



Oil and gas developments in South Africa

The oil and gas industry has the potential to provide a much needed boost to the South African economy, with the prospect that the development of new projects in the sector will provide critical support to improving energy security for the country (including electricity generation through gas-to-power technologies), will stimulate business activity and provide employment opportunities.

It is widely accepted that a clear and appropriate regulatory framework is needed in order for growth of the oil and gas industry in South Africa to be assured. At this point, there is still much work that needs to be done on this front.

For example, whilst the updated Integrated Resource Plan (IRP2019) that was issued by the Department of Energy in October 2019 recognises that natural gas has an important, although relatively modest, part to play in the energy mix for the period to 2030, significant detail is still needed, for example, by means of the still to be finalised Gas Infrastructure Plan, on how this will be achieved.

Similarly, the long-awaited Upstream Petroleum Resources Development Bill that was promulgated as a draft on 24 December 2019, as a stand-alone regulatory framework for the oil and gas industry, leaves a number of important issues unclear. These include uncertainty regarding the basis on which royalties, production bonuses and a petroleum resource rent will be levied, and how the state's right (through PetroSA) to have a 20% carried interest in all exploration and production rights will work (including any cost recovery that producers may be entitled to in relation to the carried interest).

On the same basis, the Tenth Schedule to the Income Tax Act contains a special set of tax rules for oil and gas companies that are not currently in optimal use. For example, under these rules, an oil and gas company may claim an additional tax deduction for certain capital expenditure and, aligned to a provision that currently exists in the Mineral and Petroleum Resources Royalty Act, the rules provide that an oil and gas company is entitled to enter into a 'fiscal stability agreement' with government which guarantees that the terms of the tax rules that exist as at the date that the fiscal stability agreement was entered into will apply, regardless of any subsequent change to legislation. The special tax dispensations in the Tenth Schedule are an important part of what attracts oil and gas companies to invest in exploration for hydrocarbons, either onshore or off the coast of South Africa, which is typically a very expensive exercise and has a high risk of failure from a commercial perspective. Unfortunately, there is currently a lack of certainty as to what qualifies as 'capital expenditure' for purposes of claiming an additional tax deduction and government has also failed to sign any fiscal stability agreements with oil and gas companies for a number of years.



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In the 2019 Budget Review document, National Treasury acknowledged that it has not approved any fiscal stability agreements in the past five years and indicated that it would be reviewing the tax treatment of oil and gas companies. No further indication was given, at the time or since, as to the objective of this review and it is anticipated that some announcement will be made regarding this matter in the 2020 Budget, hopefully along lines that are acceptable to all parties.

It is clear that resolute focus is required by government, working closely with industry, in order to finalise an appropriate regulatory framework for the oil and gas industry that includes financial terms that are sufficiently attractive for investors on the various points referred to above, with this being an imperative to ensure continued investment and growth in the sector.

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