Fiscal Regimes for Extractive Industries – Design and Implementation

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Conference on Natural Resource Taxation in the Asia-Pacific Region

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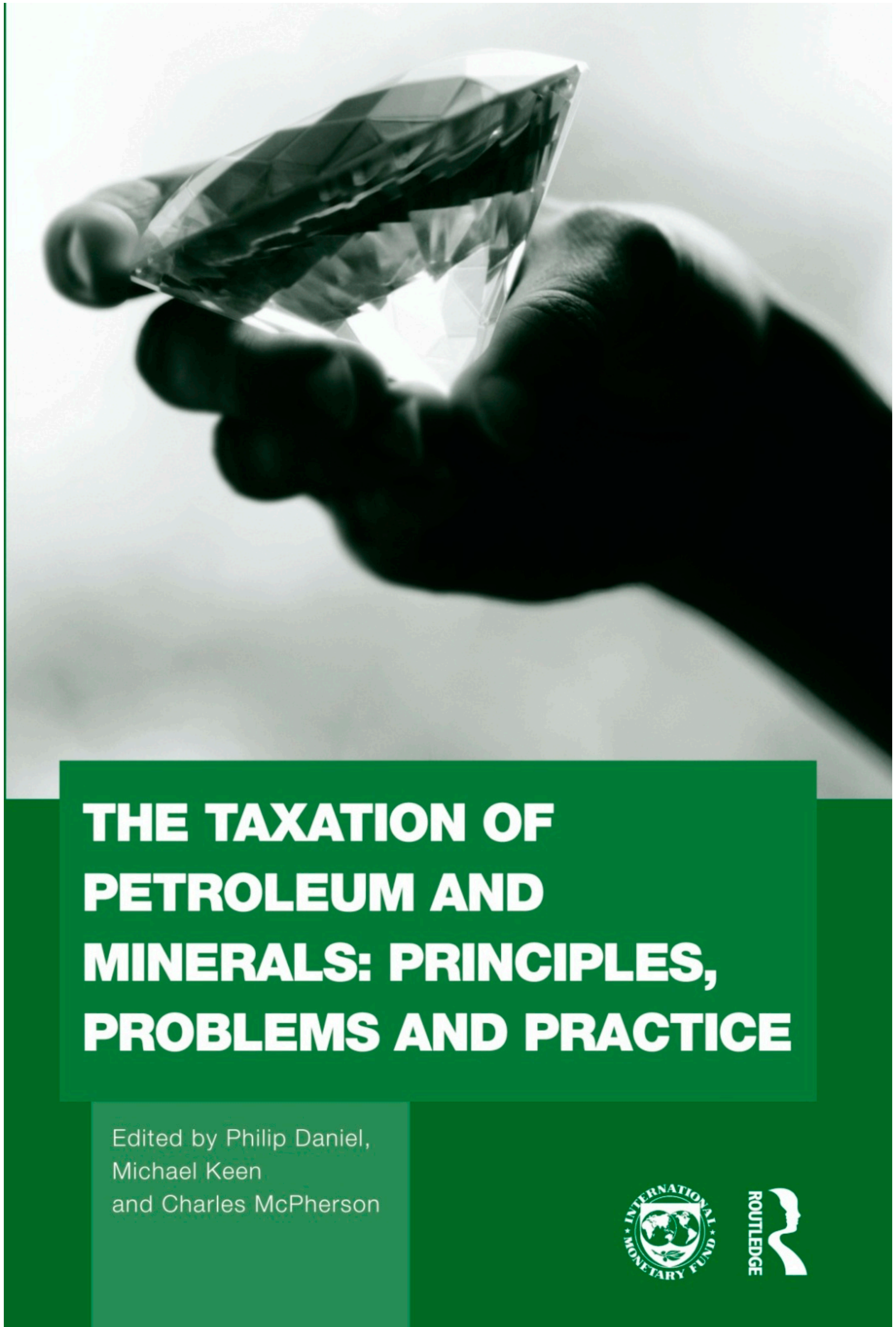


"There are few areas of economic policymaking in which the returns to good decisions are so high – and the punishment of bad decisions so cruel – as in the management of natural resource wealth"

