

BINDING PRIVATE RULING: BPR 155

DATE: 06 September 2013

The substitution of the definition of "production" with "post-exploration" must be noted.

ACT : INCOME TAX ACT NO. 58 OF 1962 (the Act)
SECTION : PARAGRAPH 1, DEFINITION OF "PRODUCTION", "OIL AND GAS RIGHT" AND "OIL AND GAS INCOME" AND PARAGRAPH 5(2)(b) OF THE TENTH SCHEDULE TO THE ACT
SUBJECT : INCENTIVE FOR OIL AND GAS PRODUCTION

1. Summary

This ruling deals with the income tax consequences for an oil and gas company, in relation to expenditure to be incurred in the development of two oil and gas fields, including the refurbishment of a floating production unit (FPU), to produce oil and gas (the FPU Utilisation Project).

2. Relevant tax laws

This is a binding private ruling issued in accordance with section 78(1) and published in accordance with section 87(2) of the Tax Administration Act No. 28 of 2011.

In this ruling references to paragraphs are to paragraphs of the Tenth Schedule to the Act applicable as at 12 April 2013 and unless the context indicates otherwise, any word or expression in this ruling bears the meaning ascribed to it in the Act.

This is a ruling on the interpretation and application of the provisions of –

- paragraph 1, definition of "production", "oil and gas right" and "oil and gas income"; and
- paragraph 5(2)(b) of the Tenth Schedule.

3. Parties to the proposed transaction

The Applicant: Oil and Gas Company

4. Description of the proposed transaction

In terms of the FPU Utilisation Project, the Applicant will undertake the development of two oil and gas fields situated offshore from South Africa, and the refurbishment of a FPU, in order to produce oil and gas.

Expenditure will be incurred by the Applicant in relation to –

- subsea and topside facilities (such as modifications and upgrades to the FPU to add capability to handle the gas processing);
- developmental wells and completions (including dual tubing to mitigate water loading); and
- subsurface work (such as pipeline network and tie-backs).

The expenditure to be incurred is typical of expenditure that will follow the field appraisal stage as referred to in the definition of “exploration” in paragraph 1. In accordance with the life stages of an oil and gas field the proposed expenditure is preliminary to the activities defined as “production” also in paragraph 1. The expenditure thus falls within the ambit of the development stage of the life cycle of an oil and gas field.

Typical expenditure that may be necessary after production has commenced would relate to either or both of the following:

- Improvements at the topside facilities, or to the subsea infrastructure, to implement new technology during shutdowns (every 3 years). Such improvements may be the replacement of a single component with more advanced equipment.
- Well work-overs, which will be undertaken to enhance the recovery from existing producing wells. This may take the form of side tracks (horizontal drilling) or fracking of existing wells.

In terms of the estimates prepared by the Applicant, expenditure incurred during the development stage will constitute 92.4% of total capital expenditure to be incurred during the combined development and production stages, whilst expenditure during the production stage will equate to 7.6%. The bulk of the post-exploration expenditure will, therefore, be in relation to the development stage.

The Mineral and Petroleum Resources Development Act No. 28 of 2002, as amended (the MPRDA) makes provision for the issue of two types of oil and gas rights, namely an exploration right and a production right. It has been assumed for purposes of this ruling that development activities may be conducted by a company that holds either an exploration right or a production right issued in terms of the MPRDA.

5. Conditions and assumptions

This ruling is subject to the following additional conditions and assumptions –

- the expenditure in relation to which the deduction is sought is –
 - incurred in the year in respect of which the additional deduction is claimed;
 - of a capital nature; and
 - does not relate to the acquisition of an “oil and gas right”, as defined in paragraph 1; and
- development activities may be conducted under an exploration right or a production right in terms of the MPRDA.

6. Ruling

The ruling made in connection with the proposed transaction is as follows:

- The proposed expenditure incurred in consequence of the FPU Utilisation Project will be “in respect of production” and “in terms of an oil and gas right”, as contemplated in paragraph 5(2) read with the appropriate definitions in

paragraph 1 of the Tenth Schedule; and will, therefore, qualify for the additional deduction in terms of paragraph 5(2)(b) of this Schedule.

7. Period for which this ruling is valid

This binding private ruling will be valid for the duration of the FPU Utilisation Project.

Issued by:

**Legal and Policy Division: Advance Tax Rulings
SOUTH AFRICAN REVENUE SERVICE**