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The Global Minimum Tax and Its Impact on the Oil & Gas (O&G) Industry

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Introduction

In Fall 2021, almost 140 members of the Organisation for Economic Cooperation and Development (OECD) / Group of Twenty (G20) Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS) — a framework for tackling tax planning strategies — agreed on a two-pillar solution, Pillar One and Pillar Two, to address the challenges arising from the digitalization of the economy.

The O&G industry should be excluded from Pillar One, which focuses on where companies pay taxes. Conversely, Pillar Two, via the Global Anti-Base Erosion (GloBE) Rules, introduces a 15% global minimum tax on corporate income, which may have an impact, though in limited cases, on the O&G industry, especially regarding the upstream sector tax incentives that often countries implement to attract contractors.

It is unlikely that the GloBE Rules will have an impact on the generally harsh legal-fiscal terms offered by well-established O&G producing countries, as under these terms contractors end up paying on their corporate income well above a 15% tax rate. However, the GloBE Rules might have a reforming impact on the lighter legal-fiscal terms offered by prospective O&G producing countries or even by established ones when offering unexplored acreage or marginal fields as in these two cases, given the higher risk for contractors, the terms are normally lighter.

Among the countries in which introducing the GloBE Rules will increase the tax burden for the affected contractors, there might be countries in which contractors might not be any longer interested in investing because of the increased tax burden. In a world where environmental policies linked to the Paris Agreement require countries to reduce their greenhouse gas (GHG) emissions, even a small percentage increase in overall income taxation for prospective contractors might represent the tipping point between investing or not investing in a country.

Note: The words ‘country’ and ‘jurisdiction’ are not overlapping completely; however, for ease of reading, I have primarily used the word ‘country’ even when it would have been more appropriate to use the word ‘jurisdiction.’

The Global Minimum Tax

Before I start analyzing in more details the specific case of the O&G industry, let me first explain

the logic of the global minimum tax. This tax establishes that a multinational enterprise (MNE) group with total annual revenues of more than EUR 750 million in at least two of the last four fiscal years pays at least a 15% income tax rate in each of the jurisdictions where the MNE group has a subsidiary or a permanent establishment (PE). Yet, the GloBE Rules do not apply in jurisdictions where the MNE Group revenues and income are below EUR 10 million and EUR 1 million, respectively.

Based on the GloBE Rules, if a source country, i.e., the country where an investment (for example, an investment in an upstream O&G operation) is carried out, does not apply the global minimum tax, another jurisdiction or more than one other jurisdiction might obtain the taxing rights for the additional tax to be paid. So, overall, a minimum effective tax rate of 15% is paid on the income derived from the investment in the source country, though the amount is split between more than one jurisdiction.

If, at the jurisdictional level, the tax on the accounting profits is set at less than a 15% effective tax rate (ETR), to bring the tax rate to a 15% ETR, the GloBE Rules introduce the Income Inclusion Rule (IIR) and, if this is not applied at all or only up to a partial amount, the Undertaxed Profits Rule (UTPR). Profits under the IIR and the UTPR are calculated based on the financial statements (with some adjustments) and not on the taxable income. The ETR is equal to a jurisdiction's Adjusted Covered Taxes / a jurisdiction's GloBE Income.

Under the IIR, the residence country (e.g., the UK) of a parent company, or of an intermediary holding company, may impose a top-up tax on the excess profit obtained in each source country (e.g., the UAE). Excess profit is defined as the GloBE Rules income minus the Substance Based Income Exclusion (SBIE, this is a source-country carve-out that excludes, for both the IIR and the UTPR, a share of tangible investment and payroll).

If the residence country does not apply an IIR, the UTPR taxpayer – that is a member of an MNE group established in another country where it has an ETR of at least 15% – will adjust its tax with reference to any top-up tax in respect of a low-taxed constituent entity of the same MNE group. Moreover, if within the MNE group more than one country where the MNE group operates enact an UTPR legislation, all the UTPR countries will get a share of the top-up tax based on each UTPR taxpayer's proportional number of employees and net assets. The IIR has priority over the UTPR.

