



INLAND REVENUE BOARD OF MALAYSIA

**TAXATION OF UPSTREAM PETROLEUM
PART I**

PUBLIC RULING NO. X/2023

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PART 1**

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DIRECTOR GENERAL'S PUBLIC RULING

Section 71B of the Petroleum (Income Tax) Act 1967 (PITA) provides that the Director General is empowered to make a Public Ruling in relation to the application of any provisions of the ITA.

A Public Ruling is published as a guide for the public and officers of the Inland Revenue Board of Malaysia. It sets out the interpretation of the Director General in respect of the particular tax law and the policy as well as the procedure applicable to it.

The Director General may withdraw this Public Ruling either wholly or in part, by notice of withdrawal or by publication of a new Public Ruling.

**Director General of Inland Revenue,
Inland Revenue Board of Malaysia.**

1. Objective

The objective of this Public Ruling (PR) is to provide explanation on the taxation of upstream petroleum in Malaysia from the perspective of the interpretation of the Petroleum (Income Tax) Act 1967 [PITA] and the scope of taxation.

2. Relevant Provisions of the Law

2.1 This PR takes into account laws which are in force as at the date this PR is published.

2.2 The provisions of PITA related to this PR are section 2 and 3 of the PITA.

3. Interpretation

The words used in this PR have the following meaning:

3.1 “Casinghead Petroleum Spirit” means any liquid hydrocarbons obtained in Malaysia from natural gas by separation or by any chemical or physical process but before the same has been refined or otherwise treated;

3.2 “Petroleum Operations” means

a) searching for and winning or obtaining of petroleum in Malaysia by or on behalf of any person for his own account or on a joint account with any other person by any drilling, mining, extracting or other like operations or process, in the course of a business carried on by that person engaged in such operations, and all operations incidental thereto, and any sale or disposal by or on behalf of that person of petroleum so won or obtained, and includes the transportation within Malaysia by or on behalf of that person of petroleum so won or obtained to any point of sale or delivery or export, but does not include—

- (i) any transportation of petroleum outside Malaysia;
- (ii) any process of refining or liquefying of petroleum;
- (iii) any dealings with products so refined or liquefied; or
- (iv) service involving the supply and use of rigs, derricks, ocean tankers and barges; and

b) any sale or disposal by Petroliaam Nasional Berhad within Malaysia of petroleum obtained from outside of Malaysia and includes the transportation within Malaysia by, or on behalf of Petroliaam Nasional Berhad of such petroleum to any point of sale or delivery within Malaysia;

- 3.3 “Person” includes a company, a partnership or other body of persons and a sole corporation;
- 3.4 “Chargeable Person” means
- (i) Petroliam Nasional Berhad,
 - (ii) Malaysia-Thailand Joint Authority,
 - (iii) in relation to each petroleum agreement, any other person carrying on petroleum operations thereunder,
- severally;
- 3.5 “Petroleum Agreement” means an agreement for exploring, prospecting or mining for petroleum entered into between Petroliam Nasional Berhad or the Malaysia - Thailand Joint Authority and any other person whereby the parties thereto share any petroleum production or any profit derived therefrom;
- 3.6 “Partnership” means an association or arrangement of any kind (including, but not limited to, joint ventures, syndicates and cases where a party to the association or arrangement is itself a partnership) between parties who have agreed to combine any of their rights, powers, property, labour or skill for the purposes of carrying on petroleum operations and sharing any petroleum production or any profit derived therefrom; and
- 3.7 “Petroleum” means any mineral oil or relative hydrocarbon and natural gas existing in its natural condition and casinghead petroleum spirit including bituminous shales and other stratified deposits from which oil can be extracted.

