Tax Increases on Oil and Gas Production

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Nigeria • Norway • Russian Federation
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CANADA

TAX INCREASES ON OIL AND GAS PRODUCTION

Since 2000, Canada has reduced its general federal corporate tax rate from 29.12 percent to 22.12 percent. Originally, this rate reduction was not scheduled to apply to resource income, including income from oil and gas production. However, after complaints from the industry, the federal government decided to begin reducing the corporate tax rates on resource income on a delayed schedule. The rate was reduced to 26.12 percent on January 1, 2005 and will be further reduced to 24.12 percent on January 1, 2006, and then to 22.12 percent on January 1, 2007. Thus, by the beginning of 2007, the corporate tax rates on resource income will be the same as the general federal corporate tax rate.[1]

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December 2005

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[1] Federal Corporate Tax Rates, 1994-2005. 1 Can. Tax. Rep. (CCH) ¶ 271 (Apr. 2005).

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CHINA

TAX INCREASES ON OIL AND GAS PRODUCTION

The Chinese State Administration of Taxation recently has issued two notices regarding tax on oil, in July and August of 2005 respectively.

The Ministry of Finance and the State Administration of Taxation issued the Notice in Regard to Adjusting Tax on Crude Oil and Natural Gas (Caishui [2005] No. 115) on July 29, 2005 and adjusted the taxes on crude oil and natural gas. U.S.-China Business Council staff provided information by telephone that this was the first slight tax increase on crude oil and natural gas in the last twenty-five years.

In the Notice in Regard to Temporary Suspension of Tax Reimbursement on Exported Gas For Use of Vehicle and Aviation and Exported Naphtha, issued by the Ministry of Finance and the State Administration of Taxation on August 25, 2005 (Caishui [2005] No. 133), the suspension will be from September 1, 2005 to December 31, 2005.

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KYRGYZSTAN

TAX INCREASES ON OIL AND GAS PRODUCTION

Kyrgyzstan has insignificant reserves of oil resources, and only one oil refinery, built in 1999 by a joint venture between Trans Hydrocarbon (Canada) and Kyrgyzstan's state oil company Kyrgoil. In 2003-2005, the Chinese oil corporation Shienli Gunji conducted repair work on about forty idle wells.[1] General principles of oil taxation were established in 1998, by the Law No. 77 on Oil and Gas,[2] which extended the general flat rate of thirty percent for taxation of companies' income to oil producers. This law was never amended in regard to taxation. Because the Kyrgyz oil sector does not provide substantial income, the issue of oil taxation does not appear economically important for the government. Because of growing political links with Western Europe, the Government of Kyrgyzstan ordered, in October 2005, the reduction of customs duties on oil and gas entering the countries of the European Union.

In the 2004-2005 period, the tax increase in the oil sector affected the retail prices of oil products only. In compliance with the 2003 amendment to the Tax Code, local authorities are entitled to set local sales tax rates. In most localities where this tax was established, the sales tax on heating oil and gasoline ranges between two and four percent.

The rates of the excise tax are approved annually by the parliament on the recommendation of the government. Between March 2003 and June 2005, the excise tax on gasoline, light and medium distillates, and black oil was reduced from 3,000 to 500 Som per ton.[3] As the Government declared, this measure was aimed at reducing the incentive for smuggling gasoline from Kazakhstan to the Kyrgyz Republic. Reportedly, this change was effective in doubling the officially declared imports of fuel and so maintaining the budget income from the excise tax.[4] However, the excise tax on gasoline in Kazakhstan is equal to KGS 160, so reaching the same level of excise tax as Kazakhstan is unlikely if the Kyrgyz state budget income is to be maintained. Oil explored, produced, and refined in the Jalalabad region, which is recognized as a special investment zone, is exempt from excise tax in order to stimulate investment in the sector. Support for this local oil industry is justified by strategic and security reasons.

Prepared by Peter Roudik
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[1] *EU Promises Kyrgyzstan Cooperation in Exchange for Reforms*, MINING JOURNAL, Dec. 9, 2005, *available at* www.miningjournal.net.

[2] ZHOGORKU KINESHA (Kyrgyz official gazette), 1998, No. 24, Item 193.

[3] Som (KGS) – yrgyz national currency. KGS 1,000 equals to US$ 24.

[4] Energy Asia News, June 7, 2005, *available at* www.securities.com.

