CHAPTER II

LITERATURE REVIEW

Petroleum, a non-renewable resource, always has a significant impact on economy of the producing countries. Each host government (of producing country) would, therefore, devise a petroleum tax system that would be most beneficial to the country. Van Meurs[1] discussed about various fiscal instruments in the petroleum exploration and production business. They include Bonuses, Rentals, Royalties, Corporation Tax, Production Sharing, Participation, Profit Sharing and Special tax, and Service Fee. The host government selects one or a combination of these fiscal terms to set a suitable petroleum tax system. Mustafaoglu[2] presented the five major petroleum tax systems: Concession System, Concession with Excess Profit Tax, Concession with Excess Profit Tax and Participation, Production Sharing Contract, and Service Contract. He compared return to the company among these systems using the specific nation tax systems and concluded that the Concession with Excess Profit Tax and Participation and Production Sharing Contract appear to have the objective to maximize the government share of the revenue, whereas the other tax regimes are geared toward encouraging exploration and development.

Boulos[3] compared petroleum tax systems used in Asia-Pacific region and concluded that Tax-Royalty (Concession) Agreements are generally considered preferable for oil and gas companies and popular among countries with low petroleum potential. The major producing countries, though, use the Production Sharing Contract as their upstream agreement with oil companies especially in the country with significant production. He also pointed out that whichever of the type of

agreements is used, the ultimate criteria for deciding to take the agreement will be the incentives offered by the host government to increase upstream activity and petroleum reserves.

Thailand uses the concession system for granting right for petroleum exploration and production. The first Thai petroleum fiscal regime was introduced in 1971[4]. This is a simple concession system. Under this system, concessionaires are required to pay Royalty (12.5% of the value of total petroleum produced) and Petroleum Income Tax (between 50-60% of net profit). This system has been revised from time to time to keep up with the changing conditions in Thai petroleum exploration and production. The latest revision was in 1989 with the main objectives to provide fairer profit split between the State and the investors and persuade international and local oil and gas companies to develop marginal fields and, at the same time, to provide tool for the government to capture additional profits accruing to concessionaires as a result of high petroleum price and/or low investment costs.

The current Thai fiscal regime, known as Thailand III, is a concession system with excess profit tax. It consists of three main terms: Royalty, Petroleum Income Tax, and Special Tax which is called Special Remuneratory Benefit (SRB)[5]. The Royalty is calculated based on the value of the amount of petroleum produced with sliding scale rate (from 5% to 15%) based on production levels. The Petroleum Income Tax shall be levied at a rate of between 50-60% of net profit. In calculating net profit, Royalty and SRB are treated as tax deductible expense. The Royalty and SRB are calculated on a block-by-block basis. No SRB is payable if there is no annual petroleum profit in that year and SRB will not be applied unless capital expenditure has been fully recovered. The SRB rate varies from year to year (but

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not exceeding 75%) depending on the Annual Revenue per Meters of well drilled plus a constant in that year[6,7,8].

Nakornthap[8] presented the idea behind Thailand III which was to liberalize the fiscal regime of Thailand I and Thailand II terms in order to be fair and attractive to both the government and the investors, and to strengthen the government administration over the land regime aspects of the concession system. He also commented that the recognition that government take based more on profit rather than gross income was the most welcome sign. These had made Thailand III both flexible and attractive. It is hoped that this fiscal system will be powerful tools for the government to achieve its goal of expediting exploration and development of natural resources in this country. Chaisilboon[9] studied the suitability of five fiscal systems – Thailand I, Thailand III, Production Sharing Contract (PSC) using in the Malaysia-Thailand Joint Development Area, PSC of Vietnam, and PSC of Cambodia – when applied for the overlapping acreage between Thailand and neighboring countries. He concluded that Thailand III was the most appropriate system as it was fair and attractive to both the government and the investors.

Johnston[10] discussed that Block Ringfencing concept could have a huge impact on the recovery of cost of exploration and development. From the government perspective, any consolidation or allowance for costs to cross a ring fence means that the government may in effect subsidize unsuccessful operations. This is not a popular direction for governments because of the risky nature of exploration. However, allowing exploration costs to cross the fence can be a strong financial incentive for the industry.