

# Azerbaijan

## **Ilham Aliyev Appointed Prime Minister of Azerbaijan**

On August 4, 2003, Ilham Aliyev, first vice president of the State Oil Company of the Azerbaijan Republic (SOCAR) was appointed the country's prime minister by presidential decree. The appointment was then approved by Azerbaijani parliament. At the extraordinary sitting, 101 out of 124 members of parliament voted for Ilham Aliyev. The same day, he resigned his SOCAR post.

On August 7, Ilham went on unpaid leave under Article 69.2 of the Election Code to run for president of Azerbaijan. Presidential elections are scheduled for this October 15. Under the Constitution, the prime minister becomes acting president in the event the president is incapable of discharging his duties.

## **Amendments to the Budgetary System Law**

On May 13, 2003, the president of Azerbaijan approved the law *On Amendments to the Law on Budgetary System* (the "Law"). The amendments introduced a consolidated budget as a new part of the state budgetary system. The consolidated budget is defined as the sum of the non-budget operations of the state budget, the budget of the Nakhchivan Autonomous Republic, budgetary organizations, as well as the revenues and expenditures of the non-budget state funds. Special purpose funds, such as State Oil Fund of the Azerbaijan Republic (SOFAZ), are considered non-budget state funds.

Under the Law, except for operational costs and the costs of placing funds with international banks and other financial institutions, all SOFAZ revenues and expenditures are included in the consolidated budget. The Law provides, however, that the budgets of non-budget state funds, including SOFAZ's, are separate from the state budget.

The Law also provides that non-budget state funds are not authorized to invest in domestic commercial activities or issue credits or guarantees. SOFAZ is authorized, however, to acquire corporate shares on international markets through professional investment managers. A report on the revenues and expenditures of non-budget state funds must be published in the press quarterly.

In the past, SOFAZ's budget was approved and regulated by the president of Azerbaijan. This practi-

ce was criticized by the International Monetary Fund which insisted on the adoption of a separate law on SOFAZ to ensure transparency of its financial operations. After lengthy negotiations, the government agreed to include SOFAZ's budget into the state budget.

As a result of those amendments, SOFAZ's budget will be subject to approval each year by the Azerbaijani parliament. As of July 1, 2003, SOFAZ had accumulated approximately \$810 million.

## **New Regulations for the Ministry of Transport**

On June 10, 2003, the president of Azerbaijan approved regulations for the Ministry of Transport (the "Regulations"). Even though the ministry was created in 1998, no regulations governing its operation were adopted until now. The Regulations are intended to define the ministry's authority and allocate powers between the ministry and other state organizations operating in the transportation sector such as Caspian Shipping Company (CSC) and Azerbaijan Airlines (AZAL).

The Regulations provide that the ministry is the central executive authority which forms and implements state policy in the railway, water, automobile, civil aviation and highway transportation and regulates relationships among those sectors. Generally, the ministry is charged with the supervisory functions in the transport sector.

The main duties of the Ministry of Transport are to:

- ! Form and implement a unified state policy for the development of transportation sector;
- ! Coordinate activities in the sector to ensure the safe, profitable and continuous operation of transportation enterprises;
- ! Prepare and control the implementation of sector and inter-sector programs;
- ! Prepare proposals for the socio-economic development of the transportation sector;
- ! Control state property in the transportation sector;
- and
- ! Implement measures to attract investment into the transportation sector.

The ministry is also responsible for other important functions such as preparation of tender docu-

ments for investment projects; registration of sea and river vessels; development of roads; coordination with the International Maritime Organization; participation on commissions for the privatization of state-owned enterprises in the transportation sector; creation of a maritime administration and a marine register; and issuance of licenses for activities in the transportation sector

The decree charged the Cabinet of Ministers and the ministry with preparing a list of transportation enterprises to be privatized. The list, however, will not include AZAL's enterprises as those are already in the process of privatization pursuant to a separate presidential instructive order.

While the Regulations grant the ministry authority in the entire transportation sector, it is apparent that the regulation of civil aviation and railroads falls outside the scope of the ministry's functions. Consequently, Azeravtonegliyyat and Azeravtiyol (state entities in the motor transport and motor road sectors) have been wound-up and their functions transferred to the ministry. Moreover, most of the functions of the Caspian Shipping Company stipulated by the Commercial Navigation Code have also been transferred to the ministry. However, AZAL and State Railway Department have retained their responsibilities and authority.

