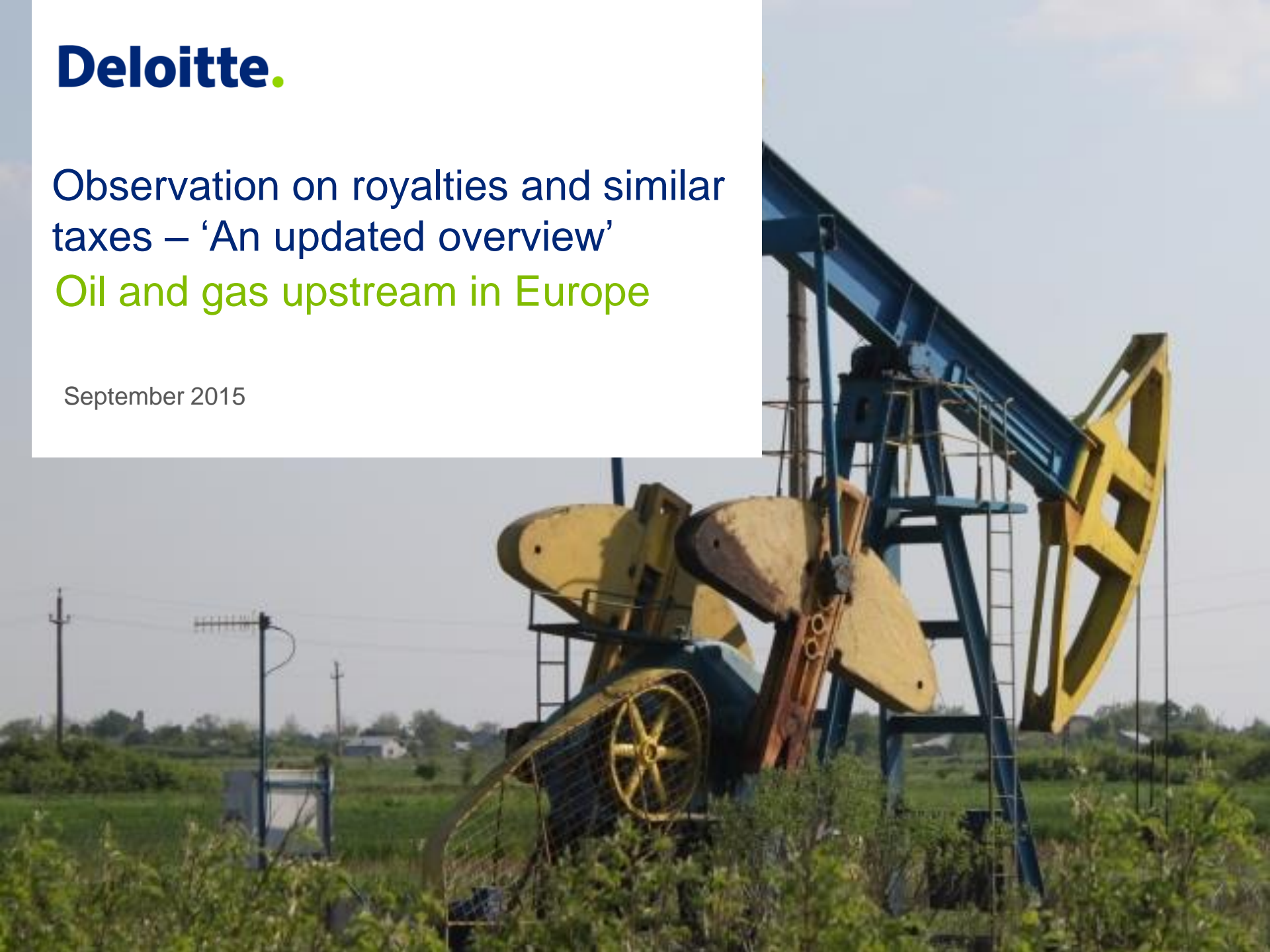


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Observation on royalties and similar taxes – ‘An updated overview’

Oil and gas upstream in Europe

September 2015



Background and methodology

- ❖ Fiscal and regulatory framework plays an important role in the overall economics of oil & gas business, given its long term business cycle. Commissioned by Federatia Patronala de Petrol si Gaze (“FPPG”), we conducted an analysis using publicly available information as of 2013 and, in February 2015, we issued our report observing the various “Royalty and similar taxes” in various European countries as a percentage of revenues. The current report is a brief update of the previous report, using 2014 data.

Actual Royalties and similar taxes differ from nominal rates

- ❖ The update must be considered within the limitation that every field is different let alone two countries. Royalties and sector specific taxes are driven by national priorities, market reality and in recent months also had been affected by or are in the process of revision due to the severe decline of oil prices.
- ❖ To have a more thorough understanding the update should be read together with February 2015 report.



