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PRODUCING AND EXPORTING GAS
MYANMAR LEGAL AND TAX DEVELOPMENTS

30 September 2017

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MYANMAR PRACTICE OVERVIEW

We are known for providing the ultimate in ground connectivity to our clients. We believe that specialization, along with tenacity, is necessary to achieve this. Therefore, in 2016, we ramped up our headcount and the number of our senior advisors, and we converted to a system of exclusively dedicated practice teams in Myanmar.

We have created 4 general practice teams (Corporate M&A, Banking and Finance, Licensing and Disputes) and 4 specialized teams (Energy, Telecommunications, Infrastructure, Real Estate & Construction and Taxation).

Each practice team comprises a team leader, who assists a partner to manage the team, and minimum 4 to maximum 10 advisers who are exclusively dedicated to only one team. All team members are, just like partners Edwin Vanderbruggen and Jean Loi, residents of Myanmar.

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Jean is one of the region's most experienced tax and regulatory specialists with more than 12 years of experience in Indochina, Myanmar and Singapore.

She has advised on a large number of project transactions and tax disputes in the specialties of structuring, power plant projects and oil & gas.

As the managing partner of VDB Loi, Jean has extensive experience with projects related to the market entries of companies in the infrastructure, telecommunications and financial services industries in the region, as well as with supply chains. She lives in Yangon.

Edwin Vanderbruggen
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Edwin is the senior partner of VDB Loi and a leading foreign legal advisor living in Myanmar since 2012. A frequent advisor to the Government on transactions and privatizations in energy, transportation and telecom, he is widely recognized for his "vast knowledge" (Legal 500) and his ability "to get difficult things through the bureaucracy" (Chambers, 2016). He advised international financial institutions on their largest Myanmar transactions so far, oil and gas supermajors, a greenfield multi-billion US$ telecom project and the Japanese Government on the Thilawa SEZ. He assisted two newly licensed foreign banks setup in Myanmar, acted for the sponsor of an 800MUS$ urban infrastructure PPP project and worked on 5 out of 7 power deals inked in 2016.

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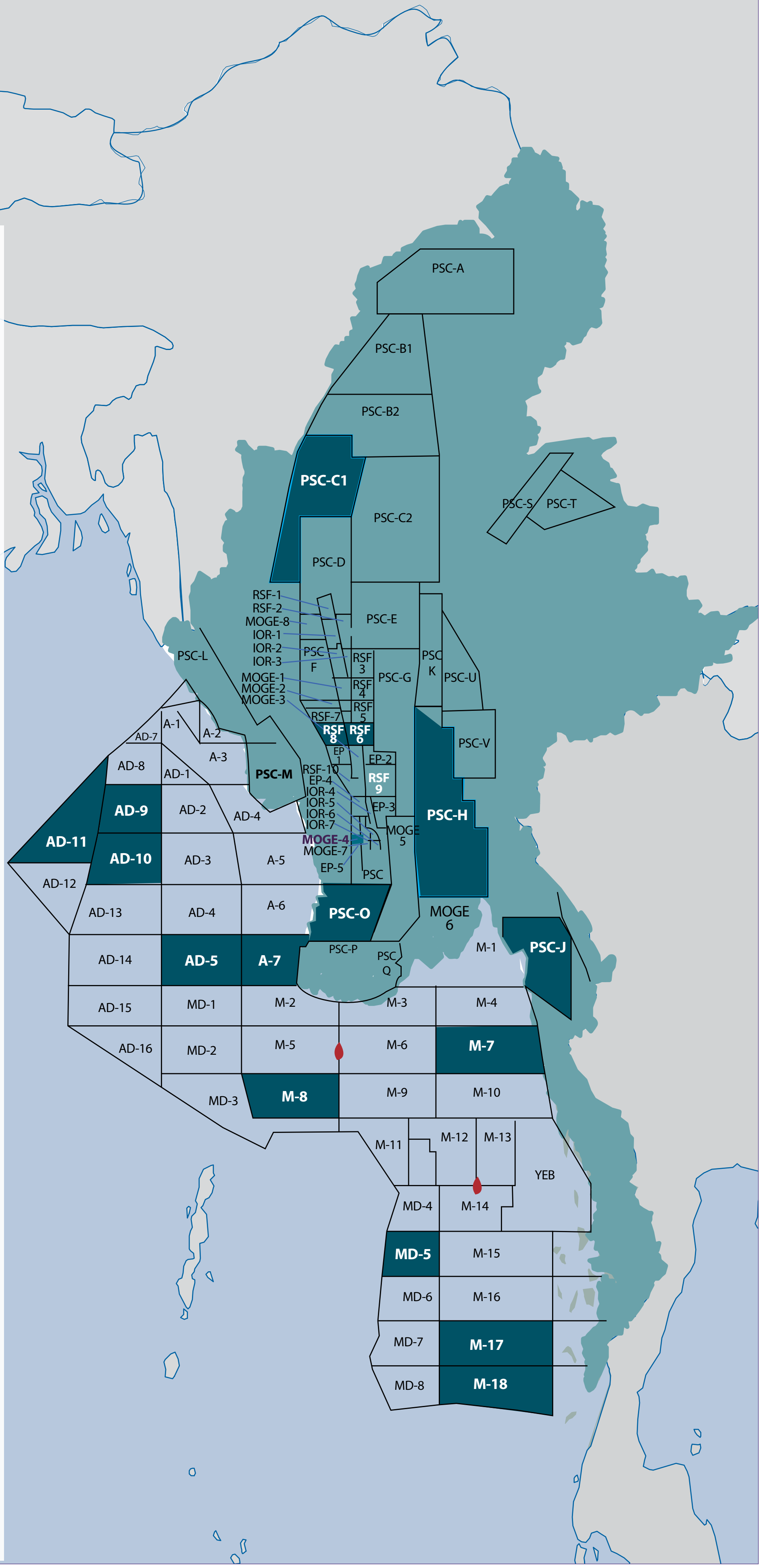


OFFSHORE BLOCKS

A-1, A-3, AD-7	Daewoo
A-6	MPRL E&P Pte Ltd
M-12, M-13, M-14	PCML
M-3, M-9, M-11	PTTEPI
M-2	Petro Vietnam
M-5, M-6, YWB	Total (TEPM)
AD-1, AD-6	CNPC
A-4, AD-2	BG Asia Pacific
A-7, AD-5	Woodside Energy
A-5	Chevron (Unocal Myanmar Offshore)
AD-9, AD-11, MD-5	Shell Myanmar Energy
AD-10	Statoil
MD-2, MD-4	ENI Myanmar B.V
AD-3	Ophir Energy
M-4, YEB	Oil India
M-7	ROC Oil
M-8	Berlanga Holding BV
M-15	Transcontinental
M-17, M-18	Reliance

ONSHORE BLOCKS

PSC-B2, EP-3	ONGC
PSC-M, RSF-5	ENI
PSC-0, PSC-J	Petroleum Exploration (PVT)
EP-1	Brunei National Petroleum
IOR-5, IOR-7, RSF-2, RSF-3	Paternas Caragali
PSC-C1, PSC-H	Pacific Hunt Energy
MOGE-4	CAOG
EP-4	JSOC
MOGE-3	PTTEP
IOR-4, IOR-6	MPRL E&P
PSC-A, PSC-B1	JSC Nobel Oil
RSF-9	Geopetro
IOR-2, MOGE-1	Gold Petro
PSC-I	Jubilant
MOGE-2	MPRL E&P
PSC-F	NPCC
EP-5	Istech
PSC-G, EP-2	PTTEP
PSC-R	SNOG

1. INTRODUCTION

Myanmar is a country rich in resources and potential, which currently has 16 onshore blocks and 19 offshore blocks in production. The offshore Yadana (TOTAL, Chevron and PTTEP) and Yetagun (Petronas, PTTEP) natural gas projects started production in 1998 and 2000 respectively under gas sales contracts to the Thai state oil company PTT. The Daewoo (Daewoo and three partners) natural gas project started production in June 2013. Natural gas produced is sold to CNPC. The offshore Zawtika (PTTEP) natural gas project started production in March 2014 and sells to PTT. The map on the next page indicates the oil and gas blocks in Myanmar:

Interestingly, Woodside Energy has made a third discovery of gas at the Pyi Thit-1 exploration well in the Southern Rakhine Basin, located offshore Myanmar. The well in Block A-6 hit a gross gas column of around 65 meters, with a net gas pay interval of 36 meters within the primary target sandstone reservoir.