Presentation Outline

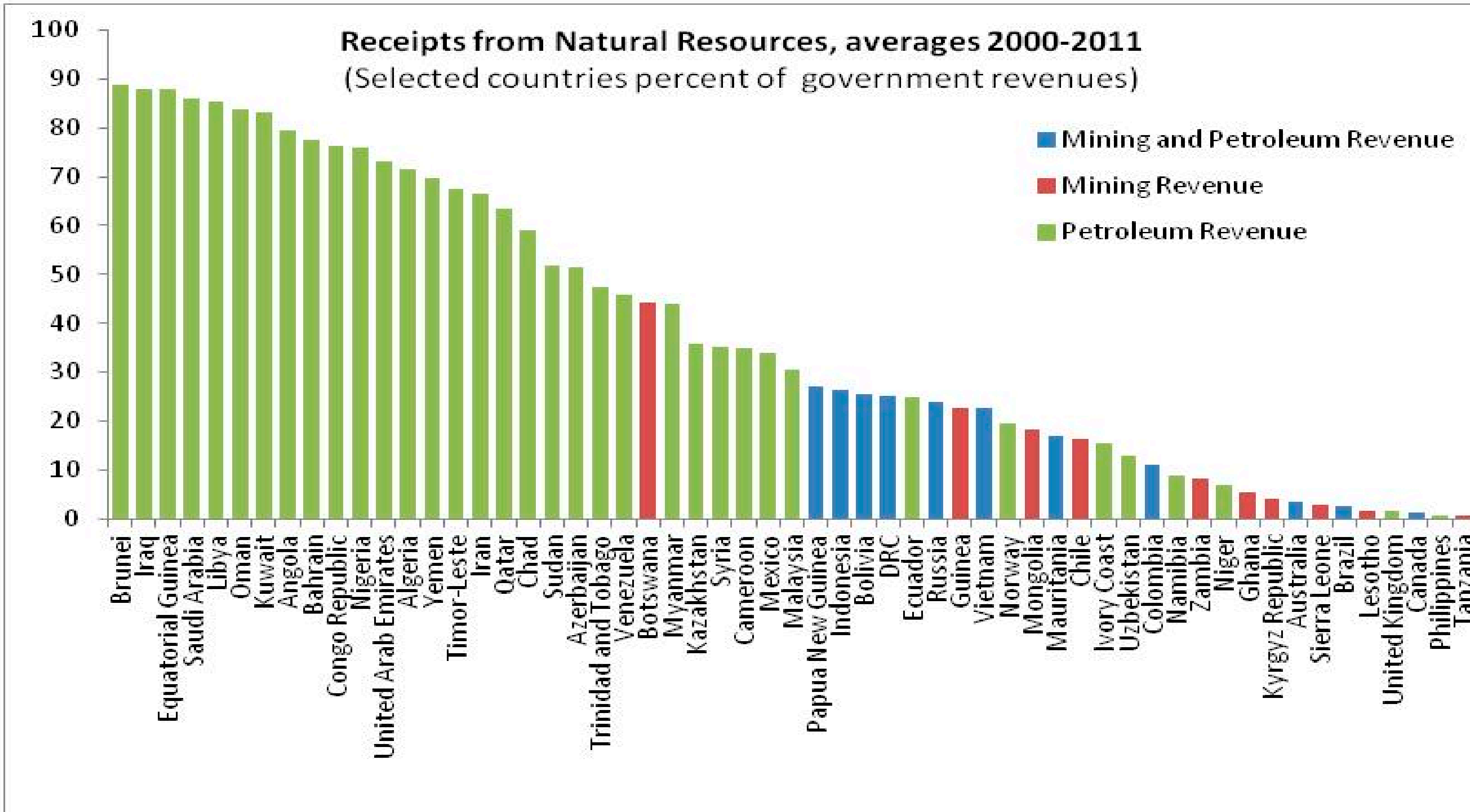
- Why is this topic important?
- Overview of key objectives for extractive industry (EI) fiscal regimes
- Overview of key EI fiscal issues to be covered in this conference

