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The main developments introduced by the Algerian New Hydrocarbon Law

PwC Tax and Legal team is pleased to provide you with a summary of the main tax and legal provisions introduced by the new hydrocarbon law#19-13 dated on 11 December 2019.

The new law introduces several measures aiming at encouraging investments in the Hydrocarbon sector. This new law provides for a more flexible contractual framework and more favorable tax regime for foreign hydrocarbon operators.

PwC Algeria team wishes you a good reading and remains at your disposal for any further information.

Presentation of the context

The Hydrocarbon sector represents the main provider of financial resources in Algeria.

Although the potential of the country in terms of hydrocarbon resources remains substantial, for both conventional and unconventional energies, Algeria has faced continued decline in the production of the existing deposits, as well as an increase of the national energy consumption. Indeed, the tenders launched in the frame of former law# 05-07, did not obtain the expected results during the past few years.

In addition, the contractual framework provided by law# 05-07 is considered as inflexible in comparison with other contractual forms used in other countries. Law#05-07 as amended and supplemented is also considered to have a complex tax system not attractive for foreign partners, which has inflicted additional obstacles to the development of the hydrocarbon sector in Algeria.

Beyond these endogenous factors, the world energy order has undergone profound changes in the past few years.

The world supply is currently characterized by a high abundance of hydrocarbon production, especially with the new exploration of unconventional deposits. While prices are remaining steady with a declining trend, renewable energies are gaining more attention in the global energy environment.

All these factors explain the need to introduce a new Law for revitalizing this strategic sector, considered as the driving force of the national economy and the main provider of revenues for the State budget.

Legal provisions

The new hydrocarbon law provides for a series of measures aiming to redefine the legal framework governing the hydrocarbon sector in Algeria, by providing more flexibility to attract foreign investments, while protecting the interests of the Algerian State.

Maintaining the majority local partnership requirement 51/49

Articles 92, 93, 94, 95, 96 and 97 of the new law provide for the retention of the rule 51/49, governing Sonatrach' partnerships with foreign companies. The application of this rule reinforces the national company's control in the hydrocarbon exploration and exploitation activities in Algeria. Considering the sensitivity of this strategic sector, the purpose behind maintaining this rule is to safeguard Sonatrach' interests in the partnership. As such, the Algerian State remains the leading partner in terms of decision-making within the partnership.

Redefinition of the roles of the actors in the hydrocarbon sector

The new law reassigns the roles devoted to each of the governmental operators involved in the hydrocarbon sector, namely: the Ministry of Energy and Mines, ALNAFT (National Agency of Valorization of Hydrocarbon Resources), ARH (Hydrocarbon Regulation Authority) and finally the National Oil Company Sonatrach.

For instance, the Ministry of Energy and Mines will only intervene in the strategic decision-making relating to energy policy.

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Hence, it will no longer intervene in technical matters thereof.

In addition, the new law highlights the independence of the two agencies, ALNAFT and ARH. Their roles are differentiated from those of the Ministry of Energy and Mines. As such, ALNFAT will exercise its authority exclusively over upstream research and exploitation activities, while the ARH will have a more prominent role in managing downstream activities in addition to its role in ensuring the respect of HSE requirements in this sector. It is also important to note that this new law gives the right to ALNAFT and ARH to terminate a contract signed with a foreign or national partner, in case the latter fails to comply with the contract clauses, without going through the Minister of Energy approval.

In addition, ALNAFT will no longer take part of the hydrocarbon exploration and/or exploitation contracts. As such, ALNAFT will confer SONATRACH and its foreign partners the right to carry out hydrocarbons activities in the frame of the contract execution. However, in accordance with article 46 of the hydrocarbon law, ALNAFT is allowed to conclude prospection service contracts in the frame of the execution of its missions especially in offshore explorations.

Conclusion of hydrocarbon contracts is dependent on a delivery of a prospection authorization issued by ALNAFT for each selected perimeter. Sonatrach's partners are selected through a bidding process or exceptionally by private agreement procedure. The new hydrocarbon law provides that the National Company Sonatrach is simply an economic operator and no longer a regulator.