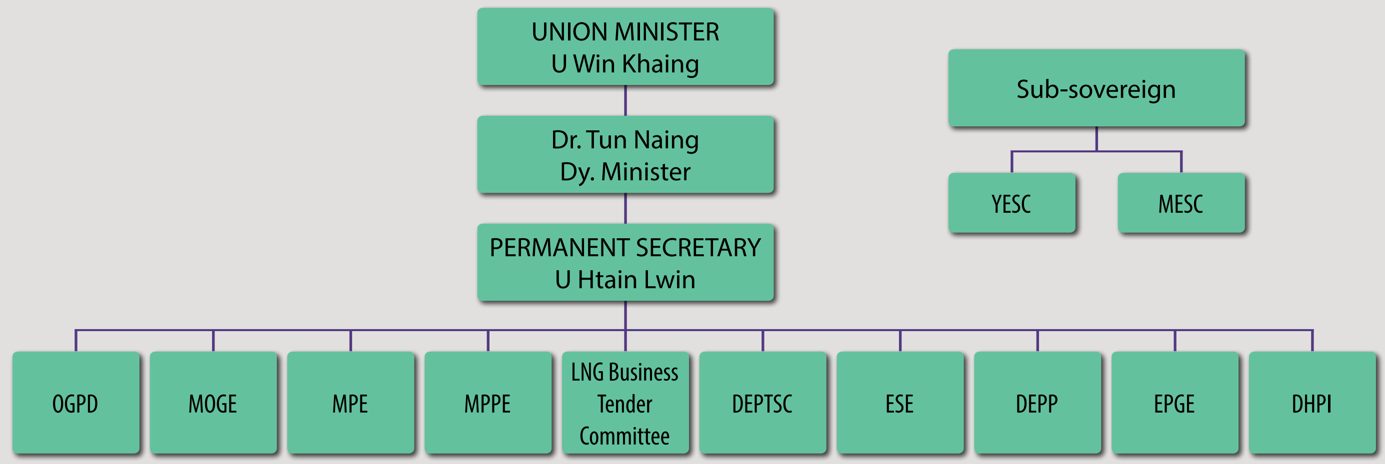
The availability of these sources potentials makes Myanmar a perfect destination for foreign investors to invest and capitalize on these resources.

Below we consider the issues foreign investors looking to invest in Myanmar's oil and gas industry should know.

2. GOVERNMENT STRUCTURE

The Ministry of Electric Power and Ministry of Energy were merged, in 2016, to form the Ministry of Electricity and Energy ("MOEE") and it is currently the coordinating body for all sectors of energy in Myanmar. The MOEE supervises both oil and gas and electricity enterprises or departments. The current Union Minister of this ministry is U Win Khaing.

In January 2013 the National Energy Management Committee was established in addition to the existing above mentioned organizations to strategize Myanmar's energy policy. The MOEE, the Myanma Oil and Gas Enterprise ("MOGE") and ten other governmental institutions involved in energy development are part of the National Energy Management Committee.



OGPD	Oil and Gas Planning Department
MOGE	Myanmar Oil and Gas Enterprise
MPE	Myanma Petrochemical Enterprise
MPPE	Myanmar Petroleum Products Enterprise
DEPTSC	Department of Electric Power Transmission and System Control
ESE	Electricity Supply Enterprise
DEPP	Department of Electric Power Planning
EPGE	Electric Power Generation Enterprise
DHPI	Department of Hydro Power Implementation
YESC	Yangon City Electricity Supply Corporation
MESC	Mandalay Electricity Supply Corporation

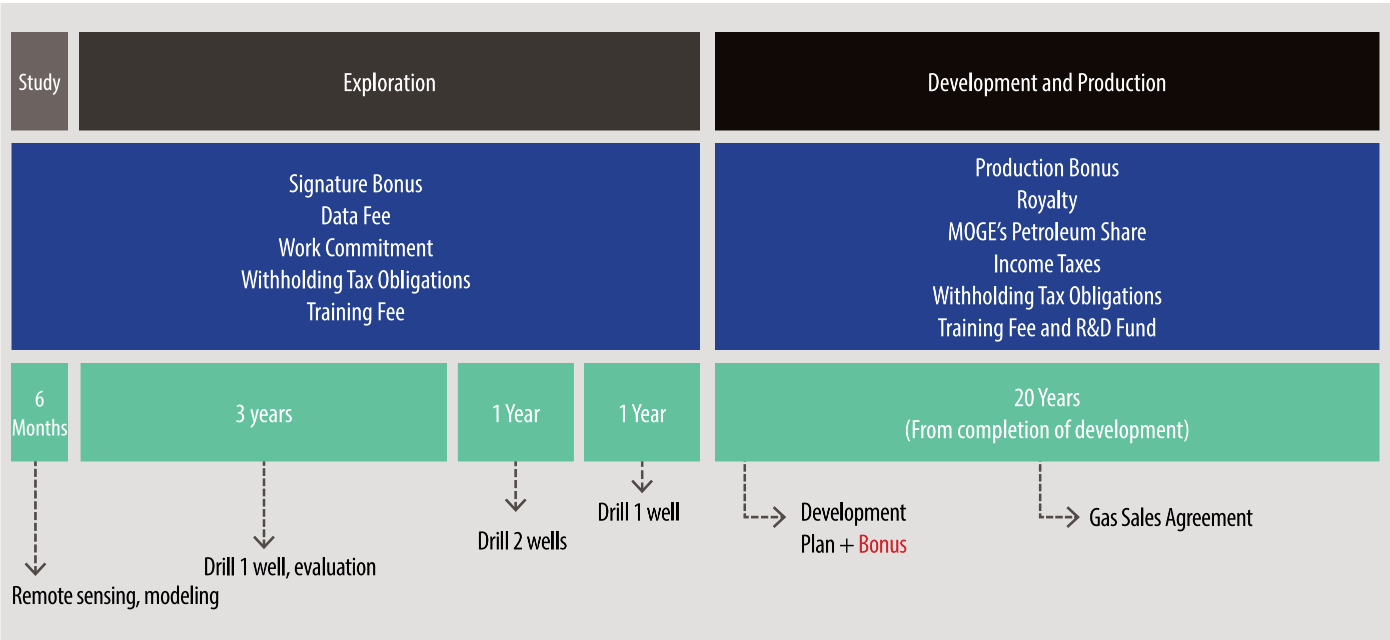
3. LEGAL AND REGULATORY FRAMEWORK

The British Law Codes of pre-independence Indian Acts are predominantly the basis for several oil and gas related laws in Myanmar. However, a production sharing contract ("PSC") is entered into between the MOGE and the relevant foreign investor, deviating from the licensing regime of the 'Anglo-Saxon' model. In addition to this, improved petroleum recovery contacts ("IPR") for more explored onshore blocks have been entered into, with three out of them being awarded in the 2013 international onshore bid round. It does not create any conflict with any existing law and the terms and conditions of such contracts will govern the foreign investor's rights and obligations.

It is important to note that the foreign investors are required to get approval for the PSC from a number of Government entities. This includes negotiations with Oil and Gas Planning Department ("OGPD") followed with obtaining approval from the MOEE. After obtaining approval from the MOEE, the PSC is required to be reviewed and approved by Attorney General's Office ("AGO") and then submitted to Economic Committee of the Cabinet for review before submitting it to the Cabinet. Once the Cabinet approval is obtained, the PSC is submitted to the Myanmar Investment Commission ("MIC Permit") for the issuance of the investment license under the Myanmar Investment Law of 2016 ("MIL").

4. MYANMAR MODEL PSC

The Myanmar model PSC issued in 2013 (the "Model PSC") is divided into three stages namely the Preparation Period, the Exploration Period and (if any) the Development Period. In addition to these stages, the Model PSC has a Study Period. The party carrying out exploration and development work is referred to as the "Contractor".

