



Special Series on Fiscal Policies to Respond to COVID-19

This is one of a series of notes produced by the Fiscal Affairs Department to help members address the COVID emergency. The views expressed in this paper are those of IMF staff and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

Natural Resource Fiscal Regimes: Tax Policy Response¹

Countries with natural resources may come under pressure to provide tax relief in response to lower commodity prices. The first best response is to let the automatic stabilizers operate with revenue from profit-based taxes falling more sharply than from production-based ones. General tax relief provided in response to the crisis should also apply to extractive industries, and VAT refunds should be paid on a timely basis to export-oriented projects. In some exceptional cases, temporary relief, for example from royalties, may be warranted.

Please direct any questions and comments on this note to cdsupport-revenue@imf.org.

I. PANDEMIC CRISIS IMPACT ON EXTRACTIVE INDUSTRIES

Prices for oil and base metals have declined significantly reflecting both the curtailment of demand triggered by the pandemic crisis, and the supply surge in oil production.² Notably, the impact on the mining industry has not been uniform as precious metal prices have increased in response to the economic uncertainty. Mining and petroleum operations may also be temporarily shut down as part of society-wide public health efforts or if employees become infected.

The profitability of extractive industries is expected to decline, with implications for the fiscal, external and real sectors. Depending on the length and severity of the crisis, mining or petroleum projects may scale back production or shut down. Relatively high cost projects will be more vulnerable. Generally speaking, operations will continue as long as the price exceeds marginal cost (including the cost of temporarily shutting down operations). Investment decisions are likely to be deferred with higher cost or risky exploration areas being most vulnerable.

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² See “*Fiscal Policy Responses to the Sharp Decline in Oil Prices*”, by IMF Fiscal Affairs Department.

II. FISCAL REGIMES FOR EXTRACTIVE INDUSTRIES

Fiscal regimes for mining and petroleum upstream activities commonly comprise production-based (e.g., a royalty) and profit-based instruments (e.g., corporate tax, resource rent tax, or profit oil sharing). Some regimes also have direct state participation. A royalty provides early revenue from the start of production and indicates the government's reserve price for preserving the resource for future extraction. Profit-based instruments often have progressive rate schedules to give the government a higher share in more profitable projects.

In response to lower commodity prices, government revenue will fall with profit-based instruments likely displaying a relatively larger decline than production-based ones. Fiscal regimes that rely more on profit-based instruments tend to have a larger automatic decline in revenue reducing the justification for discretionary policy changes.

III. TAX POLICY RESPONSE

The first-best tax policy response is to let the built-in automatic stabilizers in the fiscal regime take effect while resisting pressure for exemptions or exceptional support to mining or petroleum projects. There is no compelling reason to reduce tax rates or provide tax holidays, although intra-year provisional tax payments could be based on estimated current income reflecting lower commodity prices.

1. Economy-wide crisis-related tax measures should also apply to the extractive industries, specifically:³
 - Temporary relief from payroll taxes should be extended to the mining and petroleum sector. Mining projects tend to be relatively more labor-intensive than petroleum.
 - VAT refunds should be paid on a timely basis and where there are VAT refund arrears, these should be cleared expeditiously to improve cashflows. This benefits extractives projects that often are export-oriented.
 - The tax loss carry-forward period can be extended to provide certainty that losses can be fully recovered, or loss carry-backward provisions can be introduced with more immediate cashflow benefit.

2. Only in exceptional circumstances will discretionary tax policy support specific to the extractive industries be warranted. Tax policy relief should only be provided if financial modeling demonstrates that an ongoing project becomes financially unviable in the short to medium term as a result of lower commodity prices without the temporary support.
 - A deferral of royalty payments, a temporary reduction in royalty rates or a royalty rebate to provide cashflow relief.
 - Periodic limitations on expenditure deductions could be temporarily loosened (e.g., an increase in the cost recovery limit in a production sharing framework).
 - Loosening ring fencing provisions to allow tax consolidation between projects could shift the timing of revenue, although this complicates the application of fiscal instruments linked to cumulative cashflows (e.g., resource rent taxes or R-factor based profit oil sharing).
 - Outside of the fiscal regime, regulators may agree on a temporary basis to defer work commitments agreed with licence holders for mining and petroleum projects.

Discretionary measures should have a clear sunset provision with an end-date and be provided industry-wide with full transparency based on pre-set eligibility criteria, rather than through individual project negotiations.

³ See "Tax Issues: An Overview" by IMF Fiscal Affairs Department.