Overview: Ghana's Oil and Gas Fiscal Regime

Petroleum Commission

Presentation to Council of State

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GIGS' concerns about Ghana's Fiscal Regime

"Six Years of Oil Production in Ghana under the Ghana Hybrid System":

- An Independent Operational Result, 2010 - 2016" dated 27th May 2017 shows Government Take of 19.29%
- Ghana would have been better off adopting the "simplest" form of Production Sharing Agreement (PSA) when compared with the Fiscal System adopted by Ghana.
- Ghana has lost revenue from oil production because of Ghana's Fiscal System.
- The Petroleum (Exploration & Production) Bill falls short of what it can achieve and is detrimental to Ghana.

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PC Response: Government Take

- GIGS states that "Government Take" is 19.29% from 2010 - 2016
  - Is this assumed to include Corporate Income Tax , Royalty and CAPI?
- **PC Response:**
  Industry standard in the calculation of "Government Take" is generally:
  - Over the economic life of the field and not just over the initial few years. (Initial years have "cost pool" to recover)
  - "Government Take" is calculated as percentage of **Free Cash Flow (Economic Profit)** from the field and **not** as a share of gross income from the field.
  - "Government Take", using PC's model and the actual oil price for the first 6 years of the Jubilee Field production is approximately 48%.
  - "Government Take" on a full life cycle basis (actual prices/costs for first 6 years and a projected price of $50/bbl) was 48%

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Table 1:Actual Ghana Government Take (2007-2016)

		Project	Government of Ghana	Contractor Party
Gross Revenue	**$MM**	**16,586**[3]	**2,260**[3]	**14,326**[3]
OPEX	$MM	(1,703)[2]	(232)	(1,471)
Exploration & Appraisal CAPEX	$MM	(2,464)[2]		(2,464)
Development CAPEX	$MM	(6,008)[2]	(219)	(5,789)
Total Project Cost	**$MM**	**(10,175)**	**(451)**	**(9,724)**
NCF Before Tax	$MM	6,411	1,809	4,602
Surface Rentals	$ MM		4[1]	(4)
Royalty	$MM		693[1]	(693)
Corporate Income Tax	$MM		553[1]	(553)[1]
Additional Oil Entitlement	$MM			
NCF After Tax	$MM		3,059	3,352
Total		**6,411**	**3,059**	**3,352**
State/Contractor Take	%		**48%**	**52%**

[1]Information from Ministry of Finance Petroleum Revenue Reports (only contractor royalty)

[2] Information from Kosmos and Tullow reports

[3]Gross revenue calculated using weighted average of crude oil prices realized by the Contractor Group liftings.

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PC's Response: Profit Oil Split

GIGS's Report uses PSA Profit Oil Split of 60/40 (Government / Contractor) as "industry standard norm"

- The level of profit split depends on many factors. That statement is at best questionable as "industry standard norm"(early Indonesia model).
- Various forms of Fiscal Systems exist with each system tailored to each country's individual needs.
- WCTP and DWT PAs were negotiated at a time when there had been no prior major commercial discovery of oil and gas and the continental shelf had not been de-risked.
  - Ghana's initial objective/interest was to seek investment and capacity building
  - The discovery of the Jubilee Field is a fruit of Ghana's (first generation) fiscal licensing strategy.

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Types of Petroleum Fiscal Systems

Several types of petroleum contracts are in use throughout the world:

- **Concessions – Generally (other jurisdictions), the contractor owns the oil in the ground and Govt benefits come in the form of Royalty and Taxes. Some concessions have "Additional Make-up" in "Government Take".**
  - *First introduced in the 1800s*
  - *92 countries use concessions (some have both concessions and PSAs)*
- **Production Sharing Agreements (PSA)** – Contractor extracts the oil on behalf of the Government and owns a share of production.
  - *First introduced in Indonesia in 1966*
  - *81 countries use PSAs*
- **Service Contracts** - The contractor receives a fee for extracting the oil from the ground, e.g. the Iranian "Buy-back" system.
- ***Joint Ventures (JVs) – Not a fiscal system per se, it provides enhancement to any of the above - the state may enters into partnership with one or more oil companies***

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Key Elements of Ghana's Fiscal System

- **Royalty**
- **Government Participation**
  - Initial Interest
  - Additional Interest
- **Petroleum Income Tax**
- **Additional Oil Entitlement (AOE)**
- **Other Taxes and Fees**
  - Surface Rental
  - Withholding Tax
  - Annual Training Fees and
  - Technology allowance

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Ghana's Fiscal System: Royalties and Taxes

<u>Royalty</u>

- **Percentage of gross production of hydrocarbon to be given to the State as Royalty**
  - *Oil production - Ranges from 5% - 12.5% of gross production;*
  - *Gas production - Ranges from 3% - 10% of gross volume.*

<u>Petroleum Income Tax</u>

- **Petroleum Income Tax Law (PITL) sets default rate at 50%, unless a Petroleum Agreement makes alternative provision**
  - *In all Petroleum Agreements signed currently (including that for Jubilee, TEN and OCTP), the rate has been set at 35%, in-line with the mining sector.*
- **Current Income Tax Act 2015, ACT 896, sets the default tax rate at 35%.**

Ghana's Fiscal System: Royalties and Taxes Cont/-

Other Taxes and Fees

- **Surface Rental:**
  - *First - Generation PAs between $30 - $100 per sq. km;*
  - *Second - Generation PAs vary between $50 - $200/Sq. Km (depending on the phase of activity).*