Contractual forms for the conduct of hydrocarbon exploration and exploitation activities

The new law provides for three types of contracts with foreign partners on top the concession contract dedicated only to Sonatrach. These contractual forms aim to allow a more fair distribution of profits between partners, and provide more flexibility to them, by selecting the most appropriate contractual form, which corresponds to their business activity performed in the Algerian hydrocarbon sector.

These contractual forms are:

- The Participation Contract;

- The Production Sharing Contract;
- The Risk Service Contract.

In this respect, it is important to note that these forms are not unfamiliar to the Algerian legal system, since it has been reintroduced from the former law # 86-14. As such, it is important to highlight that law #05-07 does not clearly provide for a particular contractual form, except the denomination "exploration and exploitation contract", without specifying the legal contractual form commonly used in the international standards of the upstream activities. However, it is more likely to be assimilated to a concession contract.

On the other hand, Sonatrach in its capacity of the National Oil Company is allowed to intervene alone in the upstream activities through a concession contract, the latter is granted by ALNAFT.

The Participation Contract

The Participation Contract, as described in Articles 77 to 82, is a contractual form which defines the rights and obligations of the National Company and its foreign partners, including financing obligations of each of them during the period of research, remuneration and tax obligations.

The facilities generated in the frame of the contract are the property of the Contracting Parties during the exploitation period. However, the financing of upstream operations is carried out in proportion to each partner's participation in the said contract.

The Production Sharing Contract

Production Sharing Contract (PSC) is contractual form (which was introduced initially in the former law #86-14.

In the present law, it has been reintroduced in Articles 83, 84 and 85. In the PSC, the foreign partner bears the financial risk during the exploration phase. However, the National Company has the option to, participate in financing the research operations if it wishes. In case of a successful discovering, a sharing mechanism of hydrocarbon production is set up between the partners. As such, the foreign partner recovers the capital and operational expenditures incurred, namely "cost oil". The remaining production recovered is called "profit oil". From a tax standpoint, foreign partners bear less tax declaration obligations with the local tax administration, since the national

hydrocarbon company will calculate and pay taxes on behalf of them.

Unlike the Participation Contract, hydrocarbon facilities generated in the frame of a PSC execution are the exclusive property of Sonatrach during and after the contract expiration.

Finally, the PSC can be very profitable agreements for the oil companies involved, but often involve considerable risk, since the entire financial risk is borne by the foreign partner.

The Risk Service Contract

This type of contract is defined in Articles 86, 87 and 88 and it is mainly devoted for exploitation activities. Exceptionally, the risk service contract is concluded since the beginning of exploration phase. As the PSC, in this contractual form, the foreign partner funds the upstream operations and receives its remuneration in cash, in counter part of the incurred expenditures according to the contractual provisions (cost oil and profit oil).

From a tax point of view, contacts with local authorities are also reduced, since Sonatrach is responsible for fulfilling the tax obligations of foreign partners.

In general, this contractual form is requested when the National Company wishes to benefit from the experience and expertise of a foreign company to develop hydrocarbon deposits that are difficult to operate, or to improve and enhance the recovery of mature hydrocarbon deposits.

The Upstream Concession

The new hydrocarbon law emphasizes, in its legal section, more precisely in chapter 9, on the possibility that Sonatrach carries out on its own, upstream activities relating to exploration and exploitation of hydrocarbon deposits.

This legal form, called "Upstream Concession", is exclusively limited to the national company. The latter may, as stipulated in Article 75 of this Law, decide to transfer part of its rights and obligations in an Upstream Concession to a foreign partner, and must therefore conclude a hydrocarbon contract with the latter, in accordance with the provisions of the new Law.

Duration of hydrocarbon contracts

Articles 56 and 57 of the new law governing hydrocarbon activities provide

details on the duration of hydrocarbon contracts. Thus, taking into account the research and exploitation phase, which may not exceed 7 years, the average duration of all hydrocarbon contracts is set at 30 years. Nevertheless, contracts for the exploitation of deposits already discovered are set at 25 years. In both cases (with or without a research and exploration phase), this period may be extended for another 10 years.

