

Answer-to-Question-_1_

All Values are in million

Depreciation has been calculated on straightline basis using Capex values

Year 1

Revenue = 0

Royalty = 0

Gross Income (Revenue - Royalty)=0

Oil price = 50

Value (Gross income*oil price)=0

Deduct Opex =0

Deduct Depreciation = -.2

Profit Oil = 0

Year 2

Revenue = 10

Royalty = 1.2

Gross Income (Revenue - Royalty)=8.8

Oil price =60

Value (Gross income*oil price)=528

Deduct Opex= .5

Deduct Depreciation = .1

Profit Oil = 527.4

Year 3

Revenue = 20

Royalty = 2.4

Gross Income (Revenue - Royalty)=17.6

Oil price = 65

Value (Gross income*oil price)=1144

Deduct Opex = 1

Deduct Depreciation = 0

Profit Oil = 1143

Year 4

Revenue = 20
Royalty = 2.4
Gross Income (Revenue - Royalty)=17.6
Oil price = 70
Value (Gross income*oil price)= 1232
Deduct Opex = 2
Deduct Depreciation = .05
Profit Oil = 1229.95

We add all the above profits for all years and deduct CIT from it and the royalty bonus that needs to be paid by Lucky company = 2900.15 (this includes carried forward depreciation from year 1)-1015.0525-5 = 1880.0975

For the Government

Year 1 = 0
Year 2 = Royalty +CIT = 72 + 184.45 = 256.45
Year 3 = 156+400.05 = 556.05
Year 4 = 168+430.4825 = 598.4825

Total = 1410.9825 + Bonus of 5M = 1415.9825

Further Bonus of 7m will be added after reaching 25 m barrels.

Decommissioning refunds payable at the time of abandonment in 51 year.

2) In a concession system, the government who is the resource holder gives the exclusive right to operate to the private company in lieu of a payment. the payment made by pvt co is in the form of signature bonus+ royalty+profit based taxation. Equity participation is by Gov.

Bonus is a one time payment and does not constitute any tax on income / capital as its a 1 time payment, hence not covered under tax treaties and easy to admisniter.

Royalty is paid as soon as the production starts. it is a % of volume / value of production. Can also be defined as advalorem progressive with price, production, calculated on basis of operating margin.

Profit based taxation includes CIT, resource rent, excess profit oil tax

Hence in Concession, title of ownership and risk / right to operate passes onto the pvt co as soon as the oil hits the well head, hence risk, cost, exclusive right to operate and right to production and is with the private company.

Alternative Price Mechanism is entering into a Contract Regime i.e. Production Sharing Agreement (PSA. Risk, cost has to be borne by Private Co and exclusive right to operate is with the Government and right to production is shared by the Gov with the private company.

The revenue earned by the Gov is more in PSA and also the ownership lies with the Gov and the production is shared on the basis of a formula "Split the Barrel" on cash or kind basis.

Answer-to-Question- 4__

The following are the principals of withholding tax (WHT) matters. This is explained by covering the following Articles from OECD MTC and UN MTC. CS R - Resident country and CS S - Source country like Africa

Article 10 - Dividends i.e as given in A10.3, term dividend covers mining shares, income from corporate rights etc. - As per A10.1 - Dividends paid by RCo, company resident of contracting state (CS) R to a resident of other CS S may be taxed in the other CS S.

As per A10.2 - S may tax i,e host country / source country like Africa may tax if Rco is a beneficial owner, a company, a resident of CS R and directly holds atleast 25% of the capital of the company paying dividends throughout 365 days period including the day pf payment of dividend.

In OECD MTC, tax charged by CS S is 5% and if the above criterion is not met, then 15%. IN UN MTC, no threshold is given, it is left blank for the CS to decide upon signing of tax treaty.

Article 11 - Interest i.e as given in A11.3, term interest covers income from Gov securities, income from bonds, debentures. - As per A11.1 - Interest paid by RCo, company resident of contracting state (CS) R to a resident of other CS S may be taxed in the other CS S.

As per A11.2 - S may tax i.e host country / source country like Africa may tax if Rco is a beneficial owner, a company, a resident of CS R and directly holds atleast 25% of the capital of the company paying dividends throughout 365 days period including the day pf payment of dividend.

In OECD MTC, tax charged by CS S is 10% of gross amount of interest. IN UN MTC, no threshold is given, it is left blank for the CS to decide upon signing of tax treaty.

Article 12 - Royalty - Includes, Scientific work, any patent, trademark, design, model plan, secrfet formula or process or use of scientific, commercial, industrial instruments / equipments (reference from UN MTC)- As per OECD MTC, there is no tax sharing as exclusive right to tax is given to R CS.

CS S to levy tax on use of IP and use of tangible property including rental payment of PPE/ exploration equipment.

