THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2016

PAPER 3.04 – UPSTREAM OIL AND GAS OPTION

ADVANCED INTERNATIONAL TAXATION (THEMATIC)

TIME ALLOWED – 3¼ HOURS

You should answer **FIVE** out of the eight questions: **BOTH** questions from Part A; **ONE** question from Part B; and **TWO** questions from Part C.

Part A questions are worth 25 marks each. Part B questions are worth 20 marks. Part C questions are worth 15 marks each.

You should aim to spend approximately half of your exam time answering Part A, and the remaining half answering Parts B and C. The amount of time you spend answering each question should correspond broadly to the number of marks available for that question.

Start each answer on a new page. If you are using the on-screen method to complete your exam, you must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.

All workings should be made to the nearest month and appropriate monetary currency, unless the question requires otherwise.

Marks are specifically allocated for presentation.

PART A

You are required to answer BOTH questions from this Part.

1. The principal tax regimes for upstream oil and gas operations are Production Sharing Contracts and Tax/Royalty licence or concession arrangements. The precise fiscal terms for a given field or block are set out in the law and/or in an agreement with the international oil company (IOC). In addition to corporate income tax and production sharing, government take often includes other payments such as petroleum royalties, signature and production bonuses.

   You are required to:

   1) Explain and discuss the concept of petroleum royalties, with examples where possible; (10)

   2) Explain and discuss the concepts of signature and production bonuses, with examples where possible; and (10)

   3) Excluding corporate income tax and various forms of production sharing or government carry, briefly describe any other taxes or levies you may encounter. (5)

   Total (25)

2. It is common practice to include arbitration clauses in contracts between international oil companies (IOCs) and states for the exploration and production of oil and gas. Arbitration has also been used in bilateral investment treaty (BIT) disputes. These clauses enable the contracting parties to resolve any tax or customs disputes by way of an international arbitration tribunal, instead of using local law courts.

   You are required to:

   1) Explain the principal reasons why IOCs tend to include arbitration clauses in contracts with countries for the exploration of oil and gas; (10)

   2) Explain the impact of arbitration clauses, in relation to the taxation of oil and gas projects; (6)

   3) Explain the importance of BITs and the Energy Charter Treaty, in the context of oil and gas projects; and (6)

   4) Explain why the State arguing for lack of competence represents a major risk for IOCs in the arbitration of tax disputes. What can be done to reduce or avoid this risk? (3)

   Total (25)

PART B

You are required to answer ONE question from this Part.

3. Oil and gas producing countries establish petroleum fiscal regimes with the intention of enabling the benefits of their non-renewable resources to be directed to their citizens, while at the same time developing their oil and gas resources. The United Kingdom's petroleum fiscal regime was established in the 1970s, and has since been subject to a number of changes.

   You are required to explain the key components of the UK petroleum fiscal regime, and discuss the Supplementary Charge (SC) and the Petroleum Revenue Tax (PRT) concepts. You should answer on the basis that the 2016 Budget changes have not been implemented. (20)

4. IOC Norge AS (IOC Norge) owns a licence for the exploration of oil and gas within the Norwegian continental shelf (NCS), which is currently in its exploration phase. To date, the company has invested \$150 million in seismic work and the installation of a dry exploration well. To fund the investment, IOC Norge took out a loan two years ago from a related group company of \$250 million, on which it pays annual interest of \$12.5 million.

   The next phase of exploration, including a new well, will cost a further \$150 million, and IOC Norge is considering taking out another loan from a group company to fund the necessary work; however, current market conditions (such as the low oil price) have made IOC Norge's directors reluctant to proceed with additional borrowing.

   The directors of IOC Norge have approached you, as the company's Tax Adviser, with the following questions:

   1) **In view of the current market conditions, are there any alternatives to seeking additional funding via a loan? Do any of the alternatives offer tax incentives?** (10)

   2) **Would a new loan require any tax considerations under Norwegian law?** (7)

   3) **If the project is successful and production begins, will all accumulated losses and production expenses be tax deductible?** (3)

   Total (20)

PART C

You are required to answer TWO questions from this Part.

5. Leasing is primarily used as a method of financing in situations where a person or company is unable to provide the funds to purchase an asset. The person or company who will use the asset, known as the lessee, leases the asset from the company which owns the asset, known as the lessor. The lease may be broadly categorised as a finance lease or as an operating lease.

   You are required to:

   1) Outline the respective features of finance and operating leases, and discuss the tax implications of each type of lease when used as a means of finance by an oil and gas company. (10)

   2) Explain the International Accounting Standard Board (IASB)'s proposed approach for the recognition and measurement of leases. (5)

   Total (15)

6. The tax due diligence procedure is often a key feature in the context of an intended transaction. The goal of tax due diligence is to identify the tax-related opportunities and risks of a proposed transaction, and to gain the necessary knowledge to facilitate an optimum transaction structure in terms of tax law.

   In an oil and gas acquisition transaction, the buyer should review key information in the tax due diligence process. Information may be provided in a physical data room or an online data room, and the buyer can may request specific documentation to be added to the data room.

   You are required to outline ten key issues that should be reviewed by the buyer's team, during the tax due diligence process relating to an oil and gas acquisition. (15)

7. It is common practice in the oil and gas industry for companies to monetise their investment by transferring or selling all or part of their oil and gas licence in a specific country to a third party. This transfer can occur either before or after a significant discovery is made on the licence. More importantly, the tax implications of this transaction may also vary, depending on how the transfer is structured and the consideration received.

   You are required to explain the two principal options available to an oil and gas company seeking to transfer or sell a licence, and the tax issues which are likely to arise or should otherwise be considered in relation to the transfer. You should also identify any ways in which companies may structure the transfer to optimise the tax implications. (15)

8. Decommissioning consists of the process (and attendant expenses) through which an project operator closes down, demobilises and removes installations used in oil and gas production, including rigs, topsides, Floating Production, Storage and Offloading (FPSO) units, pipelines, depleted plugs and abandoned wells. The decommissioning process has an accounting and tax impact.

You are required to:

1) Explain the main tax implications and country concerns which relate to the decommissioning expenses of oil and gas installations. (5)

2) Explain the different solutions which have been identified by governments to mitigate these concerns and tax issues. (10)

Total (15)