Yet, a jurisdiction may still introduce a Qualified Domestic Minimum Top-Up Tax (QDMTT), which has precedence over the IIR, so that it can capture any additional tax revenues deriving from applying the GloBE Rules. The QDMTT is a domestic minimum tax permitting a source country to maintain the right of first taxation and to avoid the paradox of having useless tax incentives — without the QDMTT, other countries would cash in the tax difference between a 15% ETR and the source country reduced (by the tax incentives) ETR.

It does not matter if contractors via a subsidiary or PE invest in a country that is not an IF member or that, though an IF member, it has not implemented the GloBE Rules. If contractors are members of an MNE group having total annual revenues of more than EUR 750 million in at least two of the last four fiscal years, the rules might apply because another member of the group might apply the top-up tax.

For example, a contractor invests in Country A, which is not an IF member, via a constituent entity of its MNE group, whose parent company is resident in Country B, which has implemented the

GloBE Rules. Because of this scheme, Country B may apply an IIR top-up tax if Country A ETR is less than 15%.

GloBE Rules Implementation for Some O&G Producing Countries* — Jan. 2024

Country	Legislation Status	Income Inclusion Rule (IIR)	Undertaxed Profits Rule (UTPR)	Domestic Top-Up Tax (QDMTT)
Australia	Legislation bill almost ready	2024	2025	2024
Brazil	No announcement	No information	No information	No information
Canada	Legislation bill	2024	2025	2024
Egypt	No announcement	No information	No information	No information
Mexico	No announcement	No information	No information	No information
Nigeria	Announcement	No information	No information	No information
Norway	Legislation	2024	2025 (probably)	2024
Saudi Arabia	No announcement	No information	No information	No information
UK	Legislation	2024	2025	2024
UAE	Announcement	No information	No information	No information
United States	No near-term implementation	No information	No information	No information
Venezuela	No announcement	No information	No information	No information

*Many Middle East and North Africa countries, some of which are important O&G producers (e.g., Iraq), are not IF members, but this does not exclude them from the possibility of being subject to the GloBE Rules.

Overview of the GloBE Rules Impact on the O&G Industry

Often the O&G industry is subject to an overall income tax rate consistently higher than a jurisdiction's standard corporate income tax (CIT) rate or O&G companies have total annual revenues of less than EUR 750 million, or both. So, it is probable that many O&G companies are subject to an income tax rate higher than 15% or are as well out of the scope of the GloBE Rules if they are small companies with reference to the total annual revenues threshold, or both.

Yet, it is possible that enacting the global minimum tax will force a source country interested in attracting O&G investments — for example, prospective O&G producing countries or even established ones when offering unexplored acreage or marginal fields — to modify at least some of their profitability-based tax incentives (PBTIs), if not also some of their cost-based tax incentives (CBTIs), to not have tax incentives whose benefit will be reaped by other jurisdictions.

Various elements play a role in determining what the impact of a tax incentive is (for example, being a contractor within the remit of the GloBE Rules, the size of the tax incentive in relation to the tax base as defined by the GloBE Rules, or the magnitude of the tax benefit) so that a case-by-case analysis in each country is required and comparisons are difficult.

The O&G Industry Tax Incentives Most Affected by the GloBE Rules

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Nature of the tax incentive	Type of tax incentive

Profit-Based Tax Incentives (PBTIs)	Income tax holiday (full reduction) Income tax rate reduction (partial reduction) Withholding tax (WHT) relief on interest, services, or royalties WHT relief on dividends
Cost-Based Tax Incentives (CBTIs)	Accelerated depreciation and immediate expensing of the cost of an asset Investment allowance of more than 100% of the cost of an asset Non-refundable and non-transferable tax credits
Special Economic Zone (SEZ, uncommon for the upstream sector)	In addition to other non-tax advantages, an SEZ may offer one or more of the tax incentives mentioned in the other rows of this table

Income Tax Holiday and Income Tax Rate Reduction

Two often-used tax incentives in the O&G industry are an income tax holiday and an income tax rate reduction, both often on a temporary basis. Under the GloBE Rules, if the application of one of these two incentives reduces the taxation on the overall income below the required 15% ETR in Country A, it is reasonable to assume that the incentive will be neutralized by the application of a top-up tax in Country B (via the IIR or the UTPR, or both).

Morocco's O&G legal-fiscal framework might be an example as it offers a 10-year tax holiday from first production. From an initial valuation of how O&G corporate income is taxed in Morocco, it appears reasonable to preliminarily assume that this tax holiday from first production will be caught by the GloBE Rules. Of course, other profitability factors will affect the ETR beside the tax holiday so that more investigation is required.

