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Brazil Aims to Lift Oil Levies

Increases Expected In Taxes, Royalties Following Big Finds

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RIO DE JANEIRO -- Following news of another offshore oil find, Brazil's government is likely to join other countries that have used high oil prices as an opportunity to raise the revenues they get from the oil industry.

Currently, Brazil charges a lower tax and royalty rate than many other oil producers -- a legacy from the 1990s when the country was a net oil importer and wanted to attract companies to explore and find new deposits. But Brazil is now a net oil exporter, and it appears to have made two major discoveries in recent years that could turn the country into a major oil exporter.

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- **What's New:** Brazil may tighten rules for its fast-growing oil sector to boost revenue.
- **The Background:** Brazil is emerging as a potentially major oil power, increasing the risks of resource nationalism.
- **The Danger:** Private companies hope Brazil doesn't go too far in cutting them out.

The first discovery, a field called Tupi, is believed to have between five billion and eight billion barrels of reserves. This week, a Brazilian oil official said that a second recent discovery could hold as much as 33 billion barrels of reserves. State oil firm **Petróleo Brasileiro SA** played down the official's estimate and said it was too early to tell, but experts agree the second discovery appears large.

As in other countries, the oil bonanza is likely to become a political issue over how much the government should take for spending and how much it should leave to the private sector. That is an even bigger issue when oil prices are so high. Venezuela just this week announced a new "windfall" tax when oil prices are above \$70 and \$100 dollars a barrel.


The Brazilian government of President Luiz Inácio Lula da Silva is studying how to change the rules for the oil sector, Mines and Energy Minister Edison Lobao said recently. Other officials say there is a consensus that the government needs to raise its take from the industry, but what is unresolved is how.

The change will affect Petrobras, as the state company is called, as well as international companies operating offshore, such as Norway's **StatoilHydro ASA**, **Exxon Mobil Corp.**, BG Group PLC and Portugal's **Galp Energia SA**.

Private companies say the Brazilian government has the right to raise its take after recent discoveries, but they hope it doesn't go too far. Brazil is one of the few promising frontiers in global oil exploration. Both recent discoveries lie in an area known as the "pre-salt area" -- in very deep water and below some 5,000 meters, or 16,500 feet, of sand, rock and salt -- that is difficult and costly to reach.

"I think the government is entitled to increase its take after the Tupi discovery," said Jorge Camargo, president of the Brazilian unit of Norway's StatoilHydro. Mr. Camargo is also chairman of the steering

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committee of the Brazilian Petroleum Institute, or IBP, Brazil's main oil-industry group.

But Mr. Camargo, who made his comments before news of the latest discovery, suggested the rule changes shouldn't go too far or apply to existing contracts. "We hope that the new rules will be created respecting previous contracts. The current system has served both Petrobras and foreign firms well," he said.

Companies that produce oil or natural gas in Brazil pay 10% in fixed royalties. They also pay a special tax for large fields, between 10% and 40% of revenues depending on volume, location, depth and age of the field. Sales taxes are also levied by Brazilian states, but they are relatively minor.

Brazil's oil-regulatory agency is working out a proposal for changes that it plans to present to the government's National Energy Policy Council by the end of June. It may propose to increase the special participation tax to a range of about 40% to 60%.

Petrobras, which currently produces more than 95% of Brazil's oil, would be the hardest hit. Should special participation taxes rise to 50% to 60% of revenue, the company may have to pay an additional \$4.1 billion, more than doubling what it pays in special participation now, Nomura Equity Research analyst Xavier Miele Grunauer said in a recent report.

As private companies are set to increase their oil output in Brazil to several hundred thousand barrels a day in coming years, they would also increasingly be hit. BG Group has a 25% stake in Tupi, with Galp Energia holding 10% and Petrobras the rest. The companies expect to start producing an initial 100,000 barrels a day at Tupi in 2011, but production could peak at one million barrels a day, Petrobras has said. Several other foreign companies have recently made optimistic production forecasts for Brazil. StatoilHydro in 2010 expects to produce 100,000 barrels a day at Peregrino in the Campos Basin. Camargo calls Peregrino a "gigantic field," which means it may be subject to the payment of special participation taxes.

Brazil in 1997 ended Petrobras' monopoly on oil exploration and opened the sector to foreign competition. Petrobras has since flourished, and more than doubled its oil output to 2.35 million barrels of oil equivalent a day.

Annual auctions for oil and gas exploration and production blocks in recent years have earned the government billions of dollars. And the industry is excited to bid for more exploration blocks. But it remains to be answered whether Brazilian concessions will remain attractive after a hike in production taxes.

As special participation taxes only have to be paid on very large fields, doubling that tax at 2007 levels would have increased Brazil's government take "from a reported 57% to 62%, closer to its peers in Russia and Kazakhstan, which according to our calculations surrender over 70% of their pre-tax earnings," Mr. Grunauer said.

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