4. Introduction

- 4.1 The petroleum industry in Malaysia is a contributor to the country's revenue.
- 4.2 The Petroleum Development Act 1974 (PDA) was gazetted and Petroliam Nasional Berhad (PETRONAS) was granted the entire ownership in and the exclusive rights, powers, liberties and privileges of exploring, exploiting, winning and obtaining petroleum whether onshore or offshore of Malaysia.
- 4.3 The role of PETRONAS includes regulating and governing the development of the country's petroleum operations. This includes the awarding of petroleum agreements such as Production Sharing Contract (PSC) to international and domestic oil and gas companies for the purpose of exploring, exploiting, winning and obtaining petroleum whether onshore or offshore of Malaysia.
- 4.4 For the overlapping areas of Malaysia and Thailand, the Governments of Malaysia and Thailand have signed a memorandum of understanding to establish authorities for exploring and exploiting that area. The Malaysia-Thailand Joint Authority (MTJA) was established in 1990 to carry out responsibilities for both countries. MTJA is responsible for awarding PSC in the Joint Development Area (JDA).

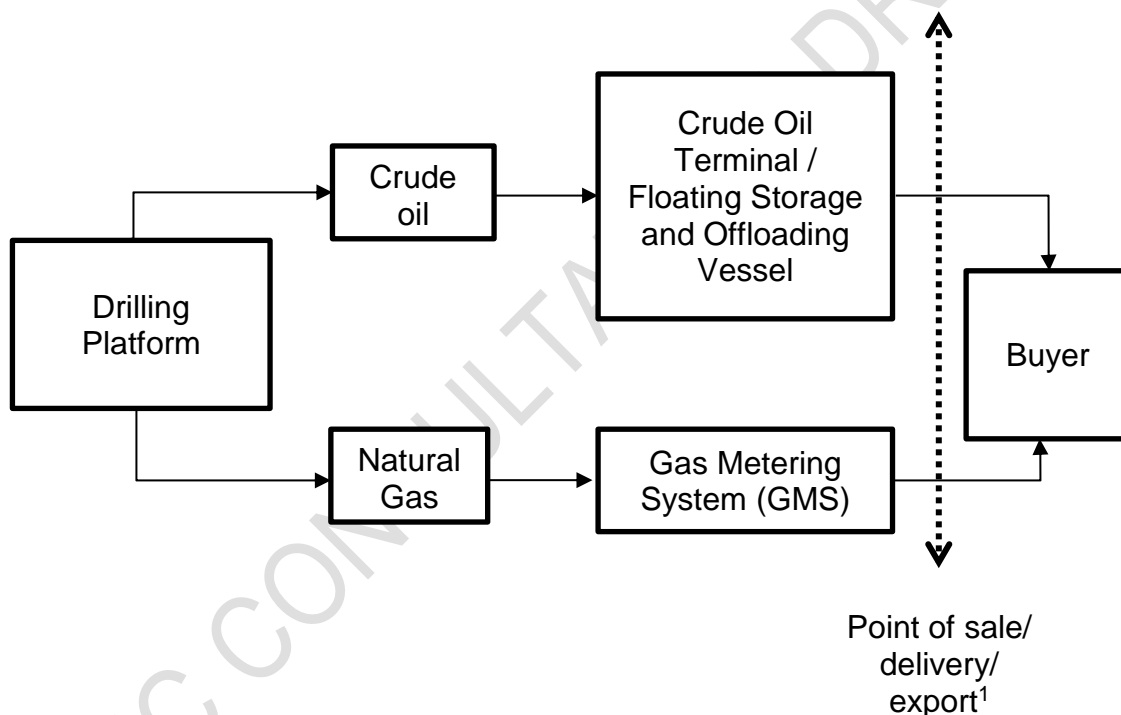
5. Scope of Taxation

The imposition of income tax for upstream petroleum activities is in accordance with the provisions under section 3 of the PITA. In this provision, petroleum income tax shall be charged for each year of assessment on the income of every chargeable person for income derived from petroleum operations.

6. Petroleum Operations

- 6.1 In general, petroleum operations begin when the Chargeable Person obtains the rights until point of sale or delivery or export.
- 6.2 Point of sale or delivery or export is not defined under PITA. However, the meaning of the point of sale or delivery or export is as stated in the petroleum agreement or any agreements for the sale of petroleum from that petroleum agreement.

