Petroleum Tax Regime in Iran

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ABSTRACT

Taxation is one of the significant phenomena in any economy as it not only generates revenues for existing government, but also serves as a fiscal tool and stabilization policy. One of the main types of taxation is the petroleum tax which accounts for more than 30% of revenue for developed countries and more than 85% for developing economies. This work focuses on petroleum producing giants in Iran. The tax system has changed over time with changing circumstances such as the structure of political environment, the nature of respective oil industry, the policies of the individual oil associations, the price of oil, and domestic demand. The study found that the tax systems of Iran are not fixed over time and they are not adequately flexible to attune to profitability or non-profitability of oil as well as price. Energy resources are one of the factors essential to the economic development of countries such as Iran and five fossil fuels, especially oil products are the most important resources that are used. As a result, use of these fuels, on the one hand, reduce the energy resources that we face with the completion of the resources and on the other hand, we are actually affected by air pollution and climate change. Energy consumption patterns of production and consumption sectors are inappropriate and that has led to the lower position of Iran among other countries in terms of energy efficiency, causing environmental problems. According to the results, a tax on gasoline, gas oil, fuel oil and liquefied petroleum gas has been reduced to increase their consumption.
Keywords: petroleum tax, profitability revenue, taxation, tax system

1. Introduction

Taxes, compulsory payments to government or state and imposed by legislature (Egwaikhide and Udoh, 2012), have over the years become a subject of interest to both stakeholder and researchers; the justification of this stems from the fact that when used properly, taxation can serve as a potent instrument for resource mobilization and allocation. Revenue from taxation generally constitutes a substantial part of total revenue of government and so this singular phenomenon has made taxes occupy prominent position in the discipline of public finance. Tax is as old as the government of any country is. It is a tool for government revenue and for fiscal policy and stabilization. Egwaikhide and Udoh (2012) stated that “as part of budgetary policy taxation can serve as an effective tool for promoting economic growth and macroeconomic stability.” Taxation, according to Ngerebo and Masa (2012), is one of the oldest economic phenomena by which the cost of providing essential service termed ‘public good’ is provided for the benefits of the citizenry. The history of taxation predates many centuries; however, the permanency of taxation became a common feature in 1874 when Great Britain made income tax a permanent level on is citizens. “Tax is a compulsory payment made on different basis and rates by citizens (corporate bodies and individuals) to the government, non-negotiable or obligatorily” (Ngerebo and Masa 2012, p. 1); it is non-negotiable because in most country’s tax systems the

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citizens do not participate in the formation or composition of tax rates and charges. Government only classifies the tax to be paid according to category of items, tax payers and group of individuals or organizations (Ngerebo and Masa 2012). Trend of taxation in the oil industry shows that among all the other sectors, this sector is dominant not only in significance as the oil industry has over the years remained the mainstay of major economies constituting about 25-30 of the revenue to Industrialized country's government and over 80% to the government of less developed countries but serve as a major employer of quality labor in world economies. Over the last decades the taxes on oil products have substantially increased (Austvik, 1997) and evidence shows that majority of oil exporting countries use different tax structure basically from the different fiscal regimes adopted. The relative importance of the sector to any economy thus necessitates the desire to understand the industry's nature and character and the laws and policies regulating it. It is against this background that this study is initiated. This paper is prepared with the aim of providing a framework for petroleum taxation in general and petroleum taxation of three oil exporting countries. This research work is meant to answer the following questions: How important are petroleum taxes for economies? What principles should govern the level and structure of taxes on oil products? And is the general level of oil product taxes in developing countries similar to that in industrial countries? The research will cover petroleum taxation in general and trickle down to taxation of Iran. It will cover history, trends, patterns and taxation of petroleum industry in general and of Iran in particular. This paper is organized as follows. Section one is the introductory sector section, it covers the background, aims of study, scope of study, and organization of the study; second two present the conceptual framework which inculcates the meaning of taxation and its different types as well as the literature review; sector three focuses on the taxation system of the case study Iran; section four gives the conclusion.

