ETHIOPIA

PETROLEUM TAX PROCLAMATION NO. 296/1986

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A Proclamation to Provide for Payment of Income Tax on Petroleum Operations

1. Short Title

This Proclamation may be cited as the "Petroleum Operations Income Tax Proclamation No. 296/1986".

2. Definitions

For purposes of this Proclamation, unless the context otherwise requires:

1) "accounting year" means the calendar year ending December 31, according to the Gregorian Calendar;

2) "affiliated person" means any person directly or indirectly controlling or controlled by, or under direct or indirect common control of, another person. For the purposes of this definition, "control" means the power to direct, administer or dictate the management and policies of such person, or the ownership of 50% or more voting rights in such person; and the terms "controlling" and "controlled" shall have meanings correlative to the foregoing;

3) "calendar quarter" means the quarter ending March 31, June 30, September 30 and December 31 according to the Gregorian Calendar;

4) "capital expenditure" means expenditure, other than pre-production costs, the benefit of which extends beyond the accounting year in which the expenditure is incurred;

5) "commencement of regular production" means the commencement of regular production from the first development area developed by the contractor;

6) "contractor" means any person with whom the Government establishes a petroleum agreement;

7) "development area" means an area containing a commercial discovery of petroleum, the development of which has been approved by the Minister of Mines and Energy;

8) "first accounting year" means the accounting year in which regular production commences from the first development area developed by the contractor;

9) "income" means every sort of revenue, from whatever source derived and in whatever form paid, credited or received, which has its origin within Ethiopia, irrespective of whether it is paid, credited or received within or outside Ethiopia;

10) "person" means any natural or juridical person;

11) "petroleum" means crude oil and natural gas and includes hydrocarbons produced from oil shales or tar sands;

12) "petroleum agreement" means a contract or other arrangement between the Government and a contractor to conduct petroleum operations;

13) "petroleum operations" means the operations involving and related to, the exploration, development, extraction, production, field separation, treatment (but excluding refining), storage, transportation up to the point of exportation or entry into a system for domestic consumption and marketing of petroleum, excluding refining of crude oil but including the processing of natural gas;

14) "petroleum operations posts" means all the posts and expenses incurred for the purposes of petroleum operations including both capital expenditure and revenue expenditure;

15) "pre-production costs" means all petroleum operations costs incurred before the commencement of regular production;

16) "revenue expenditure" means expenditure other than capital expenditure and pre-production costs;

17) "subcontractor" means any person with whom a contractor establishes a contractual relationship for the provision of services required for performance under a petroleum agreement;

18) "taxable income" means the amount of income, calculated in accordance with the provisions of this Proclamation, on which tax shall be charged, levied and collected.

3. Levying of Tax

1) Any person engaged in petroleum operations under a petroleum agreement shall pay 50% income tax on its taxable income.

2) Tax on income from petroleum operations shall be imposed on a person's taxable income of the current accounting year.

4. Determination of Income

1) In determining the income of a person from petroleum operations, there shall be brought into account the value of all petroleum produced and saved and not used in petroleum operations to which that person is entitled under a petroleum agreement.

2) The value of petroleum produced and saved shall be calculated in accordance with the provisions of the petroleum agreement and shall be communicated by the Minister of Mines and Energy to the Minister of Finance.

3) Where a person is entitled to petroleum under more than one petroleum agreement, the value of petroleum produced and saved under each agreement shall be consolidated in determining income.

5. Deductions

1) In determining the taxable income of a person from petroleum operations, all petroleum operations costs shall be deducted in accordance with the provisions of this Article.

2) Where a person incurs costs under more than one petroleum agreement, the costs shall be consolidated and be deducted in accordance with the following provisions of this Article.

3) Pre-production costs shall be capitalized and a fraction equal to one-fifth of the capitalized costs shall be deducted in the first accounting year and each of the four succeeding accounting years; provided that:

a) pre-production costs incurred in an area surrendered prior to the commencement of regular production; and

b) pre-production costs in respect of a well abandoned prior to the commencement of regular production;

shall be deducted in full in the first accounting year.

4) In an accounting year in which capital expenditure is incurred and in each of the four succeeding accounting years there shall be deducted a fraction equal to one-fifth of the capital expenditure incurred in that year.

5) In each accounting year in which revenue expenditure is incurred there shall be deducted an amount equal to the revenue expenditure incurred.

6. Period of Payments

1) Any person conducting petroleum operations in Ethiopia shall make quarterly payments on account at the end of each calendar quarter of each accounting year of petroleum operations.

2) Each quarterly payment on account shall be calculated as one quarter of the tax estimated to be payable for that accounting year. The estimates shall be based on budgets submitted by the person to, and verified by, the Minister of Mines and Energy.

3) The sum of these quarterly payments shall satisfy the liability of that person for the tax due on that person's declared taxable income for the accounting year concerned.