The diagram below shows the point of sale or delivery or export:



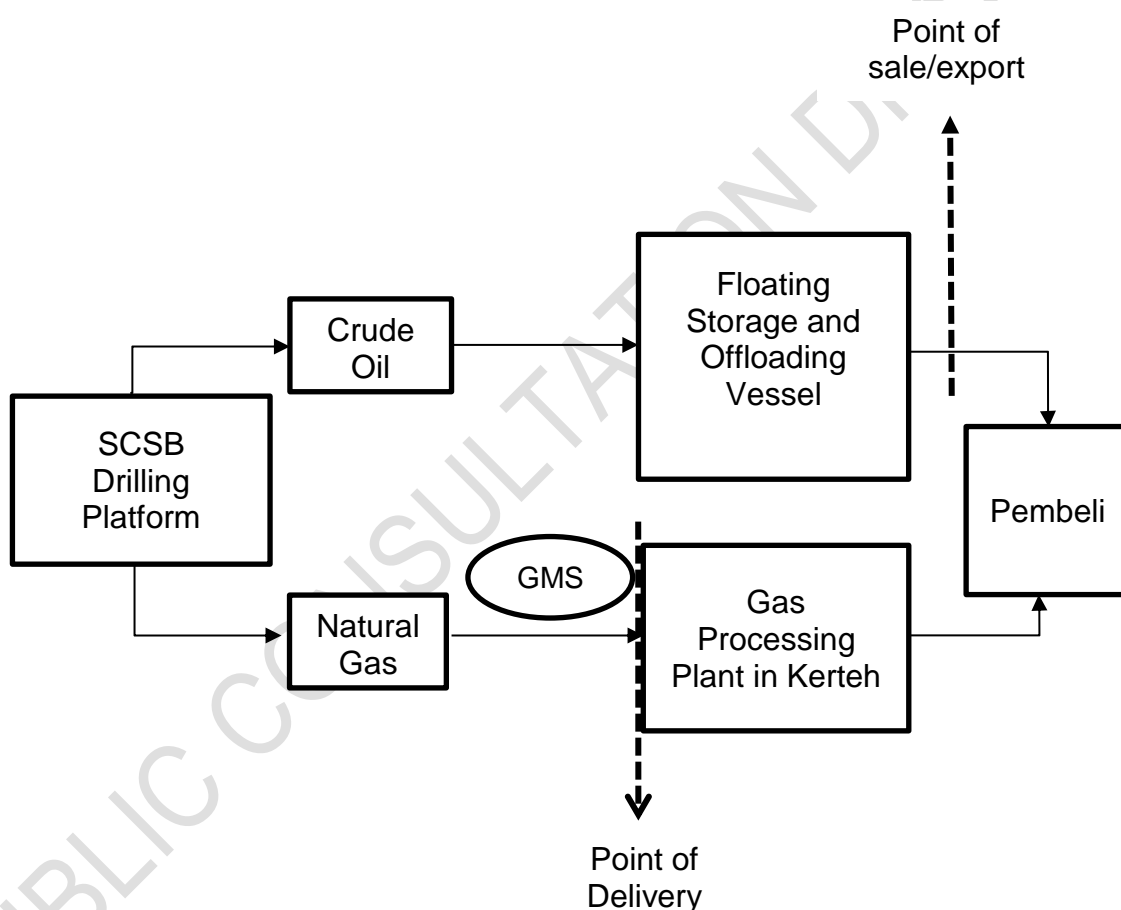
Note:

¹ The point of sale or delivery or export is not necessarily be at the same point depending on the agreements executed.

Example 1

Sinaran Carigali Sdn Bhd (SCSB) has one well that produces crude oil and natural gas. The crude oil produced will be stored in floating storage and offloading vessel offshore of Terengganu and natural gas will be delivered to the Gas Processing Plant in Kerteh.

The diagram of this example is as follows:



Based on this example, point of sale or export for crude oil is at floating storage and offloading vessel while the point of delivery for natural gas is at the inlet flange of the Gas Processing Plant in Kerteh.

