DRAFT MINING AND PETROLEUM TAX LAW

BACKGROUND

- ALL COUNTRIES WITH RICH NATURAL RESOURCES WANT MAXIMUM REVENUES FOR GOOD OF COUNTRY.
  - RISK = MINING COMPANIES UNDERPAY.
  - COUNTRY LOSES "RENT" (EXCESS PROFITS) FOREVER

  MINING COMPANIES WANT MINIMUM TAXES
  - RISK = TAXES ELIMINATE REVENUES. PROJECT IS FAILURE
  - MIGHT STOP WORK. MINERALS PERHAPS LOST FOREVER
  - THIS IS A FORM OF PROBLEM OF "HIGH GRADING"
- MIGHT NEVER INVEST, SO PROJECT NEVER OCCURS. NO REVENUES FOR GOVERNMENT.

PHYSICAL CHALLENGES OF EXTRACTION COMPANIES

TREES ARE CHEAP AND EASY TO GET

DEEP MINES TAKE VERY LARGE AMOUNTS OF CAPITAL AND TIME

ONSHORE OIL AND GAS IS MODERATELY DIFFICULT AND NOT VERY EXPENSIVE

OFFSHORE OIL AND GAS PLATFORMS VARY BUT ARE IN MANY YEARS – MOZAMBIQUE OFFERS DEEP WATER FIELDS – EXPENSIVE AND SLOW

FORMS OF TAXATION GLOBALLY

- 1. Production-Sharing
  - Country becomes a partner
  - Company pays expenses

2. ROYALTIES

   Country gets some percentage of production

   Example: 5% of value of sales of production each month

3. PRODUCTION TAX

   Company pays fixed amount or percentage of production by value or output when produced

   Complicated to administer

4. EXPORT TAX

   Company pays tax when product is exported

- 5. INCOME TAX
- Company calculates profits
  - Company pays a share of profits: 32% in Mozambique
  - Profits = Revenues received minus costs
  - Complicated but good for company because will not pay this tax if not profitable in the year

6. RESOURCE RENT TAX

Impose additional tax after company's profits = total cash invested plus interest charge

Recent form of taxation

7. TAXES FOR PARTICULAR RIGHTS

Examples: Exploration License, Land Rental, etc.

- These specific fees are normal practice.

- MOZAMBIQUE PROPOSES TO HAVE ALL THESE TAXES EXCEPT EXPORT TAXES

MY COMMENTS:

1. Complicated
2. Mozambique lacks ability to confirm companies' reports of their income.
3. Production revenues must to properly recorded
   Use independent accountants to establish that the procedures for reporting revenues and disbursements are reliable.
4. Draft laws can result in taxes more than 100% of profits.
   Mainly because production tax is not treated as an expense. Unacceptable result

- I strongly recommend that the draft laws eliminate the Production Tax and use Royalties instead.
  - Result: simpler to compute production income

    because one uses actual sales.

    Will eliminate taxation of more than 100% or economic income

CHALLENGE: DESIGN TAXES THAT BALANCE FEAR AND GREED OF COMPANIES AND GOVERNMENT

NO SINGLE SOLUTION

- MORE DIFFICULT TO DESIGN GOOD TAX SYSTEM IF COUNTRY WANTS REVENUES SOON.
  - MOZAMBIQUE GETS SOME REVENUES “SOON” IN FORM OF
    - PAYMENTS FOR EXPLORATION AND DEVELOPMENT
    - ROYALTIES

IMPORTANT CONSIDERATIONS

- REVENUES
- ADMINISTRABILITY
- SIMPLICITY OF RULES
- FAIRNESS - TREAT TAXPAYERS IN THE SAME SITUATION THE SAME WAY + NO SURPRISES
- TRANSPARENCY - EVERYONE CAN SEE AND UNDERSTAND WHAT IS HAPPENING

RIGHTS OF TAXPAYERS IN A GOOD SYSTEM

- The right to be informed
- The right to be assisted
- The right to be heard concerning objectionable acts
- The right to pay no more than the correct about of tax
- The right of appeal
- The right to certainty
- The right to privacy
- The right to confidentiality [with one's representative]
- The right to representation, and
- The right to fair and just tax system.
- These rights were proposed by the Taxpayer Advocate, part of the IRS. The exist incompletely in the US system.

