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Fiscal Regime in Petroleum Licensed Contracts

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Abstract

Fiscal regimes in petroleum licensed contracts are defined as the tools through which the return on oil wealth flows into the state treasury, it includes several forms according to the type of contract, so, the most common fiscal tools are: royalty, taxes, profit oil or rents.

This work makes a comparison between the fiscal regimes in common types of petroleum investment agreements and the difference between them according to the state share and contractor share.

The main types of these regimes are concessionary and contractual agreements and the last include two types: production sharing and service agreements. However, Algerian, Syrian, Iranian & Iraq will be examined as example for each type respectively,

The study relies on a comparison between the items of the fiscal regime and the tools through which resource revenues flow to the public treasury as well as the share of the contractor or the company that holds the concession.

Therefore, a model of fiscal regimes has been conducted for the above contracts to show the difference between the fiscal flows of each country according to the type of contract and the fiscal tools in it as royalty, taxes and others.

The study demonstrated that the contracts vary in revenue ratios depending on the sale price of oil and the cost of extraction.

Finally, we can clearly infer that the share of both the company and the state is affected by the above circumstances in a high or slight sensitivity, There is no particular type can be considered the best, as preference depends on the special circumstances of countries, for example, the Iraqi situation is difficult to use concession contracts for several considerations, including constitutional, where the Constitution of the Republic of Iraq specified the ownership of the people's oil wealth and this property cannot be relinquished to the investing companies and so on the rest of the countries, but it can be hybridized between some systems to obtain financial instruments that achieve the best choice for the parties (state and IOCs).

Keywords: oil contracts, fiscal regime, Iraq oil contracts, taxes.

الانظمة المالية في العقود البترولية

الخلاصة:

تعرف الأنظمة المالية في العقود النفطية على انها الأدوات التي يمر من خلالها العائد على الثروة النفطية الى خزينة البلد، حيث تشمل هذه الادوات عدة اشكال حسب نوع العقد وان أكثر الأدوات المالية شيوعا هو حق الملكية والضرائب ونفط الربح او الربيع. تتضمن هذه الدراسة المقارنة بين الأنظمة المالية في الأنواع الشائعة من اتفاقيات الاستثمار البترولي والفرق بينها حسب حصة الدولة وحصة المقاول وهي: اتفاقيات الامتياز، واتفاقيات التعاقد والتي تضم نوعين هما تقاسم الإنتاج، واتفاقيات الخدمات. تضمنت دراسة حالات من العقود شملت الجزائر وسوريا وإيران والعراق كمثال لكل نوع على التوالي. ان الدراسة اعتمدت على المقارنة بين مفردات النظام المالي والابواب التي يتم من خلالها تدفق إيرادات الموارد الى الخزينة العامة وكذلك حصة المقاول او الشركة صاحبة الامتياز، لذلك تم عمل موديل للأنظمة المالية في العقود أعلاه لبيان الفرق بين التدفقات المالية لكل بلد حسب نوع العقد والأدوات المالية الموجودة فيه من أجور الملكية والضرائب وغيرها.

حيث أظهرت الدراسة ان العقود متفاوتة في نسب الإيرادات اعتمادا على سعر بيع النفط وكلفة الاستخراج حيث ترتفع وتنخفض حصة كل من الشركة والدولة تبعا لتلك الظروف فبعض العقود اظهر حساسية عالية لتغير الأسعار وبعضها لتغير كلف الاستخراج والبعض الاخر يكون التغير طفيف لكلا المتغيرين، ولا يوجد نوع معين يمكن ان يكون هو الأفضل دون غيره حيث تعتمد الأفضلية على الظروف الخاصة للبلدان فمثلا الحالة العراقية من الصعوبة استخدام عقود الامتياز لعدة اعتبارات منها دستورية حيث حدد دستور جمهورية العراق ملكية الثروة النفطية للشعب ولا يمكن التخلي عن هذه الملكية للشركات المستثمرة وهكذا بقية البلدان، ولكن يمكن ان يتم التهجين بين بعض الأنظمة للحصول على أدوات مالية تحقق افضل خيار للطرفين (الدولة والشركات العالمية).

1. Introduction:

A petroleum contract is a financial and legal structure that host governments of certain oil-producing nations employ to deal with international oil companies (IOCs).

Many types of contracts have been used around the world and each type has its component and its conditions to apply while the concessionary and contractual type are the main and common types of oil contracts.

