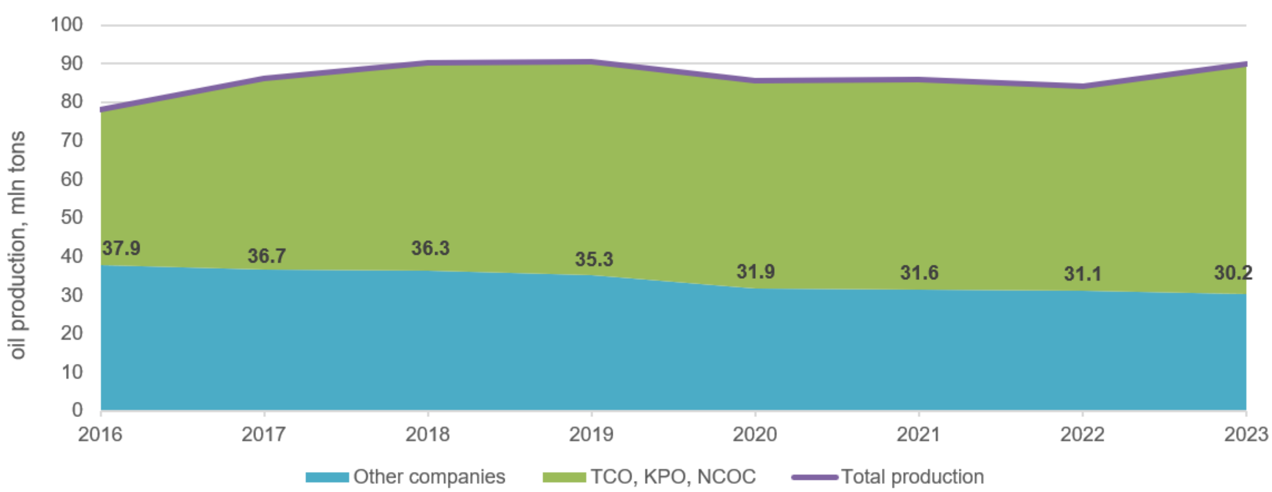
Tax burden – Order of Merit 2023

Introduction

The problem of the tax burden on oil producing companies1 in Kazakhstan is of great interest, considering their significant share in total tax revenues and the expected changes in new Tax Code. In this article, special attention is paid to the general tax regime [GTR], since about 90% of about 100 oil producing companies operate under this regime. These companies provide 31% of the total oil production, but their share in supplies to the domestic market is 96%. The GTR regulates the tax obligations of companies operating under this regime within the framework of the Tax Code of the Republic of Kazakhstan, while taxation under production sharing agreements [PSA] and improved model contracts [IMC] is governed by their own terms. The state and interested parties still have time to improve GTR, which underlines the importance of adapting tax policy to changing economic conditions and significant budget revenues from the oil sector [1.5 trillion tenge2 from companies operating on GTR were received on budget of the Republic of Kazakhstan in 2023].



Source: Compiled by ENERGY Insight & Analytics

It is extremely important to understand that in addition to its main fiscal function — replenishing the republican budget in a certain period — the Tax Code should also encourage subsoil users to increase the potential of their business through capital investments and geological exploration. The diagram above shows a clear picture: over the past few years, the production of companies working on GTR has decreased by more than 20%, from almost 38 million tons per year to 30 million tons. At the same time, the production of companies

[1] In this article, only oil producing companies are considered. Other companies in the oil and gas sector [transportation, refining, oilfield services, gas business] are outside the boundaries of this analysis.
[2] For reference: the average exchange rate in 2023 was 456.31 tenge/US dollar

working on PSA has increased. In this regard, it is likely that the current GTR requires improvements in terms of incentives for subsoil users to invest more actively in maintaining and expanding their business.

GTR overview

In Kazakhstan, the current tax regime for oil companies includes several key taxes that significantly affect the financial burden of enterprises in this industry [the tax burden is calculated as the sum of payments and taxes divided by revenue]. The main taxes applied to companies engaged in the exploration and production of hydrocarbons include:

Mineral Extraction Tax [MET]: This tax is levied on the extraction of crude oil, gas condensate and natural gas. MET is an ad valorem tax, the rate of which increases with the growth of the company's annual production volume. For oil exported outside Kazakhstan, MET rate is twice as high as for oil sold on the domestic market. In some cases, for fields with unfavorable economic conditions, the government may reduce MET.