- 6.3 The determination of point of sale or delivery or export is important in determining the income derived would be subject to tax under PITA or Income Tax Act 1967 (ITA). Income derived up to the point of sale or delivery or export is income that is subject to tax under PITA and income derived after the point of sale or delivery or export is subject to tax under ITA.
- 6.4 The same principle in paragraph 6.3 applies in determining whether expenses incurred are deductible under PITA or ITA. Therefore, any joint cost or sole cost² incurred until point of sale or delivery or export is considered part of the petroleum operation expenses and is deductible subject to the conditions stipulated under subsection 15(1) and section 72A of the PITA.

Note:

² A sole cost is an expense incurred by a contractor and not shared with another contractor in a partnership.

7. Chargeable Person

- 7.1 Referring to paragraph 3.4, the word "severally" in the interpretation means that each Chargeable Person in subparagraph i, ii and iii shall be subject to petroleum income tax separately.
- 7.2 Chargeable Person may consist of one contractor or a partnership. A partnership (referring to the meaning of a partnership in paragraph 3.6) is a joint venture between two or more contractors.

Example 2

SCSB is a contractor that carries out the exploration and exploitation of the country's petroleum resources.

On 1.1.2020 SCSB entered a petroleum agreement with PETRONAS to carry out petroleum operations within the operational area of Block PM 1 in offshore of Peninsular Malaysia. The accounting period for SCSB ends on 31st December each year.

There are two Chargeable Persons that are subject to tax under PITA as follows:

- (i) PETRONAS; and
- (ii) SCSB - Block PM 1 PSC

Example 3

SCSB and Bintang Carigali Sdn Bhd (BCSB) are contractors that carries out the exploration and exploitation of the country's petroleum resources as a partnership.

On 1.1.2015 SCSB and BCSB entered a petroleum agreement with PETRONAS to carry out petroleum operations within the operational area of Block PM 2 in offshore of Peninsular Malaysia and named as SCSB/BCSB - Block PM 2 PSC. The accounting period for SCSB and BCSB end on 31st December of each year.

There are two Chargeable Persons that are subject to tax under PITA as follows:

- (i) PETRONAS; and
- (ii) SCSB/BCSB - Block PM 2 PSC

- 7.3 Under the provisions of subsection 2(2) of the PITA, a single contractor or the same partnership enters more than one petroleum agreement, each petroleum agreement is a separate Chargeable Person. This concept is known as ring-fencing.

Example 4

Same facts as Example 2

SCSB has entered a new petroleum agreement with PETRONAS for Block PM 3 area in offshore of Peninsular Malaysia on 15.03.2021.

There are three Chargeable Persons that are subject to tax under PITA as follows:

- (i) PETRONAS;
- (ii) SCSB - Block PM 1 PSC; and
- (iii) SCSB - Block PM 3 PSC

Based on this example, SCSB has entered into an agreement to carry out petroleum operations under two petroleum agreements. Thus, SCSB is a separate Chargeable Person for (ii) and (iii) above based on the concept of ring-fencing.

Example 5

Same facts as Example 3

SCSB and BCSB are a partnership that has entered a new petroleum agreement with PETRONAS for the Block PM 4 area in offshore of Peninsular Malaysia on 30.04.2022.

There are three Chargeable Persons that are subject to tax under PITA as follows:

- (i) PETRONAS;
- (ii) SCSB/BCSB - Block PM 2 PSC; and
- (iii) SCSB/BCSB - Block PM 4 PSC

Based on this example, the same partnership has entered into an agreement to carry out petroleum operations under two petroleum agreement. SCSB/BCSB is a separate Chargeable Person for (ii) and (iii) above based on the concept of ring-fencing.

- 7.4 The expenses (sole cost) incurred by a contractor within a partnership are deemed to be incurred by a Chargeable Person provided that the expenditure meets the conditions under subsection 15(1) of the PITA.

Example 6

Facts are the same as Example 3.

SCSB has obtained a loan with a bank in Malaysia. The loan is solely used to carry out its petroleum operations. SCSB has paid interest to the bank for the loan that has been made.

Although the interest expense is solely borne by SCSB, the interest expense is allowed as a deduction because it is incurred wholly for the purpose of petroleum operations and fulfill the conditions under subsection 15(1) of the PITA.