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Executive summary

Executive summary

- ❖ We have been commissioned by Federatia Patronala Petrol si Gaze (“FPPG”) to carryout an update on our report issued for them in February this year that was based on 2013 information, considering the changes that took place between 2013 and 2014.
- ❖ This updated overview is performed as of 2014, except where explained otherwise. The updated overview is constructed based on publicly available information and doing an average computation purely on a mathematical basis for Europe*), that hopefully can help one step in bringing some focus and basic input to the discussion that should be further built on more extensive analysis and commonly agreed approach.
- ❖ In most of the countries with sizeable oil & gas production a declining trend is noted. Additionally there are a number fiscal changes to take effect from 2015. We have only looked at some countries and they are included at the end.

*) excluding CIS



Executive summary

- ❖ Keeping all the limitations in mind that can affect the results, a simple arithmetical average for the European producing countries would come to 11.7%, while the average of the closest comparable European producing countries based on well productivity would be 7.5%. At present, Romania has an average observable royalty and similar tax as a percentage of revenue of 15.7% computed as of June 30, 2015 (15% as of December 31, 2014), arising from the main companies SNGN Romgaz SA and OMV Petrom SA with 19.3% and 14.1% respectively (21.1% and 13.2% respectively as of December 31, 2014).
- ❖ If we make a comparison between the average observable royalty and similar tax as of 2014 versus 2013 we notice the following major movers:
 - ❖ **Romania:** the average observable royalty and similar tax rate increased from 13.9% (9m/14) to 15.0% (12m/14) and to 15.7% (6m/15) .This trend is primarily resulting from:
 - Higher proportion of gas versus oil;
 - The overall production mix, gas being taxed with a supplementary tax of 60% on price increase resulting from the allowance under the liberalization calendar. Average non household gas price changed from 58.7 lei/MWH during 2013 to 85.1 lei/MWH during 2014 and average gas price for house hold increased from 47.4 lei/MWH to 52.3 lei/MWH;
 - Although oil price declined in the second half of 2014, royalties charge formula uses reference price of preceding three months; in a declining market this resulted in a higher percentage of royalties.

Executive summary

- ❖ **Italy:** the average observable royalty and similar tax rate decreased from 14.4% (2013) to 11.7% (2014). Italy had a profit surcharge on oil & Gas and energy companies. The profit tax surcharge nominal rate was reduced from 10.5% (2013) to 6.5% (2014); this combined with lower profitability due to declining prices in 2014, resulted in an overall reduction in the percentage
- ❖ **United Kingdom:** the average observable royalty and similar tax rate as a percentage of revenues decreased from 11.3% (2013) to 6% (2014). A number of factors can be noted for 2014:
 - Decline in overall combined oil & gas average prices;
 - Increased maturity of fields requiring investments meant an increase of investments from GBP 14.4 billion to GBP 14.8 billion while the actual production was down by approximately 2%;
 - Operating costs increased from GBP 8.9 billion to GBP 9.6 billion;
 - Production mix has high gas volume of lesser value than oil;
 - Structural issues given a large number of marginal fields requiring various allowances and incentives such as small fields, ultra heavy brownfield, etc.

Executive summary

- ❖ **Norway:** the average observable royalty and similar tax rate decreased from 22.5% (2012) to 18.8% (2014) due to lower profitability in 2014 compared to 2012 (there was no information for 2013 at issuance of our previous report) due to: decrease in average realized oil price 90.6 USD/bbl (2014) vs 104.5 USD/bbl (2012) and average realized gas price 1.57 NOK/scm vs 1.84 NOK/scm correlated with an increase in investments in 2014 and 2013 vs 2012 and 2011 leads to a higher depreciation charge and also due to increase in exploration 2014 vs 2012 (exploration is fully deductible when incurred)
- ❖ **Hungary:** the average observable royalty and similar tax rate decreased from 25.3% (2013) to 22.9% (2014) due to decrease of oil and gas royalty rates by 6% in Q4 2014 applicable to most fields, as Brent price was below 80 USD/bbl, while in 2013 royalty rates were at highest level as Brent price was above 90 USD/bbl. This decrease of royalty rates of 6% in Q4 2014 is mentioned in article 20 (4) of Mining Law. For gas fields commissioned prior 1998 formula includes a mechanism which leads to a gradual decrease of royalty rates, due to k factor mentioned at article 20 (3) par. ba) of Mining Law.
- ❖ **Austria:** the average observable royalty and similar tax rate increased from 17.6% (2013) to 21.2% (2014) due to the fact that during 2014 the nominal royalty rates applicable in Austria increased compared to 2013 for both oil & gas.