As per UN, like explained above, CS R may tax and S may tax, hence DT relief has to be given by CS R and the % limit is not given, it is left blank for the CS to decide upon signing of tax treaty.

Article 12A - Fees for tecnical services (FTS) (reference from UN MTC as this provision is not there in OECD MTC)- Extends taxing rights to CS S / source country. It permits CS S to levy tax on income from services derived by contractors / subcontractors in respect of services provided as part of exploration, consulting , other specialised activities. Also, if no PE of RCO in CS S, S may tax. No % of gross amount in given in UN.

From the above we understand that UN is in favour of developing / African countries which a resource rich as taxing rights are also given to them and not just the resident state.

Repatriation of profits is very common in O&G sector. There is always WHT exposure as all the above are forms in which profits are repatriated and hence WHT needs to be looked into as from the host country perspective, there is WHT imposed, from home country perspective, foreign tax credit is set so that the same income is not taxed twice. Tax treaties play an important role as they reduce / remove the WHT exposure.

Also in farm in / out agreements, a very common technique of transferring license rights in extractive industries leads to WHT exposure and there are issues if there are different tax regimes in both the jurisdictions.

Debt Push Down, again a very common tax structuring technique in O&G leads to limitation of WHT in the target company jurisdiction. Since there can be exposure to BEPS in target company jurisdiction, i.e. excessive interest payments are made out of the merged entity leading to claiming of excessive tax deductions against the taxable income of the target company / local operating company.

Proper implementation of Thin Cap Rules by the country and Earning Stripping Rule - BEPS Action Plan 4 must be implemented to ensure no abusive structures are formed and WHT is not avoided

TP Rules - Commentary of Article 9, para 3B and Commentary of Article 10, para 25 must also be abided by.

Stabilisation Clause in PSAs, avoiding conduit structures are also some other ways to mitigate exposure.

Answer-to-Question-__5__

Both parts of the question will be answered together below:

Carbon Pricing Instruments (CPI) - Important policy instrument to reduce carbon footprints.

There is a social cost / negative consequences of producing and

consuming goods by economic agents which are known as Externalities (concept by Pigou 1920). This social cost has to be embedded in the cost of the products consumed / produced as Internalization.

CPI seeks to align the cost of consuming carbon intensive products, processes and the social cost in doing so. It helps to generate strong economic incentives for changes in investment, production, consumption, technological processes by reducing the dependency on additional public investment

There are 3 types of CPI

Direct - Compliance Instruments (covered entities have to pay the gov for the emissions produced by covered activities) and Carbon Crediting (it is optional, credits given to reduce / remove quantified, verified carbon emissions, these credits are tradeable).

Indirect - changes price of the products associated with carbon emission but not directly proportional to the relative emissions associated with the products. ex fossil fuel subsidies

Internal - Optional, for org to make this a part of their decision making and budget. implemented if co is transitioning to climate neutrality and co wants to reduce climate related risks.

All 3 can be used in any combination as per national social political scenario of that country in order to reduce green house gases (GHG), increase environmental standards, reduce pollution and increase international finance.

Under Compliance Instruments comes Carbon Tax and Emission Trading Systems (ETS)

Carbon Tax

Carbon tax is a tax levied by the gov on tax payers for the carbon emissions, it is an unrequited payment.

There are 3 approaches to set these

- price and standard approach
- Benchmarking approach
- Revenue target approach

This tax must be set in such a way that the tax rate includes the

marginal social cost of the damages caused.

Core features of carbon tax includes - taxpayer (who will pay the tax), tax authorities (who administer the tax paid by taxpayer), tax base (what will be taxed; emissions or fuels), tax rate (price of the carbon cost to be paid), tax event (occurrence of the situation that has caused the taxpayer to pay taxes) and point of regulation (regulating taxable event by tax authorities).

Core elements are

who to tax - identifying the taxpayer

what to tax - which fuels/ emissions, is it economically, technically viable, which sectors to tax?

when and how to tax - point of regulation, tax event, tax base to be checked.

There are 2 types of carbon taxes which are effective ways of reducing emissions:

Direct Emission Approach - Gov will tax the covered entities for the emissions produced

Fuel Based / proxy approach - Higher the fuel content higher the taxes i.e. content of carbon in CO₂ is highest hence high taxes, hence using LPG is better.

ETS

Maximum capacity / limit given by Gov for emissions however these are not permits to pollute. The economic agents can trade / sell these limits across jurisdictions / sectors to others who are struggling to reduce emissions / who have exceeded the permissible limits.

Implementation design of ETS

Prepare - understanding objectives, how this interacts with other policies

Engage stakeholders - inviting them, understanding their objectives, strategies, decision making

Scope - which emissions are covered, threshold, who are the taxpayers etc.

