

Fiscal Affairs Department

Fiscal Regimes for Extractive Industries – Design and Implementation



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THE TAXATION OF PETROLEUM AND MINERALS: PRINCIPLES, PROBLEMS AND PRACTICE

Edited by Philip Daniel,
Michael Keen
and Charles McPherson



“There are few areas of economic policymaking in which the returns to good decisions are so high – and the punishment of bad decisions so cruel – as in the management of natural resource wealth”

Presentation Outline

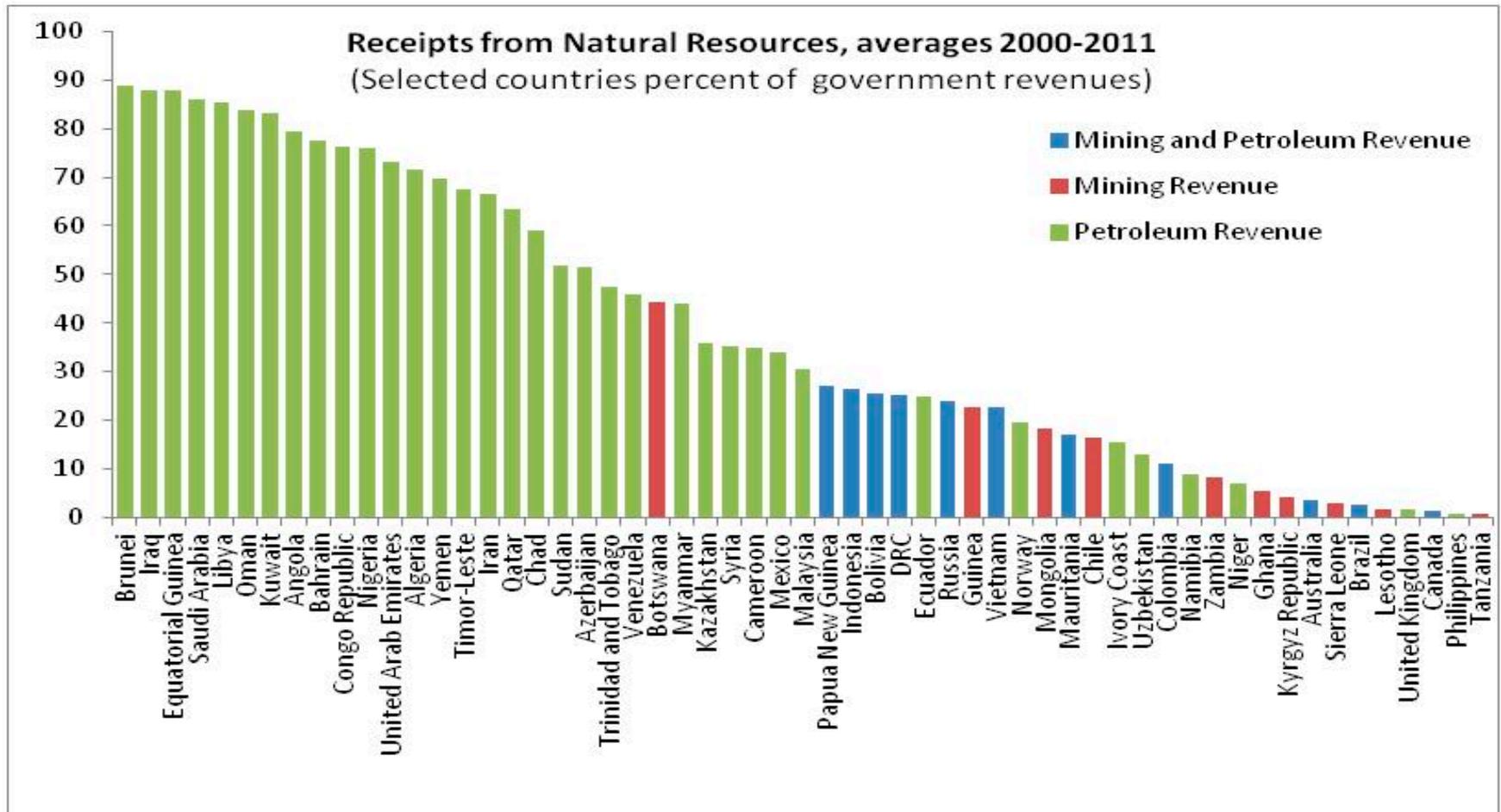
- Why is this topic important?
- Overview of key objectives for extractive industry (EI) fiscal regimes
- Overview of key EI fiscal issues to be covered in this conference