Export Customs Duty [ECD]: This duty varies monthly depending on world oil prices and is set by the Ministry of National Economy. Supplies to the EAEU markets are exempt from this duty. In 2023, there were changes in the methodology for calculating the duty, including the replacement of the quotation of Russian Urals Blend oil with the Kazakh KEBCO grade.

Rent tax on exports: This tax is applied to the value of exported crude oil and gas condensate. The tax rate increases with an increase in the price of oil, starting from the level of 50 US dollar per barrel, and can reach 32%. Unlike ECD, the rent tax is also applied to exports to the EAEU markets.

Corporate income tax [CIT]: According to GTR, CIT rate of 20% of the tax base is applied to all companies.

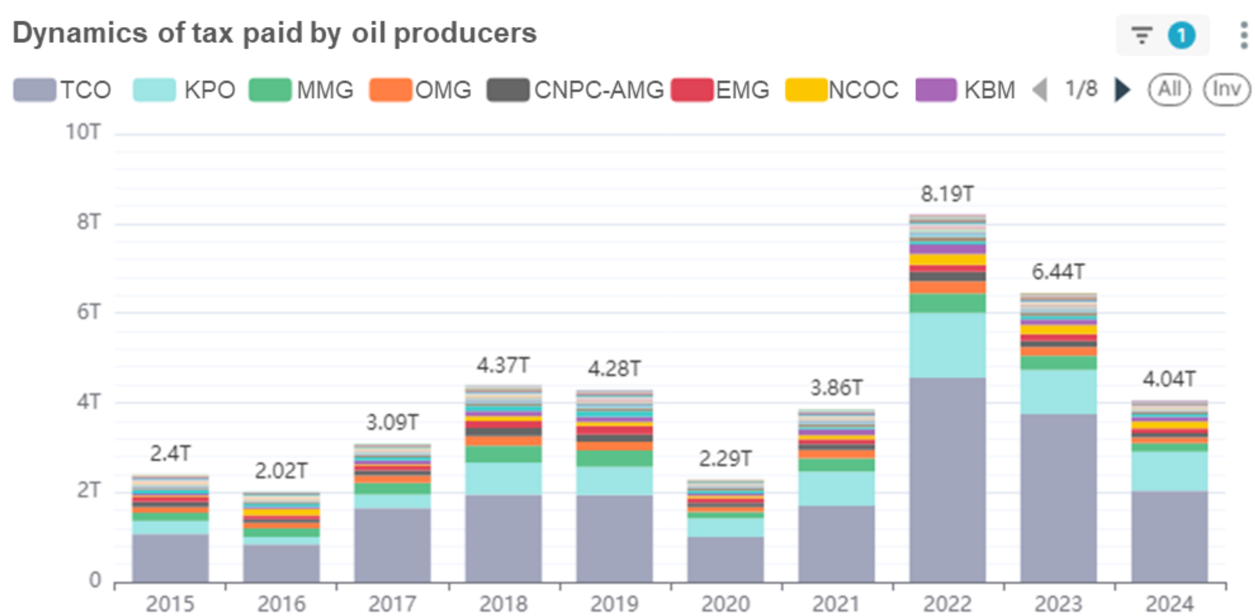
Excess profit tax [EPT]: a tax levied on additional income that a subsurface user receives in excess of established standards. The object of taxation is a part of net income exceeding 25% of the amount of deductions determined for calculating the EPT.

The current tax regime in Kazakhstan, according to S&P Global, has low investment attractiveness, which affects the country's ratings in the field of exploration and production of hydrocarbons. According to data from the KAZENERGY National Energy Report for 2023 [NER 2023], the country ranks 78th out of 112 in the ranking of attractiveness for exploration and production. In terms of the financial and tax environment, the Republic of Kazakhstan is only in the 95th position out of the same 112. This is due to the high tax burden, which does not stimulate investment in oil production, especially in low-profit fields. The Government of the Republic of Kazakhstan is considering the possibility of optimizing the tax regime, including providing fiscal incentives for mature fields and developing new projects such as shale oil production.

In addition, S&P Global analysis presented in NER 2023 shows that the conditions of IMC in Kazakhstan may not fully stimulate new investments in production. Existing contracts retain problematic aspects, such as the lack of clarity of local content requirements. This creates obstacles to attracting investors, including taxes and unstable conditions. Strict administrative requirements and obligations of companies are also noted, it can negatively affect the attractiveness of projects.