PROPOSED MINERAL TAX LAW

- THREE PARTS
  - A MINERAL PRODUCTION TAX +
  - A CORPORATE INCOME TAX +
  - A RESOURCE RENT TAX

- 1. PRODUCTION TAX
  - BASE = VALUE OF PRODUCTION
  - RATE: DEPENDS ON THE MINERAL AND NOT FIXED YET
  - REVENUES DEPEND ON ACTUAL PRODUCTION
- COMPARE TO A ROYALTY: OWNER GETS SHARE OF SALES THAT MINER GETS –
  - MUCH SIMPLER

2. CORPORATION INCOME TAX

- BASE = LEGAL NET PROFIT FOR YEAR
- RATE = 32%

3. RESOURCE RENT TAX

- CONCEPT : RAISE TAXES AFTER MINER RECOVERS ALL CASH INVESTED
- BASE = CASH PROFITS FOR YEAR
- RATE = 10% OF PROFITS
- COMMENTS:
  - A MODERN FORM OF TAXATION
  - ADOPTED IN SEVERAL COUNTRIES
  - CAPTURES PROFITS BEYOND "REASONABLE" LEVEL

PROBLEMS WITH THE DRAFT LAW

- MINERAL PRODUCTION TAX:
  - TOO COMPLICATED TO ADMINISTER + WILL CAUSE DISPUTES
-
  - DOES NOT REDUCE BASE OF INCOME TAX SO CAN RESULT IN EXCESSIVE TAXES, EVEN OVER 100% OF INCOME
  - USE A ROYALTY INSTEAD?
  - ROYALTY MEANS REVENUE EVEN IF MINER IS LOSING MONEY
    - GOOD: MOZAMBIQUE GETS MONEY
    - BAD: MINER MAY STOP OR HIGH GRADE

CORPORATE INCOME TAX

- MANY SMALL FLAWS THAT CAN BE REPAIRED
- ADVANCED COUNTRIES (CANADA, NORWAY) USE CORPORATE INCOME TAX ONLY.
  - 78% RATE IN NORWAY + SIMPLE RULES
  - POSSIBLE BECAUSE NORWAY IS ALREADY RICH
  - NO “HIGH GRADING” AS A RESULT
  - CLEAR AND SIMPLE LAW
- MOZAMBIQUE’S 32% RATE IS TYPICAL
- BASE IS UNREASONABLE
  - NO DEDUCTION FOR ROYALTIES
  - LEGAL INCOME TAX SHOULD = ECONOMIC INCOME

PROPOSED PETROLEUM TAX LAW

Three taxes (very similar to draft mineral tax law)

1. PETROLEUM PRODUCTION TAX (6-10%)
   LIKE ROYALTY

2. CORPORATE INCOME TAX (32%)

3. PRODUCTION-SHARING UP TO 60%
   LIKE RESOURCE RENT TAX
   TO CAPTURE "EXCESS" REVENUES

- COMMENTS

  1. TAXES CAN EXCEED 100% OF ECONOMIC INCOME
     - Inability to deduct Production Tax from Income Tax, or
     - 60% limitation on deductions for purpose of calculating Production-Sharing Tax