Part 1

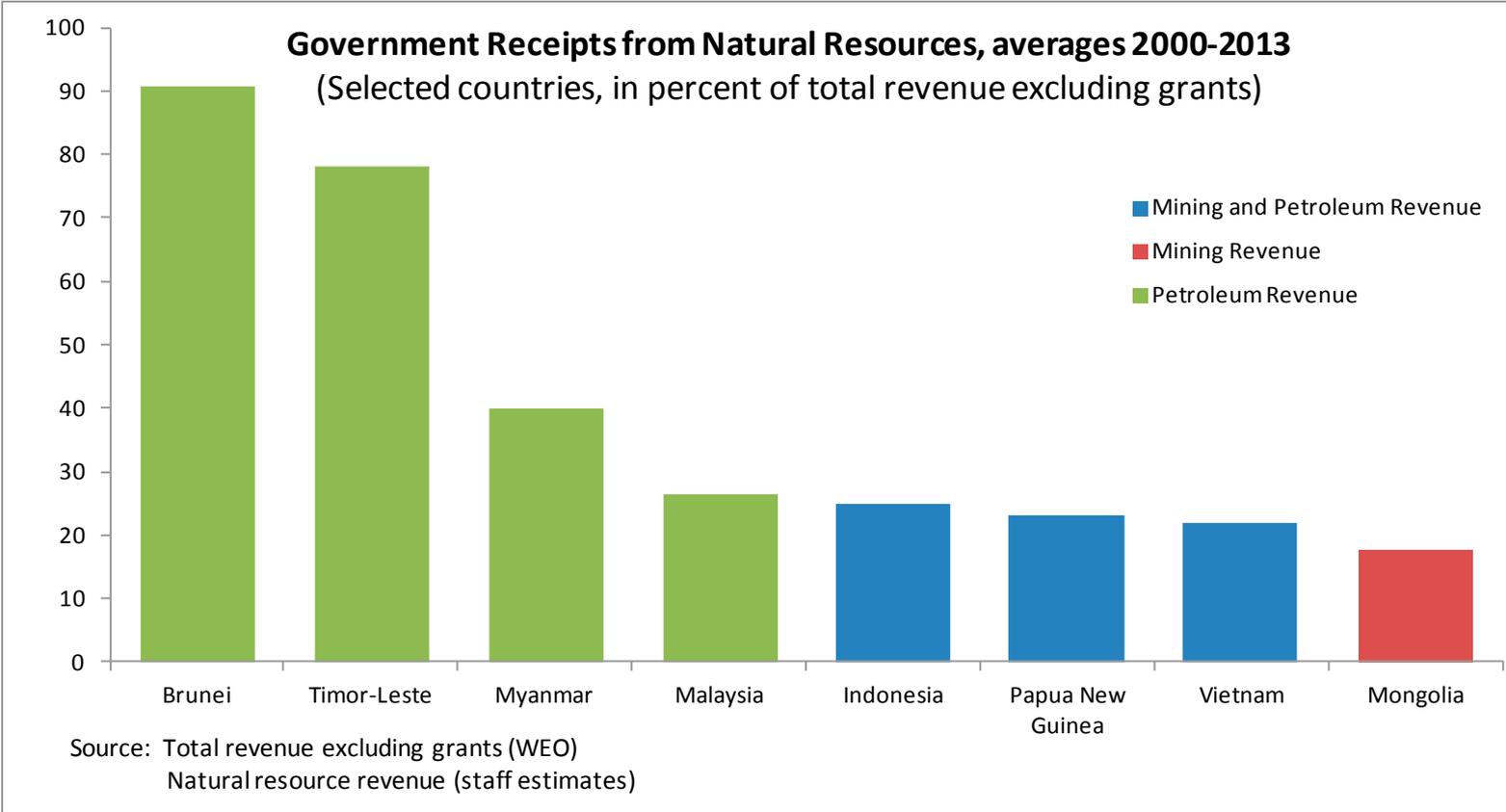
WHY IS THIS TOPIC IMPORTANT?