8. Continuing Partnership

8.1 Generally, most petroleum operations in Malaysia are carried out through partnerships according to the contractual period stipulated in the petroleum agreement. However, the contractors in the petroleum agreement may change throughout the operational period with the approval from PETRONAS.

8.2 Changes in contractor within a partnership may occur due to the following activities:

- a) farm-out is the act of selling or transferring part or all of the rights or participating interest of a party in a petroleum agreement for one area of operation to another party; or
- b) farm-in is the act of purchasing or acquiring part or all of the rights or participating interest to conduct petroleum operations by a new contractor in a joint venture with an existing partnership.

These circumstances may occur repeatedly throughout the period of the petroleum agreement.

8.3 Referring to subsection 2(3) of the PITA, where there is a change of contractor within a partnership at any time during the period of the petroleum agreement and at least one original contractor from the succeeded partnership remains, then this succeeding partnership shall be treated as one continuing partnership.

8.4 Subject to paragraph 8.3, farm-out and farm-in activities do not affect the original Chargeable Person.

Example 7

Same facts as Example 3

The table shows the percentage of ownership in the partnership is as follows:

Contractor	Percentage of Ownership
SCSB	50%
BCSB	50%

On 1.1.2020, BCSB is no longer interested in continuing its operations in accordance with this agreement and fully disposes of its rights to Nikki Exploration Co. Ltd. (NECL). Hence, the percentage of ownership in the partnership from 1.1.2020 is as follows:

Contractor	Percentage of Ownership
SCSB	50%
NECL	50%

On 1.1.2022, NECL partially disposed of its rights to Bunga Raya Sdn. Bhd. (BRSB). Hence, the percentage of ownership in the partnership from 1.1.2022 is as follows:

Contractor	Percentage of Ownership
SCSB	50%
NECL	25%
BRSB	25%

Based on the above example, Chargeable Person is still treated as continuing even though BCSB has exited from the original partnership and NECL and BRSB have become new partners with SCSB in the partnership. This partnership is still treated as a continuing partnership since SCSB as the original contractor remains in the partnership and the farm-out and farm-in activities took place within the petroleum agreement period.

If SCSB farm-out its entire rights in this partnership, then the original partnership is treated as terminated and a new partnership will be formed.

9. Partnership for Contiguous Areas

- 9.1 Referring to subparagraph 2(4)(a)(i) of the PITA, a partnership that carries on petroleum operations under two or more petroleum agreements are contiguous or connected area, the petroleum operations in that area of operation are treated to be carried out under one petroleum agreement.
- 9.2 Operational areas which share a boundary or connected at any part of the block are called contiguous. The area is still treated as contiguous even if it is only connected at one point.
- 9.3 The contiguous area is determined based on the coordinates of the block specified in the petroleum agreement. Blocks that share some coordinates are contiguous.

Example 8

SCSB and BCSB have entered a petroleum agreement with PETRONAS on 15.6.2010 to carry out petroleum operation on partnership basis in an area Block SK B offshore of Sarawak for a period of 30 years.

On 1.1.2015, SCSB and BCSB have entered two new petroleum agreements for Block SK C and Block SK D. In summary, petroleum agreements owned by the SCSB and BCSB partnerships are as follows:

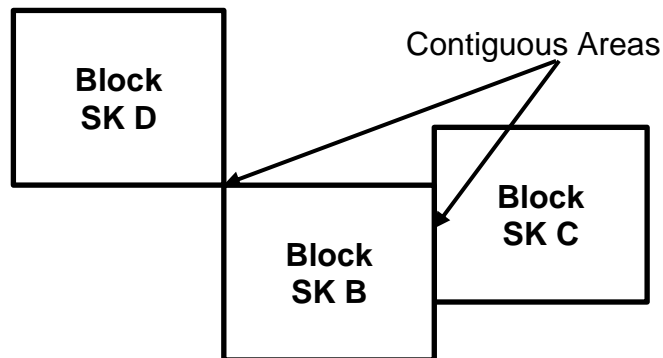
- (i) SCSB/BCSB – Block SK B PSC
- (ii) SCSB/BCSB – Block SK C PSC
- (iii) SCSB/BCSB – Block SK D PSC

The coordinate information is as follows:

Block	Longitude	Latitude
Block SK B	5' 45'30.000" N	117'0' 0.000" E
Block SK C	5' 45'30.000 " N	116' 0' 0.000" E
Block SK D	4' 35'30.000 " N	117'0' 0.000" E

It was found that Block SK B and Block SK C are contiguous as they share the same boundary based on longitude. Block SK B and Block SK D are contiguous as they share the same boundary or connected based on the latitude.

