Answer-to-Question-_1_

A) Calculation of profits for the years 2020 - 2023

Year 2020
Revenue - 0
Cost -
Bonus
-100,000
Pre exploration cost
- 1M

Deprecition - 1M

Total loss - 2.1M

Year 2021

Revenue - 32M

Operating cost - (.2M)

Pre exploration cost - (1M)

Royalty @ 10% - (3.2M)

Depreciation 2020 - 1M

Depreciation 2021 - 1M

Profit oil - 25.6M

Lucky oil profit - 10.24M (25.6 x 40%)

Tax payable
PBT - 10.24M
Add back royalties - 3.2M
Tax base - 13.44M
Tax @ 20% - 2.68M

PAT - 7.56M

Year 2022

Revenue

Revenue - 37.8M
Cost
Operating cost - (.2M)

Royalty @ 10% - (3.78M)
Depreciation - (1M)

Profit oil - 32.8M

Lucky oil profit - 13.12M

Tax payable

PBT - 13.12M
Add back royalty - 3.78M

Tax base - 16.19M
Tax @ 20% - 3.23M
PAT - 9.89M

Year 2023

Revenue - 44M
Cost
Operating cost - (.2M)

Royalty @10% - (4.4M)

Depreciation -(1M)

Profit oil - 38.4M

Lucky oil profit - 15.36M

Tax payable
PBT - 15.36M
Add back royalty - 4.4M
Tax base - 19.76M

Tax @ 20% - 3.9M
PAT - 11.46M

2) Tax payable
Refer to calculation above

2020 - No Tax payable
2021 - 2.68M
2022 - 3.23M
2023- 3.9M

Other revenue
*Royalty
2020 - No Royalty payable
2021 - 3.2M
2022 - 3.78M
2023 - 4.4M

Profit oil to Government Z

2020 - No profit oil
2021 - 15.36M
2022 - 19.68M
2023 - 23.04M

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Answer-to-Question-__2

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Tax treaties exist solely to eliminate double taxation and also are applicable in the context of the oil and gas industry.

Tax treaty provision as per the OECD MTC are applicable on the basis of the residence of the entity which is determined by place of effective management and control.

Article 23 of the tax treaty provides for mechanims relating to the elimination of double taxation. In the absence of such article oil and gas profits would be taxed twice both at source and in the residence state. Article 23 provides for double taxation relief either by exemption or by credit relief.

Application of the tax treaty to income flows

Dividends
International oil and gas companies have several complex structures with several holding companies which receive dividends from subsidaries performing exploration and extraction activities.
These companies are also required to pay dividends in an international context.

Dividends
Article 10(2) limits source state taxation from 15 to 5% provided there is more than 25% ownership. In the absence of article 10, oil and gas investors|Shareholders would have to pay a higher withholding tax at source.

Capital Gains
Article 13 provides for capital gains tax. As per article 13 capital

gains derived from sale of property will be taxed in the residence state. In the absence of such article, sale of an intangible property or sale of shares holding the asset, would be taxed at source and would also be taxed in the state of residence. It also allocates taxing rights to the source state only in situations that cover sale of immovable property.

Financing cost

Article 11(2) of the OECD MTC also may provide for a reduced treaty rate and limits source state taxation.

This article is of extreme importance as oil and gas parent company may fund subsidaries via loan financing with interest rate. The absence of this article may result in double taxation of interest expense.

Royalties from IP

Article 12 of the OECD MTC allocates taxing rights for royalties to the source state at a rate that is determined by the treaty partners. It also provides for royalty rate to be within arms length. Failure to do so can result in a transfer pricing adjustment which may lead to taxation in the source state as per domestic corporate tax rate.

Permanent establishment

Oil and gas companies operate internationally and are therefore have immense exposure to the creation of a permanent establishment

The creation of a permanent establishment can result in local taxation and denial of treaty benefits. The creation of a permanent establishment can therefore affect shareholders and investors adversly.

The definition of a PE is provided for in article 5 of the model tax convention and includes branch, office, factory, workshops, building and construction site, oil and gas wells, mines, quarries and any other place of extraction of natural resources.

Tax treaties are also subject to limitations for example in the absence of commercial substance treaty benefits may be denied. Commercial substance includes directors of the company, adequate employees and staff, tangible asset, board meetings etc.

Mutually agreed procedures

MAPs are provisions in the model treaty that support dispute resolution. MAP procedures are outlined in detail also providing adequate time lines for the resolution of disputes.

Non discrimination
Article 24 of the OECD MTC provides for non discrimination. These provisions exist to ensure there is no discrimination of tax payers based on nationality and residency.

