

# WAYS FOR IMPROVING THE SPECIFIC TAXATION SYSTEM APPLIED TO THE OIL AND NATURAL GAS SECTOR IN ROMANIA

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## **Abstract:**

*As a sequel of research from previous years, this article aims to improve the specific taxation system applied to the oil and gas sector in Romania. The first part of the paper characterizes the specific taxation system applied to this sector, from which it results that the current upstream sector taxation system is, eminently, one oriented towards achieving short-term budgetary revenues, which does not bring a balance between the needs of the present and those of the future, being, thus, unsustainable in the long term. For these reasons, the second part of the article is dedicated to outlining measures to improve the current taxation system in the oil industry in our country. Given the identified deficiencies, and in order to achieve a balance between the needs of the present and those of the future, on the one hand, and the budgetary needs of the state and other strategic objectives, as well as the needs of the state and those of investors, on the other hand, the article has identified and detailed a set of measures that could have potential beneficial effects. But these must be balanced in a way that ensures energy security, protects vulnerable consumers, does not discourage investments, and at the same time allows the proper functioning of the energy market. And adapting a flexible hydrocarbon taxation system to exogenous stressors in order to ensure the need for crude oil and natural gas in crisis conditions is the solution to this problem.*

**Keywords:** oil and gas industry, tax regime, taxation system, royalties

**JEL classification:** G18, H25, L71, E62, F64

## **Introduction: Why this approach**

Petroleum activities around the world are subject to a wide range of taxation instruments. These include taxes that apply to all other sectors of the economy and taxes specific to the oil and gas industry (EY, 2022). In addition, forms of tax revenue from rent (such as surface fees, bonuses

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and production sharing) are commonly used in the taxation of upstream activities (Deloitte, 2018c; PwC, 2019).

Petroleum tax regimes often include special provisions to modify the timing or amount of revenue allocations. These provisions are typically designed as incentives to attract investors or to address the unique attributes of an oil asset or to influence investors' choices within the scope of specific public policy objectives (Van Meurs et al., 2021).

Therefore, both in Romania and in other European countries, we encounter different types of royalties, taxes, fees or additional contributions applied to the oil and natural gas industry in conjunction with the general taxation rules specific to each state.

As such, the tax environment applicable to companies in Romania operating in the oil and gas industry consists of: the general taxation system (such as: profit tax; income tax; VAT; excise duties; local taxes and fees), and the sector-specific taxation system (such as: oil royalties due for the production of crude oil and natural gas; taxes on additional income from the sale of onshore, offshore and deep onshore natural gas; additional tax applicable to crude oil production; contributions due for the production of electricity in power plants owned by oil agreement holders; contributions due by oil agreement holders for the activity of trading natural gas and electricity; other specific contributions related to the sector).

Under these conditions, establishing an adequate oil and gas sector taxation regime for Romania must start from analyzing the specific conditions of this sector in our country.

### **Literature review: the general context of the specific tax regime in the oil and gas sector in Romania**

The accelerated increase in natural gas and electricity prices starting in the second half of 2021, with a significant impact on inflation, led to a series of intervention and consumer support measures among the European Union member states (Deloitte, 2018b).

At the Romanian level, the intervention measures began with Emergency Ordinance (OUG) no. 118/2021 on the establishment of a compensation scheme for electricity and natural gas consumption for the cold season 2021 - 2022, its approval law, OUG no. 27/2022, OUG no. 106/2022 and last but not least OUG no. 119/2022. On the other hand, Romania has already implemented a specific taxation system for the oil and gas sector for many years (e.g. additional taxes, oil royalties), which makes profits from this sector subject to an effective tax rate higher than the corporate tax rate of 16% (Mitrita and Nita, 2021).

Electricity prices have begun to rise based on a combination of factors, the most important of which is the high price of natural gas which is used in the electricity production process (CEC, 2022).

Natural gas-fired power plants are needed to meet electricity demand when demand is highest during the day or when the volumes of electricity produced from other technologies, such as nuclear power, hydroelectric power or energy from renewable sources, are not sufficient to cover demand (GDZ, 2021).

Moreover, Russia's military aggression against Ukraine, a contracting party to the European Energy Community, which began in February 2022, has led to a significant decrease in natural gas supplies to the EU. The war in Ukraine has also created uncertainty regarding the supply of other commodities, such as top coal and crude oil, used by power generation facilities, thus leading to further substantial increases and, implicitly, volatility in electricity prices.

