5% applies on all imports. This means that any goods that come into a port of entry of a GCC member state that have been subjected to customs duty in that state are not subjected to customs duty again if the goods are transferred to another GCC member state.

An exemption or reimbursement of customs duty will depend on the wording of the PSC.

In late 2005, Oman entered into a free trade agreement (FTA) with the US. The FTA is effective from 1 January 2009.

The GCC countries have entered into a FTA with Singapore, but this agreement has not yet been ratified by the Government of Oman.

VAT

Currently, there is no VAT in Oman.

Registration fees

Registration fees are payable to various ministries.

Municipality and other taxes

Oman does not impose estate tax, gift tax or dividends tax. Municipalities may impose certain consumption taxes, including tax on the income categories outlined below:

- Hotel and restaurant bills 5%
- Hotels, motels and tourism restaurants 4%
- Tax at a rate of 2% on electricity bills exceeding OMR50 per month
- Tax at a rate of 3% on lease agreements, payable by landlords

In addition, a border toll is levied on all vehicles that cross the Oman border at any points of entry.

I. Other

Payroll taxes and employee benefits

The Social Security Law (Royal Decree No. 72 of 1991) introduced a system of social security to insure employees against old age, disability, death and occupational injuries and diseases. The law currently applies exclusively to Omanis working in the private sector. Under the law, private sector employers must make monthly contributions to the Public Authority for Social Insurance at a rate of 10.5% of each Omani employee's monthly wage. Employees contribute at a rate of 6.5% of their monthly wages. Employers contribute an additional 1% of each Omani employee's monthly wage as security against occupational injuries and diseases. The Government contributes 2% of each Omani employee's monthly wage. The Public Authority for Social Insurance invests all funds received, and it pays out sums due to employees upon their retirement and as compensation for injuries and diseases.

In accordance with the Labor Law (Royal Decree No. 35 of 2003), employers must pay an end-of-service benefit (ESB) to their foreign employees. The ESB is calculated on an employee's final wage and paid according to the following guidelines:

- For the first three years of service, an equivalent of 15 days' basic pay for each year worked
- For each subsequent year, an equivalent of one month's basic pay

Special requirements for foreign nationals

An employer must make an annual contribution of OMR100 toward the vocational training levy for each non-Omani employee.

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A. At a glance

Fiscal regime

The fiscal regime that applies to the petroleum industry in Pakistan consists of a combination of corporate income tax (CIT), a windfall levy and royalty in respect of the exploration license.

Royalties	12.5%
Bonuses	Varied amounts, linked with the level of commercial production
Production sharing contract (PSC)	Product sharing applies only to offshore operations, on a sliding scale basis
Income tax rate	40% as envisaged under the Petroleum Exploration & Production Policy 2009
Capital allowances	Accelerated depreciation

B. Fiscal regime

Petroleum exploration and production (E&P) activities in Pakistan may be undertaken in accordance with two different types of agreements:

1. For onshore operations, a system based upon a petroleum concession agreement (PCA)
2. For offshore operations, a system based upon a production sharing agreement (PSA)

Corporate tax

In accordance with the Petroleum Exploration & Production Policy 2009, the rate of corporate tax is 40% of the amount of profits or gains from all new PCAs and PSAs.

The Income Tax Ordinance 2001 (the Ordinance) is the governing income tax legislation. Part I of the Fifth Schedule to the Ordinance deals with the computation of the profits and gains or income from petroleum E&P activities in Pakistan. The Fifth Schedule provides that all expenses incurred after commencement of commercial production, that are not capital or personal in nature, are deductible provided they are incurred "wholly and exclusively" for the purpose of petroleum E&P activities. However, certain expenses, such as royalty payments and depreciation, are deducted based on specific provisions of the Ordinance.

In accordance with the provisions of the Fifth Schedule to the Ordinance, there is no concept of ring-fencing for corporate tax calculations.

Dry hole

Any expenditure for searching, exploring and inquiring that results in a "dry hole" is treated as a loss on its completion or a surrender of the area back to the Government. As may be opted for by the working interest owner in the PCA or PSA, this loss is adjusted in either of the following ways:

- The loss in any year is set off against the income of that year chargeable under the heading "income from business" or any income chargeable under any other heading of income (other than income from dividends). Excess losses are carried forward for no more then six years from the year incurred.
- The loss in any year is offset against the income of such undertaking in the tax year in which commercial production commenced. Where the loss cannot be wholly offset against the income of such undertaking in that year, the excess is carried forward for no more than 10 years.

Offshore operations

In respect of offshore operations, the cost limit is 85%, including the royalty of 12.5%. The contractor can recover 100% of the cost from up to a maximum of 85% of the gross revenues.

A sliding scale PSA is used for offshore operations instead of direct government participation. The agreement is generally executed by the contractor with a government-owned entity, which is also granted the exploration license and the development and production lease. The contractor, therefore, initially receives the oil and gas profit shares and is responsible for managing the PSAs.

The profit split is established on the basis of a sliding scale for shallow, deep and ultra-deep grids. The sliding scale is based on the cumulative production, permitting a rapid recovery of investments and a higher net present value. The profit split is set out below:

1. Profit oil and gas share for wells in shallow grid areas of less than 200 meters water depth, with a depth to reservoir shallower than 4,000 meters:

Cumulative available oil or available gas from contract area	Government holdings share of profit oil or profit gas in contract area		Contractor share of profit oil or profit gas in contract area	
Million barrels of oil equivalent MMBOE	Crude oil, LPG or condensate	Natural gas	Crude oil, LPG or condensate	Natural gas
0 – 100	20%	10%	80%	90%
> 100 – 200	25%	15%	75%	85%
> 200 – 400	40%	35%	60%	65%
> 400 – 800	60%	50%	40%	50%
> 800 – 1,200	70%	70%	30%	30%
> 1,200	80%	80%	20%	20%

2. Profit oil and gas share for wells in deep grid areas of more than or equal to 200 meters and less than 1,000 meters water depth, or deeper than 4,000 meters to the reservoir in the shallow grid area:

Cumulative available oil or available gas from contract area	Government holdings share of profit oil or profit gas in contract area		Contractor share of profit oil or profit gas in contract area	
MMBOE	Crude oil, LPG or condensate	Natural gas	Crude oil, LPG or condensate	Natural gas
0 – 200	5%	5%	95%	95%
> 200 – 400	10%	10%	90%	90%

Cumulative available oil or available gas from contract area	Government holdings share of profit oil or profit gas in contract area		Contractor share of profit oil or profit gas in contract area	
MMBOE	Crude oil, LPG or condensate	Natural gas	Crude oil, LPG or condensate	Natural gas
> 400 – 800	25%	25%	75%	75%
> 800 – 1,200	35%	35%	65%	65%
> 1,200 – 2,400	50%	50%	50%	50%
> 2,400	70%	70%	30%	30%

3. Profit oil and gas share for wells in ultra-deep grid areas of more than or equal to 1,000 meters water depth:

Cumulative available oil or available gas from contract area	Government holdings share of profit oil or profit gas in contract area		Contractor share of profit oil or profit gas in contract area	
MMBOE	Crude oil, LPG or condensate	Natural gas	Crude oil, LPG or condensate	Natural gas
0 – 300	5%	5%	95%	95%
> 300 – 600	10%	10%	90%	90%
> 600 – 1,200	25%	25%	75%	75%
> 1,200 – 2,400	35%	35%	65%	65%
> 2,400 – 3,600	45%	45%	55%	55%
> 3,600	60%	60%	40%	40%

Windfall levy

A windfall levy also applies to onshore concessions. The windfall levy on oil (WLO) applies to crude oil and condensate from an onshore concession using the following formula:

$$\mathbf{WLO = 0.5 \times (M - R) \times (P - B)}$$

WLO = windfall levy on crude oil and condensate

M = net production

R = royalty

P = market price of crude oil and condensate

B = base price:

- The base price for crude oil and condensate is US$30 per barrel.
- This base price increases each calendar year by US$0.25 per barrel starting from the date of first commercial production in the contract area.

WLO applies to crude oil and condensate from an offshore PSA, using the following formula:

$$\mathbf{WLO = 0.5 \times (P - R) \times SCO}$$

WLO = windfall levy on share of crude oil and condensate

P = market price of crude oil and condensate

SCO = share of crude oil and condensate allocated to a contractor

R = base price:

- The base price for crude oil and condensate is US$30 per barrel.
- This base price increases each calendar year by US$0.25 per barrel starting from the date of first commercial production in the contract area.

For the sale of natural gas to parties other than the Government, a windfall levy on gas (WLG) applies to the difference between the applicable zone price and the third-party sale price using the following formula:

WLG = 0.5 x (PG – BR) x V

WLG = windfall levy on share of natural gas

PG = third-party sale price of natural gas

BR = base price

V = volume of gas sold to third party excluding royalty

The base price is the applicable zone price for sale to the Government. If the third-party sale price of gas is less than or equal to the base price, the WLG is zero.

The windfall levy does not apply to sales of natural gas made to the Government.

Royalty regimes

A royalty is payable in respect of onshore operations at the rate of 12.5% of the value of the petroleum at the field gate. At the option of the Government, the royalty must be paid in cash or in kind on liquid and gaseous hydrocarbons (such as LPG, NGL, solvent oil, gasoline and others), as well as on all substances, including sulfur, produced in association with such hydrocarbons. The lease rent paid during the year is not deductible from the royalty payment. A royalty is treated as an expense for the purpose of determining the income tax liability.

The following royalty schedule applies to offshore operations:

- The first 48 calendar months after commencement of commercial production – no royalty
- Months 49 to 60 inclusive – 5% of field gate price
- Calendar months 61 to 72 inclusive – 10% of field gate price
- Calendar months 73 onward – 12.5% of field gate price

Similar to onshore operations, at the option of the Government, the royalty is payable either in cash or in kind on liquid and gaseous hydrocarbons (such as LPG, NGL, solvent oil, gasoline and others), as well as for all substances, including sulfur produced in association with such hydrocarbons. The lease rent paid during the year is not deductible from the royalty payment. Royalties are treated as an expense for the purpose of determining the income tax liability.

For the purpose of calculating the amount due by way of royalty, the value of the petroleum produced and saved must be determined by using the actual selling price in the following manner:

1. If the petroleum is sold in the national market, the actual selling price means the price determined in accordance with the relevant sale and purchase agreement between the petroleum right holder and the Government or its designee, less allowed transportation costs beyond the delivery point
2. In all other cases, the actual selling price means the greater of:
   a. The price at which the petroleum is sold or otherwise disposed of, less allowable transportation costs
   b. The fair market price received through arm's-length sales of the petroleum less the allowed transportation costs
   c. The price applicable to the sales made under sub-rule 2. (a) above

C. Capital allowances

The following depreciation rates apply for onshore operations:

- On successful exploration and development wells – 10% on a straight-line basis
- On dry holes (exploratory wells) – expensed immediately upon commencement of commercial production or relinquishment, whichever is earlier
- Below-ground installation – 100% upon commencement of commercial production or relinquishment, whichever is earlier
- Initial allowance in respect of eligible depreciable assets in the year of use or commencement of commercial production, whichever is later – 50% of cost

- First-year allowance in respect of eligible plant, machinery and equipment installed in a specified rural and underdeveloped area – 90% of cost
- Normal depreciation rate on plant and machinery – 15% using the diminishing-balance method

Carryforward of unabsorbed depreciation for a maximum period of six years. If a depreciable asset is completely used and not physically available at the time of commencement of commercial production and it relates to a dry hole, it becomes a lost expenditure and it can be amortized on a straight-line basis over a period of 10 years after the commencement of commercial production (see the treatment of a lost expenditure for "dry hole" above). In these circumstances, the entire cost of the asset is amortized as part of the lost expenditure and not as depreciation

The following depreciation rates apply to offshore operations:

- On successful exploration and development wells – 25% on a straight-line basis
- On dry holes (exploratory wells) – expensed immediately upon commencement of commercial production or relinquishment, whichever is earlier
- Noncommercial well (exploration wells) – expensed upon relinquishment of license
- On facilities and offshore platforms – 20% using the declining-balance method
- Below-ground installation – 100% upon commencement of commercial production or relinquishment, whichever is earlier
- Initial allowance in respect of eligible depreciable assets in the year of use or commencement of commercial production, whichever is later – 50% of cost
- Normal depreciation rate on plant and machinery – 15% using the diminishing-balance basis
- Carryforward of any unabsorbed depreciation in respect of plant and machinery is permitted until the depreciation is fully absorbed

A depletion allowance, after commencement of commercial production, is allowed at the lesser of:

- 15% of the gross receipts representing wellhead value of the production
- 50% of profits of such undertaking before depletion allowance

From tax year 2010 onward, decommissioning cost is allowed on the following basis, subject to a certification by a chartered accountant or a cost accountant:

Where commercial production has not commenced–with effect from tax year 2010, decommissioning cost is allowed over the lower of the following term:

a. 10 years

Or

b. The remaining life of the development and production of mining lease

Such cost is permitted to be claimed starting from the year of commencement of commercial production.

Where commercial production commenced prior to 1 July 2010–reduction for decommissioning cost shall be allowed from the tax year 2010 over the lower period of:

a. 10 years

Or

b. The remaining life of the development and production or mining lease

D. Incentives

In accordance with the Petroleum Exploration & Production Policy 2009, prequalified E&P companies incorporated in Pakistan that pay dividends and receive payments for petroleum sold in Pakistan rupees (PKR) are entitled to the following incentives:

- E&P companies are encouraged to operate exploration blocks with 100% ownership.

- In case of joint ventures with foreign E&P companies, local E&P companies have a working interest of 15% in Zone I, 20% in Zone II and 25% in Zone III on a full-participation basis (required minimum Pakistani working interest). Local E&P companies must contribute their share of exploration expenditures (denominated in PKR) up to the required minimum Pakistani working interest.
- On a case-by-case basis, during the exploration phase, local E&P companies are entitled to receive foreign exchange against payment in Pakistani currency to meet their day-to-day obligations under permits, licenses and PCAs or PSAs. After commercial discovery, local E&P companies are paid up to 30% of their sale proceeds in foreign currency to meet their day-to-day operational requirements. For project financing after commercial discovery, local E&P companies are required to make their own foreign exchange arrangements, except for companies in which the Government holds a majority shareholding.

Further, the Schedule to the Regulation of Mines and Oilfields and Mineral Development (Government Control) (Amendment) Act 1976 (the Act) provides the following concessions to an undertaking engaged in exploration or extraction of mineral deposits. Please note that the concession noted below are applicable to petroleum operations:

- There is the concept of "freezing of law" in respect of mining operations. The effect is that any provisions of the mining rules or amendment in the Ordinance, made after the effective date of an agreement for the grant of a license or a lease to explore, prospect or mine petroleum, that are inconsistent with the terms of the agreement, do not apply to a company that is a party to the agreement, to the extent that they are incompatible with the agreement.
- Before commencement of commercial production of petroleum, any expenditure on searching for, or on discovering and testing a petroleum deposit, or on winning access to the deposit that is allowable to a surrendered area and to the drilling of a dry hole, is deemed to be lost at the time of the surrender of the area or the completion of the dry hole for the purpose of the Second Schedule to the Act. A lost expenditure is allowable in one of the two ways mentioned in Section B under the heading "dry hole."
- The income derived by the licensee or lessee from the use of, and surplus capacity of, its pipeline by any other licensee or lessee is assessed on the same basis as income from petroleum it produced from its concession area.
- A licensee or lessee company incorporated outside Pakistan, or its assignee, is allowed to export its share of petroleum after meeting the agreed portion of the internal requirement for Pakistan.
- Sale proceeds of the share of petroleum exported by a licensee or lessee incorporated outside Pakistan, or its assignee, may be retained abroad and may be used freely by it, subject to the condition that it shall bring back the portion of the proceeds that is required to meet its obligation under the lease.
- No customs duty or sales tax is levied on the import of machinery and equipment specified in the PCA or PSA for purposes of exploration and drilling prior to commercial discovery.
- A concessionary, ad valorem customs duty rate of 5% or 10% applies on import of specific plant, machinery and equipment by E&P companies, and their contractors and subcontractors, on fulfillment of specified conditions. Such plant, machinery and equipment are exempt from sales tax and Federal Excise duty.
- Foreign nationals employed by a licensee, a lessee or their contractor may import commissary goods free of customs duty and sales tax to the extent of US$550 per annum, subject to the condition that the goods are not sold or otherwise disposed of in Pakistan.

- Foreign nationals employed by a licensee, a lessee or their contractor may import used and bona fide personal and household effects, excluding motor vehicles, free of customs duty and sales tax, subject to the condition that the goods are not sold or otherwise disposed of in Pakistan.

All data in respect of areas surrendered by a previous licensee or lessee must be made available for inspection to a prospective licensee free of charge.

Initial participation by the Federal Government in exploration is to the extent as may be agreed upon between the Federal Government and the licensee.

E. Withholding taxes

Dividends

The general rate of withholding tax (WHT) on payment of a dividend is 10% of the gross amount of the payment. The tax withheld constitutes a full and final discharge of the tax liability of the recipient shareholder if the shareholder is an individual or an association of persons. For corporate taxpayers, the tax deducted constitutes an advance tax and is adjustable against the eventual tax liability for the relevant tax year, which is 10% of the gross dividend.

Interest

The general rate of WHT on interest is 10% of the gross amount of interest if the recipient is a resident of Pakistan. The tax withheld constitutes the full and final discharge of the tax liability of the recipient if the recipient is a resident individual or an association of persons. For corporate tax payers, such tax withheld constitutes an advance tax and is adjustable against the eventual tax liability of the company for the year. If interest is paid to nonresidents not having a permanent establishment in Pakistan, the rate of withholding is 10% of the gross amount. The tax withheld constitutes an advance tax for the recipient lender and is adjustable against the eventual tax liability of the nonresident recipient.

Royalties and technical services

Receipts in respect of royalties and technical services, that are not attributable to the permanent establishment in Pakistan of a nonresident person, are subject to WHT at the rate of 15% of the gross amount of the payment. The tax withheld constitutes the full and final discharge of the tax liability of the recipient.

Nonresident contractors

Payments made to nonresident contractors for construction, assembly or installation projects in Pakistan, including services rendered in relation to such projects, are subject to WHT at the rate of 6% of the gross amount of the payment. The tax withheld constitutes the full and final discharge of the tax liability of the nonresident contractor, provided it opts for this treatment by filing a written declaration to that effect with the taxation authorities in Pakistan within three months of the commencement of the contract. If the option is not exercised, the net profit is taxable at the 35% corporate rate of tax.

F. Financing considerations

Thin capitalization rules

The income tax law has a thin capitalization rule, whereby if a foreign-controlled resident company or a branch of a foreign company operating in Pakistan, other than a financial institution, has a foreign debt-to-foreign-equity ratio in excess of 3:1 at any time during a tax year, the deductibility of interest as a business expense is capped. Interest on debt paid by a company in that year is not a permissible deduction to the extent it exceeds the 3:1 ratio. In other words, only the interest expense arising from the loans that meet the debt-to-equity ratio requirement may be deducted.

For purposes of the thin capitalization rule, foreign debt includes any amount owed to a foreign controller or nonresident associate of the foreign controller for which profit on the debt is payable and deductible for the foreign-controlled resident company and is not taxed under this Ordinance, or is taxable at a rate less than the corporate rate of tax applicable on the assessment to the foreign controller or associate.

Interest guaranteeing

Interest guaranteeing is not applicable in Pakistan.

PSC expenditure recovery exclusions for financing costs

Whereas cost push-down is not permitted by the head office to the local branch, all expenses, including head office expenses, incurred wholly and exclusively to earn the income, are allowable for tax purposes.

G. Transactions

The working interest owner is not permitted to sell, assign, transfer, convey or otherwise dispose of all or any part of its rights and obligations under a license, lease or an agreement with a third party or any of its affiliates without the prior written consent of the regulatory authorities. This permission, however, is generally not withheld.

The transfer of any interest or right to explore or exploit natural resources in Pakistan constitutes a disposal for tax purposes. The amount of gain arising on the disposal of a right is computed as the difference between the consideration received for the transfer and the cost related to the rights. Consideration is explicitly provided to be the higher of the amount received or the fair market value.

The amount of the gain is taxable at the rate of the tax applicable for the relevant tax year.

The Ordinance explicitly provides that the amount of gain arising from alienation of any share in a company, the assets of which consist wholly or mainly, directly or indirectly of property or a right to explore or exploit natural resources in Pakistan, constitutes Pakistan-sourced income of the transferor. The amount of the gain is computed as the difference between the consideration received and the cost of the asset. If the consideration received is less than the fair market value, the fair market value is deemed to be the consideration for tax purposes. If the shares have been held for a period of more than one year, only 75% of the gain is taxable at the rate of the tax applicable for the relevant tax year.

H. Indirect taxes

Sales tax

VAT is called sales tax in Pakistan and is governed under the Sales Tax Act 1990 (the Sales Tax Act). All supplies made in the course of any taxable activity and all goods imported into Pakistan are subject to sales tax (except those listed in Schedule 6 of the Sales Tax Act).

Certain services have also been brought within the ambit of sales tax effective from 1 July 2000, including services supplied by hotels, clubs and caterers; customs agents, ship chandlers and stevedores; courier services; and advertisements on television and radio (excluding advertisements sponsored by the Government, its agencies and non-government organizations, with certain prescribed social causes).

In addition, the Federal Excise duty is levied and collected through sales tax on certain excisable goods and services, including edible oil, vegetable ghee and cooking oil; advertisements on closed circuit and cable television networks; carriage of goods by air, services provided or rendered in respect of air travel by passengers within the territorial limits of Pakistan; services rendered by shipping agents; and services rendered by persons engaged in telecommunications work in respect of telephone, telegraph, telex, telefax and similar services (exclusions apply).

The general rate of sales tax is 16% of the value of the supplies made or the goods imported. However, for goods specified in Schedule 3 of the Sales Tax Act, sales tax is charged on supplies at the rate of 16% of the retail price. In addition, certain goods attract higher sales tax rates of 18.5% and 21%.

Goods exported from Pakistan, goods specified in Schedule 5 of the Sales Tax Act and some specified goods are subject to a zero rate of GST. Supply and import of plant, machinery and equipment are zero-rated, with certain exceptions.

Goods specified in Schedule 6 of the Sales Tax Act (and any other goods the Federal Government may specify by a notification in the *Official Gazette*) are exempt from sales tax.

E&P companies are required to be registered under the Sales Tax Act because the supply of E&P products attracts sales tax.

A registered entity may recover input tax paid on imports and the purchase of taxable goods or services acquired in respect of making taxable supplies. Input tax is generally recovered by being offset against the sales tax payable on the taxable supplies.

Import duties

The Customs Act 1969 (the Customs Act) governs the taxes that apply on the import or export of dutiable goods. Section 18 of the Customs Act provides that customs duties are levied at such rates as prescribed in Schedules 1 and 2 (or under any other law in force at the time) on:

- Goods imported into or exported from Pakistan
- Goods brought from any foreign country to any customs station and, without payment of duty there, shipped or transported, or then carried to, and imported at, any other customs station
- Goods brought in bond from one customs station to another

Generally, the rate of customs duty applied to the customs value of imported goods ranges from 5% to 35%; the rate depends on several factors, including the type of commodity, the constituent material and the country of origin.

Customs duty on the import of plant, machinery, equipment and other accessories made by E&P companies, their contractors, subcontractors and service companies is governed by SRO.678(1)/2004 dated 7 August 2004 (SRO) and issued under Section 19 of the Customs Act.

The SRO provides two exemptions from customs duty:

- All machinery, equipment, materials, specialized vehicles or vessels, pickups (four-wheel drive), helicopters, aircraft, accessories, spares, chemicals and consumables not manufactured locally that are imported by E&P companies, their contractors, subcontractors or service companies in excess of 5% by value
- The goods mentioned above that are manufactured locally and imported by E&P companies, their contractors, subcontractors or service companies and other petroleum and public sector companies in excess of 10% by value

These customs duty concessions are available exclusively for E&P companies that hold permits, licenses, leases, PSCs or PSAs and that enter into supplemental agreements with the Government. Moreover, the exemption under the SRO is available in respect of the specified goods subject to satisfying conditions specified in the notification.

Items imported at concessionary rates of duty that become surplus, scrap, junk, obsolete or are otherwise disposed of or transferred to another E&P company are also exempt (upon notification of the sales tax department). However, if these items are sold through a public tender, duties are recovered at the rate of 10% on the value of the sale proceeds.

Federal Excise duty

Excise duty is a single-stage duty levied at varied rates on specified goods produced or manufactured in Pakistan, imported into Pakistan, produced or manufactured in non-tariff areas and brought to tariff areas for sale or consumption, and specified services provided or rendered in Pakistan. Table of Schedule 1 of the Federal Excise Act 2005 identifies goods subject to excise duty, including cement, various oils, fuels and lubricants, LPG and other liquefied petroleum gases and petroleum bitumen. The current rates of excise duty on oil- and gas-related products are listed on the following page.

In addition to the normal excise duty, a special excise duty is levied at the rate of 1% of the value of the goods. However, certain goods and certain classes of persons have been excluded from duty, including petroleum oils and oils obtained from bituminous minerals, crude, petroleum oil and lubricant products, natural gas and LPG.

Stamp duty

Under the Stamp Act 1899, stamp duty is paid on instruments. It is a provincial or state levy and its application varies from province to province. The rates of stamp duty also vary from instrument to instrument. The term "instrument" means a written deed, will or other formal legal document for transfer of property.

I. Other

Rental payment

In respect of an onshore concession, all holders of exploration licenses are required to pay an advance rental charge at the following rates:

- PKR3,500 per square kilometer or part thereof in respect of the five years of the initial term of the license
- PKR800 per square kilometer or part thereof in respect of each year of the initial term of the license
- PKR5,000 per square kilometer or part thereof in respect of each renewal of the license
- PKR2,750 per square kilometer or part thereof in respect of each year of the renewal of the license

For onshore operations, during the lease period, the following annual advance rental charges apply:

- PKR7,500 per square kilometer or part thereof covering the lease area during the initial lease period
- PKR10,000 per square kilometer or part thereof covering the lease area during the renewal period of a lease and further lease term extension

Contractors engaged in offshore operations are required to pay an advance annual acreage rental for the area covered under the PSA of US$50,000, plus a further rate of US$10 per square kilometer or part thereof every year.

Rental expenses are allowable deductions for payers.

Production bonuses

A production bonus is payable for onshore operations on a contract area basis as follows:

Cumulative production (MMBOE)	Amount (US$)
At start of commercial production	0.6 million
30	1.2 million
60	2 million
80	5 million
100	7 million

In respect of offshore operations, a production bonus is payable as per the table below.

Cumulative production (MMBOE)	Amount (US$)
At start of commercial production	0.6 million
60	1.2 million
120	2 million
160	5 million
200	7 million

Domestic supply obligation

Subject to the considerations of internal requirements and national emergencies, E&P companies are allowed to export their share of crude oil and condensate as well as their share of gas based on export licenses granted by the regulator. For the purpose of obtaining an export license for gas, the export volume is determined in accordance with the "L15" concept, provided a fair market value is realized for the gas at the export point. Under the L15 concept, the gas reserves that exceed the net proven gas reserves in Pakistan (including the firm import commitments vis-à-vis the projected gas demand for the next 15 years) can be considered for export. Once gas has been dedicated for export, any export licenses for agreed volumes cannot be subsequently revoked.

The following is the appendix to Schedule 1 of the Customs Act (extract) Table I (excisable goods)

S. no.	Description of goods	Heading or subheading number	Rate of duty
17	Solvent oil (non-composite)	2710.1150	PKR13 per liter
18	Other	2710.1190	PKR 0.88 per liter
21	Other fuel oils	2710.1949	PKR185 per metric ton
22	Lubricating oil in packs not exceeding 10 liters	2710.1951	10% of the retail price
23	Lubricating oil in packs exceeding 10 liters	2710.1952	10% of the retail price
24	Lubricating oil in bulk (vessels, bouzers, lorries, etc.)	2710.1953	PKR7.15 per liter

S. no.	Description of goods	Heading or subheading number	Rate of duty
25	Lubricating oil manufactured from reclaimed oils, sludge or sediment subject to the condition that, if sold in retail packing or under brand names, the loads manufactured from reclaimed oil, sludge or sediment should be clearly printed on the pack	Respective headings	PKR2 per liter
26	Mineral greases	2710.1992	PKR25 per kilogram
27	Base lubricating oil	2710.1993	PKR7.15 per liter
28	Transformer oil	2710.1997	10% of the retail price or PKR7.15 per liter, whichever is higher
29	Other mineral oils, excluding sewing machine oil	2710.1999	15% ad valorem
30	Waste oil	2710.9100 and 2710.9900	10% of the retail price or PKR7.15 per liter, whichever is higher
31	Liquefied natural gas	2711.1100	PKR17.18 per 100 cubic meters
32	Liquefied propane	2711.1200	PKR17.18 per 100 cubic meters
33	Liquefied butanes	2711.1300	PKR17.18 per 100 cubic meters
34	Liquefied ethylene, propylene, butylenes and butadiene	2711.1400	PKR17.18 per 100 cubic meters
35	Other liquefied petroleum gases and gaseous hydrocarbons	2711.1910	PKR17.18 per 100 cubic meters
36	Natural gas in gaseous state	2711.2100	PKR5.09 per million British Thermal Unit (MMBTu)
37	Other petroleum gases in gaseous state	2711.2900	PKR5.09 per MMBTu
39	Carbon black oil (carbon black feedstock), including residue carbon oil	2707.9910, 2713.9010 and 2713.9020	PKR7.15 per liter

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A. At a glance

Fiscal regime

The fiscal regime that applies in Papua New Guinea (PNG) to taxation of income derived by petroleum and gas companies consists of a combination of income tax, royalties and development levies, additional profits tax (APT) and infrastructure tax credits.

Income tax	Resident	Nonresident
Petroleum – incentive rate	30%	30%
Petroleum – new projects	45%	45%
Petroleum – existing projects	50%	50%
Gas	30%	30%
Additional tax (excluding the ExxonMobil led PNG Liquefied Natural Gas LNG Project operations)		
Petroleum and gas	2%	2%
Royalties and development levies	2% of gross revenue	2% of gross revenue
Dividend withholding tax (WHT) (petroleum and gas)	0%	0%
Interest WHT (petroleum and gas)	0%	0%
*Additional profits tax	Calculation X: 7.5% Calculation Y: 10%	Calculation X: 7.5% Calculation Y: 10%

* APT may apply to gas projects in some situations. Please refer below for further discussion on the basis of performing Calculation X and Calculation Y to calculate APT.

B. Fiscal regime

The fiscal regime that applies in PNG to the petroleum and gas industry consists of a combination of corporate income tax (CIT), royalties, development levies and development incentives.

Corporate tax

General provisions applicable to petroleum and designated gas projects

Specific corporate tax rules apply to resource projects in PNG, and the application of these rules will depend on whether taxpayers are covered under these specific provisions.

A "resource project" means a designated gas project, a mining project or a petroleum project.

A "designated gas project" means a gas project as defined under a gas agreement made pursuant to the Oil and Gas Act 1998.

A "petroleum project" means a petroleum project as prescribed by regulation or petroleum operations conducted pursuant to a development license or a pipeline license.

There are specific provisions applicable to petroleum operations and gas operations that are discussed below.

Rate of tax (applicable to oil and gas profits)

PNG resident corporations are subject to PNG income tax on their worldwide net income at a 30% corporate tax rate. Nonresident corporations are subject to PNG income tax only on their PNG sourced income. Companies engaged in petroleum and gas operations are subject to various tax rates as follows:

Resident

Petroleum (incentive projects) – 30%
Petroleum (new projects) – 45%
Petroleum (existing projects) – 50%
Gas operations – 30%

Nonresidents

Petroleum (incentive projects) – 30%
Petroleum (new projects) – 45%
Petroleum (existing projects) – 50%
Gas operations – 30%

Incentive rate petroleum operations – are those arising out of a petroleum prospecting license granted pursuant to the provisions of Division 2 of the Oil and Gas Act 1998 during the period 1 January 2003 to 31 December 2007 and in respect of which a Petroleum Development License has been granted pursuant to Division 7 of the Oil and Gas Act 1998 on or before 31 December 2017.

New petroleum operations – are projects that did not derive any assessable income from petroleum projects prior to 31 December 2000.

Existing petroleum operations – are projects that existed and derived assessable income prior to 31 December 2000.

Additional tax

If a taxpayer is subject to fiscal stabilization under the provisions of the Resource Contracts Fiscal Stabilization Act 2000, an additional 2% income tax will apply in respect of net income. However, this excludes the PNG LNG operations.

Fiscal stabilization refers to an agreement entered into by the state and the participants of long-term resources projects that guarantees the fiscal stability of the project by reference to the law in force at the date of the respective project agreement.

The fiscal stabilization agreement is usually entered into when a development contract is signed between the state and the resource developer(s).

General provisions applicable to petroleum and designated gas projects

On the following pages is a summary of certain general provisions that apply to petroleum and designated gas projects. Taxpayers should be aware that this is not an exhaustive list; other specific provisions also exist that may apply in some circumstances. In particular, specific agreements negotiated with Government authorities may modify the operation of these general provisions.

Project basis of assessment

Income derived from each petroleum or gas project is assessed on a project basis as if it were the only income of the taxpayer, notwithstanding that the taxpayer may have derived other assessable income.

A petroleum or gas project may include any number of development licenses or pipeline licenses, or a designated gas project, or a combination thereof.

Deductions are only available for expenditure attributable to the project. Where there is deductible expenditure or income not directly related to the project, this expenditure or income should be apportioned on a reasonable basis. Items of income or deductions exclusively relating to other projects are disregarded.

Allowable deductions

Allowable deductions against the assessable income of petroleum projects and designated gas projects include normal operating and administration expenses, depreciation, allowable exploration expenditure, allowable capital expenditure, interest, management fees, realized exchange losses and consumable stores.

Capital expenditure

Once a development license is issued, a distinction is made between allowable exploration expenditure (expenditure incurred prior to the issue of a development license), allowable capital expenditure (expenditure incurred after a development license has been issued) and normal depreciating assets. The rules relating to each of these are discussed separately below.

Depreciation of property, plant and equipment

Capital expenditure incurred on items of property, plant or equipment incurred after the issue of a development license is generally capitalized and depreciated under normal depreciation rules. Depreciation of fixed assets that are used in the production of taxable income is calculated using either the straight-line method or the diminishing value (DV) method. The taxpayer is required to make the election in the first year of income in which the asset is used for income producing purposes. Any change in the method of depreciation should be approved by the commissioner general.

The Internal Revenue Commission (IRC) has issued guidelines providing depreciation rates in respect of selected plant and equipment.

The following is an excerpt of some relevant assets (note that the IRC has not issued any formal guidance in respect of gas assets):

	Item	Prime cost method (%)	DV method (%)
1.	Oil – exploration		
	Drilling plant	20	30
	Seismic geophysical survey equipment	20	30
	Surveying equipment	10	15
	Camp equipment:		
	Portable sleeping, messing, etc., units	20	30
	Other camp equipment	10	15
	General plant and equipment	10	15

	Item	Prime cost method (%)	DV method (%)
	Oil rigs (offshore) and ancillary plant	10	15
2.	Petroleum		
	Drilling and downhole equipment	20	30
	Earthmoving plant and heavy equipment	20	30
	General plant and equipment	17	25
	Laboratory equipment	5	7.5
	Onshore production plant	13	18
	Offshore production plant	13	20
	Pipelines	13	20
	Pumps, motors and control gear and fittings	13	20
	Refining plant	13	20
	Shaft drilling equipment	20	30
	Tanks containing:		
	Natural crude oil and redistillates	13	20
	Other petroleum products	13	20
	Wharves and jetties	5	7.5
	Vehicles	20	30
3.	Allowable exploration expenditure (see below)		Divided by the lesser of remaining life of project or four (i.e., 25%)
4.	Allowable capital expenditure (ACE) (see below)		
	Short-life ACE (effective life less than 10 years)	n/a	25
	Long-life ACE (effective life more than 10 years)	10	n/a

Allowable exploration expenditure

Allowable exploration expenditure (AEE) is defined as expenditure (including both revenue and capital expenditure) incurred by a taxpayer for the purpose of exploration to discover petroleum or minerals in PNG pursuant to an exploration license. AEE is effectively able to be carried forward for a period of 20 years. Expenditure incurred in a project area after a development license is issued is treated as ACE.

AEE is amortized by dividing the residual expenditure by the lesser of the remaining life of the project or four (i.e., a DV depreciation rate of 25%). The amount of the deduction is limited to the amount of income remaining after other deductions, except ACE. In other words, the allowable deduction cannot create a tax loss. Where there is insufficient income, the balance of AEE is reduced only by the available deduction (i.e., the excess can be carried forward and utilized in future years).

A taxpayer will need to be carrying on resource operations to claim deductions for AEE.

Allowable capital expenditure

Allowable capital expenditure (ACE) is defined as capital expenditure incurred by a taxpayer carrying on resource operations after a resource development license is issued. ACE includes:

- Feasibility and environmental impact studies
- Construction and operation of port, or other facilities, for the transportation of resources (oil or gas) obtained from the resource project
- Provision of buildings and other improvements or plant
- Cost of providing water, light or power, communication and access to the project site
- Expenditure incurred to provide certain residential accommodation, health, education, law and order, recreational or other similar facilities and facilities for the supply of meals for employees or their dependents
- Depreciable plant that has been elected to be treated as short-life assets
- Exploration expenditure incurred after the resource development license is issued
- Certain general administration and management expenditure relating to resource projects
- Certain acquired expenditure

The following expenditure is excluded from ACE:

- A ship that is not primarily or principally used for the transport of resources (gas or petroleum) by the taxpayer in carrying out resource operations
- An office building that is not situated at, or adjacent to, the project site

ACE of a taxpayer in respect of a resource project is split into two categories and amortized over the life of the project:

- Long-life ACE — capital expenditure with an estimated effective life of more than 10 years. Long-life ACE is broadly amortized over a period of 10 years.
- Short-life ACE — capital expenditure with an estimated effective life of less than 10 years. Short-life ACE deductions are calculated by dividing the unamortized balance by the lesser of the remaining life of the project or four.

The amount of ACE deductions each year is limited to the amount of income remaining after deducting all other deductions so ACE deductions cannot produce a tax loss. Long-life ACE deductions are utilized first, and then a deduction for short-life ACE may be claimed. Where there is insufficient income to utilize the amount of deduction available in a year, the excess is deemed to be ACE incurred in respect of the next year of income.

A taxpayer will need to be conducting resources operations to claim deductions for ACE.

Disposal of property

Where deductions have been allowed or are allowable under the resource provisions in respect of capital expenditure on property that has been disposed of, lost or destroyed by a taxpayer carrying on resource operations, or the use of which has been otherwise terminated in relation to that resource project, a taxable balancing charge may arise if the consideration received is more than the undeducted balance of the expenditure. Where the consideration received is less, a balancing deduction is allowed.

As there is no capital gains tax (CGT) in PNG, any capital gains arising on disposal of property are not assessable.

Transfer of AEE and ACE

Where an interest in a resource project is disposed of, a Section 155L notice can be lodged to transfer the undeducted AEE and ACE balance from the vendor to the purchaser. This notice has to be lodged with the commissioner general no later than four months after the end of the year of income in which the interest in the resource project has been transferred.

Specific provisions applicable to petroleum projects and designated gas projects

In addition to the general provisions, some specific provisions apply to a taxpayer who undertakes petroleum operations or designated gas projects. These provisions deal with matters such as:

- Project basis of assessment
- Additional provisions relating to AEE
- Additional provisions relating to ACE
- Conversion between petroleum and designated gas projects
- Use of petroleum in operations
- Additional deductions for PNG LNG project participants

Additional profits tax

Additional profits tax (APT) potentially applies to a designated gas project, including the ExxonMobil lead PNG LNG project in the year in which the taxpayer has recovered their investment in the project and achieved a return on their investment above a prescribed level, (i.e., when the accumulated value of net project receipts of a taxpayer turns positive).

APT applies to "resource projects" which, for the purpose of the APT, means a "designated gas project."

Two calculations are required to be performed to determine the net project receipts for the purposes of the APT. These calculations require cash flow amounts to be uplifted using two different indexation factors resulting in amounts referred to as "Calculation X" and "Calculation Y."

Where a taxpayer derives an amount of taxable additional profits from a resource project as a result of Calculation X or Calculation Y, or both, the amount of APT is calculated at the rate of:

- 7.5% where such taxable additional profits arise as a result of Calculation X
- 10% where such taxable additional profits arise as a result of Calculation Y

A taxpayer may have an amount of additional tax payable under both Calculation X and Calculation Y. However, any APT payable in respect of Calculation X is deductible for the purposes of performing Calculation Y.

Capital gains

Capital gains are not subject to tax in PNG. The disposal of a capital asset may be subject to tax to the extent the disposal takes place as part of a profit-making scheme or is part of the ordinary business of the taxpayer.

While capital gains are not generally subject to tax, if depreciable plant and equipment is disposed of, a calculation of any gain or loss on disposal must be performed. Where the amount received exceeds the tax written-down value, an amount of income may be derived up to the amount of depreciation deductions previously claimed, (i.e., any gain over the original cost should not be taxed). Alternatively, if the amount received on disposal is less than the tax written-down value, an allowable deduction may be able to be claimed.

Functional currency

Income and expenses must be expressed in PNG currency (kina), unless permission has been granted by the commissioner general to report in another currency.

Transfer pricing

International related-party transactions must be carried out at arm's-length. Specific transfer pricing provisions exist that allow the commissioner general to adjust an entity's taxable income if international related-party transactions have not been conducted on an arm's-length basis (i.e., if the transaction would not have been conducted on the same basis between independent parties).

In addition, specific provisions relate to management or technical fees paid to international-related parties.

Dividends

There is no dividend WHT on dividends paid out of profits from petroleum or gas operations.

Interest

There is no interest WHT on interest paid in respect of borrowings used to finance petroleum or gas operations.

Tax year

The PNG tax year is the calendar year. However, a substituted accounting period is often permitted on written request to the commissioner general.

C. Capital allowance and tax depreciation

There are specific rules for petroleum and gas taxpayers with respect to depreciation and amortization of capital expenditure. Refer to the previous discussion of AEE, ACE and depreciation of certain plant and equipment.

D. Incentives

In addition to the various income tax concessions discussed above, the Government offers other incentives to taxpayers operating in the resources sector. Some of these are discussed in further detail in this section.

While some investors have been able to negotiate specific incentives for particular projects, the Government now aims to include all tax concessions in the domestic legislation and make any concessions available on an industry basis with the goal of developing a more neutral and equitable treatment of projects.

Pooling of exploration expenditure

Resource taxpayers (mining, petroleum and gas) may elect to pool expenditure incurred by the taxpayer or a related corporation outside of a resource project to form part of AEE of a producing resource project and claim 25% of the pooled expenditure against income from a producing resource project. The total amount of deductions allowed is limited to the lesser of 25% of the undeducted balance of the expenditure in the pool or such amount as reduces the tax payable by the taxpayer and its related corporations in respect of those resource operations for that year of income by 10%. An election to pool exploration expenditure has to be made in writing, signed either by or on behalf of the taxpayer and delivered to the commissioner general no later than the last day of the income year of the taxpayer or within such further time as allowed by the commissioner general.

Rehabilitation costs

For resource projects that commence from 1 January 2012, it is proposed that a resource taxpayer is able to transfer losses incurred in respect of environment rehabilitation incurred at the end of the project to other projects it owns. PNG uses ring-fencing provisions and calculates the profits of resources projects on a project-by-project basis. Historically, losses incurred when no further income was produced were effectively lost. Due to the political uncertainty at the time of publication, it is not certain whether the proposed changes will proceed. Affected taxpayers should seek specific advice in this regard.

Tax losses

Losses incurred by taxpayers generally may be carried forward for 20 years, subject to the satisfaction of a continuity of ownership test. If the continuity of ownership test is failed, tax losses may still be able to be carried forward and used if the taxpayer passes the same business test.

Losses incurred by taxpayers carrying on resources operations (including oil and gas operations) are able to be carried forward indefinitely. Losses of resource taxpayers may also be quarantined on a project basis.

For resource taxpayers, the undeducted AEE and ACE balances are not considered tax losses for PNG tax purposes and are kept in separate pools. As discussed on page 318, a taxpayer would need to be carrying on resource operations to claim deductions for AEE and ACE. Where a taxpayer is entitled to a deduction during a year of income, the deduction is limited to the amount of available assessable income. Any excess deduction cannot create a tax loss.

Losses are not allowed to be carried back, and there is no provision for grouping losses with associated companies (with the specific exception of certain company amalgamations).

Prescribed infrastructure development

Where a taxpayer engaged in resources projects incurs expenditure in relation to a prescribed infrastructure development, the amount of expenditure incurred is deemed to be income tax paid in respect of that project, and hence may be offset as a credit against tax payable in respect of the project.

Prescribed infrastructure development means upgrade of existing roads or construction of new roads or other infrastructure development in the project area or the surrounding areas, which are approved by the state. Accordingly, in order to qualify for the tax credits, all anticipated expenditure requires approval from the Government.

The amount of credit available in respect of prescribed infrastructure development expenditure is capped at the amount of the expenditure and is also limited to the lesser of:

- 0.75% of the assessable income from the project
- The amount of the tax payable in respect of the project

Credits for expenditure incurred (for income tax deemed to be paid) may be carried forward.

A taxpayer engaged in gas operations is entitled to additional tax credits in respect of certain expenditure incurred on behalf of the State in respect to the construction or repair of certain roads.

The amount of credit available is limited to the lesser of:

- 1.25% of the assessable income from the project
- 50% of the tax payable in respect of the project

Credits for expenditure incurred (or income tax deemed to be paid) may be carried forward. This regime in respect of gas projects is separate from that relating to general infrastructure credits (see above).

Highlands Highway–infrastructure tax credits

Tax credits were previously available for expenditure incurred in the income years 2002 and 2005, in respect of a prescribed section of the Highlands Highway.

It is proposed that from 1 January 2012, tax credits in respect of the Highlands Highway will be reinstated where the expenditure incurred by a taxpayer is for "emergency repair." Emergency repair means "in relation to the Highlands Highway, an activity carried out to restore traffic flow following an event that has resulted in the closure or partial closure of the highway, including bypass or replacement of a section of the highway, replacement of culverts, construction of temporary bridges and removal and repair of landslips."

The amount of expenditure incurred is deemed to be income tax paid, and a credit is therefore available, limited to the lesser of:

- 1.25% of the assessable income derived by the taxpayer in the year of income
- The amount of tax payable

This credit is in addition to the prescribed infrastructure development credit of 0.75% (refer to the discussion above). Credits for expenditure incurred (or income tax deemed to be paid) may be carried forward. This regime is available to taxpayers engaged in mining, petroleum and gas operations. This brings the total of the infrastructure credits available to resource taxpayers to 2% (infrastructure development credit of 0.75% and Highlands Highway credit of 1.25%).

Due to the political uncertainty at the time of publication, it is not certain whether the proposed changes will proceed. Affected taxpayers should seek specific advice in this regard.

Research and development

A 150% deduction is available for "prescribed" R&D expenditure. In order to claim the R&D tax concession, taxpayers will need to complete and submit an application annually to the Research and Development Expenses Approval Committee (within the PNG IRC) for approval prior to the start of the fiscal year.

R&D deductions may be available in respect of contributions to approved bodies or direct costs related to scientific research. Scientific research means any activities in the fields of natural or applied science for the extension of knowledge.

WHT incentives

As noted above, specific WHT exemptions are applicable to the petroleum and gas industry in respect of the payment of dividends and interest.

E. Withholding taxes

Most activities conducted by nonresidents in PNG (including PNG branches), other than individuals deriving employment income, fall under the foreign contractor and management fee WHT provisions of the domestic legislation. In addition, the receipt of certain passive income (e.g., interest, dividends and royalties) will also be subject to WHT.

Foreign contractor withholding tax

Foreign contractor withholding tax (FCWT) will apply where the income is derived by nonresidents (usually referred to as foreign contractors) from contracts for "prescribed purposes" and include installation and construction projects, consultancy services, lease of equipment and charter payments.

FCWT is levied in respect of the gross contract income. In broad terms, the PNG Income Tax Act provides that, where a foreign contractor derives income from a prescribed contract, the person is deemed to have derived taxable income of 25% of the gross contract income. This taxable income is then subject to tax at the nonresident corporate tax rate of 48%, giving an effective PNG tax rate of 12% on the gross contract payment. The local contracting party has an obligation to withhold the tax and remit to the IRC within 21 days after the end of the month in which the payment was made.

As an alternative to paying FCWT, the foreign contractor can elect to lodge an income tax return and pay tax on actual taxable income at the nonresident corporate tax rate of 48%. The FCWT is the default tax, with requests to be assessed on a net profit basis being subject to the discretion of the commissioner general. In order to be assessed on a net basis, a written request must be made to the commissioner general prior to the commencement of work under the contract.

Where the foreign contractor elects to be assessed on a net basis, a deduction should be available for all costs directly attributable to the derivation of the PNG sourced income, including depreciation of equipment. A deduction should also be available for any indirect costs related to the income (i.e., head office general administration and management expenses). The deduction for indirect costs allowed is limited to the lesser of:

- 5% of the gross income from the prescribed contract
  Or
- A percentage of head office expenses (other than expenses incurred directly in deriving the contract income) in proportion to the ratio of gross income from the prescribed contract relative to the worldwide income of the taxpayer

Please refer below for treaty WHT rates that may provide for relief from FCWT or reduction of the FCWT rate.

Management fee withholding tax

Subject to the availability of treaty relief, management fee withholding tax (MFWT) of 17% is required to be deducted in respect of management fees paid or credited to nonresidents.

The definition of "management fee" is very broad and includes "… a payment of any kind to any person, other than to an employee of the person making the payment and other than in the way of royalty, in consideration for any services of a technical or managerial nature and includes payment for consultancy services, to the extent the commissioner general is satisfied those consultancy services are of a managerial nature."

In practice, MFWT is generally applied to services rendered outside PNG by nonresidents and FCWT is applied to fees for services rendered in PNG by nonresidents.

Taxpayers should also be aware that the deduction for management fees paid by a PNG resident company to a nonresident associate cannot exceed the greater of 2% of assessable income derived from PNG sources or 2% of allowable deductions excluding management fees paid. However, a full deduction is allowed if the management fee can be supported as an arm's-length transaction. This limit does not apply in respect of payments made to non-associates.

Please refer below for treaty WHT rates that may provide relief from MFWT or reduction of MFWT.

WHT rates

In addition to FCWT and MFWT, WHT is imposed in respect of various payments to nonresidents by entities carrying on business in PNG, including interest, dividends and royalties. Certain incentive rates exist for taxpayers operating in the oil and gas industry (refer to sections regarding dividends and interest). Set out on the next page is a summary of general WHT rates:

	Dividends[1]	Interest[2]	Royalties	Management fees (including technical fees) %	Foreign contractor %
Australia	17	10	10	Nil[3]	12[4]
Canada	17	10	10	Nil[3]	12[4]
China	15	10	10	Nil[3]	12[4]
Fiji	17	10	15	15	12[4]
Germany	15	10	10	10	12[4/5]
Malaysia	15	15	10	10	12[4/6]
Singapore	15	10	10	Nil[3]	12[4/6]
South Korea	15	10	10	Nil[3]	12[4]
United Kingdom	17	10	10	10	12[4/6]
Non-treaty countries	17	15	Associate – 30 Non-associate – lesser of 10% of assessable income or 48% of taxable income	17	12

Notes:

1. Dividend WHT is not payable on dividends paid out of profits from oil and gas operations.
2. There is no interest WHT on interest paid in respect of borrowings used to finance oil and gas operations.
3. Where there is no specific technical services article, the payment should not be subject to WHT in PNG, provided all of the services were performed outside of PNG.
4. The income of residents of countries with which PNG has a Double Tax Agreement DTA will only be subject to the FCWT provisions if the nonresident is conducting business in PNG through a permanent establishment.
5. Treaty not yet in force.

6. A reduced FCWT rate may apply to foreign contractors from countries where a non-discrimination article exists in the relevant treaty.
7. Taxpayers self assess for any DTA reductions on WHTs.

F. Financing considerations

Where a taxpayer has borrowed money for the purpose of carrying out a resource project, the interest will be deductible under the normal provisions (i.e., on an incurred basis).

Where funds are not borrowed on an arm's-length basis, the interest deduction is limited to the market rate of interest that the commissioner general determines in consultation with the Bank of Papua New Guinea. Interest incurred prior to the issue of a development license is not deductible.

Interest incurred in connection with the construction or acquisition of an item of plant or capital asset is not immediately deductible to the extent it is incurred prior to the date on which the taxpayer first derives assessable income or uses the plant or capital asset for the purpose of deriving assessable income. The amount should instead be capitalized to the cost of the asset.

While no general thin capitalization rules apply in PNG, specific rules exist for resources taxpayers (mining, petroleum and gas operations). When the debt of the taxpayer and all related corporations in relation to a particular resource project exceeds 300% of equity in relation to that resource project, the deduction for the interest incurred is reduced by the excess debt over that ratio.

G. Indirect and other taxes

Goods and services tax

GST is imposed at the rate of 10% on virtually all goods and services except where the goods or services are zero-rated or are exempt. The importation of goods into the country will also be subject to GST.

Effective from 1 January 2012, any entity undertaking taxable activity in PNG is required to register and charge GST where taxable supplies exceed, or are expected to exceed, PGK250,000 in any 12-month period. The previous registration threshold was PGK100,000. Affected taxpayers should seek specific advice in this regard. Entities that are registered for GST are required to account for GST collected (output tax) and GST paid (input tax) during each month, with any excess of GST collected to be remitted to the IRC by the 21st day of the following month.

All supplies of goods or services, other than cars, to a resource company for use in resource operations, are generally zero-rated. Taxpayers require a written confirmation from the IRC stating that the entity is zero-rated to qualify for zero-rating. Taxpayers can then present the written confirmation to the suppliers when purchases are made to ensure the goods and services are supplied to them GST free.

Royalty regimes

Resource projects are subject to a royalty, equal to 2% of the gross revenue from resource sales. New petroleum projects and gas projects are also subject to a development levy that is equal to 2% of the gross revenue from resource sales. Where a project is liable for both royalty and development levy, only the royalty is claimable as a credit against income tax payable.

Customs and excise duty

The importation of all goods into PNG is subject to customs and excise duty, unless the goods are duty free or exempt. Duty is imposed on the total cost of goods, including insurance and freight. The rate of duty depends on the nature of the goods imported. It will often be the case that a zero rate will apply to goods used in the oil and gas industry to the extent that the relevant goods are not able to be sourced in PNG. However, a specific analysis must be undertaken in each instance.

Goods and consumables imported by a PNG LNG project entity in respect of the LNG project (referred to as LNG project goods and consumables) are exempt from all customs tariffs and levies. Recent changes to the Customs Act ensure the exemption is limited to goods and consumables used specifically in connection with the initial construction and subsequent phase of the PNG LNG project.

Export duties

There is no export duty on the export of petroleum or gas products.

Stamp duty

Stamp duty is imposed on dutiable instruments such as deeds, share transfers and a wide range of other documents at varying rates. Stamp duty may also apply to documents executed outside PNG pursuant to provisions that impose an obligation to lodge documents for assessment for stamp duty where they relate to property or things done within PNG.

Where the property transferred is a mining lease, special mining lease or exploration license issued under the Mining Act 1992, or the subject of a license issued under the Oil and Gas Act 1998, the rate of duty is 2% of the value.

Minerals and petroleum farm-ins, transfers of mining or petroleum information and transfers of tenements and exploration licenses are subject to stamp duty at the rate of the lesser of PGK10,000 or ad valorem duty up to a maximum of 5% of the value.

Where the acquisition is an interest in a landholding private corporation, and the underlying land is a mining lease, special mining lease or exploration license, the rate of duty is 2% of the value. This excludes any amount that is mining or petroleum information. Where the underlying land comprises a tenement, or licenses or rights, or options over any such leases or rights, the rate of duty is the lesser of PGK10,000 or ad valorem duty up to the maximum of 5% of the value of the dutiable property.

Where the underlying property is mining or petroleum information, the rate of duty is PGK10,000.

Certain transactions with respect to the PNG LNG project are exempt from stamp duty.

Other taxes

All businesses with an annual payroll in excess of PGK200,000 are subject to a 2% training levy. The amount payable is reduced by training expenses incurred by the employer for the benefit of PNG citizen employees.

PNG does not have fringe benefits tax. However, noncash benefits to employees are taxed. The provision of some benefits is exempt, (e.g., school fees and one set of annual leave fares) and other benefits are taxed concessionally.

Statutory requirements exist for employers to make superannuation contributions in respect of PNG citizen employees.

Superannuation for noncitizen employees is currently voluntary. However, it may be legislated in the future to make it compulsory.

PNG also has compulsory workers' compensation insurance requirements.

H. Other

Foreign exchange controls

A tax clearance certificate is required where certain cumulative remittances of foreign currency exceed PGK200,000 in a calendar year. Where the remittance is to a tax haven, a tax clearance will be required regardless of the amount being remitted.

In general, PNG resident companies are not permitted to receive payment for goods or services in a foreign currency. This means that, where a contract is entered into between two PNG residents in a foreign currency, such as US dollars, the settlement of the invoice has to be made in PNG currency. For exchange control purposes, a resident will include a foreign company operating actively in PNG on a branch basis.

Approval is also required from the Central Bank for a PNG resident to open and operate either a kina or a foreign currency account outside of PNG.

Business presence

Forms of "business presence" in PNG typically include companies, foreign branches and joint ventures.