Executive summary

- ❖ **Germany:** the average observable royalty and similar tax rate decreased from 18.6% (2013) to 17.3% (2014) due mostly to decrease of gas royalties from Lower Saxony (74.5% in total royalties in 2014 vs 76.3% in 2013), which have a higher level of taxation compared to oil from both lands and gas from Schleswig-Holstein.
- ❖ **France:** the average observable royalty and similar tax rate increased from 3.9% (2012) to 6.6% (2014) (no information available for 2013 at the issuance of our previous report) due to lower gas production 0,07 bn cm in 2014 vs. 1,08 bn cm in 2012; gas has 0% royalties due to low production fields vs oil royalties of 0-9%.

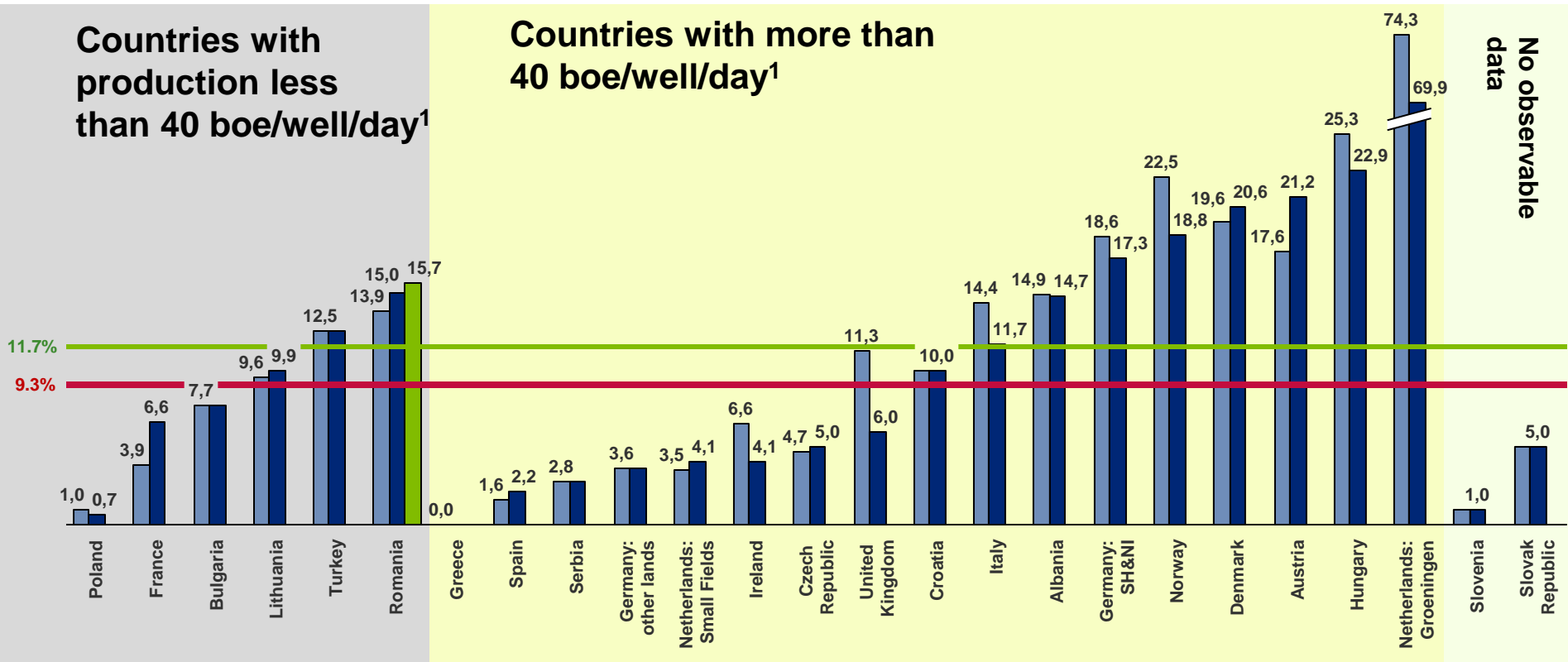
Observation on oil & gas royalties and similar taxes (updated overview)

Observable effective Oil & Gas royalties and similar taxes

■ %rate2013
■ %rate2014
■ %rate2015 H1

Countries with production less than 40 boe/well/day¹

Countries with more than 40 boe/well/day¹



No observable data

Observable effective tax rates		
		% of revenues
Romania (2014/H12015) ²	15.0% / 15.7%	- Out of which 9.7%/9.4% permanent taxation
Other countries with less than 40 boe/well/day production	7.5%	
All European countries without Groningen	9.3%	
All European producing countries	11.7%	

