

TAX REFORM IN RELATION TO THE EXPLORATION, RESEARCH AND EXPLOITATION OF HYDROCARBONS

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Legal Briefings

A Bill (the "**Bill**") that, once approved by Spanish Parliament, is due to modify the Spanish Hydrocarbons Act 34/1998, of 7 October (the "**LSH**"), and which will introduce tax and non-tax measures in relation to the exploration, research and exploitation of hydrocarbons, was sent to Spanish Congress on 18 December 2014.

From a tax perspective, the Bill will have two fundamental aims:

- Firstly, the economic revenues generated by the discovery of new hydrocarbon deposits will be channelled towards society to a greater degree, on the basis that those assets belong to Spanish society as a whole in accordance with the Spanish Constitution and legislation.

To do so, the Bill will, on the one hand, introduce a new tax on the Value of Extraction of Gas, Oil and Condensates, which will be levied on the value of the gas, oil and condensates extracted in Spanish territory; on the other hand, it will modify the current royalty on occupation (canon de superficie).

- Secondly, the aim is to achieve greater social commitment towards those communities in which hydrocarbon exploration, research and extraction is carried out.

With this objective, the Bill introduces a system of incentives for the communities in which those activities are located. Furthermore, the Bill introduces an obligation for the holders of exploitation concessions to share the revenues that they obtain from the sale of hydrocarbons with the owners of the land underlying the hydrocarbon deposits, which they will do by paying annual amounts.

We include below a brief analysis of the tax measures brought in by the planned reform of the LSH.

1. NEW TAX ON THE VALUE OF EXTRACTION OF GAS, OIL AND CONDENSATES

The Bill introduces a tax on the Value of Extraction of Gas, Oil and Condensates. This new tax is a direct and real tax levied on the value of the public products of gas, oil and condensates extracted in Spanish territory. Entities that perform gas, oil and condensate extraction activities under hydrocarbon deposit exploitation concessions in Spanish territory are subject to payment of the tax.

We summarise below the main features of this new tax:

TAX BASIS

The tax basis for tax is the sum of the value of gas, oil and condensates extracted during the tax period once the first filtration and separation has been carried out.

For these purposes, the value of extraction will be determined by the reference price approved by order of the Ministry of Industry, Energy and Tourism, which will be arithmetical average of the prices applicable over the 12 months – according to the prices of each product on the most representative markets – in each tax period.

TAX RATE AND TAX APPLICABLE

The Bill establishes a gradual scale according to the volume of production and the type of exploitation (inland or offshore). The tax rates will range between 1-8% for oil and condensate production, whereas the tax rate for gas will range between 1-5%.

The full tax amount will be the resulting amount from applying the tax rate according to the above scales to the tax basis.

TAX PERIOD AND ACCRUAL

The tax period will be the calendar year (unless the activity under the exploitation concession stops, in which case the tax period will end on the date on which it stops). The tax will accrue on the last day of the tax period.

SETTLEMENT AND PAYMENT

Entities that are subject to the tax have an obligation carry out a self-assessment of the tax and to deposit the due amount within the first 20 calendar days of the month of April following the year in which the tax accrued.

However, entities must within the first 20 calendar days of the month of October of the same year in which the tax accrues make a fractional payment on account of the tax due for the then-current tax period. The basis for calculating the fractional payment will be determined by the value of extraction during the first six months of each calendar year, and the tax rates indicated above will then be applied to those values.

2. MODIFICATION OF THE ROYALTY ON OCCUPATION

The Bill modifies the royalty on occupation (canon de superficie), a special tax levied on entities for the private use or special enjoyment of state-administered public hydrocarbons under research permits and concessions to exploit hydrocarbon deposits. As a result, the first additional provision of the LSH, which establishes that royalty, is expressly derogated.

As well as the two existing tariffs of the royalty (the first tariff related to research permits and the second related to exploitation concessions), the Bill adds another two tariffs, which will be levied on the drilling of wells and on the obtainment of seismic data respectively:

- The third tariff will accrue if wells are drilled under research permits or exploitation concessions. If a well is inland, the tariff will be €125,000, while if the well is offshore, the tariff charged will be €600,000 per well.
- Obtaining seismic data under exploration permits, research permits or exploitation concessions will be subject to a fourth tariff. The tariff is valued at €0.3/metre in the case of 2D seismic campaigns, while the tariff is valued at €0.0003/square metre in the case of 3D seismic campaigns.

The third and fourth tariffs of the royalty will accrue at the beginning of the work performed in respect of the seismic campaign or drilling of the well, as applicable.

As a result of the above, the royalty will be composed of four tariffs; both the first and the second tariffs remain unchanged.

3. INCENTIVES TO EXPLORATION, RESEARCH AND EXPLOITATION OF HYDROCARBONS

In order to ensure that the income from taxes levied on the exploration, research and exploitation of hydrocarbons is allocated especially to those areas in which those activities are performed and thus to mitigate the impact of those activities in the territories in question, the Bill proposes including a system of incentives for the autonomous regions and municipalities in which hydrocarbon exploration, research and exploitation occurs.

According to the Bill, the amount, distribution and other aspects of these subsidies will be established each year in the General State Budget, in compliance with the provisions of the General Subsidies Act 38/2003, of 17 November, according to the financial capacities existing at any given time.

4. PAYMENTS TO THE LANDOWNERS

According to the Bill, the holders of concessions to exploit hydrocarbons deposits will now have an obligation to share the revenues obtained from the sale of hydrocarbons with the owners of the land underlying where the hydrocarbons have been extracted. To that end, the holders of exploitation concessions have an obligation to pay the owners of such land 1% of the value of the hydrocarbons extracted.

For the purposes of the Bill, the owners of the underlying land will be understood to be the parties on record as such in the Cadastral Register on the date on which the exploitation concession is granted. Failure to pay the amounts due in this regard will constitute a breach of the terms and conditions of the exploitation concession itself and could result in the termination of the concession.

Finally, the Bill establishes that these payments will not have retroactive effects and they will therefore only apply to exploitation concessions granted after the Bill enters into force (it is due to enter into force on 1 January 2016, after it has passed through and been approved by Parliament).

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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