Chartered Institute of Taxation
Excellence in Taxation

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2015

PAPER 3.04 – UPSTREAM OIL AND GAS OPTION

ADVANCED INTERNATIONAL TAXATION (THEMATIC)

TIME ALLOWED – 3¼ HOURS

- You should answer **FOUR** out of eight questions.
- Each question carries equal marks.
- Start each answer on a new sheet of paper. 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 good presentation.
- For your information this paper is accompanied by:

Model Petroleum Agreement of Ghana

Petroleum Income Tax Act (1987)

1. Transfer Pricing can be defined as:

"The price charged by individual entities for goods or services supplied to one another within a multi-department, multi-office, or multinational firm."

You are required to:

1) **Explain how oil and gas companies are able to use Transfer Pricing techniques to minimise their profits and hence reduce their tax liabilities.** (10)

2) **Discuss what a given government may do to minimise the effect of such behaviours, and possible tax avoidance in the application of Transfer Pricing, on its tax revenues. You should use examples to support your discussion.** (15)

Total (25)

2. In the upstream oil and gas sector, international oil and gas companies enter into various contracts with host countries such as concession agreements, Production Sharing Contracts (PSCs) and service contracts. The fiscal regime structures associated with each of these types of contract are highly variable.

You are required to:

1) **Explain the key features of, and differences between, the main types of international oil and gas agreements mentioned above.** (10)

2) **Discuss the differences in fiscal regime structures associated with each of the international oil and gas contracts you discussed in Part 1 above.** (15)

Total (25)

3. International oil and gas contracts with governments may provide for state equity, which refers to the government share of the oil and gas development. This right to an interest in the project is generally combined with other taxation methods.

You are required to:

1) **Explain in some detail the characteristics of state equity in the upstream oil and gas sector.** (10)

2) **Discuss the revenue and taxation implications of state equity on both the host government and the international oil and gas company concerned.** (15)

Total (25)

4. The acquisition of a target company or oil and gas assets is generally achieved using sale and purchase agreements (SPAs). The taxation terms of the SPA are significant as they can include allocating the direct and indirect taxes on the sale, responsibility for prior taxes, indemnities against tax disputes, and the value of any tax losses.

Related to the above are taxation issues connected to the following:

1) The share sale and purchase agreement (seller warranties);

2) The seller imposing their tax on the sale to buyer (grossing up); and

3) Buyer protection against the seller's tax liability (Indemnity clauses).

You are required to discuss TWO of the above three points, including examples when applicable, in order to show the taxation effects on each of the seller and buyer. (25)

5. In the negotiation of upstream oil and gas contracts for exploration and production, it is common practice to include stabilisation clauses in the agreements. These stabilisation clauses may appear in different forms, depending on the purpose of the parties and characteristics of the host country.

You are required to:

1) Explain the key features and benefits of, and differences between, the different types of stabilization clauses used in oil and gas contracts. (15)

2) Discuss the main issues concerning stabilization clauses, and possible solutions which may address these issues. (10)

Total (25)

6. When taxing the revenue arising from oil and gas production, some countries include ring fencing provisions in their petroleum laws or in the exploration and production contracts. These ring fencing provisions may have different scopes and objectives. They may also have an impact upon the taxation of oil and gas companies' profits, and upon government tax revenues.

You are required to:

1) Explain the concept of ring fencing in oil and gas contracts, and the different scopes of ring fencing. Provide examples of countries which have different ring fencing provisions or regimes in place, and how they apply.

(15)

2) Discuss the impact which ring fencing may have upon the taxation of the oil and gas company concerned, and upon government tax revenues. (10)

Total (25)

7. You work for an oil and gas company which is considering participation in a bidding round for a Brazil offshore license, or even the acquisition of an existing Brazilian company with such a license. In the event that the company decides to participate in a bidding round, the bid will be put forward by a special company vehicle set up and resident in Brazil.

As the current tax manager working for the company, you are requested to suggest the available options for funding of the acquisition of the license or target company, and upcoming exploration costs. You are also requested to identify any opportunities for tax optimisation, or eventual risks with the proposed options. (25)

8. IOC BV owns, through a permanent establishment (PE) in Ghana, 50% of a license for the exploration of oil and gas in Area 1 which is already in production. Related extracts of the Model Petroleum Agreement of Ghana and the Petroleum Income Tax Act are included with this question paper. Please refer to the relevant part of the Model Agreement and Petroleum Income Tax Act in your answers.

You should assume that:

- The Area 1 first year of continuous production was in 2014;
- Agreed Corporate Income Tax rate in the Model Petroleum Agreement is 45%;
- The expenditure and gross income of 100% of Area 1 license during the last five years was as follows:

	2011	2012	2013	2014	2015
Petroleum capital expenditure	(150)	(250)	(300)	(150)	(100)
Gross income	-	-	-	400	800

- Royalty has already been paid and deducted from gross production sold.

You are required to:

1) **Calculate the individual Corporate Income Tax payable by the PE in Ghana of IOC BV in 2014 and 2015, in view of the petroleum capital expenditure and gross income shown in the table above.** (5)

2) **Calculate the individual Corporate Income Tax payable by the PE in Ghana of IOC BV in 2014 and 2015, assuming hypothetically that the first year of continuous production was 2011.** (5)

3) **In 2015 IOC BV, as the operator of the license, paid to an Oil Service Company, resident in Ghana, a total of $85 million in maintenance services to one of its platforms. What would be the Oil Service Company's corporate tax liability relating to the services provided to IOC BV?** (2)

4) **If, in January 2015, IOC assigned a 15% interest in the license of Area 1 to the holder of the remaining 50% of the license in Area 1 (which would then hold 65% of the license), how would the capital allowances for 2015 be assessed?** (3)

5) **Please review Article 12 of the Ghana Model Petroleum Agreement, and detail any aspects which you would advise your company to change or clarify.** (10)

Total (25)