PNG incorporated shelf companies are readily available. To register a branch of a foreign company, an application has to be lodged with the Registrar of Companies, accompanied with the relevant documentation. As a minimum, documents that need to be lodged include copies of the relevant contract in PNG, the certificate of incorporation and the application fee.

Tax office registration

An application for a tax file number is required for a PNG incorporated subsidiary or a branch of a foreign entity that elects to lodge an income tax return. If the branch chooses to operate as a foreign contractor, a FCWT file number will be allocated on lodgment of the copy of the contract with the IRC. It is the responsibility of the local contractor to lodge a copy of the contract with the IRC and remit the relevant withholdings.

Where an entity has employees, the entity needs to register as a group employer and remit monthly salary and wages tax withholding to the tax office.

GST registration is also required where taxable sales exceed, or are expected to exceed, PGK250,000 in an income year (increased registration threshold is effective 1 January 2012, see comments above).

Visas

Expatriate employees cannot be gainfully employed in PNG without a work permit issued by the Department of Labour and Industrial Relations (DLIR). A properly completed Application for Foreigner Work Permit and the applicable government fee needs to lodged with the DLIR for approval and issue of work permits.

In addition to work permits, an application for entry permit or visa for the employee and dependents (if applicable) will have to be prepared and lodged with the Department of Foreign Affairs and Immigration. There are government fees that need to accompany the application.

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A. At a glance

Fiscal regime

Oil and gas exploration and production (E&P) activities are conducted under license or service contracts granted by the Government. The Government guarantees that the tax law in effect on the agreement date will remain unchanged during the contract term.

Royalties

Royalties can be determined based on the following methodologies: production scales (fixed percentage and variable percentage) or economic results (the R factor calculation).

Bonuses	Not applicable
Production sharing contract (PSC)	Not applicable
Income tax rate	Corporate income tax (CIT) rate of 30%
Resource rent tax	Not applicable
Capital allowances	See Section C

B. Fiscal regime

Oil and gas E&P activities are conducted under license or service contracts granted by the Government. Under a license contract, the investor pays a royalty, whereas under a service contract, the Government pays remuneration to the contractor.

As stated by the Peruvian Constitution and the Organic Law for Hydrocarbons, a license contract does not imply a transfer or lease of property over the area of exploration or exploitation. By virtue of the license contract, the contractor acquires the authorization to explore or to exploit hydrocarbons in a determined area, and Perupetro (the entity that holds the Peruvian state interest) transfers the property right in the extracted hydrocarbons to the contractor, who must pay a royalty to the state.

It is important to note that the Organic Law for Hydrocarbons and the related tax regulations foresee that the signing of an oil and gas agreement implies the guarantee that the tax regime in effect at the date of signature will not be changed during the life of the contract. This is intended to preserve the economy of the contract so that no further tax costs are created for the contractors.

The signing of an agreement for the exploration or exploitation of a block freezes the tax regime in force at the date that the contract is signed for the entire life of the contract. An additional two points will be applicable to the income tax rate of the tax regime in force. The taxes covered by this provision are the taxes that are the responsibility of the contractor as a taxpayer.

It is important to note that tax stability is, in essence, granted for the contract activities and not directly for the entities that signed the contract. Therefore, any change in the contractor's ownership will not affect the tax stability. The tax stability only covers the contract activities (i.e., the exploration and exploitation of hydrocarbons) and no other related or distinct activities that may be performed by the legal entity (e.g., refining). Taxes (i.e., dividend tax or branch profits tax) that affect profit distributions arising from the contract activities are also covered by the tax stability.

Contractors are entitled to keep their accounting records in foreign currency, but taxes must be paid in Peruvian nuevo soles (PEN).

Corporate tax

General considerations

Resident entities are subject to income tax on their worldwide income, whereas branches are subject to income tax exclusively on their Peruvian sourced income. Exports are considered to be Peruvian sourced income.

Resident companies are companies incorporated in Peru. Peruvian law does not contain CFC (Controlled Foreign Company) legislation.

Tax rates

The CIT rate is 30%.

In addition, a dividend tax of 4.1% applies to profits distributed to nonresident individuals and corporations, as well as to resident individuals. All distributed profits, including those corresponding to prior years, are subject to this tax. The law specifies various transactions that are considered profit distributions by resident entities for the purpose of the 4.1% dividend tax, including a distribution of cash or assets other than shares of the distributing company and, under certain circumstances, a reduction in the company's capital or a liquidation of the company.

Expenses that are not subject to further tax control (i.e., expenses that might benefit shareholders, such as personal expenses, and other charges assumed by the corporation) are also considered to be dividend distributions. However, the capitalization of equity accounts is not treated as a distribution.

For permanent establishments (PEs), branches and agencies of foreign companies, a distribution of profits is deemed to occur on the deadline for filing their annual corporate income tax (CIT) return (generally, at the end of March of the following year).

The tax on dividends is basically applied through a withholding mechanism. The withheld amount is considered a final payment. Nevertheless, for dividends related to expenses not subject to further tax control, the 4.1% dividend tax is paid directly by the resident corporation, branch or PE (i.e., as a surcharge).

Taxable year

The tax year is the calendar year. The accounting year is also the calendar year, without exception.

Tax returns

CIT returns must be prepared by the taxpayer under the self-assessment method. The annual income tax return must be filed within the first three months of the following tax year. Income tax prepayment tax returns must be filed monthly. VAT, withholding taxes (WHT) and other returns (e.g., payroll tax) are also filed monthly according to a schedule published by the tax authorities based on the taxpayer's tax number.

Group treatment

Peruvian tax law does not include any provisions about taxation on a consolidated basis.

Ring-fence rules for oil and gas contracts

The contractor determines the tax base and the amount of the tax, separately and for each contract. If the contractor carries out related activities (i.e., activities related to oil and gas but not carried out under the terms of the contract) or other activities (i.e., activities not related to oil and gas), the contractor is obliged to determine the tax base and the amount of tax separately and for each activity.

The corresponding tax is determined based on the income tax provisions that apply in each case (subject to the tax stability provisions for contract activities and based on the regular regime for the related activities or other activities).

The total income tax amount that the contractor must pay is the sum of the amounts calculated for each contract, for both the related activities and for the other activities. The forms to be used for tax statements and payments are determined by the tax administration.

If the contractor has more than one contract, it may offset the tax losses generated by one or more contracts against the profits resulting from other contracts or related activities. Likewise, the tax losses resulting from related activities may be offset against the profits from one or more contracts.

It is possible to choose the allocation of tax losses to one or more of the contracts or related activities that have generated the profits, provided that the losses are depleted or are compensated to the limit of the profits available.

A contractor with tax losses from one or more contracts or related activities may not offset them against profits generated by the other activities. Furthermore, in no case may tax losses generated by the other activities be offset against the profits resulting from the contracts or from the related activities.

Income recognition

For local corporate purposes, income is recognized on an accruals basis.

Transfer pricing

Peru has adopted transfer pricing guidelines, based on the arm's-length principle. The accepted methods are the comparable uncontrolled price CUP method, the resale price method, the cost plus method and the transactional net margin, as well as other related methods based on margins. The OECD guidelines can be used as a complementary source of interpretation. Advance Pricing Agreements APAs may be agreed with the tax authorities.

Transfer pricing rules apply to operations between resident legal entities if at least one of them has had tax losses in the last six fiscal years or has tax stability or a promotional regime, and to operations between nonresident entities and entities located in tax havens. One or more legal entities are related parties if one of them participates directly or indirectly in the management, control or equity of the other one, or whenever the same person participates directly or indirectly in the direction, control or equity of diverse related entities.

In Peru, these rules must be considered not only for income tax purposes, but also for VAT and for selective consumption tax (ISC) purposes.

Monthly income tax prepayments

Taxpayers are required to pay estimated monthly income tax prepayments. Prepayments apply as a credit against the annual income tax obligation or they are refunded at the end of the fiscal year (once the tax return is filed) if requested by the taxpayer.

Taxpayers that start activities during the fiscal year make payments using a fixed quota of 2% of the net income obtained during the month. After the first year, the advance payment installment is calculated by dividing the amount of the tax for the previous taxable year by the total net income of the same year and applying that coefficient to the net income obtained during the month.

If there is no calculated tax during the previous year, the 2% quota applies.

It is possible to request a reduction of the advance tax percentage based on the financial information and tax determination made as of 31 January and 30 June of the corresponding year. If the tax authorities grant the request, the reduction may ultimately lead to a complete suspension of the required payments.

Capital gains

Capital gains are treated as ordinary income. Until 31 December 2009, capital gains derived from transactions on stock or commodity exchanges were exempt from income tax. Effective from 1 January 2010, capital gains determined by resident entities are subject to a 30% tax rate.

Expenses

Expenses incurred in the generation of revenue, or in maintaining the revenue source or in the generation of capital gains, are generally deductible for determining the income tax base.

However, expenses derived from transactions executed with entities (corporations or branches) that reside in tax haven jurisdictions are not deductible for the computation of taxable income, with the exception of payments derived from the following transactions: credit facilities and insurance for passage through the Panama Canal.

Organization expenses, initial pre-operating expenses, pre-operating expenses resulting from the expansion of a company's business and interest accrued during the pre-operating period may be deducted, at the taxpayer's option, in the first taxable year, or they may be amortized proportionately over a maximum term of 10 years.

The amortization period runs from the year when production starts. Once the amortization period is fixed by the taxpayer, it can only be varied with the prior authorization of the tax authorities. The new term comes into effect in the year following the date that the authorization was requested, without exceeding the overall 10-year limit.

It is necessary to use certain means of payment for the deduction of expenses in excess of approximately PEN 3,500 or US$1,250. The permitted means of payment include deposits in bank accounts, fund transfers, payment orders, debit and credit cards issued in Peru, non-negotiable (or equivalent) checks issued under Peruvian legislation and other means of payment commercially permitted in international trading with nonresident entities (e.g., transfers, banking checks, simple or documentary payment orders, simple or documentary remittances, simple or documentary credit cards).

Valuation of inventory

Inventory is valued for tax purposes at the acquisition or production cost. Financial charges are not allowed as part of the cost. Taxpayers may choose any one of the following methods, provided that the method is used consistently: first-in, first-out (FIFO); daily, monthly or annual average; specific identification; detailed inventory; basic inventory.

Foreign income tax

Under certain circumstances, income tax paid abroad may be used as a tax credit. However, it should be noted that unused tax credits cannot be carried forward.

Royalties

Oil and gas E&P activities are conducted under license or service contracts granted by the Government. Under a license contract, the investor pays a royalty; while under a service contract, the Government pays remuneration to the contractor.

In both cases, however, the distribution of the economic rent (royalty or remuneration) between the Government and the investor is determined based on the following methodologies:

- Production scales: this methodology establishes a percentage of royalty (or brackets of royalties starting at 5%) over certain scales of production (volume of barrels per calendar day) for the fiscalized liquid hydrocarbons and the fiscalized natural gas liquids, and other royalty percentages for the fiscalized natural gas for each valuation period. Based on the scales of production, the percentage of royalty is:

Scales of production (per barrels per calendar day)	Percentage of royalty
< 5	5%
5-100	5% to 20%
> 100	20%

- Economic results (RRE): according to this methodology, the royalty percentage is the result of adding the fixed royalty percentage of 5% to the variable royalty percentage, as per the use of certain economic results ratios

C. Capital allowances

Depreciation of tangible assets

According to the income tax regulations, the maximum annual depreciation rates for income tax purposes are 20% for vehicles; 20% for machinery and equipment used in the mining, oil and construction industries; 10% for other machinery and equipment; 25% for hardware; and 10% for other fixed assets. Under the income tax general provisions, depreciation is deductible provided that it does not exceed the maximum rates and it is registered in the taxpayer's accounting records, regardless of the depreciation method used. However, buildings are subject to a fixed 5% depreciation rate, without the accounting record requirement. If certain requirements are met, this fixed depreciation rate could be 20% (i.e., buildings constructed since 1 January 2009 completed, or to be at least 80% completed as of 31 December 2010).

Special oil and gas rules regarding investments aimed to produce hydrocarbons

The hydrocarbon law provides that exploration and development expenditures, and the investments contractors may make, up to the date when commercial extraction of hydrocarbons starts, including the cost of the wells, are accumulated in an account. At the contractor's option and with respect to each contract, the amount is amortized using either of the methods below:

- On the basis of the production unit
- Through lineal amortization, deducting the expenditures in equal portions during a period of no less than five fiscal years

Any investments in a contract area that did not reach the commercial extraction stage and that were totally released can be accumulated with the same type of investments made in another contract that is in the process of commercial extraction. These investments are amortized in accordance with the amortization method chosen in the latter contract.

If the contractor has entered into a single contract, the accumulated investments are charged as a loss against the results of the contract

for the year of total release of the area for any contract that did not reach the commercial extraction stage, with the exception of investments consisting of buildings, power installations, camps, means of communication, equipment and other goods that the contractor keeps or recovers to use in the same operations or in other operations of a different nature.

Once commercial extraction starts, all amounts corresponding to disbursements with no recovery value are deducted as expenses for the fiscal year.

Expenses with no recovery value occur as of the start of commercial extraction for the following purposes:

- Investments for drilling, completing or producing start-up wells of any nature, including stratigraphic ones, and excluding acquisition costs of surface equipment
- Exploration investments, including those related to geophysics, geochemistry, field geology, gravimetry, aerophotographic surveys and seismic surveying, processing and interpreting

The *Manual of Accounting Procedures* to be filed before Perupetro must detail the accounts considered expenditures without any recovery value.

D. Corporate tax incentives

Carryforward losses

According to Peruvian income tax law, tax losses can be carried forward and offset against the net income obtained in future fiscal years. The provisions currently in force require the taxpayer to elect one of the following procedures to offset the tax losses:

- Offset the total net tax losses from Peruvian sources obtained in the tax year against the net income obtained in the four fiscal years following its generation. The amount of losses not offset after this term is not to be available for carryforward in the following periods.
- Offset the total net tax losses from Peruvian sources obtained in the tax year against 50% of the net income obtained in the following years, without limitation.

The election should be made when the annual income tax return is filed and it cannot be changed until the accumulated losses are fully utilized.

E. Withholding taxes

Dividends or branch profits tax

Dividends and profits obtained by branches are subject to a 4.1% withholding tax (WHT).

The event that triggers the withholding obligation is the dividend distribution agreement. However, in the case of branches, it is triggered when the tax return is filed at the end of the taxable year.

Interest

Under the current Peruvian income tax legislation, the WHT rate on interest paid abroad is 30%. However, if certain conditions are met, this rate can be reduced from 30% to 4.99%. The 4.99% reduced WHT rate applies provided that the following conditions are met:

- For loans in cash, the remittance of funds to Peru must be duly documented. For such purpose, the funds should enter the country through a local bank or be used for import financing.
- The loans are subject to an annual interest rate (including fees and any additional amounts) no higher than LIBOR rate plus seven points.
- The lender and the borrower are not regarded as economically related parties.
- The loan does not qualify as a "back-to-back" or "covered" operation between related parties.

The WHT rate on interest paid abroad to nonresident individuals is 30% when the transaction is performed between related parties or with entities that reside in tax havens; otherwise, a 4.99% WHT rate will be applicable.

Royalties

Royalties are defined as any payment in cash or in kind originated in the use or the privilege to use trademarks, designs, models, plans, process or secret formulas and copyrights for literary, artistic or scientific work, as well as any compensation for the assignment in use of software or the transfer of information related to industrial, commercial or scientific experience (know-how).

The WHT rate is 30%.

Capital gains

Gains on the sale, exchange or redemption of shares, bonds and other securities issued by companies, or by investment funds or trusts incorporated or organized in Peru, are considered to be Peruvian sourced income; consequently, these gains are taxed at 30%. This includes the disposal of shares listed on the Peruvian stock exchange that are sold through centralized negotiation mechanisms.

The income tax treatment of capital gains made by nondomiciled entities depends on whether the transfer takes place within or outside Peru. If the transfer takes place in Peru, the WHT rate is 5%. Otherwise, it is 30%. In any case, when the disposal is conducted through a centralized negotiation mechanism, the Settlement Agent (CAVALI in Spanish) will have to withhold the corresponding income tax.

Since capital gains on shares listed on a local stock exchange before 1 January 2010 were exempt from income tax, some specific rules are applicable to determine the referential value of them (tax cost). In this context, that would be their value at the end of fiscal year 2009, the acquisition cost, or value of entry to the equity, whichever is higher.

Indirect transfers of shares

With effect from 16 February 2011, Law No. 29663 introduced a new category of Peruvian sourced income that may lead to a scenario under which a nonresident will be levied with income tax. Broadly, Law No. 29663 provides that a 30% income tax is imposed on any capital gain realized upon the transfer of the shares of a company located outside Peru that, directly or indirectly, holds shares (or participation interests) in one or more Peruvian subsidiaries (i.e., an "indirect transfer") in one of the following situations:

i. Where 50% or more of the fair market value of the nonresident holding company's shares is derived from the shares or participations representing the equity capital of one or more Peruvian subsidiaries at any time within the 12 months preceding the disposition

Or

ii. The overseas holding company is located in a tax haven or low-tax jurisdiction, unless it can be adequately demonstrated that the scenario described in (i) above did not exist

New Law No. 29757, which amends Law No. 29663, clarifies that the transaction described in the preceding paragraph will only be taxable where shares or participation interests representing 10% or more of the nonresident holding company's equity capital are transferred within the 12-month period. This means that transfers of shares (or participations) representing less than 10% of the nonresident holding company's equity capital are not subject to taxation in Peru even when 50% or more of the fair market value of those shares is derived from the shares (or participations) representing the equity capital of one or more Peruvian subsidiaries at any time within the 12 months preceding the dispositions.

The taxable gain is determined by deducting the tax cost from the taxable revenue. The general rule is that the tax basis of the shares or participations will be the fair market value of such shares or participations as of 15 February 2011, provided that the value is not lower than the original price paid or the acquisition cost of the shares or participations. It is important to highlight that, for shares or participations that are not listed or regularly traded on a stock exchange, the law provides that the fair market value will be the equity value they had on 15 February 2011, based on audited financial statements (not older than 12 months prior to that date) of the nonresident entity.

The nonresident seller must support the cost basis in the shares being transferred with documentation issued in accordance with the legislation of the corresponding foreign country or by any other means established by the Peruvian Tax Administration. If the basis certification procedure is not observed, the tax liability will be determined on the basis of the gross sales price, without admitting any deduction of the cost value.

The obligation of paying this resulting tax lies with the nonresident seller. However, the Peruvian company that issued the shares or participation interest has joint and several responsibility, except for the case in which the company acquiring the shares or participation interests is Peruvian. In such cases, the acquiring Peruvian company will be responsible for the payment of the corresponding tax under the title of withholding agent, as expressly stated by law.

Services

Technical assistance, digital services and other services

Revenue received from certain activities performed by nondomiciled companies is subject to Peruvian WHT on a portion of the gross revenues earned from such activities. The WHT rate varies according to the activity performed. For services, the following distinctions may be made:

- Payments for services that qualify as "technical assistance" (defined below) are subject to a 15% WHT rate provided that they are "economically utilized" within Peru, regardless of whether the services are physically rendered in Peru.
- Technical assistance is considered to be economically utilized if it helps in the development of activities or the fulfillment of the purpose of resident entities, regardless of whether it generates taxable income. Moreover, Peruvian corporations that obtain business income and consider the compensation for technical assistance as a cost for income tax purposes are deemed to utilize the service in the country economically.

The current Peruvian income tax regulations define the concept of technical assistance as any independent service, whether performed abroad or within the country, through which the provider employs its skills by applying certain procedures or techniques, with the sole purpose of providing specialized knowledge that is not the subject of a patent, required for the productive process, including commercialization, rendering services or any other activity performed by the user of the service.

Technical assistance also comprises training people for the application of the specialized knowledge.

Even though it is necessary to verify that all the characteristics are met to determine if an activity qualifies as technical assistance, it is important to highlight that the income tax regulations cite three cases in which technical assistance is understood to exist:

- Engineering services
- Investigation and project development
- Assistance and financial consulting

These terms are all defined by the income tax law.

If technical assistance services are provided together with another type of services, the compensation corresponding to each of the activities must be identified in order to grant the corresponding tax treatment. However, if it is not possible to identify the amounts separately, due to the nature of the operation, the amount must be treated under the rules that apply to the essential and predominant operation.

Finally, since 1 January 2005, special requirements are needed to secure the 15% WHT rate for technical assistance. Specifically, the service provider must supply:

- A declaration stating that the services are of the category of technical assistance
- Certification from an international audit firm stating that the hours and services provided have been reviewed and are of the type that qualifies as technical assistance

Payments for "digital services" (a term that covers a group of activities developed through the internet) are subject to a 30% WHT if they are economically utilized in Peru, regardless of where they are performed.

Services that do not qualify as technical assistance or digital services are subject to a 30% WHT, provided that they are developed within Peru. No WHT applies to services performed wholly abroad. If services are performed partially in Peru and partially abroad, a pro rata or allocation system may be used to determine the portion of the compensation for the service that is subject to WHT.

Other activities rendered partially in Peru and partially abroad

Activities undertaken partially in Peru and partially abroad by nondomiciled companies, including revenue generated by their branches or PEs, are subject to WHT on a portion of the gross revenues generated, according to the following chart (unless otherwise indicated, the WHT rate is 30%):

Activities	Percent of gross revenues	Effective tax rate %
Air transport	1	0.3
Ship leases	80	8.0*
Aircraft charters	60	6.0*
Supply of transport containers	15	4.5
Storage of transport containers	80	24.0
Insurance	7	2.1
International news services	10	3.0
Sea transport	2	0.6
Motion picture distribution	20	6.0
Television broadcast rights	20	60.0
Telecommunications services	5	1.5

* The WHT rate for these activities is 10%.

Services rendered by independent professionals

Independent professionals are subject to WHT at a 24% effective rate. This is the result of applying the general 30% rate to 80% of the income received.

Tax treaties

Peru has the following double taxation agreements currently in force:

- Decision 578 of the Andean Pact – Peru entered into treaties with Bolivia, Colombia and Ecuador to avoid double taxation based on the source of income criterion.
- Treaties with Chile and Canada – effective from 1 January 2004, treaties with Chile and Canada to avoid double taxation became enforceable. Under these treaties, any business profits obtained in Peru by a Chilean or Canadian company are subject to tax in Chile or Canada only, unless the profit is earned through a PE in Peru, in which case it is subject to Peruvian income tax, but only to the extent that it is attributable to that PE.
- Treaty signed with Brazil – effective from 1 January 2010.

F. Financing considerations

Thin capitalization

Thin capitalization rules prohibit a tax deduction for interest paid by domiciled taxpayers to related or associated enterprises. To date, the maximum debt-to-equity ratio allowed under the thin capitalization rules is 3:1.

G. Transactions

The transfer of assets, as well as of interests in contracts (farm-in or farm-out arrangements), are subject to the common income tax and VAT rules.

H. Indirect taxes

VAT

VAT is subject to tax stability, but only for the transferable nature of the VAT charged by the buyer to the seller. The stabilized regime for VAT and other ISCs also applies for exporters, which means that exports are not subject to any tax.

It should also be mentioned that the import of goods and inputs required for exploration activities is free from any taxes (based on a list detailing such goods approved by the Government authorities).

A 18%[148] VAT applies to the following operations:

a) The sale of goods within Peru

b) Services performed within Peru

c) Services performed by nonresidents within Peru

d) Construction

e) The first sale of real estate by the builder

f) The import of goods

For activities a), b), d) and e), the VAT payable is determined on a monthly basis by deducting credited VAT paid (i.e., input tax) from the gross tax charged (i.e., output VAT) in each period. As a result, VAT does not necessarily represent a financial cost but may be met through offsetting the input tax against the output tax charged in the tax period.

However, VAT paid on the import of goods or the utilization of services within Peru must be paid directly to the tax authorities, meaning that the VAT to be paid must equal the output tax with no deduction for the input VAT credit. This payment may be used as a VAT credit once paid. This may result in a financial cost as a VAT credit for the period from the date of payment until the amount is applied to offset the output tax arising from the activities in a), b), d) and e) on the previous page.

148 *The VAT tax rate was reduced to 18% by Law N° 29666 effective as from 1 March 2011.*

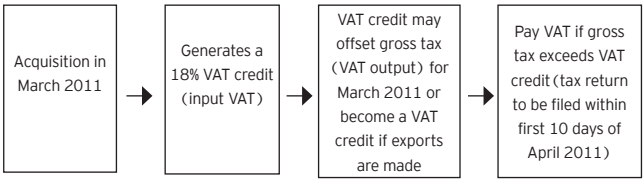
The output tax due for each taxable operation is calculated by applying the 18% VAT to the tax base (i.e., made up of the price of goods, services or construction contracts). The VAT credit consists of the VAT separately itemized in the payment voucher (or corresponding document) issued for any of the activities in a), b), c), d), e) and f) on the previous page.

To use the VAT credit, the following conditions apply: the acquisition is allowed as an expense or cost for income tax purposes, and the acquisition is intended for operations that give rise to an obligation to pay the VAT. Additionally, the tax must be stated separately in the payment voucher that must be completed according to the corresponding legal provisions, and the amount must be registered appropriately in the accounting records of the purchaser (i.e., in the purchase book).

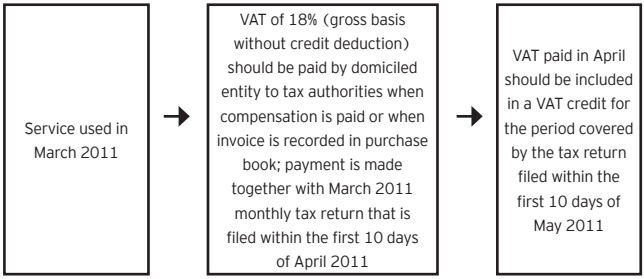
Nonresident purchasers of goods or services are not permitted to use the VAT charged as a credit, and no reimbursement is allowed under the Peruvian VAT law. Any VAT paid by a nonresident purchaser, therefore, becomes an additional cost.

The VAT credit treatment is summarized in the charts (the dates are examples only) below.

For purchasing goods in the country, acquisition of services performed by local entities, construction contracts or acquisition of real estate under its first sale:



For the utilization of services in Peru performed by nondomiciled entities:



For import of goods:

Exporters are reimbursed any VAT paid on the acquisition of goods and services. Also, exporters can apply this reimbursement as a credit to offset VAT or income tax liabilities. Any balance may be refunded by the tax administration.

Early recovery VAT system

This system allows early recovery of the VAT credit for acquisitions of goods, services, construction contracts, importations, etc., without waiting to recover such amount from a client when the invoice, including VAT, for the sales of goods, services or construction contracts is issued to the client.

In other words, this regime provides relief of financial costs (cost of money) for projects with a significant pre-operating stage and for which no advance invoice (transferring the VAT burden) can be issued periodically to the client.

Definitive VAT recovery for hydrocarbon exploration activities

Under this regime, VAT paid on the acquisition of goods and services used directly in oil and gas exploration activities can be recovered without having to wait until a commercial discovery takes place or production begins. This regime will be in force until 31 December 2012.

Joint ventures

VAT does not apply to the allocation of costs and expenses incurred by the operator in a joint venture that does not keep independent accounting records. Nor does it apply to the assignment of resources, goods, services and construction contracts made by the parties of the joint venture agreement for the performance of their common business or the allocation of the goods produced for each party under the agreement.

Likewise, any grant, sale, transfer or assignment of an interest in a joint venture is not subject to VAT.

Joint ventures that keep independent accounting records are considered to be legal entities and they are subject to VAT. Joint ventures that do not keep independent accounting records must allocate the income to each of the parties involved in the contract in proportion to their interest in the contract.

Custom duty

The custom duty rates that apply on the importation of goods into the Peruvian territory are 0%, 6% and 11%, depending on the tariff classification of the goods. Customs value is assessed using the WTO's valuation rules. Most capital goods are covered by the 0% rate.

The importation of certain goods and inputs during the exploration phase is a tax-free operation; these goods must be included in a prepublished list.

Goods can be temporarily imported for up to a period of four years. Import taxes (customs duties, if applicable, plus VAT) are suspended for temporary imports.

Selective consumption tax

The selective consumption tax (ISC) applies to luxury goods such as jewelry, cars, cigars, cigarettes, liquor, soft drinks, fuel and others. ISC rates range from 10% to 100%, generally based on the CIF (imports) or sale value, depending on the goods. However, for certain goods, such as soft drinks and fuel, the ISC is calculated on a specific basis depending on the amount of goods sold or imported.

Taxable persons for ISC purchases are producers and economically related enterprises engaged in domestic sales of listed goods, importers of listed goods, importers and economically related enterprises engaged in domestic sales of listed goods and organizers of gambling activities.

Liability to ISC arises under the same rules that apply to VAT.

To avoid double taxation, a credit is granted for the ISC paid on imports and in other specific cases.

Financial transaction tax

Operations made through Peruvian bank accounts (deposits and withdrawals) are subject to the financial transaction tax, charged at the rate of 0.005%.

Temporary net assets tax

Temporary net assets tax (ITAN) has been in force since fiscal year 2005 and is equal to 0.4% of the value of the total assets over PEN1 million. The ITAN obligation is determined based on the balance sheet as of 31 December of the previous year.

ITAN may be paid in either one or nine monthly quotas (i.e., a fractional payment). In the first case, the payment must be made with the ITAN return submitted in April.

ITAN payments may be used as a tax credit to offset income tax liabilities (i.e., monthly prepayments and the income tax payment due when the annual income tax return is filed).

Likewise, according to the ITAN law, taxpayers that are obliged to pay taxes abroad related to income arising from Peruvian sources may choose to pay the ITAN due with the amount paid for the monthly prepayments of the income tax (referred to as the option). This option may be used only if the taxpayer has chosen to make the payment in fractional amounts.

Under the ITAN regulations, a taxpayer may choose this option if its shareholders or head office are obliged to pay taxes abroad for the revenues generated by the Peruvian taxpayer.

Taxpayers choose the option by filing a sworn declaration; this declaration must be submitted when the taxpayer files its ITAN returns. If the declaration is not filed on time, it is considered not submitted and, therefore, the taxpayer may not apply for the option for the remainder of the fiscal year.

Taxpayers that choose the option effectively may use the amount paid as a tax credit, as follows:

Income tax prepayment corresponding to period	May be used as a tax credit against the quota of ITAN expiring in the corresponding month
March	April
April	May
May	June
June	July
July	August
August	September
September	October
October	November
November	December

If the amount of the income tax prepayments is higher than the amount of the ITAN to be offset, according to the chart above, the balance may not be used against the next quotas.

If the taxpayer chooses the option and directly pays some quotas of ITAN, it may not use the ITAN effectively paid as a credit against the income tax. In such cases, the ITAN paid may be regarded as an expense.

The income tax prepayments, which have been used as a tax credit against the ITAN, may also be used as a tax credit (without a right of refund) against the income tax due.

Municipal taxes

Real estate tax

The real estate tax affects real estate held by corporations and individuals. The tax rates are determined using a progressive accumulative scale based on the property's value, as follows:

Real estate value	Rate
Up to 15 tax units	0.2%
More than 15 and up to 60 tax units	0.6%
More than 60 tax units	1.0%

Vehicle tax

The vehicle tax applies to vehicles held by corporations and individuals. The tax rate is 1% of the original value upon acquisition or importation of the vehicle.

This tax applies to vehicles registered with the Vehicular Properties Office of the Public Registry in the previous three years.

Alcabala tax

Real estate transfers are subject to a 3% Alcabala tax. The taxable base is the transfer value, which cannot be less than the self-assessed value (*autoavaluo*) of the property. The first 10 tax units are exempt. The Alcabala tax must be paid by the purchaser within the calendar month following the month the transfer is made.

I. Other

Profit sharing

Employers are obliged to distribute a share of their profits among their employees. The rate depends on the company's activity, as follows:

- Fishing – 10%
- Telecom – 10%
- Industry – 10%
- Mining – 8%, including exploitation of coal mines; production of petroleum and natural gas; and extraction of iron, uranium, thorium, iron-free minerals, construction stone, clay, talc, sand and gravel, feldspar and salt
- Commerce and restaurants – 8%
- Other – 5%, including farming, stockbreeding and forestry; production and distribution of electricity; production of gas; transportation services and services related to air transportation (such as travel agencies, storage and deposit); financial services of insurance and real estate; legal, audit and accounting activities; business consulting, consulting related to informatics and data processing; and advertising, health and medical services, and education

Many oil and gas companies calculate this employee benefit using the 5% rate that applies to the "other" group of activities. This has been a matter of discussion at the judiciary level.

Profit sharing is calculated on pretax income, and the amount is deductible as an expense for determining income tax. An example of the combined-effect calculation using a 5% profit-sharing rate follows:

- Net income: 100
- Profit sharing: 5
- Net income for CIT purposes: 95
- Income tax (30% of 95): 28.5
- Combined effect: 28.5 + 5 = 33.5 (33.5% of net income)

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A. At a glance

Fiscal regime: corporate tax and production sharing

Bonuses	Bonuses are payable by the contractor to the Government upon signing, discovery or production only if stipulated in the service contract
Production sharing contract (PSC)	The service contractor receives its share of petroleum as a service fee equal to 40% of the net proceeds from petroleum operations, and the Government share under a service contract is not to be less than 60% of the net proceeds
Income tax rate	The service contractor is subject to the corporate income tax (CIT) of 30% based on net income, as provided under the 1997 Tax Code, as amended by Republic Act 9337 (Sec. 28 (A) (1))
Capital allowances	Accelerated depreciation; E: immediate write-off for exploration costs
Investment incentives	The service contractor is entitled to exemption from all taxes, except income tax

B. Fiscal regime

The Philippine Government, through the Department of Energy, as owner of natural resources, including oil and gas reserves in the Philippines, may directly explore for and produce indigenous petroleum. It may also enter into a service agreement with a service contractor for the exploration and development of oil fields under Presidential Decree (PD) No. 87, as amended, otherwise known as the Oil Exploration and Development Act. The agreement is embodied in a service contract with the Philippine Government.

The service contractor receives its share of petroleum as a service fee equivalent to 40% of the net proceeds from the petroleum operations (under the Department of Energy Model Service Contract pursuant to PD No. 87, as amended).

The service contractor is subject to CIT at a rate of 30% based on net income (proceeds), as provided under the 1997 Tax Code, as amended by Republic Act 9337 (Sec. 28 (A) (1)).

Petroleum operations

Petroleum operations are defined as searching for and obtaining petroleum within the Philippines through drilling and pressure, or suction, or similar activities and other operations incidental to these activities. The term includes the transportation, storage, handling and sale, whether for export or for domestic consumption of petroleum, but does not include any transportation of petroleum outside the Philippines, processing or refining at a refinery or any transactions in the products so refined (Section 3 (d) of PD No. 87, as amended).

Net proceeds

Net proceeds are defined as the gross income less the recoverable operating expenses and the Filipino Participation Incentive Allowance (FPIA).

Gross proceeds

Gross proceeds are defined as proceeds from the sale, exchange or disposition of all petroleum, crude oil, natural gas or casing head petroleum spirit produced under the service contract and sold or exchanged during the calendar year, and all such other income that is incidental to or arising from any one or more of the petroleum operations under the contract.

Deductions

At the outset, operating expenses incurred by a service contractor are reimbursed by the Philippine Government. The reimbursement may not exceed 70% of the gross proceeds from production in any year. If, in any year, the operating expenses exceed 70% of the gross proceeds from production, the unrecovered expenses may be recovered from the operations of the succeeding years (PD No. 87, as amended by PD No. 1857). There is no time limitation for recovery on the carryforward of unrecovered expenses to succeeding years.

Recoverable expenses

In arriving at the net proceeds, the following are allowable deductions (reimbursable expenses) for the contractor.

General expenses

All ordinary and necessary expenses paid or incurred by the contractor during the taxable year in carrying on the petroleum operations under a service contract (Rev. Reg. 1-81).

Interest

In general, interest expense paid or incurred within the taxable year is deductible (to the extent of two-thirds of the amount), except for interest on any loan or indebtedness incurred to finance exploration expenditures, for which no interest deductions will be allowed (PD No. 1857, amending PD No. 87). The prohibition on the deductibility of interest with respect to indebtedness incurred to finance petroleum exploration is explained in Sec. 34 (B) (2) (c) of the 1997 Tax Code.

Depreciation

The service contractor is granted the option of using the straight-line or double-declining balance method of depreciation on all tangible assets initially placed in service in a taxable year and directly related to the production of petroleum. The method elected for a particular taxable year must be used for assets placed in service during that year.

The general rule is that the useful life of assets used in, or related to, production of petroleum is 10 years, or such shorter life as allowed by the commissioner of internal revenue. The useful life is five years under the straight-line depreciation method for property not used directly in the production of petroleum (Sec. 34 (F) (4), 1997 Tax Code; Sec. 6 (e), Rev. Reg. 1-81).

However, pursuant to PD No. 1857, the depreciation of all tangible exploration costs, such as capital expenditures and other recoverable capital assets, are to be depreciated for a period of five years using the straight-line or double-declining balance method of depreciation at the option of the contractor.

Intangible development and drilling expenses

Intangible development and drilling expenses for producing wells incurred after the commencement of commercial production may be allowed as a deduction in the taxable year they are paid or incurred. The contractor has the option to capitalize and amortize these costs on the basis of the recoverable units of reserves in the particular oil field involved plus the units produced and sold during the same year from that oil field, or over a shorter amortization schedule as allowed by the Commissioner of Internal Revenue (Sec. 6 (h), Rev. Reg. 1-81).

If the contractor chooses to capitalize and amortize the drilling expense of producing wells (including any well that is subsequently determined to have failed to find petroleum in commercial quantities), all unamortized costs regarding the well may be deducted in full in the year of the determination (Sec. 6 (i), Rev. Reg. 1-81).

Intangible exploration costs

Intangible exploration costs may be reimbursed in full under the provisions of PD No. 1857.

Abandonment losses

If a contract area is abandoned, an expenditure incurred on or after 1 January 1979 may be deducted from the income derived from any other activity as an abandonment loss. The unamortized costs of a previously producing well and undepreciated costs of equipment are allowed as a deduction in the year that the well, equipment or facilities are abandoned by the contractor (Rev. Reg. 1-81).

Filipino participation incentive allowance

An FPIA is allowed as a deduction under general principles for computing taxable net income (Sec. 21 (1), PD No. 87). An FPIA is the subsidy granted by the Government to a service contractor if Philippine citizens or corporations have a minimum participating interest of 15% in the contract area. An incentive not exceeding 7.5% of the gross proceeds may be computed by deducting the FPIA from the market price of crude oil produced under the contract and sold during the year (Sec. 28, PD No. 87).

C. Capital allowances

A service contractor is granted the option of using the straight-line or double-declining balance method of depreciation for all tangible assets initially placed in service in a taxable year that are directly related to the production of petroleum. The method elected for a particular taxable year must be used for all assets placed in service during the year.

The general rule is that the useful life of assets used in, or related to, production of petroleum is 10 years, or such shorter life as allowed by the Commissioner of Internal Revenue. The useful life of property not used directly in the production of petroleum is five years under the straight-line depreciation method (Sec. 34 (F)(4), 1997 Tax Code; Sec. 6 (e), Rev. Reg. 1-81).

However, under PD No. 1857, all tangible exploration costs, such as capital expenditures and other recoverable capital assets, are to be depreciated for a period of five years, using the straight-line or double-declining balance method of depreciation at the option of the contractor.

D. Incentives

Under PD No. 87, known as the Oil Exploration and Development Act of 1972, the following fiscal incentives are provided for petroleum service contractors:

- A service fee of up to 40% of net production (note that, Section 18 (b) of PD No. 87 provides that the annual share of the Government, including all taxes paid by, or on behalf of, the contractor, shall not be less than 60% of net production)
- Cost reimbursement of up to 70% of gross production with carryforward of unrecovered costs
- FPIA grants of up to 7.5% of the gross proceeds for service contracts with minimum Philippine company or citizen participation of 15%
- Exemption from all taxes except income tax (for service contracts executed after 1991, a local business tax ranging from 0.5% to 3% of gross receipts may be imposed)
- Exemption from all taxes and duties for importation of materials and equipment for petroleum operations
- Easy repatriation of investments and profit
- Free market determination of crude oil prices (i.e., prices realized in a transaction between independent persons dealing at arm's-length)
- Special income tax rate of the 8% of gross Philippine income for subcontractors (for subcontracts executed after 1991, a local business tax ranging from 0.5% to 3% of gross receipts may be imposed)
- Special income tax of 15% of Philippine income for foreign employees of service contractors and subcontractors (and for Filipinos employed and occupying the same positions)

E. Withholding taxes

Dividends

Dividends received by a domestic or resident foreign corporation from a domestic corporation (i.e., a locally incorporated petroleum service contractor) are not subject to income tax.

Dividends received by a nonresident corporation from a locally incorporated petroleum service contractor are subject to withholding tax (WHT) at 30%. The tax is reduced to 15% if the recipient foreign corporation is a resident of a country that does not impose any tax on dividends received from foreign sources or allows a credit against the tax due from the nonresident foreign corporation taxes deemed to have been paid in the Philippines, equivalent to 15%.

However, if the recipient is a resident of a country with which the Philippines has a tax treaty, the more favorable tax treaty rate applies. In order to be eligible for the favorable tax treaty rate, the income recipient must file a tax treaty relief application (TTRA) with the Philippine Bureau of Internal Revenue (BIR) before the occurrence of the first taxable event. For purposes of the TTRA, the first taxable event is the first or only time when the income payor is required to withhold the tax, or should have withheld taxes, had the transaction been subjected to WHT.

Interest

In general, the 1997 Tax Code imposes a final WHT of 20% on interest of foreign loans received by a nonresident foreign corporation (Sec. 29 (B) (5) (a)). However, if the lender is a resident of a country with which the Philippines has a tax treaty, the more favorable tax treaty rate applies. In order to be eligible for the favorable tax treaty rate, a TTRA must be filed with the BIR.

Royalties

Royalties (e.g., payments for the supply in the Philippines of scientific, technical, industrial or commercial knowledge or information) paid to a domestic or resident foreign corporation are subject to a 20% final tax. Royalties paid to a nonresident foreign corporation are subject to 30% income tax, or the treaty rate if the recipient is a resident of a country with which the Philippines has a tax treaty, in which case the tax is withheld at source plus a 12% final withholding VAT. In order to be eligible for the favorable tax treaty rate, a TTRA must be filed with the BIR.

Technical services

Fees or income derived by nonresident foreign corporations for performing technical services (not related to petroleum operations) within the Philippines are generally subject to a 30% final WHT based on the gross amount.

If the provider of technical services is a domestic corporation or a resident foreign corporation, it is subject to regular CIT or the minimum corporate income tax (MCIT), whichever is higher. Beginning with the fourth taxable year immediately following the year when a corporation commences its business operations, MCIT is imposed if this tax exceeds the tax computed under the normal tax rules. As provided for by Sec. 27 (E) and Sec. 28 (A) (2) of the 1997 Tax Code, as amended, in computing the gross income subject to the 2% MCIT for sellers of services, gross income means gross receipts less sales returns, allowances, discounts and the cost of services. Cost of services means all direct costs and expenses necessarily incurred to provide the services required by the customers and clients. It includes salaries and employee benefits of personnel, consultants and specialists directly rendering the service, and the cost of the facilities directly utilized in providing the service, such as depreciation, rental equipment and costs of supplies. Any excess of the MCIT more than the normal tax may be carried forward and credited against the normal tax for the three immediately succeeding taxable years.

For as long as the services are performed in the Philippines, a 12% VAT on gross receipts applies.

In the case of technical services related to petroleum operations, Sec. 1 PD No. 1354 applies. It provides that every subcontractor, whether domestic or foreign, that enters into a contract with a service contractor engaged in petroleum operations in the Philippines is liable for a final income tax equivalent of 8% of its gross income derived from the contract. The 8% final tax is in lieu of all national and local taxes. A petroleum subcontractor provides the means necessary for the service contractor to pursue its petroleum operations (Zapata Marine Service Ltd., S.A. vs. CIR, CTA Case No. 3384, 30 March 1987).

Note, however, that for subcontracts executed after 1991, a local business tax ranging from 0.5% to 3% of gross receipts may be imposed.

Branch remittance tax

A branch profits remittance tax (BPRT) of 15%, or the treaty rate if the branch is a resident of a country with which the Philippines has a tax treaty, applies to any profit remitted by a branch to its head office. The tax is based on the total profit earmarked for remittance without any deduction for the tax component (Sec. 28 (A)(5), 1997 Tax Code). In order to be eligible for the favorable tax treaty rate, a TTRA must be filed with the BIR.

F. Financing considerations

Under PD No. 1857, two-thirds of the interest expense paid or incurred within the tax year is deductible and reimbursable (except for interest on loans incurred to finance exploration expenditures).

G. Transactions

In general, gains derived from the sale of assets, such as machinery and equipment used in business, are subject to 30% income tax and 12% VAT.

Gains from the sale of shares of stock not listed and traded in the local stock exchange are subject to 5% capital gains tax (CGT) on the net gains not exceeding PHP100,000, and to 10% tax on the excess.

A documentary stamp tax (DST) also applies to the sale or transfer of shares at the rate of PHP0.75 per PHP200 par value.

H. Other

A service contractor must register with the Department of Energy all existing service contracts and all contracts to be entered into relating to oil operations between the service contractor and a subcontractor engaged in petroleum operations (Sec. 6, Rev. Regs. 15-78).

Administrative contracts do not need to be registered, but the contractor must provide a copy to the Department of Energy (Sec. 6, Rev. Regs. 15-78).

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A. At a glance

Fiscal regime

The fiscal regime that applies in Poland to the oil and gas industry consists of a combination of corporate income tax (CIT), VAT, excise duty and real estate tax (RET).

CIT rate	19%
Capital gains tax (CGT) rate	19%
Branch tax rate	19%
VAT rate	23%
RET rate	2%

B. Fiscal regime

Both the upstream business and joint operations are under-regulated in Polish tax law. This section is therefore based on the general CIT and VAT regulations, and the practice of the tax authorities (expressed in the official tax rulings issued by the Ministry of Finance).

Nevertheless, the Polish Government is currently developing the concept of taxation for oil and gas (which may be a combination of basic CIT, royalties and additional hydrocarbon tax). Moreover, the parliamentary opposition has prepared its own bill, consisting of the key elements of a proposed oil and gas tax system. The changes are expected to come into force from 2015 or possibly even sooner.

The main tax issues are: CIT/VAT treatment of joint operations (timing of revenue recognition, treatment of buy-in payments, farm-in/ farm-out), CIT treatment of E&E expenses and asset recognition (e.g., dry wells).

Corporate income tax (CIT)

Corporations operating in Poland are subject to CIT on their Polish-sourced income at a rate of 19%. This rate applies to any type of income, including that from oil and gas activities.

Ring-fencing

Poland does not apply ring-fencing in determining an entity's corporate tax liability in relation to its oil and gas activities. Profit from one project can be offset against losses from another project held by the same Polish legal entity, and, similarly, profits and losses from upstream activities can be offset against downstream activities undertaken by the same Polish entity. A new oil and gas taxation approach in this respect may be introduced by regulations proposed by the Government.

CIT is levied on taxable income

Taxable income is the difference between aggregated taxable revenues and aggregated tax-deductible costs.

Tax losses

Aggregated annual tax-deductible costs exceeding annual taxable revenues constitute a tax loss. Losses may be carried forward to the following five tax years to offset income that is derived in those years. Up to 50% of the original loss may offset income in any of the five tax years. Losses may not be carried back.

C. Capital allowances

Depreciation

For tax purposes, depreciation calculated in accordance with the statutory rates is deductible. Depreciation is calculated using the straight-line method. However, in certain circumstances, the reducing-balance method may be allowed. The following are some of the applicable annual straight-line rates.

Item	Type of depreciating asset	Rate (%)
1	Buildings	1.5 to 10
2	Wells	4.5
3	Machinery and equipment	7 to 18
4	Computers	30

Accelerated depreciation is available for machinery and equipment, but not for wells.

D. Incentives

Research and development (R&D) relief applies to expenses for innovative technologies that can be classified as intangibles, and 150% of expenses can be deducted from the taxable base.

E. Withholding taxes

The rate for withholding tax (WHT) on dividends is 19%. The rate for WHT on interest and royalties is 20%. However, the rates may be reduced for countries with whom Poland has negotiated double tax treaties, or in line with European Union directives.

F. Financing considerations

Thin capitalization

Thin capitalization restrictions apply if a company's debt-to-equity ratio exceeds 3:1 and loans are drawn from parent and sister companies with a minimum shareholding level of 25%. As a rule, a 2% transfer tax is chargeable on such a debt, unless specific exemptions apply (shareholder's debt is not subject to transfer tax).

G. Transactions

Asset disposals

It is not possible to sell licenses or oil and gas extraction permits. It is possible to sell an enterprise as a property complex, together with all its assets and liabilities (but not licenses), as a whole. Such a transaction is outside the scope of VAT.

Farm-in and farm-out

Polish tax law does not recognize farm-ins and farm-outs, as the license issued by the state cannot be traded; therefore farm-ins and farm-outs are exercised through joint ventures, joint operations or share deals.

Joint operations

The Polish CIT Act outlines a general rule on the allocation of profits (i.e., revenues and costs) applicable among others to a joint undertaking. Assuming that cooperation is considered a joint undertaking within the meaning of the CIT Act, the CIT settlements between parties should be established in line with the above-mentioned provision and the general CIT rules.

The revenue generated within a joint undertaking should be allocated to the parties according to their shares in the undertaking, as declared in the agreement. The above rule should be applied accordingly to tax-deductible costs, costs not deductible for tax, tax exemptions and tax reliefs. In this case, the rule affects the recognition of revenues (and costs), in particular during the exploration and production (E&P) phase.

Currently, the tax authorities tend to accept that upstream cooperation should follow the CIT rules applicable to joint ventures.

What is still unclear is the point of revenue recognition for the operators, where non-operators provide extra funding for the operations, in excess of their participation interest.

H. Indirect taxes

VAT

VAT is imposed on goods sold and services rendered in Poland, exports, imports and acquisitions and supplies of goods within the EU. Poland has adopted most of the EU VAT rules.

Effective from 1 January 2011, the standard rate of VAT is 23%. Lower rates may apply to specified goods and services. The 0% rate applies to exports and supplies of goods within EU. Certain goods and services are exempt.

Excise duties

Excise duty is applied on petroleum products, alcoholic beverages, tobacco products, electricity and cars.

Item	Type of oil and gas product	Rate (PLN/1,000 liters)
1	Engine gasolines	1,565
2	Diesel oils	1,196
3	Oils intended for heating purposes	64 or 232
4	Liquefied gases used for propulsion of combustion engines (LNG and LPG)	695
5	Other engine fuels	1,822
6	Other heating fuels	64 to 232

Gases used for propulsion of combustion engines in gaseous state are taxed at the rate of PLN11.04/gigajoule (GJ). Natural gas is not subject to excise duty currently, but it will be excisable from November 2013, when the excise duty exemption is due to expire. Gas will be dutiable at the rate of PLN1.28/1GJ. The exact regime is not yet known but a wide range of exemptions are expected.

Transfer tax

As a general rule, the transfer tax applies to transactions made by entities that are not VAT registered (or those that are specifically exempt) and are not involved in professional commerce. Nevertheless, the transfer tax is also imposed on other businesses in specific situations: an incorporation of company and an increase of share capital is taxed at a rate of 0.5% on the increased or created share capital value; an additional payment contributed to company's supplementary capital is taxed at a 0.5% rate; a transfer of shares is taxed at a 1% rate; and a sale of real estate is taxed at a 2% rate.

Stamp duties

Stamp duty is levied by notaries and is generally capped at insignificant amounts.

Registration fees

There are no significant registration fees.

Other significant taxes

RET applies to land and buildings (rates per m^2) and all constructions (the rate is 2% p.a. of the initial value used for tax depreciation purposes). Many doubts surround the definition of "construction," and therefore, the scope of RET taxation in the oil and gas industry is not entirely clear and has been the subject of dispute between the taxpayers and the tax authorities. Close monitoring of the legislation and practice in this respect is required.

I. Other

Foreign exchange controls

There are no foreign exchange restrictions on inward or outward investments, apart from duties of disclosure imposed by a foreign exchange law.

Gas to liquids

There is no special regime for gas to liquids conversion.

Concessions and mining usufruct agreements

The E&P of natural resources are licensed activities. Concessions must be obtained both for the exploration and the production stages, and a detailed application has to be submitted to the minister of the environment. As a rule, concessions cannot be shared by independent entities. As the main rule under the Geological and Mining Act is that hydrocarbons are state-owned, upstream activities require a mining usufruct. It is not clear whether such rights can be shared; however, the Ministry of the Environment has permitted transfer of shares in mining usufruct agreements (MUAs), provided that the acquirer only receives a 49% interest in the MUA. This has allowed, in practice, the existence of farm-in and farm-out agreements and joint operation agreements (JOAs). From 2012, MUAs became transferable.

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A. At a glance

Fiscal regime

Companies carrying on petroleum operations in Qatar are subject to corporate income tax (CIT) in accordance with the specific terms of agreements negotiated with the state, which is represented by the national oil company (NOC). Petroleum operations are defined by law as the exploration for petroleum, improving oil fields, drilling, well repair and completion; the production, processing and refining of petroleum; and the storage, transport loading and shipping of crude oil and natural gas.

Agreements for the conduct of petroleum operations may be under a production sharing contract (PCS) where the NOC (acting as agent for the Government) will not become a party to the activities under the PSC, or under a development and fiscal agreement where the NOC participates in the petroleum operations with the international oil and gas operator.

Royalties	May apply to development and fiscal agreements.
Bonuses	Applicable to PSC contracts only.
PSC	The contracts are based on production sharing arrangements. The PSC allows the operator to explore for and produce crude oil and gas within a contract area on behalf of the Government. The operator is entitled to cost recovery and a share of production.
Income tax rate	The CIT rate specified for petroleum operations in the new 2009 law that was effective from 1 January 2010 is 35%. Agreements negotiated prior to the enactment of the 2009 tax law will continue to apply, and these rates range from 35% to 55%.
Resource rent tax	Not applicable.
Capital allowances	Specific depreciation rates are negotiated under development and fiscal agreement arrangements. The amortization of capital expenditure under PSC arrangements is based on a cost recovery model with the title to the assets transferring to the NOC after cost recovery by the operator.
Investment incentives	Dependent on the fiscal terms of the underlying agreements.

B. Fiscal regime

Corporate tax

Petroleum companies are taxed at the rate of 35% (or rates ranging from 35% to 55% for agreements that precede the enactment of the 2009 Income Tax Law) on their taxable income. Taxable income is determined in accordance with the provisions of the underlying PSC or development and fiscal agreement.

PSC arrangements generally involve the following elements:

- All risks are borne by the company. Expenditures for exploration, development, production and related activities are fully funded by the company and the Government does not fund any activity.
- Reserves are owned by the Government.
- The company is responsible for all costs but entitled to recovery out of annual production.
- Production is shared between the company and the NOC (no concept of profit sharing).
- The PSC will provide for signature and production bonuses that are not cost recoverable.
- The Government is usually not entitled to a royalty.

Petroleum revenues

Petroleum revenues represent the sales value of the company's share of net production as measured at the point of delivery as adjusted for over and under lifting and the change in inventories at year-end.

Taxable income

The taxable income for the purposes of determination of Qatar income tax is defined in the PSC and is generally defined as the total sums received from the sale or other disposition of the company's share of all net production plus taxation uplift.

Petroleum costs

All expenditure and costs defined by the PSC as exploration, appraisal and development costs are capitalized and are carried forward for recovery against future production revenues or write-off at the time of relinquishment of the interests. Expenditures qualifying for cost recovery are subject to specific rules in the PSC. Generally, the PSC requires that costs and expenses of activities carried out by the company or its affiliates are to be included in recoverable costs, only to the extent that such costs and expenses are directly or indirectly identifiable with such activities, and should be limited to the actual costs that are fair and reasonable. Certain costs are specifically prohibited for cost recovery. Excluded costs include bonuses paid by the company to the Government in accordance with the PSC, the company's Qatari income taxes paid in accordance with the PSC, foreign income taxes and other foreign taxes paid by the company. Additionally, the following costs are generally disallowed:

- Finance costs
- Marketing and sponsorship costs
- General head office/shareholder costs
- "Personal" costs
- "Unnecessary" costs (e.g., due to inefficiencies or waste or what may be determined excessive amounts)

Company taxation is usually paid by Government on behalf of the company. The NOC settles the company's tax liability from its share of production, and the tax authorities issue a tax receipt and a tax certificate for the taxes that apply to the company.

Losses

Losses may be carried forward for three years but may not be carried back. Loss carryforwards do not apply to PSCs because the entire cost is carried forward for future recovery.

Oil service companies

Oil and gas service companies are taxed at a 10% tax rate.

Resource rent tax

Qatar does not have a resource rent tax.

Ring-fencing

The fiscal terms under PSC and development and fiscal agreements are ring-fenced in Qatar and, as a general rule, expenses and tax losses on one project may not be set off against income from another project.

Farm-in and farm-out

Farm-in and farm-outs are permissible; however, before any agreement is entered into, it is mandatory for the contractor to obtain written authorization from the NOC. There is no material transfer fees associated with such transactions.

C. Capital allowances

The laws provide for specific depreciation rates for specified types of assets. The executive regulations, which are still in draft form, contain specific rules on tax depreciation. Depreciation is calculated by applying the following rates to the actual total cost on a straight line basis:

Buildings	5%
Pipelines and reservoirs	5%
Ships and vessels	10%
Aircraft	20%
Excavation tools	15%

Depreciation is applied to other categories of assets on a pooled basis at the following rates:

Computers	33%
Plant and equipment	20%
Office furniture and fittings	15%

However, capital allowances do not apply to PSCs, because the entire capital expenditure qualifies as a recoverable cost under a PSC.