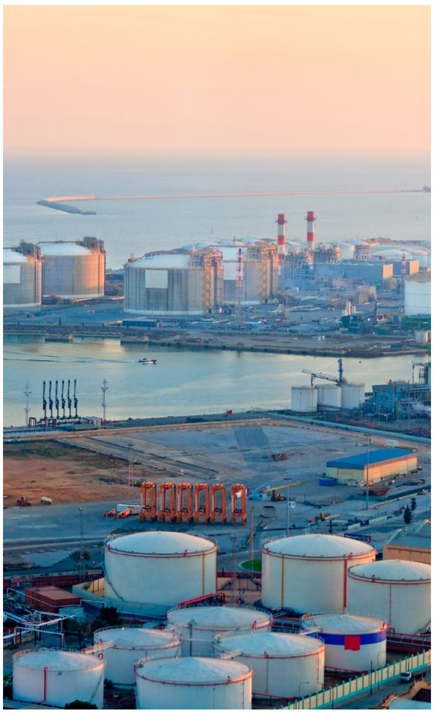


Preparation Period and study Period

The Preparation Period begins on the effective date which is usually the date of signing of the PSC and is for a six month duration, that can be extended at the discretion of the MOGE. During this period the Contractor is required to conduct an Environmental Impact Assessment, a Social Impact Assessment and an Environmental Management Plan ("Reports").

The onshore geology in Myanmar has been explored but the seismic data for offshore blocks is not available in details. By virtue of the Study Period, the Contractor gets two years to conduct technical evaluations and assessments prior to the Exploration Period. The Model PSC does reflect the minimum work commitment to be undertaken during this period, but does not specify the amount. The results of the study must be disclosed to the MOGE. At the end of the Study Period the Contractor may, at its discretion, terminate the PSC and relinquish its rights.

During the Study Period, the Contractor is required to fulfill its obligations and pay deficiency, if any, between the estimated costs and amount actually expended on study operations. The study operations are started only after obtaining approvals from the Government authorities and not before that.



Exploration Period

The Exploration Period is up to six years and the summation is derived by adding three years (Initial Exploration Period) + two years (First Extension Period at Contractor's option) + one year (Second Extension Period at Contractor's option). The Initial Exploration Period begins from the commercial operation date and at the end this period, the results of the Initial Exploration Period are disclosed to the MOGE. If MOGE is of the opinion that no further exploration operation should be pursued in the contract area, then the Contractor has an option to terminate the contract by way of giving written notice.

In case the Contractor decides to pursue exploration in the contract area at its sole discretion, the Exploration Period may be extended to additional three years as First Extension Period at the Contractor's option and for another one year as Second Extension Period at Contractor's option. The Extensions are subjected to the fulfillment of obligations, by the Contractors, under the PSC.

Myanmar model PSCs have no phased relinquishment during the Exploration Period. At the end of the Exploration Period relinquishment occurs and amounts to 100 per cent of the contract area, any discovery area, development and/or production area. In addition, there is an automatic extension of the Exploration Period, in case of any deficiency or non fulfillment of any obligation, to allow for completion of seismic or drilling operations or to appraise a discovery.

Development

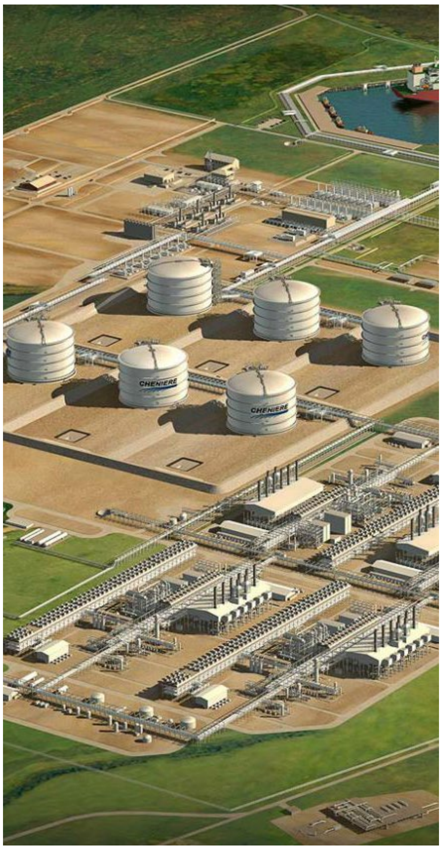
Usually the development begins from the date the Contractor notifies the MOGE of its commercial discovery relating to the development and production area. The Contractor prepares a Development plan and submits to the MOGE, which shall contain the details and extend of the proposed development area relating to the commercial discovery plus a reasonable margin. The Development Plan shall also indicate production forecast, an estimate of the investment and expenses involved and proposals relating to necessary infrastructure investments.

The PSC continues to be valid till the later of (i) twenty years from the date of completion of development in accordance with Development Plan, and (ii) the expiration of the petroleum sales contract. After the development, the parties enter into a Gas Sales Agreement in effect of which some key terms maybe added in the PSC.

5. FOREIGN INVESTMENT STRUCTURE

With the advent of the MIL, many foreign investment gateways and routes have opened up for foreign investors. It provides for benefits and introduces a new tax pattern. Under the old investment regime, tax holidays were applicable automatically on receiving the MIC permit. After the commencement of the new Myanmar Investment Law 2016, the situation has changed. The tax holiday is no more automatically available to the MIC permit holder or to the foreign investor with an Endorsement. Investment activities under the Promoted sector, classified under Notification 13/2017, are entitled to tax holidays. Tax holidays mean exemption from only Corporate Income Tax. It does not apply to any other kind of taxes like Personal Income Tax, Commercial Tax, Withholding Tax, etc.

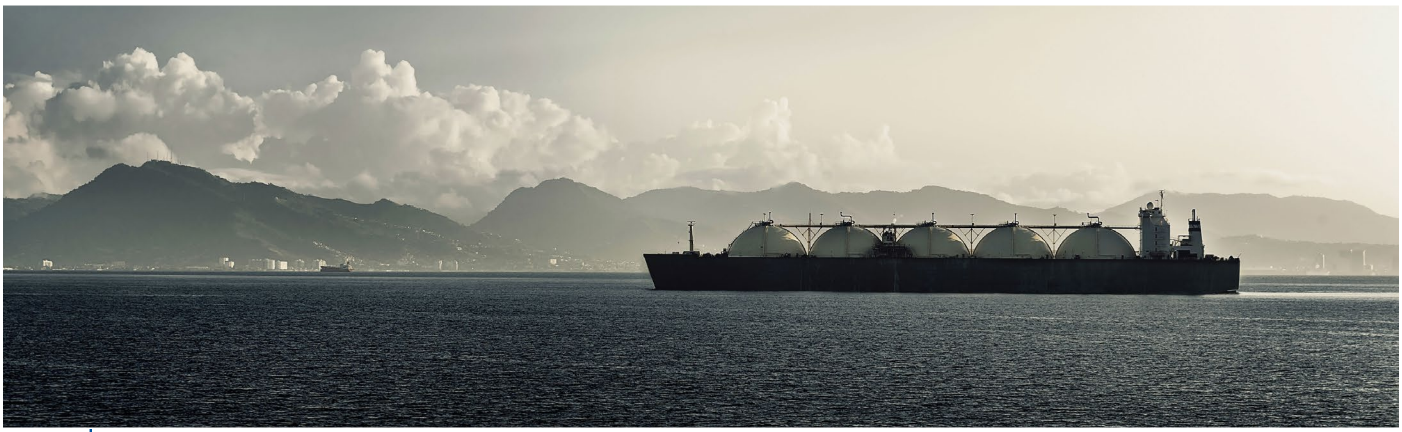
The tenure of tax holidays depends on

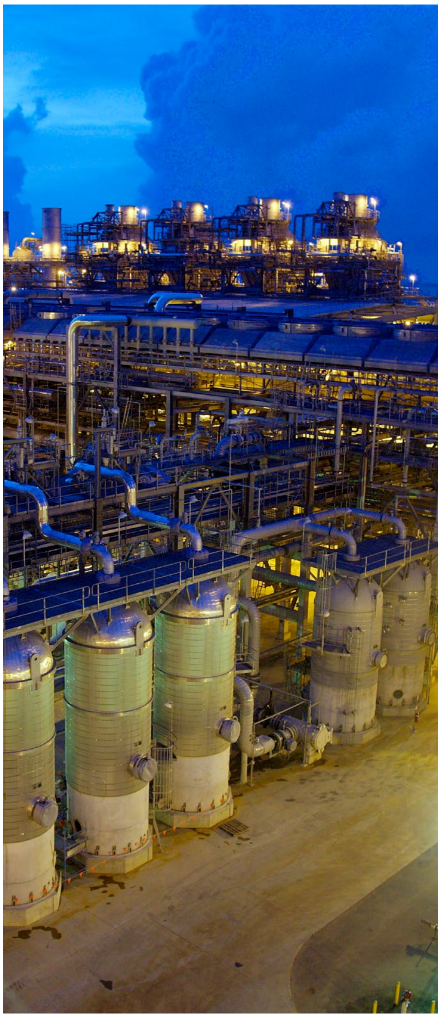


the zone or location in which investment is pursued. The tax exemption zones are determined under Notification 10/2017. There are three zones, namely zone 1 i.e. less developed region, zone 2 i.e. moderate developed region or zone 3 i.e. adequate developed region. The exemptions are for seven years, five years and three years, respectively.