- I RECOMMEND A ROYALTY – GOVERNMENT GETS A SHARE OF PRODUCTION WHEN PRODUCER SELLS IT

- MUCH SIMPLER TO ADMINISTER

2. TOTAL TAXES ARE HIGH AND WILL ATTRACT OPERATORS TO LARGE DEPOSITS.

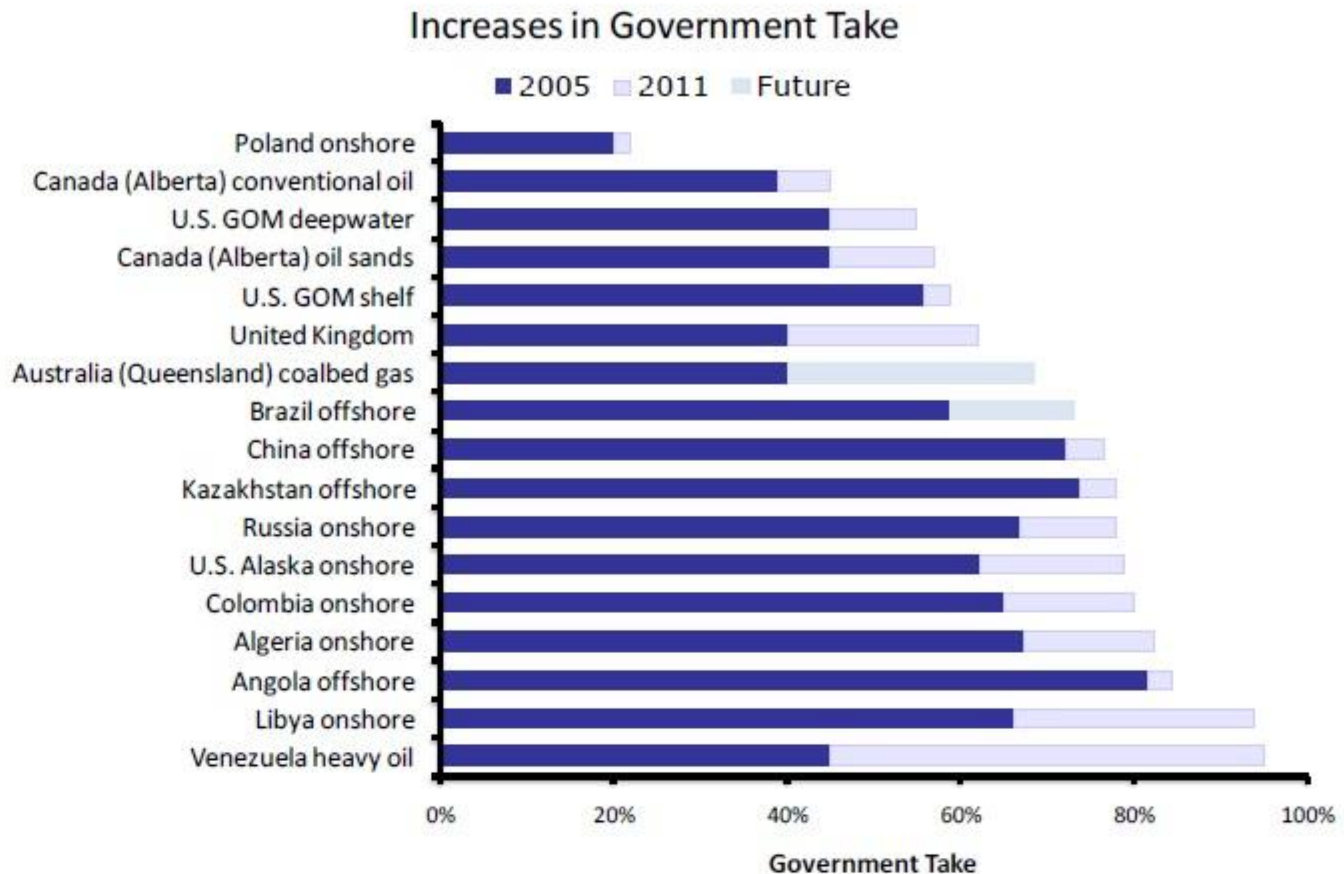
- SMALLER DEPOSITS WILL BE DEVELOPED SLOWLY
- LEGAL AND ADMINISTRATIVE SYSTEMS MUST INSPIRE CONFIDENCE

- Example of Effect of 60% limit on field producing no economic profit or loss. Taxpayer has 90% of production.