#### Reforms in SOCAR Continue

Following the basic structural reforms implemented in January of this year at SOCAR, several further actions have been taken to ensure that it will have more efficient control over its diminishing number of divisions. Thus, the Financial-Economic Department and the accounting sections of other departments have been consolidated into the Centralized Accounting Department. The Department

of Labor, Forecasting and Employee Compensation has been created out of the Department of Labor and Planning. Furthermore, three new departments – the Department of Science, Technology and Energy, the Department of Offshore Transport and the Department of Transportation and Social Development have been established.

Meanwhile, according to the president's advisor on economic issues, transfer of some of SOCAR's functions to the Ministry of Fuel and Energy (MFE) is under consideration. Among the functions to be transferred to MFE is responsibility for negotiations with foreign companies with regard to production sharing agreements. Currently, this function is performed by SOCAR unless the Azerbaijani president specifically grants this authority to the Minister of Fuel and Energy.

#### LUKOil Increases Interest in Yalama PSA

In June 2003, LUKoil Overseas B.V. International Ltd (LUKOil) transferred \$48.6 million to SOFAZ as a bonus payment in return for the expansion of the D-222 contract area in the northern part of the Caspian Sea. LUKoil also acquired an additional 20% of SOCAR's share of the Yalama PSA, increasing its share to 80%. The transaction was concluded upon a \$30 million payment to SOFAZ.

While these transactions demonstrate the strong working relationship between LUKoil and SOCAR, the government's claim that LUKoil's sale of its share in Azeri-Chirag-Guneshli PSA resulted in a tax liability is still unresolved. According to SOCAR president, Natik Aliyev, LUKoil's recent payments have reduced that claimed tax liability. LUKoil, for its part, relying on the terms of the ACG PSA, asserts that that the sale of its interest in that PSA to Inpex did not create any tax liability.

## Kazakhstan

#### Taxation

The following amendments to the Tax Code were adopted on 4 July 2003 and will come into force on 1 January 2004.

#### Taxation of Personnel: Change of Personal Income Tax and Social Tax Rates

The maximum rate of the personal income tax will decrease from 30% to 20% with the new rates varying from 5% to 20% depending on the income of the taxpayer.

The rate of the social tax with respect to Kazakhstani personnel will decrease from 21% to 7-20% and will become regressive. Likewise, the rate of the social tax with respect to expatriate managerial and engineering personnel will decrease from 11% to 5-11%.

#### Value Added Tax

Effective 1 January 2004 the rate of VAT will be reduced from 16% to 15%.

**New Tax Model Debated**

The Prime Minister of Kazakhstan ordered to form a working group to develop changes to the oil and gas tax legislation. The working group includes the representatives of the Ministry of Energy and Mineral Resources, Ministry of Finance, Ministry of Budget and Planning and the National Company KazMunayGas. The debated Model provides for the following taxes:

- 1) Signature bonus;
  - 2) Oil extraction tax;
  - 3) Excess profit tax that will not be a function of the IRR;
- and
- 4) All other taxes and other obligatory payments except for commercial discovery bonus, royalty and share of the State under production sharing.

**Oil Extraction Tax**

It is proposed in computing the oil extraction tax to take into account the prices for oil with reference to prices quoted on an international oil exchange in accordance with the following breakdown:

Oil Market Price (per barrel)	Oil Extraction Tax
12 or less	0%
Up to 15	Up to 10%
Up to 20	Up to 17%
Up to 25	Up to 24%
Greater than 25	Up to 31%

It appears that the taxes under the debated Model will be paid in accordance with legislation as at the date of payment but it is not yet clear how the netback price to Kazakhstani supplies will be calculated.

# Russia

In the period from June to August 2003, Russia introduced a number of changes to its energy law and related legislation. Below is a brief summary of recent legal developments and legislative initiatives which may be of interest to our readers.

