Delineation between resource taxes and rent

Introduction

1. The aim of this GFS interpretation is to provide a guidance on the delineation between government revenue that should be recorded as a tax on resources and government revenue that should be recorded as rent (i.e., within non-tax revenue), with respect to proceeds collected on resource leases on government owned assets (such as subsoil assets).

References in ESA 2010 and 2008 SNA

Natural resources

2. In ESA 2010 Annex 7.1, natural resources (AN.21) are defined *as "Non-produced assets that naturally occur and over which ownership may be enforced and transferred. Environmental assets over which ownership rights have not, or cannot, be enforced, such as open seas or air, are excluded. Consists of land, mineral and energy reserves, non-cultivated biological resources, water resources and other natural resources [*including radio spectra under category AN.2151*]"*.

3. Meanwhile, transferrable permits to use natural resources may give rise to the recording of a separate asset. Permits to use natural resources (AN.222) are described in ESA 2010 Annex 7.1 as *"Licences, permits and leases to use natural resources for a limited time that does not fully use up the economic value of the asset, where the agreement confers economic benefits to the holder in excess of the fees payable and the holder can realise those benefits legally and practically, for example through transferring them.*

   The natural resource continues to be recorded on the balance sheet of the owner and a separate asset, representing the value to the holder of transferring the rights to use the resource, is recognised as a permit to use natural resources. The asset recorded is the value to the holder of transferring the rights to use, i.e., the excess of the transfer price above the amount payable to the permit issuer. Examples include where a tenant of land has a fixed rent but the market rate of the rent is higher. If the tenant is able to realise the price difference through subletting, then the rights to realise the value represents an asset."

4. When following ESA 2010 paragraph 7.26, natural assets are recognised on the balance sheet *"in compliance with the general definition of an economic asset, by whether the assets are subject to effective economic ownership and are capable of bringing economic benefits to their owners, given the existing technology, knowledge, economic opportunities, available resources, and set of relative prices. Natural assets where ownership rights have not been established, such as open seas or air, are excluded."*

5. ESA 2010 paragraph 7.26 could be seen in conflict with 2008 SNA paragraph 13.50, which explains that "*it is frequently the case that the enterprise extracting a resource is different from the owner of the resource. In many countries, for example, oil resources are the property of the state. However, it is the extractor who determines how fast the resource will be depleted and since the resource is not renewable on a human time-scale, it appears as if there has been a change of economic ownership to the extractor even if this is not the legal position. Nor is it necessarily the case that the extractor will have the right to extract until the resource is exhausted. Because there is no wholly satisfactory way in which to show the value of the asset split between the legal owner and the extractor, the whole of the resource is shown on the balance sheet of the legal owner and the payments by the extractor to the owner shown as rent*". Some interpret this paragraph as an explicit deviation, for subsoil assets, from the economic ownership principle of the SNA, by assigning the ownership by convention to the legal owner.

6. However, the risks and rewards on the subsoil asset should be distinguished from the risks and rewards on the lease contract or on the extraction operations, especially given that the lease on resources can actually be recognised as a separate asset in the 2008 SNA – although currently only if its value is realizable (e.g. the lease is transferrable).

Rent

7. In ESA 2010, rent (D.45) is part of property income, is defined in paragraph 4.72: *"rent is the income receivable by the owner of a natural resource for putting the natural resource at the disposal of another institutional unit",* which also states that *"the distinction between rent and rentals is that rent is a form of property income and rentals are payments for services. Rentals are payments made under an operating lease to use a fixed asset belonging to another unit. Rent is a payment made under a resource lease for access to a natural resource."*

8. ESA 2010 paragraph 4.72 also specifies*: "There are two different types of resource rents: rent on land, and rent on subsoil resources. Resource rents on other natural resources such as radio spectra follow the same pattern."*

9. ESA 2010 paragraph 4.74 specifies on rent on subsoil assets states: *"This heading includes the royalties that accrue to owners of deposits of minerals or fossil fuels (coal, oil or natural gas), whether private or government units, who grant leases to other institutional units permitting them to explore or to extract such deposits over a specified period of time."* The treatment of other resource rents follows the same principles according to ESA 2010 paragraph 4.72.