Why so important?

A key revenue source for (increasingly) many...



...including in the Asia-Pacific region



Fiscal regimes under review

- Many countries around the world are reviewing their fiscal regimes
 - ... including in the Asia-Pacific Region
 - Is the country getting a good deal?
 - Does the fiscal regime attract investors?
 - How does the fiscal regime respond to the fall in commodity prices?
 - Can the fiscal regime be simplified?
 - How does a country apply a fiscal regime to new scenarios (e.g., deep sea mining)?

Part 2

OVERVIEW OF KEY OBJECTIVES FOR EXTRACTIVE INDUSTRIES FISCAL REGIMES

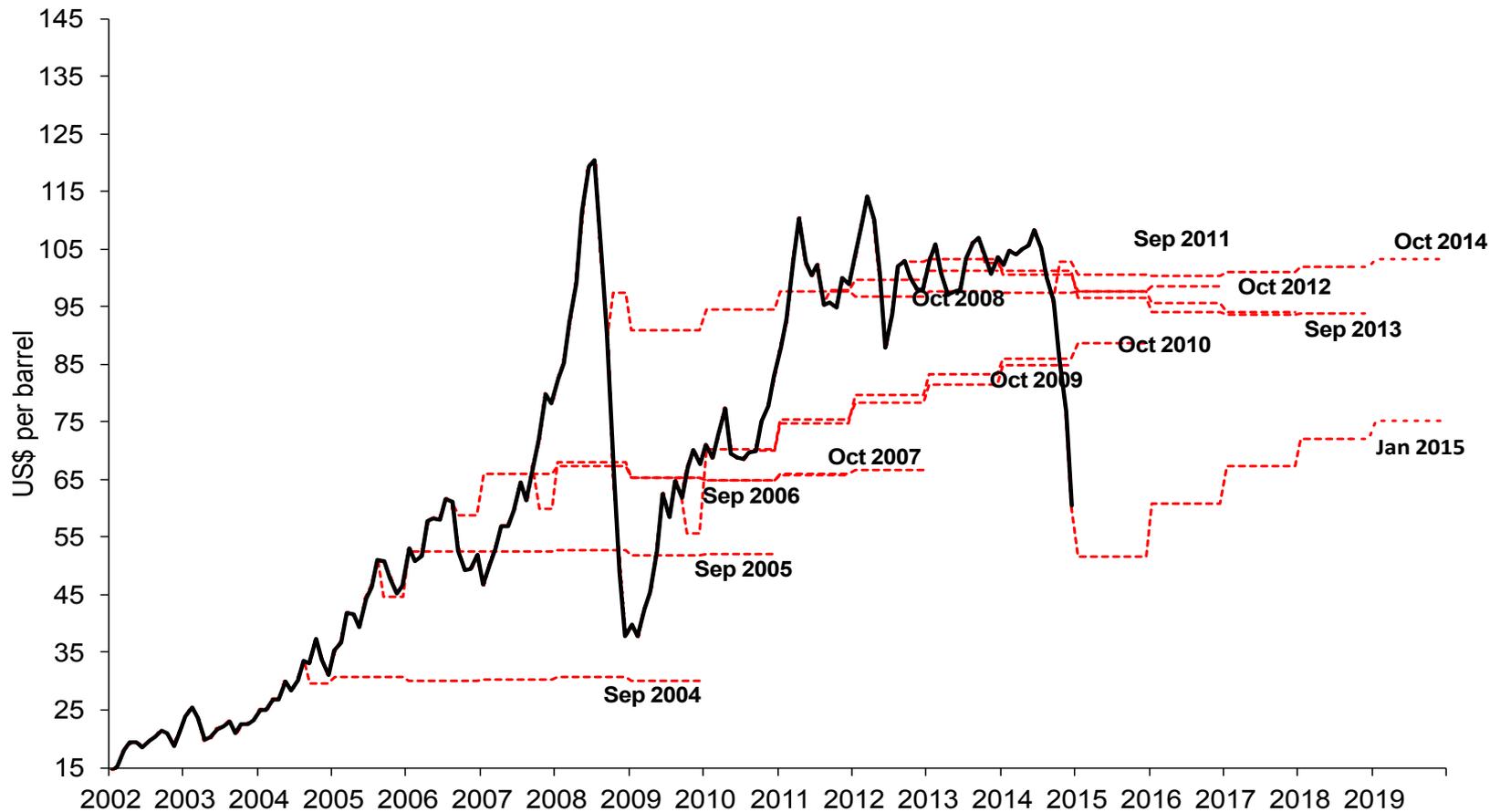
Why distinct fiscal regimes for EI?