When we study the similarities and differences between These types, we can clearly notice that the host government may use the same fiscal tools (royalty, rental, income tax, and profit share in project) for the purpose its reward from its natural resources in both types.

On the other hand, the ownership of the oil and gas can be taken into account as the main difference between them where the contractor owns the whole production in the concessionary system in opposite to the contractual system where the contractor receives a share of production in kind or in cash in return for services.

Regarding to the field abandonment, it is always decided by the contractor in the concessionary system while it may be decided by one of the two sides in the contractual system.

The national oil company may pay the income tax on behalf of the contractor under the contractual system, while the contractor pays tax under the concessionary system. It should be noted that

sometimes the government participates in cost payments when either a concessionary or a contractual system is installed. In this case the contractor does not have 100% working interest in the project area and the government achieves more rewards from the petroleum projects; such an agreement is called a joint venture.

Fiscal regimes which includes: bonus, royalty, taxes and profit share, can be considered as one of the most important contents of the contract by which the fiscal shares of the partners are determined.

Bonus: is the amount paid when predetermined events happen such as signing bonus and first production bonus

Royalties: are the money received by the owner of resource as compensation based on production volume irrespective of production costs and prices [4]. it can be calculated depending upon yearly production, cumulative production, petroleum price, or price and production together, etc.

Petroleum taxation: is the universal instrument through which governments seek to determine the crucial balance between the financial interests of the oil companies and the owners of the resource [5].

The structure (such as applied tax rates or royalty rates) rather than the type of contract is the foundation of the fiscal system. This implies that it is difficult to assert that one type is superior to another, and that each contract must be examined individually. [3]

The Figure (1) shows each type of fiscal regime and its period during the field production.

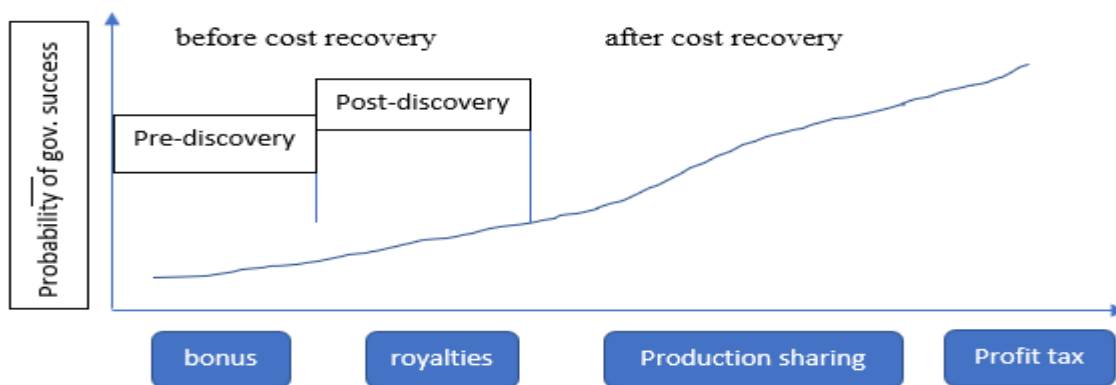


Fig. (1): Fiscal tools

2. Types of Oil Agreements

There are two common types of oil contracts according to the ownership of the petroleum in addition to the legal and fiscal systems that contract consists of, these types are:

2.1 concessionary type

This was the first sort of contract in the globe, and it is still utilized in many nations, including the United States, the United Kingdom, France, Norway, Canada, Australia, New Zealand, Libya, Algeria, and South Africa.

In such contracts, the host government cedes the title to the petroleum resource to the contractor in exchange for royalties. Typically, the state has no engagement with the IOC or licensee, who control and operate all equipment. The host country merely receives royalties, tax revenue, and other payments.

This kind of contracts characterized by:

- Oil companies have the exclusive right to explore and produce at their own expense and risk.
- The Company owns both its output and its equipment.
- Oil Company pays Royalty, Taxes on profit and Surface rental to Government.
- Oil company has right to export hydrocarbons.

Algerian concessionary contract

Algerian ex-contracts consider as a concessionary type and has the fiscal tools:

Royalty: In Algerian contract royalty was 20% from the total revenue (before costs recover).

Taxes: there are two types of taxes in the Algerian contracts which is petroleum revenue tax 30% from revenue after royalty subtraction and income tax 30% from taxable income (Revenue after royalty, revenue tax and depreciation – OPEX).