In this context, the European Commission decided that a coordinated response by the European Union Member States was needed and published the proposal for an Emergency Intervention Regulation on energy prices on 14 September 2022 (EC, 2022; EPG, 2022). According to the Commission, uncoordinated national measures could affect the functioning of the internal energy market, endangering security of supply and leading to further price increases in the Member States most affected by the crisis.

After a series of debates and some amendments, on October 6, 2022 the Regulation was published in the Official Journal of the Union Council Regulation (EU) 2022/1854 - **Regulation (EU) 2022/1854 on emergency intervention to address high energy prices.**

The regulation includes the following measures (EPG, 2022):

- ✓ Reducing electricity demand in EU Member States;
- ✓ Capping market revenues for electricity production from infra-marginal technologies;
- ✓ Temporary solidarity contribution from oil, natural gas, coal and refining companies.

To understand the general context of the tax regime specific to the oil and gas sector in Romania, we further detail these three measures from Regulation (EU) 2022/1854.

#### ➤ **Reducing electricity demand**

For the period from December 1, 2022 to March 31, 2023, the Regulation provides:

- Optional reduction of the total monthly gross electricity consumption by 10% compared to the average gross electricity consumption in the corresponding months of the reference period.
- Mandatory reduction of total electricity consumption during peak hours identified by Member States by at least 5% on average per hour. The reduction target will be calculated as the difference between the total electricity consumption during the identified peak hours and the total consumption expected by the transmission system operator in the absence of the reduction measures introduced.
- In the version published in the Official Journal of the Union, the provision was introduced according to which EU Member States may choose to target a percentage of peak hours different from the peak hours corresponding in total to a percentage of at least 10% of the total number of hours from 1 December 2022 to 31 March 2023, provided that it covers at least 3% of peak hours and energy saved under the conditions presented above.

#### ➤ **Capping market revenues for electricity production from infra-marginal technologies**

- Producers' market revenues obtained from electricity production are capped at a maximum of 180 euros/MWh.

- The obligation applies to producers of electricity from the following sources: wind energy; solar energy (thermal and photovoltaic); geothermal energy; non-reserved hydroelectric energy; biomass fuels (solid or gaseous), except bio-methane; waste; nuclear energy, lignite, crude oil products and peat.
- Member States may maintain or introduce measures that further limit producers' market revenues, provided that such measures are proportionate and non-discriminatory, do not jeopardise investment signals, ensure the coverage of investment costs, do not distort the functioning of wholesale electricity markets (FIC, 2021) and are compatible with European Union law (Biris, 2023).
- The cap targets all market revenues of producers regardless of the market time frame in which the transaction takes place and regardless of whether electricity is traded bilaterally or on a centralized market, in order not to encourage the migration of transactions to certain segments of the wholesale market.

➤ ***Temporary solidarity contribution from oil, gas, coal and refining companies***

- The solidarity contribution applies to companies with activities in the oil, gas, coal and refining sectors, which generate at least 75% of their turnover, unless Member States have already adopted equivalent national measures.
- The temporary solidarity contribution is calculated based on taxable profits that exceed a 20% increase in 2022 and/or 2023 compared to the average taxable profits in the four financial years starting from January 1, 2018.
- The applicable rate for calculating the temporary solidarity contribution is at least 33% of the taxable base calculated by reference to the excess taxable profits determined in accordance with the provisions of the Regulation. This applies only to excess profits generated in the financial year that began on 1 January 2022 and/or 1 January 2023 and for its entire duration.
- If the average annual result of the period covering the four financial years is negative, the average taxable profit is zero for the purpose of calculating the temporary solidarity contribution.
- This contribution applies in addition to generally applicable taxes and fees under national law.

### **Methodology and data: the specific fiscal regime in the oil and gas sector in Romania**

Both in Romania and in other European countries we encounter royalties, taxes, duties or additional contributions applied to the oil and gas industry in conjunction with the general taxation rules specific to each state. Therefore, the tax environment applicable to companies in Romania operating in the oil and gas industry consists of (Deloitte, 2018b; 2018c; EPG, 2019; PwC, 2021; FPPG, 2022):

✓ *the general taxation system, such as:*

- corporate tax;
- income tax;

- VAT;
- excise duties;
- customs;
- local taxes and fees;
- ✓ *sector-specific taxation system (i.e. oil and gas), such as:*
  - oil royalties due for the production of crude oil and natural gas;
  - taxes on additional income from the sale of onshore, offshore and deep onshore natural gas;
  - additional tax applicable to crude oil production;
  - contributions due for electricity production in power plants owned by oil agreement holders;
  - contributions due by oil agreement holders for natural gas and electricity trading activity;
  - the reduction of 0.25 lei/liter borne by companies in the sector for gasoline and diesel sales;
  - other sector-specific contributions.

