ROYAL MALAYSIAN CUSTOMS

GOODS AND SERVICES TAX

GUIDE
ON
UPSTREAM PETROLEUM

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INTRODUCTION

1. This industry guide is prepared to assist businesses in understanding matters with regards to Goods and Services Tax treatment on petroleum upstream industry. You are advised to read this Guide together with the GST Act 20XX, GST subsidiary legislations, General Guide on GST and other GST guides mentioned throughout this Guide.

Overview of Goods and Services Tax (GST)

2. Goods and Services Tax (GST) is a multi-stage tax on domestic consumption. GST is charged on all taxable supplies of goods and services in Malaysia except those specifically exempted. GST is also charged on importation of goods and services into Malaysia.

3. Payment of tax is made in stages by the intermediaries in the production and distribution process. Although the tax would be paid throughout the production and distribution chain, only the value added at each stage is taxed, thus avoiding double taxation.

4. In Malaysia, a person who is registered under the Goods and Services Tax Act 20XX is known as a “registered person”. A registered person is required to charge GST (output tax) on his taxable supply of goods and services made to his customers. He is allowed to claim back any GST incurred on his purchases (input tax) which are inputs to his business. Therefore, the tax itself is not a cost to the intermediaries and does not appear as an expense item in their financial statements.

GENERAL OPERATIONS OF UPSTREAM PETROLEUM INDUSTRY

Upstream Activities

5. Upstream activities include exploration, exploitation, development and production of crude oil and gas. These activities are undertaken and managed through Production Sharing Contracts (PSC) between PETRONAS and a number of

international oil and gas companies as well as with its subsidiary, Petronas Carigali Sdn. Bhd. by way of joint venture (JV).

Production Sharing Contract (PSC)

6. Any company which intends to carry out upstream activities must enter into a Production Sharing Contract (PSC) with PETRONAS. Broadly, the PSC sets out the rights and obligations of PETRONAS and the contractors. PSC will spell out the terms, conditions, responsibilities and participating interest of the PSC contractors. Each contract obligates the PSC contractors to provide all the financing and bear all the risk of exploration, development and production activities in exchange for a share of the total production.

7. PSC requires the contractors to enter into a Joint Operating Agreement (JOA) in instances whereby there is more than one contractor to a PSC. The JOA provides for the rights, obligations and liabilities of each contractor in the PSC. The contractors will normally appoint an Operator (with PETRONAS consent) to carry out the provisions of the PSC. The operator may be one of the contractors or a newly incorporated entity, a Joint Operating Company (JOC). The top management of this JOC will comprise of employees seconded from the contractors party to the PSC. The operator or JOC will not only responsible for all activities carried out in the PSC but also for the maintenance of the PSC accounts.

8. The characteristics of a PSC are as follows:-

(a) One of the contractors would become the operator or the contractors would appoint a JOC;

(b) Cost incurred by the operator or JOC would be shared among the contractors based on their participating interests;

(c) Each contractor accounts for his share of the costs in his own financial statements based on the proportion of their respective participating interests;

(d) Assets are vested in PETRONAS and any proceeds from sales of such assets belong to PETRONAS; and

(e) The contractors share common stock items and common facilities. Crude oil and gas produced would be lifted by the venture operator or JOC based on each contractor's entitlement.

GST TREATMENT FOR UPSTREAM PETROLEUM INDUSTRY

GST on Input

9. Similar with other industries, petroleum upstream industry would also be acquiring goods and services in the course and furtherance of their business. This acquisition of materials, equipment and services is considered as *input* to the industry. Any GST incurred in purchasing the input is claimable as input tax credit and can be offset against GST charged on the supply of product.

GST on Output

10. *Output* on the other hand refers to the supply of products produced in the petroleum upstream activities namely crude oil, condensate and gas. As a general rule, all types of taxable supply pertaining to upstream activities are subject to GST at *standard rate* if they are supplied locally (including to offshore) except for exportation of crude oil, condensate and gas which is subject to GST at *zero rate*.

11. Self consumption for purpose of business is not regarded as a supply. As such, gas or fuel consumed during business operations is not considered as a taxable supply.

Joint Venture (JV)

12. A joint venture (JV) is a contractual agreement where two or more parties pool resources such as fund, property, knowledge, skills, experience, time or others to undertake an economic activity under their joint control, and to obtain individual benefits in the form of a share of the product rather than joint or collective profits, in accordance to their participating interests in the venture. The JV is formed through arrangements which do not result in a separate legal entity. Therefore, the JV agreement does not result in a separate legal entity.