10. 2008 SNA paragraph 7.160 explains that rent or royalties may take the form of fixed amounts to be paid but will more commonly be defined as a proportion of the quantity or volume of the asset extracted: *"The owners of the assets, whether private or government units, may grant leases to other institutional units permitting them to extract such deposits over a specified period of time in return for the payment of rent. These payments are often described as royalties, but they are essentially rent that accrues to owners of the assets in return for putting them at the disposal of other institutional units for specified periods of time and are treated as such in the SNA. The rent may take the form of periodic payments of fixed amounts, irrespective of the rate of extraction or, more commonly, they may be a function of the quantity or volume of the asset extracted. Enterprises engaged in exploration may make payments to the owners of surface land in exchange for the right to make test drillings or investigate by other means the existence and location of subsoil resources. Such payments are also to be treated as rent even though no extraction is taking place."*

11. 2008 SNA paragraph A3.76[1] goes even further and explains that *"Payments by an extractor to the owner of the mineral resources corresponding to a share of the resource rent should be shown as property income even if they are described as taxes and treated as such in a government's own accounts."* This implies that by whatever function the payments to the owner are constructed, the purpose of resource rents is to capture the economic rent the extractor should be paying and to redirect this to the owner of the resource. The payments to the owner of the resource should thus be shown as rent even if they are otherwise described.

12. According to ESA 2010 paragraphs 15.26, 15.27 and table 15.3 on resource leases, payments associated with permits to use a natural resource are to be recorded as rent (D.45) in most cases. Only in the case where there is a foreseen use until extinction, the use is permanent and the user bears all risks and rewards, a disposal of the natural resource non-financial asset (NP.1) is foreseen.

13. ESA 2010 paragraph 15.27 also covers the case when a lease/licence/permit to use a natural resource is finite and transferrable, which may lead, in addition to the rent (D.45) recorded, to the *"creation of an asset for the user, distinct from the resource itself but where the value of the asset and the asset allowing use of it are linked. This asset (category AN.222) is only recognised if its value, the benefits to the holder in excess of the value accruing to the issuer, is realisable through*

[1] Annex 3: Changes from the 1993 System of National Accounts

transferring the asset."[2]

14. ESA 2010 paragraph 7.55 provides the definition: *"Contracts, leases and licences are recorded as assets when the following conditions are met: (a) the terms of the contract, lease or licence specify a price for the use of an asset or provision of a service that differs from the prevailing market price; and (b) one party to the contract can realise the price difference. The contracts, leases and licences can be valued by taking market information from the transfers of the instruments conferring the rights, or estimated as the present value of expected future returns at the balance sheet date compared to the situation when the legal agreement starts."* And ESA 2010 paragraph 7.57 indicates: *"The value of the asset is equal to the net present value of the excess of the prevailing price over that fixed in the agreement. Other things being equal, this will decline as the period of the agreement expires. Changes in the value of the asset due to changes in the prevailing price are recorded as nominal holding gains and losses."*

15. Thus, if a licence to use natural resources is not transferrable, no underlying contract, leases and licences asset (AN.22) is recorded in ESA 2010. When transferrable, at time the transferrable rights are auctioned off, at market value, an AN.22 asset is created that will have zero value at inception (all the proceeds exchanged at inception being instead recorded within the financial accounts, under F.89). The March 2017 guidance note on such licences[3] therefore concludes that, under ESA 2010, any upfront payment on (finite) lease/licence/permits is a prepayment of rent and not a disposal of non-produced assets of the NP.2 type, irrespective of the duration or other characteristics of the lease/licence/permit; instead, in case of a lump-sum payment when the licence is contracted, an other accounts asset (AF.8) appears as an asset of the licensee and a liability of government.

16. As a result, at inception, the value of the underlying resources are unchanged, despite being encumbered by a lease/permit/licence. However, as prices change when time passes, the AN.22 non-produced asset created starts gaining value (fluctuating positively or negatively), just like a swap gains value, later on, arising from changes in market prices. As a result, the value of the underlying resource, which changes as a result of changes in market prices, is subject to a correction (negative or positive, respectively) compared to its unencumbered value – such that the values of the underlying natural resource and of the AN.22 asset are indeed linked.

