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7.6 Summary and Recommendations

The effectiveness of an EI sector fiscal regime depends on the objectives established for that regime, on the fiscal instruments selected to achieve those objectives, and on the quality of fiscal administration.

Making a choice of overly complex instruments or combinations of instruments in fiscal design makes implementation difficult, particularly where capacity limitations constrain and distort the implementation of fiscal regimes in many countries. The goal is any fiscal administration should be simplicity. However, none of the fiscal instruments considered here is free from challenges to administration.

A narrow economic perspective on the making of choices in fiscal design has become less common, as an appreciation of political economy factors has risen. Context in a broad sense will be the prime driver behind choice in this as in all other areas of the EI Value Chain. Given the kind of states that the Source Book has identified as having the most pressing needs for cutting-edge knowledge of the subjects in the EI Value Chain (emerging producers, fragile states, reforming markets), it is more likely than not that they will come under early pressure to show results from their choices in fiscal design. Their responses will determine the credibility of their fiscal regimes with domestic constituencies (their inclusiveness) and their ability to honour long-term commitments with investors. In all of this, transparency will be a key element.

In spite of the criticisms of the royalty instrument, it is easy to see why many governments see this as a valuable instrument in their fiscal regimes. As a way of ensuring a flow of revenue from the very start of production onwards, it satisfies the need of governments with priorities in revenue collection and securing domestic credibility. Bonuses have similar advantages in this respect. However, these pragmatically chosen instruments need to be balanced by fiscal instruments that government revenues will increase with production, higher commodity prices or lower costs.

Moreover, there will be non-political contextual considerations that influence the choice of fiscal instruments and design of the overall fiscal package. Among others, these include: the nature of the resource (oil, gas or minerals); whether it is marginal or not, and its location (on-land, offshore or in deep-water). Again, these have implications with respect to implementation and administration generally.
The key principle underlying an efficient and effective fiscal regime is to strike the right balance between the risks and rewards for the investor (who requires a satisfactory risk-adjusted rate of return to justify a new investment) and the government (which requires adequate compensation for the use of a resource and a fair share of the economic rent associated with the extraction of a non-renewable resource).

The mineral-specific fiscal regime is generally contained in legislation and consists of taxes and fees that apply to all sectors (such as profits taxes, employment taxes, and import duties), plus mineral sector taxes (which generally consist of additional taxes and royalties that apply only to minerals). The fiscal terms can also be contained in contracts when the legislation is not well-developed but this is not good practice. Generally, the mineral-specific fiscal regime is administered by the taxation authority and supported by the ministry of mines.

The petroleum fiscal regime contained in legislation is often supplemented by fiscal, or other, terms specified in petroleum agreements or contracts and includes not only taxes and fees but also production sharing arrangements involving cost oil, profit oil, and royalties. The petroleum fiscal regime is generally administered by the taxation authority in close collaboration with the NRC and the El sector ministry.

A limit to the approach adopted in this is that Fiscal Design has been considered separately from the division of rents and revenue sharing, the subject of Chapter 8 in the El Source Book. Considerations of environmental and social sustainability can also play a role but are separated into another Chapter. The inter-relation between these subjects should not be neglected since in real life it will play a part.

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A well-designed fiscal regime will:

1. provide an investment environment that is fair, stable, and predictable with a tax take that responds fairly and robustly to changes in both prices and costs;
2. be transparent and applicable to all investors (a regime may change over time as a state establishes a positive track record with investors);
3. have fiscal instruments that are efficient and progressive and that provide a dependable minimum flow of tax receipts to the government each year, starting early in the project life;
4. ensure that the design and complexity of the fiscal instruments are commensurate with the administrative capacity of the government entities administering the tax regime;
5. have clearly elaborated dispute resolution procedures; and
6. protect against tax avoidance and tax evasion which can significantly reduce actual tax payments in relation to expected collections by:

a. requiring the use of internationally recognized accounting rules and standards (including foreign exchange rules) for preparing income statements for tax submissions; and

b. providing rules in the law and any related agreements for special issues such as: the use of inter-affiliate transactions (including transfer pricing, loans and management fees), ring fencing, thin capitalization, interest rate caps for borrowing, capital gains on the transfer or sale of exploration or mining rights, stabilization agreements, and the domicile of parent companies for DTTs.