

KAZAKHSTAN'S NEW TAX AND SUBSOIL USE CODES: A BRIGHTER FUTURE?



KAZAKHSTAN HAS INTRODUCED ITS MOST SIGNIFICANT TAX AND REGULATORY REFORMS FOR OIL AND GAS SINCE 2009–2010. AFTER A LENGTHY CONSULTATION PROCESS, A NEW TAX CODE AND SUBSOIL USE CODE WERE ADOPTED IN DECEMBER 2017. THE TAX CODE TOOK EFFECT FROM JANUARY 2018 AND THE SUBSOIL USE CODE WILL FOLLOW FROM LATE JUNE.

This long-awaited legislation has several ambitions: boosting Kazakhstan's attractiveness as an investment destination, particularly for exploration; simplifying administrative processes; and improving the clarity and predictability of regulation. We evaluate five key questions surrounding the reforms, which will help shape the long-term outlook for the Kazakh upstream sector.

What are the changes?

Tax Code introduces new profit-based terms

The new Tax Code is a positive step for upstream taxation. The most notable reform is the optional Alternative Subsoil

Tax (AST) for offshore (including shelf) and deep onshore fields that operate under the concession regime.

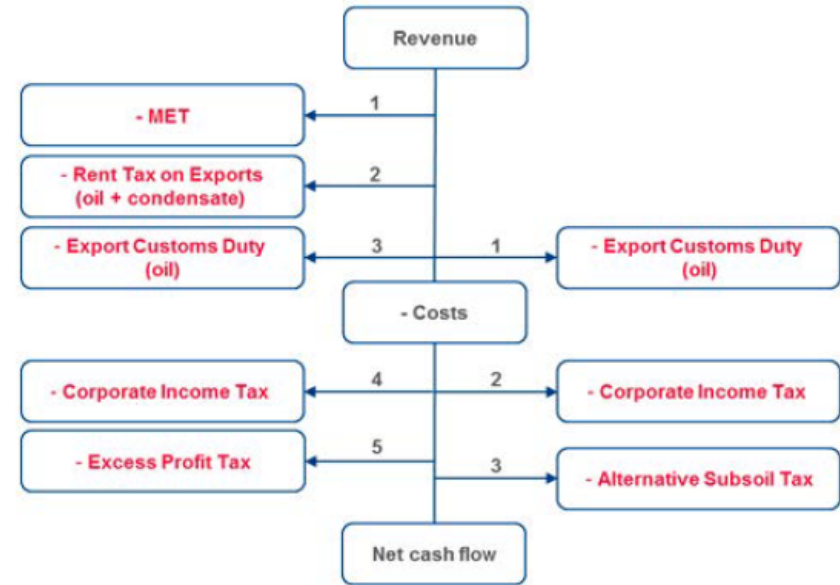
If the profit-based AST is selected at qualifying assets, it will replace four components of standard concession terms (Mineral Extraction Tax, Rent Tax on Exports, Excess Profit Tax and payments to reimburse historical state costs).

Transition to AST is voluntary. But, if selected, its application is permanent. AST will be applied according to a sliding scale that is linked to the average oil price. Other changes in the Tax Code – most notably the cancellation of commercial discovery bonuses – apply to all operators.

Standard concession

Project

Alternative subsoil tax



Source: Wood Mackenzie

Overview: alternative subsoil tax and standard concession terms

The near-term application of AST will be limited. All current offshore discoveries are governed by Production Sharing Contracts (PSCs) with stability clauses, while the vast majority of onshore production either does not qualify or is under PSCs. We expect some operators of deep onshore fields to apply for the new terms, although the deadline is extremely tight.

But some fiscal issues are largely unaddressed

Kazakhstan's new Tax Code targets a rebound in exploration and greenfield developments. It brings little cheer to operators of onshore brownfields – a core source of current government revenues and inflows into the National Fund.

For marginal fields (e.g. high-depletion or high-viscosity), the process for receiving MET breaks has not improved. Despite industry proposals, there will be no self-assessment of eligibility for reduced MET. Standard concession terms are unchanged for these assets.

Subsoil Use Code optimises legislation

The new Code replaces the 2010 Law on Subsoil and Subsoil Use and brings more clarity to sector oversight. Simplification of procedures and improvement of investment conditions are at the heart of the Code's rationale. The deepest changes are in the mining sector; although oil and gas is also affected.

However, previous reforms have not always had the desired effect. Operators from across the energy sector will therefore wait to see if the reality lives up to expectations.

Why did Kazakhstan need to improve its terms?

Kazakhstan's upstream industry is ever more reliant on its three megaprojects: Tengiz, Kashagan and Karachaganak. Production and investment growth hinge on successful expansion at the super-giant fields. The megaprojects already supply about 60% of oil and condensate. In our view, this will rise to more than 80% by 2030.