Results of 2023

According to the data of the State Revenue Committee of the Ministry of Finance of the Republic of Kazakhstan [SRC MF RK], in 2023 budget revenues from oil companies amounted to 6.44 trillion tenge. Our analysis includes the 50 largest oil producing companies, which in 2023 produced a total of 87.3 million tons of oil, which is approximately 97% of the total oil production in Kazakhstan during this period. We believe that 97% coverage is a sufficiently representative sample to continue our analysis.



Source: EXia Analytical Platform
Note: in 2024 the receipts for the period from January to August 2024 are indicated

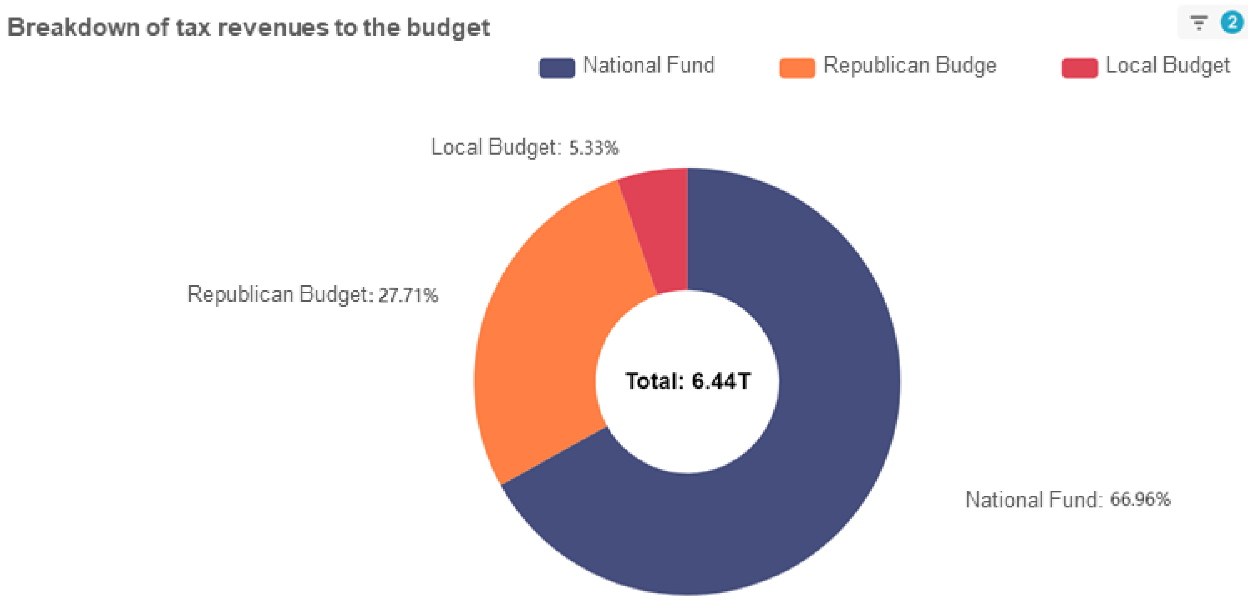
The largest oil producing company in our country, Tengizchevroil [TCO], is the undisputed leader in terms of payments to the budget. In 2023, the company TCO paid 3.7 trillion tenge to the budget of the Republic of Kazakhstan, which is 58% of all payments from oil producing companies. The top 10 taxpayers among oil producing companies also include Karachaganak Petroleum Operating [KPO] with a 15% share, Mangistaumunaigas [MMG] with a 5% share, North Caspian Operating Company [NCOC] with a 3% share and Ozenmunaigas [OMG] with a 3% share. The total share of the top 10 taxpayers amounted to 93% of the entire oil industry, or 6 trillion tenge.

It is important to note that companies such as TCO and KPO are not only the largest taxpayers in absolute terms, but also the leaders in relative terms. This is especially noticeable if we consider the taxes paid per ton of oil produced. According to the results of 2023, TCO ranks first among ten large oil producing companies with almost 130 thousand tenge of taxes per ton. KPO follows in second place with about 81 thousand tenge per ton, followed by Caspian Oil with 80.4 thousand tenge per ton. The difference between the other companies is less significant, but NCOC stands out with an indicator of 11 thousand tenge per ton, which is due to the reason set out below. The table below once again underlines the importance of TCO as a taxpayer for the republican budget, we described this in more detail in our previous article "Tengiz Effect – 2033 and further".