2.2 Contractual type

This type of contracts considers as agreement between the national oil company (NOC) and international oil companies (IOCs) to invest or manage the fields and this type of agreements is subdivided into two:

2.2.1 Production sharing contracts (PSC)

In this type of contracts, the host country and the contractor share the production in kind or in cash. In accordance with the production sharing contract, the following are the primary fiscal instruments for dividing the profit between the host government and the contractor: [6]

- Bonus
- Royalty
- Cost recovery (petroleum costs): The contractor has the right to collect a proportionate amount of his expenses.
- taxes

This kind of contracts characterized by:

- The risk is shared between the Government and the Contractor
- Typically, the Contractor receives a production share in kind.
- The Contractor never holds ownership of oil and equipment.

Syrian PS contract

The deal was signed in 2008 as a type of production sharing contract between the Syrian National Oil Company and the contractor (a consortium of Gulfsands Inc. and Emerald Inc.). The Syrian government receives a royalty rate equivalent to 12.5% of the total revenue. Before dividing the production between the contractor and the host government, the contractor must recoup his costs from the after-royalty net revenue. The profit oil share is 65 percent to the host government and 35 percent to the contractor. The contractor profit share is subject to a 10 percent income tax. The contractor take is equivalent to 34 percent of the contractor oil profit plus the cost of oil, while the government take is the sum of government profit share, royalty, and profit tax.

2.2.2 service contract (SC)

in such type of contract, the contractor gets the service costs and appointed profit fees on his services this fee is generally paid in cash and the contractor pays taxes on these profits, so this type of contracts is considered as a short terms contract and divided into many types such as technical service contract (TSC), production service contract (PSC) and development service contract (DSC).

This kind of contracts characterized by:

- The state holds the risks alone.
- The Contractor gets a constant profit fee on its services usually in cash.
- The Contractor never holds title to oil.
- The state holds title to equipment.

Iranian service contracts

This contract allows the contractor to recover production costs from the total revenue, then the contractor get a fixed fee from the revenue after cost recovery equal to 18%. The contractor fee is subject to income tax equal to 10%.

Iraq contracts

Iraq has two types of contracts, federal government contracts TSC and KRG contracts PSC, In this study, sample of TSC was taken as an example.

The technical service contract (TSC), which is used for the redevelopment of producing fields, and the development and production service contract (DPSC), which is used for the development of discovered but undeveloped fields, are the primary contracts used for the licensing of petroleum interests in Federal Iraq. The contractor is compensated on the basis of cost recovery and a per-barrel fee under both TSCs and DPSCs. This is a significant distinction between the contracts utilized in Federal Iraq and the production sharing contracts prevalent elsewhere in Iraq (Kurdistan).

3. Contracts Modeling

The four cases of contracts (Algerian, Syrian, Iranian, and Iraqi) were studied by establishing excel model Table (1) to illustrate each partner's share as a percent of the total revenue and the sensitivity of each contract for the common elements (oil price, costs, and production).

The structure of the model is consisting of: oil production which is considered as 1 BBL for the calculations, oil price which changes according to the markets, revenue which is results from multiplying production by price, cost of production which calculated according to country and oil field, fiscal tools (royalty, taxes, profit oil, profit fees and taxable income).

The results of the model will be: state share and it's percent from the revenues and contractor share and it's percent from the revenues.

In this model, range (20-120\$) of oil prices, range (8-25\$) of cost were used, these values are the range of oil prices during the study period (2019-2022) and the range of costs in those countries.

Table (1) The structure of the model

IRAQ TSC		IRAN SC		SYRIA PSC		ALGERYA C.C	
production BBL	1	production BBL	1	production BBL	1	production BBL	1
price \$/BBL	120	price \$/BBL	120	price \$/BBL	120	price \$/BBL	120
revenue \$	120	revenue \$	120	revenue \$	120	revenue \$	120
state \$	60			royalty \$	15	royalty	24
remaining \$ no more than 50% of rev.	60			remaining \$	105	remaining	96
cost \$/BBL	8	cost \$/BBL	8	cost \$/BBL	8	cost \$/BBL	8
profit fee \$/BBL	2	remaining \$	112	profit oil \$	97	revenue tax \$	28.8
remaining \$	50	taxible contractor profit \$	20.16	contractor profit \$	33.95	taxible income \$	88
gov. partianers profit fee \$	0.1	tax \$	2.016	tax \$	3.395	income tax \$	26.4
contractor profit fee \$/BBL	1.9			contractor \$	30.555		
income tax \$	0.665						
state share \$	110.765		93.856		81.445		79.2
contractor share \$	9.235		26.144		38.555		40.8
state share percent	92%		78%		68%		66%
contractor share percent	8%		22%		32%		34%

4. Results and discussion

The results from the model will be discussed by four cases, two of them with low oil price and the others with high oil price which shown below.