- Substantial rents
- Pervasive uncertainty
- Asymmetric information - (companies probably know more) at the time of negotiation
- High sunk costs, long production periods
- Extensive involvement of multinationals in some countries...and of State-Owned Enterprises in others

Few of these considerations are unique to resources—they are just bigger. What is unique is ***Exhaustibility*** — recognize revenues as transformation of finite assets in the ground into other assets

Oil price forecasts and outturns

WEO Oil Price Forecasts 2002-2019
(Monthly prices, 2014 U.S. Dollar per Barrel)



Central Objectives/Principles

- Ensure State as resource owner gets an ‘appropriate’ share – the fiscal regime should:
 - Provide Government with a revenue stream in all production periods, but also possibly with an increasing share of revenues as profitability increases (progressivity)
 - Be attractive enough to encourage investments, now and in the long run
- Fiscal terms must be “robust” in the face of changing circumstances : anticipate that the long term reality will be different from current forecast

Central Objectives/Principles (cont'd)

- Consistent with countries of similar prospectivity
- Encourage development of all viable discoveries
- Easy administration (for authorities) and compliance (for taxpayers)
- Establish by law
 - ... minimize discretionary and negotiated elements
- Stability and credibility

Part 3

OVERVIEW OF KEY EXTRACTIVE INDUSTRY FISCAL ISSUES

Three main fiscal schemes (sometimes blended)...

1. Contractual, including production sharing or service contracts
 2. Tax and royalty
 3. State ownership or participation
- These can be made fiscally equivalent
 - IMF advice works with all three
 - Design to achieve efficiency and transparency in each

Fiscal Instruments

1. Land rental/surface fees
2. Bonuses – Signature or Production
3. Royalties
4. Corporate income taxes
5. Explicit rent tax/Additional profits tax /Profit sharing
6. State participation
7. Dividend and interest withholding taxes
8. Other indirect taxes

Recommended approaches

Country circumstances require tailored advice, but generally within a framework that combines:

- A royalty on gross revenue
- A tax targeted explicitly on rents (and thus on the achieved results of extraction)
- Together with normal corporate income tax
- Bonus-bidding may have a role in promising environments

Recommended approaches (cont'd)

Such a regime ensures:

- Revenue from day one
- That government's revenue rises as rents increase

Transparent rules and contracts promote stability and credibility

- Inclusion of rent taxes reduces pressures to renegotiate or unilaterally change the rules
- But processes to allow review and revision may be needed

Government revenue yield?