17. The March 2017 guidance note indicates that this recording is applicable to all kinds of transferrable contracts/leases/permits/licences, irrespective of the underlying resource under contract: a produced asset (leading to an marketable operating lease asset, AN.221), a non-produced asset such as a natural resource (contract, leases and licences asset, AN.222), where there is no underlying asset such as a natural resource not qualifying as an asset (i.e., for a permits to undertake specific activities, AN.223), or contracts of delivery of other goods and services (AN.224).

18. Rent is recorded *"when payable"* (ESA 2010 paragraph 4.75) but is considered to accrue continuously. 2008 SNA paragraph 7.155 explains the concept *"when payable"*: "*The rent recorded for a particular accounting period is equal to the value of the accumulated rent payable over that period of time, as distinct from the amount of rent due to be paid during that period or the rent actually paid."*

19. 2008 SNA paragraph 7.154 also explicitly extends to provisions on land and sub-soil resources to other natural resources as is done in ESA 2010 paragraph 4.72[4]. Additionally, 2008 SNA covers explicitly natural resources in paragraph 7.159 *"deposits of mineral or fossil fuels"*, while paragraph 7.156 *"rent on land"* *"also includes the rent payable to the owners of inland waters and rivers"*.

[2] Underlined is modified, correcting a typo in ESA 2010.

[3] Guidance note on mobile phone licences, exploration rights and other licences, 27 March 2017

[4] Despite being inconsistent with ESA 2010 as regards mobile phone licences.

Requited and unrequited transactions – taxes

20. The nature of taxes in the national accounts is described notably in ESA 2010 paragraph 1.71 on different types of transactions and where 'requited' and 'unrequited' transactions are described, paragraph 1.79 for the role of mutual agreement in the case of taxes, paragraph 4.14 for taxes on production and imports (D.2) and paragraph 4.77 on current taxes on income, wealth, etc. (D.5).

21. ESA 2010 paragraph 1.71 states: *"Transactions involving more than one unit are of two kinds. They can be 'something for something', i.e. requited transactions, or they can be 'something for nothing', i.e. unrequited transactions. Requited transactions are exchanges between institutional units, i.e. provision of goods, services or assets in return for a counterpart, e.g. money. Unrequited transactions are payments in cash or in kind from one institutional unit to another without counterpart. Requited transactions occur in all four transaction groups, while unrequited transactions are mainly distributive transactions, for example, taxes, social assistance benefits or gifts. These unrequited transactions are called transfers."*

22. ESA 2010 paragraphs 4.14 and 4.77, defining taxes on production and imports (D.2) and taxes on income, wealth, etc. (D.5) also stress the nature of taxes as compulsory and unrequited payments to government.

23. This prescribes that most payments[5] to general government, insofar as they are to be considered as non-financial transactions and which are compulsory and unrequited, should be recorded as taxes. This is for example the case where government is not the legal or economic owner of a resource and thus cannot grant exploitation rights for the resource. Furthermore, compulsory and unrequited payments to general government are only recorded as transactions (implying *"mutual agreement"* – see ESA 2010 paragraph 1.79) due to the specific role of taxes in the system of national accounts.

24. Taxes are to be recorded on an accrual basis in the ESA 2010, while ensuring that amounts which will not be actually collected are not recorded as government revenue. This is notably described in ESA 2010 paragraphs 4.26, 4.27, 4.82 and 5.244c. Two alternative methods are foreseen for approximating the accrual of tax revenue: either "*amounts evidenced by assessments or declarations"* or "*cash receipts"* can be used as a basis for compilation. In the former case, the assessments/declaration amounts need to be adjusted by a coefficient for either reducing the tax itself or recording a capital transfer (D.995). In the latter case, a time-adjustment to account for the average delay between the event that gave rise to the tax liability and the payment needs to be used.