D. Investment incentives

All incentives under development and fiscal agreements are dependent on fiscal negotiations with the Government. The typical incentives offered under the Foreign Capital Investment Law include the following:

- 10-year tax holiday
- Customs duty exemptions until start of commercial production
- Land lease of 50 years at subsidized rates
- No restriction on repatriation of capital and dividends
- Feedstock gas or gas reserves at subsidized rates
- Favorable treatment with respect to compliance with general commercial, tax and other regulatory requirements in Qatar

E. Withholding taxes and double tax treaties

Payments made to foreign companies that are not tax resident or do not have a permanent establishment (PE) in Qatar are subject to a final withholding tax (WHT).

WHT is applicable at the following rates:

- 5%–on gross amount of royalties and technical fees
- 7%–on gross amount of interest, commissions, brokerage fees, director's fees and fees for any other payments in relation to services rendered partially or wholly in Qatar

Thus, if an entity in Qatar makes any of these payments to a foreign company, it must deduct either 5% or 7% WHT from such payments and remit this to the tax authorities.

WHT is not levied on dividends and certain categories of interest.

Relief may be available from WHT under a relevant double tax treaty.

Qatar has entered into double tax treaties with Armenia, Azerbaijan, Belarus, China, Cuba, Cyprus, France, India, Indonesia, Italy, Jordan, Korea (South), Lebanon, Luxembourg, Macedonia, Malaysia, Morocco, Nepal, Netherlands, Norway, Pakistan, Philippines, Poland, Romania, Russia, Senegal, Seychelles, Singapore, Sri Lanka, Switzerland, Syria, Tunisia, Turkey, United Kingdom, Venezuela, Vietnam and Yemen.

Qatar has also signed the following treaties, which are not yet effective:

Algeria, Austria, Bangladesh, Belgium, Brunei, Hungary, Malta, Mexico, Portugal and Sudan.

F. Financing considerations

Thin capitalization

Interest paid to a head office or related party is not deductible for tax purposes and such interest is not subject to WHT.

The accounting and tax treatment of finance costs is generally determined in accordance with the specific agreements underlying the oil and gas projects; however, finance costs are a nonrecoverable cost under most PSCs.

G. Transactions

An expenditure that qualifies for cost recovery (opex and capex) is explained in Section B. Other major transactions are explained below.

Asset disposals

Under the PSC, if the assets that qualify for cost recovery are sold, the proceeds are offset against recoverable costs or remitted to the NOC (i.e., they are considered to be the assets of the NOC). A balancing charge or allowance does not apply.

Relinquishment

The taxation of a disposal or relinquishment of an interest in a PSC is governed by the specific provisions of the PSC; however, these disposals are generally not subject to taxation.

H. Indirect tax

Customs duty and legalization fees are the only indirect taxes imposed in Qatar.

Customs duty

Qatar is a member of the Gulf Cooperation Council (GCC) and follows the Unified Customs Law across the GCC. The uniform customs duty of 5% applies on all imports. This means that any goods that come into a port of entry of a GCC member state that have been subjected to customs duty in that state are not subjected to customs duty again if the goods are transferred to another GCC member state. An exemption or reimbursement of customs duty will depend on the wording of the PSC or development and fiscal agreement. The import of drilling rigs is an exempt import under the GCC customs regulations.

Legalization fees

Commercial invoices must be legalized by the Commercial Department of the Qatari Embassy in the country of origin or by the customs authorities at the point of import in Qatar. Legalization fees are levied on the basis of invoice value and range from QAR100 on an invoice value of QAR5,000 to 0.4% of value for invoice amounts in excess of QAR1 million.

Free trade agreements

In 2009, the GCC states entered into a free trade agreement with Singapore; this agreement is effective for trade between Singapore and Qatar.

VAT

Currently, there is no VAT in Qatar.

Registration fees

Registration fees are payable to various ministries. However, the amounts of these fees are not significant.

Municipality and other taxes

Qatar does not impose estate tax, gift tax or dividends tax. Municipalities impose a license fee that is aimed at compensating the municipal authorities for central governmental services, such as the cleaning and maintenance of urban and rural areas and waste collection. The municipal fee levied on business is QAR10,000 per annum.

I. Other

Payroll taxes and employee benefits

Employee earnings are not taxed. Self-employed foreign professionals are subject to income tax on their business profits. There are no social security insurance contribution requirements or other statutory employment related deductions, nor any similar contributions required from employers. The Qatar Labour Law requires all private sector business entities to pay terminal benefits for all employees at the rate of three weeks pay per annum.

The Government operates a contributory pension scheme for Qatari employees. The scheme applies to Qatari employees in the state and public sector. Employees are required to contribute 5% of their salary to a pension fund operated by the General Corporation for Retirement and Pensions and the employer's funding obligation equals 10%. Qatari employees employed in the oil and gas sector will generally be covered by this pension fund requirement and, accordingly, an operator under a PSC, or a joint venture company operating under a development and fiscal agreement, will be required to apply the pension fund requirements for its Qatari employees.

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A. At a glance

Fiscal regime

The fiscal regime applicable to the petroleum industry in the Republic of the Congo consists of the Congolese Tax Law (especially the VAT law and decree of 1997 and 2001), the Congolese Tax Code, the Congolese Hydrocarbon Code and the production sharing contract (PSC) or concession contract concluded between the Congolese Government and the oil companies.

The rules for taxation rate, control, sanctions, prescription and tax litigation in relation to corporate tax and mineral fees (*redevance minière proportionnelle*) are contained within the general tax rules and the Hydrocarbon Code.

Corporate income tax (CIT)	34%
Surface rent[149]	Exploration permit: FCFA3,000/km^2 Exploitation permit: US$800/km^2
Bonuses	Amount specified in the government decree that grants the exploration or exploitation permit
Royalties	Rate depends on the terms of the PSC
Mineral fee	15%[150]
Capital allowances	S, E[151]
Incentives	L, RD[152]

B. Fiscal regime

There are two kinds of petroleum companies in the Republic of the Congo:

- Upstream companies that specialize in the exploration and production of oil and gas
- Companies, known as subcontractors, providing petroleum services to upstream companies

The fiscal regime that applies to upstream oil and gas companies differs from that which applies to the subcontractor companies. This guide will focus only on the fiscal regime applicable to upstream oil and gas companies.

149 *Annual surface rent is applicable to the PSC holder or participants.*

150 *Mineral fee can be paid by cash or oil equivalent.*

151 *S: straight-line depreciation at 20%; E: immediate write-off of exploration costs.*

152 *L: ability to carryforward losses; RD: research and development incentive.*

Corporate income tax

CIT is applied to the net profit of oil companies at the rate of 34%. The net profit is the difference between the net asset value at the end of a fiscal year reduced by definite charges, such as cost oil (see below) and provision for recovery of oil field.

CIT is paid out of the Congolese Government's share of profit oil (see below).

Petroleum contracts

There are two different types of petroleum contracts entered into between oil companies and the Congolese Government — a concession contract and a PSC.

Concession contract

The first type of contract, and the rarest, is the concession contract that gives the right for the company to exploit, for its own benefit, a mining title (*titre minier*). Under a concession contract, the Congolese law does not allow setting off losses of one permit against the profits of another permit. Accordingly, ring-fencing is applicable on permits.

Production sharing contract

The second type of petroleum contract, and the most common, is the PSC, under which the Congolese Government gives a right to an oil company to exploit a specific area. If oil is discovered by the company, the exploitation is made in the name of the Congolese Government. If oil is not discovered, all the costs of exploration are assumed by the company.

Pursuant to the Hydrocarbon Code, one part of the oil production is used to reimburse the costs of exploration and development incurred by the company. This is called "cost oil" and is limited to net production, called "stop oil." This part of production cannot exceed 60% of the annual production for all the permits. However, when the work is especially difficult (e.g., deep area, price of technologies), this rate can be increased to 70%.

The part of the oil production given to the company and the Congolese Government as a payment is called "profit oil." It is calculated based on all production after deduction of the cost oil and the mineral fees (*redevance minière proportionnelle*). Cost oil and profit oil are determined for each contract.

The law does not prescribe any quantitative consideration for sharing of profit oil between the company and the Congolese Government. Accordingly, the government share of profit oil is determined by the contract. In general, the part of the production given to each party depends on net production of the year and is re-examined each year to ensure compliance with the terms of the PSC.

The accounting system for a PSC is specified in the contract itself. The PSC has an appendix called "accounting procedure" that lists the methods, rules and procedure that must be followed.

Bonuses

A bonus is paid to the Congolese Government for granting a prospecting permit or exploitation permit. The amount is different for each permit and it is fixed by the government decree that grants the permit.

Annual surface rent

An annual surface rent (*redevance superficiaire*) is due by the company to the Congolese Government. The amount of this tax and its collection are fixed by Ministerial decree.

This annual surface rent must be paid each year on 20 January. It is based on the surface area stated on the permit and granted during the previous year. Pursuant to the decree dated 10 August 2000, the rates of this tax are:

- Exploration permit: XAF3,000/km²
- Exploitation permit: US$800/km²

Royalty regimes

Royalty regimes are determined by the contract if the contract provides for payment of royalty. There is no difference in the royalty rates between onshore and offshore production.

Mineral fee

A mineral fee is payable by the company to the Congolese Government at the rate of 15%. It is payable on the amount of oil produced and stored plus the amount of oil used for operational purposes, excluding amounts reinjected into the oil field to maintain power.

The mineral fee is due for payment on the 20th of each month and can be paid in cash or with oil equivalent.

Pollution tax

From the 2012 financial year, a pollution tax is payable by oil companies in production. The pollution tax is imposed by financial law at a rate of 0.2% of the annual turnover of the oil company. The pollution tax is an annual tax and is payable quarterly by installments in proportion to the production during the quarter. The pollution tax must be paid on the 20th day of the month following the quarter end.

C. Capital allowances

The tax depreciation rules for the petroleum sector are provided in the PSC according to the straight-line method of deprecation. The depreciation rates are fixed by the Hydrocarbon Code as follows:

- Cost incurred for exploration can be depreciated at the rate of 100%.
- All other capital expenditure is depreciated over a period of five years at the rate of 20% from the beginning of commercial production of each deposit.

The Congolese Hydrocarbon Code does not provide any accelerated depreciation for the assets of the petroleum company.

D. Incentives

There are incentives available in the establishment contract (*convention d'établissement*), which is related to the Investment Charter adopted by the Congolese Government to promote the role of investment in the country's economic development program. The incentives are specific for each contract.

The relevant incentives are described below.

Research and development

A permit can support losses from another permit regarding the cost of research and development. That is, research and development expenditure can be transferred between permits.

Ability to carry forward losses

In principle, losses can be carried forward for a period of three years. The amount of losses related to depreciation (*amortissement réputé différé* or ARD) can be carried forward indefinitely.

E. Withholding taxes

Dividends

Dividends distributed by an oil company to its shareholders are exempted from taxation.

Interest

The rate of interest for withholding tax (WHT) is 20%.

Technical services

The rate of WHT for technical services is 20%.

Nonresident contractors

For subcontractors, the inclusive tax (*taxe forfaitaire*) rate is 7.7% where the subcontractor applies for a short-term business license (ATE), or 20% without an ATE. The WHT must be paid on the 20th of each month.

Foreign contractor wages and salaries

The wages and salaries received by foreign contractors from oil companies are subject to WHT at the rate of 20%, based on 80% of a salary fixed in a wage scale. Except where international convention applies, foreigners are taxable if more than two weeks are spent on Congo soil.

Branch remittance tax

From the 2012 financial year, 70% of the profits earned by a branch of a foreign company are deemed to be distributed to the shareholders. The defined 70% portion shall be taxable under the tax on moveable assets at a rate of 20%. This taxation is also applicable to foreign companies doing business under an ATE.

F. Indirect taxes

VAT

The VAT rate is 18%.

The VAT treatment is the same for PSC and concession contracts as follows:

- VAT for selling: for export, there is an exemption of VAT for sales. For the local market, the VAT is due by oil distributors
- VAT for buying: the important criterion is the purpose for which the services and goods are used:
  - Exemption of VAT for all goods or services used directly for research, exploration, development, exploitation, production, transport and storage of hydrocarbons (pursuant to decree No. 2001/152 of October 2001 and Law No. 12–97 of May 1997)
  - VAT redeemable for all goods and services indirectly connected with petroleum activities
  - Non-redeemable VAT for all goods and services acquired from entities that are not on the list of suppliers and subcontractors established by the company and communicated to tax authorities

Where a company's VAT on acquisitions exceeds VAT on its sales in a reporting period, the excess is refundable to the company.

Import duties

All the goods and materials listed in Act No. 2-92-UDEAC-556-CD-SE1 of April 1992 and used for oil exploration or exploitation work are exempted from customs duties.

Export duties

In general, all exported goods are taxed at a rate of 0% to 13% plus a DAS (*droit accessoire de sortie*) of 2% of the goods' customs value.

Stamp duties

Pursuant to the Hydrocarbon Code, all stamp duties are due by the oil company.

All contracts signed between an oil company and another foreign company must be registered free of charges.

Registration fees

All registration fees (e.g., in relation to contracts or lease agreements that are not specifically exempted) are due by oil companies pursuant to the Hydrocarbon Code and the Congolese Tax Code.

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A. At a glance

Fiscal regime

The fiscal regime that applies in Romania to companies operating in the petroleum industry generally consists of corporate income tax (CIT), petroleum royalty and other oil-related taxes for special funds.

Royalties	3.5% to 13.5% on oil extraction 10% on certain transportation/transit of oil 3% on underground storage of natural gas
Bonuses	None
Production sharing contract (PSC)	None
Income tax rate	CIT rate of 16%
Resource rent tax	The Romanian authorities charge a duty for issuing the drilling and excavation authorizations needed (e.g., for oil and gas wells). The duty amount shall be computed by multiplying the surface affected by drilling and excavation activities with an amount established by the local councils, which cannot exceed RON7.
Capital allowances	C[153]

B. Fiscal regime

Corporate tax

Romanian resident companies are subject to a 16% CIT on their worldwide taxable profits. Profits are computed as the difference between the total income and total expense booked in the company's accounts, subject to certain adjustments (e.g., non-taxable revenues are subtracted, non-deductible expenses are added). Generally, expenses are treated as deductible for tax purposes if they are incurred with the goal of earning taxable income.

The value of depreciable assets is recovered through tax depreciation, which is computed based on the useful life of the asset and the depreciation method applied by the taxpayer. Expenses related to locating, exploring, developing or any other preparatory activity for the exploitation of natural resources are recovered in equal amounts over a period of five years, starting from the month when the expenses are incurred.

153 *The taxpayer may opt for the accelerated depreciation method in the case of technical equipment, tools and installations.*

Expenses related to the acquisition of any exploitation right in respect of natural resources are recovered as the resources are exploited, in proportion to the recovered value compared with the total estimated value of the resources.

Depreciation of buildings and constructions used in oil extraction, for which the useful life is limited to the duration of the reserves and which may not be used after depletion of reserves, shall be computed per unit of production, depending on the exploitable reserve of mineral substance.

Titleholders of petroleum agreements and their subcontractors that carry out petroleum operations in maritime areas (which include waters deeper than 100 meters) compute the depreciation of tangible and intangible assets related to petroleum operations for which the useful life is limited for the period of the reserve for each unit of product with a 100% degree of use, based on the exploitable reserve of the useful mineral substance over the period of the petroleum agreement.

Titleholders of petroleum agreements must create a tax-deductible provision for environmental recovery of the area affected by extraction. Such tax-deductible provisions should be of 1% applied to the difference between the revenues derived from the realization and sale of natural reserves and the expenses incurred with the extraction, processing and delivery of natural reserves during the entire period of natural reserves exploitation. Moreover, for titleholders of petroleum agreements that carry out offshore operations at depths of more than 100 meters, the tax-deductible provision for dismantling of wells, installations and annexes and for environment rehabilitation is 10% (applied to the difference between income and expenses recorded over the entire exploitation period).

Romanian companies (including petroleum companies) benefit from a fiscal credit for revenues obtained through a permanent establishment (PE) located in another country and for income subject to withholding tax (WHT) abroad if the revenues are taxed both in Romania and abroad and provided that the relevant double tax treaty concluded between Romania and the respective state is applicable. However, any fiscal credit is limited to the tax that would have been levied on the income in Romania under domestic tax rules.

A foreign company that derives income from a PE in Romania is subject to a rate of 16% on profits attributable to the PE. The Romanian legislation contains specific provisions regarding the conditions under which PEs arise in Romania. These rules are generally in line with the OECD guidelines.

Capital gains

Please refer to Section G for an explanation of the taxation of capital gains.

Functional currency

In general, accounting records must be kept in Romanian language and in Romanian currency (leu). Accounting records relating to operations carried out in a foreign currency must be kept both in national and foreign currency. Tax amounts must be declared and paid in Romanian currency.

Transfer pricing

Under Romanian law, transactions between foreign and Romanian related parties must be performed in accordance with the arm's-length principle. The Romanian transfer pricing regulations generally follow the OECD transfer pricing guidelines. Upon the tax authorities' request during a tax audit, a taxpayer is required to prepare a specific transfer pricing documentation file and present it to the tax authorities.

Dividends

Romanian legal entities that pay or distribute dividends to Romanian shareholders (legal entities) must withhold, declare and remit the tax due. The tax is computed as 16% of the gross dividend amount.

However, dividends paid by Romanian legal entities to Romanian shareholders (legal entities) that hold at least 10% of the share capital of the dividend payer for an uninterrupted period of two years ending on the date of dividend payment shall be exempt from dividend tax.

Dividends paid by Romanian legal entities to private individual shareholders are subject to a 16% tax, which must be withheld and remitted by the legal entity paying the dividend.

Royalty regimes

The law does not generally differentiate between the royalty regimes for onshore and offshore production.

Generally, the petroleum royalty represents the amounts payable by the titleholders of petroleum agreements with the Romanian state for the exploitation of oil fields and goods that are public property, for the transport and transit of oil through oil mains, and for operation of oil terminals.

The petroleum royalty due to the Romanian state by the titleholders of petroleum agreements is computed based on reference prices established by competent authorities.

The petroleum royalty is payable from the commencement date of the petroleum operations. It is payable on a quarterly basis, by the 25th day of the first month following the relevant quarter. Non-payment or late payment of the petroleum royalty may trigger late payment charges and even the cancellation of the concession title granted to the titleholder of the petroleum agreement.

C. Capital allowances

Generally, depreciable assets are any tangible, immovable assets that:

- Are held and used in production or supply of goods or services, to be rented or for administrative purposes
- Have a fiscal value exceeding the limit established by the Government at the date of their entry in the taxpayer's patrimony (currently RON1,800)
- Have a useful life exceeding one year

The law also specifically enumerates other items that should be treated as depreciable fixed assets (e.g., investments in fixed assets granted under a concession, investments made for the discovery of useful mineral resources, improvements to the already existing fixed assets).

The useful lives to be used for the computation of tax depreciation are specified by legislation. The table below summarizes the useful lives of certain general categories of assets relevant to the oil and gas industry.

Item	Type of depreciating assets	Period (years)
1	Oil and gas extraction assets	4–12
2	Assets for processing oil	7–18
3	Oil and gas transportation and distribution assets	12–60
4	Oil and gas derricks	8–12
5	Sea drilling and extraction platforms	24–36

The tax depreciation methods that may be used depend on the nature of the asset, as follows:

- The straight-line depreciation method alone may be applied for buildings.
- For technological equipment, machinery, tools, installation, and for computers and related peripheral equipment, the taxpayer may choose between the straight-line, the declining-balance and the accelerated-depreciation methods.

- For other depreciable assets, the taxpayer may choose between the straight-line and the declining-balance depreciation methods.

D. Incentives

Annual fiscal losses may be offset against the taxable profits during the following seven consecutive years (five years only for the fiscal loss recorded up to and including 31 December 2008). Losses must be recovered in the sequence they were recorded. Tax losses may not be carried back.

E. Withholding taxes

The Romanian tax regulations specifically define the income derived by nonresidents from Romania that is subject to withholding tax (WHT) in Romania. The main categories of income covered by this provision are dividends, interest, royalty, commissions, revenue from consultancy and management services (regardless of whether they are carried out in Romania), revenue from the liquidation of a Romanian legal entity and income from services performed in Romania (except for international transport and services ancillary to such transport).

In general, the provisions of the double tax treaties concluded by Romania prevail over domestic legislation. Therefore, these provisions may be invoked when levying Romanian WHT. To qualify, the nonresident income beneficiary must provide the Romanian income payer with a tax residency certificate attesting that the income recipient was a tax resident in the relevant country during the period when the relevant income was derived from Romania, as well as an own liability statement in the cases where EU legislation is applicable to the beneficiary of the income. However, in the case of "net of tax" arrangements, whereby the Romanian party bears the WHT (instead of retaining the tax from the amount paid to the nonresident), the application of the double tax treaty provision is restricted under Romanian law. In such cases, the applicable WHT must be determined based on the gross-up method. The related expenses with such tax would also be non-deductible for corporate tax purposes at the level of the Romanian income payer.

Revenues of a nonresident that are attributable to a Romanian PE of the nonresident are not subject to WHT in Romania (because the income is subject to a 16% Romanian profits tax at the level of the PE).

Dividends

Dividends paid to nonresidents are generally subject to a 16% WHT.

However, dividends paid by a Romanian legal entity or by a legal entity having its legal headquarters in Romania (i.e., societas europaea) to a legal entity residing in an EU or European Free Trade Association (EFTA) state or to a PE of an entity residing in one of the above-mentioned states (but situated in another EU/EFTA state) may be reduced to nil if certain conditions related to the legal entity receiving the dividends and to the Romanian income payer are met (please see below).

Conditions regarding the legal entity receiving the dividends include the following:

- Should be set up in one of the legal forms provided by the law and should be resident of the respective EU or EFTA state and, from a tax perspective, according to the double tax treaties concluded with third parties, should not be resident outside EU or EFTA
- Should be liable to pay profits tax or other similar tax as per the tax legislation in the state of residence without the possibility of exemption or choice of the fiscal treatment
- Holds at least 10% of the participation titles in the Romanian legal entity for an uninterrupted period of at least two years ending on the date of the payment of the dividends

Conditions regarding the Romanian legal entity paying the dividends include the following:

- Should have one of the following legal forms: joint stock company, limited partnership or limited liability company
- Should be liable to pay profits tax without the possibility of exemption or choice of the fiscal treatment

Interest and royalties

Interest and royalties are generally subject to a 16% WHT rate.

However, based on the EU Interest and Royalty Directive implemented in Romanian tax legislation as of 1 January 2011, an interest or royalty payment is exempt from Romanian WHT if the recipient is a legal entity resident of another EU or EFTA state (or a PE of a legal entity from an EU/EFTA state situated in another EU/EFTA state) that holds at least 25% of the share capital of the Romanian interest or royalty payer for an uninterrupted period of at least two years (ending on the date of the interest or royalty payment).

Technical services and nonresident contractors

According to the Romanian tax regulations, fees paid by a Romanian entity to a nonresident service provider are subject to WHT in Romania if the services are effectively rendered in Romania, except for international transport and services ancillary to international transport. As a derogation, management and consultancy services are subject to Romanian WHT regardless of where they are rendered. The WHT for these services is 16% under the domestic legislation.

Specific concern arises for service contracts (e.g., technical services contracts) whereby the nonresident transfers know-how or rights triggering royalty payments. In these cases, the provisions regarding the WHT treatment of royalties applies (at least to the part of the contract corresponding to the transfer of know-how or rights).

Attention also should be paid to the potential PE exposure that could arise, which is based on the specific characteristics of the activity carried out by the nonresident in Romania.

In this respect, Romanian legal entities, individuals and PEs of nonresidents in Romania that conclude services agreements with nonresidents for works that could give rise to a PE in Romania should register the agreements with the competent authorities within 30 days from their conclusion.

Branch remittance tax

No branch remittance tax is imposed under the Romanian legislation.

F. Financing considerations

There is no limitation on the deductibility of profits tax for interest expenses and net foreign exchange losses related to loans granted by international development banks or loans guaranteed by the state, as well as loans granted by Romanian and foreign credit institutions, financial non-banking institutions, and legal entities that may grant loans according to special laws or loans obtained based on bonds admitted to trading on a regulated market.

The interest related to loans contracted from other entities is deductible for profits tax purposes within the following limits (the thresholds apply separately for each loan):

- 6% for loans denominated in a foreign currency (this interest rate level may be updated by a government decision)
- The reference interest rate communicated by the National Bank of Romania (BNR) for the last month of the quarter, for loans denominated in the local currency

If the interest agreed between the parties is higher than the indicated threshold, the excess is not deductible for profits tax purposes and it may not be carried forward to subsequent periods. This interest deductibility limitation is applied before the debt-to-equity deductibility test is applied (described below).

Thin capitalization

In addition to the interest limitation outlined above, interest expenses and net foreign exchange losses related to loans (other than from the financial institutions as mentioned above) are deductible for profits tax purposes if the debt-to-equity ratio is less than or equal to three. Conversely, if the ratio exceeds three or is negative, the interest expenses and any foreign exchange losses are entirely non-deductible in the reporting period, but they may be carried forward to the next reporting periods until they are fully deducted, subject to satisfying the same thin capitalization test.

The debt-to-equity ratio represents the ratio between the average debt and equity, computed in the reporting period. For computing the ratio, debt (i.e., borrowed capital) comprises all credits and loans (including commercial liabilities) granted by non-financial entities (i.e., other than those mentioned above) with a reimbursement term exceeding one year. Credits and loans with a reimbursement term of less than or equal to one year are included in the computation of the borrowed capital if the term is extended and the total reimbursement term exceeds one year. Equity (own capital) includes share capital, reserves, non-distributed profits, current-period profits and other equity elements.

G. Transactions

Asset disposals

Gains derived by a Romanian company from the sale of assets are included in taxable profits and are subject to the standard 16% CIT rate. Gains are generally computed as the difference between the selling price of the assets and their fiscal value. Any revaluation of assets must be considered from a tax perspective when establishing their fiscal value. However, the unrealized revaluation reserves (i.e., not realized through depreciation) pertaining to the assets that are disposed of shall be taxed upon their disposal at 16% profits tax rate as other elements in the nature of income.

From a VAT perspective, sales of immovable property (i.e., buildings and land) are generally exempt from VAT, without credit for input VAT paid on related costs and expenses. However, companies may opt for taxation for these operations (i.e., opt to apply VAT and, therefore, recover input tax). As a derogation, the sale of a new building and of building land (as defined by law) is a taxable operation for VAT purposes (i.e., it cannot be exempt).

Income derived by foreign legal entities from sales of immovable property located in Romania or from the exploitation of natural resources located in Romania, including any gains arising from sales of any right related to such resources, are subject to the 16% CIT.

Farm-in and farm-out

Generally, a new company or a consortium (e.g., a joint venture) is set up in Romania by the parties involved in a farm-in agreement. Consortiums are entities without legal personality that are subject to specific profits tax, VAT and accounting rules.

For CIT purposes, the revenues and expenses of the consortium are attributed to each participant according to its participation quota of the association. From a VAT perspective, a consortium does not give rise to a separate taxable person. Under certain conditions, the association's rights and obligations related to VAT may be fulfilled by one of the members.

Selling shares in a company

Similar to an asset disposal, for CIT purposes, gains derived by Romanian resident companies from the sale of shares are added to profits derived from other activities and are taxed at 16%.

Capital gains derived by nonresident legal entities from the sale of ownership rights in shares held in Romanian legal entities are taxable in Romania at the standard corporate tax rate of 16%. It should be noted that the domestic legislation puts particular emphasis on the application of the above taxation rule for capital gains obtained from the sale of shares if 50% or more of the fixed asset value of the entity represents, directly or indirectly, immovable property located in Romania.

Application of the relevant double tax treaty provisions may be considered.

H. Indirect taxes

Import and export duties

Import and export duties are based on the combined nomenclature classification of the imported or exported good, in accordance with EU customs regulations.

VAT

The Romanian VAT legislation is based on the EU VAT Directive.

As a general rule, to fall within the scope of Romanian VAT, a transaction must satisfy all of the following conditions:

- Qualify as a supply of goods or services for consideration
- Have its place of supply in Romania (according to the VAT place of supply rules)
- Be performed by a taxable person (as defined by the VAT law), acting as such
- Be derived from an economic activity

Generally, the operations subject to Romanian VAT fall into one of the following categories:

- Taxable, either at 24% (the standard VAT rate) or 9%/5% (the reduced VAT rates)
- Exempt with credit (as specifically set out in the law, such as exports and intra-Community supplies of goods)
- Exempt without credit (as specifically set out in the law)
- Imports or intra-community acquisitions (taxable at the same rate as domestic transactions)

Specific VAT rules apply to supplies of goods (intra-community supplies and intra-community acquisitions of goods) or services between Romanian persons and persons from other EU member states and non-EU countries.

A taxable person established in Romania who performs taxable or exempt with credit supplies must register for VAT purposes in Romania if their annual turnover (computed based on specific rules) exceeds RON119,000. A taxable person established in Romania may also opt for VAT registration in Romania even if this threshold is not exceeded (subject to certain conditions imposed by the Romanian tax authorities). Special VAT registration rules apply to taxable persons not established in Romania or that are established via a fixed place of business.

If a taxable person who is established in another EU member state is liable to register for VAT in Romania, the registration may be made either directly or through a tax representative. A person who is not established in the EU, and who is required to register for VAT in Romania, must obtain registration through a fiscal representative.

As a general rule, persons registered for VAT purposes in Romania may deduct the Romanian input VAT related to their acquisitions only if such operations are carried out with the goal of performing transactions with the right to deduct input VAT (such as taxable or exempt with credit transactions). Certain limitations exist on the deduction of input VAT related to acquisition of cars and fuel. Deductible input VAT may be offset against the VAT collected by the taxable person (output VAT).

Specific rules apply in the case of operations qualifying as a transfer of a going concern. Specifically, the transfer of assets or a part thereof does not fall within the scope of Romanian VAT if the transferee is a taxable person and if the transfer of assets is the result of transactions such as a sale, spin-off, merger or contribution in kind to the share capital of a company. Such transactions mainly refer to cases where the assets transferred constitute an independent structure capable of performing separate economic activities.

Excise duties

Under Romanian law, excisable goods are harmonized (e.g., alcohol, alcoholic beverages, processed tobacco, electricity and energy products such as gasoline, diesel oil and natural gas) and non-harmonized (i.e., only coffee as of 1 January 2010).

Generally, Romanian regulations regarding harmonized excise duties are based on the EU excise duty legislation.

The excise duty rate in the case of energy products (including natural gas) is expressed in euro per measurement unit (gigajoule, in the case of natural gas and ton/liter in the case of other energy products) and generally depends on the type and the destination of the product.

The chargeability of excise duties occurs upon the release of the excisable goods for consumption, or when losses or shortages are ascertained (e.g., upon exit from the suspension regime, importation, losses of products).

Production of energy products (except for coke, coal and natural gas) is allowed only in authorized production fiscal warehouses. Storage fiscal warehouses (a maximum of eight allowed for each warehouse keeper authorized for production of energy products) may be used only for depositing excisable products. Moreover, in the particular case of energy products, the law provides that the additivation process can also be performed in a storage warehouse.

Authorization of premises as a fiscal warehouse (for production or storage) is subject to specific conditions. Fiscal warehouses have specific reporting obligations related to excise duty. Such locations are under the control of the competent relevant authorities and are subject to strict rules.

Under certain conditions, energy products may be transported between fiscal warehouses or between a fiscal warehouse and a customs office under an excise duty suspension regime.

The intra-community movement of energy products between EU member states is subject to specific rules under Romanian law, which generally follows EU legislation.

If an excise duty becomes chargeable upon the delivery of energy products from fiscal warehouses, it must be paid before the supply takes place.

Supplies of excisable goods destined for certain purposes mentioned in the law are exempt from excise duty, subject to specific conditions.

Stamp duties

The sale or purchase of real estate located in Romania is subject to notary and real estate publicity fees, set by applying a specific percentage to the transaction value.

Registration fees

The registration of a company in Romania is subject to certain immaterial fees.

Certain services provided by the competent authorities in relation to petroleum operations (e.g., issuing authorizations) are subject to fees computed based on the salary and other related expenses incurred by the authorities. In addition, fees for the provision of information necessary for petroleum operations (e.g., regarding the oil resources) are levied based on the volume and the quality of the information and the investigation method used for obtaining such data.

Other significant taxes

Other significant taxes include salary-related social contributions paid by the employer.

I. Other

Authorization for petroleum operations

The law establishes a detailed procedure for granting petroleum concessions (whereby the state grants the right to a legal person to perform petroleum operations) and specific rules for carrying out petroleum operations. Foreign legal entities that are granted the right to perform petroleum operations are required to set up a subsidiary or a branch in Romania and to maintain it throughout the concession period.

The transfer of any rights and obligations derived from the petroleum concession is subject to prior approval of the relevant authorities.

Special fund for petroleum products

Gasoline and diesel oil produced or obtained further to processing are subject to a contribution to the special fund for petroleum products. A contribution is levied by including a fixed leu amount, equivalent to US$0.01 per liter, in the price of these products. The obligation to compute and pay a contribution to the special fund remains with the producers and processors that are legal entities headquartered in Romania.

Domestic quality requirements

The law imposes certain quality standards that must be met for certain energy products traded on the Romanian market.

Energy products (e.g., diesel oil and gasoline) must contain a minimum percentage of biofuels (i.e., fuels used for transport and produced from biomasses). Currently, for diesel oil, the percentage is 5% of the volume, and for gasoline, the percentage is between 4% and 5% of the volume.

Environment fund

Economic operators that own stationary sources that release air pollutants are required to pay a contribution to a special environmental fund. The amount of the contribution depends on the nature of the pollutant.

Manufacturers and importers that introduce dangerous substances (as defined in the specific legislation) into the Romanian market are required to pay a contribution to the same fund.

Foreign investment

The Romanian authorities generally encourage foreign investment, and they seek to ensure non-discriminatory treatment of such investments. Associations organized by foreign investors in Romania and bodies of Romanian authorities supervise and facilitate foreign investments in Romania.

Notification requirements

Competent authorities (e.g., the BNR) must be notified of certain operations (e.g., loans and shareholding participation) carried out by Romanian entities with foreign persons.

Forms of business presence

Forms of business presence in Romania include companies, branches and associations in participation (e.g., joint ventures).

Russia

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A. At a glance

Fiscal regime

The fiscal regime that applies in Russia to the petroleum industry consists of a combination of royalties (called mineral extraction tax (MET)), corporate profits tax and export duty.

Bonuses	Bonuses are specified in the license. A maximum amount is not fixed in legislation. The minimum rates of one-time payments are established at no less than 10% of the amount of the MET, calculated on the basis of the average annual planned capacity of the subsoil user.
Production sharing contract (PSC)	No PSCs are expected to be concluded unless there is an exceptional case, such as an obligation to enter into a PSC emanating from Russia's international conventions.

Royalties (MET)

Crude oil	RUB446[154] per tonne adjusted by coefficients
Natural gas	RUB509[155] per 1,000 cubic meters extracted
Gas condensate	RUB556[156] per tonne extracted
Export duty	35% to 60%[157]
Income tax rate	20%
Capital allowances	D, E[158]
Investment incentives	TH[159]

154 *RUB470 per tonne starting 1 January 2013.*

155 *RUB582 per 1,000 cubic meters extracted for the period of 1 January 2013 to 31 December 2013; RUB622 per 1,000 cubic meters extracted starting 1 January 2014.*

156 *RUB590 per tonne extracted for the period of 1 January 2013 to 31 December 2013; RUB647 per tonne extracted starting 1 January 2014.*

157 *65% is the maximum marginal rate envisaged by the law; since 1 October 2011, the rate of 60% has applied, but the rate is revised each month and could be as high as 65%.*

158 *D: accelerated depreciation (up to twice the standard rates) is available for equipment used in the far north; E: exploration costs are deductible over 12 months.*

159 *TH: tax holidays of 7 to 15 years apply in respect of MET for certain hydrocarbon deposits in the Sakha Republic (Yakutia), the Irkutsk Oblast and the Krasnoyarsk Territory, to the north of the Arctic Circle, in the Sea of Azov, in the Caspian Sea, in the Okhotsk Sea, in the Black Sea, the territory of the Nenets Autonomous Okrug and on the Yamal Peninsula in the Yamalo-Nenets Autonomous Okrug, subject to limits on the volume extracted.*

B. Fiscal regime

The fiscal regime that applies to the petroleum industry in Russia consists of a combination of royalties (MET), corporate profits tax and an export duty on crude oil, oil products and natural gas.

Corporate profits tax

Russian resident corporations are subject to profits tax on their non-exempt, worldwide profits at a rate of 20%. The 20% rate applies to income from oil and gas activities. Tax must be paid to federal and regional budgets at rates of 2% and 18%, respectively. Legislative bodies of constituent entities of the Russian Federation have the right to reduce the tax rate for particular categories of taxpayers, with respect to the amounts of tax payable to the budgets of those entities, but to no less than 13.5%. Thus, the minimum tax rate that may be established is 15.5%.

Ring-fencing

Russia does not apply ring-fencing in determining an entity's corporate tax liability in relation to its oil and gas activities. Profit from one project can be offset against the losses from another project held by the same Russian legal entity, and, similarly, profits and losses from upstream activities can be offset against downstream activities undertaken by the same Russian entity (individual branches of foreign companies are generally taxed as separate entities for profits tax purposes). Russia has recently introduced tax consolidation rules, but consolidation is available only for a very limited number of companies due to very high quantitative criteria (for example, the annual group's revenue should not be less that RUB100 billion (approximately US$3.2 billion).

Profits tax is levied on taxable profit

Taxable profit equals non-exempt revenue less deductions. Non-exempt income includes sales income (determined with reference to accounting data for sales) and non-sale income (certain items are specifically mentioned in the Tax Code). Deductions include expenses to the extent that they are economically justified and documented in accordance with Russian legislation. However, expenditure of a capital nature is not immediately deductible.

Exploration costs are generally deductible within 12 months following the month when a particular stage in exploration work has been completed. Unsuccessful exploration costs are also written off over 12 months, as are expenses related to dry holes, following notice of liquidation of the well.

Development costs are deductible through depreciation of constructed fixed assets. This is discussed in Section C.

Export duty

Export duty is determined by the Russian Government and the rate (in US dollars per tonne) is changed every month. The Government calculates the average price of Urals blend on the Mediterranean and Rotterdam markets every month.

The rates are calculated according to the following table:

Actual price per barrel (US$)	Duty per barrel (US$)
Up to $15	0%
Between $15 and $20	35% x (actual price – 15)
Between $20 and $25	$1.75 + 45% x (actual price – 20)
More than $25	$4 + 60%[160] x (actual price – 25)

160 *65% is the maximum marginal rate envisaged by the law; since 1 October 2011, the rate of 60% has applied, but the rate is revised each month and could be as high as 65%.*

A special zero export duty is established by the Government for oil extracted from a number of oil fields in East Siberia and the Caspian Sea.

The export duty for exported natural gas is 30%. The export duty for exported liquified natural gas (LNG) is 0%.

The export duty for petroleum products, except for gasoline, is set at a rate of 66% of the export duty for crude oil.[161] The export duty for gasoline is set at 90% of the export duty for crude oil.

Mineral extraction tax

MET is levied on extracted natural gas, gas condensate and crude oil. There is no difference in calculation or payment for onshore and offshore production. MET is deductible in calculating corporate profits tax.

Crude oil

The rate of MET on crude oil is established as RUB446[162] per tonne of extracted oil, multiplied by coefficient Cp, coefficient Cd and coefficient Cr (i.e., RUB446 x Cp x Cd x Cr).

The coefficient Cp is determined by the taxpayer itself according to the following formula:

Cp = (P – 15) x R/261

P is the average price level of Urals oil for the tax period in US dollars per barrel, and R is the average value for the tax period of the exchange rate of the US dollar to the Russian ruble as established by the Russian Central Bank.

If the rate of a certain deposit's depletion is between 0.8 and 1.0, the coefficient Cd is determined by the following formula:

Cd = 3.8 – 3.5 x N/V

N is the amount of cumulative oil extraction according to the state's balance sheet of reserves of commercial minerals for the calendar year preceding the accounting year in which the coefficient Cd is applied.

V represents initially extractable oil reserves.

The coefficient Cd is determined as 0.3 if the rate of depletion exceeds 1.0.

Otherwise, the coefficient Cd is equal to 1.

If the initially extractable oil reserves of a certain deposit are less than 5 million tonnes and the deposit's depletion is not more than 0.05, the coefficient Cr is determined by the following formula:

Cr = 0.125 x Vr + 0.375

Vr represents initially extractable oil reserves.

Otherwise, the coefficient Cr is equal to 1.

To summarize, the tax rate of MET is calculated according to the following formula:

RUB446 x Cp x Cd x Cr

A zero tax rate is envisaged for extracted oil as detailed in Section D.

MET is not payable on associated gas (i.e., gas extracted via an oil well).

Special MET deductions are provided for companies operating in Tatarstan and Bashkortostan. The deductions are calculated according to the following formula:

Amount in million rubles x Kp

161 *From 1 January 2015, the export duty for dark petroleum products is set at a rate of 100% of the export duty for crude oil.*

162 *RUB470 per tonne from 1 January 2013.*

The deduction for Tatarstan is RUB630.6m and that for Bashkortostan is RUB193.5m. The coefficient Kp is an adjustment linked to the export duty for crude oil. Coefficient Kp is equal to 1 if the export duty rate for crude oil for the relevant tax period does not exceed the result of the following formula:

US$29.2 per tonne + 60% x (Price-US$182.5 per tonne)

Otherwise, coefficient Kp is zero. To be eligible, oil companies developing subsurface sites in designated areas must satisfy certain criteria concerning the relevant mineral license, period of development and initial extractable oil reserves.

Gas condensate

For gas condensate, MET is payable at the rate of RUB556[163] (approximately US$17.9) per tonne extracted.

A zero tax rate is envisaged for gas condensate extracted jointly with natural gas used for LNG production from subsurface sites that lie wholly or partially on the Yamal Peninsula in the Yamalo-Nenets Autonomous Okrug for an accumulated volume of extracted gas condensate up to 20 million tonnes. To be eligible, companies developing these subsurface sites must satisfy certain criteria concerning the relevant mineral license and period of development.

Natural gas

For natural gas, MET is payable at the rate of RUB509[164] (approximately US$7.6) per 1,000 cubic meters extracted. MET rates are differentiated for independent producers and for Gazprom and its subsidiaries in which Gazprom participates by more than 50%.[165]

MET is not payable on natural gas reinjected to maintain reservoir pressure (to facilitate the extraction of gas condensate).

A zero tax rate is envisaged for extracted natural gas used for LNG production from subsurface sites that lie wholly or partially on the Yamal Peninsula in the Yamalo-Nenets Autonomous Okrug for an accumulated volume of extracted natural gas up to 250 billion cubic meters. To be eligible, companies developing these subsurface sites must satisfy certain criteria concerning the relevant mineral license and period of development.

Production sharing contracts

Although the legislation provides that PSCs can be concluded, none have been concluded since 1996. There are significant hurdles to overcome for any oil or gas deposit to be eligible for consideration for development under a PSC. However, in certain exceptional cases, such as an obligation to enter into a PSC emanating from Russia's international conventions, a PSC might be concluded.

C. Capital allowances

Depreciation

For tax purposes, depreciating assets include assets that have a limited useful life and that decline in value over time. Licenses are not depreciated as fixed assets; expenses incurred in obtaining a license from the state are amortized over the term of the license or over two years, at the election of the taxpayer. Depreciable assets are assets with a service life of more than 12 months and a historical cost of more than RUB40,000.

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163 *RUB590 per tonne extracted for the period of 1 January 2013 to 31 December 2013; RUB647 per tonne extracted starting 1 January 2014.*

164 *RUB582 per 1,000 cubic meters extracted for the period of 1 January 2013 to 31 December 2013; RUB622 per 1,000 cubic meters extracted starting 1 January 2014.*

165 *The following reducing coefficients are envisaged for independent producers to the MET rates on natural gas: 0.493 for the period of 1 January 2012 to 31 December 2012, 0.455 for the period of 1 January 2013 to 31 December 2013, 0.447 for the period of 1 January 2014 to 31 December 2014.*

Item	Type of depreciating asset	Period
1	Oil field, exploratory drilling and extraction equipment	1–5 years
2	Gas wells for production drilling	3–5 years
3	Oil and gas exploratory wells	5–7 years
4	Development oil well, power equipment	7–10 years
5	Gas distribution network	10–15 years

Depreciable assets are allocated to depreciation groups (there are 10 groups) in accordance with their useful lives, which are determined partly by statute and partly by the taxpayer.

A taxpayer is entitled to choose either the straight-line or reducing-balance method of depreciation, taking account of special considerations established in the Tax Code. It should be noted that only the straight-line method of charging depreciation may be used in relation to buildings, installations and transmission facilities that are included in depreciation groups 8 to 10.

Special allowances

Ten percent (not more than 30% for fixed assets included in depreciation groups 3 to 7) of the cost of newly acquired fixed assets or expenses incurred in connection with the extension, modernization or partial dismantling of fixed assets may be expensed immediately.

Accelerated depreciation (up to three times) is available for fixed assets that are the object of a lease agreement and included in depreciation groups 4 to 10. There is also a provision for accelerated depreciation (up to twice the usual rates) for fixed assets employed under the conditions of an aggressive environment, such as locations in the far north, above the Arctic Circle.

There is no capital uplift or credit in Russia. Exploration costs are generally written off over 12 months.

D. Incentives

MET is not payable on oil extracted from oil deposits located:

- Partly or fully in Yakutia, the Irkutsk Oblast and Krasnoyarsk Territory (all in Eastern Siberia) up to a cumulative extraction level of oil of 25 million tonnes, but not for more than 10 or 15 years, depending on the type of the license issued to an extracting company
- Partly or fully to the north of the Arctic Circle within the boundaries of the internal sea waters and the territorial sea and on the continental shelf of the Russian Federation up to a cumulative extraction level of 35 million tonnes, but not for more than 10 or 15 years, depending on the type of the license issued to an extracting company
- Partly or fully in the Sea of Azov and the Caspian Sea up to a cumulative extraction level of 10 million tonnes, but not for more than 7 or 12 years, depending on the type of the license issued to an extracting company
- Partly or fully in the territory of the Nenets Autonomous Okrug and on the Yamal Peninsula in the Yamalo-Nenets Autonomous Okrug up to a cumulative extraction level of 15 million tonnes, but not for more than 7 or 12 years, depending on the type of the license issued to an extracting company
- Partly or fully in the Okhotsk Sea up to a cumulative extraction level of 30 million tonnes, but not for more than 10 or 15 years, depending on the type of the license issued to an extracting company
- Partly or fully in the Black Sea up to a cumulative extraction level of 20 million tonnes, but not for more than 10 or 15 years, depending on the type of the license issued to an extracting company

- Partly or fully north of 65 degrees north latitude wholly or partially within the boundaries of the Yamal-Nenets Autonomous Okrug, except for the subsurface areas located wholly or partially on the Yamal Peninsula in the Yamal-Nenets Autonomous Okrug (a separate provision covers such subsurface areas, see above) up to a cumulative extraction level of 25 million tonnes, but not for more than 10 or 15 years, depending on the type of the license issued to an extracting company

MET is not payable on extracted super viscous oil (more than 200mPa x s).

The reducing coefficient to the MET formula is applicable for deposits with initial extractable oil reserves of less than 5 million tonnes.

MET is not payable on gas condensate extracted from deposits located partly or fully on the Yamal Peninsula in the Yamalo-Nenets Autonomous Okrug up to the accumulated volume of extracted gas condensate up to 20 million tonnes, but not for more than 12 years from the start of production.

MET is not payable on natural gas extracted from deposits located partly or fully on the Yamal Peninsula in the Yamalo-Nenets Autonomous Okrug up to the accumulated volume of extracted natural gas up to 250 billion cubic meters, but not for more than 12 years from the start of production.

For profits tax purposes, losses can be carried forward for 10 years.

Export duty is not applicable to exports of LNG.

Equipment for which no equivalent is produced in Russia, which is included in a special list of the Government, is exempt from VAT on importation.

A special zero export duty is established by the Government for oil extracted from specified oil fields in East Siberia and Caspian Sea.

E. Withholding taxes

The rate for withholding tax (WHT) on dividends paid to foreign organizations is 15%. The rate may be reduced if a double tax treaty applies to a minimum of 5%. The rate of WHT on interest, royalties and leases of movable property is 20%. The minimum rate possible if a double tax treaty applies is 0%.

Technical services

Technical services provided by nonresident contractors are not subject to tax if the services do not give rise to a permanent establishment (PE).

Branch remittance tax

There is no branch remittance tax in Russia.

F. Financing considerations

Thin capitalization

Russia limits debt deductions under thin capitalization rules. Thin capitalization measures apply to the following types of debt:

- Debt obtained from a foreign direct or indirect shareholder holding more than 20% of the capital in the Russian company
- Debt obtained from a Russian affiliate of that foreign shareholder
- Debt for which a guarantee, surety or any other form of security was provided by a Russian affiliate or the foreign shareholder

The measures provide for a safe harbor debt-to-equity ratio of 3:1. Interest deductions are denied for interest payments exceeding the figure calculated if the safe harbor ratio is exceeded.

If the company's debt-to-equity ratio exceeds the safe harbor ratio, excess interest payments are deemed to be dividends and are taxed at the rate applicable to dividends payable to the foreign shareholder.

The debt or equity classification of financial instruments for tax purposes is unclear. The Tax Code does not contain detailed rules on the classification of such instruments, and, generally, the tax authorities give more weight to the form than the substance of an agreement in their analysis. Significant analysis is necessary for instruments with a variable interest rate to determine whether the interest is deductible.

G. Transactions

Asset disposals

It is not possible to sell licenses or oil and gas extraction permits. It is possible to sell an enterprise as a property complex, together with all its assets and liabilities (but not licenses), as a whole. For the seller, such a transaction is subject to VAT at a rate of 18% applicable to the sales price and to profits tax at a rate of 20% on the difference between the sales price and the net book value of the assets of the enterprise being sold.

There are no capital gains exemptions for sellers of enterprises. The state is not obliged to reissue a license to extract oil and gas to the new owner of the enterprise.

Farm-in and farm-out

Russian law does not recognize farm-ins and farm-outs because the license issued by the state cannot be traded, and parts of that license cannot be an object of any business transaction.

A quasi farm-in may be executed via a sale of shares of the licensee to an interested party.

Selling shares in a company (consequences for resident and nonresident shareholders)

Nonresidents that dispose of shares in a Russian company are subject to tax in Russia only if more than 50% of the assets of the company being sold consists of immovable property. This rule does not apply if a double tax treaty exempts income from the sale of the shares.

Resident corporations that dispose of shares in a Russian company are subject to profits tax at a rate of 20% on the difference between the sales price and the acquisition costs of those shares. There are no exemptions from this tax for corporations.

H. Indirect taxes

VAT

VAT is applied at a standard rate of 18%. The rate is 0% for exported oil, oil products, gas and gas condensate. There is no separate VAT registration; all companies are VAT taxpayers.

All sales of hydrocarbons within Russia are subject to VAT at a rate of 18%. All commercial transactions have a VAT impact, and this must be considered prior to entering into any negotiation or arrangement.

Common transactions or arrangements that have VAT implications include:

- The importation of equipment
- The supply of technical and other services in Russia or to Russian customers
- The secondment of personnel
- The sale or lease of equipment in Russia
- Asset disposals

Acquisitions and sales of shares and other financial instruments are not subject to VAT.

A VAT withholding regime applies, and this regime is different from the reverse-charge regime. If the services performed by nonresidents are subject to VAT under this regime, 18/118 of the payments must be withheld. It is not possible for nonresidents to obtain a VAT refund by obtaining a Russian VAT number.

Input VAT incurred at the development stage may generally be offset immediately, but the tax authorities often claim that it may only be offset when production starts. It is usually necessary to litigate with the tax authorities to obtain a refund before production starts.

A procedure for claiming an accelerated refund of VAT may be used by certain qualifying taxpayers and other taxpayers presenting a bank guarantee.

Generally, there are significant obstacles to obtaining an input VAT refund in respect of exports. The administration of the tax is ineffective; as a result, litigation has often been the only effective mechanism for obtaining refunds.

Equipment for which no equivalent is produced in Russia, which is included in a special list drawn up by the Government, is exempt from VAT on importation.

Import duties

Many goods, equipment and materials that enter Russia from abroad are subject to import duties. The rates vary from 5% to 30%, but a 10% to 15% rate is typical. An exemption may be obtained for goods imported as an equity contribution, and payment by installments is available for items imported under the temporary import regime.

Export duties

Please refer to Section B for a discussion of export duties on hydrocarbons.

Excise duties

Excise duty is applied to some goods manufactured in Russia, including petroleum products, alcohol and tobacco. The rates that apply to gasoline are in the range of RUB5,143 to RUB8,225 (approximately US$166 to US$265) per tonne.

Stamp duties

Stamp duty is levied by notaries and is generally capped at insignificant amounts.

Registration fees

There are no significant registration fees.

Other significant taxes

Other significant taxes include contributions to social funds (a type of social security tax paid by employers). The aggregate rate for 2012 is 30%, with an annual cap of RUB512,000 (approximately US$16,500). Payments exceeding the annual cap are taxed at a rate of 10%. No such contributions arise on payments to foreigners designated as highly qualified foreign specialists for immigration purposes.

Property tax applies to the net book value of fixed assets of Russian companies at a rate of 2.2% (subject to regional reductions and exemptions). For foreign companies with property in Russia, their immovable property is subject to this tax and other fixed assets unless exempt under a treaty.

I. Other

Investment in strategic deposits

The Government has powers to deny granting licenses to companies with foreign investment for oil and gas deposits of a strategic nature. Foreign equity investments granting 25% or more of their voting rights require prior approval.

Applicable domestic production requirements

The law on exports of natural gas states that only Gazprom and its 100%-owned subsidiaries may export gas out of Russia.

Foreign exchange controls

The currency control mechanisms that existed during the 1990s were abolished in 2005. They may be reinstated if the balance of payments deteriorates.

Transactions that may be suspicious in terms of potential money laundering are routinely reported by banks to the state's financial intelligence body.

Gas to liquids

There is no special regime for gas to liquids conversion.

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A. At a glance

Fiscal regime

Saudi Arabia's fiscal regime that applies to the petroleum and natural gas industries consists of corporate income tax (CIT) in accordance with the petroleum concession agreement (PCA).

Royalties	PCA royalties are stipulated in the particular PCA
Income tax rate:	
General	20%
Oil production	85%
Natural gas investment fields	30%
Capital allowances	Specific depreciation rates for specific asset classes, not applicable for PCA
Investment incentives	Losses

B. Fiscal regime

Corporate income tax (CIT)

Oil and other hydrocarbon activities

Saudi Arabian tax law applies to companies engaged in oil or other hydrocarbon production in the same way as ordinary capital companies in respect of their non-Saudi-owned shares. However, the income tax law applies to these companies irrespective of their Saudi or non-Saudi-owned shares.

Companies engaged in oil or other hydrocarbon production are subject to income tax at the rate of 85% on their tax base. Tax base is calculated as total income subject to tax less allowable deductions and is determined in accordance with the Saudi Arabian income tax law (effective from 30 July 2004). Saudi Arabian companies are subject to tax on income earned from worldwide sources. Deductions include expenses, to the extent they are incurred in producing assessable income or are necessarily incurred in carrying on a business for the purpose of producing income that is subject to tax. However, expenditure of a capital nature is not deductible. There is no ring-fencing of projects or activities of taxpayers engaged in oil and other hydrocarbon activities.

Natural gas investment activities

Natural gas investment tax (NGIT) applies to natural persons or legal persons (including Gulf Cooperation Council (GCC) nationals and entities (the GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates)) engaged in natural gas, natural gas liquids and gas condensates investment activities in Saudi Arabia. NGIT does not apply to a company engaged in the production of oil and other hydrocarbons.

The NGIT rate ranges from 30% to 85% and is determined on the basis of the internal rate of return on cumulative annual cash flows. The NGIT rate includes income tax of 30%.

Natural gas investment activities income is the gross income derived from the sale, exchange or transfer of natural gas, natural gas liquids, gas condensates and other products, including sulfur, as well as any other non-operational or incidental income derived within the taxpayer's primary activity, regardless of its type or source, including income derived from the utilization of available excess capacity in any facility that is subject to NGIT.

The NGIT base is the gross revenues described above less the expenses deductible under the general tax law. The amount of royalties and surface rentals shall be considered as deductible expenses.

Taxpayers subject to NGIT must ring-fence their natural gas-related activities for each gas exploration and production contract or agreement with the Government, and file separate tax returns and audited accounts for the activities under each gas exploration and production contract or agreement. A taxpayer must file a separate tax return and audited accounts for its other activities that are not related to its natural gas investment activity.

Other activities

Companies not subject to NGIT or the 85% tax rate are taxed at a rate of 20%.

PCA royalties (Government)

Royalty rates are stipulated in the particular PCA. Royalty payments in respect of production are deductible for tax purposes in calculating the tax base of a company engaged in oil or other hydrocarbon production activities.

Transfer pricing

Saudi Arabian tax law includes measures to ensure that the Kingdom's taxable income base associated with cross-border transactions is based on arm's-length prices.