Company	Type of contract	Taxes paid in 2023, billion tenge	Production 2023, million tons	Taxes per ton, thousand tenge/ton
TCO	stabilized contract	3,746.4	28.9	129.7
KPO	PSA	980.2	12.1	81.3
MMG	GTR	319.9	6.2	52.0
NCOC	PSA	204.3	18.8	10.9
OMG	GTR	198.9	4.9	40.8
EmbaMunaiGas	GTR	146.7	2.7	53.9
SNPS-Aktobemunaigas	GTR	134.8	2.7	50.4
Karazhanbasmunai	GTR	128.7	2.1	62.7
Kazgermunai	GTR	77.9	1.2	65.6
Caspian Oil	GTR	72.6	0.9	80.4
Other 40 companies	mostly GTR	427.0	7.0	61.1
TOTAL	-	6,437.4	87.3	73.7
TOTAL PSA/stabilized contract	-	4,931.0	59.7	82.6
TOTAL GTR	-	1,506.5	27.6	54.7

Source: Compiled by ENERGY Insight & Analytics

For understanding, we also emphasize that about 2/3 [67%] of the total tax revenues from oil producing companies of the Republic of Kazakhstan are directed to the National Fund of the Republic of Kazakhstan, and just over a quarter [27%] is distributed in favor of the Republican budget. The remaining 6% is distributed in favor of local budgets.



Source: EXia Analytical Platform

The table below shows the top 10 oil producing companies of the Republic of Kazakhstan by revenue, indicating taxes paid and tax burden for 2023. The average [weighted average] tax burden by the end of 2023 was 29% for all types of tax regimes, while the difference in tax burden values between PSA/stabilized contract regimes [28%] and GTR [35%] is 6%. As can be seen, the average tax burden between companies operating under a PSA/stabilized contract and GTR is comparable. The exception is NCOC, whose tax burden is only 4%. However, this is a temporary occurrence, since the company has not yet reached the indicators [triggers] at which it will transfer to a higher tax burden. It is expected that upon reaching the triggers, the tax burden for NCOC will be about 29%, which approximately corresponds to the current level of tax burden.

Company	Type of contract	Revenue 2023, billion tenge*	Taxes paid in 2023, billion tenge	Tax burden 2023, %
TCO	stabilized contract	8,876.6	3,746.4	42%
NCOC	PSA	5,601.9	204.3	4%
KPO	PSA	3,230.2	980.2	30%
MMG	GTR	878.4	319.9	36%
OMG	GTR	784.3	198.9	25%
EmbaMunaiGas	GTR	402.7	146.7	36%
Karazhanbasmunai	GTR	419.8	128.7	31%
SNPS-Aktobemunaigas	GTR	424.9	134.8	32%
Caspian Oil	GTR	142.6	72.6	51%
Kazgermunai	GTR	145.8	77.9	53%
Other 37 companies**	mostly GTR	1,073.6	414.6	39%
TOTAL	-	21,980.8	6,425.0	29%

Company	Type of contract	Revenue 2023, billion tenge*	Taxes paid in 2023, billion tenge	Tax burden 2023, %
TOTAL PSA/stabilized contract	-	17,708.8	4,931.0	28%
TOTAL PSA/stabilized contract without NCOC	-	12,106.8	4,726.7	39%
TOTAL GTR	-	4,272.0	1,494.1	35%

Source: Compiled by ENERGY Insight & Analytics
* Revenue according to standalone [not consolidated] financial statements of companies, revenue of NCOC and KPO – assessment of ENERGY Insight & Analytics.
** For three companies, financial statements are not posted on the resource of the Financial Reporting Depository of the Ministry of Finance of the Republic of Kazakhstan, they are excluded for analysis purposes.

In the Unified State System of Subsoil Use Management of the Republic of Kazakhstan [USSM], subsoil users provide reports as part of the fulfillment of contractual obligations, including on payments paid to the budget of the Republic of Kazakhstan. Tax information is published in USSM as part of the Extractive Industries Transparency Initiative [EITI] and is analyzed by us on a regular basis. Thus, the amount of revenues to the budget of the Republic of Kazakhstan for 2023, according to USSM amounted to 5.8 trillion tenge from the 50 largest oil producing companies, compared with 6.4 trillion tenge from the same companies, according to the SRC MF RK. A significant discrepancy between the data of the SRC MF RK and USSM is explained by the fact that USSM for 2023 contains information on only 38 of the 50 oil producing companies considered.

