LINCOLN LEGAL SERVICES (MYANMAR) LIMITED

NEWSLETTER 177 - 24 November 2024

Dear Readers,

Welcome to a new edition of our newsletter.

1. Important tax judgment for the oil and gas industry

The Myanmar Gazette dated 25 October 2024 published a Revenue Appellate Tribunal judgment (English translation) dated 12 September 2024 that strengthens the position of oil and gas companies concerning the deduction of so-called "non-recoverable costs" as business expenses when calculating income tax.

(a) Summary

The taxpaying oil and gas company had claimed a deduction of MMK 451,465,553 (USD 254,825) - costs that it had referred to as "own costs" - as business expenses. The tax authorities had disallowed this deduction and assessed additional income tax in the amount of MMK 99,322,421, arguing that it would be inappropriate to deduct these costs as business expenses because it would have been possible for the taxpayer to recover them from the petroleum produced in the taxpayer's offshore oil and gas fields.

The Revenue Appellate Tribunal to which the taxpayer had appealed sent the matter back to the tax authorities for further investigation, holding that

- the disputed costs were deductible as business expenses if the taxpayer had been prevented from recovering them from the petroleum produced,
- the tax authorities had too easily come to the conclusion that the disputed costs had been recoverable from the petroleum produced and therefore were not deductible as business expenses,
- the tax authorities should have consulted first with the taxpayer's auditors before deciding whether costs were recoverable or non-recoverable,
- it would be desirable if a tax audit were held for relevant years as commercial petroleum production in the taxpayer's fields had ceased and the taxpayer was about to close its business, and

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- it would be beneficial if the Internal Revenue Department issued practice statements, interpretation statements and public rulings for controversial cases such as the one decided.

(b) Background

According to the production sharing contracts accessible to the author, oil and gas is split as follows between Myanma Oil and Gas Enterprise ("**MOGE**") under the State Administration Council ("**SAC**") and the operator of an oil and gas field ("**contractor**"):

From the total production of the oil and gas field that is not used in the petroleum operations themselves ("**available petroleum**"), the contractor deducts (i) the petroleum needed to pay a royalty to the Myanmar government and (ii) the petroleum needed to reimburse the contractor for recoverable costs incurred by the contractor ("**cost petroleum**"). What remains from the available petroleum is referred to as "**profit petroleum**" and split between MOGE and the contractor according to the ratio provided in the production sharing contract.

The royalty is a certain percentage of the available petroleum that the contractor must pay to the government, at the government's option either in cash or in kind.

The costs incurred by the contractor are divided into recoverable and non-recoverable costs. As with the royalty, the contractor may use the available petroleum to pay for the recoverable costs, but not for the non-recoverable costs.

As the contractor gets reimbursed for recoverable costs, he may not deduct them as business expenses when calculating income tax. Conversely, non-recoverable costs are deductible as business expenses.

(c) Differentiating between recoverable and non-recoverable costs

According to the judgment, the production sharing contracts reviewed by the Revenue Appellate Tribunal explicitly provided that interest expenses, a "data study fee", the signature bonus, the production bonus, and expenditures for the research and development fund were non-recoverable costs and therefore deductible as business expenses from the income tax base.

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In contrast, the judgment identifies recoverable costs, which are not deductible as business expenses from the income tax base, as those referred to in sections 2.2 to 2.12 of Annexure "C" to the production sharing contracts reviewed by the Revenue Appellate Tribunal.

The judgment does not reproduce the full text of sections 2.2 to 2.12 of Annexure "C", but according to the production sharing contracts accessible to the author, these sections are lengthy and detailed and cover costs for labour, material, transportation and employee relocation, third party services, damages and losses, insurance premiums and the settlement of claims, legal expenses, charges and fees, offices, camps, warehouses and other facilities, general and administrative expenses (calculated as a percentage of the petroleum costs), and "any other reasonable expenditure" for the "necessary and proper performance of the petroleum operations".

The taxpayer argued that the "own costs" for which it claimed the deduction as business expenses were not directly incurred for joint venture activities with MOGE but for "general company-related matters", that no cost recovery had been made for them from gas sales, that it had separately accounted for recoverable and non-recoverable costs and that this accounting had been audited by a CPA, and that MOGE had approved the recoverable costs and the profit split.

The tax authorities argued that it would be inappropriate to allow the deduction of the "own costs" as business expenses as they did not consist in interest expenses, a data study fee, the signature bonus or the production bonus, but rather were "similar" to the recoverable costs in sections 2.2 to 2.12 of Annexure "C", and admitted that they had not checked whether the taxpayer had recovered them from gas sales.

(d) Decision of the Revenue Appellate Tribunal

The Revenue Appellate Tribunal sent the matter back to the tax authorities for further investigation, saying, in essence, that the tax authorities should distinguish between recoverable and non-recoverable costs only after coordinating with and obtaining confirmation from the taxpayer's auditor, but that they also had discretion to reasonably interpret the expression "inappropriate expenditure" whose deduction as business expenses is disallowed according to section 11 (b) (3) Income Tax Law.