Broadly, the tax authority has discretionary powers to:

- Disregard or reclassify transactions whose form does not reflect its substance
- Allocate income or deductions between related parties or persons under common control as necessary to reflect the income that would have resulted from a transaction between independent persons
- There are no transfer pricing guidelines or directives with regard to pricing methodologies in Saudi Arabia. However, the tax authority often reviews transactions between related parties in considerable depth.

Losses

Losses may be carried forward indefinitely. However, the maximum loss that can be offset against a year's profit is 25% of the tax-adjusted profits for that year. Saudi tax regulations do not provide for the carryback of losses.

If a change of 50% or more occurs in the underlying ownership or control of a capital company, no deduction is allowed for the losses incurred before the change in the tax years following the change.

C. Capital allowances

Depreciation deductions are calculated for each class of fixed assets by applying the prescribed depreciation rate to the remaining value of each group at the fiscal year-end. The remaining value for each asset class is calculated as the closing tax balance for the asset class at the end of the preceding year less depreciation claimed in the preceding year, and 50% of the proceeds received from asset disposals in the current and preceding years plus 50% of the cost of assets added during the current year and the preceding years.

Expenses for geological surveying, drilling, exploration and other preliminary work to exploit and develop natural resources and their fields are subject to a 20% depreciation rate. This includes expenditure assets acquired by the taxpayer in connection with the acquisition of rights to geological surveying and the processing or exploitation of natural resources.

Assets developed in respect of BOT or BOOT contracts may be depreciated over the period of the contract or the remaining period of the contract.

D. Withholding taxes and double tax treaties

The following payments made to foreign companies that do not have a permanent establishment (PE) in Saudi Arabia are subject to a final withholding tax (WHT) at the rates set out below:

Type of payment	Rate of WHT
Royalties and payments made to head office or an affiliate for services	15%
Rent, payments for technical and consulting services, dividends or remittance of PE profits, interest, insurance or reinsurance premiums	5%
Management fees	20%

Tax treaties are currently in force between Saudi Arabia and Austria, China, France, India, Italy, Japan, Malaysia, Pakistan, Singapore, South Africa, South Korea, Spain, Turkey, the UK, the Netherlands, Greece, Syria, Russia and Vietnam. Treaties have been signed with Bangladesh, Belarus, Cuba, Ethiopia, Germany, Philippines, Poland, Tunisia and Uzbekistan, but ratification procedures in respect of these have not yet been completed.

In a Circular, the Saudi Arabian tax authorities (DZIT) have provided the following procedure to claim the tax benefits under the provisions of effective tax treaties:

a. The resident party making the payment to a nonresident party should withhold and settle WHT in accordance with the provisions and rates specified in the Saudi Arabian income tax regulations.
b. If the applicable tax treaty grants exemption or reduction in respect of the WHT rate specified in the Saudi Arabian income tax regulations, the resident party making the payment would apply for refund of overpaid WHT based on the following documents:
   i. A letter from the nonresident beneficiary requesting a refund of the overpayment
   ii. A valid certificate from the tax authority in the country where the beneficiary is residing, confirming that the beneficiary is resident in accordance with the provisions of Article (4) of the treaty in that country and the amount paid is subject to tax in the country
   iii. A copy of the WHT return form for the settlement of tax together with a bank collection order confirming the settlement of the WHT.

Note: documents mentioned in points (i) and (ii) are required to be attested from the Saudi Embassy in the other treaty country and the Ministry of Foreign Affairs in Saudi Arabia.

After review of the above documents and verification that treaty provisions are applicable on the nonresident party, the DZIT will refund the overpaid amount to the Saudi Arabian entity.

E. Indirect taxes

Customs duty

The Government of the Kingdom of Saudi Arabia, as a member of the GCC, follows the Unified Customs Act across the GCC; the uniform customs duty of 5% applies on all imports. This means that any goods that come into a port of entry of a GCC member state that has been subject to customs duty in that state are not subject to customs duty again if the goods are transferred to another GCC member state.

VAT

Currently, there is no VAT or similar sales tax in Saudi Arabia.

Senegal

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A. At a glance

Fiscal regime

The fiscal regime that applies in Senegal to the upstream petroleum industry consists of the Senegalese tax law, the Senegalese petroleum code and the amend to the production sharing contract (PSC) or the contract of service concluded between the Senegalese Government and the contractor (hereafter, the holder).

The main taxes applicable in this sector are the following:

- Corporate tax
- Annual surface rent (*redevance superficiaire*)
- Royalty on production
- Additional petroleum tax

Royalties	Between 2% and 10%[166]
Bonuses	None
PSC[167]	
Income tax rate	25%
Resource rent tax	An annual surface rent tax is levied in Senegal
Capital allowances	E[168], O[169]
Investment incentives	L[170], RD[171]

B. Fiscal regime

Corporate tax

A 25% corporate tax applies to the net profit of oil companies.

The net profit is the difference between the value of the opening and closing balances of the net assets in the relevant year of assessment, less extra contributions, plus any amounts taken by associated companies during the period.

166 *The royalty applies to the holder of a PSC.*

167 *The Government share depends on the terms of the PSC or the service contract; it should be equal to a percentage of the production after covering the oil cost of the holder.*

168 *E: immediate write-off for exploration costs.*

169 *O: rules regarding currency exchange.*

170 *L: losses can be carried forward until the third fiscal year following the deficit period.*

171 *RD: R&D incentive – Senegalese petroleum code provides tax exemptions for the holders of PSCs or service contracts during the period of exploration and development.*

The profit is established after deduction of all charges that meet the following conditions and included for the fiscal year in which they were incurred:

- Incurred in the direct interest of the company or related to the normal management of the company
- Correspond to actual charges and are supported by sufficient evidence
- Reflected by a decrease of the net assets of the company

Ring-fencing

The Senegalese petroleum code does not provide that the profit from one project can be offset against the losses from another project held by the same tax entity. Accordingly, the petroleum operations should be accounted for separately.

Production sharing contracts

A PSC is concluded between the holder and the Senegalese Government and is signed by the minister in charge of petroleum activities after the approval of the minister of finance.

This PSC is approved by the president of the Republic of Senegal, published in the official journal and registered in accordance with the conditions provided by the law.

Government share of profit oil

The remaining production, after the deduction of oil costs, is shared between the state and the holder according to the value of the ratio R, defined as follows:

Value of R	Government share	Holder share
Less than 1	Ratio R	Ratio R
From 1 to 2	Ratio R	Ratio R
From 2 to 3	Ratio R	Ratio R
More than 3	Ratio R	Ratio R

R is the ratio of the net cumulated revenue over the cumulated investments, which are determined in accordance with the cumulated amounts from the effective date until the end of the civil year as follows:

- Net cumulated revenue is the total amount of the benefit after the assessment of the corporation tax.
- Cumulated investments make up the total amount of the expenditure for research, evaluation and development.

Non-recoverable expenditures

The following expenditures are not recoverable:

- Expenditures relating to the period before the effective date of the contract
- All expenses relating to operations carried out beyond the point of delivery, such as marketing and transport charges
- Financial expenses relating to financing research, evaluation and operations, as well as those relating to financing of development and transport for production purposes

Determination of cost oil

Cost oil is the sum of all expenses borne by the holder in the framework of the PSC, determined in accordance with accounting methods.

Uplift available on recovered costs

The holder can add a reasonable amount representing general expenses incurred abroad that are necessary for the performance of the petroleum operations and that are borne by the holder and its affiliated companies, determined according to the annual amount of petroleum costs (outside of financial charges and general expenses).

This additional amount may be determined as follows:

- For up to US$3 million per year: 3%
- Between US$3 million and US$6 million per year: 2%
- Between US$6 million and US$10 million per year: 1%
- More than US$10 million per year: 0.5%

Annual surface rent

An annual surface rent is due when the PSC or service contract is signed. Based on an example of a PSC, the annual surface rent is determined as follows:

- During the initial exploration period, US$5 per square kilometer, per year
- During the first renewal period, US$8 per square kilometer, per year
- During the second renewal period and during any extension provided in the PSC, US$15 per square kilometer, per year

These amounts are paid for the entire year, based on the area of the permit.

Additional petroleum tax

Holders are subject to an additional petroleum tax, calculated according to the profitability of the petroleum operations; the rate, conditions of calculation, declaration, liquidation and recovery are specified in the PSC or service contract.

If the remuneration of the holder of a PSC has already been determined according to the profitability of its petroleum operations, this method of determination of the additional petroleum tax applies in lieu of the additional petroleum tax calculated in terms of the PSC.

The additional petroleum tax is not a deductible charge for the determination of profits subject to the corporate tax.

The payment of the additional petroleum tax due for a given calendar year is required to be made, at the latest, within three months following the end of the relevant calendar year.

Royalty regimes

Holders are subject to the payment of a royalty on the value of the hydrocarbons produced. The royalty must be paid in cash to the state. The royalty is calculated based on the total quantity of hydrocarbons that is produced in the concession and that is not used in the petroleum operations.

The royalty rates applicable to the production of crude oil or natural gas are determined as follows:

- Liquid hydrocarbons exploited onshore: 2% to 10%
- Liquid hydrocarbons exploited offshore: 2% to 8%
- Gaseous hydrocarbons exploited onshore or offshore: 2% to 6%

The amount of royalty and the rules relating to the basis and recovery of the costs are specified in the PSC.

C. Capital allowances

Tax depreciation rules

The tax depreciation rules for the petroleum sector are provided for in the PSC. The fixed assets realized by the holder that are necessary for its petroleum operations are depreciated using the straight-line method of depreciation. The minimum period of depreciation is 5 calendar years, or 10 calendar years for fixed assets relating to the transportation of the produced oil or gas. Depreciation commences with the calendar year when the fixed assets are realized, or with the calendar year when the fixed assets are put into normal operation.

The Senegalese petroleum code does not provide for any accelerated depreciation for the assets of a petroleum company.

Immediate write-off for exploration costs

Hydrocarbon exploration expenses incurred by the holder in the territory of Senegal, including the cost of geological and geophysical surveys and the cost of exploration wells (but excluding the costs of producing exploration wells that may be capitalized), are considered to be fully deductible charges effective in the year they are incurred, or they may be depreciated in accordance with a depreciation method determined by the holder.

D. Incentives

Carryforward losses

The unverified amount of a deficit is deductible from taxable profits until the third fiscal year following the deficit period, unless otherwise provided in the PSC or service contract. A PSC or service contract may allow losses to be carried forward beyond the three-year period.

R&D incentives

During the R&D period, holders of PSCs or service contracts, as well as their associated companies, are exempt from all taxes, duties and fees levied in favor of the state, in particular:

- Direct tax (corporate tax)
- Tax on transfer of funds
- Tax on sales or similar tax (VAT)
- Taxes and duties that apply to petroleum products supplied to permanent facilities and drilling facilities

Any person or company that works on behalf of holders may be exempt from tax on sales or similar tax, in respect of the petroleum operations performed.

During this period, equipment intended directly and exclusively for the petroleum operations is exempt from any duties and taxes on importation into the Republic of Senegal, by the holders or companies working on their behalf.

E. Withholding taxes

Dividends

Dividends paid by a Senegalese company to a nonresident are subject to a withholding tax (WHT) at the rate of 10%.

Interest

Interest paid by a Senegalese resident to a nonresident is subject to a WHT at the rate of 16%. However, the WHT rate for the banking interest is 8%.

Royalties

A WHT on profits for "non-commercial activity" must be paid by foreign companies or individuals that provide services to a resident company if such services are used in Senegal and if the nonresident service provider has no professional installation in Senegal. The rate of WHT is 20% of the gross amount.

This tax must be paid by the local company within 15 days following the payment of remuneration to the nonresident service provider.

Branch remittance tax

Profits made in Senegal by a branch of a foreign company that are not reinvested in Senegal are deemed to be distributed and are subject to a 10% WHT.

It should be noted that, under double tax treaties concluded between Senegal and other countries, WHT may be reduced to a lower rate or avoided under certain conditions.

F. Financing considerations

Thin capitalization limits

Thin capitalization is the limitation on the deductibility of interest payments if the prescribed debt-to-equity ratio is exceeded.

The rate of interest in respect to funds placed at the disposal of a company, in addition to the authorized capital, by one or more shareholders is limited to two points above the discount rate of the central bank.

There is no limitation on the deductibility of interest that a Senegalese company may pay to a third party. The same situation applies to interest paid to a company belonging to the same group as the shareholders.

G. Transactions

Asset disposals

The PSC or service contract may be terminated if all the assets are transferred.

Income realized through the transfer of certain classes of assets of the holder is credited to the account of oil costs to be recovered.

Capital gains are taxed at the corporate tax rate of 25%. The payment of the tax can be deferred in accordance with the conditions provided in the tax law.

The registration fees to be paid depend on the kind of asset, for example:

- Shares: 1%
- Transferable bonds: 1%
- Debts: 1%

These registration fees are paid by the assignee.

It should be noted that an adjustment should be made to the amount of VAT deducted at the time of purchase of the asset if the asset is not entirely depreciated.

H. Indirect taxes

Import duties and VAT

In general, a 22.5% customs duty applies, as does VAT at a rate of 18%.

Export duty

No export duty applies.

Stamp duties

Stamp duties may apply to the registration of different contracts concluded by an oil company. The amount is XOF2,000 for each page of the agreement.

Registration fees

Registration fees depend on the type of agreement concluded.

I. Other

Exchange controls

The holder is subject to the exchange control rules of the West African Monetary Union (Regulation 09/2001/CM/UEMOA), which apply in Senegal.

However, for the duration of the PSC, the Senegalese authorities provide certain guarantees to the holder and its subcontractors for the operations carried out within the framework of the PSC, in particular:

- The right to obtain offshore loans required for performance of the holder's activities in Senegal
- The right to collect and maintain offshore all funds acquired or borrowed abroad, including the receipts from sales, and the right to dispose freely of these funds, limited to the amounts that exceed the requirements of the holder's operations in Senegal
- Free movement of funds owned by the holder between Senegal and any other country, free of any duties, taxes and commissions of any kind, the right to repatriate the capital invested under the PSC and to transfer their proceeds, in particular, interests and dividends
- The free transfer of amounts due and the free receipt of amounts receivable for any reason whatsoever, provided that the declarations required by the regulations in force are filed

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A. At a glance

Fiscal regime

Singapore has an income tax regime that is applicable across all industries. There is no separate fiscal regime for companies in the energy industry.

Corporate income tax (CIT) rate	The headline CIT rate is 17%
Capital allowances	D[172]
Incentives	A large number of incentives are offered

Withholding taxes

Interest, royalties, rent, services

Generally, the withholding tax (WHT) rates are 10% to 17%. Tax treaties may allow for a reduced rate or an exemption.

Dividends

There is no WHT on dividend distributions.

B. Fiscal regime

Scope of taxation

Income tax is imposed on all income derived from sources in Singapore, together with income from sources outside Singapore if received in Singapore. A nonresident company that is not operating in or from Singapore is generally not taxed on foreign-sourced income received in Singapore.

A company is a resident in Singapore if the control and management of its business are exercised in Singapore; the place of incorporation is not relevant.

Remittances of foreign-sourced income in the form of dividends, branch profits and services income into Singapore by a tax-resident company will be exempt from tax if certain prescribed conditions are met.

Rate of tax

The standard CIT rate is 17%. Seventy-five percent of the first S$10,000 of normal chargeable income is exempt from tax, and 50% of the next S$290,000 is exempt from tax. The balance of chargeable income is fully taxable at the standard rate of 17%.

Subject to certain conditions, a newly incorporated and tax-resident Singapore company may qualify for a full tax exemption on the first S$100,000 of normal chargeable income and 50% of the next S$200,000 of chargeable income. The exemption applies only to the qualifying company's first three consecutive years of assessment.

172 *D: accelerated depreciation is available. See Section C.*

Computation of taxable income

In general, book profits reported in the audited financial statements prepared under generally accepted accounting principles are adjusted in accordance with the Singapore tax rules to arrive at the taxable income.

Functional currency

If a company maintains its financial accounts in a functional currency other than Singapore dollars, as required under the financial reporting standards in Singapore, the company must furnish tax computations to the Inland Revenue Authority of Singapore (IRAS) denominated in that functional currency in the manner prescribed by law.

Deductions

For expenses to be deductible, they must be incurred "wholly and exclusively" in the production of income and they must be revenue expenses in nature. In addition, such expenses must not be specifically disallowed under the Singapore tax legislation. Prior to the tax year 2012, revenue expenses incurred from the first day of the accounting year when a business earns its first dollar of trade receipts could be deducted for tax purposes as an administrative concession. To facilitate the starting up of businesses, with effect from tax year 2012, it has been codified that businesses will be allowed to claim revenue expenses incurred in the accounting year immediately preceding the accounting year in which they earn the first dollar of trade receipts. If a business can prove that it has started trading and incurred revenue expenses earlier than that date, it will be allowed to deduct these expenses as well.

Expenses attributable to foreign-sourced income are not deductible unless the foreign-sourced income is received in Singapore and is subject to tax in Singapore. Offshore losses may not be offset against Singapore-sourced income.

No deduction is allowed for the book depreciation of fixed assets, but tax depreciation (capital allowances) is granted according to statutory rates (see Section C). However, a deduction for qualifying renovation or refurbishment expenditure is available subject to meeting specified conditions.

Double deductions are available for certain expenses relating to approved trade fairs, exhibitions or trade missions, maintenance of overseas trade offices, overseas investment development, logistics activities, research and development (R&D), recruitment of overseas talent and donations.

Relief for trading losses

Trading losses may be offset against all other chargeable income of the same year. Unutilized losses may be carried forward indefinitely, subject to the shareholding test (see below).

Excess capital allowances can also be offset against other chargeable income of the same year, and any unutilized amounts may be carried forward indefinitely, subject to the shareholding test and to the requirement that the trade giving rise to the capital allowances continues to be carried on (the same trade test).

A one-year carryback of up to an aggregate amount of S$100,000 of the current year unutilized capital allowances and trade losses may be allowed, subject to meeting certain conditions and compliance with specified administrative procedures. The carryforward and carryback of losses and capital allowances is subject to the shareholding test. This requires that the shareholders remain substantially (50% or more) the same as at the relevant comparison dates (shareholding test). If a shareholder of the loss-making company is itself a company, look-through provisions apply through the corporate chain to the final beneficial shareholder.

The carryback of capital allowances is subject to the same trade test that also applies to the carryforward of unutilized capital allowances.

The IRAS has the authority to allow companies to deduct their unutilized tax losses and capital allowances, notwithstanding that there is a substantial change in ownership at the relevant dates, if the change is not motivated by tax considerations, such as when the change is caused by the nationalization or privatization of industries, or if the shareholding of the company or its parent changes substantially as a result of the shares being widely traded on recognized exchanges. If allowed, these losses and capital allowances may only be offset against profits from the same business.

Groups of companies

Under group relief measures, current-year unutilized losses, capital allowances and donations may be transferred by one company to another within the same group, subject to meeting certain specified conditions. A group generally consists of a Singapore incorporated parent company and all of its Singapore incorporated subsidiaries. Two Singapore incorporated companies are members of the same group if one is 75% owned by the other or both are 75% owned by a third Singapore incorporated company.

Transfer pricing

There is specific legislation governing the arm's-length principle to be applied to related-party transactions. The IRAS may make adjustments to the profits for income tax purpose in cases where the terms of commercial relations or financial relations between two related parties are not at arm's-length.

Dividends

Dividends paid by a Singapore tax-resident company under the one-tier system are exempt from income tax in the hands of shareholders, regardless of whether or not the dividends are paid from taxed income or tax-free gains.

Anti-avoidance legislation

The IRAS may disregard or vary any arrangement that has the purpose or effect of altering the incidence of taxation or of reducing or avoiding a Singapore tax liability. The IRAS also may tax profits of a nonresident in the name of a resident as if the resident was an agent of the nonresident, if the profits of the resident arising from business dealings with the nonresident are viewed as less than expected as a result of the close connection between the two parties.

C. Capital allowances

Plant and machinery

Capital allowances or tax depreciation are given for capital expenditures incurred on the acquisition of plant and machinery used for the purposes of a trade or business. The qualifying plant and machinery are normally written off in equal amounts over three years when claimed.

The cost of the following may be written off in the year of acquisition: computers or other prescribed automation equipment, generators, robotic machinery, certain efficient pollution control equipment, certified energy-efficient equipment or approved energy-saving equipment, certain industrial noise and chemical hazards control equipment.

Businesses that incur qualifying expenditure on acquiring prescribed automation equipment may qualify under the productivity and innovation credit (PIC) scheme (see Section D).

An expenditure on automobiles, other than commercial vehicles, generally does not qualify for capital allowances.

Capital expenditures on fixtures, fittings and installations integral or attached to a building are usually considered to be part of the building and do not qualify as plant and machinery. Unless an industrial building allowance (see below) applies, this type of expenditure does not qualify for capital allowances.

Industrial buildings

An initial allowance of 25% plus an annual straight-line allowance of 3% are granted for industrial buildings or structures used for specified purposes. No such allowances are granted for commercial buildings or hotels other than hotels on the island of Sentosa that were approved before 1 September 2007.

Industrial building allowance (IBA) was phased out after 22 February 2010. Qualifying capital expenditure incurred by businesses on or before 22 February 2010 on the construction or purchase of industrial buildings or structures will continue to qualify for IBA, subject to existing IBA rules. With the phase-out, IBA will not be allowed on capital expenditure incurred after 22 February 2010 on the construction or purchase of industrial buildings or structures except in specified scenarios, subject to meeting the conditions imposed.

Land intensification allowance incentive

This new incentive grants an initial allowance of 25% and an annual allowance of 5% on qualifying capital expenditure incurred on or after 23 February 2010 by businesses on construction or renovation of a qualifying building or structure, upon meeting certain conditions. The user of the building or structure must carry out one of the specified qualifying activities as its principal activity in the building or structure. The land intensification allowance (LIA) incentive will be in place for five years, and approvals will be granted from 1 July 2010 to 30 June 2015.

Intellectual property

Writing down allowances (WDAs) are granted for capital expenditures incurred on the acquisition of specified categories of intellectual property (IP) on or before the last day of the basis period for the tax year 2015, if the legal and economic ownership of the IP lies with Singapore companies. The allowances are calculated on a straight-line basis over five years. The legal ownership requirement may be waived for IP rights acquired on or after 17 February 2006. On approval, WDAs for IP acquisition are granted to economic owners of the IP if the Singapore company has substantial economic rights over the IP but a foreign parent holds the legal title.

An accelerated WDA over two years will, on approval, be granted to an approved media and digital entertainment (MDE) company in respect of the acquisition of approved IP rights pertaining to films, television programs, digital animations or games, or other MDE contents on or before the last day of the basis period for the tax year 2015.

A 100% WDA is also available to a company that carries on a trade or business that has incurred expenditures under an approved cost-sharing agreement in respect of R&D activities for the purposes of that trade or business.

Businesses that incur qualifying expenditure on acquiring IP rights may qualify under the PIC scheme (see Section D).

Disposal of assets qualifying for capital allowances

Allowances are generally subject to recapture on the sale of a qualifying asset if the sales proceeds exceed the tax-depreciated value. If sales proceeds are less than the tax-depreciated value, an additional corresponding allowance is given.

D. Incentives

The following tax incentives, exemptions and tax reductions are available in Singapore.

Pioneer companies and pioneer service companies

The incentive is aimed at encouraging companies to undertake activities that have the effect of promoting the economic or technological development in Singapore. A pioneer enterprise is exempt from income tax on its qualifying profits for a period of up to 15 years.

Development and expansion incentive

This incentive is available to companies that engage in high value-added operations in Singapore but do not qualify for pioneer incentive status and to companies whose pioneer status has expired. Qualifying income is taxed at a rate of no less than 5%. The maximum initial relief period is 10 years, with possible extensions of up to 5 years at a time. The maximum total incentive period is 20 years.

Investment allowances

On approval, investment allowances are available to companies that engage in qualifying projects. These allowances are granted in addition to the normal tax depreciation allowances and are based on a specified percentage (up to 100%) of expenditures incurred on productive equipment.

Global trader program

The global trader program (GTP) is aimed at encouraging international companies to establish and manage regional or global trading activities with Singapore as their base. Under the GTP, approved companies enjoy a concessionary tax rate of 5% or 10% on qualifying transactions conducted in qualifying commodities and products (including energy, agricultural, building, industrial, electrical and consumer products, carbon credits), and qualifying transactions in any derivative instruments and qualifying structured commodity financing activities. Income derived from qualifying transactions in liquefied natural gas enjoys a 5% tax rate.

A sunset clause of 31 March 2021 has now been introduced for the GTP scheme.

Finance and treasury center incentive

The finance and treasury center incentive (FTC) is aimed at encouraging companies to use Singapore as a base for conducting treasury management activities for related companies in the region. Income from the provision of qualifying services to its approved network companies and from the carrying on of qualifying activities on its own account is subject to tax at a rate of 10% or such other concessionary rate for a period of up to 10 years, with possible extensions of up to 10 years at a time. Approved network companies are offices and associated companies of the company granted the tax incentives that have been approved by the relevant authority for purposes of the incentive.

A sunset clause of 31 March 2016 has now been introduced for the FTC scheme.

Approved royalties, technical assistance fees and contributions to R&D costs

Approved royalties, technical assistance fees and contributions to R&D costs paid to nonresidents may be exempt from WHT.

Headquarters program

The headquarters program consists of an international headquarters (IHQ) award and a regional headquarters (RHQ) award. The program applies to entities incorporated or registered in Singapore that provide headquarters services to their network companies on a regional or global basis. Under the IHQ and RHQ awards, companies may enjoy incentive rates of 0% to 15% for a specified period on qualifying income, depending upon the amount of commitment to Singapore. This commitment is demonstrated by various factors, including headcount, business spending and quality of people hired. Qualifying income includes foreign income from sales, services, royalties, franchise fees, management fees, commissions, and, potentially, dividends and interest income.

R&D incentives

- Liberalized R&D deductions – from tax year 2009 to tax year 2015, tax deduction can be claimed for undertaking R&D carried out in Singapore in any area (i.e., no longer required to be related to the trade or business carried on by the company) and an additional 50% tax deduction is allowed for certain qualifying R&D expenditure. If the companies outsource their R&D activities to an R&D organization in Singapore, the tax deduction available is at least 130% of the amount of R&D expenses incurred. Businesses that incur qualifying R&D expenditure may qualify under the PIC scheme (see below).
- R&D tax allowance (RDA) scheme – allows taxpayers to earn an RDA equal to 50% of its chargeable income up to S$300,000 in any tax year between tax years 2009 and 2013. The RDA may be utilized in any tax year between tax years 2010 and 2016, up to the amount of incremental R&D expenditure incurred in the basis period of the tax year of use, subject to conditions. However, with the PIC scheme, the RDA scheme will be phased out and no RDA will be granted from the tax year 2011. There are transitional rules for the use of any unutilized RDA balances till tax year 2016.

Productivity and innovation credit

Businesses that incur qualifying expenditure on the following six activities will qualify for an enhanced deduction or allowance for tax years 2011 to 2015:

- R&D
- Eligible design activities
- Acquiring IP rights
- Registering patents, trademarks, designs and plant varieties
- Acquiring or leasing of productivity and innovation credit (PIC) automation equipment
- External training and qualifying in-house training

All businesses can claim a deduction or allowance of 400% of the first S$400,000 of their expenditures per tax year on each of the above activities from their taxable income, subject to the following caps:

- For tax years 2011 and 2012 – a combined cap of S$800,000 of eligible expenditure for each activity
- For tax years 2013 to 2015 – a combined cap of S$1.2 million of eligible expenditure for each activity

Qualifying persons with at least three local employees have an option to convert up to 30% of the first S$100,000 of eligible expenditure into a non-taxable cash grant of up to S$30,000 each year from the tax year 2011 to the 2013 tax year. For tax years 2011 and 2012, a combined cap of S$200,000 applies. This cash component of the PIC scheme will be reviewed after three years.

E. Withholding taxes

Interest, royalties, rent, services, dividends

In general, WHT at a rate of 15% is imposed on interest and other payments in connection with any loans or indebtedness paid to nonresidents. However, interest paid by approved banks in Singapore on a deposit held by a nonresident is exempt from tax if the nonresident does not have a permanent establishment (PE) in Singapore and does not carry on business in Singapore by itself or in association with others or does not use the funds from the operation of a PE in Singapore to make the deposit. In addition, tax exemption applies to interest paid for qualifying debt securities issued before 31 December 2013 to nonresidents that do not have a PE in Singapore. The exemption also applies to nonresidents that have a PE in Singapore but do not use the funds obtained from the operations of the PE to acquire the debt securities. In respect of any payment for any arrangement, management or service relating to any loan or indebtedness performed by a nonresident outside Singapore or guarantee in connection with any loan or indebtedness provided by a nonresident guarantor, such payments are exempted from tax.

A 10% WHT is imposed on the payments to nonresidents of royalties for the use of, or the right to use, intangible property and payments for the use of, or the right to use, scientific, technical, industrial or commercial knowledge or information.

A 15% WHT is imposed on rent and other payments to nonresidents for the use of movable property.

Payments made to a nonresident professional for services performed in Singapore are subject to a final WHT of 15% on the gross income, unless the nonresident professional elects to be taxed at 20% of their net income.

In general, a 17% WHT is imposed on payments to nonresident companies for assistance or services rendered in connection with the application or use of scientific, technical, industrial or commercial knowledge or information and for management or assistance in the management of any trade, business or profession. Where services are performed outside Singapore, such services are exempt from tax. For management fees paid to a nonresident-related party prior to 29 December 2009, the tax exemption applies only if the fees represent a pure cost reimbursement without any mark-up and the services are rendered outside Singapore.

Tax treaties may override these WHT provisions.

Singapore does not levy WHT on dividends (see Section B).

Branch remittance tax

There is no branch remittance tax in Singapore.

F. Financing considerations

Singapore does not impose any specific debt-to-equity restrictions. To secure a deduction for interest and borrowing costs, such costs must be wholly and exclusively incurred on loans that are used to acquire income-producing assets. For borrowing costs, the deduction is further subject to certain specified conditions.

G. Transactions

Capital gains

Capital gains are not taxed in Singapore. However, in certain circumstances, the IRAS considers transactions involving the acquisition and disposal of real estate or shares to be trading gains; any gains arising from such transactions are taxable.

H. Indirect taxes

Goods and services tax

Singapore currently imposes a GST at the rate of 7% (the prevailing standard rate) on the following transactions:

- Supplies of goods and services (apart from zero-rated and exempt supplies described below) in Singapore, made in the course or furtherance of a business by a taxable person (i.e., a person who is registered or is required to be registered for GST)
- Imports of goods into Singapore unless the imports qualify for import reliefs

Exports of goods (subject to maintaining the relevant export documents) and provision of international services falling as prescribed under the GST legislation qualify for zero-rating relief (i.e., taxed at 0%). The sale and lease of residential property and the provision of certain prescribed financial services are exempt from GST.

Businesses that make taxable supplies (i.e., standard-rated supplies and zero-rated supplies) exceeding S$1 million per annum are required to register for GST.

Businesses that are not liable for GST registration may still apply for GST registration on a voluntary basis (subject to conditions).

While a GST-registered business is required to charge GST on its standard-rated supplies of goods and services, it can generally recover the GST incurred on its business expenses as its input tax subject to satisfying conditions prescribed under the GST legislation. Input tax is generally recovered by deducting it against the output tax payable, which is GST charged on standard-rated supplies made, in the GST returns. If the input tax claimable exceeds the output tax payable, the net GST amount will be refundable to the GST-registered person.

Singapore operates various schemes that aim to ease the administrative burden associated with GST compliance, as well as to improve the cash flow of businesses. They include the following:

- Major exporter scheme (MES) — this scheme allows for the suspension of GST payable on the importation of non-dutiable goods into Singapore
- Zero-GST warehouse scheme — similar to the MES scheme, this scheme allows for the suspension of GST payable on the importation of non-dutiable goods into a zero-GST warehouse
- Approved marine fuel trader (MFT) scheme — this scheme allows the approved MFT businesses to enjoy suspension of GST on their local purchase of marine fuel oil
- Licensed warehouse scheme — a licensed warehouse is a designated area approved and licensed by the Singapore Customs for storing dutiable goods with the suspension of the customs duty and the import GST

Import and excise duties

Singapore imposes customs or excise duties on a limited range of goods, namely, petroleum (motor spirits), motor vehicles, alcoholic beverages and tobacco products.

Export duties

There are no duties on goods exported from Singapore.

Stamp duty

Stamp duty is payable on documents that relate to immovable property, stocks and shares. The rate of duty varies depending on the type of document.

For documents relating to immovable property, the following rates are applied on the purchase price or market value (whichever is higher):

- Every S$100 or part thereof of the first S$180,000 — S$1.00
- Every S$100 or part thereof of the next S$180,000 — S$2.00
- Thereafter, every S$100 or part thereof — S$3.00

A flat rate of 0.2% applies to stocks and shares; it is applied on the purchase price or market value (or the net asset value in the case of non-listed shares), whichever is higher.

Different rates apply to lease agreements and mortgages.

Sellers of residential properties may be liable for seller's stamp duty depending on when the property was acquired and the holding period. In addition, with effect from 8 December 2011, certain buyers of residential properties (and residential land) are required to pay additional buyer's stamp duty on top of the existing buyer's stamp duty.

I. Other

Foreign exchange controls

Singapore does not impose any restrictions on the remittance or repatriation of funds in or out of Singapore.

Forms of business presence in Singapore

Forms of business presence in Singapore may include companies, foreign branches and partnerships (including limited liability partnerships and limited partnerships). The most suitable form of business entity depends on commercial and tax considerations.

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A. At a glance

Fiscal regime

The fiscal regime that applies to the upstream oil and gas industry in South Africa consists of a combination of corporate income tax (CIT) and royalties (the latter was implemented on 1 March 2010).

Royalties	The mineral and petroleum resources royalty became payable from 1 March 2010[173]
Bonuses	None
Production sharing contract (PSC)	None
Income tax rate	The current CIT rate for South African residents and nonresidents may not exceed 28% (to which must generally be added a 5% secondary tax (STC) on dividends declared) under the Tenth Schedule to the Income Tax Act, No. 58 of 1962 (the Act).
Resource rent tax	None
Capital allowances	D, E[174]
Investment incentives	L, RD[175]

B. Fiscal regime

The fiscal regime that applies in South Africa to the upstream oil and gas industry consists of a combination of CIT and royalties (the latter was implemented on 1 March 2010).

173 *The royalty payment is calculated as a percentage of gross sales of mineral resources. The two critical determinants for the calculation and determination of the value of the royalty are gross sales and EBIT. Gross sales is the transfer of all mineral resources as defined in Schedule 1 and 2 of the Royalty Act. EBIT is defined as earnings before interest and taxes and is the aggregate of gross sales and so much of any amount allowed to be deducted in the Income Tax Act. Various inclusions and exclusions apply to gross sales and EBIT. The royalty is payable semiannually by way of estimated payments on a basis similar to provisional tax for income tax purposes. The royalties would be deductible for income tax purposes.*

174 *D: accelerated depreciation; E: immediate write-off for exploration costs.*

175 *L: losses can be carried forward indefinitely; RD: R&D incentive.*

For years of assessment that commenced no later than 1 November 2006, oil and gas exploration and production (E&P) revenues were taxed in accordance with the provisions of the mineral lease known as OP26, and not in terms of the Act. Subject to a number of variations between leaseholders, OP26 created a fiscal stability regime based on the 1977 Income Tax Act (disregarding all subsequent legislative amendments other than those of benefit to a taxpayer).

When the Mineral and Petroleum Resources Development Act of 2002[176] became effective, it was necessary to terminate the provisions of OP26 (notwithstanding that they were guaranteed to existing leaseholders for the duration of their leases). For years of assessment commencing on or after 2 November 2006,[177] the Tenth Schedule of the Act was introduced.

The Mineral and Petroleum Resources Royalty Act (the Royalty Act), which imposes royalties on upstream oil and gas companies, was implemented on 1 March 2010.

C. Corporate tax

Essential definitions in the Tenth Schedule

An "oil and gas company" means any company for which one of the following is true:

a. Holds any oil and gas right (meaning any reconnaissance permit, technical cooperation permit, exploration right or production right)[178]
b. Engages in exploration or production in terms of any such right

"Exploration" means acquiring, processing and analyzing geological and geophysical data or other related activities for the purposes of defining a trap (i.e., a petroleum-bearing structure) to be tested by drilling, together with well drilling, logging and testing (including extended well testing), up to and including the field appraisal stage.

"Production" includes the separation of oil and gas condensates, the drying of gas and the removal of non-hydrocarbon constituent to the extent that these processes are preliminary to refining.

"Oil" means any subsoil, combustible liquid consisting primarily of hydrocarbons, other than hydrocarbons converted from bituminous shale or other stratified deposits of solid hydrocarbons.

"Gas" is defined in like terms to oil. In practice, this includes natural gas, coalbed methane and shale gas.

"Oil and gas income" means the receipts, accruals or gains derived by an oil and gas company in respect of exploration or production in terms of any oil and gas right, including leasing or disposing of that right, thereby including commercial royalty income and capital gains.

(The inclusion of capital gains does not, however, mean that such gains directly form part of the taxable income, since oil and gas income is made up of subparts, including taxable income and 66% of capital gains.)

Determination of taxable income of an oil and gas company

The taxable income of an oil and gas company is determined in accordance with the general provisions of the Act as modified by the provisions of the Tenth Schedule to the Act, which provides for a number of rate caps, allowances and incentives in the determination of oil and gas income.

176 *Act 28 of 2002.*

177 *Section 26B of the Act provides that the taxable income of an oil and gas company is determined in terms of the general provisions of the Act but subject to the provisions of the Tenth Schedule.*

178 *As contemplated in Schedule 1 of the Mineral and Petroleum Resources Development Act of 2002.*

A company that is also engaged in certain other activities (such as oil refining) is taxable on that separate income in terms of the general provisions of the Act, without having regard to the provisions of the Tenth Schedule.

If an oil and gas company earns interest on its working capital in a current account, this may constitute an accrual "in respect of an oil and gas right." However, if production revenues are to be invested in any deposit with a longer term pending, for example, the declaration of a dividend or subject to enhanced rates of interest by special arrangement, such a deposit or arrangement would not constitute oil and gas income and thus would not be taxed under the Tenth Schedule. Instead, it is subject to the normal corporate tax rate from time to time.

D. Rates of tax

Normal tax

Oil and gas companies are generally taxed at the normal corporate tax rate, subject to the provisions of the Tenth Schedule that establishes rate caps. Under the Tenth Schedule, the rate of tax may not exceed 28%.

If a foreign company that carries on trade in South Africa previously derived its E&P rights from an earlier OP26 lease (which has now converted to a "new order right"), the rate of tax may not exceed 28%.

Secondary tax on companies

Notwithstanding the provisions of the Act, the Tenth Schedule provides that the rate of secondary tax on companies (STC) may not exceed 5% of the net amount of dividends declared from oil and gas income profits.[179] If a company derives its rights from an OP26 lease (now converted to a new order right), the rate of STC on dividends from oil and gas income profits is 0%. This concession arises from the fiscal stability rights such companies enjoyed under OP26.

None of the above concessionary rates for STC, however, apply to companies engaged in refining gas.[180]

STC is in the process of being replaced by a dividend withholding tax (WHT). The dividend WHT will be a tax on the shareholder. It is anticipated to come into operation from 1 April 2012. The rate of dividend WHT has been set at 15%, but it is expected that the specific rate provisions relating to STC for oil and gas companies will generally apply to the dividend WHT. (This treatment is currently the subject of representations to the National Treasury, for adoption in the 2012 round of taxation amendments.)

Foreign currency differences

Currency gains and losses (whether realized or unrealized) for the purposes of the Act are determined with reference to the functional currency (i.e., the principal trading currency) of that company and the translation method used by the oil and gas company for the purposes of financial reporting.[181] Accordingly, if a company's functional currency is US dollars but it also transacts in pounds or rands, gains or losses in respect to the transactions will be accounted for in US dollars for tax purposes. The same principle applies to reporting income and expenditures and the calculation of tax due. Once taxable income and tax due have been calculated in functional currency, the tax figure is translated to rands at the average exchange rate for the year concerned for purposes[182] of payment to the South African tax authorities (SARS).

179 *Paragraph 3(1) of the Tenth Schedule.*

180 *"Oil and gas income" definition read in conjunction with "production" definition in paragraph 1 of the Tenth Schedule.*

181 *Paragraph 4(1) of the Tenth Schedule.*

182 *Paragraphs 4(1) and (2) of the Tenth Schedule.*

Fiscal stability

In recognition of the need for oil and gas companies to have certainty as to the tax treatment of future revenues, and in conformity with international practice, the minister of finance may enter into a fiscal stabilization contract with an oil and gas company. Such a contract binds the state and guarantees that the provisions of the Tenth Schedule, as of the date that a particular oil and gas right is acquired, apply and that the contract may not be amended for the duration of the oil and gas company's right, including any new order right (converted from an OP26 exploration sublease or an OP26 production lease in accordance with the provisions of Schedule II to the Mineral and Petroleum Resources Development Act), or any renewals of such right, and any conversions from exploration to an initial production right.[183] An oil and gas company is entitled to rescind any such agreement unilaterally.[184]

E. Capital allowances

An oil and gas company may deduct all expenditures and losses actually incurred (whether of a revenue or capital nature). The only exclusion is in relation to expenditures or losses incurred for the acquisition of an oil and gas right, although certain concessions exist in relation to farm-in and farm-out transactions (see Section G).[185]

A further deduction is permitted over and above the expenditure actually incurred, including:[186]

- 100% of all capital expenditures incurred in respect of exploration
- 50% of all capital expenditures incurred in respect of production

As a result, an oil and gas company may recognize a deduction equal to 200% and 150% of its capital expenditures related to E&P, respectively. As a general rule, any expenditure or loss (including administrative expenses) that is incurred by an oil and gas company in respect of exploration is regarded as capital in nature because it has a direct or causal relationship with the exploration activities. Acquisition of an oil and gas right does not qualify for additional allowances.

F. Incentives

Carryforward of losses

Losses incurred during the exploration phase may be offset against oil and gas income generated in the production phase. There is no ring-fencing between oil or gas fields in this regard.

Any balance of loss remaining may be carried forward without limit.

Losses in respect of exploration or production may only be offset against oil and gas income of that company and income from refining of gas acquired from South African wells. Ten percent of any excess loss may first be offset against any other income (e.g., interest income that does not constitute oil and gas income) and any balance must be carried forward to the succeeding year. Thus, a vertically integrated gas production and refining company may offset its E&P costs, typically on new wells, against refining income and incidental interest income earned on a current account used for production operations, up to the total thereof. Similarly, refining losses of such a company may, by inference, be offset, without limit, against profits from production (typically, in respect of wells whose production is sold rather than refined).

However, a vertically integrated oil production and refining company would not be entitled to set off production losses from refining income.

183 *Paragraph 8(1) of the Tenth Schedule.*

184 *Paragraph 8(4) of the Tenth Schedule.*

185 *Paragraph 5(1) of the Tenth Schedule.*

186 *Paragraph 5(2) of the Tenth Schedule.*

Unredeemed capital expenditure

The general provisions of the Act as it read in 1977 were the foundation of the OP26 prospecting and mining lease, which contained the taxation regime applicable to oil and gas companies up to 2006. That regime provided for the deduction of mining capex without any ring-fencing, either in respect to mining income or in respect to individual mines. As such, mining capex was deductible as soon as mining operations existed on any mine operated by the taxpayer. To the extent that this produced an assessed loss, it was carried forward indefinitely, subject to the rules of Section 20. Additionally, oil and gas companies were entitled in terms of the definition of "capital expenditure" in Section 36 to a 12% per annum "uplift" allowance calculated on "unredeemed" capex, that is (broadly) capex that had not been recovered through net operating revenues. This unredeemed amount generally bore a close relationship to the company's assessed loss from time to time.

With the introduction of the Tenth Schedule, the 12% uplift allowance was repealed, and that may be detrimental to those companies who had substantial unredeemed capex that would have qualified for uplift (probably on a reducing base) for some years into the future. In order to grant relief to those affected companies, they are permitted to bring forward and deduct from their oil and gas income, in the year of assessment commencing on or after 2 November 2006, the unredeemed capex of the immediately preceding year of assessment as determined in terms of Section 36(7E).

Practically, the unredeemed capex rule tends to only apply to the state oil company.

G. Withholding taxes

Dividends

Currently, no WHT applies to dividends. As explained earlier, the STC, however, is being replaced by a dividend WHT scheduled to come into operation from 1 April 2012. The rate has been set at 15% but will likely be 5% or, alternatively, 0% in the case of qualifying (OP26 lease) E&P companies.

Interest

No WHT currently applies to interest.

Effective from 1 January 2013, interest accruing to any foreign person who is not a controlled foreign company will be subject to a 10% interest WHT.

The WHT is applicable to all interest except for interest on government debt instruments, listed debt instruments, bank debts, and certain authorized bills of exchange and letters of credit.

Royalties

A 12% WHT applies to royalties on intellectual property paid to nonresidents. There is no WHT on mineral right royalties.

Technical services

No WHT applies to technical services.

Nonresident contractors

No WHT expressly applies to nonresident, independent contractors. However, in the case of individual nonresident contractors, the employees' tax withholding rules (PAYE) generally apply.

Branch remittance tax

No branch remittance applies.

Withholding of amounts from payments to nonresident sellers of immovable property

In the case where a nonresident sells an interest in a mining right, it may be subject to a withholding of 5%–10% of the amount payable by the purchaser. This is an advance payment of tax and not a final tax, and under certain circumstances may be waived by the commissioner.

H. Financing considerations

Thin capitalization limits

The thin capitalization regime in Section 31 of the Tenth Schedule of the Act applies only in relation to loans, advances or debts owed to connected persons[187] who are not tax resident in South Africa. It should be noted that Section 31(3) can apply to significant shareholders who are not connected persons.

The debt capitalization that is permitted, without denying any deduction for interest expenditure, is fixed at three times the market value of all the shares in that company. Even if the 3:1 ratio is exceeded for a temporary period, the commissioner is authorized to accept that the breach was "for good cause," without denying any interest deduction.[188]

If a loan changes from being interest free to interest bearing, or vice versa, it may be treated as interest bearing for purposes of the 3:1 ratio only in those years when interest is incurred during the year.

I. Transactions

Asset disposals

Subject to the specific provisions relating to the disposal of an oil and gas right[189] (see below), the disposal of E&P properties is subject to the general capital gains tax (CGT) rules. A capital gain, in essence, is the amount by which the proceeds realized on the disposal of an asset exceed the base cost of the asset. Sixty percent of a capital gain realized on the disposal of an asset is taxable. In the case of a resident company, the effective tax rate is 18.5% (66% of 28%).

Farm-in and farm-out — rollover relief and CGT

The general CGT rules are subject to the Tenth Schedule in the case of the disposal of an oil and gas right by an oil and gas company.

The Tenth Schedule provides special rules relating to the disposal of oil and gas rights at any stage of the E&P process and refers to "rollover treatment" and "participation treatment," either of which can be elected by the company disposing of the right.[190] The company acquiring the right is, therefore, bound by the election of the disposing counterparty. If no election is made, normal CGT rules apply.

Rollover treatment

Rollover treatment can apply where the market value of the right disposed of is equal to or exceeds:

- The base cost of that right for CGT purposes, if it is held as a capital asset
- The amount taken into account by the seller as a deduction in terms of Sections 11(a) or 22(1) or (2), in the case of trading stock

187 *A connected person in relation to a company includes any other companies that are more than 50% held by that company. A company is also a connected person in relation to another company if at least 20% of its equity share capital is held by the other company and no shareholder holds the majority voting rights of the company.*

188 *Paragraph 6(2) of the Tenth Schedule.*

189 *In terms of the Tenth Schedule to the Act.*

190 *Paragraph 7(1) of the Tenth Schedule.*

The company is deemed to have disposed of the right for an amount equal to the CGT base cost or the trading stock deduction (as the case may be) so that, from the seller's perspective, the transaction is tax neutral.

If the seller held the right as a capital asset, the acquiring oil and gas company is deemed to have incurred expenditure in respect of the right equal to the CGT base cost incurred by the selling company and on the same date as the selling company. That deemed expenditure is treated as one of the following:

- The base cost for CGT purposes if the right is acquired as a capital asset
- Expenditure incurred in the acquisition of trading stock if it is acquired for that purpose[191]

If the seller held the right as trading stock and the purchaser acquires it in turn as trading stock, the cost recognized by the seller is the cost of that stock in terms of Sections 11(a) or 22(1) or (2) and is likewise taken into account by the purchasing company.[192]

These rollover rules do not apply when the right is sold for a price less than its original acquisition cost or if the seller disposes of the right as trading stock and the purchaser acquires it as a capital asset. In such cases, the selling company must recognize a CGT gain or loss (as appropriate) and the acquiring company must recognize its actual expenditure incurred as a base cost going forward.

Participation treatment

If the company that disposes of an oil and gas right holds it as a capital asset and the market value of the right exceeds its base cost, the difference is deemed to be gross income accruing to the seller. The purchaser is entitled to deduct the same amount in determining its taxable income derived from oil and gas income (notwithstanding the general prohibition on the deduction of the cost of acquisition of oil and gas rights).[193]

If the disposed right was held by the seller as trading stock and its market value at the time of disposal exceeds the expenditure[194] incurred for purposes of Section 11(a) or 22, the purchasing company is similarly entitled to deduct an amount equal to that differential as the cost of trading stock acquired (notwithstanding the general prohibition on the deduction of expenditures incurred on the acquisition of oil and gas rights) and the seller is deemed to receive gross income of the same amount.

The Tenth Schedule makes no provision in respect of other components of a farm-in or farm-out transaction, such as the disposal of physical assets and cost-sharing arrangements. Unless the agreement is disguised as a consideration for the mining right, it is felt that the consideration constitutes:

- A recoupment of expenditures formerly incurred by the seller
- An expenditure incurred by the purchaser in respect of exploration

The question of whether an oil and gas company holds an oil and gas right as a capital or trading asset must always depend upon the facts of, and intention behind, that company's investment. As a general rule, however, it is probable that, in terms of South African taxation principles, most oil and gas companies acquire their rights as capital assets, notwithstanding that they frequently anticipate using the disposal of undivided shares of those rights to limit financial and commercial risk.

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191 *Paragraphs 7(2)(i)(A) and (B) of the Tenth Schedule.*

192 *Paragraph 7(2)(ii) of the Tenth Schedule.*

193 *Paragraph 7(3)(a) of the Tenth Schedule. It appears that the actual proceeds or expenditures incurred in respect of the disposal are irrelevant in determining the tax consequences in a participation election. Subparagraph (3)(a) apparently applies in a situation where the purchasing entity is not an oil and gas company as defined, but it is probable that relaxation is unintentional.*

194 *Paragraph 7(3)(b) of the Tenth Schedule. The subparagraph does not clearly bring this amount into taxable income.*

Selling shares in a company

The CGT implications of the disposal of shares depend on the nature of the company and the tax residency of the shareholders. South African tax residents are subject to CGT on any capital gain realized on the disposal of shares held as capital assets. The tax liability is calculated on the basis outlined under "Asset disposals" in Section G.[195]

Shareholders that are not tax resident in South Africa, however, are only subject to CGT on any capital gain realized on the disposal of shares if 80% or more of the market value of the shares is attributable directly or indirectly to immovable property situated in South Africa. Oil and gas rights are considered to be immovable property for this purpose.

J. Indirect taxes

Import and export duties

The normal customs and excise laws apply to imports and exports. Although the OP26 regime provided for generous exemptions that enabled oil and gas companies to import items free of duty, they no longer apply under the current customs and excise law. The National Treasury has indicated, however, that it intends to create a special exempt regime for oil and gas companies.

VAT

The normal VAT rules apply to oil and gas companies. Briefly, VAT liability enables rand-based expenditures to qualify for VAT credit as input VAT. Sales of crude oil are zero-rated (i.e., no VAT charge applies). Gas does not qualify for zero-rating.

VAT and customs duties

Due to the inconsistent VAT treatment of certain temporary imports for oil and gas E&P, which are administered by the customs department, the South African Oil and Gas Alliance (SAOGA) is attempting to facilitate a system whereby a deposit or insurance bond can be taken out to satisfy customs department requirements in relation to temporary importation.

Other transaction taxes

The normal rules in respect of securities transfer tax apply to oil and gas companies. Subject to certain group reorganization relief rules, the transfer of beneficial ownership of certain marketable securities (e.g., shares and rights to dividends in South African companies) is subject to the securities transfer tax at 0.25% of the transaction or market value.

K. Other

Local participation requirements may apply for grants of oil and gas rights in South Africa. Typically, a grant is subject to a back-in option of up to 10% in favor of the national oil company (PetroSA).

195 *Assuming they are companies and not natural persons.*

Spain

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A. At a glance

Fiscal regime

The fiscal regime that applies in Spain to the oil and gas industry consists of a combination of the general corporate income tax (CIT) regime with some special rules and surface tax.

Special CIT rules

Entities engaged in the exploration, investigation and exploitation of hydrocarbons are subject to the following special CIT rules:

- Advantageous depreciation regime for intangible assets
- Higher tax rate applicable for the income derived from the exploration and exploitation of hydrocarbons

Furthermore, the following specific tax benefits are available for entities whose sole business purpose consists of the exploration, investigation and exploitation of hydrocarbons and hydrocarbon substorage:

- Reduction of the taxable base, based on the depletion factor reserve
- Advantageous regime for offsetting tax losses

B. Fiscal regime

Corporate income tax

CIT is imposed on income of companies and other entities and organizations that have a separate legal status. Resident entities are taxable on their worldwide income, including the profits from their foreign branches.

Nonresident entities are taxable only for Spanish sourced income, which includes income from any kind of business activity conducted in Spain through a branch, office or other permanent establishment (PE).

As a general rule, the tax base shall be calculated by adjusting certain provisions established in the CIT Law, from the accounting profit/loss determined in accordance with Spanish generally accepted accounting principles (GAAP).

Functional currency

The euro is generally used as the functional currency for accounting purposes. However, oil and gas companies are permitted to use US dollars as the functional currency.

Nevertheless, the annual accounts of a company and also the CIT return must be expressed in euros. If the functional currency of a Spanish company is a currency other than the euro, the financial statements are required to be converted into euros. Differences arising from the conversion of the foreign functional currency into euros are recorded in a special equity account called conversion differences.

Determination of taxable income

Taxable income is the company's gross income for the tax year, as reduced by certain deductions. It is determined from the annual financial statements prepared under GAAP.

In general, all necessary expenses incurred in producing income during the year and depreciation on income-producing property may be deducted from gross income to arrive at taxable income.

However, certain items are not deductible from gross income, such as:

- Penalties and fines
- CIT
- Gifts and donations
- Expenditures for the improvement or enhancement of capital assets
- Depreciation charges that exceed the maximum rates prescribed by law, unless it can be demonstrated that the rates used correspond to the actual depreciation incurred

Provision to cover future abandonment costs is depreciated according to the annual amortization of the asset. For tax purposes, this amortization is considered tax deductible provided that it does not exceed the maximum rates prescribed by law, unless it can be demonstrated that the rates used correspond to the actual depreciation incurred.

Participation exemption regime and foreign tax relief

The exemption method may be used to avoid double taxation on dividends received from abroad and on capital gains derived from transfers of shares of foreign companies if the following requirements are met:

- At the time of the distribution of the dividend or the generation of the capital gain, the Spanish company has owned, directly or indirectly, at least 5% of the share capital of the nonresident company for an uninterrupted period of at least one year. For dividends, the one-year period can be completed after the distribution. In addition, the time period in which the participation is held by other group entities is taken into account for purposes of the computation of the one-year period.
- From 1 January 2011, that exemption was applicable in those cases in which the 5% participation had been reduced up to 3% as a consequence of a transaction carried out by the participated entity under the rollover regime or in the course of a public offer of shares, regarding those dividends paid within the three-year period since that transaction had taken place. In this case, the application of the exemption would be conditioned to the fact that the participation was not transferred, or even reduced, under the direct or indirect 3% participation, during the year in which the dividend was distributed. The foreign company is subject to corporate tax in a tax system that is similar to Spain's corporate tax system. This requirement is considered to be met if the subsidiary is resident in a country that has entered into a double tax treaty with Spain containing an exchange-of-information clause.
- The foreign company is not resident in a country identified by the Spanish tax authorities as a tax haven.
- The foreign company derives at least 85% of its income from business activities conducted outside Spain.

The exemption method is also applicable in the case of income obtained abroad by foreign branches of a Spanish company, provided that the requirements on the previous page are met.

If the exemption method does not apply, a tax credit is allowed for underlying foreign taxes paid by a subsidiary on the profits out of which dividends are paid and for foreign withholding taxes (WHT) paid on dividends.

Such tax credit is equal to the lesser of the following:

- The Spanish corporate tax that would have been payable in Spain if the foreign income had been derived in Spain
- The actual income tax paid abroad on the foreign-sourced income

Tax credits granted under the credit method may be carried forward for 10 years.

This tax credit is also applicable in the case of income for foreign branches of a Spanish company.

Transfer pricing

Spanish tax law includes the arm's-length principle and the requirement of documenting all related-party transactions.

The arm's-length principle applies to all transactions (domestic or international) carried out by taxpayers with related parties.

The following are the principal aspects of the Spanish transfer pricing regime:

- Taxpayers must use arm's-length values in their tax returns. As a result, taxpayers bear the burden of proof on transfer pricing issues.
- OECD guidelines and pricing methodology apply.
- The law provides for secondary adjustments. Under this measure, if the agreed value in a transaction differs from the normal market value, the difference between the values is recharacterized by following a substance-over-form approach.
- Advance pricing agreements (APAs) may be negotiated. They apply to the current year, the preceding year and the following four years.
- New specific statutory documentation requirements, in line with the guidelines of the EU Joint Transfer Pricing Forum, have been in force since February 2009.
- Penalties and delay interest may be imposed. Also, a specific penalty regime is applicable in the case of a lack of the documentation requirements.