Tax provisions

The new hydrocarbon Law has redesigned the tax system of oil and gas activities in order to keep it less complicated and more efficient. Indeed, a set of new tax terms, which focus extensively on encouraging the investment in the oil and gas sector and reducing the tax burden by around 20%. This readjustment is reflected in reducing the rates of three main taxes namely royalty on quantities produced, the tax on hydrocarbon revenues (TRP), and the income tax.

In the new hydrocarbon law, there has been a particular allocation of taxes for each type of contract. In this context, we will illustrate the main applicable tax provisions introduced by the new hydrocarbon Law according to each contract.

Surface tax

The calculation of this tax, as mentioned in Article 165 and 166 of this Law, is based on the surface of the contractual perimeter and the indexation of the unit tax amount per square kilometer.

The unit tax amount differs depending on the phase of the project perimeters related to exploration, retention, or exploitation and the duration concluded in each phase. This tax is declared and paid annually during the term of the concession or oil contract from the effective date of the contract.

Contracts subject to the surface tax comprise of upstream concession, production sharing contract, risk service contract, and by the contracting parties in the case of a participation contract on a monthly basis.

However, this tax is not deductible for the calculation of the hydrocarbon revenue and the income tax.

Hydrocarbon royalty

The royalty introduced in the new Law in Articles 167 to 176 is applied on the quantities of hydrocarbon-extracted payable to the public treasury on a monthly basis. The taxable base of the royalty is set on the value of the quantities of hydrocarbon extracted from the exploitation perimeter computed at the measurement point, excluding those quantities consumed for production purposes, the quantities lost and the quantities reinjected into the hydrocarbon deposit.

The Law also permits several deductions related to pipelines transfer costs, liquefaction cost of natural gas, and costs of separation of liquefied petroleum gases. Similar to the surface tax, the royalty is payable within the frame of an upstream concession by Sonatrach, production sharing contract, risk service contract, and by the contracting parties in the case of a participation.

The rate applicable to the value of the quantities extracted and defined above is accounted for 10%. Unlike the surface tax, the hydrocarbon royalty is deductible for the calculation of the tax on hydrocarbon revenue and the income tax.

With regard to the hydrocarbon royalty, the Law sets the minimum rate of 10% that will be systematically applied regardless of the size of the hydrocarbon deposit in question. Bearing in mind that the hydrocarbon royalty was set by Law#05-07 at a rate of between 5% and 20% depending on the importance of production and the geological complexity of the area where the exploited deposits are located and the sophistication of the technologies used.

Tax on hydrocarbon revenue

This tax targets hydrocarbon production revenues generated on the exploitation perimeter covered by an Upstream Concession or a hydrocarbon contract, payable on an annual basis.

The calculation of this tax is based on the value of annual production used to calculate royalties subtracted by authorized annual deductions, including, but not limited to, royalty fees, exploration and development instalments, abandonment provisions, training costs, etc. The rate depends on the project profitability, which is capped between 10% to 50% using a ratio (R). This ratio is equal to the cumulative net income divided by the cumulative expenses:

- If (R) is less than or equal to 1, the applicable rate is 10%.

- If (R) is equal to or greater than 3, the applicable rate is 50%.

- If (R) is greater than 1 and less than 3, the applicable rate is: $20\% * R - 10\%$.

- For Upstream Concessions covering a hydrocarbon field in production, the applicable rate is 50% for the year of entry into force, while the annual investment tranches are calculated by applying an annual rate of 25% for a deductible period of four years.

It is worth mentioning that the tax on hydrocarbons revenues is paid in twelve provisional instalments on a monthly basis.

In accordance with the provisions of Articles 177 to 187, the tax on petroleum revenues (TRP) has been replaced by the tax on hydrocarbon revenues (IRH) where the key difference between the two is the basis of income calculation. As of the new introductions, the investment instalments are no longer computed progressively. The formula for calculating this segment, which is currently based on investment profitability, had been replaced by a formula based on the gain of the invested dollar, which, contrary to the formula under Law# 05-07, does not take into account the time value of money. Furthermore, the applicable rates for this tax had been reduced, and vary between 10% to 50% in comparison with the previous rates (from 20% to 70%).

Income tax

In accordance with Articles 188 to 192 of the new hydrocarbon law, an income tax is introduced.