Set a cap - type of cap and time period for setting the cap

Allocate allowances - methods to allocate, eligibility criterion

Promote fully functional market - to establish rules of borrowing, banking, market participation

Compliance - reporting requirements, penalty etc

Offset - if entity has exceeded the limits, then can request a farmer in Nigeria to plant trees instead.

Consider Linking - type of link, risks and benefits of linking

Evaluate and Improve - to evaluate and see once implemented what are the areas of improvement.

Advantages of carbon taxes (opposite of below would be disadvantages of ETS)

- 1) cost effective
- 2) Generation for revenue for Gov
- 3) easy to administer
- 4) Cost certainty

Disadvantages of carbon taxes (opposite of below would be advantages of ETS)

- 1) the exact amount of emissions reduced is difficult to ascertain
- 2) carbon leakage

Answer-to-Question-__8__

- 1) Ring fencing rules - it is a practice to separate the income and expenses of 1 activity / project from income and expenses of the other activity / project
- 2) it is very common in the O&G sector, these rules are implemented by the Gov
- 3) for example in O&G, the income expenses of say upstream activities is separated from the income expenses of the other activities like midstream or downstream creating a separate taxable entity.
- 4) the costs of 1 block or license say under PSA is to be recovered from the revenue of the same block / license
- 5) these rules enforce limitation on tax exemptions of corporate income earned from various activities by 1 O&G company.
- 6) the scope of ring fencing rules includes either separating income and expenses of O&G activities from that of non O&G activities of same company or within O&G activities, separating income and expenses of

upstream from downstream

- 7) Advantage for Gov - as it helps to generate revenue
- 8) Disadv if no ring fencing rules as it leads to delayed tax receipts by Gov
- 9) Adv for cos if no ring fencing rules as they can offset their losses against the taxable income from activities / projects generating revenue. it is also beneficial for existing cos and not new entrant with just 1 license
- 10) Disadv for cos - it is not flexible as loss offsets are not possible. also administration costs increases separating income and expenses of so many activities and projects. also a hinderance for cos planning to invest in development and exploration activities in new projects as these expenses cannot be offset against other profitable projects.
- 11) examples - No ring fencing rules in US, Brazil, Saudi Arabia. Ring fencing rules in Denmark (losses are offset) and Kazakhstan (upstream losses set against downstream, Norway, UK etc.

Ways of mitigating impact of these rules:

- 1) Negotiate fiscal stability clauses - via frozen law, compensation in PSAs
- 2) Farm outs / Joint ventures
- 3) Effectively using Transfer Pricing Rules
- 4) Structure expenditure timing / plan Capex effectively
- 5) Contract aggregation / negotiate with government
- 6) Investment through Flow Through Shares and also keeping thin cap rules in mind ie by investing via equity then slowly moving towards debt.

Answer-to-Question-__2__

Part 1, 2 and 3:

Stabalisation clause is one example to explain the scenario given in the question because if this clause is not adhered to, then the investors can sue the government.

The contractual provision in the petroleum agreement protects the right of the investor against the adverse changes in tax, legal and regulatory system of the country in which it is operating / conducting O&G activities.

Significance of Arbitration - Issues arising from the case are submitted to arbitration requested in writing.

- 1) it is neutral
- 2) it is confidential, unlike proceedings in court
- 3) Arbitrators - are experts especially in technical industries like O&G
- 4) Disputes are kept outside of host countries
- 5) Based on the agreement signed between investors and Gov like in PSAs

The major issues faced by Country Y for passing a new law and overriding the stabilization clause is because of the following:

- 1) Conflict in sovereignty - issue like new laws overriding old ones
- 2) Change in public policies - like in environmental laws
- 3) Rise of BEPS issue / change in Globe rules - GMT tax of 15% is an example, as the Gov cannot implement these even if viable and an advantage to the Gov
- 4) Inflexibility as new socio economic rules cannot be implemented as they cannot override the old ones even if there are major changes in market, there are economic crisis.

The tax matters related to imposing of climate transition tax is not arbitrable because of the sovereign powers, impact on public interest etc.

These are enforceable when state can legally implement it, courts can apply it, penalties can be imposed if violated, implemented through correct procedures.

If changes are made, this leads to negotiations between investor and Gov, heavy compensation as the main objective of this clause is lost i. e. to safeguard the rights of the investor from adverse economic changes, tax and fiscal regimes. this compensation is by overruling royalty, change in profit share etc.

ICC is contractual arbitration, only both the parties can use it, used in the case of commercial disputes like PSA disputes, JVs, cost recovery, stabilisation clause breaches etc.

In BIT, foreign investor can sue the state, no contract required, investors are protected from unfair taxation.