Administration

The tax year is the same as the accounting period, which can be different from the calendar year. The tax year may not exceed 12 months. The tax return must be filed within 25 days after 6 months following the end of the tax year. In April, October and December of each calendar year, companies must make installment payments on account of CIT equal to either of the following:

- 18% of the tax liability for the preceding tax year.
- An amount calculated by applying a percentage of the CIT rate to the profits for the year (up to the end of the month preceding the date of the payment) and then subtracting from the result the tax withheld from payments to the company and advance payments of tax previously made. This alternative is compulsory for companies with turnover of more than €6,010,121.04 in the immediately preceding tax year.
- For CIT installment payments to be filed from October 2011 to December 2013, the percentage of the CIT rate will be determined as follows:
  a. 5/7 of the CIT rate to be applied by companies whose net turnover within the 12 months prior to the beginning of the fiscal year is less than €20 million
  b. 8/10 of the CIT rate to be applied by companies whose net turnover within the 12 months prior to the beginning of the fiscal year amounts between €20 million an €60 million

c. 9/10 of the CIT rate to be applied by companies whose net turnover within the 12 months prior to the beginning of the fiscal year amounts is higher than €60 million
d. The late submission of the CIT return or the late payment on account will result in the imposition of surcharges (up to 20%) and also the accrual of late penalty interests if the return is filed after 12 months from the deadline for its voluntary submission

C. Special CIT rules applicable to oil and gas companies

There are special CIT rules applicable to oil and gas companies. Some of them (depreciation of intangible assets and higher tax rate) are applicable to any company engaged in the exploration, investigation and exploitation of hydrocarbons and hydrocarbon substorage, regardless of the fact that they also perform other activities.

However, some other special corporate tax rules (in particular, depletion factor reserve and advantageous tax losses compensation regime) are only applicable to companies whose corporate business is solely the exploration, investigation and exploitation of hydrocarbons and hydrocarbon substorage.

Depletion factor reserve

Companies whose corporate purpose is solely the exploration, investigation and exploitation of hydrocarbons and hydrocarbon substorage shall be entitled to a reduction of their tax base, in respect of the depletion factor reserve, which, at the discretion of the entity, may be either of the following:

- 25% of the amount of the consideration for the sale of oil and gas products and for the provision of storage services, up to a limit of 50% of the tax base prior to this reduction
- 40% of the amount of the tax base prior to this reduction

Some accounting and material requirements should be met to benefit from the above reductions.

In particular, the amounts of the depletion factor reserve that reduce the tax base must be invested in the activities of prospecting, research or exploitation of oil and gas performed within 10 years or in "the abandonment of fields and the dismantling of marine rigs."

The taxpayer must disclose in the notes to its financial statements for the 10 years following that in which the appropriate reduction was made the amount of the reduction, the investments made with a charge to it and the depreciation or amortization taken, as well as any decrease in the reserve accounts that were increased as a result of reduction of the tax base and its use.

Advantageous tax losses compensation regime

In general, tax losses can be carried forward and offset against income in the tax periods ending in the 15 immediately succeeding years. Newly created entities may compute the offset period from the first tax period in which positive taxable income is obtained.

However, for fiscal years from 2011 to 2013, important restrictions to offset carryforward losses apply for companies with a net turnover higher than €20 million, as follows:

- Companies whose net turnover within the 12 months prior to the beginning of the fiscal year amounts to between €20 million and €60 million may only offset tax losses up to a maximum amount of 75% of the positive taxable base.
- Companies whose net turnover within the 12 months prior to the beginning of the fiscal year is higher than €60 million may only offset tax losses up to a maximum amount of 50% of the positive taxable base.

In order to reduce the impact of the above-mentioned restrictions, carried forward losses pending to be offset at the beginning of fiscal year 2012 and tax losses generated as from fiscal year 2012 may be carried forward for 18 years instead of 15 years.

Finally, companies whose corporate purpose is solely the exploration, investigation and exploitation of hydrocarbons and hydrocarbon substorage do not have a time limit for offsetting tax losses, but only 50% of each tax loss can be offset in one tax year.

Amortization of intangible assets

Companies engaged in the exploration, investigation and exploitation of oil and gas (exclusive business purpose is not required) have a special regime applicable to intangible assets.

In particular, intangible assets may be amortized at a maximum annual rate of 50%. Such intangible assets shall include exploration expenses, such as prior geological, geophysical and seismic works, costs incurred to prepare access routs to the drilling site and for land preparation, exploration evaluation works, development test drilling, restoration and conservation of wells.

There shall be no maximum amortization period for intangible assets or prospecting expenses.

Higher tax rate applicable for hydrocarbon activities

For residents and nonresidents that conduct business activities in Spain through a PE applicable for tax periods beginning on or after 1 January 2008, the general tax rate is 30%.

However, for entities engaged in the exploration, investigation and exploitation of hydrocarbons and hydrocarbon substorage owned by third parties, the applicable tax rate is 35%.

Therefore, if a company is engaged in the exploration, investigation and exploitation of hydrocarbons and hydrocarbon substorage and also carries out other activities, the applicable tax rates would be 35% for the former activities and 30% for the latter. Please note that, in that case, the company would not be allowed to apply the special rules mentioned earlier in this Section under "Depletion factor reserve" and "Advantageous tax losses compensation regime."

Entities engaged in hydrocarbon storage activities and other possible activities, but not in the exploration, investigation and exploitation of hydrocarbons, will be taxed at the general 30% tax rate and will not be entitled to any special benefits.

In addition to the CIT, nonresident entities operating in Spain through a PE are subject to a branch remittance tax at a rate of 19% (21% from 1 January 2012 to 31 December 2013), unless one of the following exceptions applies:

- Branches of EU resident entities, other than tax haven residents, are exempt from the tax.
- Branches can be exempt from the tax if a double tax treaty does not mention the tax and if the other tax treaty country provides reciprocal treatment.

Ring-fencing

In Spain, residents and nonresidents that conduct business activities through PE may offset losses against any of its profits. Therefore, Spain does not generally apply ring-fencing in the determination of the corporate tax liability.

However, if an entity is engaged in the exploration, investigation and exploitation of hydrocarbons and hydrocarbon substorage and also carries out other activities, the losses from hydrocarbon activities would be ring-fenced and are not allowed to be offset against profits of other businesses and vice versa. Group taxation is also applicable for companies taxed on identical tax rates.

Entities taxed under the special hydrocarbon regime cannot be part of a tax unity with other group entities carrying out activities subject to the general CIT rate (30%).

D. Withholding taxes

General rule: nonresidents entities operating in Spain without a PE are taxable at a general rate of 24% (24.75% from 1 January 2012 to 21 December 2013), unless an applicable double tax treaty provides a lower withholding tax (WHT) rate.

Royalties: WHTs apply at a rate of 24% on royalty payments (24.75% from 1 January 2012 to 31 December 2013). However, royalties paid to associated entities or PEs resident in the EU may be taxed at a reduced rate of 10% if specific conditions are met (an applicable double tax treaty may establish a lower WHT rate). Furthermore, from 1 July 2011, the WHT applicable to royalties paid to associated entities or PEs resident in the EU will not be applicable.

Interest and dividends: WHTs apply at a rate of 19% on interest and dividend payments – 21% from 1 January 2012 to 31 December 2013 (an applicable double tax treaty may provide for lower WHT rates).

However, under certain circumstances, interest and dividends paid to entities resident in another EU member state are exempt from tax.

E. Financing considerations

Finance costs are generally deductible for corporate tax purposes, with the following exceptions:

Thin capitalization rule

The thin capitalization rule applies where the direct or indirect net remunerated indebtedness of an entity, other than a financial institution, to one or more related persons or entities nonresident in Spain, is more than 3:1. In that case, the interest accrued on the excess shall be treated as a dividend.

However, as from 2004, this rule is not applicable when the related entity nonresident in Spain is resident in another member state of the EU, under some requirements.

Notwithstanding this, related-party transactions should be valued at market value, and, as a consequence, the taxpayer has to value its intercompany transactions on an arm's-length basis. This is a general obligation.

Therefore, it is advisable as a safeguard to maintain the 3:1 ratio of thin capitalization, to avoid transfer pricing problems with the Spanish tax authorities.

Interests paid by branches to their head office

Interests paid by branches to their head office are not tax deductible in order to determine the taxable base of the branch in Spain.

F. Surface tax

An additional tax called "surface tax" (canon de superficie) applies to oil and gas companies.

This tax should be calculated on a yearly basis on the amount of hectares of the exploration or the exploitation.

In the case of research licenses, amounts paid as a surface tax are considered for accounting purposes as part of an intangible asset; therefore, they are depreciated as an intangible asset.

In the case of exploitation licenses, amounts paid as a surface tax are considered as an expense of the tax year for accounting purposes and deductible for CIT purposes.

G. Indirect taxes

VAT

The standard VAT rate in Spain is 18% as from July 2010.

VAT is potentially charged on all supplies of goods and services made in Spain and its territorial waters (within the 12-nautical-mile limit from the shore).

If a Spanish branch is constituted, it shall be deemed as a PE for VAT purposes, and, thus, the branch will have to comply with Spanish VAT obligations, such as registration for VAT purposes and filing of VAT returns.

A nonresident EU company that is required to register for VAT purposes in Spain can register directly to the Spanish tax authorities; however, for practical purposes, it is advisable to appoint a Spanish fiscal representative. Nonresident companies that are not from another EU member state must appoint a Spanish fiscal representative to register for VAT purposes in Spain.

VAT incurred by an entity that is VAT registered in Spain is normally recoverable on its periodic VAT returns. The refund of the credit VAT can, in general, be requested at the end of each calendar year; however, under certain circumstances, this refund can be requested on a monthly basis.

Customs duty

All goods imported into Spain from outside the EU are potentially liable to customs duty. The rate of customs duty is based on the classification of the goods and whether the goods qualify for preferential rates.

Natural gas and associated products imported into Spain from outside the EU are subject to normal customs import procedures. In addition, import VAT is payable at the standard rate.

Excise duty

In Spain, the retail sale of certain hydrocarbon products is subject to a special indirect tax.

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A. At a glance

Corporate income tax (CIT) rate	28%[a] [b]
Withholding tax (%)	[c]
Dividends	0[d]
Movable capital tax	7.5%[b] [e] [g]
Nonresident withholding tax	[f]
Withholding tax on Syrian entities and individuals	[g]
Wages and salaries tax	22%[h]
Royalties	7%
Bonuses	5%
Resource rent tax	N/A
Net operating losses (years):	
Carryback	0
Carryforward	5
Investment incentives	N/A

a. The standard CIT rates range from 10% to 28%. Certain companies are taxed at flat rates.
b. A municipality surcharge tax of 10% of the tax due is imposed in addition to the normal tax rate.
c. In general, branches of foreign companies are subject to the nonresident withholding tax (WHT). However, if a branch imports goods produced by its parent company and sells the goods on behalf of the company in Syria, it is subject to the normal CIT rates.
d. WHT is not imposed on dividends paid by Syrian companies if the profits out of which the dividends are paid have already been subject to tax.
e. The tax on movable capital is a WHT that is imposed on certain payments to resident and nonresident companies and individuals, including various types of interest payments.
f. This tax is withheld from specified payments made to nonresident companies, regardless of whether the company has a branch in Syria. The payments subject to the tax include payments under turnkey contracts (for details, see Section D).
g. WHT is imposed on income derived by Syrian individuals or entities from certain contracting, construction work and services and supply work (for details, see Section D).
h. Resident employers other than branches of foreign companies withhold wages and salaries tax from salaries, wages and fringe benefits or other remuneration paid to resident and nonresident Syrian employees. The first SYP10,000 of annual income is exempt.

Oil and gas are considered to be among the most important resources in the Syrian Arab Republic. Therefore, the Government has always paid special attention to oil and gas fields and their development. The Syrian Petroleum Company, replaced later by the General Petroleum Corporation (GPC), is the governmental body responsible for supervising and monitoring operating companies working in Syria. Given the fact that Syria does not have sufficient experience to explore the country's oil and gas fields fully, foreign explorers and developers are often asked to assist in digging these raw materials from the Syrian soil. Accordingly, foreign companies are present in Syria and provide their services to the Syrian Government and other oil and gas companies. Oil and gas foreign companies are either operating companies or service companies.

B. Fiscal regime

Corporate income tax

Foreign operating companies are contracted by the GPC with a production sharing agreement (PSA), through which profits generated from the exploration and development of oil are divided between the foreign company and the GPC. As per these PSAs, contracting companies do not pay CIT prior to the discovery and development phase, as the GPC is responsible for paying such taxes during this phase. However, once oil is discovered and developed, both the contractor companies and the GPC will be subject to CIT.

The CIT rates that apply to contracting companies are as follows:

	Tax rate
Between SYP0 and SYP50k	Exempted
Between SYP50k and 1 and SYP200k	10%
Between SYP200k and 1 and SYP500k	15%
Between SYP500k and 1 and SYP1m	20%
Between SYP1m and 1 and SYP3m	24%
More than SYP3m and 1	28%

Additionally, a municipality surcharge tax of 10% is imposed on any tax due.

Production sharing agreement

A PSA is an agreement signed between the GPC as a representative of the Syrian Government and an oil and gas company (the contractor). Generally, fiscal uncertainty clauses are not included in a PSA. Per the agreement, total production is divided into the following parts:

1. Royalty percentage paid to the Government
2. Cost oil percentage
3. Profit oil percentage

Cost oil and profit oil are calculated as a percentage of production volume. The percentages of cost oil and profit oil generally vary based on the particular PSA. The contractor incurs the actual costs related to the production of oil. The actual cost incurred is then compared with the cost oil percentage. Any costs incurred beyond the limit of the cost oil percentage will be recovered from the GPC. Recoverable costs are any costs related to the production of oil.

Generally, VAT is not applicable in Syria.

Wages and salaries tax

Oil and gas companies are obliged to pay payroll taxes on the salaries and benefits remunerated to their employees. The tax rates are as follows:

	Tax rate
Between SYP10,000 and SYP15,000	5%
Between SYP15,001 and SYP20,000	7%
Between SYP20,001 and SYP25,000	9%
Between SYP25,001 and SYP30,000	11%
Between SYP30,001 and SYP38,000	13%
Between SYP38,001 and SYP50,000	16%
Between SYP50,001 and SYP75,000	19%
More than SYP75,000	22%

Royalties

As indicated above, per the PSA, the Government receives a share of the profits generated from the exploration and production of oil. Although oil and gas companies share these profits with the Government according to a specified allocation stipulated in the PSA, these profits are not considered royalties. However, oil and gas companies do sometimes pay royalties outside Syria. In such cases, the oil and gas companies are required to withhold a 7% WHT.

Exchange control regulations

Prior to September 2005, Syria had many different exchange rates that governed its local transactions (i.e., an import exchange rate, an export exchange rate and a neighboring countries exchange rate). These rates were unified into one exchange rate, called the free exchange rate, in September 2005. The unification of the exchange rate, coupled with a full liberalization of the current Syrian currency conversion policies this year, has had an impact on the level of imports and exports.

In early 2007, the Central Bank of Syria announced that a unified rate for the Syrian pound had been set and that it was linked to the Special Drawing Rights (SDR) of the International Monetary Fund. The value of the SDR is based on a weighted average of the values of a basket of the four leading world currencies at the following rates: US dollar (44%), euro (34%), Japanese yen (11%) and pound sterling (11%).

Syria's monetary policy underwent many changes from 2004 to 2007. As discussed above, these changes resulted in the unified exchange rate. As a consequence, the following two changes took place:

1. The free exchange rate is now determined by the Central Bank of Syria instead of the Commercial Bank of Syria, and this rate is issued daily.
2. The number of exchange rates has been minimized to two official exchange rates, one for public sector operations and a second for other financial activities.

Repatriation of profits abroad

Foreign currency transactions are highly regulated in Syria. Foreign currency repatriation is restricted and is only permitted in special cases. Only companies with projects licensed under specific investment laws are allowed to repatriate annual profits or capital. Oil and gas companies can be licensed under the investment law and, accordingly, can repatriate their profits. The Central Bank of Syria issued a resolution by which companies licensed under the investment law can transfer their proceeds to their foreign partners outside Syria.

Dividends

There is no WHT on dividends in Syria as long as the profits from which they are paid have already been subject to tax. However, dividend income from non-Syrian companies is subject to a 7.5% tax in addition to a 10% administrative fee imposed on the tax due.

C. Incentives

Exploration

All companies that have a PSA with the public establishment for oil refining and distribution, which are in the exploration phase, are exempt from paying CIT and are only subject to payroll taxes, as no profit has been realized yet.

Losses

Losses may be carried forward for five years for purposes of a deduction from taxable income. Losses may not be carried back.

D. Withholding tax

Service companies are registered as branches of foreign companies. These companies are subject to the supervision of the Ministry of Economy and Foreign Trade. As per Income Tax Law No. 24 of 2003, foreign branches of foreign companies are not subject to CIT. Instead, these service companies are subject to WHT or nonresident tax.

The rates for the above-mentioned nonresident tax are amended in Income Tax Law No. 60 of 2004. The current withholding rates are as follows:

- 2% for all onshore supplies
- 3% for mixed services (supplies + services) and 1% of wages and salaries tax
- 7% for pure onshore services and 3% of wages and salaries tax

This tax is withheld by the foreign company on behalf of its customers and remitted to the tax authorities. In addition, these branches of foreign companies are obliged by law to withhold the tax at the above rates when dealing with their local suppliers and services providers. Furthermore, Law No. 34 of 2008 concerning foreign companies obliged all branches of foreign companies to submit their annual audited financial statements to the Ministry of Economy and Foreign Trade within 90 days of the end of each fiscal year. However, no annual tax return is required to be filed for branches of foreign companies operating in the Syrian Arab Republic.

WHT is imposed on income derived by Syrian individuals or entities engaged in contracting, construction work and services and supply work that is performed with, or for the benefit of, the Syrian public, joint ventures (involving the private and public sectors), the private and cooperative sectors (e.g., those sectors that relate to farmers, agricultural associations and other businesses engaged in agriculture or farming), and foreign companies. The WHT rates are indicated above.

E. Financing considerations

On 6 April 2009, the Ministry of Oil issued Letter No. 12257 regarding the application of Decision No. 93 of 2008. Decision No. 93 discusses the exchange rate that should be used when calculating the tax amount due on profits resulting from an SPA signed with the Syrian Petroleum Company. This decision was issued by the Central Bank of Syria on 30 June 2008 in response to a query raised by one of the operating companies in Syria. This decision obliged operating companies that have an SPA with the Syrian Petroleum Company to adopt the quarterly exchange rate issued by the Central Bank of Syria when calculating the tax amount due on profits resulting from the SPA.

F. Indirect taxes

Customs

Customs duties are based on a basic duty plus a unified tax surcharge. The cost, insurance and freight (CIF) value of imported material is usually calculated at the free exchange rate. Duty rates are progressive and range from 1% to 100%, depending on the Government's view of the necessity of a product.

Permits must be obtained from the Ministry of Economy and Trade for the import of nearly all items. Generally, import permits are valid for six months in the private sector.

Consumption tax

Consumption tax is imposed on both imported products and local products (e.g., vehicles, gold, appliances, imported carpets, alcoholic drinks, soft drinks, tea, oil and margarine, cacao, cement, sugar, salt and bananas). The consumption tax rates range from 1.5% to 40%. The tax is imposed on:

- The value of the product that has been used for determining the custom duties in addition to the custom duties paid and other fees imposed on the "imported product." The tax should be levied upon the receipt of the product from the customs department.
- The sales value defined in the invoice. The tax should be levied when selling the products to merchants.

Consumption tax is also imposed on luxury hotels, restaurants and tourist transportation services. Tax rates range from 3% to 30%. The tax should be levied when the services are rendered. Consumption tax for each month should be transferred to the tax authorities within 10 days after the completion of the month by using manual or electronic forms that should be approved by the tax authorities.

Stamp duty

Stamp duties are imposed on contracts signed by two parties or on any documents that include legal obligations between two parties. The stamp duty rate may be a fixed rate, which varies according to the type of transaction, or a proportional rate based on the value of the document subject to the duty. The value of the document is generally determined by the total value of the contract or agreement. Stamp duty should be paid to the tax authorities within five days of signing the contracts. Any delay will be subject to a penalty equal to two times the amount of the stamp duty.

Property tax

The Ministry of Finance excludes real estate dealers from Law No. 24 of 2003 and subjects them to Law No. 41 of 2005, which states that real estate sold will be taxed on its estimated value stated in the tax authority's records. The tax rate applied will differ based on the type of the real estate (i.e., land, residential or commercial). The seller should bear this tax, and it is due to the tax authorities directly after finalizing the selling agreement. The title of the sold real estate will not be transferred to the buyer unless the seller pays the tax due. The seller should submit a statement describing the sale of real estate within 30 days of the date sold, and the tax should be transferred to the treasurer within 30 days of the submission of the statement.

Tax on income from movable capital

This tax is levied on the following types of income:

- Interest from bonds and loans issued by Syrian institutions
- Dividends from non-Syrian companies
- Interest from bonds issued by Syrian or foreign governments
- Liabilities documented with real estate guarantees
- Deposits of all kinds
- Guarantees and monetary bonds issued by legal entities
- Lottery prizes exceeding SYP1 million

Additional municipality surcharge tax and administrative fees

A new Legislative Decree, No. 35 of 2007 set additional municipality surcharge taxes and additional administrative fees and granted the provincial council of each governorate the right to determine the additional rates without exceeding a maximum limit of 10%. Executive and implementation instructions for the mentioned decree were issued and published in the *Official Gazette* of Syrian Arab Republic on 6 March 2008 (also the effective date).

On 14 December 2011, executive and implementation instructions of the mentioned Decree for 2012 have been issued and published in the *Official Gazette* of Syrian Arab Republic and became effective on 1 January 2012.

The major points of the mentioned decree and its executive and implementation instructions are as follows:

- 10% of the current capital revenue tax
- 10% of the real estate revenue tax
- 5% of the stamp duty
- 10% of customs fees
- 1% of mobile bill and prepaid cards
- 5% of the consumption (sales) tax (for certain items)
- 1% penalty levied on previously applied penalty when additional charges as set are not implemented
- SYP25 on each loan that exceeds SYP5,000 from any of the joint stock, public or private banks; amount is paid once upon signing the loan contract, opening an overdraft account or letter of credit and when renewing the loan facility

G. Other

Public Establishment for Oil Refining and Oil Derivatives Distribution

Legislative Decree No. 14 dated 14 February 2009 is related to the creation of the Public Establishment for Oil Refining and Oil Derivatives Distribution. This organization will play a supervisory role over companies involved in the refining and distribution of oil derivatives. As per Article No. 3, this establishment will handle the following tasks:

- Suggest strategies for refining oil, petrochemical industries and the distribution of oil derivatives, including the use of natural gas in automobiles and houses
- Work on the establishment of new refineries in accordance with the Government's plans in this regard
- Prepare and develop agreements to attract investors in the areas of oil refining and storage and distribution of oil derivatives
- Determine the preferences for financing investments in projects related to oil refining and distribution of oil derivatives based on its importance on a national level
- Coordination and cooperation with local, Arab and international training institutes to develop the local capabilities and develop human resources in the related institutions
- Coordination with Arab and international bodies in the field of oil refining and distribution of oil derivatives
- To follow the latest scientific and technological developments in the field of oil refining and distribution of oil derivatives
- Evaluation of the environmental impact of related activities and projects with the coordination of the Public Organization for Environmental Affairs
- Coordination with the competent authorities regarding importing and exporting activities related to associated bodies
- Supervise operating companies involved in the refining and distribution of oil derivatives

The Public Establishment for Oil Refining and Oil Derivatives Distribution replaces the Homs Refinery Company.

Tanzania

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A. At a glance

Corporate income tax (CIT)	30% or 25% [a]
Capital gains tax (CGT)	30% [b]
Branch tax rate	30%
Withholding tax (WHT):	
Dividends	5% or 10% [c]
Interest	10% [d]
Royalties	15% [e]
Management and professional fees	5% or 15% [f]
Insurance premiums	5% [g]
Rent, premiums and similar considerations	10% or 15% [h]
Natural resources payments	15%
Branch remittance tax	10% [i]
Alternative minimum tax (AMT)	0.3% [j]
Net operating losses (years):	
Carryback	0%
Carryforward	Unlimited

a. The 25% rate applies to a newly listed company in the Dar es Salaam Stock Exchange. The rate is applicable for three years following the listing. 30% of the issued shares must be held by Tanzania nationals.
b. Capital gains are treated as business income for companies and are taxed at the regular CIT rate.
c. The 10% rate is the general rate for both residents and nonresidents. The 5% rate applies to dividends paid by companies listed on the Dar es Salaam Stock Exchange. Dividends are exempt if a resident recipient company owns at least 25% of the voting capital of the payer of the dividends. The dividend WHT is a final tax.
d. This tax applies to residents and nonresidents. It is a final tax for resident individuals and nonresidents. Resident companies credit the WHT against their annual CIT.
e. This WHT applies to both residents and nonresidents. It is a final tax for nonresidents only.
f. The 5% rate applies to residents (technical service providers in the mining industry) and the 15% rate applies to nonresidents. The WHT on technical, management and professional fees (services fees) is a final tax.
g. This tax applies to nonresidents only.

h. The 10% rate applies to residents. The 15% rate applies to nonresidents. This WHT is a final tax for nonresidents and for individuals not engaged in business.
i. This tax applies to the after-tax profits of branches of foreign companies.
j. This a tax on turnover, which applies to companies with a perpetual tax loss for three consecutive years.

B. Fiscal regime

The fiscal regime that applies in Tanzania to the petroleum industry is the same regime that applies to other industries. It consists of CIT, CGT, value-added tax (VAT), import duty and royalties. It includes some tax exemptions on import duties and relief on VAT for exploration companies.

The Tanzania Petroleum Development Corporation (TPDC) is the institution established by the Government for the development of the exploration, prospecting and production of oil and gas. The TPDC acts on behalf of the Government, including entering into production sharing agreements (PSAs) with investors in the oil and gas industry, signing agreements on behalf of the Government, and acting as a regulator of the industry.

Corporate tax

In Tanzania, a resident corporation is subject to income tax on its worldwide income at the rate of 30%. A nonresident corporation is taxed on its Tanzanian sourced income only, which is also taxed at the 30% rate. However, a new company is taxed at a reduced rate of 25%, if 30% of its equity shares have been issued to the public and it is listed on the Dar es Salaam Stock Exchange.

Corporations enjoying tax incentives (accelerated depreciation) having perpetual tax loss for three consecutive years due to the respective incentive shall pay AMT at a rate of 0.3% on turnover; the payment shall be computed from the third year of the perpetual loss.

Ring-fencing

Tanzania applies ring-fencing in the determination of corporate tax liability for mining companies effective from 1 July 2010. Profits from one mine carried out by the same company in different locations are treated as separate mining operations and are taxed separately. Unlike the mining sector, there are no ring-fencing rules in the oil and gas industry. However, it is likely that ring-fencing in the oil and gas industry may be introduced in the near future following the amendments made for the mining sector.

Corporate tax is imposed on net taxable income. Taxable income is determined based on audited financial statements and is calculated as gross revenue less tax-deductible expenses allowable under the Income Tax Act 2004. Allowable deductions include expenses incurred wholly and exclusively in the production of income.

An expenditure of a capital nature is not tax deductible, but a tax depreciation allowance based on statutory rates is available. In the context of the oil and gas industry, this is mostly in the form of capital allowances available in respect of depreciable assets, referred under Section C.

Capital gains or losses

Capital gains on the disposal of depreciable assets are treated as business income for the corporate entity and are taxed at the normal corporate tax rate of 30%. However, CGT does not apply to companies listed on the Dar es Salaam Stock Exchange or for a resident company if the shareholding of the resident company is 25% or more.

Gains from the realization of investment assets are taxed at 30%. Capital losses from the realization of investment assets are only deductible against capital gains from the same investment assets and not from ordinary income. Net capital losses can be carried forward for use in subsequent years.

Functional currency

Income accounting must be reported in local currency, Tanzanian shillings (TZS). However, upon application and approval by the Tanzania Revenue Authority, an entity can account for income in a foreign currency under the terms and conditions in the approval.

Transfer pricing

Tanzania has no transfer pricing rules, but the tax law includes provisions to ensure that the Tanzanian-sourced taxable income associated with cross-border transactions is at arm's-length prices. Application of the Organization for Economic Cooperation and Development (OECD) model in determining transfer prices is permitted.

Additional petroleum tax

The PSAs provide for payment of additional petroleum tax (APT) calculated on the basis of a development area in accordance with the provisions of the PSA. APT is calculated for each year of income, and it may vary with the real rate of return earned by the company on the net cash flow from the development area in question. The APT due must be paid in cash at the time and in the manner that the commissioner of income tax may reasonably require. The rate for APT is either 25% or 35%.

It should be noted that APT has not yet been introduced in practice, but the requirement is retained in the relevant PSAs entered into by oil and gas exploration companies with the Government of Tanzania.

Royalty regimes

Petroleum royalties are administered and collected under the Petroleum (Exploration and Production) Act 1980. Royalties are collected by the TPDC and are paid to the central Government as follows:

- For onshore projects – 12.5%
- For offshore projects – 5%

C. Capital allowances

For tax purposes, depreciable assets include assets with a limited effective life that decline in value over time. Examples of depreciable assets include plant and equipment, mining petroleum permits, retention leases and licenses that are categorized under Class Four of the Third Schedule of the Income Tax Act 2004. Natural resource exploration and production rights and assets in respect of natural resource prospecting, exploration and development expenditures are depreciated at the rate of 20%.

D. Incentives

Exploration

Expenditure for exploration qualifies on a straight-line basis at a rate of 20% of the capital allowance.

Tax holiday

Tanzania does not have a tax holiday regime other than for companies operating in the export processing zones.

Tax losses

Income tax losses can be carried forward indefinitely. Tax losses may not be carried back. However, a carryback may be allowed for companies in the construction industry.

Research and development

A tax deduction in respect of R&D expenditures is limited to improvement of business products or processes and agricultural improvements.

E. Withholding taxes

Dividends

Dividends paid by a Tanzanian entity are subject to WHT at a rate of 10%; the tax is due on an accrual basis. However, companies listed on the Dar es Salaam Stock Exchange pay WHT at a reduced rate of 5%. WHT on dividends is deducted at the source and is a final tax.

There is a participation exemption on dividends for resident-to-resident entity shareholders if the shareholding is 25% or more.

Interest and royalties

Interest and royalties paid to nonresidents are subject to a final Tanzanian WHT of 10% and 15%, respectively, unless altered by a relevant double tax agreement.

Branch remittance tax

A branch remittance tax (repatriated income of the domestic permanent establishment (PE)) is applicable at a rate of 10%. No exchange control regulations apply. Repatriation of branch profits can be effected freely after payment of statutory taxes.

F. Financing considerations

Thin capitalization

The total amount of interest that may be allowed for corporations that are foreign owned by 25% or more for a year of income shall not exceed the sum of interest equivalent to a debt-to-equity ratio of 70:30. Stated differently, the thin capitalization rules apply to companies that are foreign owned by 25% or more and the debt-to-equity ratio is more than 70:30. This has a tax effect of a restriction of the interest charge to 70%.

G. Transactions

Asset disposals

The disposal of natural resources, exploration, and production rights and assets in respect of natural resource prospecting, exploration and development expenditures is regarded as a disposal of a depreciable asset. The difference between the written-down value and the consideration price is treated as business income and is taxed at a corporate tax rate of 30%.

Farm-in and farm-out

Under the PSA, an entity may assign or transfer to a corporation or firm any of its rights, privileges or obligations, provided that the Government is notified and given written copies of the assignments and agreements, and any assignment shall be binding to the assignee.

Selling shares in a company (consequences for resident and nonresident shareholders)

A share disposal is generally subject to the CGT regime because it is regarded as a disposal of an investment asset. A nonresident that disposes of shares in a Tanzanian company is only subject to tax in Tanzania if the sale involves the transfer of the registration of shares in Tanzania from one party to another.

H. Indirect taxes

VAT

Under Tanzanian law, all persons who make taxable supplies of goods and services and whose turnover in any given year is TZS40 million or more must register for VAT. The standard rate of VAT is 18% for all taxable goods and services, including the importation of taxable goods and services. VAT is a multi-staged tax that applies at each transaction point throughout the supply chain.

All exports are zero-rated. Specified goods and services that are exempt from VAT include fuel and financial services. Some persons or institutions are VAT-relieved, including companies engaged in exploring and prospecting for oil and gas.

Both Tanzania resident and nonresident entities engaged in the oil and gas industry may be subject to VAT on services and products supplied, with the exception of imports or supplies used solely for the purpose of exploring and prospecting for oil and gas (which are VAT-relieved).

VAT applies to all taxable supplies of goods and services made or imported by a taxable person in the course of furtherance of business and includes:

- Making a gift or loan of goods
- Leasing or letting goods for hire
- Barter trade and exchange of goods
- Appropriation of goods for personal use or consumption by taxable person or by any other person

Entities below the VAT registration threshold may choose to register voluntarily for VAT. A registered entity may recover the VAT charged on goods and services acquired for the furtherance of its business as an input tax. Input tax is generally recovered by being offset against VAT payable (output tax) on taxable supplies.

Import duties

All goods, equipment and materials entering Tanzania from overseas are subject to customs import duties, unless specifically exempt. The general rate of customs duty applied to the customs value of imported goods ranges from 0% to 25%.

However, special exemptions apply for companies engaged in the exploration and prospecting of oil and gas for capital equipment and other items necessary for the oil and gas business.

Export duties

There are no duties applied to goods exported from Tanzania except for raw cashew nuts.

Excise duties

Excise duty is levied on some goods manufactured in Tanzania, such as soft drinks, beer, tobacco and selected imported goods, including petroleum products.

Stamp duty

Stamp duty applies to specified transactions. Generally, a stamp duty is imposed under different heads of duty, the most significant of which is a conveyance duty on a transfer of property (e.g., land, buildings, certain rights, goodwill).

The transfer of shares in a company that predominantly holds land interests may also be subject to stamp duty on the underlying land interests.

Stamp duty legislation differs in relation to the types of instruments or transactions.

I. Other

Pay as you earn

Resident individuals, including expatriates, are taxed on their worldwide income based on the resident tax rates, while nonresidents pay tax on Tanzanian-sourced income only. The resident minimum tax rate is 15%, and the maximum rate is 30%, while the nonresident rate is 20%. Employers have the responsibility to withhold and pay the tax due from employees' entire remuneration on a monthly basis.

Skills development levy

Employers are obligated to pay 6% based on the monthly gross remuneration for all employees.

National Social Security Fund

It is mandatory for all employees, including expatriates, to register and contribute to the NSSF. The NSSF is a pension scheme that requires each employee to contribute 10%, while the employer contributes 10% of all employees' monthly gross salaries.

Local municipality council services levy

The local municipal authorities impose a service levy, at a rate of 0.3% of the turnover or sales payable, on a quarterly basis.

Double tax treaties

Tanzania has double tax treaties with the following countries: Canada, Denmark, Finland, India, Italy, Norway, South Africa, Sweden and Zambia.

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A. At a glance

Fiscal regime

Thailand's oil and gas fiscal regimes are classified as Thailand I, Thailand II and Thailand III regimes. Each regime incorporates different benefit sharing structures.

Royalties	5% to 15%[196]
Bonuses	Progressive rate[197]
Production sharing contract (PSC)	50%[198]
Income tax rate	50%[199]
Investment incentives	TH, O[200]

B. Fiscal regime

The fiscal regime that applies in Thailand to the petroleum industry consists of a combination of petroleum income tax, PSC and royalties. Annual bonus and special remuneration benefits (SRB) also apply to petroleum concessions granted under the Thailand II and Thailand III regimes, respectively.

Petroleum income tax

Companies engaged in petroleum exploration and production in Thailand are subject to petroleum income tax at the rate of 50% of annual profits, in lieu of corporate income tax (CIT), which is imposed under general tax laws. Petroleum income tax is regulated under the petroleum income tax law.

Taxation consequences are classified according to the regimes commonly known within the oil and gas industry as the Thailand I, Thailand II and Thailand III fiscal regimes. Each regime incorporates different benefit sharing structures (see next page for details).

Ring-fencing

Ring-fencing applies in respect of projects taxed between Thailand I, Thailand II and Thailand III regimes, as described below.

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196 *For petroleum concessions granted under the Thailand I and Thailand II regimes, 12.5%, and 5% to 15% under the Thailand III regime.*

197 *Petroleum concessions granted under the Thailand II regime are subject to an annual bonus at progressive rates.*

198 *PSCs apply only to contractors that operate in the Malaysia–Thailand Joint Development Area (JDA).*

199 *The income tax rate for projects in the JDA is 0% for the first eight years, 10% for the next seven years and 20% thereafter.*

200 *TH : tax holiday, O: other – deepwater incentives (depth greater than 200 meters).*

Thailand I regime

The majority of the concessions awarded prior to 1982 are subject to the Thailand I tax regime. Benefits are shared in the following manner:

Royalty	12.5% of the value of petroleum sold.
Petroleum income tax	Half of annual profits. Taxable profit is subject to ring-fencing. All projects in Thailand I and Thailand II can be offset against one another but cannot be offset with projects in Thailand III.

Thailand II regime

Petroleum concessions under Thailand II regime are awarded in conjunction with an announcement from the Industry Ministry. They are subject to the following benefit sharing structure:

Royalty	12.5% of the value of petroleum sold.
Annual benefits	Petroleum concessionaire undertakes to limit deductible costs and expenses to no more than 20% of the annual gross revenue or pays annual benefits to the Government for the excess portion.
Annual bonus	Concessionaire pays an annual bonus to the Government at progressive rates, which depend on production volume.
Petroleum income tax	Half of annual profits. Taxable profit is subject to ring-fencing. All projects in Thailand I and Thailand II can be offset against one another but cannot be offset with the projects in Thailand III.

Thailand III regime

Petroleum concessions awarded after 14 August 1986 are subject to the Thailand III fiscal regime. This regime also applies to petroleum concessions where the concessionaire has exercised an option to be regulated by the Thailand III regime. The benefit sharing structure can be characterized as follows:

Royalty	Sliding scale (5% to 15% of the value of petroleum sold) based on production levels, calculated on a block-by-block basis.
Special remuneration benefits (SRB)	The concessionaire pays SRB to the government based on a percentage of annual petroleum profit. The percentage can vary from 0% to 75% depending on annual revenue per meter drilled.
Petroleum income tax	Half of annual profits. A midyear income tax payment (half of projected annual tax) is also required. Taxable profit is subject to ring-fencing. All projects in Thailand III can be offset against one another but cannot be offset with the projects in Thailand I and Thailand II.

Accounting period

The first accounting period officially commences on the date of the first sale or disposal of petroleum, subject to a royalty. Effective from that date, the company has a duty to file petroleum income tax returns and pay any tax due.

The accounting period is of a 12-month duration. Nevertheless, under the following circumstances, an accounting period may be shorter than 12 months:

- For the first accounting period, the company may choose any year-end date
- The company ceases operations
- The director-general of the Revenue Department permits a change of the year-end date

If a company transfers its assets or rights relating to petroleum operations to another party prior to the commencement of the first accounting period, the law considers the transfer date to be an accounting period for the purpose of this transitional situation (commonly known as a "one-day" accounting period). The company is then required to file an income tax return and pay any income tax due on the transfer transaction.

Determination of profit

Petroleum income tax is levied on annual profits, based on taxable revenues less deductible expenses. Taxable revenues include revenue from the sale of petroleum,[201] the value of the petroleum disposed, the value of petroleum delivered in lieu of a royalty, revenue from the transfer of assets or rights relating to petroleum operations and any other revenue arising from petroleum operations (e.g., interest on surplus funds deposited with financial institutions in a savings deposit or similar accounts).

Tax-deductible expenses generally include expenses that are normal, necessary, not excessive and that are paid in total, specifically for petroleum operations, regardless of whether they are paid in Thailand or outside Thailand. Capital expenditures (inclusive of pre-production expenditures and losses incurred prior to the first accounting period), surface reservation fees and income tax, and penalties and surcharges imposed under the petroleum income tax law are not deductible. A deduction for expenditures of a capital nature is available in the form of depreciation expenses (see below).

Inventory valuation

Closing or ending inventory may either be valued at cost or at the lower of cost or market value. The accounting method used to determine the cost may not be changed unless permission is obtained from the director-general of the Revenue Department.

Foreign currencies

Foreign currency transactions must be translated into baht at the rates of exchange on the transaction dates. Assets and liabilities denominated in a foreign currency remaining at the year-end date are translated into baht at the latest average buying or selling rate (as appropriate), as announced by the Bank of Thailand.

Donations

Donations to public charities are limited to 1% of taxable profit, after deducting any tax loss carried forward.

201 *The term "petroleum" includes crude oil, natural gas, natural gas liquid, by-products and other naturally occurring hydrocarbons in a free state whether solid, semi-solid, liquid or gaseous; it includes all heavy hydrocarbons that can be recovered at source by thermal or chemical processes but does not include coal, oil shale or other kinds of rocks from which oil can be extracted by application of heat or chemical process.*

Tax return filings and payment

Annual tax return

A concessionaire must file a petroleum income tax return (Por Ngor Por 70) and pay the related tax within five months after the year-end date. The tax return must be accompanied by the audited financial statements for that year. If the concessionaire holds both Thailand III concessions and non-Thailand III concessions (i.e., Thailand I or Thailand II, or both), it is required to file two separate tax returns: one return for profits generated from the Thailand III concessions and the other for profits generated from Thailand I or Thailand II concessions, or both.

Half-year tax return

In addition to the annual return, concessionaires holding petroleum concessions under the Thailand III regime must file a midyear tax return and pay half of their projected annual income tax within two months after the midyear. This requirement does not apply to concessionaires holding Thailand I and Thailand II concessions. The interim tax is creditable against the annual tax payable at the end of the year.

Production sharing contracts

PSCs apply only to contractors that operate in the Malaysia–Thailand JDA, which is governed under Malaysia–Thailand Joint Authority. Annual profits arising from the exploration and exploitation of any petroleum in the JDA are exempt from income tax for the first eight years of production, subject to income tax at a rate of 10% for the next seven years and thereafter at a rate of 20%. If the contractor is subject to tax in Malaysia, the tax payable is reduced by 50% of the amount of the tax charge.

The primary features of PSCs are:

- Royalty – 10% of gross production of petroleum
- Notional expenditure – 50% of gross production of petroleum is treated as a notional deductible expenditure
- Share profit – the remaining portion of gross production of petroleum after deducting royalty and notional expenditure is divided equally between the Joint Authority and the contractor
- R&D contribution – 0.5% of both the notional expenditure and the share profit must be paid to the Joint Authority

Royalty regimes

Petroleum royalties are collected under the Petroleum Act. Royalties are applied to both onshore and offshore production. The royalty can be paid in cash or in kind, but the rate may differ between the Thailand I and Thailand II regimes and the Thailand III regime.

Royalty rate for Thailand I and Thailand II regimes

If the royalty is paid in cash, it is generally levied at a rate of 12.5% of the value of the petroleum sold or disposed.

If the royalty is paid in kind, a volume of petroleum equivalent in value to 1/7 of the petroleum sold or disposed, or equivalent to 14.28% of the gross revenue, is payable in kind.

The royalty paid on products sold domestically cannot be treated as a tax-deductible expense; however, the royalty payable in respect of exported crude oil qualifies as a tax-deductible expense.

The royalty payable on products sold domestically under the Thailand I and Thailand II regimes is creditable against the income tax but may not exceed the tax payable.

Royalty rate for Thailand III regime

If the royalty is paid in cash, a sliding scale determines the amount of the royalty payable. The scale is as follows:

Monthly sales volume	Rate %
0–60,000 barrels	5.00
60,001–150,000 barrels	6.25
150,001–300,000 barrels	10.00
300,001–600,000 barrels	12.50
More than 600,000 barrels	15.00

The volume of royalty paid in kind is equivalent in value to the royalty paid in cash, as set out above.

A deep-sea, offshore exploration block (deeper than 200 meters) is only subject to 70% of the royalty that would otherwise be payable (see above).

Royalties charged on both domestic and export sales qualify as tax-deductible expenses but may not be used as a tax credit.

C. Capital allowances

Capital expenditure is defined as an expenditure incurred for the purpose of acquiring assets or benefits, whether directly or indirectly, if such assets or benefits aid the business for a period of more than one year. It includes expenditures and losses incurred prior to the first accounting period, which are to be depreciated at rates not exceeding the prescribed rates.

The rates are as follows:

Type of asset	Rate % per year
Buildings:	
Durable building	5
Temporary building	100
Aircraft and accessories	33.33
Cost of acquiring concession and petroleum reserves	10
Cost of acquiring lease rights:	
No agreement or renewable	10
Limited lease period	Lease period
Other capital expenditures not mentioned above:	
Tangible capital expenditures	20
Capital expenditures for deep-sea exploration blocks (deeper than 200 meters)	20
Intangible capital expenditures incurred by a company that entered into a gas sale agreement with Petroleum Authority of Thailand before 1979	20
Others not stated above	10

D. Incentives

Tax holiday

A contractor that conducts exploration in the JDA and signs a PSC with the Joint Authority is granted a tax holiday for the first eight years of production.

Tax losses

Tax losses incurred may be carried forward for 10 years. The 10-year period begins at the same time as the first accounting period. A one-day accounting period (see Section B) is not counted as an accounting period for this purpose. No carryback of losses is allowed.

Regional exploration incentives

A concessionaire pays a royalty equal to 70% of the full royalty that would otherwise be payable for the petroleum produced from a production area within a designated offshore exploration area. An offshore exploration block is an exploration block, designated by the Department of Mineral Fuels, that has a water depth in excess of 200 meters. The offshore deepwater block is allowed to deduct capital expenditure at the rate of 20%.

E. Withholding taxes

Dividends and profit remittance tax

Generally, dividends and remittance profits paid to overseas shareholders are subject to 10% withholding tax (WHT). However, dividends and remittance profits distributed from profits incurred from petroleum income are exempt from income tax and WHT.

Interest

Interest paid to a company located overseas is subject to 15% WHT. However, if the country has a tax treaty with Thailand and the receiver is a financial institution, the rate may be reduced to 10%.

Royalties and technical service

Under Thai tax law, a resident entity is required to deduct 15% WHT on royalties or technical services paid to overseas residents. However, the rate may be reduced to 5%, 8% or 10% depending on the type of royalty and the particular countries involved.

F. Financing considerations

Thin capitalization rules do not apply under Thai tax laws. However, interest is not treated as a deductible expenditure for petroleum income tax calculation purposes.

G. Transactions

Asset disposals and farm-in and farm-out

Transfer between unrelated parties

If a concessionaire transfers its assets or rights relating to petroleum operations to another party, the concessionaire must determine the profits on that transfer; the concessionaire is subject to petroleum income tax on the profit at the rate of 50%. Such profits are calculated as the excess of the transfer price over the net book value of the assets or rights transferred. Profits are, however, deemed to be "earned" only if cash or benefits are paid as consideration for the transfer. Accordingly, profits are not deemed to be earned under a farm-in arrangement.

The Petroleum Income Tax Act (PITA) expressly states that if a new participant in a concession is required to incur expenses for the purpose of petroleum exploration and development in order to acquire a petroleum interest but such expenses are not paid to the existing participants, these expenses are not regarded as income of the existing participants.

Transfer between related parties

If the transfer is made between related parties (i.e., a parent company and its subsidiary company or between two fellow subsidiaries with a common parent company), it is deemed that neither profit nor loss arises from the transfer. The purchaser inherits the seller's cost base, such that any taxable gain or loss is effectively deferred until the asset or interest is sold outside the group.

Selling shares in a company

Profits incurred from share disposals between Thai resident companies are subject to CIT in Thailand at the rate of 23% (to be reduced to 20% from January 2013). Profits incurred from share disposals between nonresident companies are not subject to Thai tax. However, a gain arising from the sale of shares by a nonresident to a Thai resident is subject to Thai WHT at 15%, unless the gain is protected by the relevant tax treaty.

H. Indirect taxes

Import duties

Equipment brought into Thailand for use in petroleum operations is exempt from import duty and VAT if it is brought by a concessionaire or a direct contractor.

VAT

VAT is levied on the value added at each stage of production and distribution, including servicing. The current rate is 7% of the domestic sale or service. VAT on exports is imposed at the rate of 0%. The VAT registrant is obliged to submit VAT on a monthly basis by the 15th day of the month following the supply subject to VAT. VAT paid by a supplier of goods or services (input tax) is credited against VAT collected from customers (output tax). The excess of VAT claimable over VAT payable can be refunded in cash or carried forward to offset any future output tax. Goods sold or services provided in the JDA are exempt from VAT.

Export duties

Export duties are only levied on some specific products prescribed by the customs department, such as rice, wood and rubber.

Excise duties

Excise duties are levied on some products manufactured in Thailand, such as cars, electricity products, drinks, liquor and tobacco. Refined products are subject to excise tax, and the rate depends on the type of the product. Crude oil is not subject to excise tax.

Stamp duty

Thailand imposes a stamp duty of 0.1% (i.e., 1 baht per 1,000 baht) on the total remuneration or value of service contracts if the service contract is concluded in Thailand or concluded outside of Thailand but brought into the country at a later date. If the agreement is signed within Thailand, the liability to pay the stamp duty arises when the agreement is executed, and the stamp duty must be paid within 15 days after execution. However, if the agreement is executed outside Thailand, it is subject to stamp duty within 30 days after the agreement is brought into Thailand.

Registration fees

The concessionaire is subject to the following registration fees:

- Application fee — THB50,000 per application
- Surface reservation fee — THB200,000 per annum
- Demarcation survey fee — THB500 per kilometer, or a fraction thereof
- Boundary mark onshore — THB1,000 per mark

I. Other

Companies that engage in petroleum exploration and production in Thailand are governed by two principal laws: the Petroleum Law and PITA. Petroleum companies are also governed and regulated by the Department of Mineral Fuels of the Ministry of Energy. Since this type of company is not regulated under the Foreign Business Act, it can be wholly owned by a foreigner without obtaining a business license from the Ministry of Commerce.

Trinidad and Tobago

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A. At a glance

Fiscal regime

Companies engaged in upstream operations in Trinidad and Tobago (T&T) are subject to a special fiscal regime, principally governed by the Petroleum Taxes Act (PTA). In summary, the following taxes, levies and imposts apply to companies engaged in the exploration and production of oil and gas:

Petroleum profits tax (PPT)	50% of chargeable profit (petroleum operations in deepwater blocks: 35%)
Unemployment levy (UL)	5% of chargeable profit
Supplemental petroleum tax (SPT)	The applicable rate of tax is based on the weighted average crude price and is applied to the gross income from the disposal of crude oil, less certain incentives (see Section B); not applicable on gas sales
Petroleum production levy (PPL)	Lower of 4% of income from crude oil for producers of more than 3,500 BOPD or proportionate share of local petroleum subsidy
Petroleum impost (PI)	Proportionate share to defray expenses of the Ministry of Energy and Energy Affairs (MOEEA)
Royalties	The applicable rate varies and is dependent on the particular agreement with the Government of Trinidad and Tobago (GOTT) (see Section B)
Green fund levy (GFL)	0.1% of gross revenue
Capital allowances	D, U[202]
Investment incentives	L[203]

B. Fiscal regime

Upstream

Generally, companies engaged in business activities in T&T are subject to corporation tax at a rate of 25%. Companies engaged in the business of manufacturing petrochemicals, liquefying natural gas and transmission of natural gas are subject to corporation tax at the rate of 35%.

202 *D: accelerated depreciation; U: capital uplift or credit.*

203 *L: losses can be carried forward indefinitely (only with regard to PPT).*

Companies engaged in upstream operations in T&T are subject to a special fiscal regime, principally governed by the PTA.

An entity engaged in the business of exploring for, and the winning of, petroleum in its natural state from the underground reservoir in T&T, on land or in a marine area, must do so either under an exploration and production license (license) or a production sharing contract (PSC).

Companies engaged in upstream petroleum operations are subject to various taxes, levies and imposts, of which the most significant are PPT of 35%/50%, UL of 5% and SPT at rates based on the weighted average crude oil price.

Generally, businesses operating under a license may be consolidated for tax purposes; however, those conducted under a PSC are ring-fenced (with the exception of the 2006 version PSC, also referred to as "tax-paying PSC").

PSCs, with the exception of tax-paying PSCs, mandate that the GOTT settle the T&T tax liabilities of the operations out of GOTT's share of profit oil or profit gas. The tax-paying PSCs require the operator to settle its own tax liabilities out of its share of profit oil or profit gas.

Petroleum profits tax

The PTA provides that PPT is payable each financial year on the profits or gains (or amounts deemed to be profits or gains) of any person accruing in or derived from T&T or elsewhere, whether received in T&T or not, in respect of, among other things, "production business."

The PTA defines "production business" as the business of exploring for and winning petroleum in its natural state from an underground reservoir. For these purposes, petroleum is defined as any mixture of naturally occurring hydrocarbons and hydrocarbon compounds. The definition of "production business" includes the physical separation of liquids from a natural gas stream and natural gas processing from a natural gas stream, produced by the production business of a person engaged in separation or processing activities. It does not include the liquefaction of natural gas.

PPT is charged at a rate of 50% on the chargeable profits of any person in respect of a production or refining business. "Refining business" is defined as the business of the manufacture from petroleum or petroleum products of partly finished or finished petroleum products and petrochemical by a refining process. PPT is charged at a reduced rate of 35% on petroleum operations in deepwater offshore blocks. A deepwater offshore block is an offshore block where at least half of the acreage therein is more than 400 meters below sea level.

PPT is assessed on an annual basis, and the PPT return is due on or before 30 April of the year following the year of income. Taxes are due and payable quarterly (i.e., 31 March, 30 June, 30 September and 31 December each year).

Expenses that are wholly and exclusively incurred in the production of taxable income are deductible in arriving at the taxable profits for PPT purposes, except where specific provisions govern the treatment of expenditures.

Restrictions or limitations apply to the deductibility of certain expenses. For instance, the deductibility of management charges paid to nonresidents of T&T is restricted to the lesser of the management charges or 2% of the tax-deductible outgoings and expenses, exclusive of capital allowances and such management charges.

In arriving at the taxable profits for PPT purposes, in addition to expenses wholly and exclusively incurred in the production of income, accumulated tax losses and certain allowances are also available (see Sections D and C, respectively).

Unemployment levy

The UL is charged at a rate of 5% on chargeable profits as calculated for PPT purposes. In contrast to PPT, carried-forward losses cannot be carried forward for UL purposes. The UL is not deductible in the calculation of chargeable profits, is assessed on an annual basis and is payable in quarterly installments.

Supplemental petroleum tax[204]

SPT is imposed on windfall profits, calculated on gross income from the sale of crude oil (including condensate). Income from the disposal of natural gas is not subject to SPT. The tax is charged on the gross income of marine and land operations at varying rates based on the weighted average annual crude oil price.

The rates of SPT are as follows:

Weighted average crude prices US$	Marine[205]		Land and deepwater[206]
	A License and contract issued prior to 1 Jan 1988	B License and contract issued on or after 1 Jan 1988	
0.00–50.00	0%	0%	0%
50.01–90.00	42%	33%	18%
90.01–200.00	SPT rate = base SPT rate[207] + 0.2% (P[208] – US$90)		
200.01 and over	64%	55%	40%

In calculating the SPT liability, the following deductions, discounts and credits are allowed:

- Deduction of royalties and the overriding royalties paid from crude disposals assessed to SPT
- Sustainability incentive, which is a discount of 20% on the rate of SPT for either:
  - Mature marine oil fields[209]
  - Small marine oil fields[210]

  The MOEEA must certify mature marine oil fields and small marine oil fields.
- Investment tax credit of 20% of qualifying capital expenditure incurred in either:
  - Approved development activity in mature marine oil fields and mature land oil fields
  - Acquisition of machinery and plant for use in approved enhanced oil recovery projects

  The MOEEA must certify all development activities carried out in mature marine and land oil fields and enhanced oil recovery projects.

SPT returns and applicable taxes are due on a quarterly basis.

PSCs are subject to SPT on disposals of crude oil, unless the contract expressly exempts the contractor.

Petroleum production levy

The PPL only applies to a production business if the business produces petroleum at a daily average rate in excess of 3,500 barrels and the person is beneficially entitled to receive the proceeds of the sale of the petroleum. Petroleum for these purposes does not include petroleum in the gaseous state.

204 *Column C is applicable to deepwater blocks.*

205 *Columns A and B are applicable to marine activities (except deepwater blocks).*

206 *Columns C and D are applicable to land activities.*

207 *Base SPT rate is equal to the SPT rate applicable at the crude price range of US$50.01 to US$90.00.*

208 *P = weighted average crude oil price in US$.*

209 *Mature land oil fields or mature marine oil fields are oil fields that are 25 years or older from the date of first commercial production.*

210 *Small marine oil fields means a field that has production levels of 1,500 barrels or less of oil equivalent per day.*

PPL is calculated as the lesser of either 4% of the income from the crude oil disposed or the share of the subsidy prescribed by the MOEEA. It is payable monthly. No deductions are available in calculating PPL.

Petroleum impost

Every licensee and party to a PSC is liable for PI in respect of all crude oil and natural gas won and saved. PI rates are determined by the minister of the MOEEA and published in the *Official Gazette*. The tax is imposed to defray the administrative cost of the MOEEA and is payable annually.