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KUWAIT

TAX INCREASES ON OIL AND GAS PRODUCTION

Historically, oil producers in Kuwait, as in other Gulf countries, operated as concessionaires of the Kuwaiti government, which is, by law, the sole owner of all natural resources, including the oil in the ground.[1] The amount of oil production revenues owed to the government was subject to the terms of concession agreements concluded with each producer. The income tax law on corporations in Kuwait did not impose any special tax on oil producers per se.[2] In the early seventies twenty-two major oil producing companies, including Kuwait, met in Teheran under the auspices of OPEC, and agreed that each private oil producer must be charged a fifty-five percent oil production tax.[3]

Between 1971 and 1974, however, Kuwait opted to nationalize the operations of its private oil producers and control all aspects of its oil industry. As a result, the taxation of oil producers became a moot point following the nationalization.

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[1] Article 21 of the Kuwaiti constitution provides that all natural resources and all their revenues are the property of the state.

[2] Kuwaiti income tax law issued by Emiri Decree Number 3 of 1955.

[3] *See* "The Petroleum Market: 1970-2001", posted at the New York University, Stern School of Business website, *availableat:* http://64.233.161.104/search?q=cache:y8rWQAglBUJ:pages.stern.nyu.edu/~lcabral/teaching/oil.pdf+oil+production+taxes+kuwait&hl=en.

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NIGERIA

TAX INCREASES ON OIL AND GAS PRODUCTION

Nigeria has not increased its taxes with respect to oil and petroleum production during the course of the past twelve to eighteen months. However, with respect to consumers, on Tuesday, December 6, 2005, President Obasanjo presented the 2006 Appropriation Bill to the joint sitting of the National Assembly in Abuja, the capital of Nigeria. The president has proposed an increase in the Value Added Tax (VAT) from a flat rate of five percent to a new rate of ten percent. The effect of a VAT increase is to pass on to the consumer the production costs in all industries, not only in petroleum production. The law will allow the government to collect a tax from the consumer, if enacted by the legislature, rather than have producers pay a five percent increase in production costs directly. The economic impact of VAT on oil and petroleum products will be felt more directly by consumers than the producers. The VAT is collected on behalf of the government by businesses and organizations.[1]

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[1] *OPS Kicks Against 10% VAT*, THE PUNCH, Dec. 8, 2005, *available at* http://odili.net/news/source/2005/dec/8/435.html.

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NORWAY

TAX INCREASES ON OIL AND GAS PRODUCTION

Executive Summary

Petroleum activities on the Norwegian Continental Shelf are taxed at the regular corporate tax of twenty-eight percent, a special petroleum tax of fifty percent, and other levies. In March 2004 the Norwegian Government presented a Report on Taxation to the Parliament. The report states that the corporate tax rate of twenty-eight percent will not be increased, because the trend internationally is to decrease corporate taxes.

I. An Overview of Petroleum Taxation in Norway

The Norwegian Ministry of Finance states on its website that "petroleum activities on the Norwegian Continental Shelf are taxed through normal corporate tax, a special petroleum tax and various levies."[1] Furthermore, the Norwegian State has direct financial interests in petroleum activities through its direct ownership interest in oil and gas fields on the Continental Shelf.[2] The state pays a share of all investments and operating costs, which are equal to its ownership share, and in return receives a corresponding share of revenues from the oil and gas production on the different fields, in the same manner as other licensees.[3]

Norway's oil revenues amount to $38bn annually.[4] The Norwegian Parliament, Stortinget, decided in 1990 that revenues from petroleum activities that the Norwegian Government receives should be transferred to a Petroleum Fund.[5] The fund's purpose is to invest the large surplus that the Norwegian petroleum activities generate.[6]

As mentioned, the taxation of petroleum activities is partly based on the ordinary corporate tax rate, which is twenty-eight percent. Because petroleum production is very lucrative, a special tax of fifty percent is also applied to these activities.[7] The corporate tax and the special petroleum tax are based on the net profits from petroleum activities.[8] The Norwegian Petroleum Directorate (NPD) states

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[1] Ministry of Finance, Petroleum Taxation, http://www.odin.no/fin/english/topics/p4500279/p4500281/006041-990059/dok-bn.html (last visited Dec. 9, 2005).

[2] *Id.*

[3] *Id.*

[4] *Centre-left bloc wins Norway poll,* BBC News, Sept. 13, 2005, *available at* http://news.bbc.co.uk/2/hi/europe/4236744.stm.

[5] Ministry of Finance, The Norwegian Government Petroleum Fund, http://odin.dep.no/fin/engelsk/p10001617/006051-990060/index-dok000-b-n-a.html (last visited Dec. 9, 2005).