Case 1

In this case, oil price \$20/bbl. and cost (CAPEX & OPEX) \$8/bbl. are used and the results was, as Figure (2) shows, Algerian contract is the best one as a percent of revenues for the state share and Syrian is the worst one while Iraq has a moderate effect between them and this is due to the items of its contracts.

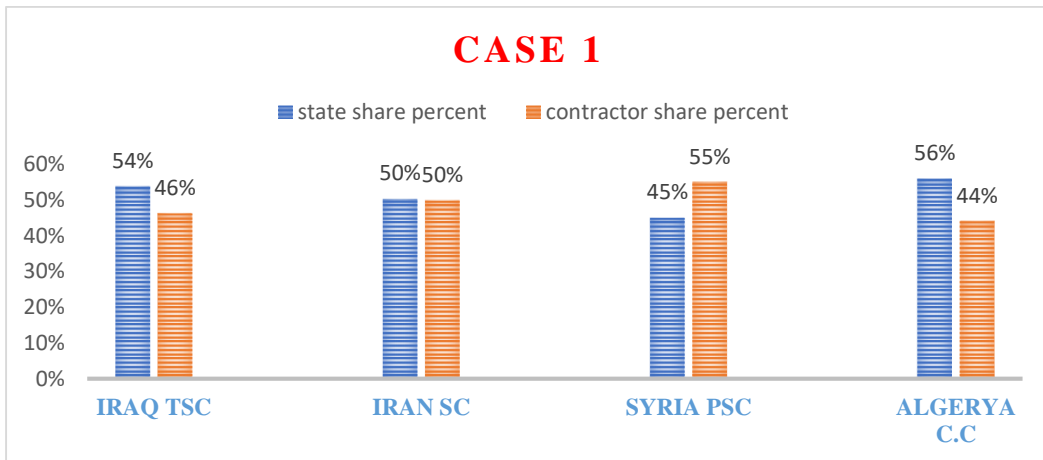


Fig. (2): Model results @ price \$20 & cost \$8

Case 2

In this case, oil price \$20/bbl. and cost (CAPEX & OPEX) \$25/bbl. are used and the results, as Figure (3) shows, Algerian contract is the best one as a percent of revenues for the state share and Iraqi is the worst one.

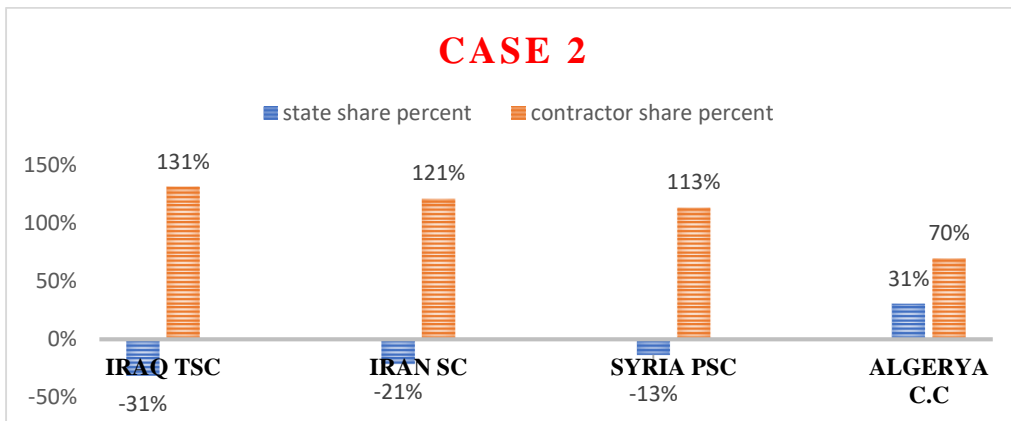


Fig. (3): Model results @ price \$20 & cost \$25

Case 3

In this case, oil price \$120/bbl. and cost (CAPEX & OPEX) \$8/bbl. are used and the results, as Figure (4) shows, Iraqi contract is the best one as a percent of revenues for the state share and Algerian is the worst one.