13. To manage the JV, the contractors will appoint;

(a) one of the contractors or

(b) a third party known as a joint operating company (JOC)

as the operator to make acquisitions on behalf of the JV. Supplies of the JV will be made by each contractor based on his participating interest of the JV.

14. The concept of JV described above are the characteristics of a PSC arrangement and as such, it is considered as a Joint Venture for GST purposes and the respective PSC contractor is known as a venturer under the GST joint venture, whilst the operator of the joint venture is known as a venture operator.

15. Since PETRONAS is a party to a PSC agreement, it is considered to be one of the venturers to the joint venture for GST purposes. Thus, PETRONAS has to account any supply arising from its share of the JV.

16. The treatment for the GST joint venture is as follows;

(a) all venturers in a PSC and a JOC, if any, must be registered under GST. The JV must be registered under the name of the venture operator which is either ;

  (i) one of the venturers who is appointed as the venture operator, or

  (ii) a JOC who is appointed to manage the JV

(b) the venture operator shall maintain a separate account for the joint venture;

(c) any taxable supply of goods or services for the purposes of carrying on a business of the joint venture between a venturer and the venture operator shall be *disregarded*;

(d) in circumstances where —

  (i) each venturer acquires any taxable supply of goods or services for the joint venture, the venturer shall claim the deduction of input tax on acquisitions made by him in respect of the joint venture;

(ii) the venture operator acquires any taxable supply of goods or services for the joint venture, the venture operator shall claim the deduction of input tax on acquisitions made by him in respect of the joint venture;

(e) each venturer shall account and pay for the tax on the supplies made by him in respect of the joint venture.

17. The GST treatment on the transactions relating to JV operations [as in **Appendix 1]** are as follows:

(a) *Awarding of contract (PSC)*

The awarding of the PSC blocks by PETRONAS to the contractors (venturers) is not regarded as a supply under GST even though PETRONAS has a share in the output of the PSC.

(b) *Cash Call*

This term refers to fund for capital or operational expenditure that each venturer pays up his share of the costs to the venture operator according to his participating interest in the JV. This cash call is not a supply.

(c) *Joint Interest Billing (JIB)*

JIB is a monthly statement of expenditures issued by a venture operator or a JOC to the venturers to justify for the expenses incurred in the JV operation. Thus, it is not a supply.

(d) *Royalty*

10% royalty amount taken by PETRONAS in the form of oil barrels to settle any cash payments to the State and Federal Government. This royalty is not considered as a supply under GST.

(e) *Handing over of assets to PETRONAS*

The handing over of the assets back to PETRONAS at the end of a joint venture is not a supply under GST.

(f) *Farming-out / Farming-in*

Farming-out / Farming-in transaction under PSC joint venture incurs when there is a transfer of participating interest in a PSC between existing venturers or to a new venturer. If there is a consideration involved, it is considered as a taxable supply and subject to GST at standard rate. If there is no consideration involved, then the farming-out / farming-in transaction is not regarded as a supply.

(g) *Relinquishment of PSC participating interest*

Relinquishment of PSC participating interest by a JV venturer to PETRONAS is not considered as a supply because it is made without a consideration.

Supply Base

18. Currently, there are two supply bases in Malaysia, namely Kemaman Supply Base and Asian Supply Base.

(a) Kemaman Supply Base

Pangkalan Bekalan Kemaman Sdn. Bhd. which is known as Kemaman Supply Base (KSB), is licensed under Section 65 / 65A of the Customs Act 1967 and is eligible to enjoy facilities under the Warehousing Scheme (WS). Thus, GST treatment for supply of goods and services to or from KSB is as follows ;

- GST on importation of goods into KSB is *suspended*.
- GST on supply of imported goods between KSB and other warehouses under a warehousing scheme outside KSB is to be *suspended.*
- Supply of local goods into KSB is subject to GST at *standard rate* and the supply of such goods (being value-added or not) between KSB and other warehouses under a warehousing scheme outside KSB is subject to GST at *standard rate.*
- Supply of imported goods within KSB is to be *disregarded*.

- Importation of services into KSB is subject to GST at *standard rate* under a reverse charged mechanism.
- Supply of local services into KSB is subject to GST at *standard rate.*
- Supply of services between KSB and other warehouses under a warehousing scheme outside KSB is subject to GST at *standard rate.*
- Supply of services within KSB is subject to GST at *standard rate.*
- Supply of goods and services from KSB to the principal customs area (PCA) is subject to GST at *standard rate*.
- Exportation of goods and services from KSB is subject to GST at *zero rate*.
- Goods and services used for own consumption in KSB are subject to GST at *standard rate*.