[6] *Id.*

[7] Ministry of Finance, Petroleum Taxation, http://www.odin.no/fin/english/topics/p4500279/p4500281/006041-990059/dok-bn.html (last visited Dec. 9, 2005).

[8] Norwegian Petroleum Directorate, The Norwegian Petroleum Tax System, updated February 23, 2005, *available at* http://www.npd.no/English/Emner/Ressursforvaltning/Promotering/whynorway_tax_system.htm.

that the marginal tax on petroleum is relatively high but that there are also favorable features to the petroleum tax system. The NPD states that "there are no signature bonuses, and all relevant expenses for the activities on the NCS are tax deductible".[9] This includes operating expenditures, exploration costs and research and development. Investments enjoy a high depreciation rate that start as soon as the investment is made. For the special tax, an uplift of thirty percent of investments can be deducted. This uplift exists so that normal returns on investments are not subjected to the special tax. Financial costs may be deducted against the corporate tax and the special petroleum tax.[10]

There is a norm price that is the basis on which the taxable income from oil production is assessed. This price should correspond to the price that independent parties would pay for the petroleum on a free market.[11]

II. Tax Increases

In March 2004 the Norwegian Government presented a White Paper on Taxation to Stortinget.[12] The White Paper is based on a report by the Tax Committee that was presented to the Minister of Finance in February 2003.[13] The tax measures presented in the White Paper are to be implemented over the fiscal years 2005, 2006 and 2007. The objective of the reform is mainly to achieve a "more efficient and fair tax system and reduce tax and excise levels."[14] In its tax reform proposal the Government proposes that the "the 28 percent *tax rate on ordinary income,* which is also the tax rate on corporate income, be upheld."[15] The Government does not believe that the corporate income tax should be increased because many other countries are decreasing theirs. The Government further states "Norway continues to have a relatively low *formal* tax rate on corporate income, but the broad tax base implies that the *effective* tax rate on company profits is in the international middle range. All in all, company taxation would appear to remain well adapted to the international situation, but developments need to be monitored."[16]

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[9] Norwegian Petroleum Directorate, The Norwegian Petroleum Tax System, updated February 23, 2005, *available at* http://www.npd.no/English/Emner/Ressursforvaltning/Promotering/whynorway_tax_system.htm.

[10] *Id.*

[11] *Id.*

[12] Stortingsmelding [St.meld.] No 29 (2003-2004) Om skattereform [Government Report] (Nor.), *available at* http://odin.dep.no/fin/norsk/dok/regpubl/stmeld/006001-040024/dok-bn.html.

[13] Ministry of Finance, Report on Taxation, at http://www.odin.dep.no/fin/english/topics/p4500279/reform/bn.html (last visited Dec. 9, 2005).

[14] Ministry of Finance, Fiscal Budget 2006 – Continued Strong Economic Growth, No 76/2005, Oct. 10, 2005, *available at* http://www.odin.no/odinarkiv/norsk/fin/2005/pressem/006071-070685/dok-bn.html.

[15] Stortingsmelding [St.meld.] No 29 (2003-2004) Om skattereform [Government Report] (Nor.). First chapter of report has been translated into English, *available at* http://www.odin.dep.no/fin/english/topics/p4500279/006071-040005/dok-bn.html.

[16] *Id.*

Reviewing the information available on the Norwegian Government's and the Norwegian Petroleum Directorate's websites no information on increases in the special petroleum tax was found.[17]

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[17] Norwegian Petroleum Directorate, http://www.npd.no/Norsk/Frontpage.htm (last visited Dec. 9, 2005) and Odin, Information From the Government and the Ministries, http://www.odin.no (last visited Dec. 9, 2005).

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RUSSIAN FEDERATION

TAX INCREASES ON OIL AND GAS PRODUCTION

Executive Summary

Oil producers are subject to the fixed federal tax on exploration of mineral resources paid monthly. Since 2003, a correction factor taking into account monthly fluctuation of world oil prices and currency rates is used in calculation of the tax amount. The federal government periodically amends the amount of export duty for oil producers. The current rate introduced on October 1, 2005, is almost thirty percent higher than the previous one in force since August 1, 2005.

I. Amendments to Major Tax Laws

Russian tax legislation is based on the Federal Law on Principles of the Taxation System in the Russian Federation of 1991, and Tax Code of the Russian Federation, which entered into force in 2002. Both acts list the tax on exploration of mineral resources as one of major federal taxes paid by oil producers, investors, and parties participating in the production sharing agreements. The Tax Code defines the payment procedures and amount of other taxes levied on oil producers. The most recent amendment to the Tax Code related to the tax on exploration of mineral resources was passed in 2003.[1] The amendment changed the procedure for defining the tax base for counting the tax amount, and established that the tax rate for oil exploration is Rubles 340 (equal to US$12) per one metric ton. A correction factor reflecting the dynamics of world oil prices is to be used as well.