Profits on fiscal monopolies

25. Within taxes on products, ESA 2010 foresees a specific case within taxes on imports, excluding VAT and import duties (D.2122) and taxes on products, except VAT and import taxes (D.214): Profits of fiscal monopolies are described within ESA 2010 paragraphs 4.18b and 4.20j. ESA 2010 paragraph 4.20j states: *"profits of fiscal monopolies which are transferred to the state, [..]. Fiscal monopolies are public enterprises which have been granted a legal monopoly over the production or distribution of a particular kind of good or service in order to raise revenue and not in order to further the interests of public economic or social policy. When a public enterprise is granted monopoly powers as a matter of deliberate economic or social policy because of the special nature of the good or service or the technology of production — for example, public utilities, post offices and telecommunications, railways and so on — it is not considered as a fiscal monopoly."*

26. The specific tax category of profits of fiscal monopolies can potentially be applicable where economic rent is captured by a public corporation that has been granted a monopoly status.

27. 2008 SNA paragraph 7.96e on profits of fiscal monopolies references some natural resources among the examples given of goods that are part of a fiscal monopoly: petroleum products and

[5] other than fines or penalties.

salt.

28. ESA 2010 does not specify time of recording rules for D.214j beyond the general rules applicable to taxes on productions and imports (D.2), i.e., when activities, transactions or events that create the tax liability, as qualified by use of time-adjusted cash or assessments and declarations with a coefficient / D.995.

Dividends

29. According to ESA 2010 paragraph 4.53, *“dividends are all distributions of profits by corporations to their shareholders.”* It should be noted that dividends exclude super-dividend excesses (ESA 2010 paragraph 4.55), which are recorded as financial transactions. Dividends are *“not recorded on an accrual basis”*, meaning that they are not recorded when the profits that give rise to them are made (ESA 2010 paragraph 4.57), but when the shares start being quoted on an ex-dividend basis, following a decision by the shareholders of the corporation based on the annual report of the previous year.

Discussion of the issue

Ownership of natural resources

30. The ownership of natural resources may differ between different jurisdictions. Subsoil assets may either be owned by the owners of the land below which they are located or ownership may only be by government. In the European countries, the latter case, ownership by government, is more common. This is also the case for some inland waterways such as lakes and rivers, for which a government ownership is more common.

31. Ownership rights cannot be established over all natural resources. Some examples of natural resources over which ownership right cannot be established are the open sea and air. These are examples specifically mentioned in ESA 2010 paragraph 7.26 and are thus excluded from the asset boundary.

Different recording option to be considered

32. Whenever government can and does establish ownership over the use of natural resources and obtains payments from users due to this, the following transactions could potentially be considered:

    a. Rent. Preconditions for recording as rent are that general government is considered the economic owner of a natural resource.

    b. Tax. As a result of its economic activities (related to the using the natural resource or extracting from it), the user pays a tax. The preconditions for recording a tax are that the payments to government are compulsory and unrequited.

    c. A more specific tax case, where profits of fiscal monopolies are accumulated and transferred to government. This refers to public corporations or quasi-corporations that have a legal monopoly to produce or distribute a particular good to raise revenue (and not to further the interests of public economic or social policy).

    d. Dividend payments to shareholders, of which the government. The precondition for recording dividend income D.42 of the government is that government must be (part) owner of the entities using the non-produced asset.

Is the payment compulsory?

33. Payments to use a natural resource are typically compulsory. The payment being compulsory fulfils one of the two key features of taxes or can be seen as a reflection of the relationship between the owner of the natural resource and the user, as established by a contract or by government owning the user (public corporation). Government may impose payments by the exploiting unit that are not negotiated (e.g. underpinned by a law); for instance, the government may impose an income tax, typically imposed on all corporations equally as implied by the

mention of corporation tax within ESA 2010 paragraph 15.30. On the other hand, government, as the economic owner of natural resource assets, will typically negotiate payments by the user within a contract.

Is the payment unrequited?