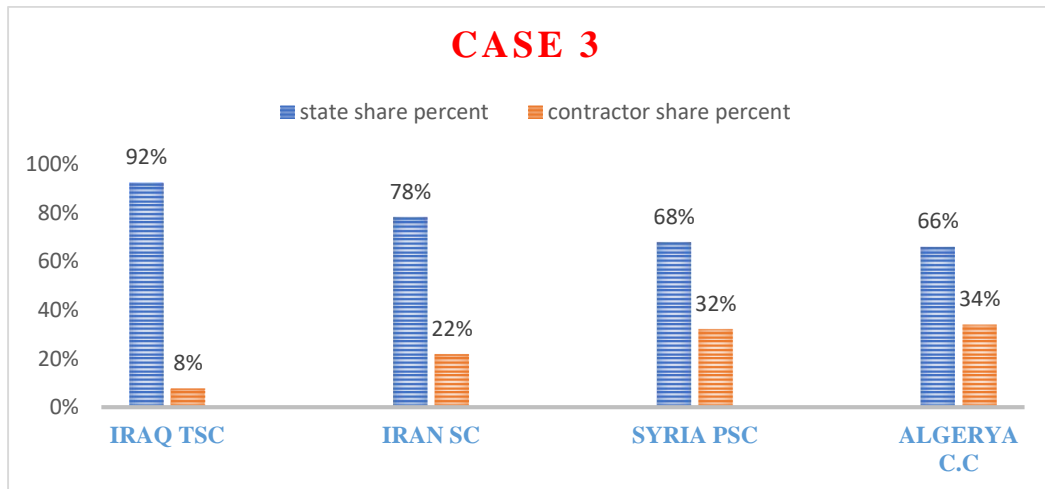


Fig. (4): Model results @ price \$120 & cost \$8

Case 4

In this case, oil price \$120/bbl. and cost (CAPEX & OPEX) \$25/bbl. are used, so, the results, as Figure (5) shows, Iraqi contract is the best one as a percent of revenues for the state share and Syrian is the worst one.

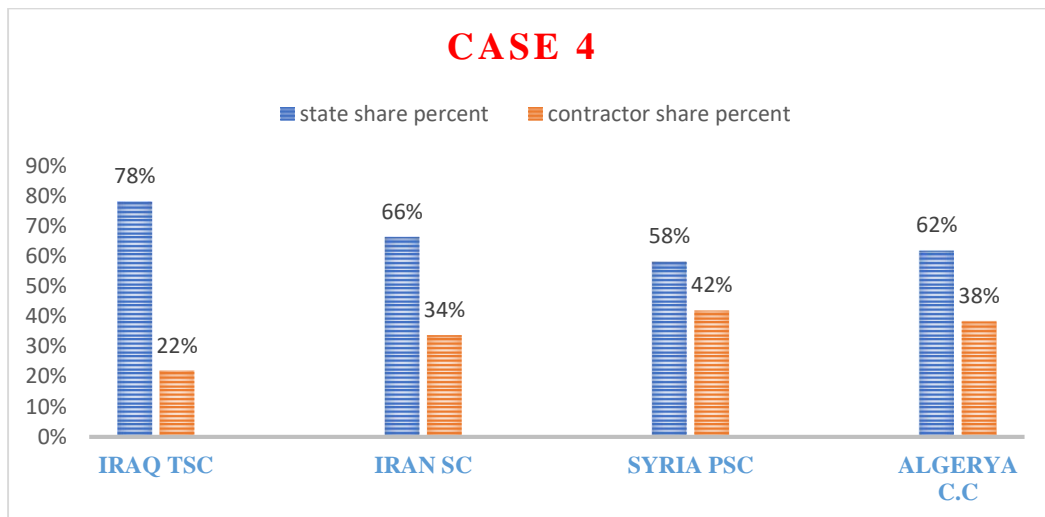


Fig. (5): Model results @ price \$120 & cost \$25

5. Conclusions

Fiscal tools are the more important technique to manage the partners' shares. According to the excel model, Algerian contract is the best one at the conditions of low oil price due to? In Iraqi oil contracts, the state shares are the most effected by high costs and low prices, but Iraq consider one of the low-cost countries it between 8-12\$ according to region and the complexity of the field, so the Iraqi fiscal regime is the best for its conditions. Each country has its conditions and there is no appointed type fits all conditions and can be approved. If the country wants to maximize its revenues it should be studies the best fiscal regime and puts the best tools that make the optimum choice to the state and the contractor. Sometimes the contracting process is not only depending on the fiscal but political and legal considerations.

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