Fiscal Regimes for Extractive Industries – Design and Implementation

Peter Mullins
Fiscal Affairs Department
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“There are few areas of economic policymaking in which the returns to good decisions are so high – and the punishment of bad decisions so cruel – as in the management of natural resource wealth.”
Presentation Outline

• Why is this topic important?

• Overview of key objectives for extractive industry (EI) fiscal regimes

• Overview of key EI fiscal issues to be covered in this conference
Part 1

WHY IS THIS TOPIC IMPORTANT?
Why so important?

A key revenue source for (increasingly) many...
...including in the Asia-Pacific region

Government Receipts from Natural Resources, averages 2000-2013
(Selected countries, in percent of total revenue excluding grants)

Source: Total revenue excluding grants (WEO)
Natural resource revenue (staff estimates)
Fiscal regimes under review

• Many countries around the world are reviewing their fiscal regimes

... including in the Asia-Pacific Region

– Is the country getting a good deal?
– Does the fiscal regime attract investors?
– How does the fiscal regime respond to the fall in commodity prices?
– Can the fiscal regime be simplified?
– How does a country apply a fiscal regime to new scenarios (e.g., deep sea mining)?
Part 2

OVERVIEW OF KEY OBJECTIVES FOR EX extrative INDUSTRIES FISCAL REGIMES
Why distinct fiscal regimes for EI?

• Substantial rents
• Pervasive uncertainty
• Asymmetric information - (companies probably know more) at the time of negotiation
• High sunk costs, long production periods
• Extensive involvement of multinationals in some countries...and of State-Owned Enterprises in others

Few of these considerations are unique to resources—they are just bigger. What is unique is *Exhaustibility* — recognize revenues as transformation of finite assets in the ground into other assets.
Oil price forecasts and outturns

WEO Oil Price Forecasts 2002-2019
(Monthly prices, 2014 U.S. Dollar per Barrel)
Central Objectives/Principles

• Ensure State as resource owner gets an ‘appropriate’ share – the fiscal regime should:
  – Provide Government with a revenue stream in all production periods, but also possibly with an increasing share of revenues as profitability increases (progressivity)
  – Be attractive enough to encourage investments, now and in the long run

• Fiscal terms must be “robust” in the face of changing circumstances: anticipate that the long term reality will be different from current forecast
Central Objectives/Principles (cont’d)

• Consistent with countries of similar prospectivity
• Encourage development of all viable discoveries
• Easy administration (for authorities) and compliance (for taxpayers)
• Establish by law
  ... minimize discretionary and negotiated elements
• Stability and credibility
Part 3

OVERVIEW OF KEY EXTRACTIVE INDUSTRY FISCAL ISSUES
Three main fiscal schemes (sometimes blended)...

1. Contractual, including production sharing or service contracts
2. Tax and royalty
3. State ownership or participation
   • These can be made fiscally equivalent
   • IMF advice works with all three
     – Design to achieve efficiency and transparency in each
1. Land rental/surface fees
2. Bonuses – Signature or Production
3. Royalties
4. Corporate income taxes
5. Explicit rent tax/Additional profits tax /Profit sharing
6. State participation
7. Dividend and interest withholding taxes
8. Other indirect taxes
Recommended approaches

Country circumstances require tailored advice, but generally within a framework that combines:

• A royalty on gross revenue
• A tax targeted explicitly on rents (and thus on the achieved results of extraction)
• Together with normal corporate income tax
• Bonus-bidding may have a role in promising environments
Recommended approaches (cont’d)

Such a regime ensures:

- Revenue from day one
- That government’s revenue rises as rents increase

Transparent rules and contracts promote stability and credibility

- Inclusion of rent taxes reduces pressures to renegotiate or unilaterally change the rules
- But processes to allow review and revision may be needed
Government revenue yield?

Not only do the regimes vary greatly, but also the revenue yields

• Simulations for petroleum suggest government shares of: 65 to 85 percent
• Lower share for mining: 40 to 60 percent
Evaluation is essential...

Two approaches:

1. Model tax effects on exploration, development, and extraction

2. Scenario analysis – the IMF Fiscal Analysis of Resource Industries (FARI) modeling system
   - Uses indicators related to objectives and criteria
     ... such as average effective tax rate, progressivity in prices
Tax Administration is critical ...

• EI tax administration should not in principle be hard

• Nonetheless, often both difficult and badly done
  – Complex regimes
  – Fragmented administration (e.g., little coordination between regulatory agency and tax administration)

• Principles of effective modern tax administration are equally relevant to EI
... with demand for Transparency

• Transparency of the design of the fiscal regime and its implementation is crucial
  ... but often absent

• Number of EI transparency initiatives:
  – Extractive Industries Transparency Initiative (EITI)
  – Company reporting requirements under US Dodd-Frank Act and EU Directives
  – Natural Resource Charter and the Natural Resources Governance Institute
Current and Emerging Challenges

• Ensuring stability and credibility
• Fiscal terms in legislation or contracts?
• International tax and base erosion and profit shifting (BEPS)
• Regional coordination
• Role of National Resource Companies
Information Sources

• IMF Board Paper (August, 2012) on “Fiscal Regimes for Extractive Industries: Design and Implementation” available at:


• Forthcoming book:

International Taxation and the Extractive Industries
due for release in early 2016
Existing Publications

THE TAXATION OF PETROLEUM AND MINERALS: PRINCIPLES, PROBLEMS AND PRACTICE

Edited by Philip Daniel, Michael Keen, and Charles McPherson

Fiscal Policy Formulation and Implementation in Oil-Producing Countries

Editors

J.M. Davis, R. Ossowski, and A. Fedele

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