Part 1

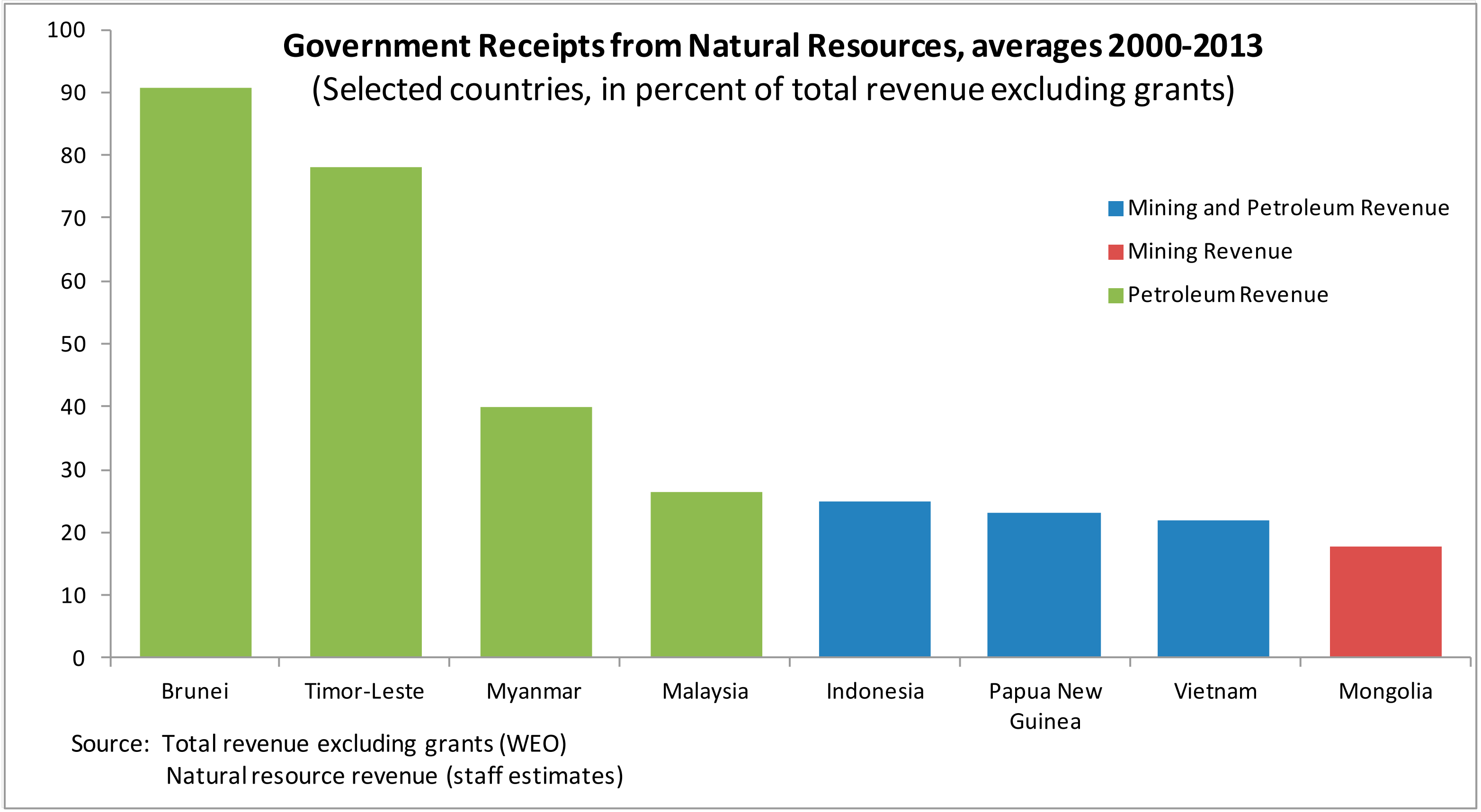
WHY IS THIS TOPIC IMPORTANT?