The following is a broad outline of the taxation system specific to the oil and natural gas sector, currently consisting of the following legislative regulations in force:

➤ ***Petroleum royalty*** (Law no. 238/2004):

- The law requires oil agreement holders to pay an oil royalty to the state budget;
- The royalty rates currently applicable are between 3.5% and 13% for natural gas and between 3.5% and 13.5% for crude oil depending on the amount of gross production extracted per quarter;
- Oil royalties are calculated based on reference prices established by the competent authorities and are due on the 25th of the first month of the following quarter;
- The reference price of natural gas used for the calculation of royalties is determined based on the Day Ahead price of the CEGH hub in Baumgarten, Austria, in accordance with ANRM Order No. 32/2018, which recorded values significantly higher than the average prices achieved by natural gas producers in Romania (we will return to this topic in the chapter dedicated to the analysis of royalties in the oil industry).

➤ ***Tax on additional income from the sale of natural gas from onshore production*** (Government Ordinance no. 7/2013):

- The tax is calculated by applying a rate of 60% for income between 45.71 lei/MWh, adjusted by the CPI rate, and 85 lei/MWh, respectively 80% for income exceeding 85 lei/MWh.
- From the tax calculation base, royalties due for additional income as well as investments in the upstream sector of a maximum of 30% of additional income are deducted, to which tax rates of 60% and 80% are applied.
- The tax on additional income represents a deductible expense when determining taxable profit.

- The additional revenue is determined as the difference between (1) the weighted average price of natural gas sold from own domestic offshore and/or deep-sea onshore production, from which the costs of transportation, distribution, storage and other logistical costs borne by the petroleum agreement holder are deducted, and (2) the minimum base price of the calculation interval corresponding to the price grid starting from 85 lei/MWh, multiplied by the volume of gas sold from own domestic offshore and/or deep-sea onshore production.
- The percentage rates applied to additional income for the purpose of determining the tax range from 15% to 70% depending on the price charged. Starting with January 1, 2019, the price thresholds used for calculating the tax are adjusted each year, using the annual consumer price index.

➤ ***Tax on additional income from the sale of natural gas from offshore and/or onshore deep-water production*** (Law no. 256/2018 republished with the amendments to Law no. 157/2022 – "Offshore Law"):

- The so-called Offshore Law was amended in May 2022 with the aim of ensuring predictability, stability and unlocking investments in the Black Sea [Deloitte, 2018a].
- The tax on additional income from the sale of natural gas from offshore production applies to the targeted companies starting from November 2018, thus the amendments to Law No. 157/2022 refer to the tax base, the limit on the deductibility of investments when calculating profit tax and the application of these taxes also in the sphere of onshore deep-water production.
- The legislative framework provides for the obligation of entities holding offshore, deep-sea onshore petroleum agreements and those relating to these areas, including their subsidiaries, to calculate, declare and pay tax on additional income.
- The tax on additional income will represent a deductible expense when determining the fiscal result for profit tax.
- The taxpayer can also deduct his investment in the upstream segment up to 40% of the total additional income tax.
- The royalty regime and the tax regime applicable to exploration, development, exploitation and abandonment activities will not change during the application of the petroleum agreements, if they have been introduced in the petroleum agreements.

➤ ***Tax applicable to crude oil production***(Government Ordinance no. 6/2013 on the establishment of special measures for the taxation of the exploitation of natural resources, other than natural gas):

- This tax is calculated by applying a rate of 0.5% of the revenues from the exploitation of crude oil production, including in the situation where oil agreement holders process crude oil in their own refinery.

- The amounts related to this tax represent, for economic operators in the extraction of crude oil (CAEN code 0610), deductible expenses when determining taxable profit, under the provisions of Law No. 571/2003 on the Fiscal Code, with subsequent amendments and supplements.

