



TP Spotlight

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Pricing methodologies for oil / gas condensate / petroleum products: overview, application and the opinion of the tax authorities

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Consulting on Transfer Pricing issues

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Dear readers,

We offer you an overview of the pricing methodologies for exported crude oil, gas condensate and petroleum products, as well as practice for their application in the Republic of Kazakhstan and the opinion of the tax authorities. Disputes on transfer pricing between commodity companies and tax authorities have been going on since entry into force of the Law of the Republic of Kazakhstan «On Transfer Pricing». Separate pricing rules were developed in this regard. In our opinion, such innovations should lead to a decrease in the number of audits on transfer pricing issues in the oil and gas sector.



In September 2021, the Government of the Republic of Kazakhstan («RK») approved the Rules (methodology) for pricing of the following types of goods:

- exported crude oil and gas condensate¹,
- goods produced from oil².

Pricing rules (methodologies) have been developed in accordance with the Transfer Pricing Law of the Republic of Kazakhstan³ («TP Law»).

Below is an overview of methods and background for their development, their features and controversial issues.

Background and general provisions of pricing methodology for exported crude oil and gas condensate



At present, the RK has approved eleven pricing rules (methodologies) which provide a special procedure for determining prices for certain types of goods, including natural gas, steel, cotton fiber, natural uranium concentrate, titanium, etc.

The development of methodology for determining market prices for commodities was initiated in 2016. That was due to tax audits under the TP Law, the results of which often caused disagreements between taxpayers and tax authorities, for example, non-acceptance of documents and sources of information by the tax authorities, as well as different interpretations of concepts. Historically, such disputes have resulted in significant additional tax charges.

According to the official comments of the tax authorities, this methodology was developed to regulate legal relations between taxpayers and state authorities and to establish a pricing procedure for exported oil and gas condensate.

Specific features of pricing methodology for exported crude oil and gas condensate



The main feature of this methodology is that in addition to the Ministry of Energy of Kazakhstan, as the authorized body in charge of hydrocarbon production, representatives of the oil and gas sector, international pricing agencies, consulting companies, as well as major international traders took part in its development.

¹Decree of the Government of RK No. 647 dated 21.09.2021

²Decree of the Government of the RK No. 682 dated 27.09.2021

³Subparagraph 3) paragraph 10 of Article 10 of the Law of the RK «On Transfer Pricing»

The document regulates calculation of prices for crude oil shipped in the following directions:

- CPC-R terminal using the CPC⁴ pipeline,
- through Black Sea ports on FOB terms (except for the CPC terminal),
- using Mediterranean Sea ports along the route of the RK railway station and/or Aktau port – Baku/ Sangachal – Ceyhan,
- using Caspian Sea ports on FOB terms,
- using the ports of the Baltic Sea,
- along the Druzhba main oil pipeline,
- by rail transport.

Pricing formulas for such goods include:

- price from the official source of information on the goods, calculated as the average price from the average quotations for goods on each shipment, taking into account the quotation period,
- differential taken into account depending on the conditions of supply, including the costs in its composition,
- «spread⁵,» that is, one or the average of several consecutive average quotes published in official sources of information,
- price adjustment by API degree in the form of a premium or discount.

Among other things, this method determines the applicable sources of information for each direction, and also regulates the concept of «primary document» as documentary evidence on paper and (or) in electronic form of the fact of transaction or event and the right to perform it.

Similar pricing rules apply to the export of gas condensate.

At the same time, the Rules do not apply to transactions with crude oil produced by subsoil users under production sharing agreements (PSAs). It should be noted that there are separate pricing rules for such transactions⁶.

Controversial points



One of the controversial aspects of the application of this methodology is retrospective application.