Although this income tax is similar to the corporate income tax to a great extent under the former law#05-07, it takes into account both provisions of the present hydrocarbon Law and the provisions of the Direct Tax Code alike. In that sense, the taxable income of the financial year is calculated including depreciation rates set forth by the local Law, and the research expenses borne at the end of the research period stipulated in the hydrocarbon Law at a fixed rate of 30% on the taxable base. The income tax is payable to tax authorities within the same deadline of the annual tax return submission. In terms of the

application scope per contract, the income tax is entitled for financial years' incomes performed by the National Company in execution of the upstream concessions, production sharing contracts, risk services contracts, or by the contracting parties in the case of a participation.

Tax on the remuneration of foreign co-contractors

Concerning the taxation of the remuneration of foreign companies, Articles 193 to 197 provide for the introduction of a specific tax.

This mainly concerns the application of income tax on the gross remuneration of foreign contracting partners under a production-sharing contract or under a risk services contract at a fixed rate of 30% of the gross remuneration. Nevertheless, the tax is paid by the National Company in twelve provisional instalments on a monthly basis for the financial year in the name and on behalf of the foreign co-contractor.

The Law also indicates that in the event where the gross remuneration of the foreign co-contractor is determined in kind, the quantities concerned shall be valued by applying the prices defined in accordance with the hydrocarbon contract. Furthermore, the gross remuneration of the foreign co-contractor in the case of a production-sharing contract or a risk services contract is deductible for the calculation of the income tax of the National Company.

The flat-rate royalty on anticipated production

In accordance with articles 198 to 201, this royalty is based on the value of production same as provided in the hydrocarbon royalties (any quantity of hydrocarbon extracted from the

exploitation perimeter) at an taxation rate accounted for 50%.

The royalty is declared and paid monthly by the National Company in the case of an upstream concession, a production sharing contract or a risk service contract and by the contracting parties in the case of a participation contract.

The said royalty on anticipated production will be regularized by the National Company or by the Contracting Parties no later than 1 March of the year following the year concerned.

Other tax-related provisions

Concerning the tax applicable on the transfer of rights and obligations in a hydrocarbon contract, or on the change of control of one of the contracting parties, the applicable rate remains as previously applied accounting for 1% in accordance with Article 205 of the new law.

Moreover, in section 1 of Chapter 30 of the new hydrocarbon Law, it is provided for the upholding of the Flaring Tax, this non-deductible tax, is entitled at an amount of DZD 12,000 per thousand normal cubic meters (Nm³).

This tariff shall be indexed at the beginning of each calendar year by ALNAFT, the quantities subject to this tax are defined in Article 215 of this Law.

Taxes applicable by type of contract

As explained above, the new law provides a singular remedy for the taxation applicable to each type of hydrocarbon contract.

Thus, Production Sharing and Risk Services contracts are subject to the same tax regime, which includes the following taxes:

- Surface Tax;
- Hydrocarbon royalty;
- Tax on Hydrocarbon Income;
- Income tax for Sonatrach;
- Tax on the Remuneration of the Foreign Co-contractor.

As for the Participation Contract, it has a different tax regime compared to the other two contractual forms, it contains the following elements:

- Surface Tax;
- Hydrocarbon royalty;
- Tax on Hydrocarbon Income;
- Income tax for each of the parties.

Transitional provisions

In accordance with Article 230 of the new law, contracts concluded under previous Laws, in particular Laws 86-14 and 05-07, shall remain in force in accordance with their provisions, but it may not be extended or renewed, beyond the initial contractual period

However, the provisions of the new hydrocarbons law relating to health security and environment in addition to the provisions relating to abandonment and restoration of sites are immediately applicable to exploration/operating contracts and parallel contracts or any other type of contract signed under the Law 05-07.

Regardless of the provisions of article 230, a company which is part of a hydrocarbon contract governed by Law 05-07 may request to benefit from the provisions of the new Law, provided that no production has been carried out before February 24th, 2013.

In accordance with Article 231 of this Law, the request must be submitted by the concerned company to ALNAFT for consideration within a period no later than one year from the date of publication of this Law.

We remain at your entire disposal for any further information or query.

Yours truly,

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