➤ **Capping natural gas prices for natural gas sales made by oil agreement holders and the contribution to the Energy Transition Fund** (GEO no. 27/2022 amended by GEO no. 119/2022)

- Natural gas producers are obliged to make available, to suppliers of household customers and those of thermal energy producers, the quantities of natural gas from their own production, calculated according to Annex 5 of GEO no. 27/2022, at a price of 150 lei/MWh. For the production of electricity in their own natural gas-fired power plants, an internal transfer price (for example, within the same legal entity) of a maximum of 100 lei/MWh is established.
- Contribution to the Energy Transition Fund for electricity production, applicable including to holders of petroleum agreements who own electricity production plants by burning natural gas, which has a 100% share of revenues from the sale of electricity exceeding 450 lei/MWh and the cost of CO<sub>2</sub> certificates. During the period 01.04.2022 - 31.08.2022, a similar contribution of 80% was applicable for electricity production from natural gas-fired plants.
- The contribution to the Energy Transition Fund for the electricity and natural gas trading activity, calculated as the difference between the average monthly selling price and the average monthly purchasing price, imposes a quota of only 2% to cover the rest of the operators' expenses and possibly achieve a profit margin (Annex 6.1 of GEO 27/2022 amended by GEO 119/2022 starting with 01.09.2022).

➤ **Contribution for reducing gasoline and diesel prices** (GEO no. 106/2022):

- During the period 1 July-30 September 2022 (later extended until 31 December 2022), economic operators that sell gasoline and diesel to end customers - natural and legal persons who purchase fuels from warehouses and/or distribution stations for their own consumption -, and that grant a price reduction of 0.5 lei/liter, including VAT, on the selling price, benefit from the state budget from a compensation of 0.25 lei/liter, including VAT, related to the discount granted. For fractions of a liter, the price reduction and the compensation, respectively, were granted proportionally.
- The compensation measure provided for in the GEO was applied for the sale of gasoline and diesel to final customers for their own consumption, both at retail and at wholesale through suppliers'/distributors' warehouses.

➤ **Contribution due by license holders** (GEO no. 114/2018 amended by GEO no. 1/2020):

- Starting with January 2020, the level of contributions of license holders in the field of electricity and natural gas is established annually by order of the president of ANRE (i.e. Order no. 143/2021 in force for 2022).

At the end of this paragraph, we must emphasize that it can be observed that **royalties and taxes on additional income** contribute in a similar proportion to the specific taxation of the upstream natural gas sector in Romania.

At the same time, we must mention that these taxes are applied additionally, cumulatively with the common taxation system (profit tax, VAT, excise duties, local taxes and fees, etc.), so that the oil and gas upstream activity records significantly **higher costs of taxes and fees paid and administrative and compliance costs than in the case of companies operating in common activities (trade, generic services, etc.)**.

### **Discussions: characterization of the specific taxation system applied to the oil and gas sector in Romania**

Considering the concrete aspects related to its evolution and effects during the period 2013-2023, the taxation system in the upstream natural gas sector in Romania can be characterized by the following:

➤ **Complete lack of stability and predictability.**

In the last 10 years, over 20 regulatory acts have been identified with an impact on the upstream natural gas sector, bringing important changes, including:

- ✓ Introduction and permanentization of the tax on additional income following deregulation.
- ✓ Introducing an increased rate and limiting the investment deduction in terms of additional income tax.
- ✓ Introducing tax on additional offshore income and limiting the deductibility of investments for corporate tax.
- ✓ Changing the reference price for calculating royalties.
- ✓ Introduction and elimination of construction tax.

Thus, not only can we not characterize the taxation system as stable or predictable, but it seems that the state authorities have made it a goal to **(i) make frequent and significant changes that conflict with the very original purpose of the law** (such as: making a transitory tax permanent, establishing an *additional tax* for offshore activity through legislation whose initial purpose was *to encourage the activity*, given that the level of royalties in Romania - calculated at a rate of 13% - was also still among the highest, compared to similar offshore jurisdictions, reversing the trend of market liberalization) and from **(ii) making sudden changes, which do not allow for multi-annual planning (characteristic and necessary for the upstream natural gas sector)**.

In the context where fiscal competition is taking place at the international level in order to attract investments, it is expected that the lack of stability and predictability in the Romanian tax system will lead to a decrease in Romania's attractiveness as an investment destination.