**Amendments to PSA Legislation Approved by the Russian President**

On June 6, 2003 the Russian President signed into law the Bill on Supplementing Part II of the Tax Code of the Russian Federation, Amending and Supplementing Certain Other Legislative Acts of the Russian Federation and Recognition of Certain Legislative Acts of the Russian Federation Ineffective, which bill introduced crucial changes in the Federal Law On Production Sharing Agreements, dated December 30, 1995, as amended (the "PSA Law"). The amendments to the PSA Law significantly curtailed the PSA regime by narrowing the range of grounds for subjecting subsoil plots to be developed under such regime. Namely, the only basis for inclusion of any subsoil plot in the list of subsoil plots to be developed under the PSA legal regime shall now be the lack of opportunity to explore and develop such plot under the general licensing regime, which lack should be confirmed by an unsuccessful auction for the grant of subsurface rights on the terms and conditions specified by the Federal Law

on Subsoil, dated February 21, 1992, as amended (the "Subsoil Law").

**Rules on Protection of Subsoil**

On June 6, 2003 the Russian Federal Mining Supervisory Board (Gosgortekhnadzor) approved by its Resolution No. 70 the Rules of Subsoil Protection In Refining of Minerals ("Rules No.70"), and by its Resolution No. 71 the Rules of Protection Subsoil ("Rules No.71").

Rules No. 71 represent a set of legislation applicable to all organizations engaged in the extraction and refining of natural resources, subsoil use not related to the extraction of natural resources, and to those involved in underground survey and geological works. Rules No. 71 address such issues as (i) requirements applicable to the designing, construction and commissioning of subsoil use facilities, (ii) geological surveying of subsoil operations, (iii) planning and projections of mining operations, (iv) opening and development of deposits, (v) production operations, (vi) requirements applicable to the development of oil and gas deposits, (vii) additional requirements applicable to the development of fields located with complex geological structures and other difficult natural conditions, (viii) preparation of extracted natural resources, (ix) requirements applicable to the refi-

ning of minerals, **(x)** environmental protection in subsoil operations, **(xi)** abandonment of facilities related to subsoil operations, **(xii)** liability issues relating to violations of the Subsoil Law and related subsoil use legislation.

Rules No. 70 deal directly with preliminary refining of hard rock minerals, except for refining of radio-

active raw materials. Rules No. 70 established detailed requirements for designing of industrial refining facilities, for refining operations, for determination, accounting and rating of losses of useful components, and liability issues relating to violations of the Subsoil Law and related subsoil use legislation.

## Ukraine

### Draft Law on Oil and Gas Rent

On July 9, 2003, the Parliament of Ukraine passed in the first hearing the Draft Law of Ukraine On Rental Payments for Oil and Natural Gas (the "Draft Law"), which purports to replace Presidential Decree No. 785/94 On the Establishment of Rental Payment for Oil and Natural Gas Extracted in Ukraine, dated 21 December 1994, currently in force. The Draft Law sets forth the definition, amounts and the procedure for the payment of rent for oil and natural gas, liability of rent payers and provisions for the control over the accuracy of the rent calculation and payment.

The Draft Law defines the payers of oil and gas rent as business entities exploiting oil-and-gas bearing deposits, regardless of their form of ownership, as well as their subsidiaries and branches. The rent shall be levied on oil and natural gas, extracted within the territory of Ukraine during respective tax (reporting) periods.

The Draft Law proposes to calculate rental payments on the basis of differentiated rent rates and the actual price of the extracted oil and/or gas. The rent rates shall be differentiated according to the mining and geological conditions of the development of respective oil and gas deposits. However, the Draft Law provides that for oil and gas sold at regulated prices the calculation of

rental payments shall be based on such regulated prices.

The Draft Law also provides for exemptions from the above rental payments. The first exemption covers oil and gas extracted within the territorial waters and the exclusive (sea) economic area of Ukraine; the second exemption extends to the volumes of oil and gas, in excess of basic volumes, extracted from difficult-to-work and exhausted deposits.

### Settlement of Debts between Energy and Water Supply Companies

By Order No. 450-p (the "Order"), dated 24 July 2003, the Cabinet of Ministers of Ukraine allowed the mutual settlement of debts for water-supply and drainage services, on the one hand, and energy resources, on the other hand, between coal mining, water supply, and energy generating companies and the state company Energorynok. The mutual settlement relates to the debts accrued as of 1 January 2003 and amounting to UAH40,645,700, or approx. USD7,625,800.

Under the Order, the debts shall be settled on the basis of protocols executed by all settlement parties. As a condition for settlement, each party shall be obligated to pay applicable taxes within a three-day period after the settlement.