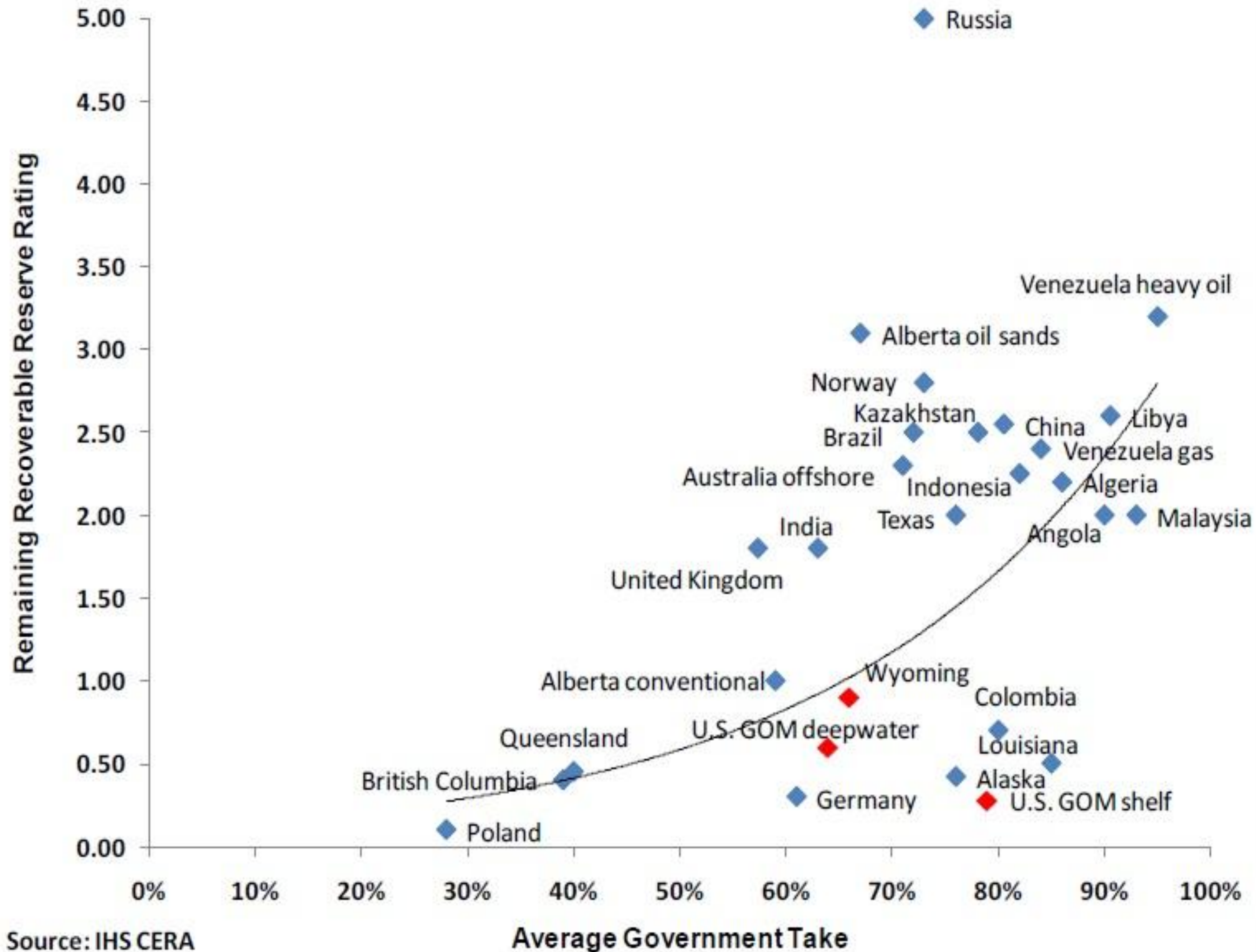
  Gross sales 200
  IPP (20)
  Available Petroleum 180
  Economic Cost before IPP 200 [note TP bears all costs]
  60% limit on Ec. Cost = .6 x 180= 108
  Profit Petro. 180- 108 = 72
  Govt's 10% share 7.2
  TP share 64.80
  Govt. gets 20 IPP + 7.2 Prod. Share = 27.2
  TP gets (27.2)

- Result: Taxes on nonexistent income beyond "royalty". Worse if govt. has larger share or where IPP is not deductible because it attracts Corp. Inc. Tax (.32 x 20)
- **Recommendation: At least let Tax Authority reduce Royalty in dire cases. See Saskachewan potash royalties. Better: drop this in favor if RRT in Petro Law.**