- **Annual Training Fees and one-time Technology Allowance:**
  - *Training allowance: US$ 300,000/year - Tullow's DWT*
    US$250,000/year - Heritage's South-West Tano Block
  - *Technical support: US$500,000 /year - Tullow's DWT*
    US$2,000,000 - Eni's Offshore Eastern Keta

- **An additional payment(AOE) is to be made to the government if the post tax Rate of Return for a project exceeds a targeted level.**
  - *For example, trigger points at 12.5%, 17.5%, 22.5%, and 27.5% RORs, AOE terms become more progressive over time.*

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Ghana's Fiscal System: Govt. - Participation

Government Participation

- Initial Interest
  - GNPC on behalf of the State is mandated currently to hold a minimum **initial participating carried interest of 15%. However, existing contracts have 10%.**
  - GNPC does not pay exploration and development cost but pays production expenses.
- Additional Interest
  - GNPC on behalf of the State can opt to acquire a negotiated additional interest after declaration of commerciality.
  - GNPC does not pay the exploration cost but pays development and production costs

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Comparison of Systems -Economic Assumptions

	Equatorial Guinea	Gabon	Ghana	
			Jubilee	Heritage
Royalty Rate (%)	15	4.5	5	12.5
Bonus ($MM)	15	9	NIL	NIL
Carried Interest (%)	N/A	N/A	10	12
State Participation	N/A	15	3.6	13
Tax Rate (%)	35	35	35	35
AOE Applicable Rates (%)	N/A	N/A	5 - 25	10 - 30
Profit Share (%)	10-60	50-75	N/A	N/A
Cost Recovery Limit (%)	70	75	N/A	N/A
Capital Allowance (%)	10	20	20	20

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Comparative Results of Fiscal Terms @ $65 Oil Price (2008 – 2036) Undiscounted

	Equatorial Guinea	Gabon	Ghana	
$MM			Jubilee	Heritage
Bonus	18	9	-	-
Royalty	4,852	1,462	1,624	4,060
CAPI/State Participation	-	1,130	3,200	4,869
Income Tax	-	-	4,383	2,947
AOE	-	-	-	-
Profit Oil Share	6,555	8,359	-	-
Total	11,425	11,374	9,208	11,875
Gov't Take (%)	66%	66%	53%	68%

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Comparative Results of Fiscal Terms @ $50 Oil Price (2008 – 2036) Undiscounted

	Eq. Guinea	Gabon	Ghana	
$MM			Jubilee	Heritage
Bonus	18	9	-	-
Royalty	3,732	1,124	1,249	3,123
CAPI/State Participation	-	622	2,229	3,229
Income Tax	-	-	2,231	1,226
AOE	-	-	-	-
Profit Oil Share	3,093	4,587	-	-
Total	6,843	6,343	5,709	7,578
Gov't Take (%)	69%	64%	58%	77%

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Positive Aspects of Ghana's Fiscal System

- Its attractive to investors – state guarantees contractor stability of terms and conditions of Petroleum Agreements.
- Guaranteed minimum Government Take through the payment of an ad-valorem royalty
- Additional Oil Entitlements calculated on the basis of Rate of Return ensures that Ghana can capture part of windfall profits that could otherwise accrue to the contractor
- GNPC has Initial and Additional Participating Interests in each field
- Higher tax rate of 35% compared with the Corporate Income Tax of 25%

Cost Recovery: PSA vs. Ghana's Fiscal System

PSA: 'Cost Recovery'

- The cost recovery mechanism allows an agreed maximum (ceiling) percentage of revenues (cost oil) to be used by the contractor to recover pre-defined "petroleum costs". Typically, the ceiling for cost oil (for cost recovery) ranges between 40 - 60% each year.
  - *The ceiling for cost oil guarantees income each year to the Government ("profit oil") as is the case with Royalty.*
  - *Unrecovered costs in any year can be carried forward and recovered in subsequent years (Unlimited carry-forward of losses).*

Ghana's Fiscal System: Capital Allowance

- 5-year straight-line capital allowance deduction for exploration, appraisal and development costs and other capital expenditures from petroleum revenues

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PC's Conclusion (1) on GIGS's Report

- No superiority of one Contract Type over the other.
- "Government Take" is computed based on net (not gross) revenues.
- Elements within fiscal systems may be adjusted depending on benchmark results to achieve desired Government Take.
- Generally, in pure PSAs, Concessions and Royalty Tax Systems (as in Ghana), all contractor's costs are expected to be recovered over field life.
- Prudent cost management is therefore always critical in any fiscal system

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PC's Conclusion (2) on GIGS's Report

- Same financial result can be attained through the right combination of Taxes and with effective monitoring and tax administration, regardless of which system is adopted
- GIGS uses the Jubilee Field fiscal terms in their analysis. The Jubilee PAs were negotiated at a time when Ghana's basins had not been de-risked. If South West Tano Fiscal Terms are applied to Jubilee data, government take rises to approx. 67%
- There is obviously room for Ghana to extract more rent within the current fiscal system to commensurate Ghana's risk profile
- Ghana's Fiscal System is as good as a Production Sharing Agreement and has all key elements of PSA and perhaps more, except Cost Recovery ceilings.

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Thank You

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