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

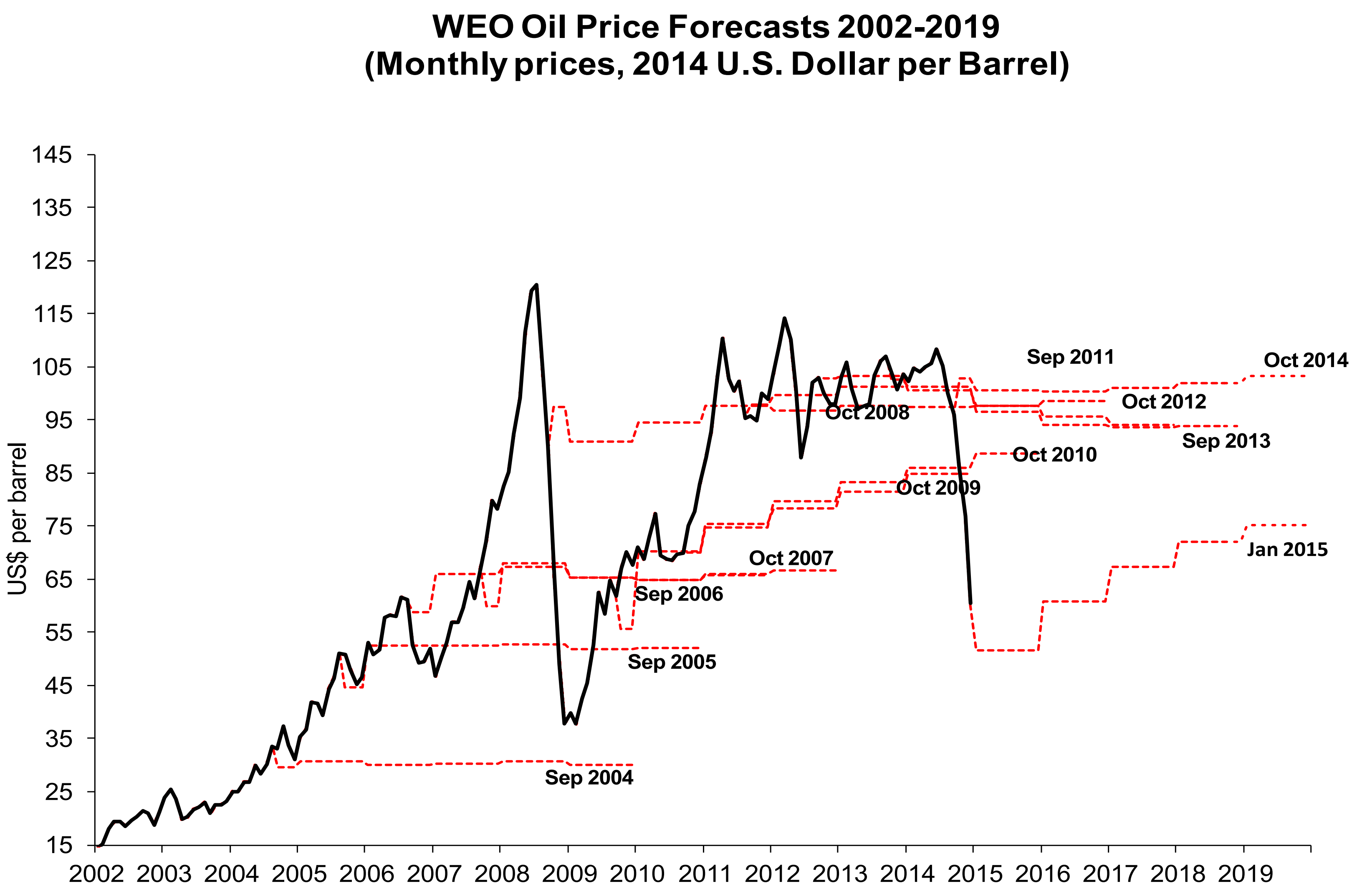
OVERVIEW OF KEY OBJECTIVES FOR EXTRACTIVE INDUSTRIES FISCAL REGIMES

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



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

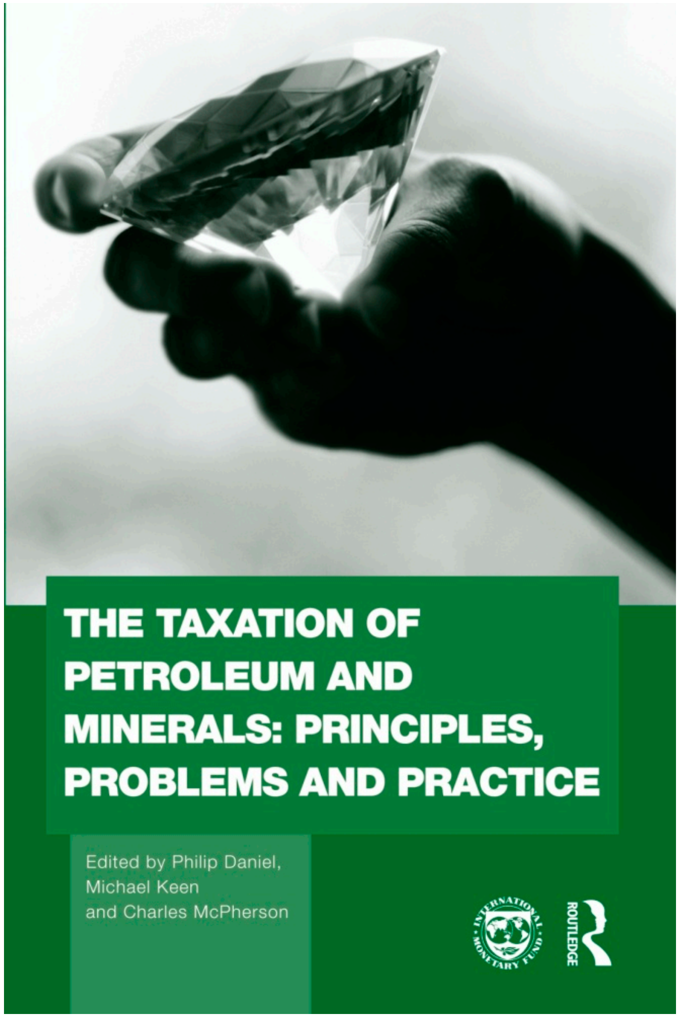
- IMF Board Paper (August, 2012) on "Fiscal Regimes for Extractive Industries: Design and Implementation" available at:

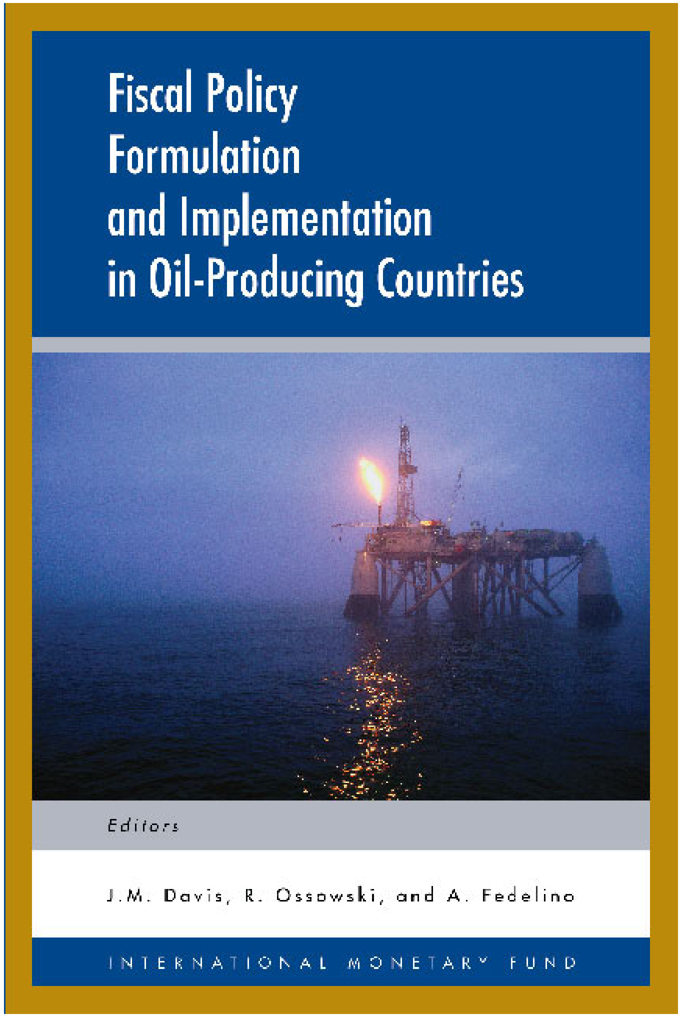
http://www.imf.org/external/np/pp/eng/2012/081512.pdf