6. FOREIGN OWNERSHIP RESTRICTIONS

The MIL mandates the foreign investors to cooperate with a local partner to hold an interest in onshore and offshore shallow water blocks. In order to invest in onshore blocks, foreign investors are required to cooperate with one of the approved, registered domestic entities listed on the website of the Ministry





of Electricity and Energy. For offshore shallow water blocks a foreign investor must co-operate with, as a minimum, one national company registered with the OGPD. However, offshore deep water blocks require no cooperation due to the high costs and requisite technical expertise involved.

The law does not specify any level of the local partners' participation and the form for such contribution. Hence decisions on these factors will be solely commercial decisions. A foreign investor, should take into account the intention behind this aspect when negotiating the local partner's contribution, which is to increase the level of experience and knowledge of the local oil and gas industry in Myanmar.

The level of participation and the participating interest of the local partner will be determined by the memorandum of understanding and subsequently a joint operating agreement ("JOA") signed between the foreign investor and local partner. Importantly, the terms of the JOA must be approved by the MOEE.

7. TRANSFER OF AN INTEREST IN A PSC

Myanmar licenses domestic and foreign companies to carry out exploration and production of oil and gas under a system of PSC with MOGE. Under the PSC, as is the case in many countries, the Contractor will explore the blocks granted to it, and in case of a commercial discovery will develop the natural resources. MOGE will sell the oil or gas and share the proceeds with the Contractor after the Contractor has first recovered its costs. The Contractor also pays 25% corporate income tax ("CIT") on its profit petroleum.

The usual questions which comes to the mind while talking about transfer of interest are:

- ***Are there restrictions in terms of buyers when selling an oil and gas interest?***

Yes and no. Most Myanmar PSCs provide that the company can assign its interest in the PSC, or part thereof, to an affiliate. Depending on the PSC, this may still require the permission of the MOGE, despite that it is merely an intra-group transfer. Other, more recent PSCs, will typically provide that MOGE permission is only needed for transfers to third parties. In practice, however, the MOEE may recommend that the same procedure for approval is pretty much followed in either case. Most Myanmar PSCs will allow the company the right to transfer the interest to any third party. However, MOGE needs to grant its approval to the transfer. This approval, most PSCs provide, shall not be unreasonably withheld. In reality, MOGE is mostly concerned with the operator, and less with non-op Contractors. The primary relationship is with the operator. So, when there are changes to the non-op Contractors without a change in operators, MOGE and the Government tend to not object to such transfers.

- ***What is the procedure to obtain government approval for assigning an oil and gas interest?***

There is no regulation that spells out the appropriate procedure for assigning an interest in a PSC. Nevertheless, the practice is fairly well established. The above MOGE process takes about 3 months in our experience, and another 2 to 3 months before the Myanmar Investment Commission ("MIC"). Depending on the circumstances, the Capital Gains Tax may be the most challenging issue that can cause time delays.

- ***Can the MOGE change the PSC in the course of a transfer from a seller to a buyer?***

Particularly for older PSCs, there must be a temptation with the MOEE to update the text of those agreements. After all, the current PSCs used by MOEE feature more rules

in favor of the Government, not in the least, the 40%/45%/50% capital gains tax on the sale of an oil and gas interest. Given that MOGE approval is required for any transfer, although it may not be "unreasonably withheld", there is at least the possibility for the Government to grant this approval only subject to an "update" of the PSC terms to assure there is an alignment with current Myanmar law. This is harder than it seems, we believe. First of all, there is no basis in the PSC for the Government to withhold approval to a transfer by a company based on a proposed change to the PSC terms. Secondly, many transfers do not concern 100% of the interest. One company, say Chevron's 28.3% stake in Yadana and Sein, may seek to sell its interest, but the other Contractor PTTEP and the operator Total, will stay in place. It would not be possible for MOGE to change the PSC just for the buyer of Chevron's stake without also changing the terms for PTTEP and Total, and for this there is no legal basis in the PSC at all. How much capital gains tax ("CGT") does the seller have to pay? This is a complicated story. By way of context, Myanmar has a CGT regime. The general CGT has been set at 10% across the board. Previously, non-residents realizing a gain on an asset in Myanmar –say shares- were taxed at a 40% rate on the net gain. For gains on an oil and gas interest, however, separate tax rates of 40%, 45% and 50% were created through a notification in 2006 ("2006 Notification"), at a time when the Government still had the right to do so without the National Assembly. In the budget year of 2014-2015, the Union Tax Law picked up the same rates, but with the different taxable amount in MMK rather than in US$. Right now, the rates are as follows:

Capital Gain	Capital Gains Tax
1. Up to the amount equivalent to MMK100,000 million	40%
2. For an amount equivalent to from MMK100,001 million to MMK150,000 million	45%
3. For an amount equivalent to MMK150,001 million and above	50%

Older PSCs did not provide anything on CGT, and it remains unclear, depending on the text, if for such PSCs MOGE will have to absorb the CGT, should any be due. Most recent PSCs provide in a "payment on Net Profit" which is at identical rates 40%/45%/50% and with identical taxable amounts at least as was provided in the 2006 Notification. But, remarkably, in some PSCs it is stated explicitly that the "payment on Net Profit" is an Income Tax, whereas other PSCs state nothing of the kind. In fact, this was one of the few amendments one could make to the proposed Model PSCs in the 2013 offshore tender round and we advised clients at the time to propose explicitly mentioning that this is an income tax. Why is the difference important? Because only a "tax" can be reduced under a tax treaty. More on this below.

8. COMMERCIAL TERMS FOR PRODUCTION AND EXPORT OF GAS

	Commercial Terms	Cost
1.	Royalty	Payable at the rate of 12.5 % of Available Petroleum (not coverable from Cost Petroleum).
2.	Production Bonus	Progressive per rate of production- US$ 0.5 million to US$ 6.0 million for onshore blocks and US $ 1 million to US$ 10 million for offshore blocks.
3.	State Participation	15%-25% in onshore blocks, and 20% (with the right to increase to 25% if the reserve is greater than five trillion cubic feet on a BOE basis)
4.	Employment and Training	US$ 25,000 per year during the Exploration Period and US$ 50,000 during the Development and Production Period on training funds for onshore PSCs and at least US$ 50,000 per year during Exploration Period and US$ 100,000 during the Development and Production Period for offshore PSCs.
5.	Cost Recovery	Limited to Cost Petroleum which is Max. 50% of Available Petroleum for onshore blocks, 60% for offshore blocks and 70% for offshore blocks exceeding a water depth of 2,000 feet
6.	Domestic Requirement	20% of DMO - 90% of the fair market value in US dollars

- ***Rate of return on transportation of gas***

One of the more difficult calls to make is to appreciate what will happen once the PSC will be replaced with, at least where gas is concerned, a Gas Sales Agreement ("GSA"). If the exploration is successful, the Government will conclude a GSA with the Contractor. The operator will propose a development plan which includes wider economic terms, including those related to ownership, financing and construction of pipeline and/or transportation facilities. Such pipeline and transportation will be under a separate contract between the Government and the Contractor. This is part of where Contractors make their investment back. However, it is actually very difficult to pin down the financial conditions of such agreements in advance. The Model PSC will normally only refer to some general principles in this respect. Thus, this is an area of considerable uncertainty. The Model PSC provides in this regard: "For the payment of transportation tariffs by the users of the facilities which are based upon the costs of financing, constructing, operating and maintaining the pipeline and/or other transportation facilities, including depreciation thereof, any applicable taxes, and a reasonable return on investment" What is a reasonable rate of return? The MOEE's standpoint is that this will have to be agreed upon later, as part of the GSA. Many operators would probably prefer to agree to this in advance rather than after a commercial discovery.