Romania's international **reputation** can be raised. In the offshore field, **the introduction of the new tax on additional income came after significant investments were made, commercially viable perimeters were identified and exploitation intentions were announced in the coming periods**. Thus, it seems that Romania confirms, once again, that it is willing to change the rules mid-game, as it has done in other areas (e.g. renewable energy). In light of these changes, it is expected that Romania will not have a positive reputation (not being

a credible, reliable partner), which affects opportunities in terms of attracting investments in the future.

➤ ***Paradoxical policy in the offshore field, lack of correlation between the level of risk/difficulty of exploitation and the taxation regime***

If at a global level a correlation is observed between the difficulty of exploitation, on the one hand, and the level of taxation on the other hand, in the sense that more advantageous taxation systems are practiced to encourage more difficult exploitations (with higher investments and higher risk), **in Romania, however, the situation is paradoxically opposite, offshore exploitations (usually more difficult and riskier, requiring higher investments), suffer a higher effective tax burden than in the case of onshore exploitations and in any case approximately 5 times higher than the average of countries with a predominantly offshore specificity in 2021 and 2022.**

Moreover, in its current form, the offshore tax regime generates a total government take of *approximately 90%* of the profits generated by a standard offshore oil or gas project.

The Romanian tax system is thus one that effectively **discourages** future offshore investments. In the context in which (i) national natural gas production has suffered considerable declines as the existing conventional deposits are gradually exploited and depleted, and (ii) specialists estimate that maintaining or even increasing national production could be achieved substantially only through offshore deposits, **it is expected that the current tax system will lead to (i) discouraging offshore investments, (ii) limiting activity to mature onshore deposits in production, with a high degree of depletion and sharp decline, and, implicitly, to (iii) decreasing national production and increasing dependence on imports.**

Moreover, in general, it can be observed that the system of royalties and additional taxation is not differentiated according to the difficulty of exploitation or according to the techniques used, there being no incentive to encourage them. Therefore, also from this perspective, Romania seems to be one step behind.

➤ ***The trend of slowing down/reversing the market liberalization process***

The introduction of price caps for the sale of natural gas clearly represents a step backwards in the trend towards price liberalisation. The effects are the usual ones for such measures: distorting the incentive system of economic agents (discouraging them, in this case), and the decision-making system of consumers (encouraging them to rely on a certain energy consumption and certain technologies through artificially low prices).

➤ ***Technical deficiencies***

Leaving aside the macro reasoning and the opportunity for introducing certain measures, we appreciate that, in certain distinct cases, the implementation of the measures itself leaves much to be desired.

**The change in the reference base** for calculating royalties is, in our view, criticizable from a strictly technical perspective, as this reference is unrepresentative of local market conditions.

Setting an irrelevant reference (at the time of decision-making, at a higher level than that of the local market) signals that obtaining higher revenues for the state budget is more important than encouraging market development based on the principle of market value.

Using a reference price from a foreign market (irrelevant to the local market) for the purpose of calculating royalties contradicts:

- **The principle of fairness of taxation in the Fiscal Code**, which ensures that the tax burden of each taxpayer is established based on the contributory power, respectively depending on the size of the income. Given that the CEGH price is not related to the local market (in some cases being over 50% higher than local prices, in other cases up to 24% lower than local prices - we will return to this topic in detail later) **the taxation is carried out arbitrarily by reference to unrealized income, or by referring to only a part of the income achieved**. Under these conditions, we cannot talk about imposing **additional income** (according to the reasoning and purpose of the law), income being defined strictly from an accounting perspective, as *increases in economic benefits* (or, these economic benefits can only be equal to the actual price achieved).
- **The practice at European level**, where reference prices are set exclusively by reference to relevant local references [Deloitte, 2018d].

Also, even if it is appreciated *that* the new taxes on additional income contain elements of taxation based on profitability (as they contain components of deductions of investments made), the modern approach being the combination of royalty elements with elements of taxation related to the profitability of projects, **however, we appreciate that this intention was poorly implemented from an administrative technique perspective**.

It can be seen that, worldwide, taxation systems in the *upstream* oil and gas sector are made up of several elements, a common approach being the combination of royalties (with immediate effect), with taxation that takes into account *the profitability* of exploitation (with long-term effect). This combination ensures a reasonable balance, an alignment between the constant and immediate needs of the state and the needs of the taxpayer to correlate the tax due with the profitability of his projects.

However, taxes on additional income in Romania still do not act as true taxes on profitability since, as a direct effect of the calculation method, producers owe and pay this tax even before the investment is recovered (investment deductions being limited, producers owe and pay tax from the very beginning).