The amendment provides the formula under which the correction factor is counted. It is based on the average oil price for URALS oil during the tax period and the current currency rate for the U.S. dollar. The correction factor is to be defined monthly and applied to the tax rate paid to the end of every month. The correction factor is not applied if the producer has reached the maximum oil production limit set by the production-sharing agreement.

II. Changes to the Customs Export Duty

The Government Regulation No. 939 on Approval of Customs Duty Rates for Export of Oil and Oil Products from Russia to the States non-Members to the Customs Agreement has been in force since December 9, 2002.[2] This regulation is regularly updated in order to increase the duty rate. In 2005, the Regulation was amended three times, obliging the exporters of Russian oil and oil products to pay a duty in the amount of US$ 136.2 per 1,000 kilograms of the exported oil since June 1, 2005. As of August 1, 2005, the rate was increased to US$ 140.00. A new, almost thirty-percent increase entered into force on

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[1] SOBRANIE ZAKONODATELSTVA ROSSIISKOI FEDERATSII [Collection of Russian Federation Legislation, official gazette, SZ RF] 2003, No. 23, Item 2174.

[2] SZ RF, 2000, No. 52, Item 5141.

October 1, 2005, under which the duty rate was established in the amount of US$ 179.9 per 1,000 kilograms.[3]

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[3] SZ RF 2005, No. 38, Item 3826.

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SAUDI ARABIA

TAX INCREASES ON OIL AND GAS PRODUCTION

Executive Summary

On January 12, 2004 the Saudi Council of Ministers approved a new income tax law to replace the existing fifty-year-old law taxing foreign investors. The new law reduces tax rates from forty-five to twenty percent for foreign companies and individuals, excluding citizens of the Gulf Cooperation Council countries that do business in Saudi Arabia. However, the twenty percent tax rate does not apply to natural or legal persons working in the areas of natural gas investment and oil and hydrocarbon production. The tax rate is thirty percent for those taxpayers working in the area of natural gas investment only, and is eighty-five percent for those persons working in the production of oil and other hydrocarbons. Although oil and gas production is controlled by the government, companies which win contracts from the Saudi Oil Company are subject to the new income tax, taking into consideration any deductions or allowances determined by the agreement. On the other hand, unlike many industrial countries, most of the taxes imposed on imported petroleum and gas products are subject to a low consumption tax rate of five percent.

I. Oil Tax

Prior to the year 1988, oil companies involved in exploration and production in Saudi Arabia were paid a fixed tax rate, subject to the terms and conditions provided on the companies' contracts with the government, which could affect the overall tax rate for each company. For example, the Royal Decree No. 7634 of 16/3/1370H corresponding to December 26, 1950 stated:

> Every company carrying on time business of oil production or any other hydrocarbonic materials in the Kingdom shall be subject to an income tax at the rate of 85 percent of its "net operations' income" less deduction prescribed for in Article 3 of this Royal Decree. Net operations' income means gross revenues stated in Article 13 of Royal Decree No. 3321 less:
>
> a) Amounts deductible in accordance within Article 14 of said Decree after allowing sums paid to the Saudi Arabian Government.
> b) Time amount deductible according to this Decree is the total of all taxes (except income tax prescribed for, herein) revenues, rents, fees or any other amount paid or required to be paid to Saudi Arabia Government.[1]

At that time, this Decree applied to ARAMCO only.[2] Companies such as Getty Oil Co. were governed by the provisions of the Royal Decree No. 3321 and the concessions agreement concluded

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[1] Royal Decree No. 7634 of 16/3/1370H corresponding to December 26, 1950. *See also* BUSINESS LAWS & TAXATION IN SAUDI ARABIA: BUSINESS PRACTICES & PROCEDURES, 156-157 (Kamal S. Nasr Ed., Riyadh, Saudi Arabia: K.S. Nasr, 1981).