(b) *Asian Supply Base*

Asian Supply Base Sdn. Bhd. (ASB) is located in the free port of Wilayah Persekutuan Labuan and thus, the GST treatment on designated area will apply to ASB. GST treatment for supply of goods and services to or from Asian Supply Base is as follows;

- Supply of goods and services (except for goods and services prescribed by the Minister of Finance as subject to tax) within ASB is *not subject to GST*.
- Supply of goods (except for goods prescribed by the Minister of Finance as subject to tax) from principal customs area to ASB is subject to GST at *zero rate*.
- Supply of services from principal customs area to ASB is subject to GST at *standard rate*.
- Supply of goods and services from ASB to principal customs area is subject to GST at *standard rate*.
- Supply of goods and services (except for goods and services prescribed by the Minister of Finance as subject to tax) from ASB to another designated area is *not subject to GST*.

- Importation of goods and services (except for goods and services prescribed by the Minister of Finance as subject to tax) into ASB is *not subject to GST*.
- Exportation of goods and services from ASB is subject to GST at *zero rate*.

Malaysia-Thailand Joint Development Area (JDA)

19. Malaysia-Thailand Joint Development Area (JDA) is an overlapping economic zone located offshore between Malaysia and Thailand in the Gulf of Thailand. JDA was established to resolve the overlapping claims between Malaysia and Thailand over the hydrocarbon resources in the area.

20. GST treatment for activities related to JDA are as follows :

- Importation of materials and equipments listed under the "JDA Master Exemption List (MEL)" into the JDA is given *relief from GST.*
- Importation of materials and equipments which are not listed under the 'JDA MEL' into the JDA is given 50% *relief from GST.*
- Importation of services into the JDA with respect to the petroleum upstream operations is given 50% *relief from GST.*
- Supply of goods produced in the JDA to Malaysia is given 50% *relief from GST.*
- Exportation of goods produced in the JDA to the Kingdom of Thailand or a third country is subject to GST at *zero rate*.
- Supply of goods and services to the JDA is given 50% *relief from GST.*
- Any person in the JDA is given *relief from payment of GST* for supply of goods and services made within the JDA.
- Movement of returned goods or goods sent out for repair/ coating/ rewinding/ other related services from the JDA to Kemaman or Songkla Supply Base or other licensed warehouse in Malaysia or Thailand is *not a supply.*
- Movement of such goods (being goods sent out for repair/ coating/ rewinding/ other related services from the JDA) from Kemaman or

Songkla Supply Base or other licensed warehouse in Malaysia or Thailand back to the JDA is *not a supply.*

Unitization Area

21. GST treatment for unitization areas are as follows :

(a) *Fairley Baram Field*

(i) Fairley Baram (FB) field is a unitization area which is located at the border of Malaysia and Brunei.

(ii) The entire FB crude oil is imported by pipelines from platform FBPP1 (Brunei), via platform BAP-AA in Malaysian waters, into Miri Crude Oil Terminal (MCOT) in Malaysia. The GST on the imported FB crude oil is suspended if MCOT qualifies for the GST warehousing scheme. If MCOT does not qualify for the GST warehousing scheme, the imported FB crude oil is subject to GST at standard rate.

(iii) The FB crude co-mingles with other Miri Crude before it is sent for export. The exportation of the crude is subject to GST at zero rate.

(b) *Asam Paya Field*

(i) Asam Paya is an onshore field which straddles the Malaysia and Brunei border. The unitization agreement is between PETRONAS and Brunei Shell Petroleum (BSP).

(ii) The crude oil and gas extracted from Asam Paya Field are delivered to the Rasau Station (Brunei) and then delivered to Seria Crude Oil Terminal (SCOT), Brunei, via pipeline.

(iii) PETRONAS has to account in the GST return the export value of the Malaysian portion of the Asam Paya crude oil and gas sold to BSP.

(c) *Kinabalu Field*

(i) Kinabalu field is located between Malaysia and Brunei international border. The field is divided into three main areas, namely Main, East and Deep.

(ii) The unitization area is the S1/S2 oil reservoir in Kinabalu Deep (operated by Talisman Malaysia Ltd.) which straddles into Brunei water, with drilling wells located on both sides of the international border. The crude oil and gas extracted from both wells are delivered by pipelines to Labuan Crude Oil Terminal (LCOT) and Labuan Gas Terminal (LGST) respectively where the titles of the Brunei portion of the crude oil and gas are transferred to PETRONAS.