Moreover, the introduction of these taxes should have coincided with the reduction of the royalty amount, in such a way as to maintain the total level of taxation on the project, but with a different temporal allocation over the duration of the project: first, royalties would be paid, and over time, the tax on additional income would increase in importance.

On the contrary, additional taxes were added to the royalties owed, completely increasing the level of taxation from the very beginning.

In international practice, *additional taxes* are usually applied to sales prices considered surplus, for producers who make an excess profit (i.e., above a level considered normal for the sector).

**By limiting the deductibility of offshore investments from a profit tax perspective** (specifically, by reducing deductible expenses with tax depreciation of investments made), the

tax base of offshore producers is artificially broadened, compared to the rest of the economic agents in Romania.

This approach is contrary to the practice at European level, where specific taxation in the upstream sector with profitability elements is (i) similar to the mechanism applied to other sectors of activity and/or (ii) contains measures to encourage investment (e.g. faster deduction, over-deduction of investments, etc.).

Since the formula for calculating income subject to the additional offshore tax does not allow for the deduction of royalties related to this income, we consider that double taxation of *additional income* (royalties, followed by tax on additional income) is generated.

The deductibility of investments to a maximum of 30% of the additional revenues recorded (up to 85 lei/MWh), modified only by Law no. 157/2022 of May 25, 2022 (which, among other things, eliminated the over-taxation below the threshold of 85 lei/MWh and increased the limit for deducting investments from the additional tax, from 30% to 40%, also reiterating the stability guarantee, in the sense that there will be no more tax increases or new taxes, a "guarantee" included, moreover, in Law no. 256/2018) discourages onshore investment projects with high costs or risks (for example, exploration or deep-sea wells).

However, it would be wrong to say that these measures are completely incoherent. On the contrary, the specific taxation system of the upstream natural gas sector in Romania brilliantly fulfills the objective (the only one, in fact) for which it was designed: that of generating additional budgetary revenues *in the short term*. In light of this single objective, it is explained why the effective tax rate in Romania has become by far the highest among the European countries analyzed, as well as the recent increases in specific taxes and fees collected, at a pace significantly disproportionate to the evolution of revenues in this area.

The problem is that these additional budget revenues came at the cost of (i) discouraging future investments and (ii) discouraging local production (with, of course, reducing energy independence and increasing dependence on imports).

It is clear that, as future production is discouraged and will continue its inevitable decline, state budget revenues will also decline.

At the same time, it is obvious that the other possible objectives were not taken into account when the measures that led to the current form of the taxation system were taken, namely (we will detail below):

➤ **Employment**

The number of employees depends on the scale of the activities. In a taxation system with a tendency to increase the tax burden, investors will concentrate their activities in projects with the highest and most reliable returns.

➤ **The environment**

From the analysis carried out, no measure based on environmental criteria was identified. On the contrary, as natural gas is an important factor in the energy mix that contributes to a reduction of greenhouse gases, **discouraging investments and production of natural gas may indirectly encourage the consumption of other energy sources** (relatively more harmful to the environment from a greenhouse gas perspective, such as oil, and especially coal).

➤ **Energy security**

The current taxation system acts contrary to the objective of energy security, having the effect of discouraging local production and encouraging imports (a fact already observable by the increase in natural gas imports in 2019).

The current taxation system of the upstream natural gas sector is, therefore, eminently one oriented towards achieving short-term budgetary revenues, which does not bring a balance between the needs of the present and those of the future, being unsustainable in the long term. For these reasons, in the following paragraph we will try to identify some measures to improve the current taxation system in the oil industry in our country.

**Results: System improvement measures**

Given the identified deficiencies, and in the sense of bringing a balance between: **(i) the needs of the present and those of the future, (ii) the budgetary needs of the state and the other strategic objectives**, respectively **(iii) the needs of the state and those of investors**, we believe that the following measures could have potential beneficial effects:

➤ **Reducing the effective tax burden.**

Through this reduction, to a level closer to the average of European countries, competitiveness can be improved, in order to encourage investment and production in Romania.

**Correlating taxation with the degree of difficulty and risk of exploitation**, in the sense of encouragement, through a more favourable tax regime, related to more difficult exploitations (for example, lower taxation for offshore and for onshore exploitations that require improved techniques compared to conventional techniques, such as deep-sea ones, etc.).