Royalties

Every exploration and production licensee must pay a royalty at a rate stipulated in the license on the net petroleum won and saved from the licensed area. Historically, applicable royalty rates have ranged from 10% to 15% for crude oil and US$0.015/mmcf for natural gas.

Green fund levy

The GFL is a tax imposed at the rate of 0.1% of the gross sales or receipts of the company. It is payable on a quarterly basis.

GFL is not deductible in arriving at the taxable profit for PPT and UL purposes.

C. Allowances

In arriving at the chargeable profit for PPT and UL purposes, the following are the allowances available.

Signature bonuses

Signature bonuses may be capitalized and written off over five years on a straight-line basis.

Production bonuses

Production bonuses are deductible when paid.

Royalties

Royalties are deductible when paid.

Work-over allowance

This allowance provides for the deduction of costs incurred for work overs, maintenance or repairs on completed wells and qualifying sidetracks. These costs must be approved by the MOEEA.

Dry-hole allowance

Dry-hole allowance applies to all expenditures, both tangible and intangible, incurred on a dry hole and for development of a dry hole. The expenditure is available as an allowance in the financial year in which such development dry hole or dry hole is plugged and abandoned and certified by the MOEEA. The allowance is limited to the difference between the expenditure and the allowance claimed under tangible and intangible costs.

Tangible drilling costs

Expenditures of a tangible nature incurred in respect of the production business carried on by any person must be capitalized, and the applicable capital allowance must be claimed. Tangible drilling costs include costs incurred in respect of plant and machinery, related costs, import duty and installation costs. Tangible allowances are available from the year of expenditure as follows:

- Initial allowance – 20% (of cost in year one)
- Annual allowance – 20% (of residue in years one to five)

Intangible drilling and development costs

Expenditures of an intangible nature incurred in respect of production business must be capitalized, and the applicable capital allowance must be claimed. Intangible drilling and development costs include all expenditures incurred in exploration operations and exclude all tangible drilling costs and acquisitions for rights. In addition, they include costs incurred in connection with working the oil wells or searching for, discovery of and winning access to deposits. The allowances granted with regard to intangible cost are as follows:

- Initial allowance – 10% (of cost in year one)
- Annual allowance – 20% (of the residue on the declining balance from the commencement of commercial production or from the year following the year the expenditure was actually incurred, whichever is earlier)

Exploration expenditure is available in the year the capital expenditure is incurred.

Deepwater allowance

The PTA provides that in computing the taxable profits of a person who incurs, on or after 1 January 2006, capital expenditures on drilling exploration wells in a deepwater block, the person is granted a capital allowance for exploration expenditures equal to 140% of the expenditures. It should be noted that the PTA defines deepwater as that part of the submarine area that has a water depth more than 400 meters. In addition, a deepwater block is defined as 50% or more of a licensed area or contract area that lies in deepwater.

Heavy oil allowance

This allowance is for all costs incurred on heavy oil projects (i.e., oil 18 degrees API or lower) and includes tangible and intangible drilling costs, as follows:

- Year one 60% of costs
- Years two to six 18% of costs

It should be noted that when an election is made to claim a heavy oil allowance, no additional claim may be made in respect of tangible drilling costs and intangible drilling and development costs.

Capital gains

The taxation of capital gains is not specifically addressed under the provisions of the PTA. Notwithstanding, other principal pieces of legislation, such as the Income Tax Act (ITA) and the Corporation Tax Act (CTA), impose tax at specified rates on "short-term capital gains." Short-term capital gains are defined as gains arising on the disposal of assets within 12 months from the date of acquisition.

D. Incentives

PPT losses

Tax losses that cannot be wholly offset against income for the same year may be carried forward and offset against income from succeeding years, without restriction. No loss carrybacks are allowed. Carried-forward losses can be carried forward only for PPT purposes.

E. Withholding taxes

Withholding tax (WHT) is levied at source on distributions and on payments made to nonresidents (if the person or company is not engaged in trade or business in T&T).

The term "payment" is defined as a payment without any deductions whatsoever, other than a distribution, with respect to interest, discounts, annuities or other annual or periodic sums, rentals, royalties, management charges, or charges for the provision of personal services and technical and managerial skills, premiums (other than premiums paid to insurance companies and contributions to pension funds and schemes), commissions, fees and licenses, and any other such payments as may from time to time be prescribed.

In summary, WHT is levied if all of the following conditions are met:

- A payment, as defined in the ITA, is made.
- The payment is made to a nonresident of T&T.
- The nonresident is not engaged in trade or business in T&T.
- The payment is deemed to arise in T&T.

The applicable rate of WHT with regard to payments is 15%.

The applicable rate of WHT on distributions made is 10%, but if the distribution is made to a parent company, the rate is 5%.

However, if there is a double taxation agreement in force, the rate of WHT is the lower rate provided in the treaty, if applicable.

Branch operations

In addition to the taxes outlined above, an external company (i.e., branch of a nonresident company) that carries on a trade or business in T&T is liable for WHT at the rate of 5% on the deemed distribution of profits to its head office.

Double tax relief

If it is established that WHT applies under domestic legislation, the provisions of an applicable double tax treaty may provide relief from the domestic provision. The GOTT has successfully negotiated various double tax arrangements that seek to provide, among other things, relief from T&T tax.

The GOTT has entered into tax treaties with Brazil, Canada, China, Denmark, France, Germany, India, Italy, Luxembourg, Norway, Spain, Sweden, Switzerland, the UK, the US and Venezuela.

In addition to the above, a multilateral arrangement (the Caricom Treaty) has also been entered into with the following members of Caricom: Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines.

Unilateral relief

A credit is available to residents for foreign taxes paid on foreign-sourced income. The credit may not exceed the T&T tax payable on the underlying foreign-sourced income.

F. Financing considerations

Investment income

Interest received on bank deposits and certificates of deposits held at financial institutions in T&T, as well as interest on bonds and similar instruments, are taxable.

Dividends received from nonresident companies paid from profits not derived from or accruing in T&T are subject to tax. Dividends received by resident companies from other resident companies are tax exempt.

Foreign exchange controls

T&T has a floating exchange rate regime. Commercial banks and licensed foreign exchange dealers set the exchange rate. Residents may hold foreign currencies for their own account. Profits may be repatriated without the approval of the Central Bank of T&T.

Debt-to-equity rules (thin capitalization)

In general, no thin capitalization rules apply in T&T. However, if a local company pays or accrues interest on securities issued to a nonresident company and if the local company is a subsidiary of, or a fellow subsidiary in relation to, the nonresident company, the interest is treated as a distribution and may not be claimed as a deduction against the profits of the local company.

G. Indirect taxes

VAT

VAT is chargeable on the entry of goods imported into T&T and on the commercial supply within T&T of goods or prescribed services by a registered person.

The tax rate is 15%, except in the case of an entry or a supply that is zero-rated. It should be noted that natural gas, crude oil, and specified vessels and rigs used in offshore drilling and exploration are zero-rated goods and, therefore, are subject to VAT at the rate of 0%.

Companies and other businesses are required to register for VAT if their turnover exceeds TT$360,000 a year. A company that is registered for VAT may recover any VAT incurred in relation to its operations.

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A. At a glance

Fiscal regime

The fiscal regime that applies to the petroleum industry in Uganda consists of a combination of income tax, VAT, Stamps Act (for transfer taxes), Excise Act, production sharing agreements (PSAs) with the Government of Uganda and royalty-based taxation.

However, Uganda is in the formative stages of petroleum exploration, and early production is scheduled for 2013–14. The laws and policies, therefore, will continue to change in the near future. At the moment, the PSAs are confidential.

Royalties	Percentages are provided in the PSAs and depend on barrels of oil per day (BOPD.)
Bonuses	Most of the contractors are required to pay a signature bonus.
PSA	In addition to issuing licenses to contractors, the Petroleum (Exploration and Production) Act provides for the entry into a PSA by contractors and the Government. The PSA details specific obligations and requirements of the parties to the agreement. These include work programs and financial obligations; health, safety and environment (HSE) requirements; and other data and reporting obligations. Details of the various PSAs are still confidential
Income tax rate	30%
Resource rent tax	There is a provision for surface rentals in most of the PSAs.

B. Fiscal regime

Corporation tax

A contractor and subcontractor are subject to income tax on their non-exempt worldwide income at a rate of 30%. Taxable income equals gross income less deductions.

Limitation on deduction

A deduction is only allowed against the cost oil derived by the contractor from petroleum operations in a contract area (i.e., contract revenues and expenses are determined separately for each contract area; there is no consolidation of different contract areas allowed) for that year of income. The excess is carried forward to the following year of income and is deductible in that year against the gross income arising from the petroleum operations in the contract area until the excess is fully deducted or the petroleum operations in the contract area cease.

Cost oil is defined in the Income Tax Act (ITA) amendment as contractors' entitlement to production as cost recovery under a petroleum agreement.

Decommissioning costs reserve and decommissioning expenditure

Under a decommissioning plan, the amount of decommissioning costs reserve incurred by a contractor in respect of petroleum operations during a fiscal year is deductible in that year. The decommissioning plan must be approved under a petroleum contract.

Decommissioning expenditure in a year of income is not deductible, except to the extent that the total amount in the current and previous years of income exceeds the total amount calculated according to the formula:

$$A + B$$

Where:

A = the total amount deductible under subsection (1) in the current year and previous years of income

B = the total amount deductible under this subsection in previous years of income

If, at the end of decommissioning of a contract area, the total amount deductible exceeds the decommissioning expenditure actually incurred by the contractor, the amount of the excess is included in the contractor's production share for the year of income in which decommissioning ends.

In the 2010 amendments, new provisions were introduced to cover contractors' non-petroleum income and extend general tax collection measures to petroleum taxation.

Allowable contract expenditure

The expenditures that may be deducted for the purposes of ascertaining the chargeable income of the contractor from petroleum operations are prescribed in the Eighth Schedule to the ITA.

Transfer of interest in a petroleum agreement

a. If an initial contractor (*transferor contractor*) disposes of an interest in a petroleum agreement to another entity or a person (*transferee contractor*) whereby such new party becomes a new contractor in such petroleum agreement, the following rules apply:

a. Any excess costs under Section 89C(2) attributable to the interest at the date of the disposal are deductible by the transferee contractor, subject to the conditions prescribed in that section.

b. The transferee contractor continues to depreciate any allowable contract expenditure attributable to the interest at the date of disposal in the same manner and on the same basis as the transferor contractor would if the disposal had not occurred.

c. The cost base for the purposes of calculating any capital gain or loss on disposal of an interest in a petroleum agreement will be determined in accordance with Part VI of the Act.

d. In a subsequent disposal of the whole or part of the interest disposed under paragraph (c), the cost base for the purposes of calculating any capital gain or loss on disposal of the interest is the amount of the transferor contractor's capital gain on the prior disposal of the interest if any, less the sum of:

i. The excess costs up to the date of the disposal that are deductible by the transferee contractor under paragraph (a)

ii. The depreciation of capital expenditure incurred up to the date of disposal that is deductible by the transferee contractor under paragraph (b)

e. The amount of the transferor contractor's capital loss on disposal of the interest, if any, is treated as income of the transferee contractor on the date of the transfer of the interest.

f. In the case of a depreciable or intangible asset, the transferee contractor continues to depreciate or amortize the asset in the same manner and on the same basis as the transferor contractor would if the disposal had not occurred.

g. In the case of any other asset, the transferee contractor's cost base for the asset is the transferor contractor's cost base immediately before the disposal.

Tax accounting principles

- A contractor shall account on an accrual basis.
- Except as may be otherwise agreed in writing between the Government and a contractor, and subject to the provisions of Section 89L of the ITA, all transactions shall be accounted for at arm's-length prices, and a contractor shall disclose all non-arm's-length transactions in return for a specified period, if required to do so by the commissioner.
- A contractor shall, for purposes of taxation:
  - Maintain accounts for a contract area in Uganda shillings (UGX) and in United States dollars (US$), and, in the case of any conflict, the accounts maintained in US$ shall prevail.
  - Use the exchange rates prescribed for conversion of currencies as follows:
    - The Government or a contractor shall not experience an exchange gain or loss at the expense of, or to the benefit of, the other, and any gain or loss resulting from the exchange of currency will be credited or charged to the accounts.
    - Amounts received and costs and expenditures made in UGX, US$ or any other currency shall be converted into UGX or US$, as the case may be, on the basis of the average of the buying and selling exchange rates between the currencies in question, as published by the Bank of Uganda, prevailing on the last business day of the calendar month preceding the calendar month in which the amounts are received and costs and expenditures paid.
    - In the event of an increase or decrease, one time or accumulative, of 10% or more in the rates of exchange between UGX, US$ or the currency in question during any given calendar month, the following rates will be used:
      - For the period from the first of the calendar month to the day when the increase or decrease is first reached, the average of the official buying and selling exchange rates between US$, UGX or the currency in question as issued on the last day of the previous calendar month.
      - For the period from the day on which the increase or decrease is first reached to the end of the calendar month, the average of the official buying and selling exchange rates between US$, UGX or the currency in question as issued on the day on which the increase or decrease is reached.
- A contractor shall maintain a record of the exchange rates used in converting UGX, US$ or any other currency.

Allocation of costs and expenses

Costs and expenses incurred by a contractor in respect of activities that would only qualify in part as contract expenses shall be allocated to the books, accounts, records and reports maintained for that purpose, in a manner that:

- Avoids any duplication of costs
- Fairly and equitably reflects the costs attributable to the petroleum operations carried out
- Excludes any costs and expenses that would be allocated to those activities that do not constitute petroleum operations

Any exploration, development or production expenditure associated with a unit development involving a discovery area that extends into a neighboring country shall be allocated on the basis of the petroleum reserves attributable to that portion of the discovery area located in Uganda.

Valuation of petroleum

For the purposes of determining a contractor's gross income derived from petroleum operations from a contract area, petroleum shall be valued and measured in accordance with the provisions of regulations to be presented by the minister of finance to parliament.

Petroleum revenue returns

"Petroleum revenues" means tax charged on income derived by a person from petroleum operations, government share of production, signature bonus, surface rentals, royalties, proceeds from sale of government share of production, and any other duties or fees payable to the Government from contract revenues under the terms of a petroleum agreement.

The procedures relating to furnishing a return of income, cases where a return of income is not required and extension of time to furnish a return of income apply to a contractor, subject to the following modifications:

- A contractor shall furnish a return for a year of income not later than one month after the end of the year.
- A contractor shall furnish a return not later than seven days after the end of every month in respect of the provisional payments required under collection and recovery provisions of the law (Section 89P(B)).
- Not less than 30 days before the beginning of a year of income, a contractor shall furnish a return including particulars for each calendar quarter of the year, estimated to the best of the contractor's judgment, and shall furnish updates of the return within seven days after the end of each of the first three calendar quarters in the year.
- The commissioner may require any person, whether taxable or not, to furnish a return on the contractor's behalf or as an agent or trustee of the contractor.
- In addition to a return furnished on a contractor's own behalf, the commissioner may require a contractor acting as an operator in a contract area to furnish a return in respect to that area on behalf of all contractors with an interest in the petroleum agreement.
- A return required under this section shall include particulars of government petroleum revenues and other taxes prescribed by the commissioner.
- A return required for any period shall be furnished, whether government petroleum revenues or other taxes are payable for the period or not.
- The commissioner may make provision permitting or requiring a contractor to submit returns electronically.

In addition to a return required, a contractor shall file an annual consolidated petroleum revenue return with the commissioner at the end of each year of income, not later than 90 days after expiry of the year of income.

A person who fails to furnish a return of income for a tax period within the time required by this section commits an offense and is liable to pay a penal tax equal to 2% per annum of the tax payable for that period.

Application of ITA provisions dealing with assessments, self-assessment and additional assessments

The above provisions apply to a contractor subject to the following modifications:

- An assessment made by the commissioner on a contractor may relate to petroleum revenues and not only to chargeable income.
- To make an assessment on chargeable income, the commissioner can go as far back as three years instead of the normal five years.
- The provisions dealing with self-assessment apply to a contractor, notwithstanding that a notice has not been published by the commissioner in the *Official Gazette* as taxpayers to which this section is to apply for a year of income.

Objections and appeals relating to petroleum revenues shall be determined in accordance with the ITA.

Collection of other revenues

The provisions of the ITA relating to collection, recovery and refund of tax shall apply to contractors with the following modifications:

a. Petroleum revenues and other taxes charged in any assessment shall be payable within seven days after the due date for furnishing a return.
b. A contractor shall, in each calendar quarter, make a provisional payment consisting of:
   i. In the case of income tax, one quarter of the contractor's estimated income tax for the year
   ii. In the case of petroleum revenues other than income tax, the amounts payable for the quarter under the petroleum agreement.
c. Unless otherwise agreed between the Government and a contractor, all payments or refunds of petroleum revenues, other than those payable in kind, and other taxes shall be made in US$.
d. A contractor shall pay petroleum revenues, other than those payable in kind or payable to the Government's nominee under the terms of a petroleum agreement, and other taxes to the Uganda Revenue Authority (URA).
e. Subject to paragraph (f), the refunds section shall apply to refunds of petroleum revenues and other taxes payable to the Government.
f. Late payment, or refunds of government petroleum revenues and other taxes payable to the Government shall, for each day on which the sums are overdue during any month, bear interest compounded daily at an annual rate equal to the average rates published by Bank of Uganda plus five percent (5%) points.
g. Where a contractor has paid government petroleum revenues in kind and the amount payable subsequently needs to be adjusted for any reason, the adjustment will be made in cash unless otherwise agreed between the Government and a contractor.
h. A payment of petroleum revenues made by a contractor shall be allocated by the commissioner against amounts payable in the order in which they become due and in such a way as to minimize any interest or penalties payable by a contractor.

Failure to furnish returns

a. A contractor who fails to furnish a return or any other document within the time prescribed by the ITA is liable to a fine of not less than US$50,000 and not exceeding US$500,000.
b. A contractor who files false or inaccurate returns commits an offense and is liable on conviction to a fine not less than US$50,000 and not exceeding US$500,000 or its equivalent in UGX, and where there is fraud, a fine not less than US$500,000 or its equivalent in UGX.

c. Where a contractor convicted of an offense under subsection (b) fails to furnish the return or document to which the offense relates within a period specified by the court, or furnishes false or inaccurate returns, that contractor is liable to a fine not exceeding US$100,000.

Making false or misleading statements

A contractor or person who makes a statement to an officer of the URA that is false or misleading in a material particular, or omits from a statement made to an officer of the URA any matter or thing without which the statement is misleading in a material particular, commits an offense and is liable to conviction:

- Where the statement or omission was made knowingly or recklessly, to a fine not less than US$500,000 or imprisonment for a term not exceeding one year, or both
- In any other case, to a fine not less than US$50,000 and not exceeding US$500,000

A reference in this section to a statement made to an officer of the URA is a reference to a statement made in writing to that officer acting in the performance of his or her duties under the ITA, and includes a statement made:

- In a return, objection or other document made, prepared, given, filed or furnished under the ITA
- In information required to be furnished under the ITA
- In a document furnished to an officer of the URA otherwise than pursuant to the ITA
- In answer to a question asked by an officer of the URA
- To another person with the knowledge or reasonable expectation that the statement would be conveyed to an officer of the URA

C. Capital allowances (Eighth Schedule of the ITA)

Classification of expenses for income tax purposes

The Income Tax (Amendment) Bill classifies expenses for income tax purposes as:

- Petroleum capital expenditures — these are contract expenses that qualify as development and production expenditures
- Petroleum operating expenditures — these are contract expenses that qualify as exploration expenditure and operating expenses

Petroleum capital expenditures shall be depreciated for income tax purposes and allowed as a deduction in any year of income using the straight-line method over the expected life of the petroleum operations or over a period of six years, whichever is the lesser, except in respect of those expenditures that shall include costs of transportation facilities installed up to the delivery point including, but not limited to, pipelines, compressors and storage facilities. These shall be depreciated on a unit of production basis. Deductions shall commence at the later of the year of income in which the capital asset is placed into service or the year of income in which commercial production commences from the contract area.

Definition of allowable contract expenditures

For each year of income, beginning with the year of income in which commercial production commences from the contract area, allowable contract expenditures that shall be deductible for the purpose of the calculation of income tax payable by a contractor shall consist of the sum of:

- Petroleum operating expenditures
- Allowable deductions for depreciation of petroleum capital expenditures
- Any operating loss from previous years of income

The expenditures that may be deducted for the purposes of ascertaining the chargeable income of the contractor from petroleum operations are prescribed in the Eighth Schedule to the ITA.

D. Withholding taxes

The rate of tax applicable to a participation dividend paid by a resident contractor to a nonresident company is 15%.

The rate of tax applicable to a nonresident subcontractor deriving income under a Ugandan sourced services contract, where the services are provided to a contractor and directly related to petroleum operations under a petroleum agreement, is 15%. However, consideration needs to be given to the double taxation agreements that Uganda has with Denmark, India, Italy, Mauritius, the Netherlands, Norway, South Africa and the UK.

A contractor is also required to withhold tax at 6% in respect of payments amounting to UGX1 million or, in aggregate, exceeding it, made to a resident subcontractor.

WHT on international payments

An entity is required to withhold 15% from a payment it makes to another entity if the payment is in respect of a dividend, interest, royalty, rent, natural resource payment or management charge from sources in Uganda.

The tax payable by a nonresident person is calculated by applying the 15% rate to the gross amount of the dividend, interest, royalty, natural resource payment or management charge derived by the nonresident person.

Interest paid by a resident company in respect of debentures is exempt from tax under the Uganda ITA if the following conditions are satisfied:

- The debentures were issued by the company outside Uganda for the purpose of raising a loan outside Uganda.
- The debentures were widely issued for the purpose of raising funds for use by the company in a business carried on in Uganda.
- The interest is paid to a bank or a financial institution of a public character.
- The interest is paid outside Uganda.

	Residents	Nonresidents
Dividends	15%	15%
Interest	15%	15%
Royalties	-	15%
Management and technical fees	-	15%
Natural resource payment	-	15%
Lease of equipment	-	15%
Payment by government entities	6%	-
Professional fees	6%	15%

Branch remittance tax

In Uganda, tax is chargeable on every nonresident company that carries on a business in Uganda through a branch that has repatriated income for the relevant year of income. The tax payable by a nonresident company is calculated by applying a 15% rate to the repatriated income of the branch for the year of income. If a downstream oil and gas entity is a branch of an overseas company, it is affected by this clause, in addition to the other relevant tax clauses.

E. Payroll and social taxes

Employment income includes an employee's wages, salary, leave pay, payment in lieu of leave, overtime pay, fees, commission, gratuity, bonus, or the amount of any traveling, entertainment, utilities, cost of living, housing, medical or other allowance. The employer must deduct income tax under the Pay As You Earn (PAYE) system on a monthly basis, and it must be remitted to the URA by the 15th day of the month following the month of deduction.

The combined employer and employee contribution by a member to the National Social Security Fund (NSSF) is 15% of the total employee cash emoluments. Five percent is deducted from the employee's salary, and 10% contributed by the employer. Employees' contributions to the NSSF are not deductible for PAYE purposes. Payments to the NSSF must be made by the 15th day of the month following the month of deduction.

F. VAT

A VAT regime applies in Uganda. All taxable transactions (i.e., those that are not exempt or zero-rated) are subject to VAT. The VAT is applied at rates between 0% and 18%.

Goods and materials imported into Uganda are generally charged VAT at the rate of 18%. A drilling rig imported into Uganda may be subject to 18% VAT. However, the VAT paid at importation is claimable if the Uganda entity is VAT-registered.

A Uganda resident entity should register for VAT and charge 18% VAT on fees for contract work, but it can recover any tax paid (input VAT) against VAT charged (output VAT). It pays the difference to the tax authorities (or can claim the difference if the input VAT exceeds the output VAT).

A nonresident entity may also be required to apply for registration. A nonresident person who is required to apply for registration but who does not have a fixed place of business in Uganda shall appoint a VAT representative in Uganda and, if required to do so by the commissioner general, lodge a security with the commissioner general.

If a nonresident person does not appoint a representative, the commissioner general may appoint a VAT representative for the nonresident person.

The VAT representative of a nonresident person shall:

- Be a person ordinarily residing in Uganda
- Have the responsibility for doing all things required of the nonresident under the VAT Act
- Be jointly and severally liable for the payment of all taxes, fines, penalties, and interest imposed on the nonresident under the VAT Act

Common transactions and arrangements that have VAT implications include:

- Importation of equipment and vessels
- Sale or lease of equipment in Uganda
- Sale of products in Uganda
- Asset disposals

No VAT is charged if products are exported. To qualify as VAT-free, exports must also be supported by evidence that indicates the goods have left Uganda.

According to the Ugandan VAT law, the supply of refined petroleum fuels, including motor spirit, kerosene and gas oil, spirit-type jet fuel and kerosene-type jet fuel, is exempt from VAT but is subject to excise duty. The supply of liquefied petroleum gas is also exempt from VAT.

The supply of crude oil is, however, subject to VAT at the standard rate of 18%.

No VAT is charged on both crude and refined petroleum products that are exported from Uganda because all exports are zero-rated for VAT purposes. The VAT registration threshold is UGX50 million (equivalent to about US$25,000). However, entities trading below this threshold can choose to register voluntarily for VAT.

G. Customs

On 2 July 2009, the East African Community (EAC) Gazette was issued to amend the Fifth Schedule (Exemption Regime) of the EAC Customs Management Act 2004, exempting machinery, spares and inputs but not including motor vehicles imported by a licensed company for direct and exclusive use in oil, gas, or geothermal exploration and development upon recommendation by a competent authority of a partner state. This notice came into force on 1 July 2009.

Otherwise, the general rate of customs duty applied to the customs value of imported goods varies from 0% to 25%, depending on several factors, including the type of commodity, its end use, constituent material and country of origin. Import duties apply to most imports at a maximum rate of 25% if the imports originate outside East Africa.

Some imports of heavy machinery are exempt from import duties.

A WHT of 6% also applies to non-exempt imports, but this WHT may be offset against the final income tax of the importer (i.e., as an advance corporation tax). VAT at 18% is also charged on every import of goods other than an exempt import and on the supply of imported services, other than an exempt service, by any person.

H. Export duties

With the exception of hides and skins, there are no duties applied to goods exported from Uganda.

I. Excise duties

Excise duties are applied to some goods manufactured in Uganda and petroleum products, alcohol and tobacco. Excise duties on most refined petroleum products vary between UGX200 and UGX850 per liter. Excise duty is not generally levied on goods bound for export.

J. Stamp duty

Stamp duty is charged on various legal documents and agreements (e.g., transfer of shares, issue of shares). The rate of duty ranges between 0.5% and 1%, although a lower rate of UGX5,000 may apply, depending on the subject matter.

Generally, stamp duties are imposed under different heads of duty, the most significant of which are duties on the transfer of property (e.g., land, tenements and certain rights, including rights to extract and goodwill). Plant and equipment may also be subject to duty if conveyed with other dutiable property.

A transfer of shares in a company that predominantly holds land interests may also be subject to stamp duty on the underlying land interests.

The investment trader facility that enabled investors, upon execution of insurance performance bonds, to claim input VAT incurred before they start actual production of taxable supplies has been scrapped. Companies can only register for VAT purposes, at the earliest, three months to the expected date of production of taxable supplies and, therefore, can only claim input VAT incurred in the previous six months.

The Stamps (Amendment) Act 2009 has amended the schedule to the Stamps Act prescribing the stamp duty rate payable on insurance performance bonds to be UGX50,000 and not 1%.

K. Capital gains tax

Refer to "Transfer of interest in a petroleum agreement" in Section B.

L. Financing considerations

Uganda's income tax system contains significant rules regarding the classification of debt and equity instruments and, depending on the level of funding, rules that have an impact on the deductibility of interest. These rules can have a significant impact on decisions made in respect of financing oil and gas projects.

Thin capitalization

Thin capitalization measures apply to the total foreign debt of Ugandan operations of multinational groups (including foreign related-party debt and third-party debt). The measures apply to Ugandan entities that are foreign controlled and foreign entities that either invest directly into Uganda or operate a business through a Ugandan branch.

The measures provide for a safe harbor foreign debt to foreign equity ratio of 2:1. Interest deductions are denied for interest payments on the portion of the company's debt exceeding the safe harbor ratio.

The debt or equity classification of financial instruments for tax purposes is subject to prescribed tests under the law. These measures focus on economic substance rather than on legal form. If the debt test contained in the new measures is satisfied, a financing arrangement is generally treated as debt, even if the arrangement could satisfy the test for equity.

M. Transactions

Selling shares in a company (consequences for resident and nonresident shareholders)

A share disposal is generally subject to the CGT regime if the shares are a business asset. If the transaction involves a Uganda resident company disposing of the shares at a gain, tax applies at the rate of 30%. The Income Tax Amendment Act 2010 subjects disposal of shares in a private company to capital gains under general clauses of the ITA, which also covers petroleum transactions.

Similarly, Uganda's income tax law imposes a tax on a gain derived by either a resident or a nonresident from the disposal of a share in a company whose property principally consists directly or indirectly of an interest or interests in immovable property located in Uganda.

N. Other

Uganda Investment Authority

The Government monitors investment into Uganda through the Uganda Investment Authority (UIA). The Government's policy is generally to encourage foreign investment, and there has been a recent trend toward relaxing the controls on the purchase of real estate by investors. Incentives are granted for certain levels of investment.

Domestic production requirements

Exploration entities must comply with other domestic production requirements provided for by other regulatory bodies such as the National Environmental Management Authority (NEMA), the Ministry of Energy and Mineral Development, the national oil policy and its proposed regulatory bodies, which are yet to be set up.

Licensing oil exploration contracts

In Uganda, the Petroleum (Exploration and Production) Act Cap 150 provides the framework for regulating oil exploration.

An entity is required to obtain a petroleum exploration license or a petroleum production license, or both, as the context requires. The application for a license is made to the Ministry of Energy and Mineral Development. The minister may require other information about the controlling power over the company, especially if the company is controlled by individuals resident outside Uganda. The petroleum exploration license is usually granted for four years and is renewable for two years.

If petroleum has been discovered in the contract area, the person who has made a discovery may apply for a petroleum production license over any block or blocks in that area that can be shown to contain a petroleum reservoir or part of a petroleum reservoir.

An application for a production license must be accompanied by a report on the petroleum reservoir, a development plan and any other relevant information. A petroleum production license is first granted for 25 years and is renewable thereafter.

An annual charge is made in respect of the license. The annual charge is payable upon grant of the license and thereafter on the anniversary of the grant until termination of the license. The holder of a license is also required to pay a royalty in accordance with the license.

The Petroleum (Exploration and Production) (Conduct of Exploration Operations) Regulations S.I.150 -1 also sets out guidelines for offshore operations, pollution prevention and control, use of explosives, and health and safety.

The guiding principles in relation to expenditures incurred during exploration and subsequent production are governed by the PSA with the Government, represented by the Ministry of Energy and Mineral Development. An expenditure incurred during exploration is allowed, but only against production of oil. Uganda is in the process of rolling out a national policy, but the discussions have not yet concluded.

Foreign exchange controls

There are no foreign exchange controls in Uganda.

Business presence

Forms of business presence in Uganda include locally incorporated companies, foreign branches and joint ventures (incorporated and unincorporated). In addition to commercial considerations, the tax consequences of each business should be taken into account when setting up a business in Uganda. Unincorporated joint ventures are commonly used by companies in the exploration and development of oil and gas projects.

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A. At a glance

Fiscal regime

The fiscal regime that applies in Ukraine to the oil and gas industry consists of a combination of corporate profit tax (CPT), production royalties and subsoil use payments.

Export duty	No duty for oil and UAH400 per 1,000m^3 /tonne for natural gas, or 35% of the customs value if it exceeds UAH400 per tonne/1,000m^3
Bonuses	Oil and gas exploration and production (E&P) permits are generally purchased at an auction. The starting bidding price of each subsoil use permit is calculated by the state, case by case, based on the amount and the value of the deposit's resources. It may not be lower than 2% of the projected total net profit of a well or deposit, excluding the capital investments. In certain cases (e.g., prior exploration and evaluation of deposit at the bidder's cost, production sharing agreement (PSA) regime, gas or oil production by companies where no less than 25% of shares are state-owned), there is no auction.
PSA	Available
CPT rate	21%

Production royalties:[211]

Crude oil	UAH792.54–UAH2,141.86 per tonne
Gas condensate	UAH792.54–UAH2,141.86 per tonne
Natural gas	UAH0–UAH237 per 1,000m^3

Payments for subsoil use:[212]

Crude oil and gas condensate	UAH147.63 per tonne
Natural gas	UAH42.05 per 1,000m^3

211 *Adjustment coefficients established by the Ministry of Economic Development and Trade of Ukraine apply to the rates of production royalties.*

212 *Adjustment coefficients may apply to the rates on payments for subsoil use.*

Capital allowances	PD[213]
Investment incentives	TE, AC, DR, CI[214]

B. Fiscal regime

The fiscal regime that applies in Ukraine to the oil and gas industry consists of a combination of CPT, production royalties, subsoil use payments, excise tax, export and import duty, VAT and other taxes generally applicable to Ukrainian taxpayers.

Corporate profit tax

Ukrainian resident companies are subject to CPT on their non-exempt, worldwide profit at a rate of 21% (19% in 2013 and 16% starting 2014). The 21% rate applies to profit from oil and gas activities. There is a CPT exemption for companies producing coal bed methane, to last until 2020. There are also tax exemptions for profits from sale of equipment operating on alternative fuels (including coal bed methane) and from energy-efficiency projects.

Ring-fencing

Ukraine does not generally apply ring-fencing in determining a company's CPT liability in relation to oil and gas activities. Profit from one project can be offset against losses from another project held by the same Ukrainian legal entity, and, similarly, profit and losses from upstream activities can be offset against downstream activities undertaken by the same Ukrainian entity (branches of foreign companies are generally taxed as separate entities for CPT purposes).

However, PSAs are ring-fenced for tax purposes. Ring-fencing also applies to the activities the profits on which are exempt for corporate profit tax purposes (including coal-bed methane production and use).

Ukraine does not have tax consolidation or grouping rules for different legal entities.

CPT is levied on taxable profit

Taxable profit equals non-exempt worldwide income less cost of goods, works and services, also referred to as operating expenses, and other expenses.

Non-exempt income includes income from operational activity and other income (certain items are specifically mentioned in the Tax Code).

Operating expenses (cost of goods) are recognized in the period in which income from sale of relevant goods is recognized, while other expenses are recognized in the period in which they are incurred. The Tax Code limits the deductibility of certain types of expenses.

The rules regarding recognition of oil and gas E&P expenses are unclear and contradictory. Depending on the types of costs they could be either capitalized and recognized for tax purposes via depreciation, treated as a tax-deductible cost of sales when oil or gas is sold, or treated as a tax-deductible cost if the project is liquidated.

Gas and oil exploration costs and field infrastructure development costs (except for the cost of fixed assets and the costs of construction of productive wells incurred after putting these into production) are deductible as the cost of produced oil or gas. This rule defers the recognition of successful exploration costs until the company starts selling oil or gas. There are no rules in the Tax Code for attributing historic exploration costs to a particular supply of oil or gas.

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213 PD: partial deductibility — well repair, reconstruction or improvement costs are deductible when incurred, if up to 10% of the well's initial value at the beginning of the respective year. Expenses exceeding the above limitation should be depreciable.

214 TE: profit of entities involved in coal bed methane production activity is tax exempt until 2020; AC: decreasing adjusting coefficients to subsoil use payments are applicable to qualifying entities; DR: different royalty rates, including zero-rated, apply in certain cases; CI: coal bed methane production incentives — materials and equipment for production of coal bed methane are exempt from VAT and customs duties upon importation into Ukraine.

There is also a material uncertainty regarding tax treatment of unsuccessful oil and gas exploration costs. Under the general rule, unsuccessful mineral exploration costs are deductible when the project is liquidated. However, it is unclear whether this rule applies to non-productive oil and gas exploration costs. Depreciable costs are discussed in Section C.

Transfer pricing

For CPT purposes, transactions between related parties, as defined by the law, and transactions with nonresidents and other persons who are not considered as CPT payers on a regular basis are subject to transfer pricing regulations. The regulations provide that, for tax purposes, the transactions between such parties must be reported at arm's-length prices. For VAT purposes, transfer pricing rules apply to all transactions.

The contractual price is deemed to be an arm's-length price, unless the tax authorities prove otherwise. The burden of proof that the contract price is not at an arm's-length rests on the tax authorities. For CPT purposes, there is a 20% safe harbor. The tax authorities may adjust taxpayers' tax obligations as a result of the application of the arm's-length prices. To reassess taxpayers' liabilities based on the application of arm's-length prices, the tax authorities must go to court.

Production royalties

Production royalties are levied on volumes of extracted hydrocarbons (gas, gas condensate and oil) payable by production companies. Royalties are deductible for CPT purposes. Production royalties are summarized in the table below.

Production royalty			
Mineral resources	Rates, UAH	Unit of measurement	Criteria
Oil and gas condensate	2,141.86	tonne	Applies to oil extracted from the fields, bedding up to 5,000 meter depth.
	792.54	tonne	Applies to oil extracted from the fields, fully lying at more than 5,000 meter depth.
	0	tonne	Applies to additional volumes of oil and gas condensate produced under investment programs for development of depleted, hard-to-reach fields or wells. The list of fields is to be determined by the Government. This rule applies to state-controlled companies (25%), subsidiaries and branches of the same, and participants of joint activity agreements if the state-controlled company participation in a joint activity exceeds 25%.
Gas	237	1,000m^3	Applies to gas and oil well gas extracted from the fields, bedding up to 5,000 meter depth.
	118.5	1,000m^3	Applies to gas and oil well gas extracted from the fields, fully lying at more than 5,000 meter depth.

Production royalty			
Mineral resources	Rates, UAH	Unit of measurement	Criteria
Gas	59.25	1,000m³	Applies to gas and oil well gas extracted from the fields, bedding up to 5,000 meter depth (except for gas and oilwell gas produced from offshore fields). This rate applies if the gas is sold to an entity designated by the Cabinet of Ministers of Ukraine for the state gas reserve for individual consumers and to the volume of the technological gas determined under separate rules.
	47.4	1,000m³	Applies to gas and oil well gas extracted from the fields, fully lying at more than 5,000 meter depth (except for gas and oil well gas produced from offshore fields). This rate applies if the gas is sold to an entity designated by the Cabinet of Ministers of Ukraine for the state gas reserve for individual consumers and to the volume of the technological gas determined under separate rules.
	11.85	1,000m³	Applies to gas and oil well gas produced from offshore fields. This rate applies if the gas is sold to an entity designated by the Cabinet of Ministers of Ukraine for the state gas reserve for individual consumers and to the volume of the technological gas determined under separate rules.
	0	1,000m³	Applies to additional volumes of natural gas produced under investment programs for development of depleted, hard-to-reach fields or wells. The list of fields is to be determined by the Government. This rule applies to state-controlled companies (25%, directly or indirectly), subsidiaries and branches of the same, and participants of joint activity agreements if the state-controlled company participation in a joint activity exceeds 25%.

Production royalty rates are subject to monthly adjustment. The adjusting coefficients to production royalties on oil and gas condensate are calculated by the Ministry of Economic Development and Trade of Ukraine on the basis of the following formula:

AC = AP/BP

AC is the adjusting coefficient; **AP** is the average price for one barrel of Urals oil at the London Exchange within the current tax (reporting) period, calculated in UAH at the exchange rate of the National Bank of Ukraine as of the first day of the month following the tax (reporting) period; **BP** is the base oil price which is the price of Urals oil at US$100/barrel (the base oil price of US$100/barrel applies in 2012 only).

If the coefficient is lower than 1, it is deemed to be 1.

The adjusting coefficients to production royalties on natural gas are calculated by the Ministry of Finance of Ukraine on the basis of the following formula:

AC = AP/BP

AC is the adjusting coefficient; **AP** is the average customs value of imported natural gas in the tax (reporting) period; **BP** is the base gas price which equals US$179.5 per 1,000m^3.

If the coefficient is lower than 1, it is deemed to be 1.

Both adjusting coefficients are published by the Ministry of Economic Development and Trade of Ukraine on its official website. These coefficients should be monitored as they can significantly increase base royalty rate.

Subsoil use payments

Payments for subsoil use are payable by all subsoil users producing mineral resources in Ukraine (including during exploration stage). For oil and gas, the calculation base for this payment is the volume of mineral resources actually extracted.

Subsoil use payments			
Mineral resources	Rates, UAH	Units of measurement	Additional notes
Oil and gas condensate	147.63	tonne	
Gas	42.05	1,000m^3	Applies to natural gas, including gas dissolved in crude oil, oil gas, ethane, propane, butane

Note: Subsoil use payments are subject to adjusting coefficients as follows:

Qualifying criteria	Adjusting coefficient
Extraction of off-balance sheet mineral resources (conditions apply)	0.5
Extraction of mineral resources from technogenic deposits	0.5
Extraction of mineral resources from subsidized deposits	0.01
Extraction by the taxpayer of mineral resources from fields approved by the state expert evaluation on the basis of geological explorations carried out at the taxpayer's expense	0.7

Recirculation gas, and mineral resources that are left in the well to prevent cavings or water breakthrough are exempt from subsoil use payment (conditions apply).

Tax liabilities on extraction of mineral resources from one deposit during one reporting period are calculated according to the following formula:

Tl = Vmr x Sr x Ac,

Tl represents tax liabilities; **Vmr** stands for the amount of extracted mineral resources from one deposit within one reporting period (in units of weight or volume); **Sr** is the standard rate for subsoil use payments stipulated for oil and gas extraction activities; Ac is the adjusting coefficient when applicable.

Subsoil use payments are deductible for CPT purposes.

Non-production subsoil use payments

Taxpayers that use subsoil to store oil, oil products and gas pay a levy for non-production subsoil use. For gas, the tax is calculated by applying the rate in hryvnia to the active volume of gas that is stored in the reservoir bed. For oil, the tax is calculated by applying the rate in hryvnia to the storage area.

Types of subsoil use	Units of measurement	Rates/per year, UAH
Use of reservoir beds for storage of natural gas and gaseous products	1,000m^3 of active gas volume	0.26
Use of natural or artificial mines for storage of oil and liquid oil products	m^3	0.26

Production sharing agreement

There has been no extensive practice of PSA in Ukraine. The first and only PSA with a nonresident investor was concluded in 2007. Until December 2011, there was an exhaustive list of areas available for PSA, which contained only three oil and gas fields; however, this list has been abolished, so a larger number of areas is potentially available to the bidders.

Under PSA, the state retains the title to the subsoil resources and gives the investor the right to conduct E&P of subsoil resources. Part of oil or gas produced under the PSA is used to recover the investor's expenses (cost compensation oil or gas), and the remaining part is distributed between the state and the investor as profit oil or gas. Prior to production distribution, these resources belong to the state.

Throughout the PSA duration, the investor is not taxed under general requirements of the Tax Code. Some mandatory taxes and payments, e.g., royalties, are substituted by the production distribution between the investor and the state. PSAs are ring-fenced for tax purposes. If the investor is engaged in business activities outside of the PSA, they are taxable under general rules. As such, all activities under the PSA must be recorded into a separate balance sheet.

Importantly, the state guarantees that tax rules effective as of the date of signing the PSA will apply throughout its term, unless a tax is abolished or its rate decreases. In the latter case, the new tax rules apply as they become effective.

PSA tax registration and compliance

Both local and nonresident investors may enter into a PSA with either the state or a state-owned company. Nonresidents entering into a PSA should register a PE in Ukraine. In such a case, both special PSA tax rules and domestic tax rules for PEs potentially apply, which should be resolved in the PSA.

Taxes payable under the PSA regime

There is an exhaustive list of taxes the investor must pay under a PSA, namely:

- CPT
- VAT
- Payments for subsoil use

The investor is also obliged to administer Ukrainian payroll taxes (personal income tax (PIT) and unified social tax) and pay state duty where applicable. Other taxes are substituted by production distribution between the state and the investor.

The Tax Code specifically provides that the following events are tax-neutral for the PSA purposes:

- Distribution of profit production between the investor and the state
- Transfer of the PSA-related property from the investor to the state upon expiration of the PSA or after full compensation of the property by cost production
- Compensation or distribution of profit production by the operator to other PSA investors
- Transfer of property between the parties to the PSA and the operator when required for the PSA execution

Tax exemptions applicable to investors under the PSA do not apply to their contractors or subcontractors (except for some VAT incentives).

Certain PSA taxes are paid according to special rules as outlined below.

CPT under the PSA regime

The investor is deemed to be a Ukrainian CPT payer with CPT payable quarterly and in cash only.

The investor should keep separate CPT accounting of PSA activities, as CPT on profit derived from other activities is payable under general rules. If several investors participate in a PSA, they should appoint an operator responsible for keeping all financial and tax accounting under the PSA.

CPT incentives do not apply to taxable profit received by the investor from activities pertaining to the PSA, unless otherwise stipulated by the PSA.

Tax basis for CPT purposes is the investor's profit. However, the Tax Code provides for certain peculiarities of CPT calculation under the PSA:

- Taxable profit is calculated based on the value of the investor's profit production share, less the unified social tax paid and less the investor's other expenses (including work costs accrued prior to the first profit production) under the PSA, provided these expenses have not been recovered by the cost compensation production.
- The list of expenses covered by cost compensation production is not explicitly determined by the law. However, the cost of fixed assets, field exploration, development and extraction are includible as expenses that should be compensated by the cost compensation production, when incurred.
- The cost of fixed assets not covered by the compensation production is depreciable under general rules.
- For the investor's PE, funds and property provided by the head office to finance the activities under the PSA are not taxable, if in line with the program of works as approved by the inter-ministry commission.
- If the tax base is negative, carryforward of losses is allowed throughout the PSA duration.

Withholding tax under the PSA regime

WHT does not apply to a nonresident investor's income derived under the PSA, when remitted by its PE in Ukraine. This WHT exemption arguably does not cover the investor's subsidiaries in Ukraine that do not qualify as investors under the PSA. Furthermore, WHT exemption is unlikely to apply to other types of Ukraine-sourced income that may be payable, i.e., to any income derived outside of the PSA scope.

VAT under the PSA regime

The investor's sale of production derived from the PSA is subject to VAT under general rules. However, there are several VAT and export and import duty exemptions envisaged under the PSA:

- Importation of goods and ancillary services into the customs territory of Ukraine for the PSA execution purposes is not subject to import taxes (less excise tax).

- Importation of hydrocarbon raw materials, oil or gas produced under the PSA in the exclusive economic zone of Ukraine is not subject to import duties or taxes (including VAT).
- Exportation of production acquired by the investor under the PSA is not subject to export taxes.
- Exportation by the investor of the above goods and other tangible assets, previously acquired in the customs territory of Ukraine under the PSA, is not subject to export taxes, except VAT, which applies at 0%. This rule applies if the exportation is required to perform under the PSA.
- Services provided by a nonresident in the customs territory of Ukraine to the investor for the PSA execution are not subject to VAT.

The above exemptions also apply to legal entities (e.g., contractors, subcontractors, carriers) providing goods and services for the PSA execution purposes under relevant agreements (contracts) with the investor. Should the investor use the goods or services not for the PSA purposes due to the contractor's or investor's fault, the contractor or the investor will have to pay all previously saved taxes.

Importantly, the investor's VAT registration under the PSA is not subject to cancellation, regardless of the absence of supplies or purchases subject to VAT during the previous 12 calendar months.

Payment for subsoil use under the PSA regime

The rates, terms, procedures and conditions for subsoil use payments are negotiated and stipulated by the PSA. However, the subsoil use payment rate may not be lower than that prescribed by the Tax Code as of the date of the PSA.

Payroll taxes under the PSA regime

Payroll taxes, namely PIT and the unified social tax, apply under general rules.

Other taxes and contributions under the PSA regime

Under the PSA law and the Tax Code of Ukraine, the production share payable to the state replaces other state and local taxes.

C. Capital allowances

Depreciation

Productive oil and gas well construction costs are depreciable over 11 years. The annual depreciation rate depends on the year of oil and gas well operation and ranges from 18% to 3% of a well's historic value.

Production year	Depreciation rate
1	10%
2	18%
3	14%
4	12%
5	9%
6	7%
7	7%
8	7%
9	7%
10	6%
11	3%

Well repair, reconstruction or improvement costs are deductible when incurred, if up to 10% of the well's initial value. Expenses exceeding the above limitation should be depreciable. The book value of a well used in oil or gas production is not subject to indexation.

There are general depreciation rules for mineral resources production costs (other than the oil and gas exploration costs mentioned above and the cost of wells). There is an uncertainty as to whether these rules should apply to oil and gas companies as, historically, these have not been used in practice. The practice on the matter under the current tax law is still forming.

Fixed assets acquisition and construction costs are depreciable under general rules

The cost of fixed assets is depreciable under general rules (16 groups for tangibles, with minimum depreciation terms of 2 to 20 years). Several depreciation methods are available (straight-line, declining-balance, double-declining balance depreciation, sum-of-the-years-digits and unit-of-production depreciation methods).

Certain costs (special permit and license cost, geological information cost) may be treated as intangibles

These are depreciated during the legally established term of use. If the title document does not provide for the term of use, the asset is depreciable during 10 years. General depreciation methods are applicable.

Special allowances

There is no capital uplift or credit in Ukraine.

D. Incentives

Please refer to sections B and H for a discussion about tax incentives (see, among other, CPT and VAT incentives for coal bed methane producers, adjusting coefficients to subsoil use payments, different rates of production royalties).

E. Withholding taxes

Interest, dividends, royalties and certain other kinds of Ukrainian-sourced income received by a nonresident are subject to WHT at the rate of 15%.[215] The WHT rate on freight (or any other similar payment for carriage of goods by maritime, air, automobile or railway transport) is 6%. The tax rate on payments for adverting services provided by nonresidents equals 20%, payable at the expense of the Ukrainian service recipient. There are also several WHT rates on payments for different insurance services. WHT rates can in some cases be reduced or eliminated by virtue of a double tax treaty.

Technical services

Technical services provided by nonresident contractors should not be subject to Ukrainian WHT, unless they fall within the definition of engineering.

If the services give rise to a PE, Ukrainian CPT will apply to nonresident's profit under the general rules.

Branch remittance tax

There is no branch remittance tax in Ukraine. However, the law could be interpreted in a way that WHT at the general rate of 15% should apply to repatriation of Ukrainian profit of the branch to its nonresident head office. The possibility of eliminating this tax based on a double tax treaty is uncertain.

215 *There is also a list of other types of income which are subject to WHT at the rate of 15%.*

F. Financing considerations

Thin capitalization

No thin capitalization rules are in effect in Ukraine.

However, there is a "quasi thin capitalization rule" that limits deductibility of interest expenses incurred by Ukrainian companies with 50% or more foreign shareholding for the benefit of nonresident shareholders and their related parties. Qualifying interest expenses are allowed for deduction, to the extent they do not exceed the amount of interest income received by the company plus 50% of its taxable profit for the relevant period (less interest income received).

The remaining interest may be carried forward indefinitely, subject to the same limitation.

G. Transactions

Under Ukrainian law, the permit for subsoil use issued by the state to the investor may not be granted, sold or otherwise transferred to any other legal entity or individual. Thus, sale of assets of a company does not result in the transfer of an oil and gas license or subsoil use permit.

Farm-in and farm-out

Ukrainian law does not recognize farm-ins and farm-outs because the license and permits issued by the state cannot be traded, and parts of that permit cannot be the object of any business transaction.

Historically, the most practicable way of benefiting from an existing permit held by a Ukrainian company was to enter into a "joint activity" with the permit-holding company. However, over the last five years, the Ukrainian tax authorities have been threatening to invalidate joint activity agreements to which Ukrainian license-holding companies are a party. We are not aware of cases when joint activity agreements have actually been invalidated. Still, this risk should be taken into account when choosing the operating option.

A quasi farm-in may be executed via a sale of shares of the permit holder to an interested party.

Selling shares in a company

Nonresident companies that dispose of shares in a Ukrainian company are subject to Ukrainian WHT at 15% on capital gains. If the cost of shares in the hands of nonresidents is not properly confirmed, WHT could potentially apply to the entire sale proceeds. The resident buyer acts as a tax agent. WHT could be eliminated by virtue of a double tax treaty. There is no mechanism for administering WHT where the transaction is carried out between two nonresidents with settlements outside of Ukraine if no Ukrainian intermediary is involved.

Resident companies that dispose of shares in a Ukrainian company are subject to Ukrainian CPT at 21% on the margin between the share sale price and any share acquisition expenses borne in the same period. Transactions with securities (including shares and other corporate rights) are partly ring-fenced for CPT purposes. Losses from sale of shares can only be offset against income from sale of other shares or corporate rights. However, profits on sale of shares are subject to CPT under the general rule.

H. Indirect taxes

VAT

Domestic trading in oil and gas is subject to 20% VAT (the VAT rate will be reduced to 17% from 2014).

Importation of natural gas into the customs territory of Ukraine is tax exempt, unlike oil importation, which is subject to VAT at the general rate. The importer is entitled to VAT credit in the amount of VAT paid on importation, subject to certain conditions.

Exportation of oil and gas is subject to 0% VAT.

To recover VAT input incurred in connection with oil and gas E&P, an oil or gas exploration company must be registered as a VAT payer in Ukraine. The company will not qualify for mandatory VAT registration until it starts selling oil or gas, unless it has other businesses generating VAT output. A voluntary registration is possible if the company's share capital or the book value of the company's assets exceeds UAH300,000 (approximately US$37,500).

However, during the start-up stage, the oil or gas exploration company will not be entitled to a cash refund of accumulated VAT receivable. VAT input incurred in connection with oil and gas E&P can only be accumulated to be offset against future VAT liabilities. This is because Ukrainian law limits the right to receive a VAT refund for newly established companies (12 months), and the companies whose supplies subject to VAT are smaller than the claimed VAT refund (unless VAT input arises as a result of purchase or construction of fixed assets).

Furthermore, the oil or gas exploration company should monitor its supplies subject to VAT to maintain its VAT registration. The VAT registration of a taxpayer can be cancelled if its supplies to other VAT payers during 12 calendar months constitute less than 50% of total supplies. The VAT registration can also be cancelled if the taxpayer's tax return does not show transactions subject to VAT during 12 calendar months (for special VAT treatment under PSA regime.

Supplies of natural gas to population, state-funded institutions that are not registered as VAT payers or housing companies are accounted for VAT purposes on a cash basis.

Till the end of 2012, domestic supplies of natural gas imported by NAK Naftogaz of Ukraine, the national oil and gas company, are zero-rated (with certain exceptions).

Incentives

Materials and equipment for production of alternative fuels are exempt from VAT and customs duties upon importation into Ukraine, which applies to coal bed methane as one of the alternative fuel sources.

The Cabinet of Ministers of Ukraine issues the list of items that could be exempt under this rule. In addition, this exemption only applies if the importer uses these materials and equipment for its own production purposes and there are no identical materials and equipment with similar characteristics produced in Ukraine.

There are also a few exemptions related to importation of equipment that operates on alternative fuels (including coal bed methane).

Import duties

Import duties on natural gas and crude oil are zero-rated. However, refined products are subject to import customs duties at varying rates of 0% to 10% of their customs value.

Export duties

Ukraine imposes export customs duty on gas.

Export specification	Rate
Natural gas in gaseous state	35% of the customs value, but not less than UAH400 per 1,000m³
Liquefied natural gas	35% of the customs value, but not less than UAH400 per tonne

Excise tax

In Ukraine, crude oil and gas is not subject to excise tax. However, import and the first sale of locally manufactured liquefied gas are excisable at the rate of €44 per 1,000 kilo. Import and the first sale of locally manufactured refined oil products are also excisable. The rates vary depending on the type of the product from €19 to €198 per 1,000 kilo. Excise tax exemptions apply.

Stamp duties

State duty is levied by notaries and is generally capped at insignificant amounts, except when real estate is sold.

Registration fees

There are no significant registration fees.

I. Other significant taxes

Unified social tax

Unified social tax is levied on employees' salaries and administered by employers. The rate of employer contribution varies from 36.76% to 49.7% depending on the class of professional risk at work. The rate of employee contribution, which is withheld from the salary, is 3.6%. The tax base for unified social tax is capped at 17 living wages for working persons (currently UAH18,241 or approx US$2,280).

Personal income tax

The standard personal income tax (PIT) rate is 15% for income in the form of salary, other incentive and compensation payments, or other payments and rewards. The increased rate of 17% applies for income exceeding tenfold the minimum salary (currently UAH10,730[216] or approximately US$1,340). The higher PIT rate applies to the exceeding amount. Different rates apply in certain instances (e.g., salary of miners – 10%). The employer is obliged to withhold PIT from employees' payroll and remit it to the treasury.

The Tax Code establishes social PIT benefits that are applicable to certain categories of employees (e.g., for parents with many children, disabled, students). Ukrainian tax residents are eligible for tax credit if they incur certain kinds of expense during a year (e.g., expenses on mortgage, education, medical treatment).

Environmental tax

Ukrainian legal entities, PEs of nonresidents that perform oil and gas production activities in the customs territory of Ukraine, its continental shelf or its exclusive (sea) economic zone are subject to environmental tax if these activities cause:

- Pollution of air from stationary (movable) sources
- Pollution of water
- Waste disposal in designated places (except for recycling)
- Formation and overdue storage of radioactive waste

The rates vary significantly depending on the amount, nature of stationary pollutants, concentration of pollutants, object of pollution and level of hazard, etc.

The tax is also due for emissions of pollutants by movable sources of pollution. Fuel manufacturers and importers act as tax agents. Fuel manufacturers pay this tax quarterly on the basis of the amount of the fuel actually sold, and the importers pay it upon the customs clearance of fuel, based on the amount of fuel imported. Tax rates in 2012 are UAH16.34 to UAH50.095 per tonne depending on the type of fuel.