(iii) The crude oil and gas are transferred from the well in Malaysian waters (principal customs area) and the well in Brunei waters to LCOT and LGST respectively in Labuan. The importation of such crude oil and gas into Labuan must be declared in Customs Form No.1. since Labuan is a designated area,

- the importation of crude oil and gas from the well in Malaysian waters (principal customs area) into Labuan is subject to GST at zero rate, and
- the importation of crude oil and gas from the well in Brunei waters (overseas) into Labuan is not subject to GST.

(iv) However, if the crude oil and gas are goods prescribed by the Minister of Finance as subject to GST in Labuan, then their importation into Labuan is subject to GST.

FREQUENTLY ASKED QUESTIONS

Q1: My company has signed a PSC agreement to operate a block in the peninsular of Malaysia. We are still on exploration phase but can we register under GST in order to claim input tax credit on purchases of materials and equipment that we have bought for exploration and drilling purposes?

A1: Since your company has a written contract to carry on petroleum upstream activities and intend to make a taxable supply, you may apply for voluntary registration under the GST to qualify you to claim input tax credit on such purchases. Please refer to *GST Guide on Registration* for detailed explanation on voluntary registration.

Q2: Under the Production Sharing Contract (PSC), cost incurred by PSC contractors for the petroleum operation will be reimbursed and charged into the PSC joint account. Will such charges e.g. secondment of staff be disregarded for GST purposes?

A2: Yes, such charges shall be disregarded if they are incurred for the purpose of carrying on the business of the joint venture.

Q3: Will PSC contractors be able to claim Input Tax Credit (ITC) on their allocated share of expenditures based on the Joint Interest Billing (JIB) statement issued by the operator or JOC, i.e. treat JIB statement as a valid tax invoice?

A3: No because JIB is just a statement of expenditures. The venture operator or JOC will bear the GST incurred on their purchases but later will be able to claim the ITC from the Customs. Each venturer (PSC contractor) however, need to account for the output tax on supplies made from his share of the joint venture.

Q4: Can "borrow and return" activities undertaken within the same PSC arrangement be excluded from GST i.e. treat as an "out of scope"? This "borrow and return" activities are carried out to ensure continuous running of operations and minimise business disruptions.

A4: If "borrow and return" activity involves borrowing and returning of equipment, it is not considered as a supply of goods because the same equipment borrowed will be returned to the owner and it does not involve any consideration. Thus, such activity will be disregarded.

However, if "borrow and return" activity involves swapping or loan of raw materials, it is considered as a supply of goods and subject to GST at because the raw materials have been used and the replacement will not be the *same* raw materials (although of a similar or same kind of raw materials) that were being swapped. Thus, this type of activity is subject to GST at standard rate and GST is calculated based on the book (cost) value of the goods being borrowed.

Q5: What is GST treatment for assets or consumables written off and sold as scraps?

A5: Assets or consumables which are written off are subject to GST at scrap value if they are sold as scraps. If they are destroyed in a manner approved by the GST office, they are not subject to GST.

However, assets or consumables which are relinquished to PETRONAS upon termination / expiration of a PSC term are not subject to GST.

Q6: What is GST treatment on rental of rig from a non resident lessor?

A6: Importation of rig on a leasing arrangement is subject to GST at the point of importation. However, the rental charges payable for the rig during the duration of the lease are not subject to GST.

If the local recipient continues to lease the rig after the expiry of the lease, the rental charges payable are subject to GST at standard rate. He should then account for the GST using the reverse charged mechanism.

Q7: My company provides repair and maintenance services for Floating Storage and Offloading (FSO) or Floating Production Storage and Offloading (FPSO) in the high seas. Do such services attract any GST?

A7: Yes. Repair and maintenance services for FSO and FPSO are subject to GST at standard rate.

Q8: Is Floating Storage and Offloading (FSO) or Floating Production Storage and Offloading (FPSO) be regarded as part of petroleum upstream activity or shipping activities, and what is GST treatment on services provided by FSO and FPSO?

A8: Both FSO and FPSO are regarded as part of petroleum upstream activity because they provide storage and offloading facilities for exporting crude oil and condensate overseas via offshore. However, services provided by FSO and FPSO are subject to GST at standard rate.

Q9: What is GST treatment on contributions / payments made to PETRONAS as requested in the PSC such as research cess payment and abandonment cess payment?

A9: Contributions / payments made to PETRONAS such as research cess payment and abandonment cess payment are not subject to GST.

Q10: My company operates a block (oil field) in the east coast of Peninsular Malaysia. Some of the expenditures incurred include lease of barges and tuck boats provided by a transport company. Are those charges subject to GST and claimable as an input tax?