[2] The name of the operating company in Saudi Arabia was changed to Arabian American Oil Company (ARAMCO) in January 1944. Two partners, Standard Oil Company of New Jersey (later renamed Exxon) and Socony-Vacuum (now Mobil Oil Company), were added in 1946 to gain investment capital and marketing outlets for the large reserves being discovered in

pursuant to the Decree. The Te Japanese Arab Oil Co. Ltd. was governed by the concessions agreement dated November 10, 1957. The income tax rate for these companies was at fifty percent.[3] On November 1, 1974, however, the income tax rate to be applied to these companies was raised to eighty-five percent.[4]

In 1988 ARAMCO was converted to a totally Saudi-owned company called Saudi Arabian Oil Company (Saudi ARAMCO). Since the 1990s, Saudi ARAMCO has been responsible for all domestic exploration and development and its mandate was expanded gradually to include all Saudi Arabia.[5] Although oil production is dominated by the state through its ownership of ARAMCO,[6] the new income tax law of January 12, 2004 preserved tax rate per unit on companies and foreign investors engaged in the production of oil and other hydrocarbons productions at the rate of 85 percent.[7] Thus companies that engage in contracts with the state-owned company in exploration, production, collection, treatment, and transportation of oil are subject to this tax. The income tax is determined according to the new law in addition to any special deductions or allowances that may be agreed on by the parties in any contract between the Saudi Arabian Government and the foreign companies. It will also open the door for any foreign investors or companies to enter the Saudi market.

II. Natural Gas Tax

Due to the nature and unique features of the natural gas investment activity, the Income Tax Law has a separate chapter regulating it. The natural gas investment tax is imposed on every natural or legal person, including Saudis and others who receive the same treatment as Saudis, engaged in natural gas, natural gas liquids, and gas condensates investment activities within the Kingdom.[8] The 2004 new tax law added a new set of special rules for taxation of foreign investors engaged with the state-owned company in contracts in exploration, production, collection, treatment, transportation, processing, and

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Saudi Arabia. These four companies were the sole owners of ARAMCO until the early 1970s. *See* the on-line versions of handbooks previously published in hard copy by the Federal Research Division of the Library of Congress as part of the Country Studies/Area Handbook Series sponsored by the U.S. Department of the Army between 1986 and 1998, http://countrystudies.us/ (last visited on Dec. 13, 2005),

[3] In Supplementary Income Tax Law No. 17/2/28/7634 Dated 16/3/1370 H (Dec. 26, 1950), Article 1 stated "Every company which has been or is obliged to be registered under the Registration of Companies Law (which was approved by Royal Decree No. 144) and which operate in the production of petroleum or the other hydrocarbons in the Kingdom of Saudi Arabia shall be chargeable to income tax for each tax year expiring after the date hereof at 50 percent" The rate was raised was raised then gradually from 55, 66, 65. *See* 3 BUSINESS LAWS OF SAUDI ARABIA 3.13-183 (Nicola H. Karam trans. (2002), London: Graham and Trotman, 1982).

[4] As of 15/9/1394H (Oct. 14, 1974) the tax rate on oil producing companies was 65.66 percent of net income. However, beginning on 17/10/1394H (Nov. 1, 1974) the income tax rat was eighty-five percent. See Royal Decree No. M/65 of 13/11/1394H (Nov. 27, 1974) p 65. *See also* RANO CHANNAN, SAUDI ARABIAN TAXES, SOCIAL INSURANCE LAW, BUSINESS LAW, LABOUR LAW 27(1992).

[5] *See* Saudi Arabia: Country Study, *supra* note 2.

[6] *See* Anthony H. Cordesman, *Building True Wealth Versus Over-dependence on Petroleum and the State: Final Review*, in SAUDI ARABIA ENTERS THE 21ST CENTURY 106, 133(Center for Strategic and International Studies, Dec. 2, 2002).

[7] *See* art. 7 of the Income Tax law, Royal Decree No. 12, of January 12, 2004, Official Gazette (Umm Al Qura) of April 30,2004, effective July 29, 2004.

[8] *See Saudi Arabia introduces new gas taxation system for foreign investors*, ALEXANDERS' GAS AND OIL CONNECTIONS: NEWS AND TRENDS: MIDDLE EAST, volume 9, issue #11 - Wednesday, June 2, 2004, http://www.gasandoil.com/goc/news/ntm42211.htm (last visited Dec. 13, 2005).

fractionation of natural gas liquids and gas condensates.[9] The new Law incorporates the Natural Gas Investment Tax (NGIT) regulations that were issued in 2003 as a separate law adding a new set of special rules for taxation of foreign investors in the natural gas sector.[10] The tax rate on companies engaged in natural gas investment activities is set at a flat rate of thirty percent. All other gas-related activities are subject to an additional Natural Gas Investment Tax (NGIT) "tax rate table", which essentially provides for a thirty percent NGIT tax when the internal rate of return is eight percent or lower, and increases as the internal rate of return increases. The maximum NGIT tax rate is eighty-five percent when the internal rate or return is twenty percent or more (*see* the tax rate table applicable to the taxpayer's natural gas investment tax in Art. 48 of the attached Law).[11] Again, the NGIT taxpayer is determined according to the new law in addition to any "special deductions or allowances that may be allowed by the Contract between the Saudi Arabian Government and the NGIT taxpayer."[12] The objective of the new law is to encourage investments. The Minister of Petroleum and Mineral Resources Kingdom of Saudi Arabia stated:

> The tax code allows the investor to make attractive returns and bring equitable revenue to the Kingdom. As part of that initiative, four major exploration areas have been awarded to international companies in a highly transparent manner. These companies have already commenced their exploration activities. The opening of the upstream natural gas business to international investment is also expected to lead to further expansion of petrochemical industries in Saudi Arabia.[13]

Finally, it is worth mentioning that in Saudi Arabia, the majority of products including oil and gas products are subject to the consumption tax rate of five percent.[14] Such rates are substantially low compared to those rates imposed by consuming nations. The Saudi government blames energy taxes as the element responsible for soaring oil and gas prices, especially when the market prices for oil and gas increase. They asserted that eighty percent of the price of oil, especially in European Countries, for example, is made up of taxes.[15]

On November 19, 2005, King Abdullah Ibn Abdulaziz of Saudi Arabia called upon oil-consuming nations to reduce or cut taxes imposed on petroleum products, especially when the price of oil is up, in order to ease the burden on their citizens. King Abullah's statement was delivered after he met with General Rodrigo de Rato, International Monetary Fund Director, in Jeddah, Saudi Arabia. King Abdullah asserted that the kingdom and other main producers had acted responsibly by increasing production whenever there have been shortages of crude oil. He called upon the industrial nations to

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[9] *See* art. 45 of the Income Tax law, Royal Decree No. 12, of January 12, 2004, Official Gazette (Umm Al Qura) of April 30,2004, effective July 29, 2004.

[10] *See id* arts. 44-55.

[11] *See id* art. 48.

[12] *See Saudi Arabia introduces new gas taxation system for foreign investors*, *supra* note 6.

[13] Ali I. Al-Naimi, Saudi Arabia: Economic, Oil and Mineral Restructuring and Reforms, 2 Royal Institute of International Affairs (London: Catham House, Nov. 29, 2004).

[14] Saudi Arabia: Key Economic Indicators 4, 2001 Country Reports on Economic Policy and Trade Practices, (Bureau of Economic and Business Affairs, U.S. Department of State, February 2002). For more information, visit the Saudi Customs website at http://www.customs.gov.sa/arabic/default.htm (last visited Dec. 13, 2005).

[15] M. Ghazanfar Ali Khan, *Cut Energy Taxes, Says Abdullah,* ARAB NEWS Nov. 20, 2005, *available at* http://www.arabnews.com/; OPEC Members Say Consumer Countries Should Cut Oil Taxes, AXCESS NEWS, Nov. 19, 2005, *available at* http://www.axcessnews.com.

play their part by lowering taxes on refined petroleum products and taking a stand against oil market speculation.[16]

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[16] King Abdullah Calls on Nations to Reduce Taxes on Petroleum Products, AL-RIYADH, Nov. 20, 2005, *available at* http://www.alriyadh.com; Abdullah Al-Shihri, Saudi King: Oil Importers Should Cut Taxes, COMCAST, Nov 19, 2005, *available at* http://www.comcast.net/news/finance/index.jsp?cat=FINANCE&fn=/2005/11/19/267591.html

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UNITED KINGDOM

TAX INCREASES ON OIL AND GAS PRODUCTION

Executive Summary

The government has recently announced that the taxes applying to companies that extract oil from the North Sea are to increase. The government claims that this increase is to ensure that all non-financial sectors of the economy are evenly taxed, given the large and sustained rise in the cost of a barrel of oil. Opponents of the increase claim that it is a 'raid' on corporate profits and does not take into account the volatility of the oil and gas market.

The pre-budget speech prepared by the Chancellor of the Exchequer and delivered on December 5th, 2005, announced the government's intention to increase taxes on North Sea oil companies by ten percent to a total of fifty percent on all oil production from this area. The ultimate aim of this increase is to balance the promotion of investment and development in the oil industry and fairness for taxpayers.

