



Shell South Africa Upstream B.V.

Carel van Bylandtlaan 30
2596 HR The Hague
The Netherlands

Tel +27 21 408 9111

Fax +27 21 419 2864

Email j.eggink@shell.com

Internet <http://www.shell.com>

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Committee Secretary Standing Committee on Finance
Parliament of SA

Dear Mr Wicomb

Shell welcomes the opportunity to comment on the draft Taxation Laws Amendment Bill ("TLAB") of 2013, and submit these comments in respect of our Upstream Oil and Gas business in South Africa.

1. Our comments are contained in Annexure 1 – see below, HOWEVER – **Shell's main concern is to get clarity on the possible exclusion of onshore oil and gas operations from the definition of an "oil and gas right " in the 10th schedule of the Income Tax Act No.58 of 1962.**
2. In our view onshore oil and gas operations require a similar tax regime as offshore oil and gas, hence must be included in the 10th schedule fiscal stability agreement.
3. The current definition in this draft Bill seem to only refer to offshore oil and gas in respect of the 10th schedule and does not mention onshore oil and gas, hence our concern, as there is not sufficient clarity to enable us to conclude that both onshore and offshore oil and gas operations are included in the 10th schedule (draft TLAB section 165(1)(i)).
4. We note and welcome other tax amendments proposed to the 10th Schedule (e.g. 0% withholding tax dividends and interest) as it will help to stimulate investment needed to develop the oil and gas industry in South Africa. Oil and gas exploration ventures are complex, difficult and expensive to bring to production, hence we welcome the tax proposals to stimulate the industry, as oil and gas development will provide both local security of energy plus economic stimulation and much needed job creation.
5. We are however greatly concerned that the proposed amendment to the definition of the "oil and gas right" in the 10th Schedule seem to exclude ONSHORE oil and gas operations, and request that section 165(1)(i) of the TLAB be: i) amended to include onshore oil and gas operations or ii) unilaterally withdrawn. If enacted, onshore oil and gas operations will be excluded from the provisions of the 10th schedule and there will be no fiscal stability for income taxes.
6. If our interpretation is correct this will be detrimental to growth and stability of the fledgling unconventional (UC) oil and gas operations that will commence once licenses are

granted to explore and develop shale gas in South Africa. It is our view that UC Oil and Gas may hold significant energy security and socio-economic benefits for South Africa. Exploration for these resources is aligned to government's recently published Draft Integrated Energy Plan which foresees a greater role for natural gas in the local energy mix (Government Gazette 36690, dated 2013.07.24). It is also aligned to the National Development Plan.

7. Unconventional Gas (UCG) is a new emerging industry in South Africa and Onshore Unconventional Gas has not been explored yet, so its potential is as yet unproven and very uncertain. These projects are located in remote areas far from existing infrastructure. Onshore UCG requires long exploration and appraisal periods (up to 10 years) with many wells and pilot projects requiring a high upfront capital commitment that may not lead to any returns. Moreover, development and subsequent production in case UCG is proven, require high and extended investment and these projects in itself are not expected to generate net cash flows for possibly two decades. **In summary:** Onshore Unconventional oil and gas operations are as complex, difficult and costly to bring to production as offshore oil and gas and may have a much longer payout period – hence these venture are exposed to high financial risks and must be included in the 10th schedule tax regime to provide the requisite fiscal incentives and stability. Other countries (eg.UK, Algeria, China and Argentina) have provided some measure of fiscal incentives and stability to help UCG get off the ground, and stimulate the growth and development of unconventional oil and gas business.

8. Shell has submitted the comments as above to National Treasury and SA Revenue Services.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Jan Willem Eggink', written over a faint circular stamp or watermark.

Jan Willem Eggink

General Manager

Shell South Africa Upstream B.V.

**Annexure 1: Shell SA Upstream comments on
Draft Taxation Laws Amendment Bill, 2013 (2013.07.04)**

- A The amendment in paragraphs 165(1)(h) & (i) of the draft TLAB of the definition of 'oil and gas right' in the Tenth Schedule makes the term (and hence the Schedule itself) applicable only to offshore rights. This would remove the tax incentives (uplift on capex as a deduction etc.), and the associated fiscal (tax) stability arrangements, for onshore projects. It also leaves open the question of whether any other specific regime is applicable to onshore Exploration & Production operations, or does the default corporate tax regime apply? As indicated in our covering letter we believe that onshore unconventional oil and gas operations must be included in the 10th schedule of the Income Tax Act no. 58 of 1962, as argued in our covering letter.
- B The introduction in paragraphs 165(1)(b) & (c) of the TLAB of the definitions 'fiscal stability agreement' and 'fiscal stability rights' in its reference to sections 13 & 14 respectively of the Mineral and Petroleum Resources Royalty Act ('Royalty Act'), creates uncertainty, in that these references should probably refer to the 10th schedule? Also fiscal (royalty) stability is handled separately in the Royalty Act. It is not consistent with paragraph 8(1) of the Tenth Schedule which stipulates that the fiscal stability agreement will/must guarantee the terms of the Schedule at the date of execution. We would like to meet with National Treasury and SARS to get further clarity on this.
- C The revised definition of 'exploration' (paragraph 165(1)(a) of the TLAB) also creates a problem for 'unconventional' operations as it uses the term 'reservoir'; the present definition, which uses 'structure' is problematic as unconventional resources are often not in clearly delineated structures, but rather in accumulations that together make the resource viable for exploration and eventual production. This section may require amendment to take cognizance of unconventional oil and gas resources geology and its formation.
- D In Section 165 (1)(j), the definition 'post-exploration' is substituted for 'production'. This seems to overlap with 'abandonment'. More clarity is required to enable a better understanding of this definition.
- E Although not directly provided for in the Schedule or the TLAB, the Explanatory Memorandum introduces the notion that authority to issue fiscal stability agreements might practically be delegated to the Minister of Mineral Resources so that that can be issued automatically with each new or renewed right as necessary. This concept will streamline the licensing process, but license holders and operators need to understand how this will work and the nature of the relationship between the Mineral Resources and National Treasury/SARS, regarding this issue.