2. Conceptual Framework Taxation

Conceptual Framework 2.1 Taxation A tax is a fee charged or levied by the government on a product, income or activity. According to Black's Law Dictionary, tax can be basically classified into two broad groups: direct and indirect taxes. If it is levied directly on income of individuals or corporations it is terms as direct taxes; taxes levied on goods and services is termed indirect tax. According to Encarta Encyclopedia 2009, taxation is deemed: "the most important source of revenues for modern governments, typically accounting for 90 percent or more of their income. The remainder of government revenue comes from borrowing and from charging fees for services. Countries differ considerably in the amount of taxes they collect. In the United States, about 30 percent of the gross domestic product (GDP), a measure of economic output, went for tax payments in 2000. The 30 percent figure is relatively low from a historical standpoint. As a result of a new round of tax cuts in 2003, the tax percentage share of GDP was expected to be lower than at any time since 1959 when many major government programs, such as Medicare and Medicaid, did not exist. In Canada about 35 percent of the country's gross domestic product goes for taxes. In France the figure is 45 percent, and in Sweden it is 51 percent. In addition to using taxation to raise money, governments may raise or lower taxes to achieve social and economic objectives, or to achieve political popularity with certain groups. Taxation can redistribute a society's wealth by imposing a heavier tax burden on one group in order to fund services for another. Also, some economists consider taxation an important tool for maintaining the stability of a country's economy." There are various kinds of taxes the government imposes;

these taxes are: (a) personal income tax, also called 'income tax' imposed on the income of individuals including wages, salaries and other earnings from one's occupation such as interest earned on savings account and certain types of bonds, rents, royalties earned on sale of copyrighted books and dividend from stocks; (b) Corporate Income Tax – imposed on the net income of corporations (c) Payroll Tax – taxes levied on only wages and salaries (d) all sources of income (d) taxes levied on the sale of goods and services such as sales taxes, excise duties, value added taxes and tariff (e) property taxes – taxes levied on individual's wealth – the value of a person's assets both real (houses, cars and artwork) and financial (stocks and bonds) and (f) Estate, inheritance and gift taxes. 2.2 Petroleum Taxation The total tax burden borne by oil companies depends on three factors: the type of taxes; the tax base and the tax rate. Oil companies generally pay four (4) types of taxes: production taxes – levied on the value of the oil extracted from the ground; corporate income taxes levied on the net income of corporations; property taxes – applicable to oil properties, which may be based on the assessed value of future expected production from oil reserves in the ground and sales taxes on purchase of both inputs and equipment for needed for capital improvements (Alberro and Hamm, 2008). Most countries rely on a combination of severance taxes (ST) (taxes on production), corporate income taxes CIT) (taxes on profits), property taxes and sales taxes (SAT). According to (Alberro and Hamm, 2008) oil companies generally pay the same taxes as other corporations as well as production taxes levied on the value of exploited oil. However, each country employs a different strategy for taxing the industry; some countries emphasize on the value of current production, while others rely more on property taxes or corporate income taxes. Also, not all countries levy all these taxes, not do all states use the SAE rates or even the same taxable bases. Taxation plays a central role in matters of fiscal policy, the objective of petroleum taxation according to Nwete (2004) are numerous among which are: exercising government rights and control over public asset; regulating the number of participants in the industry and more important amassing revenue for its socio-political and economic obligations and as a tool for fiscal policy and stabilization. According to Nwazeaku (2005) petroleum profit tax involves the charging of tax on the income accruing from petroleum operations. Anyanwu (1993) documented that: "petroleum profits tax is charged, assessed and payable upon the profits of each accounting period of any company engaged in petroleum operations during any such accounting period, usually one year (January/December)" International Monetary Fund analysis of 30 less developed countries and industrial countries in 1990-1991 showed that tax revenues from petroleum have a significant relationship with government budget and GDP. The survey showed that: consumption of petroleum products rises almost as fast as GNP (elasticity of 0.8); total government tax revenue from all sources tends to rise faster than GNP (elasticity of 1.2) and tax revenue from petroleum products rises more slowly than total tax revenue (elasticity of 0.7). The survey concludes thus that tax revenue from petroleum products rises more slowly than GNP (elasticity of 0.9). The result illustrated the importance of taxation of petroleum products, especially in the upstream sector and for less developed economies. The reason adduced is that fuel taxes is one of the easiest and fastest way of revenue generation; this is based on the premise that demand for fuel is relatively inelastic ensuring "buoyant revenue as income rises and tax rate are increased". So, while petroleum product taxes are relevant for developed countries, they thus become more important in less developed countries.