Withholding Tax (WHT) Reliefs

According to the GloBE Rules, a WHT on interest, services, or royalties is attributed to the jurisdiction of the investor receiving the payment, i.e., the residence country. This means that these three types of WHTs contribute to the calculation of the residence country ETR. Consequently, if the source country offers a WHT relief on interest, services, or royalties, but then there is additional taxation to be paid in the residence country, in case the ETR is below 15% in the latter, the tax incentive will become useless for the source country.

Conversely, a WHT on a non-portfolio dividend is attributed to the source country, and it contributes to determining the source country ETR for the company that distributes the dividends. When the ETR is 15% or more, there is no effect on a source country WHT exemption or reduction, but when the ETR is less than 15%, a top-up tax may be imposed abroad.

Contractors often are subject to the four types of WHTs when they carry out O&G operations. For example, if they are using debt financing from a bank or a parent company, on the amount received, contractors will pay interest, which is generally deductible in the source country and taxable, unless exempted, in the residence country.

Yet, the GloBE Rules include the Subject to Tax-Rule (STTR), which is a treaty-based rule (i.e., it requires the existence of a bilateral tax treaty (BTT)) that applies to cross border intragroup payments, which are frequent in the O&G industry, such as for interest. When, in the residence

country, the payee pays less than a 9% tax rate on these payments, the source country may tax the same payment as well to guarantee a minimum level of taxation. This rule has priority over the QDMTT, IIR, and UTPR. If no BTT applies between two countries, the source country may already impose a tax on these payments, and there is no need for the STTR.

Accelerated Depreciation and Immediate Expensing

Accelerated depreciation and immediate expensing create a tax deferral as the payment of the tax is postponed to the future, so they might create a distortion in the ETR calculation as they reduce the amount of the covered taxes. To avoid this, the GloBE Rules fictitiously include the deferred taxes in the covered taxes at the minimum rate. Yet, a tax must not be deferred for more than five fiscal years, because, in that case, a top-up tax will have to be paid under the recapture rule. The accelerated depreciation and immediate expensing of long-term intangible assets are subject to the recapture rule.

Yet, there are two positives for the O&G industry. First, the five-year recapture rule does not apply to tangible assets, which also include in addition to property, plant, and equipment, inter alia, O&G reserves and exploration and evaluation assets, provided that the tax rate applied after the deferral is at least 15%. Second, timing differences concerning, inter alia, de-commissioning expenses, rehabilitation expenses, and research and development, are out of the scope of the recapture rule.

Investment Allowance of More Than 100%

An investment allowance is a tax relief given for a capital expenditure on some qualified assets. If contractors may deduct more than 100% (an uplift) of the purchase cost of an item or of its depreciation expense, it is highly probable that the investment allowance will be affected by a top-up tax in another country if the ETR is reduced below 15%.

In the United Kingdom, in 2022, to spur investment in the North Sea, the Energy Profits Levy introduced an 80% investment allowance for qualifying expenditures. Because of this, ring-fenced capital expenditures (and some related operating expenditures as well) could produce an 80% uplift so that if contractors spent 1 pound, they would have a tax relief of 1.80 pounds. If upstream O&G operations are profitable, the government should be compensated for these tax incentives by other fiscal elements so that the collected income tax is never too low. Yet this is not always the case. In 2023, the government reduced the rate to 29% and maintained the 80% rate for decarbonization expenditures.

Non-Refundable and Non-Transferable Tax Credits

According to a country's enacted tax legislation, if in a fiscal year, a contractor shall pay taxes for an amount lower than its given tax credits, usually the unused tax credits may be reimbursed, carried forward, or lost. For example, in the UK, the research and development tax credits and, in the US, the CCUS tax credits permit contractors to lower their tax bill.

The GloBE Rules on tax credits are quite complicated (explaining how the GloBE Rules categorize tax credits goes beyond the purpose of this blog post), but it is important to understand that according to the GloBE Rules, tax credits may either reduce the amount of the payable tax or of the taxable income.