34. When a corporation, whether public or private, is allowed to use natural resources over which government exercises its ownership rights, associated payments to government can generally be considered as requited in the meaning of ESA 2010 paragraph 1.71 when the corporation gets back in direct return what it is paying for. However, taxes are unrequited transactions in the national accounts because the taxpayer does not fully or directly get back in return what it is paying for. There are some borderlines cases (betterment levies, checking services associated with permits to undertake a specific activity where the payment is out of proportion to the government service provided) however that are nonetheless considered as taxes. Yet, where an institutional unit can gain clear benefits from using a natural resource owned by government in exchange for payments to government, those payments to government should be considered as requited transactions. This is particularly the case when benefits and payments tend to be proportionate.

35. Since payments for the use of a natural resource to the owner of the natural resource are requited, it follows that these payments cannot be recorded as tax.

36. Profits on fiscal monopolies (D.2122/D.214j) can only be recorded for *"public enterprises"*, i.e., public corporations / quasi-corporations. If the corporation is privatised, the recording of this specific tax cannot continue (and there will be an impact on aggregates such as gross value added B.1g at that time, as remaining options are to record rent D.45 or taxes on the income or profits of corporations D.51b).[6]

37. Payments for natural resources as profits on fiscal monopolies (D.214j/ D.2122) are not included in the examples given in ESA 2010 paragraph 15.30 and table 15.4. In ESA 2010 paragraph 4.20j natural resources are neither mentioned in examples of fiscal monopolies, even though 2008 SNA mentions natural resources in the corresponding paragraph 7.96e. Furthermore, ESA chapter 15 distinguishes between the payments made for a natural resource and those associated with permits to undertake specific activities. The deviation between ESA and SNA could thus be seen as deliberate, whereby it can be assumed that fiscal monopolies in the ESA exclude public enterprises engaged with the exploitation of natural resources. This is in line with the recording practice of the EU and EFTA countries, with none of the reporting countries utilising profits on fiscal monopolies (D.214j) in the case of natural resources.

Rent

38. As payments to government for the use of natural resources owned by government are to be considered as requited, the recording of a tax should be rejected. Payments would only be unrequited if government was not the owner of the natural resource asset.

39. 2008 SNA paragraph 7.160 indicates clearly that royalties (rent) often take the form of payments per quantity or volume of extraction of the natural resource. From this, it can be inferred that other payments per quantity or volume can similarly be assimilated with the recording of rent (D.45).

40. Similarly, this opens the question whether payments based on turnover are correctly considered as a tax on production (D.29) when government is the owner of the natural resource and engaged in a leasing, permit or licensing contract with the taxpayer. Payments based on sales can be considered as an efficient way by the government (as owner of the resource) to extract additional economic rent from the leasing, permit or licensing contract. These payments can be more effective for government to capture the potential benefits from a natural resource by also collecting price fluctuations of natural resources over and above the fixed price established in a

[6] If the privatised corporation continues to exercise (licenced) monopoly powers, quantity and price of the output are not expected to change.

leasing, permit or licensing contract.

41. Treating payments based on turnover as rent (D.45) can be compared to the approach taken for the treatment of interest on broad index-linked bonds in the ESA 2010. The property income on bonds linked to a broad index is interest (D.41) despite the variable nature of the payments, which are themselves based on price fluctuations in the market. The motivation for these variable payments can be to take out some of the risk for the bondholder, thereby lowering the risk premium. Similarly, in the case at hand, government is able to extract economic rent more efficiently by lowering the risk for the licence holder.

42. Even if payments for the use of a natural resource are collected via a broad class of taxes imposed on various institutional units involved in the exploitation, transportation and distribution of extracted natural resources, they could be classified as rent (D.45) if government is the economic owner of the natural resource in question.

43. It seems apparently fairly straightforward to distinguish dividends and withdrawals of income of quasi-corporations from rent. For dividends (D.421) and withdrawals from the income of quasi-corporations (D.422), the board of directors declare dividends applicable and shareholders approve the dividend. It is then paid to all in that class of shareholding according to proportions owned. In contrast, rent (D.45) is paid according to the contractual obligation.

44. However, when leases of natural resources extended to 100% owned public corporation gives rise to large dividend payments compared to the royalties or other surtaxes paid (and to the limit, cases of free leases and no surtaxes), one could judge that the dividend is *de facto* a rent in disguise. This is particularly plausible if the dividend (after super-dividend testing) or the operating profit seems routinely disproportionate compared to the equity invested. In this case, a reclassification of all or part of the nonfinancial flow under rent (D.45) should be envisaged.