9. PARENT GUARANTEE

A parent company guarantee and a performance bank guarantee is required to be provided by the Contractor in the form set out in the model PSC. The performance bank guarantee equates to 10 per cent of each minimum commitment phase. After the completion of twenty days following the date of completion of the respective period the MOGE releases the performance bank guarantee. Under the parent company guarantee, the parent company is required to discharge all obligations of the Contractors upon the Contractor's failure to perform. The drawback of this form of guarantee is that the parent company would ultimately be guaranteeing all of the Contractor's obligations, not just the minimum work commitments. As far as we are aware, the MOGE wishes all parent company guarantees and performance bank guarantees to have the same terms and has been unwilling to accept limitations to this guarantee.

The parent guarantee clause usually adapts the following stated wording:

"We hereby absolutely and unconditionally guarantee to the Myanmar Oil and Gas Enterprise, Ministry of Electricity and Energy, the Government of the Republic of the Union of Myanmar that the CONTRACTOR is financially sound and technically competent and shall perform the task such as funding necessary capital, assets and supplying machinery, equipment, tolls, technicians, specialists and discharge of expenditure obligations undertake by it through the……… Offshore Block…….Production Sharing Contract, for the exploration, extraction and development work of the……… Offshore Block…..and we hereby undertake to discharge all its obligation under the Contract on its failure to perform"

10. SOME LEGAL ISSUES

Myanmar constitutional law echoes the permanent sovereignty idea. Section 37 of the 2008 Constitution provides that

> *"The Union [...] is the ultimate owner of all lands and all natural resources above and below the ground, above and beneath the water and in the atmosphere in the Union".*

Although expropriation may be legal in international law, Myanmar's domestic law provides for measures which allow expropriation which is only limited to certain circumstances. The 2016 Myanmar Investment Law provides the following articles:

> *Section 52: The Government guarantees not to nationalize any investment carrying out in accordance with the law. Except under the following conditions, the Government guarantees not to take any measures which expropriate or indirectly expropriate or is likely to effect a result in the termination of an investment:*
>
> *a. actually necessary for the interest of the Union or its citizen;*
> *b. non-discriminatory manner;*
> *c. measures in accordance with the applicable Laws;*
> *d. prompt, fair and adequate payment of compensation.*
>
> *Section 53: A fair and adequate compensation shall be designated as an equivalent to the market value prevailing at the time of expropriation of the investment. However, that designation shall be based on a fair consideration of public interest as well as the interests of the private investor, and shall take into account the present and past conditions of investment, the reason for expropriation of the business or property, the fair market value of the investment, the purpose of expropriating the business or property, the profits acquired by the investor during the term of investment, and also the duration of the investment.*

Remarkably, Section 52 comprises a unilateral commitment under domestic law not to nationalize any investment, except under certain circumstances. This 2016 legal development has not been rejected in the Model PSC which has remained largely unchanged for the

last decade. This raises an interesting question. If the Government has committed to not nationalizing an operator, can a contractual agreement to the contrary be enforceable under Myanmar law? Probably not. Under the Myanmar Contract Act, for example Section 24, a contractual provision with an unlawful object is void anyway.

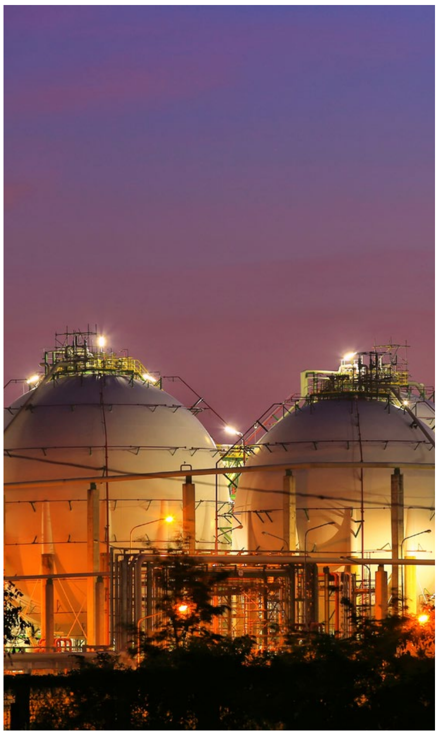
11. SALIENT TAX FEATURES OF PRODUCTION SHARING CONTRACTS IN MYANMAR

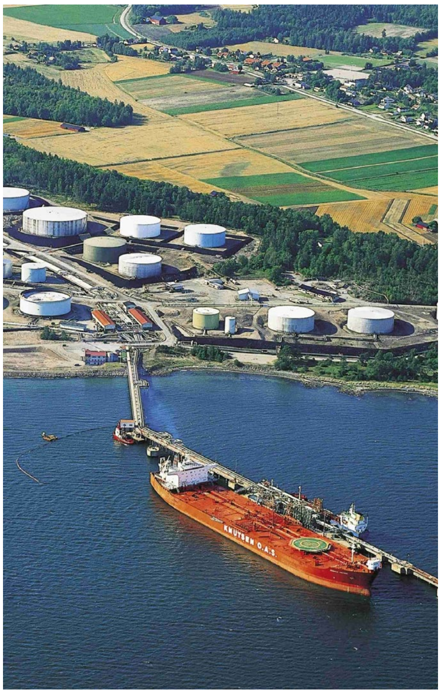
- ***What are the key tax points of PSCs in Myanmar?***

In general, the Myanmar Companies Act requires a foreign company to obtain a Permit (formerly called Form of Permit) from the Company Registration Office in order, "to carry on a business in Myanmar". In order to obtain this Permit, a Myanmar corporate entity (either a branch or subsidiary) is required to be established. In practice, the MOGE has recommended that a branch be opened for oil and gas projects in Myanmar. The current CIT rate is 25% for Myanmar companies, branches registered under the Myanmar Companies Act 1914, and companies operating under permission from the MIC (i.e. foreign-owned resident companies with an investment license from the MIC granted under the Foreign Investment Law and Myanmar Investment Law 2016).

In general, there is no withholding tax on distribution of dividends. Further, there is no tax on profit remittance by a branch once CIT has been paid. Note that before remitting dividends overseas, Central Bank approval is required.

The PSC will normally refer to the Myanmar Income Tax Law ("ITL") with respect to rates. However, a PSC or a side letter with the MOGE may override the ITL since the provisions are approved by the Ministry of Planning and Finance ("MOPF") in relation to the finance





and taxation parts of the agreement. Therefore, the terms of the PSC and side letter will take precedence over the ITL, including any tax laws promulgated after the PSC or side letter is signed. If the terms of the PSC and the side letter are inconsistent, as a matter of international investment law and in terms of the position adopted in practice by the Internal Revenue Department ("IRD"), the side letter will be deemed to override the provisions of the PSC and the tax law (so long as the side letter is approved by the MOGE and the MOPF).

Under the old investment regime, CIT exemptions were automatically granted for 5 years to all the MIC permit holders. However, under the current MIL, tax exemptions will be awarded only to the investments which are in the promoted sector. The upstream oil and gas is not listed under the promoted sector and hence tax exemptions are not applicable.

- ***What are the tax implications of cost recovery, royalty, data fee, training fee, bonuses?***

Cost recovery and royalty:

With respect to any development and production area, expenses relating to exploration, development and production operations are recoverable from available petroleum (net of royalty paid in kind) up to a ceiling/limit, which may vary from PSC to PSC. Under the standard terms and conditions of PSC, the maximum cost recovery rate (ranging from 50% to 70%) is based on the depth of the water and whether the PSC is for an onshore block, onshore block or deep water block. See attached Annex for the relevant rates

All exploration costs are recoverable from available petroleum, except as agreed under the contract. "Available petroleum" is petroleum produced and saved and not used in the petroleum operations. The cost can be recovered in the quarter it was incurred.

The royalty rate may vary from PSC to PSC. Under the standard terms of conditions, the rate is 12.5% of available petroleum.

Available petroleum that is not taken for purposes of paying for royalty or not taken as cost petroleum, will be allocated between the MOGE and the Contractor (Profit Petroleum Allocation). The Profit Petroleum Allocation may vary from PSC to PSC, but are based on several factors, including water depth, crude oil, natural gas and whether the PSC is for an onshore block, offshore block or deep water block.