GOVERNMENT SHARES ARE RISING



MORE RESOURCES? HIGHER TAXES



WORLD ROYALTY RATES

Table 2.1: Royalty and Severance Tax Rates

Jurisdiction	Royalty & Severance Tax Rates	Range of Levy
Onshore		
Algeria onshore	12.5–23%	0–40%
Australia (Queensland) coalbed gas	10%	
Canada (Alberta) conventional oil	0–40%	
Canada (Alberta) oil sands	1–9% of gross revenue or 20–40% of net revenue	
Canada (British Columbia)	2–5% of gross revenue or 15–35% of net revenue	
Colombia onshore	8–25% for oil, 6.5–20% for gas	
Germany onshore	10%	
Indonesia coalbed gas	-	
Libya onshore	-	
Poland onshore	PLN 5.39 per thousand m^3 (effective 1%)	
Russia onshore	0–20% for oil, US$0.14 per Mcf	
U.S. Alaska onshore	12.5%	
U.S. Louisiana onshore gas	20–25%; 12.5% severance for oil, US$0.331 per Mcf for gas	
U.S. Texas onshore	20–25% royalty; 4.6–7. 5% severance	
U.S. Wyoming gas	12.5% royalty; 6% severance	
Venezuela conventional gas	25%	
Venezuela heavy oil	33.3%	
Offshore		
Angola offshore	-	0–18.75%
Australia offshore	-	
Brazil offshore	10%	
China offshore	0–12.5% oil; 0–3% for gas	
India offshore	5–10%	
Indonesia conventional gas offshore	-	
Kazakhstan offshore[68]	5–18% for oil 0.5–1.5% for gas	
Malaysia offshore	10%	
Norway offshore	-	
United Kingdom offshore	-	
U.S. GOM deepwater	18.75%	
U.S. GOM shelf	18.75%	

Source: IHS CERA

Table 2.3: Range of Special Petroleum Taxes

Jurisdiction	Special Petroleum Tax & Windfall Tax	Range of Levy
Onshore		
Algeria onshore	30–70%	0–75%
Australia (Queensland) coalbed gas	-	
Canada (Alberta) conventional oil	-	
Canada (Alberta) oil sands	-	
Canada (British Columbia)	-	
Colombia onshore	30–50%	
Germany onshore	-	
Indonesia coalbed gas	-	
Libya onshore	-	
Poland onshore	-	
Russia onshore	-	
U.S. Alaska onshore	25–75%	
U.S. Louisiana onshore gas	-	
U.S. Texas onshore	-	
U.S. Wyoming gas	-	
Venezuela conventional gas	-	
Venezuela heavy oil	50%	
Offshore		
Angola offshore	-	0–70%
Australia offshore	40%	
Brazil offshore	0–40%	
China offshore	20-40%	
India offshore	-	
Indonesia conventional gas offshore	-	
Kazakhstan offshore	0–60%	
Malaysia offshore	70%	
Norway offshore	50%	
United Kingdom offshore	32%	
U.S. GOM deepwater	-	
U.S. GOM shelf	-	