Sur-taxes on corporations involved in the exploitation of natural resources

45. Sometimes additional taxes on profits are specifically levied on corporations engaged in the extraction of government-owned natural resources over-and-above taxes on production and taxes on the income or profits of corporations levied on all corporations equally (with similar legislation not distinguishing between the type of activity of corporations on a specific basis). These can be called sur-taxes[7], or sometimes ring-fenced taxes[8], on corporations involved in the exploitation of natural resources. Typically, they are designed so as to be unavoidable; i.e., all corporations involved in the use of natural resources need to pay them and corporations not involved or gaining from the exploitation of natural resources do not need to pay them.

46. Sur-taxes are typically levied in addition to other payments to general government in relation to the natural resource. However, despite their name, sur-taxes are not necessarily to be classified as taxes for the purposes of national accounts. If government is the owner of the resource, surtaxes can be seen as a way to capture the economic rents more effectively from the companies involved in the exploitation of natural resources. When entities have been granted the exclusive right to use a natural resource, recording the sur-tax payments to government as rent needs to be considered.

47. As regards rent and sur-taxes on natural resources, the borderline is not always easy to determine. Nonetheless, we can consider that such sur-taxes are designed to collect economic rent. For natural resources with large fluctuations in the price of the natural resource, it is difficult for government to determine *ex-ante* the efficient amount to be collected, i.e., the economic rent.

48. The possibility of governments to *ex-post* collect additional taxes on profits of corporations are

[7] An example of surtax is when legislation imposes a 60% income tax on extraction companies or activities, while the normal rate is 20%. In this case, assuming 1.2 billion is being actually collected and accrued in a given accounting period, the 1.2 billion will then be partitioned between 0.4 billion in D.5 and 0.8 billion in D.45.

[8] A ring fence arrangement is usually more specific as it typically prevents taxable profits from resource extraction to be reduced by other activities' losses within the income tax due by a legal unit or by a given taxpayer. For instance, a block-by-block tax can be charged on the profits from individual mines, gas or oil fields, which is imposed in addition to other corporation taxes.

distinct from private owners of natural resources who cannot *ex-post* garner revenue not stipulated in a leasing, permit or licensing contract. This *ex-post* ability to collect additional economic rent is an important argument for recording rent (D.45) in the case of sur-taxes on government-owned natural resources. In general, an important criteria to be taken into account is whether economic rents (monopoly profits) would be captured by the company involved in the use of the natural resource in the absence of the sur-tax.

49. Another instance where sur-taxes on the exploitation of natural resources could be recorded as rent is where it appears that a sur-tax is imposed as a convenient administrative alternative to a lease, permit or licensing contract.

Conclusions on the recording in government finance statistics

50. Taxes on natural resources, including when they are levied on the quantity extracted, exploited or produced, should be recorded as rents (D.45), provided that the conditions of requited payments as laid down in ESA 2010 are met. Thus:
    - if general government owns the natural resource, a rent should be recorded, particularly when the payments are proportional to the quantity extracted;
    - if general government does not own the natural resource, a tax needs to be recorded.
51. Payments dependent on the value of production can be regarded as a proxy for quantity and should thus be classified as rent (D.45) if government is the owner of the resource and otherwise as a tax on production (D.29).
52. Sur-taxes on the profits of corporations involved in the extraction of natural resources should also be considered as rent (D.45) rather than as taxes on the income or profits of corporations (D.51b), if government is owner of the natural resource.
53. Any arrangement similar to fiscal monopolies are recorded as rent D.45 rather than taxes D.2122/D.214j, when concerning the exploitation of natural resources.
54. When a lease of natural resources extended to a 100% owned public corporation gives rise to large dividend payments compared to the royalties or other surtaxes and seem disproportionate compared to the equity invested, a reclassification of the non-financial flow under rent should be envisaged.
55. In implementing this guidance, no distinction should be made between different kinds of natural resources.