Factors affecting tax revenues

Tax revenues are influenced by several key factors, such as the average price of Brent crude oil, the exchange rate of tenge to the US dollar, and the volume of oil production and exports. However, it is important to keep in mind that there is no 100% correlation between these factors and tax revenues, since there is a time lag due to the fact that taxes are paid with a certain delay. Usually, taxes for the previous quarter are paid in the next quarter, which creates a temporary difference between the accrual and payment of taxes to the budget.

Year	The amount of taxes, trillion tenge	The average price of Brent, USD/barrel	Average exchange rate, tenge/USD	Oil exports, million tons
2021	3.86	70.86	426.03	65.71
2022	8.19	100.93	460.48	64.32
2023	6.44	82.49	456.31	70.54

Source: Compiled by ENERGY Insight & Analytics

The increase in tax revenues between 2021 and 2022 was more than doubled due to several factors. The main role was played by a significant increase in the average price of Brent crude oil by 42%, from about 71 to almost 101 US dollar per barrel. This factor provided an increase in taxes in the amount of 3.8 trillion tenge, or 89% of the total change. In addition, the increase in tax revenues in 2022 was facilitated by an increase in the average exchange rate of tenge to US dollar, from 426 to 460. The decrease in oil exports by 4% did not have a significant impact.

In 2023, on the contrary, tax revenues decreased by 1.8 trillion tenge, which is primarily due to a drop in oil prices by almost 18% compared to the previous year. All other things being equal, the factor of the decline in the price of Brent reduced the amount of taxes by 3.1 trillion tenge. An additional unfavorable factor for budget revenues was the strengthening of the tenge against US dollar. The growth of oil exports by 9.6% in 2023 only partially [by 1.5 trillion tenge] compensated for the fall in oil prices and the strengthening of the tenge.

Preliminary results for 2024

Understanding the key factors affecting tax revenues from oil production is critically important for planning the republican budget. In addition, due to the high volatility of energy prices, it is critically important to recognize trend reversals in a timely manner and reflect budget adjustments taking into account changing input data.

This is especially critical for our country, given the dominant role of the oil and gas industry, especially in terms of tax revenues. According to the Law of the Republic of Kazakhstan dated December 5, 2023 No. 43-VIII LRK "On the Republican budget for 2024-2026", 7.6 trillion tenge is planned for 2024 in the form of tax revenues from oil companies to the National Fund of the Republic of Kazakhstan and in the form of ECD. It means that the share of the industry in the total revenues of the republican budget [excluding transfers from the National Fund of the Republic of Kazakhstan] and the National Fund of the Republic of Kazakhstan is set at 34% in 2024.

However, there is a fairly high probability that the target of 7.6 trillion tenge from oil production will not be reached by the end of the year. According to the reports on the execution of the republican budget and information on tax receipts and payments to the National Fund as of September 1, 2024, the fact of revenues for the first half of 2024 from oil production amounted to 3.7 trillion tenge, that is, 49% of the annual plan. It means that in order to fulfill the annual plan, for the remaining four months until the end of 2024, tax revenues from oil production must equal revenues for the first eight months of the year. The unreality of such a scenario has already been assessed by the Ministry of National Economy of the Republic of Kazakhstan, which was reflected in a decrease in the forecast for oil revenues from 7.6 to 6.3 trillion tenge in the forecast of social and economic development of the Republic of Kazakhstan for 2025-2029 [stage 2]. In addition to the revised forecast from the Ministry, two objective unfavorable factors also indicate the improbability of a scenario with a significant increase in revenues in the second half of the year.

Firstly, revenues from oil production strongly depend on Brent quotations, the latest trends in the global energy market do not inspire optimism, at least in the near future. As we can see in the diagram below, the price of Brent reached its peak this year in early April, and since then there has been a downward trend. The main reason for the cautious sentiment in the energy market is the increase in the unemployment rate in the United States above the psychological mark of 4%, which may be a harbinger of recession in the world's largest economy. Analyst J.P. Morgan estimates the probability of a recession in the United States in 2025 at 45%. In response to the rising unemployment rate, the Federal Reserve System [FRS] recently announced a key rate cut for the first time since 2020. In any case, the positive effect on the US economy from monetary policy easing will be delayed.