Source: IHS CERA

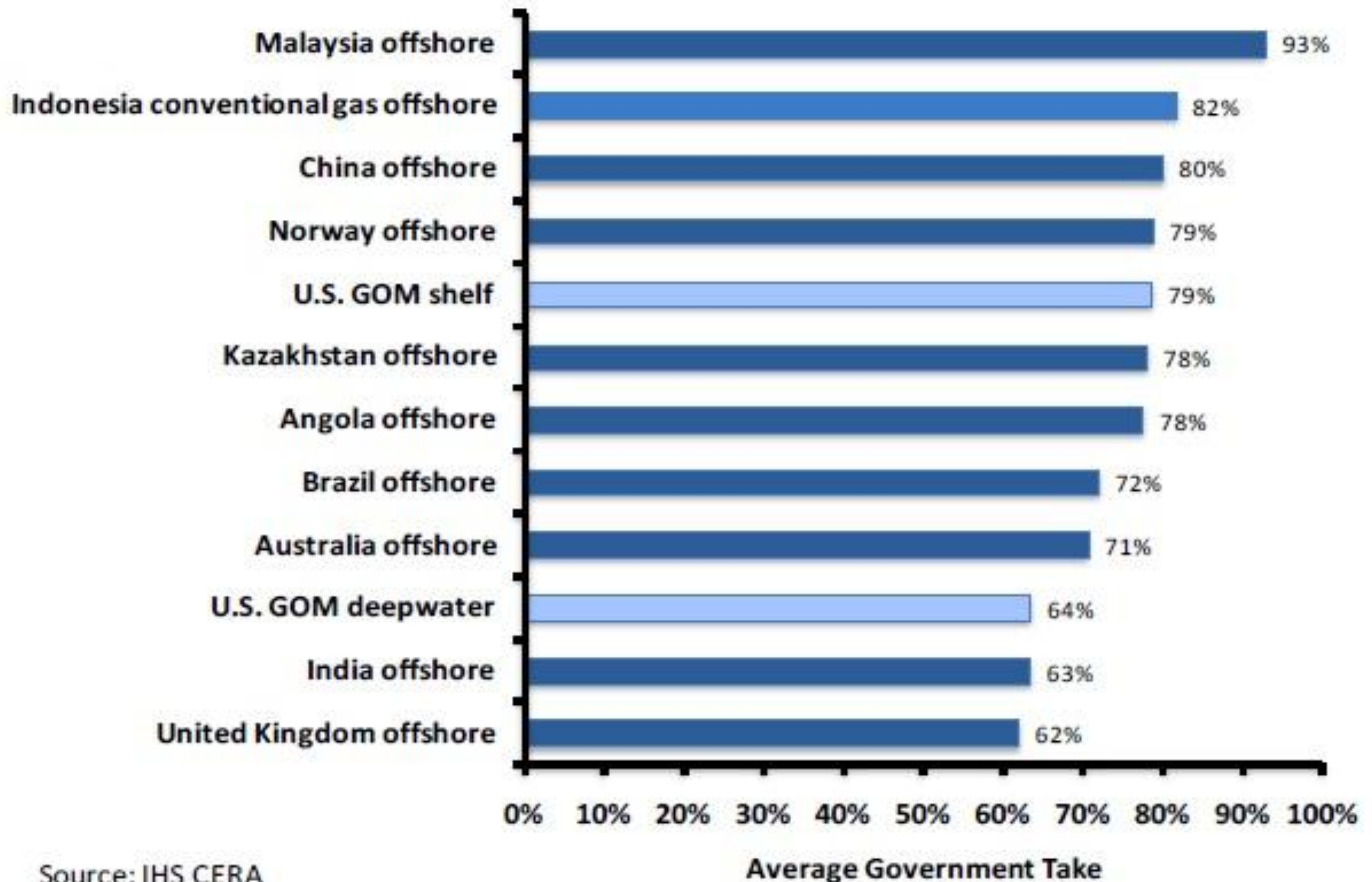
WHO TAKES FROM PROFITS?

Table 2.8: Reliance on Profit-Based Levies

Fiscal System	Average Government Take	Reliance on Profit-based Levies
Venezuela heavy oil	95%	Medium
Malaysia offshore	93%	High
Libya onshore	91%	High
Angola offshore	90%	High
Algeria onshore	86%	High
U.S. Louisiana onshore	85%	Low
Venezuela conventional gas	84%	Low
Indonesia conventional gas offshore	82%	High
Colombia onshore	82%	High
China offshore	80%	High
Indonesia coalbed gas	79%	High
U.S. GOM shelf	79%	Low
Kazakhstan offshore	78%	High
U.S. Alaska onshore	76%	High
U.S. Texas onshore	76%	Low
Norway offshore	73%	Total
Russia onshore	73%	Low
Brazil offshore	72%	Low
Australia offshore	71%	Total
Canada (Alberta) oil sands	67%	High
U.S. Wyoming onshore	66%	Low
U.S. GOM deepwater	64%	Low
United Kingdom	62%	Total
Germany onshore	61%	Low
Canada (Alberta) conventional oil	59%	Low
India offshore	57%	High
Australia (Queensland) coalbed gas	40%	High
Canada (British Columbia)	39%	High
Poland onshore	28%	Medium