Not only do the regimes vary greatly, but also the revenue yields

- Simulations for petroleum suggest government shares of: 65 to 85 percent
- Lower share for mining : 40 to 60 percent

Evaluation is essential...

Two approaches:

1. Model tax effects on exploration, development, and extraction
 - James L. Smith, 2012, “Modeling the Impact of Petroleum Exploration and Development,” IMF Working Paper
2. Scenario analysis – the IMF Fiscal Analysis of Resource Industries (FARI) modeling system
 - Uses indicators related to objectives and criteria
 - ... such as average effective tax rate, progressivity in prices

Tax Administration is critical ...

- EI tax administration should not in principle be hard
- Nonetheless, often both difficult and badly done
 - Complex regimes
 - Fragmented administration (e.g., little coordination between regulatory agency and tax administration)
- Principles of effective modern tax administration are equally relevant to EI

... with demand for Transparency

- Transparency of the design of the fiscal regime and its implementation is crucial
 - ... but often absent
- Number of EI transparency initiatives:
 - Extractive Industries Transparency Initiative (EITI)
 - IMF Guide on Resource Revenue Transparency and proposed Pillar IV of the Fiscal Transparency Code
 - Company reporting requirements under US Dodd-Frank Act and EU Directives
 - Natural Resource Charter and the Natural Resources Governance Institute

Current and Emerging Challenges

- Ensuring stability and credibility
- Fiscal terms in legislation or contracts?
- International tax and base erosion and profit shifting (BEPS)
- Regional coordination
- Role of National Resource Companies

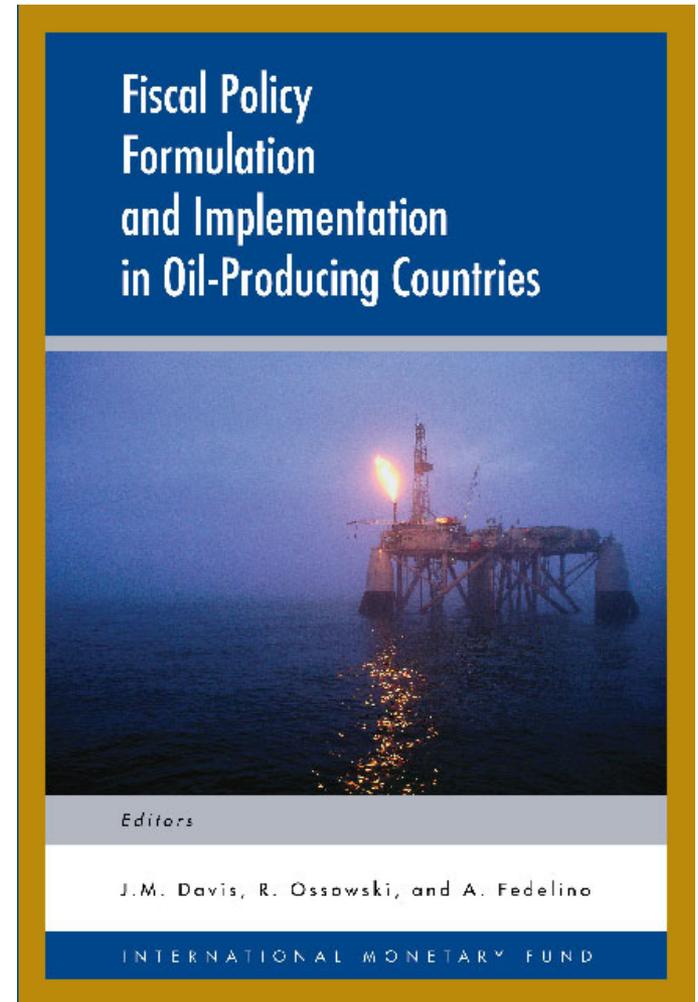
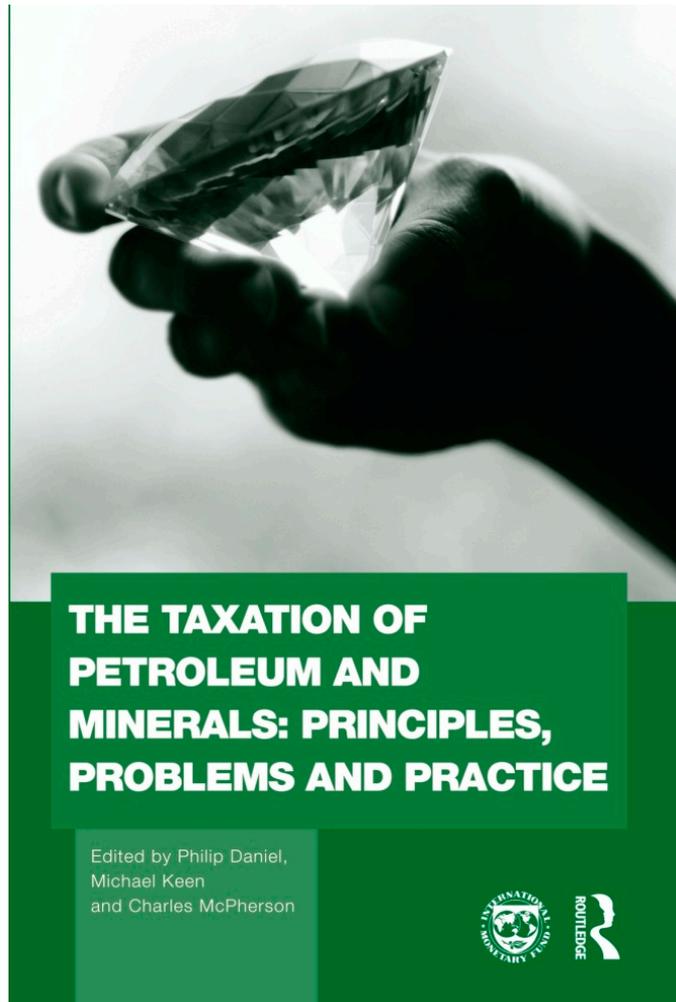
Information Sources