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216 The minimum salary equals UAH1,094 from 1 April 2012, UAH1,102 from 1 July 2012, UAH1,118 from 1 October 2012, UAH1,134 from 1 December 2012.

Land tax

Oil- and gas-producing companies are subject to land tax under general rules. Land tax rates are variable depending on the land plot, its location and characteristics.

Special water use levy

The entities using water under the regime of "special water use" pay a levy for the special use of water (which includes both intake and discharge). Special use of water can be performed either based on a special water use permit or based on an agreement. The rate of levy depends on the volume of consumed water, the water source, the region and the purpose of special water use. The levy does not apply to sea water.

End consumer levy: surcharge to natural gas price

Ukrainian companies and their branches selling natural gas in Ukraine to consumers pay the end-user levy of 2% or 4% of the price of the natural gas, depending on the consumer. The payment is a surcharge to the state-established tariff of natural gas supplied to both legal entity and individual consumers in a calendar month.

Transportation royalty

The companies that manage main pipelines and provide services of transporting natural gas, oil and oil products via pipelines through Ukraine pay royalty for transportation of oil, gas and oil products. This tax is mainly paid by national pipeline operators (UkrTransNafta, NAK Naftogaz). Royalty for transportation is calculated as a fixed rate in UAH per unit. For oil and oil products, the tax base is actual amount of oil transferred through the territory of Ukraine via pipelines. For natural gas, the tax base is determined by multiplying the agreed distance of gas transportation route by actual amount of natural gas transported via this route.

Item	Rate, UAH*
Transit pipeline transportation of natural gas	UAH1.67/1,000m^3 of gas per 100km
Transit pipeline transportation of oil and oil products *	UAH4.5/tonne

* Adjusting coefficients apply to royalties for oil and oil product transportation if the pipeline transportation tariff is changed by the Government.

** Provisional payments of royalty for transportation of gas are payable every 10 days (on the 15th and 25th of the current month, and on the 5th of the next month) based on the volumes of natural gas transported through Ukraine. Final payment for the reporting month is due within 30 calendar days of the end of the month.

J. Other

Foreign exchange controls

The official exchange rate of the Hryvnia against the US dollar can be found on the website of the National Bank of Ukraine (NBU) www.bank.gov.ua.

The commercial exchange rate may differ from the official one. A wide variety of controls are imposed with respect to the use, circulation and transfer of foreign currency within Ukraine and abroad. These controls, which affect almost all international business transactions, include the following:

- As a general rule, transactions between Ukrainian residents and cash settlements within Ukraine may not be carried out in foreign currency; cross-border settlements in hryvnia have recently been allowed, but there is no procedure to implement this rule.

- All statutory accounting and tax reporting, as well as tax payments, must be in Ukrainian currency.
- Wages and salaries paid to Ukrainian citizens must be in Ukrainian currency.
- Ukrainian companies must obtain an individual license (permission) from the NBU to engage in certain business transactions, including the opening of bank accounts abroad.
- Ukrainian exporters must repatriate their export proceeds within 180 days of export. Similarly, Ukrainian importers must import goods within 180 days from the moment when the payment for such goods was made. Failure to comply results in penalties.
- Payments for services rendered by nonresidents, as well as cross-border lease and royalty payments, are subject to price evaluation review if the total amount of the contract (or the total annual amount payable under several contracts for similar services between the same parties) exceeds €100,000 (or its equivalent in another foreign currency). The governmental information, analysis and expert center in the foreign trade sphere (SC Derzhzovnishinform, www.dzi.gov.ua) for monitoring foreign commodities markets conducts the price-evaluation reviews.

Ukrainian currency may be used to purchase foreign currency.

Gas to liquids

There is no special regime for gas-to-liquids conversion. Ukraine only imposes excise tax and export duties on liquefied gas. Refer to Section H for more detailed information.

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A. At a glance

Corporate income tax (CIT) rate	*
Capital gains tax (CGT) rate	*
Branch tax rate	N/A**
Withholding tax	N/A**

* See Section B for more information.

** Neither the federal Government of the United Arab Emirates (UAE) nor the individual Emirates currently levy these taxes.

B. Taxes on corporate income and gains

Corporate income tax

Although there is currently no federal UAE taxation, each of the individual Emirates (Dubai, Sharjah, Abu Dhabi, Ajman, Umm al Quwain, Ras al Khaimah and Fujairah) has issued corporate tax decrees that theoretically apply to all businesses established in the UAE. However, in practice, these laws have not been applied. Taxes are currently only imposed at the Emirate level on oil- and gas-producing companies (oil and hydrocarbon companies with actual production in the UAE) as per specific government concession agreements that are confidential, and on branches of foreign banks under specific tax decrees or regulations, or fixed-in agreements with the Rulers of the Emirates in which the branches operate. Oil companies also pay royalties on production. Tax rates are agreed on a case-by-case basis.

Capital gains derived by oil and gas production companies and branches of foreign banks are taxed as business profits.

Note that this is merely how the practice has evolved in the UAE. There is no general exemption in the law. Anyone investing in the UAE should be aware of the risk that the law may be more generally applied in the future and of the remote risk that it may be applied retroactively.

The income tax decrees that have been enacted in each Emirate provide for tax to be imposed on the taxable income of all corporate bodies, wherever incorporated, and their branches that carry on trade or business, at any time during the taxable year, through a permanent establishment in the relevant Emirate. Corporate bodies are taxed if they carry on trade or business directly in the Emirate or indirectly through the agency of another body corporate.

VAT

There is currently no VAT in the UAE. The introduction of VAT in the UAE is under consideration at the federal level, though no draft legislation has been released at this stage.

Tax incentives

Some of the Emirates have free zones that cater to the oil and gas sector (non-production), which offer tax and business incentives. The incentives usually include tax exemptions at the Emirate level or a 0% tax rate for a guaranteed period, the possibility of 100% foreign ownership, absence of customs duty within the free zone and a "one-stop shop" for administrative services. The free zones include, but are not limited to, the Dubai Multi Commodities Centre (DMCC), the Dubai Airport Free Zone (DAFZ), Dubai International Financial Centre (DIFC) for financial services, Dubai Internet City (DIC), Dubai Media City (DMC), Dubai Studio City (DSC) and Jebel Ali Free Zone (JAFZ). Approximately 30 free zones are located in the Emirate of Dubai alone.

C. Customs duties

The member states of the Gulf Cooperation Council (GCC), which are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the UAE, approved regulations for the implementation of the GCC Customs Union on 22 December 2002. All of the states have adopted the unified customs duty generally calculated at 5% of the invoice value on most goods (except those on the exempted list) imported into the region. If goods are shipped directly from a non-GCC country to the customer, duty is payable at the first entry point. The duty is levied on the cost, insurance and freight (CIF) value of the imported goods as evidenced by the manufacturers' or suppliers' invoices. The duty is payable by the importer of record.

D. Foreign exchange controls

Neither the federal Government of the UAE nor the individual Emirates impose foreign exchange controls.

E. Tax treaties

The UAE has more than 40 tax treaties currently in force, including treaties with Algeria, Armenia, Austria, Azerbaijan, Belarus, Belgium, Bulgaria, Canada, China, Cyprus, the Czech Republic, Egypt, Finland, France, Germany, India, Indonesia, Ireland, Italy, Korea (South), Lebanon, Luxembourg, Malaysia, Malta, Mauritius, Morocco, Mozambique, Netherlands, New Zealand, Pakistan, Philippines, Poland, Romania, Seychelles, Singapore, Spain, Sri Lanka, Sudan, Syria, Tajikistan. Thailand, Tunisia, Turkey, Turkmenistan, Ukraine, Uzbekistan and Vietnam.

In addition, treaties with the following countries are in various stages of negotiation, renegotiation, signature, ratification, translation or entry into force: Bosnia-Herzegovina, Greece, Hong Kong, Jordan, Kazakhstan, Mongolia, Yemen and Switzerland.

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Where relevant, information reflects proposed measures included in the draft Finance Bill 2012 clauses published by the UK Government on 29 March 2012.

A. At a glance

Fiscal regime

The fiscal regime that applies in the UK to the oil and gas industry consists of a combination of corporation tax, supplementary charge and petroleum revenue tax.

Corporation tax rate	30% ring-fence (26% non-ring-fence[217]) – profits from oil and gas exploration and production are subject to the ring-fence rate
Supplementary charge rate	32% (from 24 March 2011, previously 20%)
Petroleum revenue tax rate	50% (for fields that received development consent before 16 March 1993)
Capital allowances	D, E[218]
Investment incentives	L, RD[219]

B. Fiscal regime

Corporation tax

UK tax-resident companies are subject to corporation tax on their worldwide profits, including chargeable gains, with credit for any creditable foreign taxes.

217 *Reducing to 24% on 1 April 2012, 23% on 1 April 2013 and 22% on 1 April 2014.*

218 *D: accelerated depreciation; E: immediate write-off for exploration costs.*

219 *L: losses can be carried forward indefinitely; RD: R&D incentive.*

The taxable profits of a UK company are based on its accounting profits as adjusted for a number of statutory provisions.

Non-UK tax-resident companies are subject to corporation tax only if they carry on a trade in the UK through a permanent establishment (PE). In general, the UK for these purposes includes UK land and territorial waters only. However, the taxing jurisdiction of the UK is extended to include income from exploration or exploitation of the natural resources of the seabed and subsoil of the UK continental shelf.

As a result, a non-UK tax-resident company that undertakes exploration or exploitation activities on the UK continental shelf is deemed to have a UK PE. The taxable profits of a UK PE are computed on the assumption that the PE is a separate entity dealing wholly independently with the nonresident company of which it is a PE.

The existence of a UK PE of a non-UK tax-resident company is subject to the application of any double tax treaty between the UK and the country of residence of the company, although the UK's double tax treaties normally preserve the UK's taxing rights in respect of exploration or exploitation activities.

A company is UK tax-resident if it is either incorporated in the UK or its central management and control is located in the UK. However, companies that are regarded as resident under domestic law, but as nonresident under the "tie breaker" clause of a double tax treaty, are regarded as nonresident for most tax purposes.

The current rate of corporation tax is 30% for ring-fence profits (see below) and 26% for non-ring-fence profits (although, as noted on the previous page, this is scheduled to reduce to 22% by 2014).

The ring-fence

For corporation tax purposes, UK exploration and production activities (both onshore and offshore) are treated as a separate ring-fence trade from other trading activities, such as refining and marketing. As a result, a company's ring-fence trading profits are calculated separately from its profits from any non-ring-fence trade. The main consequence of the ring-fence is that non-ring-fence losses may not be offset against the profits from a ring-fence trade. However, losses from a ring-fence trade can be offset against non-ring-fence profits.

Similar rules apply for capital gains purposes (i.e., non-ring-fence capital losses cannot be offset against ring-fence capital gains, but ring-fence capital losses can be offset against non-ring-fence capital gains, providing a timely election is made).

Timing of corporation tax payments

Large companies are required to pay corporation tax on their ring-fence profits in three equal installments based on the estimated liability for the year. For a company with a calendar year-end, installment payments are due on 14 July and 14 October during the year, and on 14 January following the year-end.

Similarly, large companies are required to pay corporation tax on their non-ring-fence profits in four equal installments, again based on the estimated liability for the year. For a company with a calendar year-end, installments are due on 14 July and 14 October during the year, and on 14 January and 14 April following year-end.

Taxation of income

Strict rules determine whether sales of oil and gas are considered to be arm's-length or non-arm's-length. Arm's-length sales are taxable based on the actual price realized, whereas non-arm's-length sales are taxable based on the market value of the oil or gas sold. Specific valuation rules apply in determining the market value of non-arm's-length sales and the UK tax authorities, i.e., HM Revenue & Customs (HMRC), maintain a database of statutory values for certain common crude oil types.

Nomination scheme

Anti-avoidance provisions also exist to prevent manipulation of the tax rate differential between exploration and production activities, and other activities, by the allocation of oil sales to lower-priced sales contracts, using hindsight (known as "tax spinning"). In particular, in certain circumstances, these provisions require the taxpayer to "nominate" oil sales contracts within two hours of agreeing to the contract price.

Tariff receipts

In general, tariff receipts are taxed as part of a company's ring-fence trading profits for corporation tax purposes.

Relief for expenditures

To be deductible for corporation tax purposes, trading expenditure must be incurred wholly and exclusively for the purposes of the company's ring-fence or non-ring-fence trade. In addition, no relief is available for qualifying trading expenditure until the company has actually commenced trading, which, in the case of ring-fence activities, is generally considered to be when a decision has been taken to develop a field. It is not considered that exploration, or the sale of a small quantity of oil as the result of unsuccessful exploration, constitutes the commencement of a trade. Most trading expenditure incurred prior to the commencement of a trade will typically qualify for relief in the period when the trade commences.

In addition, the corporation tax treatment of expenditure depends on whether it is capital or revenue in nature; this distinction depends, among other things, on the life cycle of the related fields. In particular, the exploration stage of a field mainly involves capital expenditure, including expenditure on intangible assets, such as oil licenses and drilling exploration and appraisal wells, whereas the production phase may involve a mixture of revenue and capital expenditure. At the end of the field's life, decommissioning expenditure is treated as capital in nature.

In general, revenue expenditure incurred wholly and exclusively for the purposes of the company's ring-fence trade is deductible as it is accrued, whereas relief is only available for capital expenditures to the extent that capital allowances are available (see Section C for further details).

Losses

The UK loss rules distinguish between different types of losses, including trading losses, finance losses and capital losses. Trading losses can be utilized by a company against its taxable profits (of any type) in the period when the loss arose, or they may be carried back one year against any profits. In addition, trading losses can be surrendered to other companies in the same group to offset their profits arising in the same period. If trading losses are not used by the company in its current or prior period or surrendered to another company, they are automatically carried forward to offset future profits of that company arising from the same trade.

In certain circumstances, the one-year carryback period is extended. In particular, under current legislation, losses arising in the year of cessation of trade or losses that arise from capital allowances for decommissioning expenditure (see Section C) can be carried back to 17 April 2002 for losses incurred in accounting periods beginning on or after 11 March 2008 (previously, the carryback period was restricted to three years).

Finance losses

Losses resulting from loan relationships can be utilized against profits in a number of ways. They can either be offset against profits of the same accounting period or non-trading profits of an earlier period or a subsequent period, or they can be surrendered to other companies in the same group in the same period by way of group relief. However, financing costs are not generally deductible for supplementary charge or petroleum revenue tax purposes.

Capital losses

Capital losses may be offset against any chargeable gains arising in the same accounting period and, to the extent they are not fully utilized, may then be carried forward to be offset against future chargeable gains. Capital losses cannot be used to reduce trading profits or any income other than chargeable gains.

An election can be made to transfer a chargeable gain or allowable loss to another company in the same group. Finance Bill 2012 includes proposed legislation which will provide that an election cannot be made to transfer a ring-fence chargeable gain accruing on or after 6 December 2011 to a company not carrying on a ring-fence trade.

Special rules exist for members joining a group that prevent losses from being offset against gains in certain circumstances. In addition, special rules exist for ring-fencing, as noted above.

Currency issues

A company's taxable profits are generally calculated by reference to the functional currency of the company for accounting purposes. However, capital gains are calculated by reference to sterling (British pounds).

Transfer pricing

The UK transfer pricing regime aims to ensure that, for corporation tax purposes, transactions between connected parties take place on arm's-length terms. If arm's-length terms are not used, these terms are imposed for tax purposes. Several methods for determining the arm's-length price are available, and there are strict documentation requirements to support the method chosen and the prices reached. This is particularly relevant to the sale of oil and gas (see above), the provision of intercompany services, intercompany funding arrangements (see below), and bareboat and time charter leases in respect of vessels such as rigs and floating production, storage and offloading units (FPSOs).

In addition to transactions between a UK tax-resident company and a non-UK tax-resident company, the UK's transfer pricing regime also applies to transactions between two UK tax-resident companies and to transactions between a ring-fence trade and a non-ring-fence trade within the same company. For example, the appropriation of crude oil from the exploration and production business of a company to its refining business would be subject to the rules.

The treatment of dividends

The UK adopted a dividend exemption system in respect of dividends received on or after 1 July 2009. Generally, the UK dividend exemption provides for a full exemption from UK corporation tax in respect of distributions that are not of a capital nature from either UK or foreign companies. If distributions do not meet the exemption, they will be subject to UK corporation tax.

Generally, a dividend will be treated as an exempt distribution if:

- The recipient company controls the company paying the dividend
- The dividend is in respect of non-redeemable ordinary shares
- The dividend is in respect of a portfolio holding (i.e., the recipient owns >10% of the issued share capital of the payer)
- The dividend is from a transaction not designed to reduce tax
- The dividend is in respect of shares accounted for as liabilities

Targeted anti-avoidance rules exist to prevent abuse of the exemption system.

Treatment of foreign branches

Companies resident in the UK are taxed on their worldwide profits, including the profits from their foreign branches. UK tax relief may be available for overseas taxes suffered by way of double taxation relief. Any excess foreign tax credits can be carried back three years or carried forward indefinitely against profits from the same branch. The Finance Act 2011 introduced an exemption for foreign branch profits whereby, from 19 July 2011, each company within the charge to UK corporation tax can make an irrevocable election to exempt the future profits and gains of all its foreign branches. The election takes effect from the start of the next accounting period after it is made.

Supplementary charge

Supplementary charge is an additional tax (32% from 24 March 2011 and previously 20%) on UK exploration and production activities. Taxable profits for supplementary charge purposes are calculated in the same manner as ring-fence trading profits but without any deduction for finance costs. Finance costs are defined very broadly for this purpose and include the finance element of lease rentals and any costs associated with financing transactions for accounts purposes.

The due date for payment of supplementary charge is the same as that for ring-fence corporation tax. However, for periods starting before and ending on or after 24 March 2011, the additional 12% supplementary charge is payable separately, with the timing of payment based on a separate deemed accounting period commencing on 24 March 2011 and ending on the date of the actual accounting period.

Supplementary charge is not deductible for corporation tax purposes.

Field allowances

Field allowance is available in respect of certain high pressure high temperature (HPHT) fields, certain ultra heavy oil fields, certain smaller fields and certain West of Shetland gas fields that meet the relevant criteria and reduces the company's ring-fence profits for supplementary charge purposes.

Finance Bill 2012 includes proposed legislation which extends the criteria and available allowance for smaller fields and includes a new category of allowance for certain large deepwater developments.

Petroleum revenue tax

Petroleum revenue tax is charged on a field-by-field basis rather than an entity-by-entity basis, and it only applies to fields that received development consent before 16 March 1993. Petroleum revenue tax is charged in six-month periods ending 30 June and 31 December and is based on profits calculated in accordance with specific statutory provisions, rather than on accounting profits.

Income and expenditure are dealt with separately for petroleum revenue tax purposes. In particular, each participant is required to file returns in respect of its share of the oil and gas won and saved in each chargeable period, together with any other chargeable receipts, such as tariff and disposal receipts. However, expenditure must be claimed separately and does not become allowable until HMRC gives formal notice (which may be after the period when the expenditure is incurred).

Petroleum revenue tax is deductible for corporation tax and supplementary charge purposes, giving a combined headline effective tax rate of 75% for fields subject to petroleum revenue tax.

Timing of petroleum revenue tax payments

A participant is required to make a payment on account of its petroleum revenue tax liability for a chargeable period within two months of the end of that period. In addition, six installment payments must be paid based on one-

eighth of the payment on account of the previous chargeable period, beginning two months into the chargeable period. Once an assessment has been raised, any petroleum revenue tax balance due, and not previously paid, is payable six months after the end of the chargeable period.

Income

As with corporation tax, strict rules apply to determine whether sales of oil and gas are considered to be arm's-length (and taxable based on the actual price realized) or non-arm's-length (and taxable based on statutory values).

Hedging

As petroleum revenue tax is a tax on oil won and saved, only physical hedging contracts with third parties result in a tax-effective hedge for petroleum revenue tax purposes (e.g., a physical forward sale to a third party).

Tariff receipts

Petroleum revenue tax is also chargeable on tariff and disposal receipts (e.g., rentals for the use of infrastructure) received by the participant for the use, or in connection with the use, of a qualifying asset on a taxable UK field. However, the taxable receipts may be subject to specific exclusions and exemptions.

Expenditure

Expenditure incurred in finding, developing and decommissioning a field, together with the costs of extracting and transporting the oil, is generally allowable for petroleum revenue tax purposes. There is no distinction made between capital and revenue expenditure for petroleum revenue tax purposes; however, certain types of expenditure are specifically prohibited, such as interest, production-related payments, subsidized expenditure or the cost of acquiring land and buildings. A supplement of 35% is available for certain types of expenditure incurred in any period, up to and including the period when the participant reaches a break-even position in respect of the relevant field.

Expenditure on assets that are used to earn tariff income is an allowable expense for petroleum revenue tax purposes, to the extent that the tariff income is subject to petroleum revenue tax.

Losses

If a loss accrues to a participant in a chargeable period, it can be carried back against profits from the same field in preceding chargeable periods (on a last in, first out basis) or, if no carryback claim is made, the loss is carried forward automatically against profits from the same field in future chargeable periods. Losses are offset against profits before any oil allowance is made (see below).

The carryback and carryforward of losses are indefinite. In certain circumstances, any losses from an abandoned field that cannot be relieved against the profits of that field can be claimed against the profits of another field.

Oil allowance

Oil allowance is a relief designed to prevent petroleum revenue tax from being an undue burden on more marginal fields, and it allows a certain amount of production to be earned petroleum revenue tax-free for at least the first 10 years of a field's life. The allowance is given after all other expenditure and allowances, with the exception of safeguard (see below).

The amount of oil allowance varies depending on the location of the field and the timing of the development consent. It is either 125,000, 250,000 or 500,000 metric tons per chargeable period, which equates to 2.5 million, 5 million or 10 million metric tons, respectively, over the life of the field. The oil allowance is converted into a cash equivalent in each chargeable period based on the company's taxable income in the chargeable period. If the oil allowance due has not been fully used in a chargeable period, the excess remains available for future use, subject to the maximum allowance available for the field.

Safeguard

Similar to oil allowance, safeguard is also a relief designed to prevent petroleum revenue tax from being an undue burden on more marginal fields, and it allows a company to earn a specific return on its capital before being subject to petroleum revenue tax. Safeguard applies after all expenditure and other reliefs have been taken into account; it only applies for a certain number of periods and is now largely historic.

Deferral or opt-out of petroleum revenue tax

If a field is not expected to pay petroleum revenue tax, HMRC may accept that submission of petroleum revenue tax returns for that field can be deferred indefinitely. This is intended to avoid the needless disclosure of potentially sensitive expenditure information and to ease the compliance burden placed on the participants.

An election is available to take a specific field out of the charge to petroleum revenue tax (provided that all of the field participants agree to the election). The election to opt out of petroleum revenue tax should be successful if either no profits subject to petroleum revenue tax will accrue to any of the participants or the profits potentially subject to petroleum revenue tax will not exceed the participant's share of oil allowance for the field. The election is irrevocable.

C. Capital allowances for corporation tax and supplementary charge

Expenditure on assets used in a ring-fence trade

A 100% first-year allowance (FYA) is available on most capital expenditure incurred for the purposes of a company's ring-fence trade, including expenditure on plant and machinery, together with expenditure on exploration, appraisal and development. A number of exclusions to the FYA regime apply, including expenditure on ships and plant and machinery for leasing.

For asset acquisitions, it is important to note that the amount of the purchase consideration that qualifies for capital allowances cannot generally exceed the amount of costs that qualified for relief in the hands of the seller. This means that relief is not available for premium paid-for license acquisitions.

FYAs are only given if the assets are used wholly and exclusively for the purposes of the ring-fence trade; therefore, an FYA can be withdrawn if the asset is sold or if it is no longer used in the ring-fence trade within five years of incurring the expenditure.

If an FYA is not claimed in the year when the expenditure is regarded as being incurred, it is not available in subsequent years and the expenditure instead attracts writing-down allowances of 25% a year for most intangible expenditures, 25% a year for plant and machinery, or 10% a year for expenditure on long-life assets or mineral extraction assets on a reducing-balance basis.

Expenditure on assets used in a non-ring-fence trade

Capital allowances of 20% (18% from 1 April 2012) a year on a reducing-balance basis are available on most expenditures of plant and machinery used in a non-ring-fence trade. However, assets purchased on or after 26 November 1996, with a useful economic life of 25 years or more, attract capital allowances at a reduced rate of 10% a year (8% from 1 April 2012).

Decommissioning

Most decommissioning expenditure is considered to be capital in nature for tax purposes and qualifies for a special 100% capital allowance. This includes expenditure on demolition, preservation pending reuse or demolition, and preparing or arranging for reuse (including removal). Specifically, this may include mothballing installations, plugging wells, dumping or toppling rigs, and restoring sites.

A special 100% capital allowance may be claimed in respect of ring-fence trades for pre-cessation decommissioning expenditure, subject to a number of conditions.

Finance Bill 2012 includes proposed legislation that would restrict the rate of relief for decommissioning expenditure for supplementary charge purposes to 20% for decommissioning carried out on or after 21 March 2012.

Asset disposals

The disposal of an asset that attracted capital allowances may give rise to a balancing charge or an allowance for capital allowance purposes. This is generally calculated by comparing the sale proceeds received to the remaining capital allowances available in respect of the asset.

D. Incentives

Ring-fence Expenditure Supplement

If a company has a ring-fence loss in a particular period but it, or other companies in its group, does not have ring-fence taxable profits against which the losses can be offset, the company can claim Ring-Fence Expenditure Supplement (REFS). This increases the ring-fence losses the company carries forward to the next period by 10% (6% for periods commencing prior to 1 January 2012). It can be claimed for a maximum of six years (these years do not have to be consecutive).

Tax holidays

The UK does not have a tax holiday regime.

R&D allowances

Exploration and appraisal expenditure incurred before a field is considered commercial qualify for 100% R&D allowances for corporation tax and supplementary charge purposes, but not for any enhanced allowances. Enhanced tax relief may be available for qualifying R&D for expenditure not related to exploration and appraisal at a rate of 130% for large companies and, from 1 April 2011, 200% for small or medium-sized companies.

E. Withholding taxes

In general, withholding tax (WHT) applies at 20% on both interest payments and royalties, subject to any relief provided under an applicable double tax treaty.

The UK has an extensive network of double taxation agreements with overseas jurisdictions. Treaty relief for WHT on royalties can be claimed automatically. However, a nonresident recipient of interest must make a claim for repayment or an application for relief at source to the UK Centre for Nonresidents to benefit from treaty relief. In addition, there are a number of exemptions in respect of interest WHT, including exemptions for payments to other companies charged to UK corporation tax and payments to qualifying banks.

The UK does not levy WHT on dividend payments, and it has no branch remittance tax.

F. Financing considerations

Finance costs are generally deductible for corporation tax purposes but not for supplementary charge or for petroleum revenue tax purposes. In addition, deductions for finance costs in computing the profits of a ring-fence trade are only permitted if the money borrowed has been used to meet expenditure incurred in carrying on oil extraction activities or on acquiring a license from a third party.

If borrowing is from a connected party or is guaranteed by another group company, the UK's transfer pricing regime, which includes thin capitalization provisions, may apply. The effect may be to restrict deductions for finance costs to those that would have been available if the loan had been from an unconnected third party. This involves consideration of both the amount of the loan and the terms of the loan that could otherwise have been obtained from a third party.

Thin capitalization

There are no statutory or non-statutory safe harbor rules in the UK in respect of thin capitalization. Instead, the UK relies purely on the arm's-length test for connected party debt. The arm's-length test can be a source of uncertainty, as neither UK legislation nor the Organization for Economic Cooperation and Development (OECD) Guidelines offer practical assistance as to how to evaluate arm's-length debt. HMRC is often willing to enter into discussions or provide advance clearance on potential thin capitalization issues when relevant funding arrangements are put in place, in order to give some certainty as to the tax treatment likely to apply in specific circumstances.

G. Transactions

Capital gains

Capital gains realized by a UK tax-resident company on the sale of a chargeable asset are subject to corporation tax (26% for non-ring-fence gains and 30% for ring-fence gains). There has historically been some uncertainty as to whether a ring-fence gain is subject to the supplementary charge. However, Finance Bill 2012 includes proposed legislation which provides that ring-fence chargeable gains accruing on or after 6 December 2011 will be subject to the supplementary charge. A capital gain is usually calculated as the excess of sales proceeds less any qualifying capital expenditure. In addition, an allowance is available for inflation; the amount of the reduction is based on the increase in the Retail Prices Index (RPI).

A non-UK tax resident is not normally subject to UK tax on its capital gains. However, if a non-UK tax resident realizes a gain from disposal of UK exploration or exploration rights or assets (or unquoted shares in a company that derive the greater part of their value from such rights or assets), this gain is subject to UK tax.

Any unpaid tax can be assessed against the licensees of the fields owned by the company sold. Gains on the sale of assets situated in and used in a trade carried on by a UK tax-resident company or a PE in the UK are subject to corporation tax.

Farm-in and farm-out

If a license interest is farmed out for non-cash consideration (such as subordinated interests, development carry, license swaps, work obligation), the consideration must be valued. It is important that the farmer-in agrees to the value of any rights-based consideration to avoid a possible future challenge from HMRC. If all or part of the consideration given cannot be valued, the disposal is deemed to be for a consideration, equal to the market value of the asset.

Farm-outs of license interests relating to undeveloped areas (i.e., areas for which no development consent has been granted and no program of development has been served or approved) are deemed to be for zero consideration to the extent that the consideration consists of an exploration or appraisal work program. Otherwise, these proceeds are taxable.

Swaps

Swaps of license interests in undeveloped areas are also deemed to take place for zero consideration, to the extent that the consideration is in the form of another license relating to an undeveloped area.

Swaps of license interests in developed areas are deemed to take place for such consideration as gives rise to no gain or no loss.

Allowable base costs deducted from consideration received on disposal

Consideration given to acquire an asset can be deducted when computing a chargeable gain, as can incidental costs of acquisition and disposal and expenditures to enhance the value of the asset. However, any expenditure allowed as a deduction against profits in calculating corporation tax is not allowable.

Complex rules apply that may "waste" the base cost deduction over the life of the license, thus reducing the base cost.

Ring-fence rules

Gains or losses arising on the disposal of an interest in an oil field or assets used in connection with the field (but only if they are disposed as part of a license transfer) are ring-fenced. Gains on disposals of shares, field assets disposed of outside a license transfer and disposals of licenses that do not have determined fields are not ring-fenced. Ring-fence gains cannot be offset by non-ring-fence losses. Ring-fence losses can be offset against ring-fence gains, but they can only be offset against non-ring-fence gains to the extent that a claim is made within two years for the loss to be treated as non-ring-fence.

Reinvestment relief can be claimed if the proceeds of a disposal that falls within the ring-fence rules are reinvested in certain "oil assets," including disposals made on or after 24 March 2010 and reinvestment in intangible drilling expenditure.

Substantial shareholding exemption

The substantial shareholding exemption (SSE) applies if a shareholding of more than 10% of a trading company's share capital is disposed of, subject to certain conditions. Any gain is exempt from capital gains tax (CGT) if the vendor has held a "substantial shareholding" in the company for a continuous 12-month period, beginning not more than two years before the disposal. Numerous other detailed requirements must be met to qualify.

H. Indirect taxes

VAT

The standard rate of VAT in the UK is 20%, with reduced rates of 5% and 0%. VAT is potentially chargeable on all supplies of goods and services made in the UK and its territorial waters. Both UK resident and nonresident companies may be required to register for UK VAT if supplies exceed the VAT threshold or there is an intention to make future taxable supplies. However, from 1 August 2012, the VAT threshold for nonresident companies will be removed, meaning all nonresident companies making taxable supplies in the UK must register for UK VAT. A nonresident company that is required to register for UK VAT can register directly with the UK tax authorities. There is no requirement to appoint a VAT or fiscal representative. VAT incurred by an entity that is VAT registered in the UK is normally recoverable on its periodic VAT returns.

A specified area is licensed for both onshore and offshore oil and gas exploration or exploitation purposes, often to a consortium of companies. One of the participating companies in a consortium usually acts as the "operating member" (the OM) under a joint operating agreement. In this situation, the OM incurs UK VAT on the supplies it receives for the consortium, so it is essential that it registers for UK VAT to obtain credit for the VAT charged. In addition, it is important for the "participating members" of the consortium to register for VAT to recover input VAT.

In the UK, the VAT treatment of the sale of hydrocarbon products produced as a result of a successful exploration and production program depends on the product itself, where it is sold and to whom it is sold. Natural gas and associated products imported into the UK (via a gas pipeline) from a field outside the UK territorial waters are subject to formal customs import procedures; although, from 1 January 2011, the importation of natural gas has been exempt from import VAT.

Excise duty

Excise duty is payable on certain hydrocarbon products in the UK if these products are removed from an excise warehouse for "home use" (i.e., they are removed for domestic use). Products stored in an excise warehouse are afforded duty suspension. The rate of excise duty payable in respect of hydrocarbon products is based on the classification of the product.

Customs duty

All goods imported into the UK from outside the European Union are potentially liable to customs duty. The rate of customs duty is based on the classification of the goods and whether the goods qualify for preferential rates. However, customs relief and regimes may allow goods to be imported at a reduced or zero rate of duty, provided the goods are used for a prescribed use under customs control, within a specified time limit. Normally, a business must seek prior authorization from HMRC to utilize any customs relief or regimes.

Insurance premium tax

The insurance premium tax (IPT) is a tax on premiums received under taxable insurance contracts.

Two rates of IPT apply:

- A standard rate of 6%
- *A higher rate of 20% for insurance supplied with selected goods and services*

All types of insurance risk located in the UK are taxable, unless they are specifically exempt.

In respect of the oil and gas industry, onshore installations in the UK and those within the 12-mile limit are liable to IPT. However, IPT does not apply to installations located outside UK territorial waters.

Appropriate allocations must be made when certain insurance policies cover both UK and non-UK risks, to determine the proportion of the premium that will be subject to IPT.

Stamp taxes

Stamp taxes only apply in the UK at the following rates: 0.5% of the consideration on the sale of shares and up to 5% of the consideration on the sale of an interest in UK land and buildings. The tax is generally payable by the purchaser. Relief is available for transfers between group companies and some other forms of reorganization. However, this relief is hedged around with anti-avoidance rules, so it is essential to seek specific advice before relying on the availability of a relief. In the case of land transfers to a company connected with the transferor, the market value is substituted for the consideration if it is higher.

A license may be an interest in land, but stamp taxes do not apply to licenses situated in territorial waters because, for these purposes, the territory of the UK ends at the low watermark. Offshore structures fixed to the seabed may amount to an interest in UK land if they are connected to land above the low watermark (e.g., a pier or jetty). It is generally considered that the section of an undersea pipeline on the seaward side of the low watermark does not give rise to an interest in land, although this is not completely certain. The owner of the landward section, including any termination equipment and associated structures, generally possesses an interest in the land. On a sale, it is sometimes difficult to allocate the consideration between the interest in the land and buildings and equipment, which may not be regarded as technically part of the land and buildings.

I. Other

Forms of business presence

Forms of business presence in the UK typically include companies, foreign branches and joint ventures (incorporated and unincorporated). In addition to commercial considerations, it is important to consider the tax consequences of each type of entity when setting up a business in the UK. Unincorporated joint ventures are commonly used by companies in the exploration and development of oil and gas projects.

Foreign exchange controls

There are no foreign exchange restrictions on inward or outward investments.

Anti-avoidance legislation

The UK's tax law contains several anti-avoidance provisions, which apply in certain areas, such as financing, if a transaction is not carried out for genuine commercial reasons.

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A. At a glance

Fiscal regime

The fiscal regime that applies to the petroleum industry in the United States (US) consists of a combination of corporate income tax (CIT), severance tax and royalty payments.

Royalties	Onshore:[220] 12.5% to 30%, negotiated or bid with the mineral interest owner Offshore:[221] 18.75% effective for 19 March 2008 auction, 16.667% in certain previous lease auctions and 12.50% for older leases
Bonuses	Onshore: negotiated or bid with the mineral interest owner Offshore: competitive bid process

220 *Onshore mineral interests can be held by the federal Government (managed by the Department of the Interior's Bureau of Land Management and the Department of Agriculture's US Forest Service), states, Indian reservations (managed by the Bureau of Indian Affairs and the Bureau of Land Management), individuals, corporations, trusts.*

221 *Offshore mineral interests (Alaska, Gulf of Mexico and Pacific) are owned by the US Government and are managed by the Offshore Energy Minerals Management (OEMM), an office of the Bureau of Ocean Energy Management, Regulation and Enforcement (BOEMRE), a bureau of the U.S. Department of the Interior.*

Income tax rate	CIT rate of 35%[222]
Severance tax	Severance tax is payable to the state where the product is extracted, including onshore and offshore state waters. The tax rates and the tax base vary by state; for example, states calculate the tax based on a flat amount per volume produced or as a percentage of gross receipts. Additionally, it is common for different tax rates to apply for different types of products produced
Capital allowances[223]	D, E[224]
Investment incentives	L, RD[225]

B. Fiscal regime

The fiscal regime that applies to the petroleum industry in the US consists of a combination of CIT, severance tax and royalty payments.

Corporate tax

US resident corporations are subject to income tax on their worldwide income, including income of foreign branches at a rate of 35%. Income of nonresident corporations from US sources that is not subject to withholding tax (WHT) or treaty protection is also subject to tax at 35%. The 35% rate applies to oil and gas activities and to non-oil and gas activities.

The US does not apply ring-fencing in the determination of CIT liability. Profit from one project can offset losses from another project held by the same tax entity, and, similarly, profits and losses from upstream activities can offset downstream activities or any other activities undertaken by the same entity. The US tax law allows a US parent corporation and all other US corporations in which the parent owns, directly or indirectly through one or more chains, at least 80% of the total voting power and value of the stock to form a consolidated group, which is treated as a single taxable entity.

Corporate tax is levied on taxable income. Taxable income equals gross income less deductions. Gross income includes all taxable ordinary and capital income (determined under tax law). Deductions include expenses to the extent they are incurred in producing gross income or are necessary in carrying on a business for the purpose of producing gross income. However, expenditures of a capital nature are not generally immediately deductible.

Capital expenditures incurred by the oil and gas industry are recovered through deductions available for intangible drilling and completion costs (IDC and ICC), cost or percentage depletion for leasehold cost basis or accelerated methods of depreciating tangible assets (see Section C). Additionally, there may be deductions available for other types of capital expenditures: for example, expenditures incurred to establish an initial business structure (organization or start-up costs are capitalized and amortized over 15 years).

An overriding principle in the US taxation of the oil and gas industry is that almost all calculations involving assets are calculated on a unit-of-property (tax property) basis; this includes property basis, gain or loss on disposal, abandonment and property-related deductions (depletion, depreciation and amortization). Although the concept and actual determination of a unit of property (i.e., separate property) can be very complicated, in practice, a unit of property is frequently treated as equating to a lease or an oil and gas well.

Special deductions are allowed against income, including, in limited circumstances, percentage depletion and Section 199 deductions.

222 *US federal rate. State tax regimes vary and include income, franchise, production and property taxes.*

223 *Capital allowances vary depending on the type of taxpayer and the nature of assets (see discussion on next page on integrated and independent producers).*

224 *D: accelerated depreciation; E: accelerated write-off for intangible drilling costs.*

225 *L: losses can be carried forward for 20 years; RD: R&D incentive.*

Profits from oil and gas activities undertaken by a US resident company in a foreign country are generally subject to tax in the US. The US tax may be reduced by foreign income tax paid or accrued if applicable (see next page).

Alternative minimum tax regime

In addition to the regular tax system, the US imposes an alternative minimum tax (AMT) regime, which requires a separate calculation of alternative minimum taxable income (AMTI). The AMT rate is 20%. AMT often affects oil and gas companies that have large IDC deductions, especially in years with low taxable income due to IDC deductions, loss carryforwards or low commodity prices.

There are numerous preferences and adjustments that are added to, or subtracted from, a company's regular tax income to determine its AMTI. Items that most commonly affect the oil and gas industry are depreciation, IDC and the last-in, first-out inventory method, known as LIFO. These calculations are complicated, and they are not explained in detail in this chapter.

In brief, the taxpayer must recalculate taxable income and deductions under the prescribed alternative methods (generally involving earlier income inclusion and decreased deductions due to slower methods of recovery or longer recovery periods, or both).

The following are common recalculations required for AMT purposes for the oil and gas industry:

- The depreciation deduction is recalculated using a slower method.
- The IDC deduction is recalculated by capitalizing and amortizing the current-year IDC using either 10 straight-line (SL) or the unit of production ratio for AMT preference purposes. Additional computations (not detailed here) are required to determine the final amount of the AMT IDC preference. AMT IDC amortization is not allowed on any prior-year IDC expenditures.
- For independent producers, the treatment of IDC as a tax preference was repealed. However, the benefit of the repeal was limited. Therefore, an independent producer must still determine the amount of preference IDC to be added back for AMT purposes, if any.
- For integrated producers only, the adjusted current earnings (ACE) IDC adjustment is the excess of the IDC deducted for regular tax over the amount allowed for ACE IDC amortization less the amount already added back as an AMT IDC preference. The ACE IDC amortization is calculated based on capitalizing all of the IDC and amortizing it over 60 months. The taxpayer may continue to amortize the IDC capitalized for ACE purposes until it is fully amortized, even if this causes the taxpayer to have a negative ACE IDC adjustment.
- LIFO is not allowed for ACE purposes.

State and local taxes

In the US, state and local taxes can be a significant cost of doing business onshore or in state waters. Each state has its own tax statute. The details of the various state requirements are numerous, and they are not included in detail in this chapter.

State income tax

Most states impose a tax based on the income of companies doing business within the state. Generally, state corporate taxable income is calculated by making certain state-specific additions and subtractions to federal taxable income. Alternatively, some states calculate state taxable income based on gross receipts, subject to state-specific definitions and modifications. State taxable income is apportioned to an individual state based on a factor that generally compares the property, payroll or sales activity within the state to those same factors within and outside the state. Apportioned income is multiplied by the state income tax rate to determine the tax due. State income tax rates typically range from 0% to 12%.

State franchise tax

Many states impose a franchise tax on any company that is:

- Organized in the state
- Qualified to do business, or doing business, in the state
- Exercising or continuing the corporate charter within the state
- Owning or using any of the corporate capital, plant or other property in the state

Generally, the franchise tax rate is calculated by multiplying the value of the apportioned assets, capital stock or net worth employed in the state by the franchise tax rate. Franchise tax rates typically range from 0.15% to 1.0% of the taxable base.

Foreign entity taxation

The tax issues associated with inbound investment into the US for oil and gas ventures bring into play unique rules and regulations specific to the oil and gas area. Similarly, inbound investment[226], in general, has a defined set of tax rules and regulations governing the taxation of a foreign multinational, regardless of the industry.

Taking the rules for inbound investment into the US first, a foreign multinational is generally subject to US tax on its US-sourced income under US domestic tax principles, unless a bilateral income tax treaty applies that supplants the ability of the US to tax certain types of income. For example, certain activities that take place in the US may give rise to a taxable trade or business under US domestic tax principles, while under an applicable income tax treaty, the activity may be exempt from US tax by agreement of the treaty parties. An example of this treatment may be rental of equipment to a US party on a net basis, whereby the lessee takes on most of the risks and costs associated with leasing the asset from the foreign party.

Further, regardless of whether a foreign multinational is attempting to apply an applicable income tax treaty or not, certain domestic tax provisions may apply, such as Section 163(j), which governs the amount of interest expense that is deductible in the US against US taxable income. Such amount is generally limited to a percentage of earnings before interest, taxes, depreciation and amortization (EBITDA) after applying a complex formula set forth in the regulations under Section 163(j). Similar issues for inbound financing of US operations will entail debt/equity characterization, the conduit financing regulations and thin capital considerations.

Another area of the US federal income tax provisions that may be applicable to foreign multinationals investing in the US is set forth in Section 897. This section, known as the Foreign Investment in Real Property Tax Act rules (FIRPTA), sets forth the tax provisions for determining if an investment in the US constitutes an investment in "US real property." If so, there are specific provisions that are meant to preserve the ability of the US to tax any built-in gain or appreciation that may arise while the foreign multinational owns the real property and subsequently disposes of it. The gain-triggering rules encompass such obvious transactions as a sale but also can be triggered by what would otherwise be a tax-free restructuring of the FIRPTA property owner.

226 *Any reference to "inbound investment" refers to an investment into the US by a nonresident foreign person, including a multinational foreign corporation.*

The US federal income tax rules and regulations have a very complex subset, the Foreign Oil and Gas Extraction Income provisions (FOGEI), which deals with the credibility of foreign taxes paid in connection with foreign extraction activity of a foreign branch of a US company, or a partnership in which a US company is a partner, or a controlled foreign corporation (CFC) owned by a US company. These provisions would potentially be applicable to a foreign multinational to the extent it had a taxable US presence through which foreign extraction activity was conducted or controlled. Moreover, there are anti-deferral provisions, the US Subpart F provisions of the US federal income tax code and regulations, which prevent the deferral of income from US taxation on a current basis for income derived from the transportation, processing and sale of minerals and the products made therefrom. These rules are referred to as the foreign oil related income provisions of Section 907 (FORI). Similarly, there is a whole host of special federal income tax provisions (and state tax provisions), not discussed here, which are applicable to foreign multinationals investing in US oil and gas extraction activity.

Capital gains

Gains and losses resulting from the sale of capital assets are subject to US tax at the ordinary rate of 35%. Capital gains or losses are determined by deducting the adjusted cost basis of an asset from the proceeds (money received or receivable and the market value of any property received or receivable).

Assets held for one year or less and inventory or assets held for sale in the ordinary course of business are treated as non-capital assets and generate ordinary income or loss upon their sale.

Non-inventory assets that are used in the taxpayer's trade or business for more than one year are considered trade or business assets. The disposition of trade or business assets generates ordinary losses or Section 1231 gains that may (subject to certain limitations) be treated as capital gains. However, the US tax authorities require that certain previously claimed ordinary deductions be recaptured as ordinary income at the time of sale if the property is sold for a gain. For example, if tangible assets are sold at a gain, the depreciation deducted must be recaptured up to the amount of the gain. Upon the sale of a leasehold interest, the taxpayer is required to recapture all IDC and depletion taken that reduced the tax basis, up to the amount of the gain realized on the property, if the property was placed in service after 31 December 1986. There are different recapture rules for property that was placed in service prior to 1 January 1987.

Although the tax rate is the same for ordinary income and capital transactions, capital losses are only deductible against capital gains and not against ordinary income. Net capital losses can be carried back three years and carried forward five years. Trade or business losses incurred in the ordinary course of business are deductible against taxable income.

Oil and gas leases held for more than one year generally result in trade or business gains and losses upon sale, subject to recapture as discussed above. Gains or losses on the disposition of property must be calculated for each tax property (i.e., property by property, not in total). Recapture is also calculated on a property-by-property basis.

Capital gains or losses derived by a US resident company on the disposal of shares in a foreign company are generally treated as US-sourced capital gain or loss. However, if the stock in the foreign corporation constitutes stock in a CFC when sold, or at any time during the five years prior to the date of sale, certain rules can apply to, in effect, re-source the income as foreign source dividend income, to the extent of the selling shareholder's share of the accumulated earnings and profits of the foreign corporation. In addition, the selling shareholder may be entitled to a foreign tax credit on such earnings.

US companies with foreign branch active businesses (including oil and gas producing assets, in most cases) have capital gains or losses on disposal of foreign branch assets, which could be foreign-sourced or US-sourced depending on the facts. Moreover, even if the sale of a foreign branch asset, such as equipment, is sourced as foreign under the sourcing provisions, additional rules could apply that recapture, as US-sourced income, a portion of the gain equal to the amount of depreciation taken in the US in prior tax years related to the foreign branch asset.

Functional currency

Under the US income tax law, taxpayers are required to calculate their taxable income using the US dollar.

Transfer pricing

US tax law includes measures to ensure that the US taxable income base associated with cross-border transactions is based on arm's-length prices. Several methods for determining the arm's-length price are available, and there are strict documentation requirements to support the method chosen and the prices reached. This is particularly relevant to the sale of commodities, intercompany services, intercompany funding arrangements, bareboat and time charter leases.

Dividends

Dividends paid by US resident companies are taxable unless the recipient is eligible for a dividend-received deduction or treaty provisions apply to reduce the tax rate.

For US resident corporate shareholders, all dividends received are included in the gross income. The company is entitled to a dividend-received deduction for dividends received from a US domestic corporation of 100% if it owns between 80% to 100% of the payor, 80% if it owns between 20% to 79.9%, and 20% if it owns less than 20% of the payor.

For corporate nonresident shareholders, dividends paid or credited to nonresident shareholders are subject to a 30% WHT (unless the rate is reduced by an applicable income tax treaty). The WHT is deducted by the payor on the gross amount of the dividend.

Royalty payments

Petroleum royalties are paid to mineral owners, which can be the state or federal Government, individuals, Indian reservations, corporations, partnerships or any other entity for onshore leases. Royalty payments are excluded from gross income of the working interest owner.

For onshore projects, wellhead royalties are paid to the mineral owner. Wellhead royalties are generally levied at a rate of 12.5% to 30% (based on the lease or contract) of the gross wellhead value for all of the petroleum produced.

Gross wellhead value is generally the posted spot price for the production location or the actual revenue received, less any costs. The types of costs are processing, storing and transporting the petroleum to the point of sale.

For offshore projects, wellhead royalties are paid to federal Government (OEMM) (shared with the appropriate state if the well is located in state waters) based on the royalty percentage at the time of the auction. As discussed above, this royalty is paid on the gross wellhead value of the production.

C. Capital allowances

The oil and gas industry is capital-intensive. For US tax purposes, costs associated with the acquisition of a lease (project), costs to develop a lease and production-related costs (opex) have various treatments. Production-related costs are generally deductible in the year paid or accrued for tax purposes. Acquisition and development costs are generally capitalized expenditures for both book and tax purposes. It should be noted that there are exceptions that allow for deducting some of these capitalizable expenditures, based on specific statutory authority.

It should also be noted that the rules that apply to foreign (a non-US location) leases are different from those for US domestic leases. US domestic leases include leases up to the 200-mile limit in the Gulf of Mexico. Generally, owners of foreign leases are required to capitalize costs and depreciate or amortize such costs over longer time frames. Leasehold costs may only be recovered based on cost depletion (i.e., percentage depletion is not allowed on foreign leases).

Additionally, tax recovery rules vary significantly based on the designation of the company as an "integrated oil company," an "independent producer" or a "major integrated oil company."

An integrated producer is defined as a company that has exploration and production activity and either:

- Gross receipts in excess of US$5 million in retail sales of oil and gas for the taxable year
- Refinery runs that average in excess of 75,000 barrels of throughput per day

An independent producer or royalty owner is defined as any taxpayer that is not an integrated producer.

In 2006, Congress created a subset of integrated producers called "major integrated oil companies," which is defined as producers of crude oil that have an average daily worldwide production of at least 500,000 barrels, gross receipts in excess of US$1 billion for the last taxable year ended during the 2005 calendar year and at least a 15% ownership in a crude oil refinery. Currently, the rule regarding the amortization of geological and geophysical (G&G) costs is the only provision of the US federal tax law that utilizes the definition of a major integrated oil company.

Leasehold costs

Leasehold acquisition costs include costs to acquire the lease (e.g., lease bonus payments, auction bid payments, G&G costs incurred in years beginning before 9 August 2005, attorney fees and title transfer fees). These types of costs are capitalized to the property acquired and are recovered through depletion. Cost depletion attempts to match the deduction for the tax basis in the property with the rate at which the production occurs over the life of the reserves. Thus, the cost depletion rate is calculated as current-year volumes sold, divided by the total volume of reserves in the ground at the beginning of the taxable year. This ratio is then multiplied by the remaining adjusted basis of the mineral property at the end of the year. Cost depletion is allowed for all types of taxpayers and for domestic and foreign mineral properties.

Independent producers and royalty owners who own US domestic property are allowed percentage depletion based on the statutory rates and limitations. For oil and gas production, the statutory rate is 15% of gross income, limited to 100% of the net income of the property, determined on a property-by-property basis. Percentage depletion is further limited to 1,000 barrels of production a day. Percentage depletion is prorated to the eligible property based on the ratio of 1,000 barrels to the total average daily production volume. The limited percentage depletion is compared with the cost depletion on a property-by-property basis. The taxpayer is allowed a deduction equal to the higher of the cost or percentage depletion on a property-by-property basis. Lastly, the taxpayer is subject to an overall taxable income limitation such that percentage depletion cannot exceed 65% of the taxpayer's taxable income (with certain adjustments). Any depletion limited by the 65% limitation can be carried forward to future years without expiration. The actual depletion deducted in the current-year return is the amount that reduces the leasehold basis for the year.

G&G costs

Costs expended for G&G have different tax treatment depending on the taxpayer's classification, the date on which the costs were incurred and whether the lease is domestic or foreign.

For all taxpayers with tax years beginning before 9 August 2005, domestic and foreign G&G were treated as part of the leasehold costs and were depleted. G&G incurred relating to foreign leases is still subject to these provisions.

For taxpayers that are not defined as major integrated oil companies, G&G incurred in taxable years beginning after 9 August 2005 is capitalized as an asset, separate from the leasehold cost, and amortized over 24 months using the half-year convention.

For taxpayers defined as major integrated oil companies, all of the above rules relating to domestic and foreign G&G costs apply to costs incurred before 18 May 2006. Additionally, for US leases, the amortization period has been extended to five years for G&G costs incurred after 17 May 2006 but before 20 December 2007. For G&G costs incurred after 19 December 2007, the amortization period has been further extended to seven years.

Development costs

Development expenditures include IDC and tangible property expenditures. IDC is a capitalizable cost, but the current US tax law allows taxpayers to make an election to deduct domestic IDC in the first year it is incurred. This is a taxpayer-level election, and, once it is made, it is binding for all future years. If this election is not properly made, the IDC is capitalized to the leasehold or tangible property basis and recovered through depletion or depreciation, as appropriate.

In almost all cases, a company will want to make the initial election to deduct domestic IDC because the present value benefit of the tax deduction is generally significant. If the taxpayer is an independent producer that has made the initial election to deduct IDC, the amount of the IDC deduction is equal to 100% of the IDC incurred in the current year. If the taxpayer is an integrated producer that has made the initial election to deduct IDC, the amount of the IDC deduction is equal to 70% of the IDC incurred in the current year, with the remaining 30% capitalized and amortized over 60 months.

If the taxpayer made a proper initial election to expense the IDC, the taxpayer may make a year-by-year election to capitalize some or all of its otherwise deductible IDC. If the IDC is capitalized under this yearly election, it is amortized over 60 months. Some taxpayers may want to consider this yearly election to capitalize some or all of the IDC as part of their tax planning. Two examples of when the yearly election might be beneficial are when a taxpayer is paying AMT or if a taxpayer has a large net operating loss carryforward.

IDC on property located outside of the US is capitalized and, based on taxpayer entity election, is either amortized over 10 years or depleted as part of the leasehold cost basis.

Tangible property is a depreciable asset. As such, it is depreciated using either the unit of production (UoP) method or the modified accelerated cost recovery system (MACRS). The UoP method uses a similar ratio used to calculate cost depletion multiplied by the adjusted basis of the tangible equipment; thus, depreciation is calculated over the entire productive life of the property. The MACRS is based on the class life as determined by the Internal Revenue Service (IRS) on a declining-balance method. For tangible equipment used in the US, the MACRS method is the percentage of the declining balance shown in the table on the next page, which is based on the recovery period of the asset. During late 2010, Congress extended and modified the depreciation provisions to provide for the temporary 100% expensing of certain qualifying property, effectively allowing immediate expensing. Qualified property must have been acquired by the taxpayer after 8 September 2010 and before 1 January 2012, and placed in service by the taxpayer before 1 January 2012 (1 January 2013, in the case of certain property having longer production periods, and certain aircraft). Qualified property acquired between 1 January 2012 and 31 December 2012 may be eligible for 50% expensing.

Foreign assets may use the UoP method or the MACRS method, but they are required to use the straight-line (100%) declining balance over the longer alternative recovery period for MACRS. Over the years, the IRS has published revenue procedures[227] that list the recovery periods of various types of tangible property. The following table gives examples of the typical oil and gas tangible equipment MACRS recovery periods for domestic assets. [228]

Item	Kind of depreciating asset	Industry in which the asset is used	Period
1	Oil and gas transportation asset, (including trunk line, pipeline and integrated producer-related storage facilities)	Gas supply or transportation	15 years 150%
2	Petroleum and petroleum products distribution asset used for wholesale or retail sales	Marketing petroleum products	5 years 200%
3	Oil production asset (including gathering lines, related storage facilities and platforms, excluding electricity generation assets)	Oil and gas extraction	7 years 200%
4	Gas production asset (including gathering lines, related storage facilities and platforms, excluding electricity generation assets)	Oil and gas extraction	7 years 200%
5	Onshore and offshore platform	Oil and gas extraction	7 years 200%
6	Asset (other than an electricity generation asset) used to separate condensate, crude oil, domestic gas, liquid natural gas or liquid petroleum gas for product pipeline quality (i.e., gas processing compression or separation equipment, but not if the manufacture occurs in an oil refinery)	Gas processing (production)	7 years 200%

227 *Rev. Proc 87-56;1987-2.C.B.674.*

228 *TAM 200311003.*

Item	Kind of depreciating asset	Industry in which the asset is used	Period
7	Petroleum refining (including assets used in distillation, fractionation and catalytic cracking of crude into gasoline and its other products)	Petroleum refining	10 years 200%
8	Onshore drilling equipment	Oil and gas drilling	5 years 200%
9	Offshore drilling equipment: • For contract drillers • For oil and gas producers	Oil and gas drilling Oil and gas drilling	5 years 200% 7 years 200%
10	LNG plant (including assets used in liquefacation, storage and regasification, connections, tanks, related land improvements, pipeline interconnections and marine terminal facilities)	Gas liquefaction and regasification	15 years 150%

Capital allowances for income tax purposes are not subject to credits unless they qualify as R&D costs.