Due to the availability in public sources of the draft methodology published in 2017⁷, the provisions of this version of the draft began to be applied by both taxpayers and tax authorities. According to the legislation⁸, a regulatory legal act does not apply to relations that arose before its enactment. Thus, taking into account that the Rules for pricing of crude oil and gas condensate were adopted and approved only in 2021, for transactions made before 2021, the provisions of the TP Law apply. This position is also confirmed by comments from the tax authorities. However, as law enforcement practice shows, determining the spread quotation period based in deliveries made before the adoption of the methodology remains the subject of disputes between taxpayers and tax authorities. The reason for this is that the TP Law does not define the significance of the spread in the pricing for crude oil, which raises questions whether the spread is a differential component or a market price component and, based on this, what should be used to determine the spread quotation period.

Along with the inclusion in the final version of the methodology⁹ of items relating to a separate procedure for determining the price of sales via the Caspian Sea ports, the formula for calculation along the route of the RK railway station and/or Aktau port – Baku/ Sangachal – Ceyhan, changes in the components of the differential, there was exclusion of the procedure for price determination in respect of the People's Republic of China («PRC») and countries of Central Asia.

According to comments by the tax authorities, paragraph 1 of the methodology provides a general formula for calculating the transaction (sale) price applicable to determining the price of crude oil and gas condensate in directions for which there are no separate pricing formulas, including in the direction of the PRC and countries of Central Asia. Among other things, it is reasonable to be guided by the existing law enforcement practice in relation to such transactions.

⁴The Caspian Pipeline Consortium pipeline system is a single pipeline system starting at Tengiz (RK) and passing through Atyrau (RK), Astrakhan, Komsomolsk, and Kropotkin to the Terminal near Novorossiysk (Russia). FOB terms are applicable in this direction (FOB terms stipulate that the seller must deliver the goods to the port and load them on a vessel specified by the buyer; in this case, the seller assumes the costs of the goods delivery on board)

⁵Price difference between different quotations published in official sources of information

⁶Decree No. 653 of the Government of the Republic of Kazakhstan dated 02.11.2016

⁷Draft Rules (methodology) for pricing of crude oil and gas condensate

⁸Art. 37 of Law No. 213-1 of 2498.03. "On normative legal acts"

⁹Revision of the draft Rules (methodology) for pricing of crude oil and gas condensate dated 15.04.2021

Review of the pricing methodology for goods produced from oil



On October 10, 2021, the Decree of the Government of the RK¹⁰ approved the Pricing rules (methodologies) for goods produced from oil.

This methodology establishes pricing rules for petroleum products, including sources of information (under the headings Refinitiv and Argus Caspian Market) on the following types of supplies:

- through the ports of the Azov-Black Sea and Baltic basins,
- at a fixed price.

The Decree also amended the list of exchange goods¹¹, according to which oil and petroleum products supplemented with the following names of goods:

- middle distillates (fuel for jet engines) - TN VED EEA code 271019210,
- heavy distillates (gas oils) - TN VED EEA codes 2710194210 - 2710194250, 2710195109,
- heavy distillates (fuel oil) - TN VED EEA codes 2710196201 - 2710196809, 2710203101 - 2710203909.

This addendum allows applying of the quotation period to petroleum products, established in the TP Law on exchange commodities except for oil - not more than sixty-two calendar days before the date of transfer of ownership to the buyer and not more than sixty-two calendar days after it¹².

Thus, these legal acts were introduced in order to establish the procedure for determining the transaction price of crude oil / gas condensate / petroleum products, including determination of the differential components and the applicable sources of information.

According to the comments of the tax authorities, the adoption of the Rules (methodology) will ensure transparency of the pricing mechanism, increase revenues to the state budget, eliminate disputes arising between exporters and authorized bodies and reduce the number of transfer pricing audits. In this connection, the historical focus on the export of resource goods in the RK will gradually shift to financial transactions, service transactions, imports of consumer and industrial goods and intangible property license transactions.



¹⁰Decree of the Government of the RK № 682 dated 27.09.2021

¹¹Decree No. 638 of the Government of the RK "About approval of the list of exchange-traded commodities" dated 06.05.2009

¹²Paragraph 2 of Article 13 of the Law "On Transfer Pricing"

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