- IMF Board Paper (August, 2012) on “Fiscal Regimes for Extractive Industries: Design and Implementation” available at:

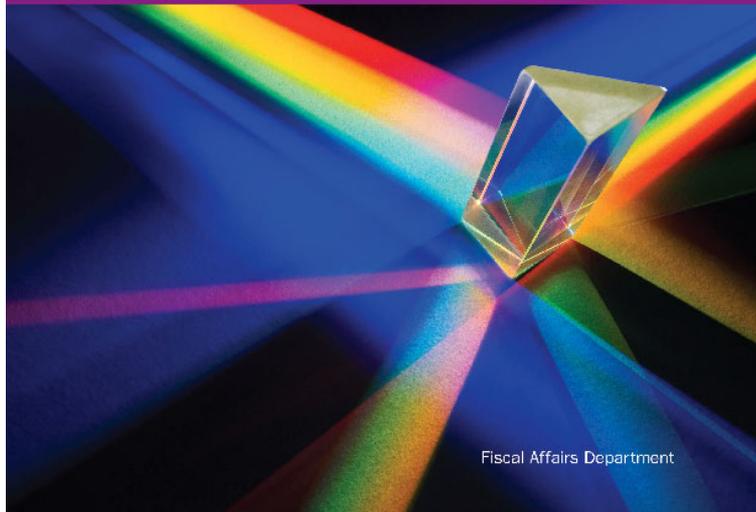
<http://www.imf.org/external/np/pp/eng/2012/081512.pdf>

- Forthcoming book:
International Taxation and the Extractive Industries
due for release in early 2016

Existing Publications



Guide on
Resource Revenue Transparency



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