The last substantive form of tax measures affecting North Sea oil production was passed in 2002 when the price of a barrel was approximately $25, with an average cost of $19 per barrel over years 1992-2002. The cost has since risen to $55 per barrel, averaging $32 in the years 2002-2005, resulting in a greater pre-tax capital return for North Sea oil producers, which is vastly disproportionate to the return of other non-financial sectors of the economy.[1]

Experts initially predicted that this increase would last only into the short term; forecasts now indicate, however, that the rise in prices will continue for at least the medium term. This is the reasoning that the Chancellor of the Exchequer has used to justify the government's intention to increase the supplementary corporation tax on oil and gas companies. Others argue, however, that the tax increase is a 'raid' on the profits of oil and gas companies that is jeopardizing jobs in the field to pay for the increase in government borrowing and reduced economic growth over the past few years.[2]

The government has also announced its intention to:

> Introduce a Ring Fence Expenditure Supplement to uplift all expenditure by North Sea oil companies without taxable income, to ensure that the value of tax relief is maintained over time. This replaces and extends the current Exploration Expenditure Supplement. The

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[1] HER MAJESTY'S TREASURY, PRE-BUDGET REPORT, BRITAIN MEETING THE GLOBAL CHALLENGE: ENTERPRISE, FAIRNESS AND RESPONSIBILITY, Dec. 5, 2005, ch. 5, ¶ 5.127, *available at* http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr05/report/prebud_pbr05_repindex.cfm.

[2] Ben Russell, *Brown fends off angry attacks from oil industry*, INDEPENDENT (London) Dec. 7, 2005, *at* 11.

> Government intends to open discussions with industry to examine wider structural issues which have implications for the stability of the North Sea oil tax regime.[3]

The Finance Act will introduce these measures, which, notwithstanding any other issues, will be effective from January 1, 2006. The Chancellor of the Exchequer has emphasized that there will be no further North Sea Oil tax increases for the remainder of the life of the current Parliament, that is currently expected to extend to 2010.

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[3] HER MAJESTY'S TREASURY, *supra* note 1, ¶ 1.530.

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VENEZUELA

TAX INCREASES ON OIL AND GAS PRODUCTION

The Venezuelan government has decided to end the low tax and royalties rates granted to the oil companies operating in Venezuela in the 1990s as an incentive to investments and exploration in the oil-rich country. During the last year, and especially after the increase in the crude price, the government determined that the economic basis for granting such a favorable tax treatment was no longer valid. Therefore it was decided to update those rates according not only to the increase in the world market price but also to the considerable increase in the oil production in the country.

I. Royalties

Royalty duties are established in the Hydrocarbons Law (H.L.)[1]. The Law provides that the State is entitled to a thirty percent participation in the form of a royalty of the volumes of hydrocarbons extracted from any reservoir.[2]

If proven to the satisfaction of the Executive that a mature reservoir or an extra heavy oil reservoir from the Orinoco Belt[3] cannot be economically produced with the thirty percent royalty, such royalty may be reduced to twenty percent to make the production economically feasible, and the Executive is likewise empowered to increase such royalty, fully or partially, to bring it again to thirty percent when proven that the production of the reservoir is economically feasible with such increase.[4] A reduction to 16 2/3 percent may be applied by the Executive on projects for bitumen blends from the Orinoco Oil Belt under the same circumstances.[5]

Petroleos de Venezuela (PDVSA-the state run petroleum company) subsidiaries are obliged to pay this tax at rate of 16 2/3 percent. The government of Venezuela, however, guaranteed a reduced royalty rate of one percent as a way to attract investment and aid initial project economics during the 1990s.[6] During this period of opening the petroleum industry to encourage investment in development projects and, because of the expensive and untested nature of the technology, the companies entered into "strategic association agreements" with the Venezuelan government, by which they were given a

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[1] LEY ORGANICA DE HIDROCARBUROS, (H.L). DECREE 1.510 of Nov. 2, 2001 in GACETA OFICIAL (G.O.) November 13, 2001. This report does not address natural gas production.

[2] *Id.* H.L. art. 44.

[3] A Venezuelan zone rich in oil.

[4] H. L., *supra* note 2.