Source: marketwatch.com

Secondly, OPEC is also adjusting its oil production plans to partially offset the expected drop in oil demand due to a slowdown in the growth of the world's largest economies. Kazakhstan, as a country that voluntarily joined OPEC+ format, is expected to fulfill its obligations to reduce oil production within the established quota. The factor of production decline is also unfavorable for the amount of tax revenues from the industry.

According to the analyzed companies, budget revenues for the first 8 months of 2024 amounted to 4.04 trillion tenge. Taking into account the rate of revenues and taking into account the above factors, the forecast of revenues from oil producing companies for the year may be at the level of 6 trillion tenge.

Expected changes in new Tax Code

Significant changes are expected in new Tax Code of Kazakhstan aimed at optimizing the tax burden on oil producing companies. One of the key changes will be the reduction of the export duty on oil with the transfer of the tax burden to the mineral extraction tax. This change can be implemented within the next two years.

Reducing ECD and increasing MET will allow oil prices to align with prices in the countries of the Eurasian Economic Union [EAEU], such as Russia and Belarus. This change is aimed at preventing the export of oil and petroleum products abroad and eliminating the need to introduce artificial bans. Manufacturing companies will be able to benefit from higher prices in the domestic market, which will also lead to an increase in tax revenues to the budget and the National Fund. These additional funds can be used to compensate for the growing costs of socially vulnerable segments of the population associated with higher prices for petroleum products.

In addition, it is planned to systematize tax benefits for MET for mature and depleted deposits. Currently, companies are forced to individually negotiate a reduction in MET rates for such fields. The new approach involves the introduction of an alternative oil tax [AOT], which will be universally applied to all depleted fields. This will simplify tax administration and make it easier for companies with low-yield deposits, especially in Mangistau region.

It is expected that these changes will be expressed in new Tax Code and will probably come into force in 2026. There is still time to make sure that the introduction of such measures will definitely increase the competitiveness of oil companies, increase the investment attractiveness of Kazakhstan's oil production and ensure the country's energy security.

Bottom line

Tax policy plays an important role not only as a source of replenishment of the republican budget, but also as a tool to stimulate investments in exploration and new technologies. This is especially important for maintaining or increasing production in mature and depleted fields, as well as for the development of fields with hard-to-recover reserves, such as shale oil and gas, bituminous oil. In order to attract new investors, it is necessary to create attractive conditions for investments in risky exploration projects, and it is important for existing subsurface users to maintain sufficient funds for reinvestment after taxes and fulfillment of obligations.

Although the instrument proposed to investors since the beginning of 2023 in the form of IMC for fields with hard-to-recover reserves is a positive step to increase the investment attractiveness of the oil and gas industry in Kazakhstan, the international rating agency S&P Global assesses its impact on attracting large investments as limited. The preferences provided by IMC may not be sufficient against the background of more favorable conditions offered by other countries that successfully attract international investment in exploration and production.

Additional global factors, such as uncertainty in the demand for hydrocarbons in the long term, low investor interest in investing in this sector and the impact of the energy transition, force companies to carefully select projects. This is an important point that should be taken into account, since Kazakhstan considers IMC to be a solution for attracting investments, whereas S&P Global, whose opinion is guided by many investors, evaluates this approach differently. Perhaps we should reconsider this issue and find a more balanced solution that suits both sides.

To solve the accumulated problems in the oil industry of Kazakhstan, it is necessary to update the General Tax Regime in new Tax Code. It is also worth considering the possibility of using other forms of contracts, such as risk-service or stabilized contracts [including PSA], provided that national interests are preserved, conditions for society are transparent and reasonable guarantees of return on investment for investors are created.

ENERGY Insights & Analytics

Analytical center "ENERGY" LLP (ENERGY Insight & Analytics) is a joint venture between the KAZENERGY Association and IT company AppStream. The company aims to become a priority source of data, analytical information, and recommendations for Kazakhstan's oil, gas, and electric power industries, allowing decision-makers to analyze and predict the most significant industry indicators with details on leading market players. Activities of ENERGY Insight & Analytics incorporate the whole analytics cycle with consequent stages: Descriptive, Diagnostic, Predictive, and Prescriptive analytics.

The key tool and product of ENERGY Insight & Analytics is internally developed software - the Analytical Platform EXia, aimed to identify, localize, format, and present data most efficiently for the specified use cases in a kind of Software-as-a-Service.