Source: IHS CERA

TAKE FROM OFFSHORE



INCOME TAX RATES

Table 2.2: Range of Income Tax Rates

Jurisdiction	Nominal Income Tax Rate	Range of Tax
Onshore		
Algeria onshore	30%	0–50%
Australia (Queensland) coalbed gas	30%	
Canada (Alberta) conventional oil	16.5% federal; 10% provincial	
Canada (Alberta) oil sands	16.5% federal; 10% provincial	
Canada (British Columbia)	16.5% federal; 11% provincial	
Colombia onshore	33%	
Germany onshore	15% federal: 14% municipal	
Indonesia coalbed gas	40%	
Libya onshore	-	
Poland onshore	19%	
Russia onshore	20%	
U.S. Alaska onshore	35% federal; 1–9.5% state	
U.S. Louisiana onshore gas	35% federal; 8% state	
U.S. Texas onshore	35% federal	
U.S. Wyoming gas	35% federal	
Venezuela conventional gas	34%	
Venezuela heavy oil	50%	
Offshore		
Angola offshore	50%	20–50%
Australia offshore	30%	
Brazil offshore	34%	
China offshore	25%	
India offshore	25%	
Indonesia conventional gas offshore	40%	
Kazakhstan offshore	20%	
Malaysia offshore	38%	
Norway offshore	28%	
United Kingdom offshore	30%	
U.S. GOM deepwater	35%	
U.S. GOM shelf	35%	

Source: IHS CERA

RECOMMENDATIONS

1. Edit the law. Fix definitions. Easy.
2. Replace Production Tax with Royalty for simplicity. If not, at least make the PRT deductible in computing corporate tax.
   - Mozambique must not have tax rate over 100%!
3. Allow tax administration to eliminate royalties if taxpayer can show undue hardship.
   - Saskatchewan example in potash industry
4. Provide clear explanation of amortization and depreciation schedules. Offer tables.
5. Establish a transparent national oil and gas fund.
6. Base cash flow based tax on real cash flow, meaning ALL costs, such as taxes paid and all investments and costs

7. Clarify taxpayer rights, such as to hearing and appeal
8. Add branch profits tax to avoid tax-free repatriation
   - Concept: tax transfers made to affiliates or parent as if dividends at 20% rate.
9. Add a branch interest tax to perform same function
10. No time limit on loss carry forwards. Now 5 years. No logic to the limit.
11. Put all taxpayers on accrual method. It is normal. Cash method too easily abused.
12. Require accountants' opinion that internal processes are sufficient to assure taxpayer can generate accurate statement of revenues and disbursements.
   - Source: Section 404 of the Sarbanes-Oxley Act of 2002 makes a company's management evaluate and report on the company's internal controls. Also, company's outside auditor must review and issue an opinion on management's evaluation, and to issue its own opinion on the adequacy of those internal controls. See a public company report.

13. Allow taxpayers to contest inter-company pricing adjustments in court if they show the adjustment was clearly arbitrary and capricious.
14. If an affiliate resells a product of the taxpayer which it does not materially improve, set the sales price to the affiliate at the same price as the affiliate gets for its resale of the product.
15. Require reporting of all intercompany transactions and uncertain tax positions. Modify IRS forms. Easy.
16. Provide a fresh list of depreciation rates and residual values (I suggest zero) for specific items used in the oil, gas and mineral industries, including period to amortize exploration and development.
17. Allow deductions for rehabilitation./restoration of land only for actual payments into a fund the government can access.

18. Make sure Mozambique income taxes qualify for foreign tax credits.
19. Use cash flow as trigger for higher income tax, not as base for separate tax.
20. Have disclosure of uncertain tax positions and intercompany transactions.
21. Include all costs in calculating resource rent taxes, not just 60%
22. Better, dump production-sharing in favor of cash flow plus interest approach as trigger for higher taxes. Production-sharing is harsh and complex.
23. Base thin capitalization on values, not cost.