Data fees, training fees, production bonuses and signature bonuses:

- Data fees are determined in accordance with the PSC. If the data fees are not cost recoverable, then they will be deductible for CIT purposes.
- Training fees are determined in accordance with the PSC. Under the standard terms and conditions of PSC the minimum fee to be spent is US$50,000 during the exploration period and it shall be increased to US$100,000 during the development period, depending on whether the PSC is for an onshore block, offshore block or deep water block. If the training fees are not cost recoverable, then they will be deductible for CIT purposes.
- Production bonuses are determined in accordance with the PSC, and may vary based on whether the PSC for an onshore block, offshore block or deep water block. If the production bonuses are not cost recoverable, then they will be deductible for CIT purposes.
- Signature bonuses are determined in accordance with the PSC, and they vary considerably. If signature bonuses are not cost recoverable then they will be considered as deductible for CIT purposes.

How do Myanmar's double taxation agreements apply to gains on oil and gas interests?

As mentioned above, Myanmar levies a special CGT on capital gains realized on oil and gas interests with rates of 40%, 45% and 50% depending on the amount of the gain realized.

In Myanmar tax law, a capital gain "means any profit realized from the sale, exchange or transfer of any capital asset". This is simply one of the categories of taxable income under the ITL. According to Section 3(q) of the ITL, shares are included in the definition of capital asset, as are land and assets of an enterprise.

A number of Myanmar Double Taxation Agreements ("DTA") (notably those with India, Malaysia, Korea, Singapore, Thailand and Vietnam, the DTA with the UK being a notable exception) provide in an article (often Article 13) on capital gains which are modeled after either the Organization for Economic Cooperation and Development or the United Nations Double Tax Convention. This treaty provision addresses gains on various categories of assets which can be relevant to oil and gas companies. Which actual category applies to any given situation may be more complicated to determine than at a first glance. Article 13 of the DTA refers to three types of gains that may be relevant:

Article 13:

- *Gains on "**immovable property**" may be taxed in the source state. The term "immovable property" is not in itself denied in the DTA, but it is telling that "income from immovable property […] shall in any case include rights to variable or fixed payments as consideration for the working of, or the right to work, minerals deposits, sources and other natural resources" . This raises the possibility that a (right to explore and exploit an) oil or gas well can fall within the term "immovable property" for the purposes of the DTA. In combination with Article 13 paragraph 2, one can take the view that a when a non-resident enterprise has rights to an oil or gas well in Myanmar, from the perspective of the DTA, such enterprise would be deemed to have a PE in Myanmar and the oil or gas interest is an immovable property that is held by such PE.*

- *Gains from the "**alienation of a permanent establishment (alone or with the whole enterprise)**" (or movable goods thereof) may be taxed in the source state. A non-resident company with an interest in a PSC will normally have a Myanmar PE for the purposes of the DTA. Accordingly, the alienation of the interest in the PSC by the non-resident company could be seen as the alienation of its PE. On such income, Myanmar would have taxing right under the DTA.*

- *Gains from the "**alienation of shares of a company**" can, depending on the DTA and the situation, be taxed in the state of residence of the company in question. This may apply to oil and gas investment situations, including the situation where it is deemed that the company "principally holds immovable property situated in a Contracting State".*

It is not entirely clear how the concepts are applied in Myanmar taxation of gains made by companies in the oil and gas sector is aligned with the categories of assets listed in the Capital Gains article in Myanmar's DTAs, if indeed a treaty with such a provision applies to the situation. Other questions loom, such as the distinction in certain Myanmar DTAs between exploration and extraction of natural resources. For example, the Myanmar-India DTA only treats "a place of extraction of natural resources" as a permanent establishment under the DTA, the Myanmar-Singapore DTA also refers to certain kinds of exploration, and the Myanmar-UK DTA does not refer to extraction of natural resources at all.

The more common situation under Myanmar's tax treaties is that Myanmar retains the right to tax a capital gain realized by a non-resident on oil and gas interests situated in Myanmar. However, the rules of each special DTA will determine the outcome of any analysis as does the structure of the individual transaction. Both must be examined carefully for each individual situation before coming to any final conclusion.

- ***Multiple blocks, one entity, one tax calculation?***

One of the more tricky issues that the MIC will need to tackle relates to the legal and tax structure of multiple blocks. One operator will have an interest in several blocks at the same time. This will be the case for Shell, Reliance, India Oil, Woodside (which already has 2 interests) ENI and Total (which already holds an interest in Yadana).

Though it is clear that cost recovery and profit oil accounting must be conducted on a ring-fenced basis, that is to say per individual PSC, the other scale components of the Contractor take, notably the income tax calculation, will depend on the legal structure and the tax calculation rules.

This is particularly the case when one and the same legal entity is used to hold interests in multiple blocks.

- ***Commercial Tax impact on PSCs***

The upstream oil and gas sector, it seems fair to say, was hit with a significant increase in terms of the cost of the support services needed for the exploration of hydrocarbons with the reform of the Commercial Tax in 2014. Geo-physical services, drilling services and most other types of oil field services will, if they are rendered in Myanmar, be subject to the 5% CT impost except if they are excluded from CT. The "cargo transportation" seems to be the only category of the exclusion which might apply to certain oil field services.

Providing the use of equipment such as barges and drilling equipment as well as a wide range of other services will be difficult to fit into any of the excluded categories. Do the PSCs exempt such services from Commercial Tax? Not as clearly as one would hope. Art 17.1 of the MOEE's Offshore Model PSC provides that:

> *"MOGE shall assume and discharge all Myanmar's taxes imposed upon CONTRACTOR, its contractors and subcontractors, including import and export duties, customs duties, sales tax and other duties levied on materials, equipment and supplies brought into Myanmar by CONTRACTOR, its contractors and sub-contractors for Petroleum Operations".*

"Sales tax" includes, in our view, CT. The potential problem is that there is no clear reference to services, only to tangibles "brought into" Myanmar. Will the IRD and MOGE be willing to interpret the PSC in a sense that no CT applies to services rendered in Myanmar? After all, it is undisputed that the income withholding tax and CT does apply to such oil ¬field services. Previously this question did not arise because most typical oil field services were not mentioned on the Schedule 7 of the CT. So, oil field service providers have a new issue to address.

Oil field service providers should also take note of the tax rate restructuring for income tax on salaries ("PIT").

The following table gives a summary of the tax implications:

Tax Item	Notes
Taxable income	Company share in Profit Petroleum
Expense deductions which the PSC lists as being deductible for Income Tax purposes	• Business expenses that are not cost-recoverable • Interest that is not cost-recoverable • Production bonus • Others
General expense deductions under Income Tax Law	• Not deductible: - "Expenses not commensurate with income" - Personal expenses • Deductible - Depreciation - Interest - Others
Loss carry Forward	Income Tax Law: 3 years or (more) as agreed in the side letter

- ***Special Goods Tax***

Myanmar has introduced Specific Goods Tax ("SGT") with the enactment of Specific Goods Tax Law ("SGTL") effective from 1 April 2016, financial year 2016-2017. SGT is imposed on 17 types of specific goods including kerosene, gasoline, diesel, jet fuel and natural gas as per the UTL.

Section 4(a) of SGT states that "any person who is engaged in any of the following business activities is liable to tax as set out in schedule of this law:

- import of specific goods into Myanmar;
- production of specific goods locally in Myanmar;
- export of specific goods to overseas."

Therefore, importer, producer and exporter of specific goods are subject to pay SGT. SGT rates are announced on a yearly basis together with the UTL. SGT is based on landed cost for importation of specific goods and shipped value (free on board) for exportation of specific goods.

Petroleum products including kerosene, gasoline, diesel, jet fuel and natural gas are categorized under the specific goods that are subject to 8% SGT. Especially for the export of natural gas, which party (MOGE, Contractor or both) should bear the SGT costs will be examined and determined under the PSC.

12. ENVIRONMENTAL AND SOCIAL ISSUES

Somewhat of a wildcard in the whole oil and gas exploration process is the required approval from the Ministry of Natural Resources and Environmental Conservation ("MONREC"). MONREC is a combination of the Ministry of Environmental Conservation and Forestry and the Ministry of Mines which were independent and separate Ministries. In accordance with the Environmental Conservation Law of 2012 ("ECL"), the MONREC regulates the environmental aspects of investment projects, and has electively the power to veto a project. The MONREC has created a committee for the evaluation of the environmental impact of business activities.