Pending any practice statements, interpretation statements or public rulings, we think that this means that ultimately, for costs incurred by oil and gas companies to be deductible as business expenses, the tax authorities must be satisfied that the costs (ii) were not

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recovered from petroleum produced, as confirmed by the taxpayer's auditor, and (ii) are not explicitly referred to as "recoverable" in the production sharing contract.

2. Amendments to the standard contract between overseas employment agencies and migrant workers

Independent media reported in mid-November that on 14 May 2024, the Ministry of Labour amended the standard contract that overseas employment agencies must conclude with Myanmar workers who the agencies send abroad.

(a) Overseas employment agencies responsible for ensuring workers' remittances

The standard contract already previously contained language to the effect that the agency had to "educate the worker to help him understand the ways to legally remit to his home country the basic wage or salary that he will receive from the relevant country", and that the worker had to remit to family members at least 25% of his wage or salary either monthly or every 3 months through the official banking system, the holders of a remittance business license (RBL), or international money remittance services connected to the banking system.

In the amended contract, a clause has been added according to which the "agency shall be responsible for ensuring that the workers who it sent remit money back to their families legally".

We understand that the Ministry of Labour under the SAC has taken action against at least 146 overseas employment agencies (suspending dispatches, prohibition to post new job advertisements, imposition of fines) for failure to cause the workers dispatched by them to make the remittances.

(b) Overseas employment agencies to assist in the enforcement of compulsory military service

Furthermore, the amended standard contract now contains a clause obliging foreign employment agencies to assist in the enforcement of compulsory military service: "If a worker sent abroad and working there is called up for military service according to the National Service Law, the overseas employment agency shall notify the relevant employer and worker and provide necessary assistance to enable the worker to return to his home country on time to perform military service when his contract expires."

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3. Formation of initial gold screening teams and a license review committee

On 25 October 2024, the Ministry of Natural Resources and Environmental Conservation ("**MONREC**") under the SAC declared gold trading an essential service and issued Notification 55/2024 which tightly regulates gold trading. Among others, gold shop owners must apply for MONREC licenses and trade only at prices determined by the "Mineral (Gold) Reference Price Determination Committee" (see previous newsletter).

On the same day, MONREC formed initial screening teams in each Region and State and the Union Territory to which gold shop owners must submit their license applications, as well as daily and monthly transaction records and a balance sheet within 5 days from the end of each month.

MONREC furthermore formed a license review committee which is in particular tasked with reviewing license applications passed on by the initial screening teams and, if it deems it necessary, requesting the Ministry of Home Affairs to check whether an individual or a director or shareholder of a company has a criminal record, requesting the Inland Revenue Department to check whether the deposit of 25% of the "business volume" that applicants have to make with a bank is from taxed sources, and requesting the Anti-Money Laundering Central Board to check whether the deposit is from legal sources.

The notifications can be found in Burmese on MLIS.

We understand that initial screening teams have been accepting license applications since 18 November 2024.

4. Luxury appartment for rent

We are posting this for a friend:

160 sqm with 2 ensuite bedrooms. Large kitchen and dining area, plus living. Open plan. Wooden floors. All mod cons. (Voltage stabiliser, water filtration, A/C). Well furnished with quality items. Upper level, 10th. floor with lift. Price to be negotiated. Contact Peter: sanlan.peter@gmail.com

(Photos on the next page.)

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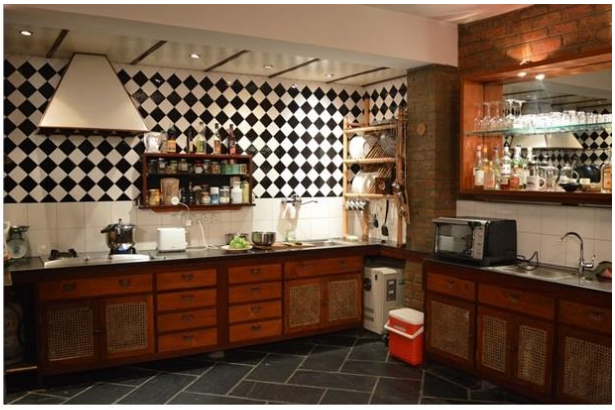

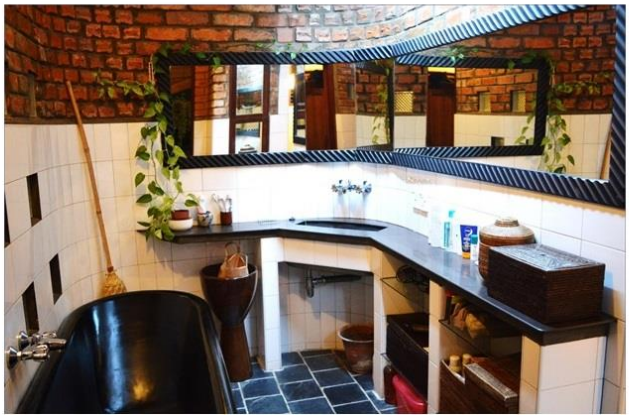

We hope that you have found this information useful.

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About Lincoln Legal Services (Myanmar) Limited

Lincoln Legal Services (Myanmar) Limited provides the full range of legal and tax advisory and compliance work required by investors. We pride ourselves in offering result-oriented work, high dependability and a fast response time at very competitive prices. Please do not hesitate to contact us:

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