4) In the event that the sum of the quarterly payments is less than the tax due on the declared taxable income for the accounting year concerned, the difference shall be paid with the submission of the declaration of income. In the event that the sum of the quarterly payments is greater than the tax due on the declared taxable income for the accounting year concerned, the difference shall be refunded within 30 days from the date of notification of the assessment.

7. Capital Expenditure

1) Capital expenditure shall include, but shall not be limited to, expenditure on the following:

a) wells drilled in any development area during the development and production period;

b) wells drilled outside a development area which result in a commercial discovery;

c) plants, platforms and other production facilities, machinery, fixtures, pumps and the installation thereof;

d) pipelines and storage tanks and the installation thereof;

e) the construction of industrial buildings, structures and works of a permanent nature;

f) major enhancement expenditure on any production facility;

g) the acquisition of, or of rights in or over, petroleum deposits.

2) Notwithstanding the definition of capital expenditure in Article 2(4) above, capital expenditure shall not include expenditure on the following items:

a) furniture and office equipment excluding data processing equipment;

b) buildings used as retail shop, showroom, offices and dwelling houses.

8. Revenue Expenditure

1) Revenue expenditure shall include, but shall not be limited to, expenditure on the following:

a) geological and geophysical studies and surveys, and topographical and geographical surveys preparatory to drilling;

b) drilled wells which do not result in commercial discovery other than wells in any development area;

c) costs of production including pumping, transportation, storage and handling of petroleum; repairs, maintenance and replacement expenditure, but excluding major enhancement expenditure;

d) the costs of abandoning a well and the related production facilities, if any, including the costs of making safe the abandoned area, removing the production facilities and restoring the environment;

e) general and administrative expenses incurred in Ethiopia for the purposes of petroleum operations;

f) general and administrative expenses incurred outside Ethiopia, and the costs of processing survey results, technical reports and other data in a country outside Ethiopia; provided, however, that:

i) the amounts expended are attributable to petroleum operations in Ethiopia and are fairly and reasonably allocated thereto;

ii) the expenses incurred were for services actually rendered; and

iii) the amount paid for such services corresponds to the normal rates paid by other businesses or persons similarly situated for similar services rendered in similar circumstances.

g) management or professional commissions or fees, including those paid to persons outside Ethiopia; provided, however, that:

i) the amounts paid are attributable to petroleum operations in Ethiopia and are fairly reasonably allocated thereto;

ii) such commissions or fees were paid for services actually rendered; and

iii) the amount paid for such services corresponds to the normal rates paid by other businesses or persons similarly situated for similar services rendered in similar circumstances.

h) interest payments on loans raised for the purpose of conducting petroleum operations other than exploration, including interest payments by a person outside Ethiopia which are freely and reasonably allocated to a branch, office or other division maintained in Ethiopia by that person; provided, however, that interest payments shall not be deductible:

i) where the interest payment exceeds the amount that would have been payable on a loan concluded at arm's length where the loan, the repayment thereof and the interest payable constitute the only consideration for the making of the loan;

ii) unless the loan proceeds, with respect to which interest is paid, are applied to petroleum operations in Ethiopia. Where only part of the loan proceeds are applied to petroleum operations in Ethiopia, only the interest payable with respect to that part of the loan proceeds shall be deductible;

iii) unless tax on interest payments has been deducted and paid to the Income Tax Authority in accordance with Article 15(2) of this Proclamation; or

iv) unless the loan which may have been obtained from a bank, insurance or other sources with respect to which interest is paid, has been approved by the Minister of Finance in consultation with the Minister of Mines and Energy.

2) Revenue expenditure shall also include payments, except income tax, made to the Government or any agency thereof pursuant to any petroleum agreement, including, as appropriate, royalties, annual rentals, bonuses and supplementary revenue payments.

9. Surrender or Abandonment

Where the contractor:

a) surrenders all or part of a contract area; or

b) abandons any well

after the commencement of regular production, the balance of any costs incurred in the area surrendered or in respect of the well abandoned not previously deducted against income shall be deducted in the accounting year of surrender or abandonment.

10. Transfer or Assignment of Rights

1) Where rights under a petroleum agreement are transferred or assigned, the consideration received by the transferor or assignor shall be treated as a receipt derived from petroleum operations. The transferee or assignee shall in such cases be treated as having incurred capital expenditure or, where appropriate, pre-production costs of an amount equal to that consideration.

2) Where the transfer or assignment takes place before the commencement of regular production, the transferor or assignor shall be entitled to deduct, from the receipt, all the petroleum operations costs incurred in respect of the rights transferred or assigned.

11. Valuation of Assets

1) If an asset representing capital expenditure is brought into use by being transferred or purchased from an affiliated person for use in petroleum operations, or if an asset representing capital expenditure is brought into use without being purchased or transferred, it shall be deemed, for purposes of income tax, to have been transferred, purchased or brought into use at the lowest of the following:

a) the market value of the asset at the date of purchase or transfer;

b) the actual cost of the asset to the person that uses the asset in petroleum operations at the date of purchase or transfer;

c) the actual cost of the asset to any affiliate of the person that uses the asset in petroleum operations.