The Notification 616 released in December 2015 known as the Environment Impact Assessment Procedure 2015 ("EIAP") gives two major assessment requirements to implement the Oil and Gas projects in Myanmar, depending upon its size, type and requirements: one is the Initial Environment Examination ("IEE") and the other is the Environmental Impact Assessment ("EIA"). According to the Annexure 1 (Categorization of Economic Activities for Assessment Purposes) of EIAP the following upstream oil and gas activities require IEE or EIA, depending upon the size of the project:

Type of Activity	Criteria for IEE	Criteria for EIA
Onshore Oil and Gas Seismic Surveys	All sizes	All Sizes
Onshore Oil and Gas Exploration Drillings	-	All Sizes
Onshore Oil and Gas Production drilling and production activities	-	All Sizes
Offshore Oil and Gas Seismic Surveys	All sizes	-
Offshore Oil and Gas Exploration Drillings	-	All sizes
Offshore Oil and Gas Production drilling and production activities	-	All sizes
Production of liquid products from natural gas (this may include methanol and petroleum liquid products such as naphtha, gasoline, kerosene, diesel fuel, waxes, and lubes)	-	All sizes

An EIA is an in-depth study of the impact of a proposed project or business on the physical, biological and socioeconomic environment. The MONREC requires that the EIA be conducted by a qualified third party licensed by the Environmental Conservation Department ("ECD"). Section 5 of the ECD Rules and Procedures lays out which topics you (actually, your service provider) will need to cover. These are the following:

- Project overview, objectives
- Environmental, socioeconomic and health policies and legal requirements
- Summary of measures taken to reduce adverse effects
- Management/monitoring plans for each phase of the project (preconstruction, construction, operation, termination and post-termination)
- Maps, aerial and satellite photos
- Work schedule, allocation of funds and duties
- Sub-programs for managing and monitoring these sectors: air quality; water quality; waste; sound; smell; chemical substance; soil erosion and silt deposits; biodiversity; health and safety for workplace and society; cultural heritage; employment and training
- Contingency plans

13. EXPORTING GAS AND THE SPECIAL GOODS TAX

Commercial Tax, Special Goods Tax and Myanmar's Petroleum Production Sharing Contracts

Since the 2014 reform of the Commercial Tax system, Myanmar applies a Commercial Tax in connection with the production and/or export of natural gas in or from Myanmar. In 2016 this was replaced with a Special Goods Tax, sort of an excise tax system. Presently, the production, and perhaps, the export of gas are both taxable events under the SGT.

There are plenty of uncertainties surrounding the application of the SGT to the domestic extraction of gas and its export to overseas buyers. If both the production and the export are taxable, surely there must be an offset between both tax impositions. Indeed, the SGT does know such an offset system for producers and exporters. Input SGT paid on specific goods during importation can be offset against output SGT payable on production & sale and export and input SGT paid on purchase of specific goods from another producer for the purpose of production and export can be offset against SGT payable on production & sale and export. But it remains untested in connection with extraction of natural resources that are subsequently exported.

In this note, we examine how the new SGT system impacts existing Production Sharing Contracts (PSCs).

What does the PSC say about Special Goods Tax?

Unsurprisingly, there is no reference in any Myanmar PSC to SGT, specifically. SGT did not exist yet when Myanmar concluded its last PSCs. But the basic idea of Myanmar's PSCs is, or at least was (more on that below) that the Contractor pays for his own income tax as per Myanmar law, and that other taxes levied upon the Contractor, mainly indirect taxes of course, are assumed by the Myanma Oil and Gas Enterprise (MOGE). Central to this rule is 17.1 of the PSC. S. 17.1. b) ii) of the Model PSC which provides, or rather provided, that:

> *"MOGE shall…assume and discharge all exactions applicable under the Laws of the Union of Myanmar in respect of property, capital net worth and operations, including any tax imposed upon sales, gross receipts or transfers of property or any levy on or in connection with operations performed hereunder by CONTRACTOR, its Contractors or its Subcontractors".*

This catch-all tax assumption for MOGE has a carve-out in 9.11, which specifies that the Contractor has to pay income tax in Myanmar. Myanmar PSCs do not exempt third parties from their income taxes either. So, for example, the income tax oilfield service providers incur in Myanmar remains taxable, and the Contractor is not exempted from deducting the appropriate withholding taxes which correspond with that service provider's income.

But, the principle that the Contractors only pay for their income tax, and not for indirect taxes, no longer applies to all PSCs. The crucial provision 17.1. was amended by the MOEE as part of the reconsideration during the 2012-2013 onshore and offshore rounds. The MOGE has proposed adding language to Section 17.1(b)(i)-(ii) of the onshore and offshore PSCs, and this language has found itself in most new PSCs. The new language specifies that the MOGE assumes and discharges all Myanmar taxes imposed on the contractor (or its contractors or sub-contractors), including sales taxes, customs and import duties, "during the Exploration Period and the following period (if any) which the CONTRACTOR conducts the drilling operations of the appraisal wells for the purpose of development of Petroleum". This refers to the Exploration Period itself and, in addition, to any extension of that Exploration Period under Articles 3.4 and 3.5 of the PSCs.

So, the post-2012 PSC no longer has the blanket sales tax assumption for MOGE which pre-2012 PSCs mostly had. However, under many of Myanmar's existing producing gas fields, the previous regulation stands and that remains binding between the parties.

As a result, the post-2012 PSC itself does not guarantee an exemption of customs duties and Commercial Tax (CT) or SGT into the development phase. However, nothing prevents the Contractor from applying for an exemption of customs duties and CT at such stage under the MIL. Granting such request would be within the authority of the Myanmar Investment Commission (MIC). It is, however, subject to the MIC's discretion. Thus, would have no legal basis under Myanmar law to demand that the exemption is granted.

In practice, we are a little unsure of how the new language in the PSC can be brought in line with its actual implementation, which is under the FIL and in accordance with the MIC Permit that is granted to the operator. In actual practice, the MIC Permit specifies a period of a number of years during which the customs duty and CT exemption is valid. Anything that is included as equipment in the MIC proposal will be eligible to receive an import license and a tax exemption (this is done by completing an additional administrative process). The language in the PSC does not really recognize how this works in reality.

Is the Contractor or MOGE "the Manufacturer" in the sense of the SGT law?

The SGT has to be paid by, among other things, "the Manufacturer". Under Article 3(d)(iii) SGT Law, the term 'manufacture' includes 'extraction' and s. 3(e) defines Manufacturer as "a person who produces specific goods in own factory or arranges for others to so produce".

Could one look at the SGT question as a matter of proper allocation of the duty to pay the SGT? In other words, can it be said that the Contractor is a "manufacturer" in the sense of the SGT law? Or rather, is MOGE the "manufacturer"?

In Myanmar's producing gas fields, clearly extraction is taking place. The question is, is this done by the Contractor, by MOGE or by both? In other words, what is the true nature of a PSC?

There are strong arguments to suggest that the production of gas in Myanmar is carried out by the state-owned MOGE. As per the Constitution, the state owns the resources, not the Contractors. The Contractors offer a service on a risk-bearing basis, and the state uses that service to extract gas. According to the State-Owned Economic Enterprises Law, extraction of gas is solely permitted by the state, possibly in cooperation with private parties who receive a share of the sale proceeds from the sale of the extracted gas.

However, we believe that, depending on the language of the PSC, that should not even matter. More precisely, based on the language of the pre-2012 Model PSC, the MOGE assumption applies to "…exactions or…taxes…on or in connection with operations performed.. by Contractor". Thus, even if the SGT would be levied on the Contractor ('s operations) and not on MOGE, MOGE would still have to assume the cost of such tax under PSCs which follow the pre-2012 Model PSC. The fact that the SGT is imposed upon Contractor, or MOGE, or even Contractor's contractors or subcontractors, is not relevant for those PSCs. MOGE would have to assume that cost, regardless.

Does the MOGE have the power to exempt SGT by means of a PSC?

The approach taken for most indirect taxes in the PSC is that the MOGE, a state-owned enterprise that has its own juristic personality under Myanmar law, commits to the Contractor that the MOGE shall "(i) […] assume and discharge all Myanmar's taxes imposed upon CONTRACTOR […]". In other words, the MOGE will assume the cost of these taxes rather than the Government or the State exempting these taxes for Statoil (neither the Government nor the State are parties to the PSC as far as domestic Myanmar law is concerned).