[5] *Id.*

[6] *Exxon Mobil resisting new Venezuela's royalty in Cerro Negro Heavy Oil Faja Operation*, PETROLEUM WORLD, Feb. 23, 2005, *available at* http:// www.petroleumworld.com/storyt05022301.htm.

number of tax benefits such as a reduced royalty rate of one percent instead of 16 2/3, for seven to nine years.[7]

This rate was increased from one percent to 16.6 percent on October 2004.[8] The government based the rate hike decision on the fact that the economic conditions have changed since the time those contracts were entered in the 1990s, the technology had proved successful, and that the price of crude oil has soared as well as the productivity of the wells, which according to the Minister of Energy, has increased 300 percent.[9]

In the context of the opening of the oil industry, companies formed under association agreements (both strategic and profit-sharing) with clauses whereby the benefit of lower royalties depended on the level of projected income, which obviously depends on the price.[10]

II. IncomeTax

On April 2005, the Venezuelan government announced an increase in the income tax on private oil projects to fifty percent from thirty-four percent as part of a campaign to increase revenue from its petroleum operations energy.[11] The lower rate was paid, according to the government statements, because the oil companies filed their income tax as services companies under a thirty percent rate and not oil production companies, which should pay a fifty percent rate.[12]

The president has announced that the SENIAT, the Venezuelan tax agency, will reclassify taxes and a company that drills, produces, operates, or processes oil will have to pay income tax of fiftypercent. The tax measures will affect foreign companies working in the world's fifth largest oil exporter through the promotional operational agreements signed in the 1990's. The government also is renegotiating with foreign businesses involved in thirty-two operating contracts to convert the deals to joint ventures under the new terms set by H.L. in 2001.[13]

III. Conclusion

Event though the tax increase for oil companies in Venezuela is resisted, many analysts, irrespective of their political affiliation, agree that some sort of re-definition of the "opening of the oil industry" was needed for some time. In addition to obtaining income higher than anyone would have foreseen more than a decade ago when the operational contracts were signed, foreign oil companies

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[7] EL ESTADO VUELVE POR SUS FUEROS Y AUMENTA LAS REGALIAS PETROLERAS, Alia2 Agencia Lationamericana de Informacion y Analisis 2, Venezuela, Oct. 19, 2004, *available at* http://www.alia2.net/article122489.html.

[8] Id. at 3.

[9] *Id.* at 3.

[10] *Id.*

[11] S. Rodriguez, *Venezuela to Raise income tax on oil companies to 50%*, Apr. 19, 2005, *available at* http://www.indymedia.org.uk/ennull309534.shtml.

[12] UNA MASIVA Y DELIBERADA EVASION DE IMPUESTOS, Petroleos de Venezuela (PDVSA), August 2005, *available at* http://www.pdvsa.com/index2.html.

[13] *Venezuela to Raise income tax on oil companies to 50%*, *supra* note 11.

have been using accounting practices to evade paying income tax as oil companies at a higher rate than the regular service companies who are taxed at a lower rate.

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TAX INCREASES ON OIL AND GAS PRODUCTION

A GENERAL SURVEY OF OIL-PRODUCING NATIONS

A survey of Internet resources available through the Lexis-Nexis database and other information providers found few examples of countries raising taxes on oil producers since mid-2004.

Argentina – In May 2004, Argentina increased its export tax on crude oil from twenty percent to twenty-five percent, and that on liquefied petroleum gas from five percent to twenty percent.[1]

Ecuador – In April 2005, more than twenty international oil companies operating in Ecuador were engaged in a dispute with the government of Ecuador over the amount of income taxes they owed. The government claimed the companies had under-reported income between 1998 and 2001. In October 2005, Ecuador's government was reported to be planning to increase its share of profits in contracts with private investors to fifty percent from what it claims was a twenty percent share. Oil analysts are quoted as saying that current contracts, signed in the 1990s, set an average split of seventy percent for private operators and thirty percent for the government.[2]

Indonesia - Indonesia, which has suffered from declining crude oil production and a reluctance by foreign corporations to invest in oil exploration or production, has acted to reduce the taxes imposed on foreign oil companies. In late January 2005, the Indonesian government issued new regulations removing taxes on imported drilling equipment. As of September 2005, foreign oil producers were complaining about the uncertainties in the Indonesian tax system, with the Chief Executive Officer of the Chevron Corporation telling the annual meeting of the Indonesian Petroleum Association that: "Indonesia should take steps to clearly define a company's tax obligations …"[3]

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[1] *Respol YPF lifts Jan-Sep Gas Output 12%*, MERCOSUR, November 12, 2004, *available at* http://www.falklands.com/Detalle.asp?NUM=4609 .

[2] *EnCana Sells Ecuador Assets to China,* INTERNATIONAL OIL DAILY, September 14, 2005, *via* LEXIS-NEXIS Online Database.

[3] *Indonesia's Purnomo Pledges to Raise Oil Output, Ease Tax Burden*, INTERNATIONAL OIL DAILY, October 25, 2004; *Indonesia Tries Harder to Tempt Oil Investors*, PETROLEUM INTELLIGENCE WEEKLY, September 5, 2005, both stories *via* LEXIS-NEXIS Online Database [need a Lexis file number].