FISCAL AFFAIRS

Special Series on Fiscal Policies to Respond to COVID-19

Revenue Administration: Safeguarding Revenues for Oil-Producing Countries

This note provides guidance to governments and revenue administrations on risks and actions needed to support their oil and gas (O&G) sector by alleviating companies' short-term cash flow pressures, ensuring the sector's compliance with the fiscal regime, and safeguard revenue from this and related sectors during the COVID-19 pandemic and collapse in oil prices. It supplements other notes the IMF has issued in response to the COVID-19 pandemic.[1, 2, 3]

In the short-term, the COVID-19 outbreak is reducing global demand for oil, contributing to price volatility. Countries that are dependent on oil production for a significant portion of their revenues face a substantial drop in oil prices. This will affect many oil producing developing countries, where revenue from the sector can exceed 80 percent of total revenues.[4]

Where administration of the O&G sector is fragmented between several regulatory agencies, collaboration is critical for governments to manage compliance and mobilize revenue effectively. In the longer term, if a national oil company is involved in revenue administration, governments will need to address conflict of interest and transparency concerns.

In applying this guidance, revenue administrations need to consider their implementation capabilities and local conditions carefully, taking into account the stage that the crisis may have reached in their country and the stage of government's responses to the crisis.

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

1 Especially: IMF notes on Tax and Customs Administration Responses and Business Continuity for Revenue Administrations, April 2020, Special Series onCOVID-19, https://www.imf.org/en/Publications/SPROLLs/covid19-special-notes.

2 See, for example, Collecting Taxes During an Economic Crisis: Challenges and Policy Options, IMF Staff Position Note, July 14, 2009, https://www.IMF.org/external/pubs/ft/spn/2009/spn0917.pdf.

3 See: Natural Resource Fiscal Regimes: Tax Policy Response, April 2020; Special Series onCOVID-19, https://www.imf.org/en/Publications/SPROLLs/covid19-special-notes.

4 See, for example, Revenue Administration: Administering Revenues from Natural Resources- A Short Primer, IMF Staff, June 17, 2014, https://www.imf.org/en/Publications/TNM/Issues/2016/12/31/Revenue-Administration-Administering-Revenues-from-Natural-Resources-A-Short-Primer-41604.

Appropriately defined functions, policies and procedures that focus on attaining long-term objectives, plans, and voluntary compliance become even more important during this crisis. This note focuses on existing administrative measures that require increased attention from tax administrations, and measures that address risks related directly to the COVID 19 crisis.

I. IMMEDIATE MEASURES FOR OIL AND GAS SECTOR

To mitigate the impact of the sudden downturn in the economy linked to the COVID-19 crisis on companies in the oil and gas sector, tax administrations could consider:

- Implementing a risk-based approval process and streamlining the VAT refund processes.
- Adopting deferred VAT payments for imported capital goods to taxpayers with proven compliance histories and who post financial security.
- Where there are VAT refund arrears, these should be cleared expeditiously.
- Undertaking more post-refund audits for lower-risk claims, as part of the annual verification plans and preserving pre-refund audits only for higher-risk claims.
- Defer royalty payments for crude oil produced but not sold and placed in storage.

To safeguard compliance and support the O&G sector, tax administrations could consider:

- Ensuring appropriate focus on price verification and metering (quantity, quality, and price) to ensure accurate reporting of royalties and major taxes.[5]
- Identifying and monitoring risks associated with contractors leaving the country due to reductions in capital spending by international oil companies in O&G operations.[6]
- Identifying risks associated with, and monitoring, the exodus of expatriates and ensuring all taxes are assessed and paid.
- Continuously assessing economic changes in the sector to identify new risks.
- Scrutinizing requests for reductions to tax installment payments.

II. MEASURES TO ADDRESS FILING RISKS FOR THE OIL AND GAS SECTOR

A. PRE-CRISIS FILINGS AND REPORTING PERIODS

Corporate income tax returns filed for the year ending 2019 will reflect income, expenses and taxes payable prior to the impact of COVID-19 or the fall in crude oil prices. Tax administrations should ensure proper liabilities and payment terms are established for 2019 and prior returns to safeguard compliance and to alleviate short-term cash flow pressures that companies in the O&G sector will face. Revenue administrations should consider:

- Reviewing and monitoring all O&G risks identified in current and prior reporting periods. Identify and prioritize taxpayers for current or future compliance actions based on the severity of the compliance issues.

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5 Including; (1) that the volume of each lift will be determined by an independent inspector; (2) the operator, the government, and the lifting party may witness the taking of measurements; (3) meter measurements will be taken immediately before, during, and after loading; (4) meters are calibrated for each lift; and (5) measurements are corrected to standard temperature and atmospheric pressure of 60 degrees Fahrenheit and 14.5 pounds of pressure per square inch.

6 These contractors may have accrued tax liabilities, plus assets disposals in the country before leaving. Revenue administrations should identify and verify these tax liabilities and assets disposals before departure, and initiate collection action where appropriate.

Liabilities should be established through on-time filing, but payment arrangements may need to be set up to address company cash flow concerns.