2) Where an asset ceases to be used for the purposes of petroleum operations, the value to be taken into account for the purposes of income tax shall be:

a) in the case of a sale at arm's length, the proceeds therefrom; and

b) in any other case the market value of the asset at the date it ceases to be used.

3) Except for income received in the form of petroleum, the valuation of all other income received in the form of a benefit in kind shall be approved by the Income Tax Authority.

12. Dividend

No income tax shall be paid on dividends paid to shareholders by a person out of income derived from petroleum operations.

13. Taxation of Foreign Subcontractors

1) Foreign subcontractors engaged in performing services in Ethiopia for a contractor in connection with petroleum operations shall, commencing from the date of adoption, by the Minister of Mines and Energy, of the development plan in respect of a commercial discovery, be deemed to have earned a taxable income equal to

10% of all amounts paid by a contractor to the foreign subcontractor.

2) Notwithstanding sub-Article (1) of this Article, the following payments shall be deducted in calculating the taxable income of a foreign subcontractor:

a) amounts paid for the movement of personnel and equipment to Ethiopia prior to commencement of petroleum operations in Ethiopia, and from Ethiopia after completion thereof; and

b) payment by a contractor to a foreign subcontractor to reimburse that subcontractor for payments made to a third party on behalf of the contractor for goods and services which are incidental to the sub-contract and would not normally, under generally accepted international petroleum industry practice, be regarded as payment for services rendered by the foreign subcontractor, and does not include a charge for handling or administration.

3) Where services are provided outside a development area, the foreign subcontractor shall not be liable to income tax in Ethiopia.

4) For the purposes of this Article, payments made under sub-Article (2) (a) above is excess of the amounts normally paid under generally accepted international petroleum industry practice, having regard to the circumstances of the agreement, shall not be deducted.

5) Payments made by, or on behalf of, a contractor to a foreign subcontractor shall be deductible only where an invoice has been issued therefor. The subcontractor shall in each case issue a distinct and separate invoice to the contractor with respect to:

a) payment for services;

b) payments made for the movement of personnel and equipment as stated under sub-Article (2) (a) above; and

c) payments made under sub-Article (2) (b) above, with copies of all supporting documents.

6) When paying an invoice rendered by a foreign subcontractor, a contractor shall:

a) deduct an amount of tax payable by the subcontractor at the rate of 50% on the taxable income calculated in accordance with sub-Articles (1) and (2) of this Article;

b) issue to the subcontractor a certificate showing the gross amount of the invoice, the amount deducted for tax and the net amount payable; and

c) retain a copy of the invoice and certificate for a period of three years.

7) The deduction by a contractor of tax from payments to a foreign subcontractor in accordance with the provisions of this Article shall discharge the full income tax liability of the foreign subcontractor.

8) Any person conducting petroleum operations in Ethiopia, that engages a foreign subcontractor to perform services in Ethiopia in connection with these petroleum operations, shall pay to the Income Tax Authority the tax owed by such subcontractor within 14 days after the end of the calendar quarter in which payment to the subcontractor takes place.

14. Carry Forward of Losses

A loss sustained by a person engaged in petroleum operations in one accounting year may be carried forward for a maximum of 10 succeeding accounting years.

15. Tax on Interest Payments

1) Where interest is paid on a loan, the lender shall be liable to income tax at the rate of 15% on the interest.

2) The borrower shall deduct, from payments of interest, income tax at the rate of 15% and shall pay to the Income Tax Authority the tax deducted within 14 days after the end of the calendar quarter in which the interest is paid, and shall make a return of interest paid and tax deducted in such form as the Income Tax Authority shall specify.

3) The deduction by the borrower of tax from interest payments to the lender shall discharge in full the income tax liability of the lender in respect of said interest.

16. Drilling Costs

1) When for the purposes of Articles 7(1)(b) and 8(1)(b) above, it is not possible to determine before the declaration of income is made for any accounting year whether a well drilled during the accounting year has resulted in a commercial discovery the expenditure on drilling the well shall be treated as capital expenditure under Articles 7.

2) Where in any later accounting year it is determined that a well to which sub-Article (1) of this Article applies has not resulted in a commercial discovery, the expenditure shall be reclassified as revenue expenditure and a deduction shall be made in determining taxable income for the later year of an amount equal to the balance of the expenditure not previously allowed.

17. Conflict with Other Laws

The income tax laws presently in force in Ethiopia shall not apply to matters provided for in this Proclamation.

18. Power to Issue Regulations

The Minister of Finance shall have the power to issue regulations necessary for the effective implementation of this Proclamation.

19. Effective Date

This Proclamation shall enter into force on the date of its publication in the Negarit Gazeta. (April 5, 1986)