A10: Yes. Lease charges are subject to GST at standard rate. However, they are claimable as an input tax credit (ITC).

Q11: **What is the GST treatment on gas or fuel consumed during operations?**

A11: The consumption of gas or fuel during operation for purpose of business is not regarded as a supply and not subject to GST.

Q12: What is the GST treatment on renting of fishing tool which is used to collect fallen objects during drilling?

A12: Renting of fishing tool is subject to GST at standard rate.

Q13: My company provides installation, coating and fabrication works for petroleum upstream operators. Are those services subject to GST?

A13: Yes. Those services are subject to GST at standard rate. You need to charge GST on the services you provide and your clients (if GST registered person) can claim input tax credit on the GST they have paid in getting the services.

Q14: During a delivery of crude oil from a depot in Malacca to a refinery in Port Dickson, a substantial loss has been detected in the shipment. What is GST treatment on loss during delivery?

A14: Loss of crude oil during delivery is subject to GST. However, if the loss during delivery is due to theft or spillage which is supported by the relevant documents such as audited theft or spillage verification report, it is not subject to GST provided that a police report or an insurance claim report is made.

Q15: What is the treatment of GST on government grant given for funding approved Research & Development (R & D) which are directly related to the development and well being of the petroleum industry?

A15: All government grants are not subject to GST if there is no supply for the grants made.

Q16. Seismic study involves collecting data for identifying prospective wells in the high seas. Does the service performed trigger any GST?

A16: Yes. Seismic study is subject to GST at standard rate.

Q17: Company X would like to sell some of his assets to generate some fund for his drilling activities. What is GST treatment on the sale of assets?

A17: Sale of assets is subject to GST at standard rate.

Q18. Does abandonment of a PSC block (whereby all assets including the platform belong to PETRONAS and will be relinquished to PETRONAS) subject to GST?

A18: Relinquishment of assets to PETRONAS upon expiration of a PSC is not regarded as a supply for GST purposes. If assets under a PSC are written off during the life of a PSC and have no salvage value, then the write-off would not be subject to GST. If there is any scrap value received, then GST is chargeable on such value.

Q19: What is the GST treatment on leakage, oil spill and shrinkage?

A19: Leakage, oil spill and shrinkage are not a supply and as such, are not subject to GST. However, the leakage, oil spill and shrinkage should be supported by the audited leakage, oil spill and shrinkage verification report.

Q20: Can my company claim special sales tax refund on any capital goods like drilling equipment and machineries that we have acquired before the implementation of GST?

A20: No. Your company can not claim special sales tax refund on capital goods. Special sales tax refund is also not allowable on non trading stocks like raw materials, semi-processed goods, materials which are used indirectly in the manufacturing process (fuel, lubricating oil, detergents and chemicals) and consumables (stationeries).

Q21. Company Y, a GST registered person, has paid sales tax on his trading stock held on hand on the implementation date of GST. Can Company Y claim for special sales tax refund?

A21: Yes. Since Company Y is a GST registered person and he has held the sales tax paid goods on GST implementation date, he is eligible to claim the special sales tax refund on condition that he has all the supporting documents such as invoice and customs declaration form available for claim.

However, after obtaining the special refund, if Company Y later returned the goods to the supplier, he must pay back the amount of that special refund to the Customs by accounting it as his output tax in his GST return.

Q22: What is GST treatment on non-reviewable contract that was signed before the implementation of GST?

A22: For non-reviewable contract signed not less than 2 years before the GST implementation date, the supplies made on or after that date is subject to GST at zero rate for a period of 5 years after the GST implementation date provided that the

(a) supplier and the recipient are GST registered persons;

(b) supply is a taxable supply; and

(c) recipient of the supply is making wholly taxable supply.

However, for non-reviewable contract signed within 2 years before the GST implementation date, the supplies made on or after that date are subject to GST at standard rate.

FEEDBACK OR COMMENT

22. Any feedbacks or comments will be greatly appreciated. Please email your feedbacks or comments to either Mohd Hisham B. Mohd Nor (*m_hisham.nor@customs.gov.my*) or Aminul Izmeer B. Mohd Sohaimi (*izmeer.msohaimi@customs.gov.my*).

FURTHER ASSISTANCE AND INFORMATION

23. Further information can be obtained from :

(a) GST Website : www.gst.customs.gov.my

(b) GST Tel : 03-88822111

(c) Customs Call Centre :

- Tel : 03-78067200 / 1-300-88-8500
- Fax : 03-78067599
- E-mail : ccc@customs.gov.my

APPENDIX 1

FLOW CHART OF TRANSACTIONS IN JOINT VENTURE (JV)