ADIT

Chartered Institute of Taxation
Excellence in Taxation

# THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2017

# PAPER 3.04 – UPSTREAM OIL AND GAS OPTION

## ADVANCED INTERNATIONAL TAXATION (THEMATIC)

TIME ALLOWED – 3¼ HOURS

This paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **One** question from **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

**Further instructions**

- All workings should be made to the nearest month and in appropriate monetary currency, unless otherwise stated.
- Start each answer on a new page and clearly indicate which question you are answering. 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.
- Marks may be allocated for presentation.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering Parts B and C.
- The first 15 minutes of the exam consists of reading time. You will be allowed to annotate the question paper during this time; however, you will **not** be permitted to start writing or typing your answer, or use a calculator. The Presiding Officer will inform you when you can start answering the questions.

## PART A

**You are required to answer BOTH questions from this Part.**

1. Taxes and duties payable under the principal tax regimes for upstream oil and gas operations vary, according to the type of oil and gas contract in place. Governments may use different tools and mechanisms in order to enhance their share of revenues from their oil and gas resources. Royalties, signature and production bonuses, rentals, state equity and carried interests, export duties, VAT and other indirect taxes are among the tools and mechanisms available to governments seeking to obtain additional revenue from oil and gas operations.

   **In this context, you are required to discuss the following:**

   1) **The mechanism and relevant aspects of 'State equity and carried interests'.** (10)

   2) **The application of VAT and indirect taxes.** (15)

   Total (25)

2. Intellectual property (IP) and other intelligence-based assets play a considerable role in the development of oil and gas projects, as these projects rely heavily on cutting-edge technology for improved efficiency, quality data for identifying the best prospects, and extensive expertise provided by in-house professionals.

   The costs of obtaining these IP and intelligence-based assets may constitute a significant proportion of the project costs, increasing the importance of robust planning in order to optimise the tax treatment of such matters.

   **You are required to discuss:**

   1) **The significance of tax planning and different agreements, in relation to the holding of IP.** (10)

   2) **The tax treatment of IP developed in each of the following jurisdictions:**

      a) **Switzerland**

      b) **Netherlands**

      c) **Luxembourg**

      d) **United Kingdom**

      e) **Brazil**

      (15)

   Total (25)

## PART B

**You are required to answer ONE question from this Part.**

3. When it comes to international investment in oil and gas assets, a primary issue is whether to acquire a target company by obtaining shares in that company, or alternatively by acquiring the assets of the company.

   **You are required to discuss the issues which buyers need to analyse before embarking upon such an acquisition.** (20)

4. One of the first aspects to be considered by a tax adviser at the beginning of an oil and gas project is the holding structure to be used in the host state. In this analysis, one of the adviser's principal concerns should be the tax impacts on the repatriation of profits from the local structure in the event that the project is successful in finding commercially viable hydrocarbon deposits.

   **You are required to discuss the issues which should be considered in relation to the repatriation of profits, and alternative holding structures which may be used.** (20)

## PART C

**You are required to answer TWO questions from this Part.**

5. The current UK oil and gas tax regime comprises three elements:

 1) Ring Fence Corporation Tax;
 2) Supplementary Charge; and
 3) Petroleum Revenue Tax.

 **You are required to:**

 **1) Briefly discuss the mechanism of the UK petroleum fiscal regime. Your discussion should include tax allowances, transfer pricing, the 'ring fence' concept, capital allowance, tax consolidation, and any other aspects which you deem significant.** (6)

 **2) Explain the workings of the three tax components of the current UK petroleum fiscal regime.** (9)

 Total (15)

6. The merger and acquisition of oil and gas companies presents a number of significant tax issues. Among these tax issues are the application of interest deductions on loans to finance the purchase, and use of the deductions in the local country, generally known as 'debt push down'.

 **You are required to:**

 **1) Discuss the tax implications of interest deductions, in the context of the asset or share purchase of oil and gas companies.** (8)

 **2) Discuss the tax implications of interest deductions in cases where this deduction is 'pushed down' to the target company's country.** (7)

 Total (15)

7. The possibility of the host government changing the agreed tax regime applicable to an oil and gas project after production has begun is one of the biggest risks faced by oil companies in their activities. However, there are instruments that may be used to prevent or discourage host states from introducing windfall taxes or changing the tax regime for existing contracts.

 **You are required to:**

 **1) Briefly outline the ways in which the host government may alter the tax regime and reduce the economic returns of the oil company.** (3)

 **2) Explain the instruments available to the investor to defend against these changes, and discuss specific examples of past cases.** (12)

 Total (15)

8. Thin capitalisation rules in a host state's domestic legislation can represent an obstacle which oil and gas companies need to carefully consider before setting up their funding strategy for a new project. However, the complex variety of funding alternatives can be seen as an opportunity to plan a company's funding operations in order to preserve the tax utilisation of paid interest expenses.

**You are required to:**

1) **Explain what is meant by 'thin capitalisation rules', and discuss the different ways in which thin capitalisation rules may introduce limitations for oil and gas companies, and their tax effects.** (9)

2) **Discuss possible planning alternatives which may be used to bypass thin capitalisation restrictions.** (6)

Total (15)