D. Incentives

Exploration

IDC expenditures incurred for property located in the US are immediately deductible for income tax purposes for independent producers, and 70% is deductible for integrated producers (see Section C).

Tax losses

Income tax losses can be carried forward for 20 years; however, the utilization of a carried-forward loss is subject to meeting detailed "continuity of ownership" requirements (broadly, continuity means no more than a 50% change in stock ownership within a three-year period). Tax losses may be carried back for two years.

Regional incentives

Various state and local governments may give incentives to continue production on properties that are marginally producing, such as waiving production or property taxes, or both.

Section 199 deduction (manufacturing deduction)

Section 199 was enacted in 2004 and became effective beginning in 2005. The manufacturing deduction is applicable to various industries, and the production of oil and gas is specifically listed as an extraction activity that qualifies for the deduction.

The manufacturing deduction was 3% at the time of enactment, increased to 6% for taxable years 2007 to 2009 and is fully phased in at 9% for taxable years beginning in 2010 for non-oil and gas industries. For the oil and gas industry, the rate was frozen at 6%. The manufacturing deduction is based on the appropriate percentage of qualified production activities income (QPAI), but it is limited to 50% of production wages, and it is further limited to taxable income.

QPAI is calculated as the domestic production gross receipts (DPGR) less the cost of goods sold and other expenses and losses or deductions allocable to such receipts.

Working interest revenue and related hedging income and losses are included in DPGR. An example of income that does not qualify as DPGR is non-operating interest revenue (e.g., royalty income and natural gas transportation income). Receipts related to selling self-constructed DPGR real property assets may qualify as DPGR.

Expenses included in the calculation of QPAI are all expenses incurred for producing oil and gas, IDC, depletion, and company interest expense and overhead allocable to the activity.

Research and development

As of the date of this printing, no federal R&D credit regime is in effect. For amounts incurred before 1 January 2012, US tax law provided for an R&D tax credit for qualified R&D expenditures. The R&D credit has had a long and varied history, and it allowed two calculation methods. The R&D credit regime in place for amounts incurred before 1 January 2012 allowed a company to choose the "old" method or an alternative simplified credit (ASC) method. The ASC method is much simpler than the old method. It eliminates the base period limitations, thereby allowing more taxpayers to qualify for the credit, and significantly simplifying the calculation. The ASC requires a company to calculate the average R&D expenditures for the three prior tax years. The R&D expenditures that qualify for credit are those in excess of 50% of the three prior years' average expenditures. For amounts incurred before 1 January 2012, the R&D credit under the ASC method is 14% if the taxpayer elects to reduce asset bases and deductions for expenditures, or 9.1% if the taxpayer elects not to reduce asset bases and deductions of qualified expenditures.

Note that, as of the date of this printing, the 2011 R&D tax credit regime is not in effect for 2012; however, the 2011 R&D tax credit regime may be subject to extension during the 2012 US Congressional sessions.

Additionally, certain states have adopted R&D credit regimes to create incentives for companies.

E. Withholding taxes

Interest, dividends and royalties

Interest, dividends, patent and know-how royalties paid to nonresidents are subject to a final US withholding tax (WHT) of 30%, unless modified by a treaty.

Branch remittance tax

The US imposes a branch profits tax of 30%, unless modified by a treaty.

Foreign-resident WHT

In general, if non-employee compensation is paid to a nonresident, the company must withhold tax on the payment and remit the withholding to the IRS. The withholding rate is 30%, unless it is reduced by a treaty.

F. Financing considerations

Thin capitalization

The US income tax system contains significant rules regarding the classification of debt and equity. These rules can have a significant impact on decisions made in respect of the financing of oil and gas projects, including the following:

- Thin capitalization measures apply to recharacterize debt to equity for related-party debt if the debt-to-equity ratio is too high. No guidance is provided by the IRS, but a debt-to-equity ratio of 3:1 is generally acceptable. Interest expense on any recharacterized debt is prohibited.
- Additionally, interest expense may be prohibited if it is paid on loans made or guaranteed by related foreign parties not subject to US tax on the interest, under Section 163(j).

- These thin capitalization measures apply to the total debt of US operations of multinational groups (including foreign and domestic related-party debt and third-party debt). The measures apply to all US entities and foreign entities with effectively connected income.

Section 163(j) provides for a safe harbor debt-to-equity ratio of 1.5:1. Interest deductions may be limited for interest payments on the portion of the company's debt that exceeds the safe harbor ratio. The limitation is complicated, but it generally defers the company's interest expense. Interest expense in excess of interest income is limited to 50% of the adjusted taxable income. Adjusted taxable income is taxable income with interest expense, depreciation, depletion and amortization deductions added back. Any amount limited in the current year carries over to the following tax year and is once again subjected to the 50% adjusted taxable limitation.

If the company's debt-to-equity ratio does not exceed the safe harbor ratio, interest is fully deductible, provided the company can satisfy this test. Under the arm's-length test, the company must establish that the level of debt could be obtained under arm's-length arrangements, taking into account industry practice.

The debt or equity classification of financial instruments for tax purposes is subject to prescribed tests under law. These measures focus on economic substance rather than on legal form.

The debt or equity measures are relevant to the taxation of dividends (including imputation requirements), the characterization of payments from nonresident entities, the thin capitalization regime, and the dividend and interest WHT and related measures.

The US does not impose interest quarantining. Corporate-level debt deductions may be used to offset all income derived by the borrowing entity regardless of the source or the type of income.

G. Transactions

Asset disposals

The disposal of an oil and gas property generally results in a taxable event, unless the disposal qualifies as a statutory non-taxable event (e.g., like-kind exchange and involuntary conversions). Depletion, depreciation, IDC deductions and IDC amortization are subject to recapture if the proceeds received upon disposal exceed the asset's adjusted basis at time of disposition. Any amounts recaptured are included in taxable ordinary income. If the proceeds are less than the adjusted basis of the asset, a tax loss may be allowed against ordinary income (see Section B).

Like-kind exchanges and involuntary conversions

The US tax statute generally allows taxpayers that exchange certain like-kind property to defer the gain. The taxpayer may have to recognize some or all of the gain immediately if the recapture rules apply. The gain that is deferred is not to be taxed until the newly acquired property is sold. Specific rules must be followed to take advantage of the gain deferral treatment for both like-kind exchanges and involuntary conversions.

Additionally, if assets are lost or damaged through an involuntary conversion (e.g., hurricane, flood or fire), taxpayers may replace the property with like-kind property and, similarly, may qualify to defer the gain.

The oil and gas industry often uses these statutory provisions to exchange or replace property and defer potential gain. Gain deferral can be achieved in a variety of circumstances. For example, oil and gas mineral properties are considered to be real property for these purposes, and they can be exchanged for other mineral properties whether developed or undeveloped. Because mineral interests are considered to be real property, royalty mineral interests can be exchanged for working interests. They can also be exchanged for other non-mineral real property (e.g., ranch land). Note that IDC recapture rules may apply to these transactions.

Tangible lease and well equipment is like-kind to other tangible lease and well equipment. The rules related to tangible property are much more restrictive in qualifying as like-kind.

Since mineral properties generally consist of both real property (reserves in the ground) and tangible property, care must be taken in dividing the exchange transaction into separate transactions and in ensuring that like-kind property is received in each exchange. Tangible equipment is not like-kind to the mineral interest. Any property received in the exchange that is not like-kind, including cash, may cause part (or all) of the gain to be recognized on a current basis.

The property received in a like-kind exchange or involuntary conversion uses the carryover basis from the property exchanged. The basis must be adjusted if non-like-kind property is received or any gain is recognized on the transaction.

Abandonment

If an oil and gas property is abandoned or considered worthless for tax purposes, then the adjusted basis remaining in the property may be deducted in the current tax year as a trade or business loss and may be offset against ordinary income.

Sharing arrangements — joint development of oil and gas property

It is common in the US oil and gas industry for entities to enter into sharing arrangements under which one party pays part or all of the development costs of the other party to earn an interest in the mineral property. Two of the most common sharing arrangements are farm-ins and carried interests. If structured properly, these arrangements can be entered into with little or no current income tax implications under the "pool of capital" doctrine. The arrangements must be structured so that the investment made by both parties relates to the same oil and gas property or properties. For example, assume Taxpayer X, owner of the mineral interest, structures an arrangement whereby Company A agrees to drill and pay all the costs for the first well on a tract. If Company A receives an interest in the same property as its only consideration, the arrangement should be accorded non-taxable treatment for both parties. If either party receives cash or non-cash consideration for entering into the arrangement, the "other" consideration is likely to be immediately taxable. For example, it is common for the mineral interest owner to receive cash at the time of entering into the sharing arrangement. While the sharing arrangement should be afforded non-taxable treatment, the mineral interest owner generally has a taxable event with respect to the cash received.

It is common for one party to pay a disproportionately larger share of the drilling and completion costs to earn an interest in the mineral property. These disproportionate costs, representing amounts in excess of the parties' percentage interest, may not be fully deductible currently. As a result of these limitations on deductions, it is common to structure these arrangements to be treated as partnerships under US tax law. The partnership structure currently allows the taxpayers to obtain some or all of the deductions that otherwise may be limited. The tax partnership rules are very complicated, and care should be taken because the partnership structure may affect the economic outcome of the arrangement (see the discussion in Section I regarding forms of business presence).

Selling shares in a company (consequences for resident and nonresident shareholders)

Generally, a share disposal is subject to the capital gains tax (CGT) regime. Nonresidents that dispose of shares in a US company are not generally subject to US federal income tax because the domestic tax rules source the gain to the residence of the seller. However, the main exception to this rule is if the stock of a US company constitutes a "US real property interest," in which case the company is treated as a US real property holding company. If it is determined that the stock of a US company constitutes a US real property interest, any resulting built-in stock gain is subject to tax.

H. Indirect taxes

VAT and GST

The US does not have a VAT or GST tax regime.

Sales and use taxes

Most states and localities (e.g., cities, counties, parishes and transportation districts) impose a sales tax on sales, except on sales for resale. These taxes generally include both tangible personal property and enumerated services. The taxable base generally includes the total amount for which the tangible personal property is sold, including any services rendered by the seller in connection with the sale. Services purchased separately are not generally taxable, unless they are specifically enumerated as taxable.

In addition, most states and localities impose a "use" tax. Use tax is a tax imposed on the storage, use or other consumption of a taxable item purchased, for which sales tax has not already been charged by the seller. Sales and use tax rates typically range from 3% to 9% of the fair value of the taxable item sold.

If a company establishes "nexus" (a presence sufficient that the state has jurisdiction to impose a tax on the company) in a state, it will generally need to obtain a sales tax permit, collect the proper taxes from customers on behalf of the state and file sales tax returns. Although each state has slightly different nexus requirements, a company generally is subject to tax collection requirements if it leases, rents or sells tangible personal property in the state, furnishes services in the state that are taxable under the statute, holds property in the state for resale, maintains a business location in the state, operates in the state through full-time or part-time resident or nonresident salespeople or agents, or maintains an inventory in the state of tangible personal property for lease, rental or delivery in a vehicle owned or operated by the seller.

Property tax

Many states, counties and cities impose ad valorem tax on real or tangible personal property located in the jurisdiction on a specified date each year. Real property and personal property are valued by assessors at fair market value, and tax is assessed as a percentage of the fair market value. Generally, property is assessed according to its status and condition on 1 January each year. The fair market value of real and personal property must be determined by the following generally recognized appraisal methods: the market approach, the cost approach or the income approach.

Severance tax

Many states impose a tax on the extraction of natural resources, such as oil, coal or gas. Returns generally must be filed by each operator or taxpayer that takes production in kind. The operator must withhold tax from royalty and non-operator payments.

Petroleum products tax

Many states impose a tax on petroleum products delivered within the state. Generally, any company that makes a sale of petroleum products to a purchaser in a state that is not a licensed distributor, or does not hold a direct payment certificate, pays a tax based on the gross earnings derived from the sale of the petroleum products.

Other taxes

In addition to the above taxes, many states impose other state-specific taxes. For example, some states impose an inspection fee on petroleum products distributed, sold, offered or exposed for sale or use, or used or consumed in a state. The inspection fee can be imposed on fuels removed from a terminal using a terminal rack and must be collected by the owner of the inventory, or the position holder, from the person who orders the withdrawal.

Some states impose a tax based on the gross receipts of companies that transport natural gas by pipeline for hire, sale or use, in addition to all other taxes and licenses levied and assessed. Some states impose fees on underground storage tanks under the hazardous waste control law.

Import duties

All goods, equipment and materials that enter the US from overseas are subject to customs import duties. The U.S. Customs and Border Protection (the CBP) regulates imports into the US. The CBP directly processes the clearance of imported goods and enforces the customs regulations of the US. The CBP also enforces the laws of other governmental agencies that may require special documentation at the time of import or may impose additional obligations upon importers (such as excise tax or other collections).

The customs duty applied to the customs value of imported goods may vary depending on several factors, including the type of commodity, its end use, the constituent material and the country of origin. Duty rates may be ad valorem (at a percentage) or a specific amount (rate per unit or quantity), or a combination of both. For example, LNG is generally "free" of duty, greases are dutiable at 5.8% of the import value, while some petroleum products, such as motor fuel and motor fuel blending stock, attract a duty rate of US$0.525 per barrel effective to 1 January 2013. Ethanol that is denatured is subject to an ad valorem duty of 1.9%, may be subject to an added duty if imported for fuel use and may be subject to a specific excise tax.

Upon importation into the US and within 15 calendar days after arrival in US territory, the importer or their representative (customs broker) must file an "entry" (CF-3461) for the release of the merchandise. Ten working days after the release of the merchandise, the importer is responsible for filing the "entry summary" (CF-7501) with accurate information, together with the appropriate duties, taxes and fees.

It is important to note that, under Section 484 of the Tariff Act, as amended (19 U.S.C. 1484), the importer of record (IOR) is responsible for using "reasonable care" to enter, classify and value imported merchandise. The importer must also provide any other information necessary to enable CBP to assess duties properly, collect accurate statistics and determine whether any other applicable legal requirement is met. Even when the importer of record uses a customs broker to make the entries, the importer remains liable for the customs broker's acts made on its behalf, including any broker errors.

Export duties

There are no duties applied to goods exported from the US.

Excise tax

The US federal excise tax is applied to some goods manufactured in the US, including petroleum products, alcohol, tobacco and some luxury products. Excise taxes are imposed on all the following fuels: gasoline (including aviation fuel and gasoline blend stocks), diesel fuel (including dyed diesel fuel), diesel-water fuel emulsion, kerosene (including dyed kerosene and kerosene used in aviation), other fuels (including alternative fuels), compressed natural gas (CNG) and fuels used in commercial transportation on inland waterways. It is important to note that some excise taxes other than fuel taxes affect the oil and gas industry, most notably environmental taxes, such as the oil spill liability tax.

The excise tax varies depending on the product. For example, the 2011 excise tax on gasoline was US$0.183 per gallon, and on aviation gasoline it was US$0.193 per gallon, while on diesel fuel and kerosene it was US$0.243 per gallon. (Note that, as of this printing, the 2011 excise tax rates remain current for 2012; however, the rates may be subject to adjustment during the 2012 US Congressional sessions.)

Excise taxes may also be imposed at the state level and vary by product and state. For current information pertaining to state-level excise taxes, please consult with any of the oil and gas contacts listed for the US.

The rate of the oil spill liability tax is presently US$0.08 per barrel; this rate is scheduled to be in effect to 31 December 2016 and then increase to US$0.09 to 31 December 2017. As this rate may be modified by Congress after this publication, readers are advised to consult with any of the oil and gas contacts listed for current rates. This tax generally applies to crude oil received at a US refinery and to petroleum products entering into the US for consumption, use or warehousing. The tax also applies to certain uses and the exportation of domestic crude oil. The time when the tax is imposed, as well as the entity that is liable for it, depends on the specific operations of importing or exporting.

Stamp duty

The US does not have a stamp duty regime.

Registration fees

The US does not impose registration fees at the federal level. Some states impose a transfer tax on the transfer of title of tangible or real property.

I. Preference programs

Foreign trade zones

Foreign trade zones are established to encourage and expedite US participation in international trade; to foster dealings in foreign goods imported not only for domestic consumption, but also for export after combination with domestic goods; and to defer payment of duties until goods are entered into the commerce of the US.

There are two kinds of foreign trade zones:

- General purpose zones (often an industrial park or port complex whose facilities are available for use by the general public)
- Subzones (normally, single-purpose sites when operations cannot feasibly be moved to, or accommodated by, a general purpose zone)

The main financial benefits of foreign trade zones include duty deferral, duty elimination on exports, duty reduction (inverted tariff relief) and local ad valorem tax exemption. Other benefits include lower administrative costs, lower security and insurance costs, no time constraints on storage, shorter transit time and improved inventory control. There are also community benefits such as retention of existing jobs, attraction of new employment, investment in the local community, local improvements to infrastructure, and increased local purchases of goods and services.

Duty drawback

A drawback is a refund, reduction or waiver, in whole or in part, of customs duties and certain other taxes collected upon the importation of an article or materials that are subsequently exported or used in the production of goods that are exported.

Several types of drawback are authorized under Section 1313, Title 19, of the US code: manufacturing, unused merchandise and rejected merchandise.

Specific guidelines apply for a drawback between the members of North American Free Trade Agreement (NAFTA) (NAFTA drawback claim). Under the NAFTA drawback regime, the rule known as "the lesser of the two" is sometimes applied. There are also specific collections that cannot be refunded, waived or reduced by a NAFTA country as a condition of export.

Other significant taxes

Other significant US taxes include payroll taxes paid by employers, including Social Security tax at the rate of 6.2% (the rate was reduced by 2% for two months and may be reduced for additional time by the 2012 Congress) up to the annual wage limitation (for 2012, the limit is US$110,100 per employee), and Medicare tax at the rate of 1.45% with no income limitation.

J. Other

Foreign Investment Review Board

The US Government does not allow foreign companies to purchase offshore leases directly. Additionally, the Department of Commerce requires foreign parties to report investment in the US on a quarterly and annual basis if certain criteria are met.

Forms of business presence

Forms of business presence in the US typically include companies, foreign branches, joint ventures (incorporated and unincorporated) and partnerships. In addition to commercial considerations, the tax consequences of each type of entity are important to consider when setting up a business in the US.

Unincorporated joint ventures are commonly used by companies for the exploration and development of oil and gas projects. Unincorporated joint ventures are treated as tax partnerships under US tax law, unless the joint venture owners elect to take production in kind and not be treated as a partnership. Partnership operations flow through the entity, meaning that the income and deductions are reported by the partners on their tax returns. Therefore, all US federal income tax is paid by the partners, not at the entity level. Additionally, there are very complex rules that must be followed that deal with partnership capital accounts.

There are various US reporting requirements for tax partnerships (e.g., a federal information tax return must be filed annually). In addition, if there are foreign partners, tax withholding and reporting may be required. Lastly, most states treat partnerships as flow-through entities and require information returns to be filed. But some states impose income tax at the partnership level or require the partnership to withhold, remit and file reports on partner distributions to out-of-state or foreign partners.

Pending legislation

As of the date of this printing, there are administrative proposals and anticipated legislation that may ultimately change oil and gas taxation significantly. Consideration should be given to these new or potential tax changes in US planning.

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A. At a glance

Fiscal regime

This article describes the fiscal regime in force as of 1 January 2012, which is applicable to almost all subsurface users in Uzbekistan except for those operating under production sharing agreements (PSAs) signed with the Government of Uzbekistan.

The generally applicable fiscal regime that applies in Uzbekistan to exploration and production (E&P) contracts in the oil and gas industry consists of a combination of corporate income tax (CIT), bonuses, subsurface use tax, excess profits tax (EPT), and other generally established taxes and contributions.

Bonuses

The subsurface users are subject to both a signature bonus and a commercial discovery bonus.

Subsurface use tax

Companies conducting extraction or processing of natural resources are obligated to assess and pay a subsurface use tax (similar to a royalty). The rates vary depending on the type of mineral extracted or processed.

Excess profits tax

Subsurface users extracting, producing and selling natural gas (export), cathode copper, polyethylene granules, cement and clinker are generally subject to EPT.

Corporate income tax

CIT is applied to all companies under general tax regime at a rate of 9%. Companies are also subject to infrastructure development tax at a rate of 8% on net statutory accounting profit after CIT.

Investment incentives

Foreign companies engaged in exploration and prospecting for oil and gas are provided with certain tax incentives.

B. Fiscal regime

The generally applicable fiscal regime that applies in Uzbekistan to E&P activities in the oil and gas industry (except for PSAs) consists of a combination of CIT, bonuses, subsurface use tax, EPT, and other generally established taxes and contributions.

The taxes applicable to subsurface users are as follows:

Applicable taxes	
Bonuses	Variable
Subsurface use tax	2.6% to 30%
EPT	50%
CIT	9%
Excise tax	Variable
VAT	20%
Infrastructure development tax	8%
Contributions on revenue	3.5% in total
Unified social payment	25%
Property tax	3.5%
Land tax	Generally immaterial
Water use tax	Generally immaterial
Other taxes and contributions	Variable

Bonuses

The subsurface users are generally subject to both a signature bonus and a commercial discovery bonus.

Signature bonus

The signature bonus is a one-off payment levied on subsurface users for the right to conduct prospecting and exploration of mineral resources.

Depending on the type of the mineral resource, the amount to be paid to the budget varies from 100 to 10,000 times the minimum monthly wage (MMW), while for hydrocarbons it is 10,000 MMW. One MMW is set at UZS62,920 (approximately US$35), as of 1 January 2012.

Commercial discovery bonus

The commercial discovery bonus is a fixed payment paid by subsurface users when a commercial discovery is made on the contract territory.

The base for calculation of the commercial discovery bonus is defined as the world market value of the extractable minerals duly approved by the competent state authorities. The rate of the commercial discovery bonus is fixed at 0.1% of the value of approved extractable resources.

Subsurface use tax

The taxpayers of subsurface use tax are defined as legal entities conducting extraction or processing of minerals. The taxable base is the average actual sales value of extracted (processed) minerals. The rates differ depending on the type of minerals extracted or processed (30% for natural gas, 20% for crude oil and gas condensate.

Excess profits tax

Subsurface users extracting, producing and selling natural gas (export), cathode copper, polyethylene granules, cement and clinker are generally subject to EPT. In general, the taxable base is the difference between the selling price and the cut-off price set by legislation, as well as certain taxes. Currently, the established tax rate is 50% for all the above products. EPT for natural gas is calculated as follows:

Product	Taxable base (cut-off price)	Tax rate
Natural gas	Selling price above US$160 per 1,000 cubic meters	50%

Taxpayers are also obliged to transfer excess profit remaining after taxation to a special investment account at the time when the EPT payment is due. These special-purpose funds are disbursed only with the approval of the Ministry of Economics and the Ministry of Finance of the Republic of Uzbekistan for financing investment projects and for modernization and technical upgrading of main production, among other things. In other words, these funds are set aside from normal operations for specific purposes that are controlled by the Government.

Subsurface users operating under PSAs are not subject to EPT.

Corporate income tax

General

CIT is applied to all companies at the rate of 9% in respect of taxable income. Taxable income is calculated as the difference between aggregate annual income (after certain adjustments) and statutory deductions. The following items are generally not deductible for tax purposes:

- Non-business expenses
- Entertainment, business travel and certain voluntary insurance expenses in excess of established statutory limits
- Interest on overdue and deferred loans (in excess of normal loan interest rate)
- Losses resulting from misappropriations of funds or assets
- Audit expenses, if an annual audit was conducted more than once for the same period
- Charitable donations
- Litigation expenses
- Penalties and other

Special deductions

Taxable profits may be reduced by certain special deductions, including the following:

- Amounts reinvested in main production in the form of purchase of new technological equipment, new construction, and reconstruction of buildings and facilities used for production needs (less current depreciation), up to 30% of taxable profits, over a five-year period
- Charitable donations of up to 2% of taxable profits

Tax depreciation

The following are the applicable depreciation rates in Uzbekistan:

Assets	Rate (%)
Buildings and structures	5
Trains, ships, airplanes, pipelines, communication equipment, and electric power lines and equipment	8
Furniture and production machinery and equipment	15
Cars, computers and office equipment	20
All other assets	15

Intangible assets are amortized for tax purposes over the useful life of an asset, the life of the company, or five years (if useful life cannot be determined), whichever is less.

Relief for losses

Tax losses can be carried forward for five years. However, the amount of losses carried forward that may be deducted each year is subject to a limit of 50% of taxable profits for the year. Losses incurred during a profits tax exemption period (period during which a company might have been on a profits tax holiday (e.g., exemption for certain period of time) based on a special incentive) cannot be carried forward.

Groups of companies

The tax law does not allow offsetting profits and losses among members of a tax group.

Capital gains

Capital gains are generally included in taxable profits and are subject to tax at the regular CIT rate. Capital gains received by a nonresident from sale of shares or participation interest in an Uzbek resident legal entity are subject to withholding tax (WHT) at a rate of 20%. This rate may be reduced or completely eliminated by virtue of a double tax treaty between Uzbekistan and the country of residence of the income recipient.

C. Investment incentives

In accordance with the Presidential Decree dated 28 April 2000 (as amended), "On measures of attraction of direct foreign investments into prospecting and exploration of oil and gas," foreign companies engaged in exploration and prospecting for oil and gas are supported by certain tax incentives, including, in part, the following:

- Exemption from all taxes and mandatory contributions for the period of exploration and prospecting
- Exemption from customs payments (including import customs duties, import excise tax and import VAT, but excluding customs processing fee) on imported equipment and technical resources necessary for conducting prospecting and exploration

In accordance with the Presidential Decree, joint ventures involved in the production of oil and gas, established with the participation of foreign companies that were engaged in exploration and prospecting for oil and gas, are exempt from CIT for seven years from the commencement of oil and gas production.

By a special resolution of the Government (or investment agreement), a company with foreign investments may potentially be granted additional tax exemptions and other benefits, depending upon the importance of the company's project to the Government, the volume of the investment to be made and other factors.

D. Withholding taxes

In the absence of a permanent establishment (PE) in Uzbekistan of a nonresident company, Uzbek WHT applies to a nonresident's income derived from Uzbekistan sources. The general WHT rate is 20% (dividends, interest, insurance premiums – 10%; international communications and freight – 6%). Double tax treaties may also provide for either exemption from Uzbek WHT or application of reduced WHT rates.

Dividends and interest paid by Uzbek companies domestically (except for interest paid to Uzbek banks) are subject to 10% domestic WHT.

E. Financing considerations

There are no thin capitalization rules in Uzbekistan.

F. Indirect taxes

Import duties

The import of goods and equipment is generally subject to import customs duties at various rates (if any) based on the established list (according to customs classification codes). There are certain exemptions provided by the legislation.

Excise tax

Companies producing or importing excisable goods in the territory of Uzbekistan are subject to excise tax. The list of excisable products with the respective tax rates is established by legislation. Natural gas- and liquefied gas-producing companies must assess the tax on sale or disposal of the products at the rates of 25% and 26%, respectively, including export sales (but excluding sales to the population). Fuel products are indexed to certain rates depending on the type of products sold or disposed and may not be less than certain minimum tax amount established for each fuel product. Import of crude oil and oil products is subject to 20% excise tax (distillates – 30%).

VAT

VAT is imposed on the supply of all goods and services including imports, unless they are zero-rated or exempt. Hence, crude oil, natural gas and gas condensate sold in the territory of Uzbekistan are subject to 20% VAT. Export sales of certain goods including sales of crude oil, natural gas and gas condensate are subject to zero-rated VAT, which means that the entities may generally offset respective input VAT against other taxes and contributions or recover it back (based on certain administrative procedures and certain limitations). Imports of goods and equipment are generally subject to 20% import VAT.

Place of supply rule

The applicability of Uzbek (reverse-charge) VAT on "imported" works and services purchased from nonresidents is determined based on the deemed place of supply of a given supply. It is important to note that, under the place of supply rules, a service may be physically performed outside of Uzbekistan but deemed to be supplied in Uzbekistan for VAT purposes. Examples of services taxed in this way include a supply of a service related to immovable property located in Uzbekistan or a consulting service performed outside of Uzbekistan for a customer inside Uzbekistan. If the place of supply is deemed to be outside of Uzbekistan, the underlying supply is not subject to Uzbek VAT. The rules determining the place of supply for works and services are generally as follows:

- The place where immovable property is located for works and services directly related to such property
- The place where works and services are actually carried out for works and services related to movable property
- The place of business or any other activity of the customer for the following works and services: transfer of rights to use intellectual property, consulting services, audit services, engineering services, design services, marketing services, legal services, accounting services, attorney's services, advertising services, data provision and processing services, rent of movable property (except for rent of motor vehicles), supply of personnel, communication services
- Otherwise, the place of business or any other activity of the service provider

Stamp duties

No stamp duty currently applies in Uzbekistan.

Registration fees

Insignificant fixed fees apply.

G. Other

Infrastructure development tax

Infrastructure development tax at a rate of 8% is imposed on net statutory accounting profit less assessed CIT.

Contributions on revenue funds for pensions, roads and reconstruction of educational facilities

Contributions to funds for pensions, roads and reconstruction of educational facilities are separate contributions assessed on sales revenue (net of VAT and excise tax) at the base rates of 1.6% for pensions, 1.4% for roads and 0.5% for reconstruction of educational facilities, i.e., 3.5% in total.

Property tax

Property tax is generally imposed at a rate of 3.5% on the average annual net book value of fixed and intangible assets.

Unified social payment

The unified social payment (social tax) is paid by employers at a rate of 25% on the total payroll cost (except for certain exempt items).

Social contributions of individuals

The employer is obliged to withhold and remit a mandatory pension fund contribution from local employees at a rate of 5.5% from salaries and other taxable benefits. Employers also make mandatory monthly contributions to individual accumulative pension accounts of local employees at a rate of 1% of salaries and other taxable benefits of employees, and the amounts of such contributions are subtracted from accrued individual income tax.

Individual income tax

The employer is obliged to withhold and remit individual income tax to the budget at progressive tax rates (up to 22%).

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A. At a glance

The fiscal regime that applies to the petroleum industry in Venezuela consists of a combination of corporate income tax (CIT), royalty tax, indirect taxes and special contributions.

CIT rate	50% of net profits
Royalties	Up to a maximum of 33.33% on the value of the crude oil extracted
Tax on capital gains	50%
Alternative minimum tax (AMT)	50% of gross profits

B. Fiscal regime

Oil activities in Venezuela

According to the Organic Hydrocarbons Law, upstream activities are reserved for the Venezuelan state, which must perform the activities directly or through state-owned enterprises.

Upstream activities can be performed through joint venture corporations (empresas mixtas) in which the state owns at least 50% of the shares (qualifying the entities as state-owned enterprises). The National Assembly must approve the incorporation of any mixed entities and the conditions for their operation. These joint venture corporations are owned by Petróleos de Venezuela, S.A. (PDVSA), the Venezuelan state-owned oil and gas holding company, with at least 50% of the shares.

Corporate income tax

A joint venture corporation that undertakes oil activities is subject to a 50% CIT rate on its annual net profits from Venezuelan and foreign sources of income.

Annual net profits are determined by subtracting the costs and deductions allowed by the income tax legislation from the gross receipts of the taxpayer. For Venezuelan-sourced income, these calculations are subject to the inflation adjustment rules.

Entities must determine their Venezuelan-sourced annual net profits separately from their foreign-sourced annual net profits. In the determination of the Venezuelan-sourced annual net profits, only costs and expenses incurred in Venezuela are allowed, provided the conditions established in the income tax law and regulations are met. Likewise, in the determination of foreign-sourced net annual profits, only costs and expenses incurred abroad may be deducted, provided relevant conditions are met.

Royalties

According to the latest amendment of the Organic Hydrocarbons Law (August 2006), the royalty to be paid to the state is equivalent to 30% of the extracted crude; however, it may be reduced to 20% if it is proven that the oil field is not economically exploitable. The amendment also creates the following additional taxes:

- An extraction tax equivalent to one-third of the value of the extracted liquid hydrocarbons
- An export registration tax of 0.1% of the value of the exported liquid hydrocarbons
- In addition, any company that develops activities related to hydrocarbons is subject to the following taxes

Superficial tax

Superficial tax applies to the superficial extension without being exploitive, the equivalent of 100 tax units (TU) (100 TU currently approximates US$2,093) for each square kilometer per year. This tax increases each year by 2% during the first five years and 5% for each year following the fifth year. Please note that the TU is annually updated.

Own consumption tax

The own consumption tax applies at a rate of 10% of the value of each cubic meter (m^3) from products derived from hydrocarbons produced and consumed as fuel from operations, based on the price sold to the final consumer.

General consumption tax

The general consumption tax is a tax paid by the final consumers, which is withheld monthly and paid to the National Treasury. The general consumption tax rate is set annually by law. For products derived from hydrocarbons sold in internal markets, the tax is between 30% and 50% of the price paid by the final consumers.

An additional royalty is included in the law on the terms and conditions for the incorporation and functioning of joint venture corporations equal to 3.33% of the crude oil extracted from the corresponding oil field. The royalty tax rate is established in the mandatory bylaws of each joint venture company and is calculated on the value of the extracted crude oil delivered to PDVSA.

Tax on capital gains

Internal income tax legislation provides that capital gains arising from the sale of stocks, quotas or participation by companies engaged in oil activities are subject to income tax at a 50% rate.

Tax on dividends

According to the Venezuelan income tax law, dividends distributed by a company for activities in the oil industry that exceed its previously taxed net income are subject to tax at a 50% rate. Net income from dividends is the income received as such, fully or partially paid, in money or in kind.

The net income is defined as the income approved at the shareholders' meeting, which is the basis for the distribution of dividends. Taxed fiscal net income is that income used for the calculation of the income tax liability.

The portion that corresponds to each share in the profits of stock companies and other assimilated taxpayers, including those resulting from participation quotas in limited liability companies, is considered to be a dividend.

AMT

The AMT is the difference (if any) between 50% of the gross sales and the sum of the following taxes paid in the respective fiscal year:

- Income tax (50% of the fiscal year's net profits)

- Royalty tax (up to a maximum of 33.3% of the amount of the crude oil extracted)
- Other taxes effectively paid based on income (municipal tax, among others)
- Special contributions allowed

If the taxes paid exceed the additional tax, there is no possibility for the taxpayer to credit the excess in future fiscal years.

Relief for tax losses

Operating losses may be carried forward for three years. No carryback is permitted.

Foreign-sourced losses may not offset Venezuelan-sourced income. Such foreign-sourced losses may be carried forward three years to offset only foreign-sourced income.

Losses attributable to tax indexation may be carried forward for one year.

Income tax withholdings

Payment		Tax rate %
Interest	Resident individuals	3[229]
Interest	Resident corporations	5[230]
Interest	Nonresident individuals	34[231]
Interest	Nonresident corporations	34[232]
Royalties[233]	Non-domiciled corporations	34[234]
Royalties[233]	Nonresident individuals	34[235]
Professional fees	Resident individuals	3[229]
Professional fees	Resident corporations	5[230]
Professional fees	Nonresident individuals and corporations	34[236]
Rent of immovable property	Resident individuals	3[229]
Rent of immovable property	Resident corporations	5[230]
Rent of immovable property	Nonresident individuals	34
Rent of immovable property	Nonresident corporations	34[237]
Rent of movable goods	Resident individuals	3[229]
Rent of movable goods	Corporations	5[230]
Rent of movable goods	Nonresident individuals	34
Rent of movable goods	Nonresident corporations	5
Technical assistance	Domiciled corporations	2[238]
Technical assistance	Resident individuals	1[235]
Technical assistance[239]	Nonresident individuals[237]	34[240]

Payment		Tax rate %
Technical assistance[239]	Non-domiciled corporations	34[241]
Technological services	Domiciled corporations	2[235]
Technological services	Resident individuals	1[235]
Technological services	Nonresident individuals[242]	34[243]
Technological services	Non-domiciled corporations	34[244]
Sales of shares[245]	Resident individuals	3[229]
Sales of shares[245]	Corporations	5[230]
Sales of shares[245]	Nonresident individuals	34
Sales of shares[245]	Nonresident corporations	5

Other significant taxes

The following table summarizes other significant taxes.

229 *WHT applies to payments of more than VEF7.500,01 (US$1.744,18). The tax is imposed on the payment minus VEF225(US$52,32).*

230 *WHT applies to payments of more than VEF25 (US$5.81).*

231 *WHT is imposed on 95% of the gross payment. Consequently, the effective WHT rate is 32.3% (95% x 34%).*

232 *In general, the WHT rate is determined at progressive rates up to a maximum of 34%. It is applied to 95% of the gross payment. Interest paid to foreign financial institutions that are not domiciled in Venezuela is subject to WHT at a flat rate of 4.95%.*

233 *Royalties paid to nonresidents are taxed on a deemed profit element, which is 90% of the gross receipts.*

234 *The WHT rate is determined at progressive rates up to a maximum of 34%. Because royalties paid to non-domiciled corporations are taxed on a deemed profit element, the maximum effective WHT rate is 30.6% (90% x 34%).*

235 *Because royalties paid to nonresidents are taxed on a deemed profit element, the effective WHT rate is 30.6% (90% x 34%).*

236 *Professional fees paid to nonresidents are taxed on a deemed profit element, which is 90% of the gross receipts. Consequently, the effective WHT rate is 30.6% (90% x 34%).*

237 *The WHT rate is determined by applying the progressive rates up to a maximum of 34%.*

238 *Technical assistance and technological services provided from local suppliers are treated as services.*

239 *Payments to nonresidents for technical assistance are taxed on a deemed profit element, which is 30% of the gross receipts.*

240 *Because payments to nonresidents for technical assistance are taxed on a deemed profit element, the effective WHT rate is 10.2% (30% x 34%).*

241 *The WHT rate is determined at progressive rates up to a maximum of 34%. Because payments to non-domiciled corporations for technical assistance are taxed on a deemed profit element, the maximum effective WHT rate is 10.2% (30% x 34%).*

242 *Payments to nonresidents for technological services are generally taxed on a deemed profit element, which is 50% of the gross receipts.*

243 *Because payments to nonresidents for technological services are taxed on a deemed profit element, the effective WHT rate is 17% (50% x 34%).*

244 *The WHT rate is determined by applying the progressive rates up to a maximum of 34%. Because payments to non-domiciled corporations for technological services are taxed on a deemed profit element, the maximum effective WHT rate is 17% (50% x 34%).*

245 *This tax applies to transfers of shares of corporations non-domiciled in Venezuela that are not traded on national stock exchanges. The WHT rates are applied to the sales price.*

Nature of tax	Rate paid
VAT imposed on goods and services, including imports; the national executive may exonerate acquisitions of goods and services from tax for up to five years; the law provides an indexation system for input VAT during the preoperational period for enterprises engaged in certain industrial activities; input VAT generated during the preoperational phase of industrial projects intended primarily for export is refunded	12%
Municipal tax; business activity tax, generally based on gross receipts or sales; the rate varies depending on the industrial or commercial activity	0.5% to 10%
Social security contributions on monthly salary of each employee, up to five minimum salaries	Employer: 9%, 10%, 11% Employee: 4%
National Institute of Cooperative Education; contributions required if employer has five or more employees	Employer, on total employee remuneration: 2% Employee, on profit share received, if any, from employer at year-end: 0.5%
Housing policy contributions on the monthly integral salary (under the Labor Law) of each employee	Employer: 2% Employee: 1%
Unemployment and training contributions on the monthly salary of each employee, up to 10 minimum salaries	Employer: 2% Employee: 0.5%
Science and technology contribution	0.5% to 1% of gross income
Anti-drug contribution	1% of operating income
Endogenous development contribution	1% of financial profits
Contribution to the National Fund for Development of Sports, Physical Activities and Physical Education	1% of net income or financial profits

Integral salary

Integral salary includes any remuneration, benefit or advantage perceived by the employee in consideration for the services rendered, whatever its name or method of calculation, as long as it can be evaluated in terms of cash value, to include, among others: commissions, bonuses, gratuities, profit sharing, overtime, vacation bonus, food or housing.

C. Financing considerations

Foreign exchange controls

Under the foreign exchange control system in Venezuela, the purchase and sale of currency in Venezuela is centralized by the Central Bank of Venezuela. This limits foreign currency trade in Venezuela and other transactions.

In May 2010, the Government modified the Law on Exchange Violations, broadening the definition of foreign currency to include securities denominated in foreign currency or susceptible to being paid in foreign currency.

Debt-to-equity rules

Venezuelan income tax legislation establishes a safe harbor method that denies the interest deduction for interest payments to related parties domiciled abroad if the average of the payor's debts (with related and unrelated parties) exceeds the amount of the average of its fiscal equity for the respective fiscal year.

D. Other tax issues

Transfer pricing

Under the transfer pricing rules, cross-border income and expense allocations concerning transactions with related parties are subject to analysis and special filings. The rules contain a list of related parties and acceptable transfer pricing methods.

Controlled foreign corporations

Under the CFC rules, income derived by a controlled foreign corporation (CFC) that is domiciled in a low-income tax jurisdiction is taxable to its Venezuelan shareholders. The tax authorities have issued a list of low-income tax jurisdictions and may invoke the "substance over form" rules contained in the Venezuelan Master Tax Code to challenge the form chosen by the parties. Consequently, if a transaction is motivated solely by a tax-avoidance purpose or by a reduction of the tax liability, it may be disregarded for tax purposes.

Provisions

Provisions for inventory obsolescence and accounts receivable are not deductible; amounts are deductible only when inventories or accounts receivable are effectively written off.

Depreciation

In general, acceptable depreciation methods are the straight-line and the unit-of-production methods. The declining-balance and accelerated-depreciation methods are not accepted. Venezuelan law does not specify depreciation rates. If the estimated useful life of an asset is reasonable, the depreciation is accepted. Estimated useful lives ranging from 3 to 10 years are commonly used.

There is no provision related to the minimum useful lives of the business assets of the oil companies, and, generally, the tax depreciation is the same as the accounting and financial depreciation.

Tax indexation

Companies must apply an annual inflationary adjustment. A company carries this out by adjusting its non-monetary assets, some of its non-monetary liabilities and its equity to reflect the change in the consumer price index from the preceding year. These adjustments affect the calculation of depreciation and the cost of goods sold. Their net effect is recorded in an inflation adjustment account and is added to taxable income or allowed as a deduction.

Effective from tax years beginning after 22 October 1999, the tax indexation rules apply only to the reconciliation of Venezuelan-sourced income; thus, foreign-sourced non-monetary assets and liabilities are not subject to tax indexation.

Tax on special prices of the international hydrocarbons market

The Law of Special Contribution due to Extraordinary Prices of the Hydrocarbons International Market (the Windfall Oil Price Tax) published in *Official Gazette* Nº 38,910 on 15 April 2008 was repealed by the Decree Nº 8,163. The Decree was issued by the Presidency of the Republic and published in *Special Official Gazette* Nº 6,022 of 18 April 2011, establishing a Special Contribution for Extraordinary Prices and Exorbitant Prices in the International Hydrocarbons Market. This law establishes a special contribution payable to companies exporting, for sale purposes, certain hydrocarbons including liquid hydrocarbons, both natural and upgraded, and their derivatives. Mixed companies selling natural and upgraded liquid hydrocarbons and derivatives to Petróleos de Venezuela, S.A. were expressly included.

The Decree Law defines (i) Extraordinary Prices as those where the monthly average of international quotes of the Venezuelan liquid hydrocarbons basket exceeds the price set out in the Annual Budget Law for the respective fiscal year, but is equal to or lower than US$70 per barrel, and (ii) Exorbitant Prices as those where the monthly average of international quotes of the Venezuelan liquid hydrocarbons basket exceeds US$70 per barrel.

In the case of Extraordinary Prices, when the monthly average of international quotes of the Venezuelan liquid hydrocarbons basket exceeds the price set out in the Budget Law for the respective fiscal year but is equal to or lower than US$70 per barrel, the rate shall be equivalent to 20%, to be applied on the difference between both prices. In the case of Exorbitant Prices, the rate of the special contribution shall vary as follows:

i. When Exorbitant Prices are greater than US$70 but less than US$90, a rate equivalent to 80% of the total amount of the difference between both prices shall be applied.
ii. When the Exorbitant Prices are greater than or equal to US$90 but less than US$100, a rate equivalent to 90% of the total amount of the difference between both prices shall be applied.
iii. When the Exorbitant Prices are greater than or equal to US$100, a rate equivalent to 95% of the total amount of the difference between both prices shall be applied.

This tax shall be settled by the Ministry of Popular Power for Energy and Petroleum and be paid on a monthly basis.

Where the Ministry of Popular Power for Energy and Petroleum has approved projects for either new reservoir developments or increasing the production of exploitation plans in ongoing projects, an exemption is available from these contributions, provided the total investment has not yet been recovered.

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A. At a glance

Fiscal regime

In Vietnam, the Petroleum Law, with its guiding Decree and Circulars, as well as other tax regulations, covers the fiscal regime applicable to organizations and individuals (referred to as contractors) conducting exploration and exploitation of crude oil, condensate (collectively referred to as crude oil) and natural gas in Vietnam.

Bonuses	Defined in production sharing contract (PSC) for each contract
PSC	Based on production volume
Corporate income tax (CIT)	32%–50%
Resource tax	Crude oil: 7%–29%; natural gas: 1%–10%
Investment incentives	CIT rate of 32%, rate of recoverable expenditure is up to 70%
Export duties	Crude oil: 10%
Tax of transfer of capital in oil and gas contract	25%

B. Fiscal regime

Foreign petroleum companies are permitted to participate in, and operate, the exploration, development and production of petroleum resources in Vietnam by entering into a PSC with the Vietnam Oil and Gas Group (Petrovietnam).

The PSC shall be in accordance with the model contract issued by the Vietnamese Government.

Product sharing

Product sharing for crude oil is based on the profit oil that is computed by reducing the resource tax and cost petroleum from the actual crude oil output.[246]

The same principle is applicable to natural gas.

Bonus and commission

A bonus or commission is a lump-sum payment made by foreign parties to PSC to the Government (Petrovietnam) (i) after declaration of the first commercial discovery and (ii) after the first commercial production date. In addition, the foreign parties to PSC shall also pay Petrovietnam a data fee and training fee.[247]

Resource tax[248]

Crude oil and natural gas are subject to resource tax.

The payable resource tax on crude oil or natural gas equals the average taxable output of crude oil or natural gas per day in the tax period multiplied by the tax rate and multiplied by the number of days of exploitation of crude oil or natural gas in the tax period.

The tax rates applicable to crude oil are as follows:

Output (barrels per day)	Encouraged investment projects	Other projects
Up to 20,000	7%	10%
More than 20,000 to 50,000	9%	12%
More than 50,000 to 75,000	11%	14%
More than 75,000 to 100,000	13%	19%
More than 100,000 to 150,000	18%	24%
More than 150,000	23%	29%

The tax rates applicable to natural gas are as follows:

Output (million cubic meters per day)	Encouraged investment projects	Other projects
Up to 5	1%	2%
5 to 10	3%	5%
More than 10	6%	10%

Corporate income tax[249]

Petroleum companies are taxed at the rate of 32% to 50% on their taxable income according to the new Corporate Income Tax Law, which came into effect 1 January 2009. The specific rate shall be determined by the prime minister for each PSC. The amount of CIT payable shall be computed by multiplying the rate of tax with the taxable income. Net operating tax losses are allowed to be carried forward for five years to offset against future taxable income. Carryback losses are not allowed.

The taxable income is defined as revenue earned from exploration and exploitation of oil and gas in the tax period as reduced by deductible expenses. Other income such as royalties and interest are added to the taxable income.

246 *Model PSC issued under Decree 139/2005/ND-CP dated 11 November 2005, Article 6.1.*

247 *Ibid, Articles 9.1–9.4. 10.1–10.2.*

248 *Resolution 928/2010/UBTVQH12 dated 19 April 2010.*

249 *Circular 32/2009/TT-BTC dated 19 February 2009 on oil and gas taxation, Part II, Section IIII.*

Revenue earned from exploration and exploitation of oil and gas is the total value of crude oil and gas that is actually sold under arm's-length contract in the tax period; otherwise, the taxable price shall be determined on the basis of the average price in the international market.

Deductible expenses include:

- Expenses actually incurred in relation to activities of exploration and exploitation of crude oil or gas not exceeding expenses that are determined as revenue earned from the sale of crude oil or gas multiplied by the rate of recoverable expenses that is agreed in the oil and gas contract. Under the 2000 Law on Oil and Gas, the standard recovery rate is 50%.[250] If the rate of recoverable expenses is not mentioned in the oil and gas contract, the deemed rate of 35% will be used.[251]
- Expenses supported by legal evidence documents.

Non-deductible expenses include:

- Expenses that exceed the contractual rate of recoverable expenses
- Expenses that are not allowed as recoverable in the oil and gas contract
- Expenses that are not allowed under the prevailing regulations on CIT

Capital transfer tax[252]

The gain from transfer of participating interest in the oil and contract is subject to a capital transfer tax (CTT) rate of 25%. The payable CTT equals taxable income multiplied by the tax rate.

The taxable income is determined as transfer price less purchase price of the transferred capital less transfer expenses.

Scientific and technological development fund (R&D fund)[253]

Petroleum companies are allowed to appropriate up to 10% of the annual taxable income prior to assessing CIT to establish an R&D fund. This fund is reflected in the annual CIT return. A report on its utilization is required to be furnished to the tax authorities along with the annual CIT return.

At least 70% of such funds should be utilized within five years, failing which it shall attract the normal rate of CIT on the unused balance together with interest on the CIT.

Expenses funded from the R&D fund shall not be deductible for CIT purposes.

C. Incentives

Corporate income tax

The following incentives are available for encouraged projects:

- CIT rate of 32%[254]
- Recoverable expenses rate up to 70%[255]

The encouraged projects are the projects where petroleum operations are conducted in deepwater and remote offshore areas, in areas where geographical and geological conditions are difficult and other areas in accordance with the list of blocks decided by the prime minister; and the coal gas projects.[256]

250 *The Law on Oil and Gas No 19/2000/QH10, Article 1.8.*

251 *Circular 32/2009/TT-BTC dated 19 February 2009 on oil and gas taxation, Part II, Article 14.2.*

252 *Circular 32/2009/TT-BTC dated 19 February 2009 on oil and gas taxation, Part II, Section IV.*

253 *Circular 130/2008/TT-BTC dated 26 December 2008, Part C, Section VIII.*

254 *The Law on Oil and Gas No 19/2000/QH10, Article 1.14.*

255 *The Law on Oil and Gas No 19/2000/QH10, Article1.8.*

256 *The Law on Oil and Gas No 10/2008/QH12, Article 1.2.*

Accelerated depreciation

Accelerated depreciation under the straight-line method is permitted if a petroleum company is operating with high economic efficiency. The depreciation rate could be as high as two times the limits set by the Ministry of Finance.[257]

D. Withholding taxes[258]

Foreign contractors that provide services to a petroleum company operating in Vietnam are liable to pay foreign contractor tax (FCT), which comprises VAT and CIT. The applicable tax rates are as follows:

Business activity/industry	Deemed CIT rate
Commerce: distribution, supply of goods, material, machinery, equipment associated with services in Vietnam	1%
Services, equipment lease, insurance, oil rig lease	5%
Construction	2%
Other production, trading activities, transportation	2%
Lease of air plan, plan engine, plan parts, ships	2%
Reinsurance (from 1 March 2012)	0.1%
Transfer of securities	0.1%
Loan interest (from 1 March 2012)	5%
Royalties	10%
Derivatives financial service (from 1 March 2012)	2%

Business activity/industry	Deemed VAT rate
Services, equipment lease, insurance	5%
Construction, installation with the supply of materials or machinery, equipment	3%
Construction, installation without the supply of materials or machinery, equipment	5%
Other production and business activities, transportation	3%

Note: VAT is calculated at the rate of 10%.

E. Indirect taxes

Export duties[259]

Exported crude oil and gas shall be subject to export duties. The payable export duties equal quantity of exported crude oil and natural gas multiplied by dutiable price and multiplied by export duty ratio.

The quantity of exported crude oil and natural gas is the quantity of crude oil and natural gas that is actually exported.

The dutiable price is the selling price of crude oil and natural gas under arm's-length contract.

257 *Circular 203/2009/TT-BTC dated 20 October 2009 on fixed assets and depreciation, Article 13.*

258 *Circular 134/2008/TT-BTC dated 31 December 2008. Decree 122/2011/ND-CP dated 27 December 2011, Article 1.8.*

259 *Circular 32/2009/TT-BTC dated 19 February 2009 on oil and gas taxation, Part II, Section II.*

Export duty ratio equals [100% – ratio of resource tax temporarily calculated in the tax period] multiplied by export duty rates of crude oil and natural gas.

The ratio of resource tax temporarily calculated in the tax period equals [estimated payable resource tax by crude oil and natural gas divided by estimated output of crude oil and natural gas] multiplied by 100%.

From 1 January 2011, the export duty rate of crude oil is 10%.[260]

Import duties

The following goods imported and used for oil and gas activities will be exempt from import duties:[261]

- Machinery, equipment and transportation means necessary for oil and gas activities and certified by the Ministry for Science and Technology
- Materials necessary for oil and gas activities and not available domestically
- Medical equipment and medicine used in oil rigs and floating projects and certified by the Ministry of Health Care
- Office equipment imported and used for oil and gas activities

VAT

VAT, at the rate of 5% or 10%, shall be imposed on all goods and services used for business or consumption. However, the following imported goods that are not available domestically shall be exempt from VAT:[262]

- Machinery, equipment and material imported for scientific research and technological development
- Machinery, equipment, parts, transport means, and material imported for exploration and development of oil and gas wells
- Oil rigs and ships imported to form fixed assets or leased from abroad and imported for business activities and for re-lease

Exported crude oil and other unprocessed natural resources are exempt from VAT.[263]

F. Financing consideration

According to the CIT regime, interest expenses paid on bank loans utilized to finance taxable operations are generally deductible. Interest expenses paid on loans borrowed from non-financial institutions or non-economic organizations are also deductible, provided that the interest rate does not exceed 150% of the rates announced by the State Bank of Vietnam.[264]

260 *Circular 184/2010/TT-BTC dated 15 November 2010, Appendix I.*

261 *Decree 87/2010/ND-CP dated 13 August 2010, Article 12.10.*

262 *Circular 129/2008/TT-BTC dated 26 December 2008 on VAT, Part A, Section II, Point 17.*

263 *Ibid, Part A, Section II, Point 23.*

264 *Circular 130/2008/TT-BTC dated 26 December 2008 on CIT, Part A, Section IV, Point 2.14.*

Foreign currency

The following list sets forth the names and symbols for the currencies of the countries discussed in this book.

Country	Currency	Symbol
Algeria	Dinar	DZD
Angola	Kwanza	AOA
Argentina	Peso	ARS
Australia	Dollar	A$
Azerbaijan	Manat	AZN
Bahrain	Bahraini dinar	BHD
Benin	CFA franc	XOF
Brazil	Real	BRL
Cameroon	CFA franc	XAF
Canada	Dollar	C$
Chad	CFA franc	XAF
Chile	Peso	CLP
China	Yuan Renminbi	CNY
Colombia	Peso	COP
Côte d'Ivoire	CFA franc	XOF
Cyprus	Euro	€
Democratic Republic of Congo	Franc	CDF
Denmark	Krone	DKK
Ecuador	US dollar	US$
Egypt	Egyptian pound	EGP
Equatorial Guinea	CFA franc	GQE
Gabon	CFA franc	XAF
Ghana	Cedi	GHS
Greenland	Danish Krone	DKK
Iceland	Krona	ISK
India	Rupee	INR
Indonesia	Rupiah	IDR
Iraq	Iraqi dinars	IQD
Ireland	Euro	€
Israel	New Shekel	ILS
Kazakhstan	Tenge	KZT
Kenya	Shilling	KES
Kuwait	Kuwaiti dinar	KWD
Libya	Dinar	LYD
Malaysia	Ringgit	MYR

Foreign currency

Country	Currency	Symbol
Mauritania	Ouguiya	MRO
Mexico	Peso	MXN
Mozambique	Metical	MZN
Namibia	Dollar	N$
The Netherlands	Euro	€
New Zealand	Dollar	NZ$
Nigeria	Naira	NGN
Norway	Krone	NOK
Oman	Rial	OMR
Pakistan	Rupee	PKR
Papua New Guinea	Kina	PGK
Peru	Nuevo sol	PEN
Philippines	Peso	PHP
Poland	Zloty	PLN
Qatar	Riyal	QAR
Republic of the Congo	Franc	XAF
Romania	Leu	RON
Russia	Ruble	RUB
Saudi Arabia	Saudi riyal	SAR
Senegal	CFA franc	XOF
Singapore	Dollar	S$
South Africa	Rand	ZAR
Spain	Euro	€
Syria	Syrian pound	SYP
Tanzania	Shilling	TZS
Thailand	Baht	THB
Trinidad and Tobago	Dollar	TT$
Uganda	Shilling	UGX
Ukraine	Hryvnia	UAH
United Arab Emirates	UAE dirham	AED
United Kingdom	Pound sterling	£
United States	US dollar	US$
Uzbekistan	Uzbekistan som	UZS
Venezuela	Bolivar	VEF
Vietnam	Dong	VND

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