- Monitoring, initiating, and conducting cost recovery audits in strict adherence with the terms of the production sharing contracts and corporate income tax act to preserve the government's audit rights and prevent overstatement of costs.
- Monitoring the price structure at the pump and the margins of oil tanker distributors in case of subsidy reduction.
- Monitoring derivative reporting; in times of falling crude oil prices derivate hedging contracts give rise to taxable gains that should be reported.

B. TAX FILINGS AND REPORTING PERIODS FOR 2020 AND FUTURE PERIODS

Tax filings, installments, and remittances for the 2020 tax year will be affected by the economic consequences of the pandemic and falling oil and gas prices. Oil and gas operations, investment decisions and changes to corporate structures will introduce new compliance risks. Revenue administrations should consider:

- Implementing effective information and knowledge sharing between regulators to ensure that critical information and expertise is available to enhance the administration and monitoring of the sector. In the medium term, these protocols can be formalized into Memoranda of Understanding (MOU).
- Risk assessing and monitoring the volume of crude oil that is produced and placed into storage and subsequently sold to ensure that royalties and revenues are reported. An excess supply of crude oil will create situations where oil is produced but cannot be sold. Shutting in wells is expensive and may damage the production capabilities of the reservoir. Oil producers will continue to produce and temporarily place the unsold production into storage facilities.
- Monitoring dispositions of interests, whether by mergers and acquisitions or bankruptcy, and ensuring that resulting capital gains or losses are correctly reported, reassessments are issued on time, tax is paid, or ensuring that the liability is registered, as in many cases the country is a preferred creditor.
- Risk assessing the effect of financial restructuring on taxes payable, including the impact of debt forgiveness, conversions of debt to equity, and revision to critical terms of debt instruments.
- Scrutinizing closure and turnaround costs to ensure appropriate classification of capital and operating costs.
- Apply existing loss carry-forward and carry-back provisions to ensure losses are applied correctly.
- Implementing electronic filing and payment for large O&G companies and subcontractors to ensure taxpayers can file returns, assessments are issued, and taxes are collected and reconciled to payments.
- Accelerating the installation of the latest metering technology to ensure accurate meter readings of quality and quantity along the entire production chain, which information can be directly conveyed to the tax authority and other regulators electronically.

III. COMPLIANCE IMPROVEMENT MEASURES TO MOBILIZE REVENUE

Tax administrations are encouraged to identify and implement strategies to mobilize revenue during the crisis. The following measures could be considered:

- Immediate measures to be intensified during the crisis.

- Developing and enhancing compliance improvement plans for economic sectors that benefit from the collapse of oil prices, for example, agriculture, consumer staples, chemicals, and telecommunications.[7]
- Investigating local service providers and suppliers' tax assessments and VAT refund claims to ensure all revenues are reported.
- Enhancing taxpayer services and contacting taxpayers regularly to stay in constant contact with companies to discuss technical issues, acting more like "company tax facilitators."

Medium- and longer-term measures to be carried out once the crisis abates:

- Identifying new long-term derivative strategies designed to lock in future losses.
- Evaluating the fiscal regime and understanding the options available in different circumstances that might evolve both during and after the crisis to ensure the revenue administration's preparedness.[8]
- Establishing clear separation between commercial and regulatory roles. The involvement of a commercial entity in the regulatory functions of government is a clear conflict of interest and should rule out the integration of O&G revenue administration within a national oil company.
- Increasing transparency by regularly publishing contracts and revenues collected from the sector in accordance with EITI reporting guidelines.

IV. SPECIFIC CUSTOMS ADMINISTRATION MEASURES

In many countries, customs control of O&G exports and equipment imported for their production is not optimal, even though data that customs produces is critical for ensuring transparency and determining natural resource revenues. With the decrease in O&G prices linked to COVID-19, it is all the more important to ensure that flows crossing borders are accurately recorded and that the data can be used to formulate policies and verify revenue.

For customs administrations, it is critical to ensure that procedures and controls relating to oil and gas export activity are in place, and, if not, to build or strengthen them depending on the situation. Particular attention should be paid to the following:

- Measuring and recording the quantity and quality of O&G lifted for exports, and correctly applying valuation rules.
- Monitoring risks and performing (desk) audits as needed, related to imports and exports of equipment for the O&G sector, for possible overstated and understated values, against applicable customs valuation rules.
- Monitoring and audit of dual-purpose goods which have been exempted upon import for use in the O&G sector exclusively.

Should revenue administrations require assistance with developing strategies, plans, or expanding or adapting some of the suggestions above in order to address promptly the impact of the COVID-19 pandemic in the O&G sector, the IMF FAD is prepared to assist through consultations and recommendations based on each administration's needs.

7 See IMF Fiscal Affairs Department Note Safeguarding Revenue Streams and Restoring Revenue Administration Activities After the COVID-19 Crisis, April 2020 (not yet published).

8 See: Natural Resource Fiscal Regimes: Tax Policy Response, April 2020; Special Series onCOVID-19, https://www.imf.org/en/Publications/SPROLLs/covid19-special-notes.