Moreover, notwithstanding that all the categories of tax credits reduce the ETR, for contractors, the

tax credits that will most likely reduce the ETR and that will require the application of a top-up tax are the tax credits that the GloBE Rules call Other Tax Credits (OTCs), which are non-refundable and non-transferable tax credits. These tax credits are among those that impose a direct tax reduction treatment so that the tax credits correspond to a reduction of the covered taxes.

Special Economic Zone (SEZ) Tax Incentives

An SEZ is an area in which a government has established a business-friendly environment by providing, inter alia, one or more tax incentives, simpler administrative procedures, or abundant labor supply (or any combination of these factors). Whether the GloBE Rules might affect an SEZ tax treatment depends on the types of tax incentives offered by the SEZ. So, for example, VAT incentives and duty-free export incentives will be unaffected, but PBTIs such as an income tax holiday will reduce the ETR and thus potentially trigger the application of a top-up tax.

In the O&G industry upstream sector SEZs are rare. An example is Colombia, where, starting in 2014, the government permitted the declaration of offshore free trade zones (FTZs) so that contractors could have tax incentives while they carried out upstream O&G operations offshore. The government also permitted the creation of continental or insular FTZs to carry out activities related to the O&G activities offshore.

Yet, according to each country's legislation, there might be some benefits for the O&G industry upstream sector in having SEZs either for carbon capture, utilization, and sequestration (CCUS) linked to upstream O&G operations or for the liquefaction of natural gas within the liquefied natural gas (LNG) value chain (especially in integrated projects as contractors carry out, first, exploration and production and, second, liquefaction and export).

The Impact of Domestic Tax Policy Responses on Contractors

As stated above, it is probable that many O&G companies are subject to an income tax rate higher than 15% or are outside of the scope of the GloBE Rules if they are small companies with reference to the total annual revenues threshold, or both.

However, if a source country realizes that the introduction of the GloBE Rules might result in an ETR below 15% and consequently in the imposition of a top-up tax in another country, the source country might decide to enact some domestic tax policy responses to avoid subsidizing tax benefits that will be collected by one or more other countries.

Each country will have to evaluate the pros and cons of introducing such tax policy responses if it risks losing a substantial amount of revenues versus the pros and cons of maintaining the status quo if it risks only losing a small amount of revenues. Yet, many developing countries do not have the expertise necessary for introducing these tax policy responses. Having the required tax skillset, a resource-rich country might implement one or more of the three following basic tax policy responses:

1. Revising the applied tax incentives;
2. Adopting a QDMTT; and
3. Adopting a simplified Domestic Minimum Tax (DMT).

Conclusion

O&G contractors need to be aware of the future introduction of the GloBE Rules. It is highly probable that notwithstanding that the source country is not an IF member, contractors will end up paying the global minimum tax in the shape of a backstop tax from another jurisdiction. It is premature to understand all the nuances brought about by the introduction of the GloBE Rules and their effects on the O&G tax incentives.

Given the complexity of the GloBE Rules and, generally, of the legal-fiscal terms applying to O&G concession agreements (we can judge an O&G legal-fiscal framework by the interaction of all the legal-fiscal elements and not by a single legal-fiscal factor), it seems that each country is a different case so that comparisons between countries are difficult.

Contractors might want to initially focus on those three PBTIs (income tax holiday, income tax rate reduction, or WHT reliefs) and three CBTIs (accelerated depreciation and immediate expensing, investment allowance of more than 100%, and non-refundable and non-transferable tax credits) as these tax incentives appear as those that the GloBE Rules will affect the most so that a source country will most likely try to modify them to be GloBE Rules compliant.

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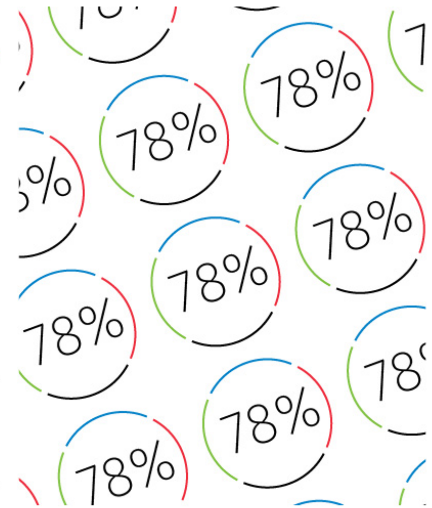

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