3. Following the Nationalization of the Iranian Oil Industry

A set of reasons including, above all, financial inequalities and rampant poverty in Iran gave rise to a nationalistic movement in Iran pioneered by Mosaddeq, which culminated in the nationalization of Iranian oil Industry in 1951. Petroleum taxation revenues between the British and Iranian governments can be noted that the British government made far more money from petroleum taxation than did Iran from royalties. The scale of poverty in Iran as well as this sheer inequality might have affected nationalistic movements in Iran. According to the nationalization law validated by both Iranian Parliaments, the entire oil industry was nationalized and all relevant stages "including exploration, development and exploitation were to be carried out and controlled solely by the Iranian government." For the first time in the history of Iran, the country was legally considered the owner of its petroleum wealth. However, financial difficulties as well as deliberate attempts by the intelligence of the United States undermined the Mosaddeq government. The plans for nationalization and Iranian ownership of its oil assets were brought to an early end in 1953 through a U.S.-British backed military coup. After Mosaddeq's government was overthrown, negotiations restarted resulting in an agreement with a consortium consisting of seven major American oil companies and British Petroleum as its shareholders. The agreement was a very complicated and long document composed of 51 articles attempting to reconcile its concessionary nature with the Iranian Nationalization Act concealing its sheer lopsidedness. For example, the word "stated payment" was used instead of Royalty, because of the negative connotation attached to the latter, and Iran was even denied its share in the consortium. The title to oil was transferred to the consortium once the oil reached wellhead, making the Iranian government an owner with no rights. The contract was for 25 years but could easily be extended for up to another 15 more years. In fact, the Consortium was an agent working on behalf of the National Iranian Oil Company (NIOC). Based on Article 28 of the agreement, the consortium was exempted of all custom tariffs and taxation.

Before the 1951 Nationalization of the Iranian Oil Industry, all operations were conducted by the foreigners and the government played the role of a bystander watching. "after the passage of the Nationalization law (1951), the Iranian government went to the other extreme by controlling "all operations of exploration, extraction and exploitation." The grave economic and political conditions that ensued in the subsequent years revealed that realism demanded modernization. Thus, it was decided to encourage the flow of foreign investment in oil, but at the same time provide for Iran's participation through some kind of partnership with foreign oil concerns." Four years after the Consortium agreement, the first petroleum law of the Iranian history was drafted. However, it did not address the territories already granted to the Consortium.

It was rather an essential legal background to further cooperation with other IOCs for attracting much needed investment and technology. During this period, Iran had a contractual regime unaffected by legislation, the Consortium, and a separate legislative framework for areas outside of the Consortium territories. The Act prescribed Joint Ventures with government participation. The minimum share for National Iranian Oil Company (NIOC) participation in any of the ventures had to be 30 percent, which was a principle not always, adhered to. As was the case with the 1953 Consortium, contracts were to be agreed for a period of 25 years with compulsory relinquishment requirements starting after 10 years not leaving the IOC with more than 1000 square kilometers. Agreements had to contain a minimum IOC operational undertaking and be passed by both Iranian Parliaments. Contrary to the Consortium agreement, foreign companies were liable to all forms of taxes. Until 1974, based on this Act, a number of Joint Operating Agreements (JOAs) and Production Sharing Agreements between Iran and IOCs were struck.

Iran started with its 1957 petroleum law which has been described as pragmatic. This was the first-ever detailed legislation considering natural resources. However, as discussed above, a few years before this law, the Iranian Parliaments had nationalized the petroleum industry completely, which could not survive for more than two years and has been described as radical and unrealistic. An important incentive for Iran was to participate in production and maintain a degree of control on its own resources. The 1974 law was more of a response to the 1973 oil shock and an attempt to capture a greater proportion of the resource rent. This prescribed service contracts and was a reflection of the maturity of the Iranian oil industry. The 1987 law was however, an ideologically driven legislation which obviously stemmed from the statist attitude of the Islamic Republic towards the economy, and underscored its pessimistic attitude towards foreign participation, obviously exacerbated during the war. However, the pressing need of the Iranian petroleum industry for capital did not allow this mind-set to last beyond 10 years. A more pragmatic attitude was adopted from the 1990s onwards at attracting foreign investment. The change was necessary because of an obvious failure in and an inadequacy of the previous system in prescribing pure service contracts. In other words, it was a return to the 1974 law with only an insignificant alteration of the terms used i.e., prescription of Buyback instead of Risk service contracts. The Enactment of Protection and Encouragement of Foreign Investment Act in 2003 bears testimony to the claim that the Iranian Regime was changing its previously strict and xenophobic attitude towards foreign investment. The act which grants assurance to foreign investors, facilitates the approval procedure and introduces new contractual mechanisms for foreign investment was the first of its kind after the 1979 Revolution. This new found pragmatism, more than anything else, had to do with the country's inability to provide funds for its very capital-intensive economic projects particularly in the upstream petroleum industry, along with the stressed role of foreign investment in development of the country during the Presidency of President Mohammad Khatami (1997-2005). It was during this period that the government demonstrated willingness to engage itself in bilateral investment treaties and double taxation treaties with developed countries. More signs of pragmatism can be detected in a massive privatization program aimed at transferring ownership of most mother industries to private owners starting in 2005. The Iranian experience suggests a number of reasons giving rise to or justifying legislative changes. This can be summarized under three headings. It should be acknowledged that more often than not it is not a single reason but a combination of these reasons led to changes in legal policies:

Ideology: This was particularly obvious in the case of the 1987 law. The 1951 nationalization of the Iranian oil industry was also ideologically driven.

Oil Price Fluctuations: Changes in oil prices affect the bargaining position of oil producing countries vis-à-vis foreign IOCs. At times when prices are higher, there certainly exists more willingness for investment and risks are welcomed in return for prospectively higher revenues. After the 1973 oil boom, the government modified its contractual mechanisms to obtain higher income.

Failure of Existing System: Petroleum laws are always legislated with a number of implicit goals. The establishment of the Consortium and legislation of the 1957 was a tacit acknowledgement of the failure of the previous system i.e. complete control and ownership provided for by the Oil Nationalization Act of 1951. Buy-back mechanism also owes its existence, at least partly, to the failure of the state in funding the petroleum industry from its own budgetary resources.

The significance and importance of oil to the Iranian economy cannot be overemphasized; Iran is the 9th in the world and the second largest producer of oil in the Organization of Petroleum Exporting Countries. According to Amuzegan (2008) in the mid 2008 – the 100th anniversary of commercial oil discovery in Iran – the country's petroleum deposits, the price of its crude, its foreign exchange reserves, and its annual oil export receipts and its annual tradable set historic records. With more than a century of oil discovery, Iran is the oldest oil exporting country in the Persian Gulf Region; and with continued discovery of new oil fields; its current reserves have always exceeded domestic consumption and exports. Its current proven oil deposits in situ are estimated to be 520 billion barrels which constitutes 11.6 percent of the world's known petroleum reserves (Amuzegan, 2008). The unique role of oil revenue in economy of Iran can be seen in the structure of government budget and programs. Iran has a discretionary licensing system. The government receives a large share of the value created through: taxation of oil and gas activities, direct ownership in fields on the Norwegian continental shelf and dividends from its shareholding. Petroleum taxation is based on the Iranian rules for ordinary corporation tax. The petroleum tax system has been designed to provide neutrality, so that an investment project which is profitable for an investor before tax will also be profitable after tax. This makes it possible to harmonize the desire to secure significant revenues for the community with the requirement to provide sufficient post tax profitability for the companies. Owing to the extraordinary profitability associated with the production of petroleum resources, a special tax is also levied on the income from these activities. The ordinary tax rate is 30-32%, while the special tax rate is 50% (Amuzegan, 2008).

4. Conclusion

A legal study of the trend of the Iranian petroleum Tax reveals that it has thus far been a reflection of political, ideological and global significance attached to natural resources as well as internal developments. Based on the presented material, it can be concluded that as more time passes by from the Islamic Revolution of 1979 the trend is that more pragmatism is creeping into the country's petroleum policy causing the country to call for more foreign investment and increase income of Iran Government, is created by Tax of use of productions of petroleum.

In general, the environmental tax is harm reduction and environmental factors is that they have been implemented a new fiscal policy in recent decades in Western Europe and North America. The result of the environmental tax, Iran has been a tendency towards the use of this type of tax. Environmental policies to deal with emissions include market-based policies, including tax credits Tax direct emissions, taxes on the consumption or use of goods or inputs in the production process is pollution, as indirect taxes as well as a variety of environmental laws and regulations and surveillance. Direct taxes, it is the best option, but due to problems in the run, all countries are mainly due to the ease of implementation of indirect taxes. There are scattered provisions for taxation effects of some commodities, such as gasoline, kerosene, automotive and ... in Iran without a coherent environmental goals and revenue targets to meet only with government funding.

This study and its results are relevant to the current situation is that the price is not out of Market government monopoly supply, they have achieved, If the private sector to take action for supply oil products, liberalization of prices and removal of subsidies in the energy sector, the results will change.

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