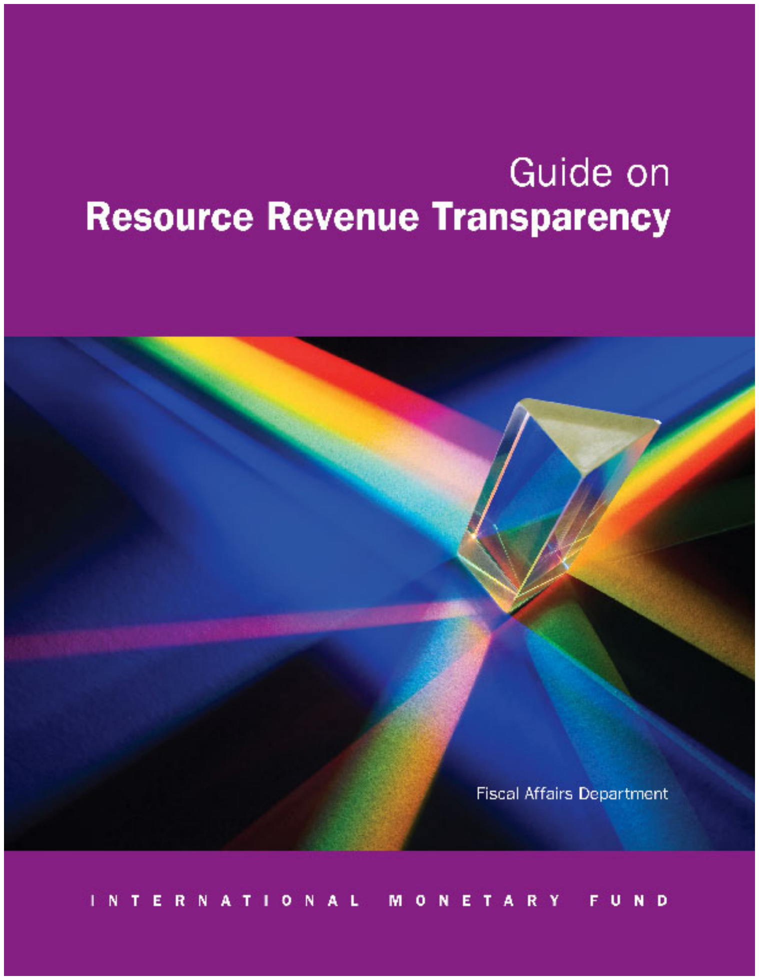
- Forthcoming book:

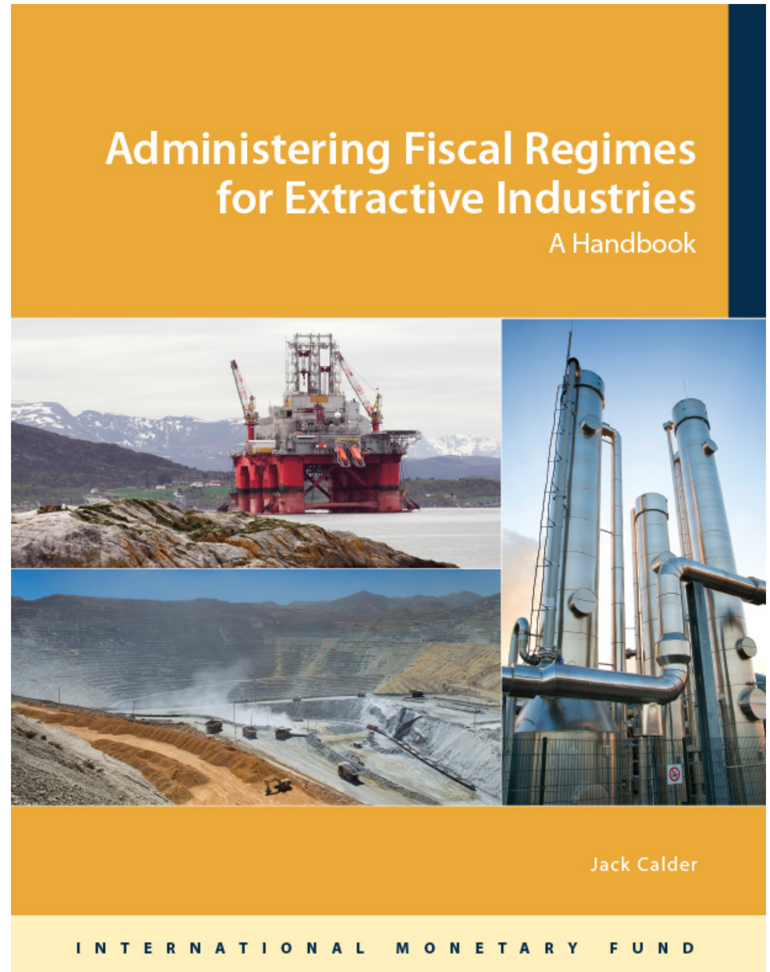
  International Taxation and the Extractive Industries due for release in early 2016

Existing Publications






Guide on
Resource Revenue Transparency
Fiscal Affairs Department
INTERNATIONAL MONETARY FUND


Administering Fiscal Regimes
for Extractive Industries
A Handbook
Jack Calder
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