Under Myanmar law, a party to a contract is, without a doubt, allowed to agree that it will bear the cost of certain taxes that are triggered in connection with the agreement. There is no provision in the Myanmar Contract Act (MCA) which would prevent such a provision from being operative. For example, the Stamp Duty Act itself provides explicitly in Section 29 that "[i]n the absence of an agreement to the contrary, the expense of providing the proper stamp shall be borne" by a list of designations stated in the law. So, there is not really an exemption granted by the MOGE. In other words, the question of whether it is within the MOGE's or the Government's authority to exempt any of these taxes does not actually come into play in Articles 17.1(b)(i) and (ii) of the PSC. For the same reason, any change in future tax legislation is unlikely to lead to a different outcome.

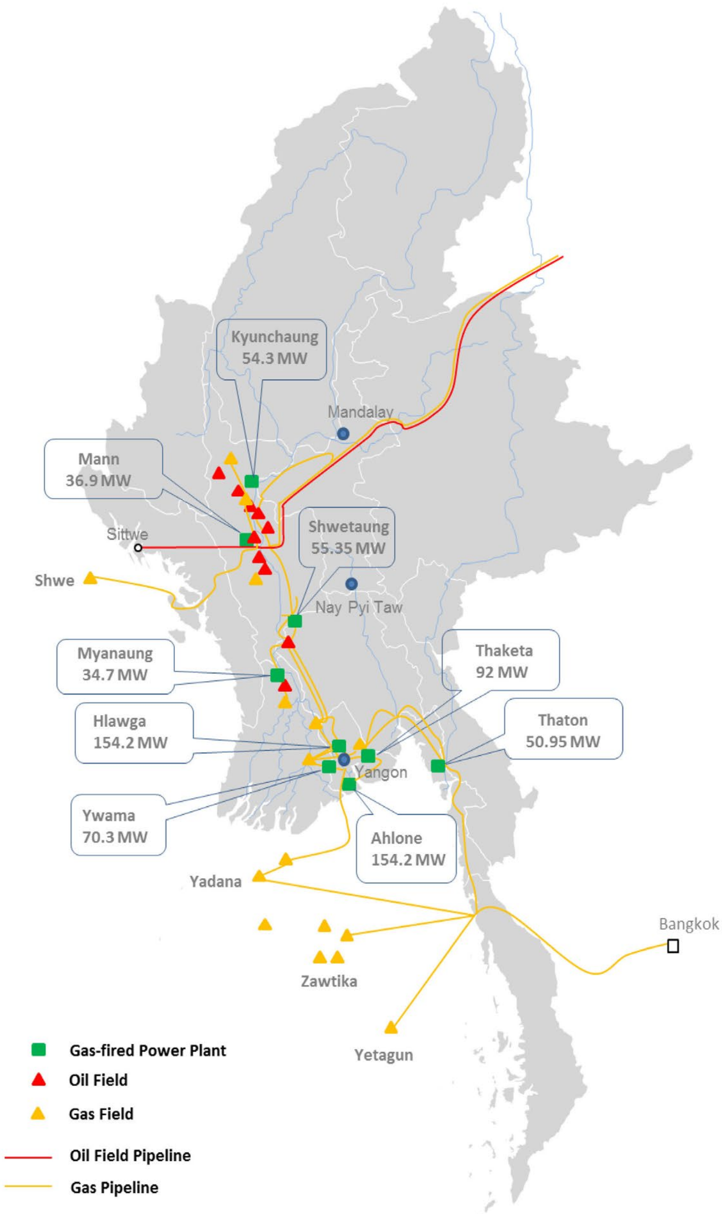
The situation, however, is different for Article 17.1(b)(iii) of the MCA, which states that the MOGE is not obligated to bear the cost of "taxes on tobacco, liquor, and other taxes charged on goods and services, import and export duties, customs duties and sales tax and any other tax levied upon articles imported for personal use by the CONTRACTOR […]".

Is the SGT cost-recoverable as per the PSC?

If for some reason the MOGE would not have to assume the cost of the SGT, perhaps for those PSCs which follow the 2012 Model PSC, the question is raised if the SGT would be cost-recoverable. The PSC has no limitative definition of "recoverable costs". It states that "CONTRACTOR shall recover all costs and expenses in respect of all Petroleum Operations" (s. 9.4).

The scope of "Petroleum Operations" may be relevant here, as some PSCs include the "marketing" of the petroleum and others do not have such reference.

A non-limitative list of expenses is found in the Accounting Annex, but , not surprisingly given the catch-all MOGE tax assumption in 17.1., no reference is made to sales taxes. The Accounting Annex does take the basic view that if there are any taxes applied to materials used by the Contractor, these are also recoverable.



Source: Consultant based on JICA, MOE, JOGMEC and JEPIC data

How do the pipeline agreements affect the SGT question?

The PSC is not the only legal document between the MOGE and the Contractors. Once a well goes into production, an Export Gas Sale Agreement and a Gas Transportation Agreement is concluded.

Do these contracts shed any light on the impact of the SGT on the "Exporters" of gas? There are few certainties to go on, most likely. But the principle underlying most of these contracts seems to be, again, that any taxes will be accounted for in the balance of the benefits between the parties.

Would imposing SGT constitute a "change of law" in the PSC?

The Myanmar Model PSC has a stabilization clause, but not all older PSCs have the same version. In addition, various versions of a "change of law" clause are found in other documents between Contractors and the MOGE.

In some more recent PSCs, the stabilization clause reads as follows: "If a material change occurs to the either MOGE's or CONTRACTOR's economic benefits after the Commencement of the Operation Date of the Contract due to the promulgation of new laws decrees, rules and regulations, any amendment to the applicable laws, decrees, rules and regulations or any reinterpretation of any of the foregoing made by the Government, the Parties shall consult promptly and make all necessary revisions or adjustment to the relevant provisions of the Contract in order to maintain the affected Party's normal economic benefit hereunder".

The Model PSC's stabilization clause leaves a lot of issues open. It does not seem to oblige MOGE to compensate any adverse economic effect that is the result of a new law, regulation or interpretation, but simply to "maintain the affected Party's normal economic benefit". One party might think there is still a "normal" benefit for the affected party, despite the change. In addition, there is no timetable for doing so.

Conclusions

Generally speaking foreign investors when making an investment in a country become subject to the tax laws of that host state. Unless they have any special arrangements in place to protect them from tax changes (stabilization agreements), they are impacted by taxes they may not have foreseen at the time they made the investment. Sometimes, those new taxes render a project less profitable or, in rare cases, even loss generating. That is the risk of any enterprise, both domestic and overseas.

However, the issue of unforeseen tax increases becomes more sensitive for a country's reputation when the state enters into a commercial deal with foreign investors. In a normal commercial contract between two private parties, one of the two does not have the power to tax the other. In a contract between, essentially, the Myanmar Government and an oil and gas contractor, this is different. Any additional Myanmar tax cost is also, practically speaking, a change of the commercial deal between MOGE and the contractors. It does not really matter for Myanmar how it earns money from an oil and gas PSC, whether as profit petroleum or as tax, in this case SGT. It flows in the same coffers. Imposing an unforeseen tax on Contractors practically speaking, without reasonable mitigation, may be seen by some as changing the commercial deal unilaterally.

The amendment of s. 17.1 in the 2012 Model PSC was by no means intended to enable the surprise introduction of a new indirect tax, designed to hit, at least in part, the contractors of the MOGE. Eliminating a customs duty exemption is quantifiable for contractors, but the possibility of the Government imposing a future indirect tax of an unknown percentage is simply not sustainable for any commercial arrangement with private parties.

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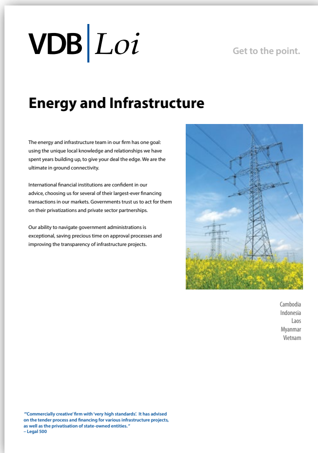

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