¹ For categorization purposes, same production data is used as per previous report. 2014 production/well update might be different

² Permanent taxation includes royalties, construction tax, tax on crude oil sales, while temporary taxation refers to supplementary tax for Oil & Gas introduced in 2013

Fiscal Regime Changes 2014 _ 2015

Fiscal regimes changes European countries 2014 _ 2015¹⁾

United Kingdom

- ❖ **Extensive consultations with industry** on measures to incentivize investments and maintain jobs in oil and gas sector of North Sea
- ❖ **Reduction of supplementary charge (“SC”) from 32% to 20% starting 01.01.2015**
- ❖ Reduction of petroleum revenue tax (“PRT”)²⁾ from 50% to 35% for periods ending after 31.12.2015
- ❖ Introduction of a **62.5% of investment allowance** for expenditure incurred after 1 April 2015:
 - Deduction additional to investment costs and may lead to an effective SC rate significantly lower than 20%
 - Transitional provisions will be implemented for fields that benefited from other allowances
- ❖ Introduction of a **62.5% of investment allowance** for high pressure high temperature oil & gas projects from a cluster area which encourage exploration and appraisal for surrounding area
- ❖ Extension to 10 years of the ring fence expenditure supplement which provides an uplift of 10% on a company’s closing loss ring fence loss pool at the end of an accounting period. Previously, only 6 claims could be made.
- ❖ In the summer Budget statement it was confirmed that additional categories of expenditure would be added in the scope of investment allowance

Italy

- ❖ In February 2015 **CIT surcharge** (6.5% in 2015) applicable to several industries, including upstream oil & gas, **was declared unconstitutional**.
- ❖ The CIT surcharge will **not be applicable starting the date of publication of decision** of the Constitutional Court

1) Given the extensive nature and continuous update, we may not have captured all the changes. These are some of the key changes noted to date.

2) Petroleum revenue tax applies to fields developed prior to 1993

Fiscal regimes changes European countries 2014 _ 2015

Germany Lower Saxony

- ❖ **Reduction of royalties starting with 01.01.2015:**
 - gas: 7.5% - 30% instead of 9.25% - 37%
 - oil: 0%/9%/18% instead of 0%/9.5%/19%

Germany Schleswig-Holstein

- ❖ Implementation of a **price sliding scale royalty for oil with rates of 21-40%** starting with 01.01.2015; For oil price per ton up to 556 EUR per ton royalty rate is 21%
- ❖ Gas royalty for producing fields is maintained at 18% while for the new fields will apply a 40% royalty

Romania

- ❖ **Elimination of construction tax.** According to New Fiscal Code, construction tax will be maintained in 2016 and it is intended to be eliminated starting 2017.
- ❖ Elimination of tax on crude oil from domestic production (18.95 RON/ton in 2015)

Hungary

- ❖ **Reduction of royalty from 12% to 2% for non-conventional oil & gas fields** and those which require special exploitation methods

Estonia

- ❖ **Increase of mineral extraction tax to 2 EUR / ton** of oil shale extracted from 1.39/1.67 EUR /ton

Limitations and Acknowledgements

Limitations and acknowledgments

Methodology:

In compiling information, we have used only publicly available information, as indicated at various places within the analysis and summarized at the end. To keep objectivity, inference has been kept to minimum, in line with the objective of the analysis to present an overview. The extent of publicly available information, especially information from the regulators and other relevant bodies, varies from country to country that creates inherent limitation. Such limitations are highlighted within each country snapshot.

Limitations:

The analysis is not a regulatory advice, assessment of various other regulatory frameworks. It has limited relevance in terms of comparability except highlighting information based on publicly available information that can facilitate a further analysis and debate.

Carrying out such a broad level analysis has inherent limitations due to difference in various countries economic conditions, Oil & Gas industry history and relevant importance to that country, offshore vs. onshore, gas vs. oil, size and age of the field and inability to capture the complexities of all variations in different systems.

Limitations and acknowledgments

No detailed discussions with reporting entities or regulatory bodies were carried out to appreciate broad understanding of the publicly available information. Any reader of this analysis must read this report as an indicative analysis and not as a basis for investment decision, understanding project linked Government take analysis or for management decision making.

Deloitte was commissioned by “Federatia Patronala Petrol si Gaze” (“FPPG”), to perform an overview of the observable effective royalty and similar taxes in Oil & Gas industry across Europe, in order to have a comparative analysis. Any other party should carry out a thorough analysis for their own needs gathering and using the relevant information.

Limitations and acknowledgments

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Deloitte in the process of compiling this analysis, has used publicly available data and makes no representation in respect of independently auditing this information or verifying the completeness of accuracy of this information.

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