KAZAKHSTAN'S NEW TAX AND SUBSOIL USE CODES: A BRIGHTER FUTURE?



KAZAKHSTAN HAS INTRODUCED ITS MOST SIGNIFICANT TAX AND REGULATORY REFORMS FOR OIL AND GAS SINCE 2009–2010. AFTER A LENGTHY CONSULTATION PROCESS, A NEW TAX CODE AND SUBSOIL USE CODE WERE ADOPTED IN DECEMBER 2017. THE TAX CODE TOOK EFFECT FROM JANUARY 2018 AND THE SUBSOIL USE CODE WILL FOLLOW FROM LATE JUNE.

This long-awaited legislation has several ambitions: boosting Kazakhstan's attractiveness as an investment destination, particularly for exploration; simplifying administrative processes; and improving the clarity and predictability of regulation. We evaluate five key questions surrounding the reforms, which will help shape the long-term outlook for the Kazakh upstream sector.

What are the changes?

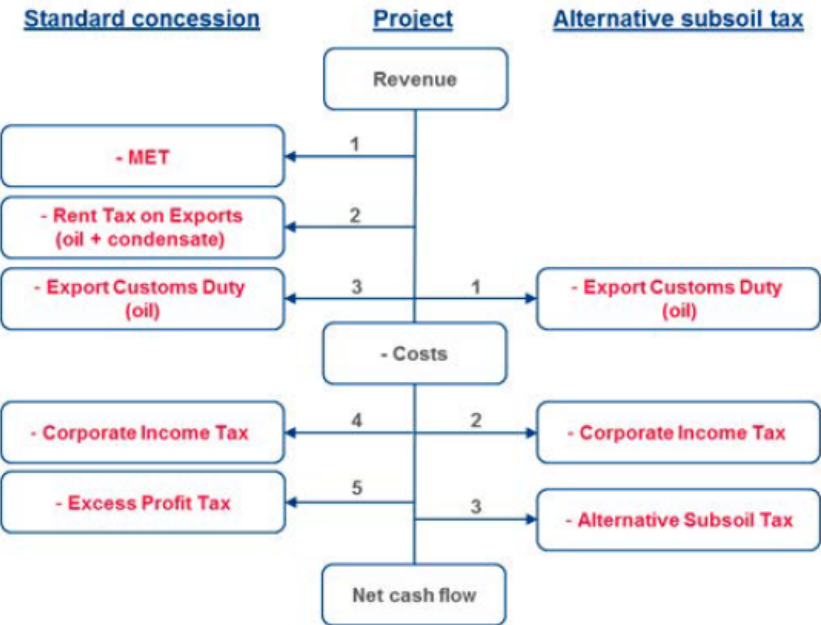
Tax Code introduces new profit-based terms

The new Tax Code is a positive step for upstream taxation. The most notable reform is the optional Alternative Subsoil

Tax (AST) for offshore (including shelf) and deep onshore fields that operate under the concession regime.

If the profit-based AST is selected at qualifying assets, it will replace four components of standard concession terms (Mineral Extraction Tax, Rent Tax on Exports, Excess Profit Tax and payments to reimburse historical state costs).

Transition to AST is voluntary. But, if selected, its application is permanent. AST will be applied according to a sliding scale that is linked to the average oil price. Other changes in the Tax Code – most notably the cancellation of commercial discovery bonuses – apply to all operators.



Source: Wood Mackenzie

Overview: alternative subsoil tax and standard concession terms

The near-term application of AST will be limited. All current offshore discoveries are governed by Production Sharing Contracts (PSCs) with stability clauses, while the vast majority of onshore production either does not qualify or is under PSCs. We expect some operators of deep onshore fields to apply for the new terms, although the deadline is extremely tight.

But some fiscal issues are largely unaddressed

Kazakhstan's new Tax Code targets a rebound in exploration and greenfield developments. It brings little cheer to operators of onshore brownfields – a core source of current government revenues and inflows into the National Fund.

For marginal fields (e.g. high-depletion or high-viscosity), the process for receiving MET breaks has not improved. Despite industry proposals, there will be no self-assessment of eligibility for reduced MET. Standard concession terms are unchanged for these assets.

Subsoil Use Code optimises legislation

The new Code replaces the 2010 Law on Subsoil and Subsoil Use and brings more clarity to sector oversight. Simplification of procedures and improvement of investment conditions are at the heart of the Code's rationale. The deepest changes are in the mining sector, although oil and gas is also affected.

However, previous reforms have not always had the desired effect. Operators from across the energy sector will therefore wait to see if the reality lives up to expectations.

Why did Kazakhstan need to improve its terms?

Kazakhstan's upstream industry is ever more reliant on its three megaprojects: Tengiz, Kashagan and Karachaganak. Production and investment growth hinge on successful expansion at the super-giant fields. The megaprojects already supply about 60% of oil and condensate. In our view, this will rise to more than 80% by 2030.