➤ **Increasing the degree of correlation of taxation with the profitability of exploitation projects.**

Even though the taxation system in the upstream field of natural gas should not be based exclusively on the profitability of the producer, **a consumption of finite resources is recorded regardless of the outcome**.this consumption, the taxation system must be the result of a compromise between the constant and immediate needs of the state and the effective profitability of the projects.

This compromise could be achieved by implementing a system consisting of royalties (relatively constant budget revenues, throughout the duration of production) alongside a tax linked to profitability (with the admission of initial losses, including those in the exploration phase), which generates longer-term revenues.

Specifically, taxes on additional income should allow for losses from the initial phases, the full deduction of investments made, so that additional taxes are due starting with the full recovery of the investment by the producer.

From an employment perspective, perhaps the highest impact could be achieved by significantly reducing or eliminating specific taxation for small or low-yield projects, which would encourage the expansion of lower-yield activities, which are currently not a priority for large investors.

From an environmental perspective, encouraging the production and consumption of natural gas (at the expense of other more polluting sources) is itself expected to have a positive effect on the environment, due to the relatively low greenhouse gas emissions.

Significant elimination/reduction of the **2% contribution established by GEO no. 114/2018 on the turnover related to operations subject to ANRE licenses**[Deloitte, 2019], which is currently levied *for ANRE financing* (previously ANRE managed to obtain adequate financing through a tax of approximately 20times lower).

➤ ***Adoption of market-relevant reference prices.***

For the proper functioning of the reference price mechanism for calculating the royalty, we consider that (i) it must be established by reference to the specifics of transactions related to local production (mostly long-term supply contracts, not spot) and (ii) it must represent a relevant level, which can be **the weighted average of prices registered on the local market during the reference period.**

The opportunity for a possible correlation of the market value principle in the matter of profit tax with the value used to calculate the value of production from the perspective of royalties could also be analyzed (the value of production could be calculated by reference to the prices achieved by producers when they fall within the market range, otherwise, the value of production would be calculated by reference to the median of the market range (which would act, de facto, as a reference price).

➤ ***Ensuring stability/predictability for existing and potential investors.***

Last but not least, it should be noted that **legislative changes are imperative to ensure stability/predictability for existing and potential investors.** The taxation system must not only be brought to a balanced and sustainable stage, it must also be maintained over time, through appropriate stability clauses, ensuring a stable legislative framework for long-term and very long-term investments such as those in the oil and gas industry (the applicable tax regime should remain the one from the moment of the start of the investments/exploitation).

## **Conclusions**

The results of this analysis reveal the growing importance of the oil and gas sector in the economy. This comes at a time when global energy prices are at high levels, and Europe in particular is facing higher natural gas and electricity prices, largely amplified by the conflict in Ukraine.

At the end of this analysis of the specific tax regime applied to the oil and gas sector in Romania, several **conclusions** can be drawn, namely:

- The current context is unprecedented, both at the global, regional and local levels and requires intervention measures, but these must be balanced so as to ensure energy security, protect vulnerable consumers, not discourage investments and at the same time allow the proper functioning of the energy market.
- Regulation (EU) 2022/1854 on emergency intervention to address high energy prices comes with a series of measures that must be respected in the process of reviewing national policies in force.
- At the same time, a series of national particularities and implicitly the current blockages determined by GEO 119/2022 [Concordia, 2022] must be taken into account, such as the calculation of the royalty: for quantities transferred at a regulated price for the electricity production activity, it is necessary that the royalty be calculated at the regulated price and not at the price established on a market other than the local one, significantly higher than the regulated price.
- Contribution to the Energy Transition Fund for electricity and natural gas trading activity: it must be clarified which costs are covered in the category of acquisition costs (e.g. costs incurred to bring the goods to market), otherwise the current provisions constitute a ban on imports given that the margin cannot exceed the 2% threshold.
- Thus, the implementation of the measures of the EU Regulation should be carried out simultaneously with the revision of national legislation in order to ensure the proper functioning of the energy market. Moreover, the application of the solidarity contribution under the EU Regulation should be analyzed in the context of the national fiscal regime and implicitly in terms of its impact on investments in the sector. Romania's decision to introduce the solidarity contribution, including on which financial year or financial years it will apply, was communicated to the European Commission by 31 December 2022, according to the Regulation.

Given that Romania has already implemented a series of national measures presented in our analysis, the Romanian authorities should take them into account and analyze to what extent they are equivalent to the solidarity contribution proposed by the Regulation.

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