

# Rig services and taxation

By  
Petter Osmundsen

*University of Stavanger*

## **(1) Overview**

The paper addresses the treatment of rig services in oil company taxation. This is an important topic for international petroleum taxation, owing to the high level of rig rates. Tax exemption of rig services is usually fairly straightforward, since the normal position is that oil companies and rig contractors are independent entities – ie, arm's length prices exist. However, new challenges emerge with a trend towards oil companies owning rigs and the ownership of rigs organised as joint ventures between rig contractors and oil companies. With rig ownership located in tax havens, oil companies may then have an incentive to set a high rig rate in order to shift profits out of heavily taxed petroleum provinces.

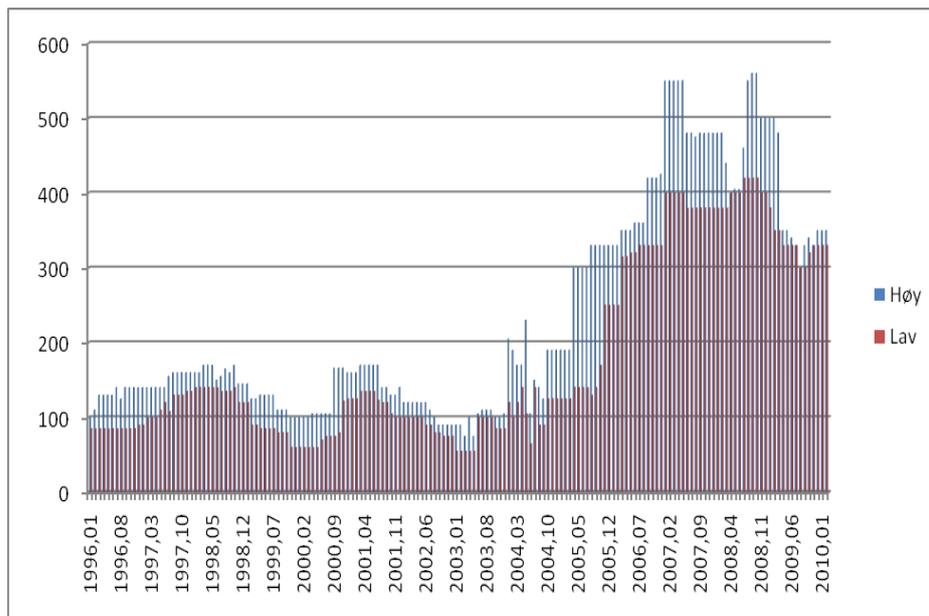
## **(2) Methods**

Rig contracts and organisational patterns for rig ownership are examined, along with available academic literature on rig contracts, such as Corts (2000), Corts and Singh (2004), Kaiser and Snyder (2013) and Osmundsen et al (2006, 2008, 2013). Extensive meetings have been held with key specialists in oil taxation offices, oil companies and rig contractors. Rig charters have been studied and rig rates analysed.

## **(3) Results**

Tax control of rig ownership organised as a joint venture presents challenges, but the availability of panel data sets of rig rates mean the problem is smaller than for a number of other tax issues. The Norwegian oil tax office (OSK) has not worked much on transfer pricing for rigs, since the normal position hitherto has been chartering between independent parties. However, rates and second-hand values for rigs can be found in updated databases (such as R S Platou, see figure). The challenge is to adjust for different rig types, charter durations, timing of charter fixture, contractual terms and so forth.

Awareness that this type of company structure will attract the attention of the OSK will impose natural limits. The OSK can also subsequently cut through or amend internal pricing, and impose a tax penalty.



**Figure 1.** Lowest and highest rig rates per month for high-spec semi-submersible rigs on the Norwegian continental shelf from January 1996 to February 2010, expressed in USD 1 000 per day. Data source: R S Platou.

#### (4) Conclusions

The joint venture construction may pose a built-in threat to the tax base in the petroleum sector. A joint venture is subject to the tax regime of the country of registration, possibly a tax haven with virtually no tax, while the charter rate is deducted from taxation in the petroleum regime where the resource rent tax is high. When the licence owns the rig, it will to a certain extent (depending on the rig contractor's holding) deal with itself (internal transaction). It is not difficult then to identify owner constellations where all parties will be served by the highest possible rig rates, since this involves transferring profits from high petroleum taxation to moderate or zero national taxation (tax-induced profit shifting). This is clearly problematic from the perspective of the government's primary goal of revenue capture. The question is whether this problem should be dealt with by banning specified company structures and ownership models, or whether it can be overcome in other ways. Implementing effective taxation by precluding specific contractual structures is not desirable. Generally speaking, such provisions could limit value creation and specifically curb rig availability. Actions of this kind would probably also be impossible because they will come into conflict with the WTO and bilateral trade agreements. The challenges related to joint ventures can be handled in the tax assessment of oil companies. No basis accordingly exists for prohibiting these types of structure.

#### References

- Corts, K (2000), "Turnkey Contracts as a Response to Incentive Problems: Evidence from the Offshore Drilling Industry", working paper, Harvard University.
- Corts, K S, and J Singh (2004), "The Effect of Repeated Interaction on Contract Choice: Evidence from Offshore Drilling", *Journal of Law, Economics, and Organization* 20 (1), 2004, 230-260.
- Kaiser, M J, and B F Snyder (2013), *The offshore drilling industry and rig construction in the Gulf of Mexico*, Lecture Notes in Energy, Vol 8. Springer-Verlag, London.
- Osmundsen, P, Rosendahl, K E and T Skjerpén (2013), "Contract Structure and Rig Rates", IAEE European Conference 2013, Dusseldorf, 18-21 August 2013.
- Osmundsen, P, T Sørensen and A Toft (2008), "Drilling Contracts and Incentives", *Energy Policy* 36, 8, 3138-3144.
- Osmundsen, P, A Toft and K A Dragvik (2006), "Design of Drilling Contracts – Economic Incentives and Safety Issues", *Energy Policy* 34, 2324-2329.