Conclusion
As per the aforementioned, clearly tax treaties play a vital role in the international tax context as it provides certainty over income flows and also helps in resolving disputes and elimination of double taxation. The existence of tax treaties also facilitates international trade and encourages investment. The OECD MTC is considered as soft law which is legally non-binding but is political binding and therefore cannot be used in a court of law however having a law that supports international taxation is of utmost importance.

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Answer-to-Question-_3

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1) Carbon taxes can be defined as a tax that is levied on emissions of greenhouse gases that result in global warming. A carbon tax system can be levied in the form of an ETS (Emission trading schemen) which can incentivise business to reduce carbon emissions.

These schemes are placed at the top most stage of carbon production and usage such as power plants. The EU ETS was implemented in 2005 and works on a cap and trade basis. A cap is set on the total amount of the emmission. Companies are allowed to purchase and sell emission allowances which can also be traded by the companies. If a company exceeds a cap it will have to purchase additional emission allowances at a cost which could be quite costly to purchase, thereby overall reducing GHG emissions.

A carbon tax system can have several advantages that can boost climate change mitigation and sustainable development

- Carbon taxes can be implemented in no time while leving a cost on the emissions.

- Carbon taxes are not uncertain and can be estimated accurately by companies.

- Carbon taxes are permanent incentives to GHG emission reduction

- Revenues from carbon taxes can be used to invest in greener and more sustainable technologies and for the welfare of the wider community.

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Answer-to-Question-__5_

1) Interest deductions are tax deductible. Interest expense incurred on loans obtained to buy assets vs shares of a company holding the asset can have different implications.

It would be difficult to obtain a tax deduction on interest in those cases where loans were obtained to purchase shares of the company holding the asset, as dividend payments to the residence state may be tax exempt by virtue of participation exemption.

Furthermore interest deductions in a PSC regime will not be recoverable as cost oil and the parent of the oil and gas company will need to acquire the asset rather than share in the company owning the asset.

Types of interest deductibility approaches.

Thin cap rules

Thin cap rules are another form of interest deductibility/Restriction. Thin cap is applicable on related party debt used to acquire assets or shares of oil and gas companies.

Thin cap rules are based on DER (Debt to equity ratio). Should the debt to equity of the company exceed the ratio prescribed as per local laws, the relevant financing cost on the loan will be disallowed.
Examples include USA and Australia. USA implements a DER of 3:1.

Earning stripping rule | interest barrier rule

Under this rule interest deduction is limited to a percentage of tax adjusted EBITDA. Germany is a prime example of earning stripping rule wherein interest expenditure does not exceed 30% of the companies EBITDA.

Participation debt limitation

Under this limitation, interest on loans obtained to purchase participation in another company will be restricted should the dividends under this participation become tax exempt under foreign participation provisions. Netherlands is a prime example that implements participation debt limitation.

2)Tax implications on debt push down

Debt push down - Share acquisition

Under the debt pushdown strategy, the debt is notionally pushed down to the acquired company so that the interest deduction is used against the profits of the acquired company.

Under this strategy a new SPV company is formed in the same jurisdiction as the target company. The purchasing company,
the new SPV and the target company form a tax consolidated group.

This allows the interest deduction in the SPV to be offset against the income of the target company. This strategy can only be used if there are local rules that provide for a tax consolidation.

Furthermore the tax consolidation of the group can be optimal and tax beneficial as tax losses can be offset within the group and any other capital gains from future sale of the asset can be offset against expenses of the entire tax group.

Debt pushdown - Asset purchase

Under this strategy the SPV will purchase the asset as most jurisdictions allow interest deduction in circumstances where loans were obtained to purhcase business assets that generate taxable income.

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Answer-to-Question-_6__

Issues to be reviewed during tax due diligence process

- Type of tax regime and taxes applicable including review of local laws pertaining to carry forward losses, repatriation of profits, capital gains tax and indirect taxes such as VAT.

- Review of holding structures and the taxation of income flows including the funding structure for the investment.

- The need of an intermediate holding company for income repatriation.

- Reviewing ring fencing provisions and its applicability to the investment.

- Determing applicability of interest limitation rules and its deductibility as per local laws.

- Determining if the value of the assets can be uplifted so as to obtain a higher depreciation deduction for tax purposes.

- Determining the availability of intangible property that can be tax amortized.

- Identification of any transfer pricing exposure areas pertaining to intra group transfer of assets and liabilities.

- Determining taxation of the seller i.e. wether the seller is taxed in the source country where the assets are located or in the country of residence.

- Determining the anticipated future expenses pertaining to the acquisition and if these costs will be tax deductible in the future.