Therefore, Block SK B, Block SK C and Block SK D are deemed to be carrying out petroleum operations under one petroleum agreement although all three agreements are separately executed. In this example, the Chargeable Person is SCSB/BCSB - Block SK B, SK C and SK D PSC.

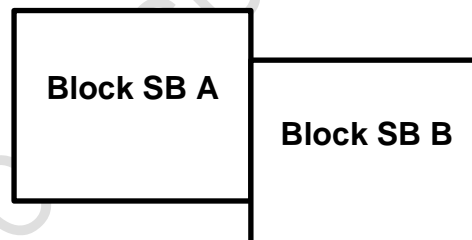


Petroleum operations area for SCSB and BCSB partnerships

- 9.4 The provision of subparagraph 2(4)(a)(i) of the PITA does not apply to petroleum agreement entered by a single contractor because it is not a partnership.

Example 9

SCSB has entered two petroleum agreements with PETRONAS for Block SB A petroleum agreement and Block SB B in offshore of Sabah on 21.2.2021 and 1.6.2022 in the contiguous areas.



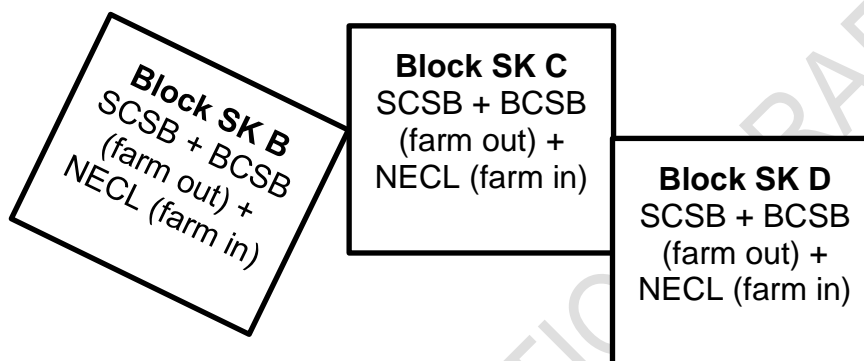
Both of these petroleum agreements cannot be considered as being carried out under one petroleum agreement as they do not meet the provisions under subparagraph 2(4)(a)(i) of the PITA.

- 9.5 In the event of a farm-out or farm-in for the same partnership that carries out petroleum operations in the contiguous area, then the petroleum operation in that operation area is still deemed to be carried out under one petroleum agreement.

Example 10

Same fact as example 8.

On 1.1.2020 BCSB is no longer interested in continuing operations and has disposed of its rights in all three operating blocks to NECL. The partnership still carries out petroleum operations as usual.



Referring to the above example, the partnership SCSB/NECL – Block SK B, Block SK C and Block SK D is deemed to be continuing from the partnership SCSB/BCSB – Block SK B, SK C and SK D PSC based on subsection 2(3) of the PITA despite there are farm-out and farm-in in all three operating blocks as SCSB who is the original contractor remains in the partnership and the farm-out and farm-in activities took place within the petroleum agreement period.

All three blocks are still located within the same contiguous area. Based on subparagraph 2(4)(a)(i) of the PITA, the partnership that carries out petroleum operations under two or more petroleum agreements where the operating area under the agreements is contiguous, the petroleum operation is treated to be carried out under one petroleum agreement.

Therefore, all three petroleum agreements entered by SCSB and BCSB are still treated as being carried out under one petroleum agreement despite the farm-out and farm-in in all three blocks.

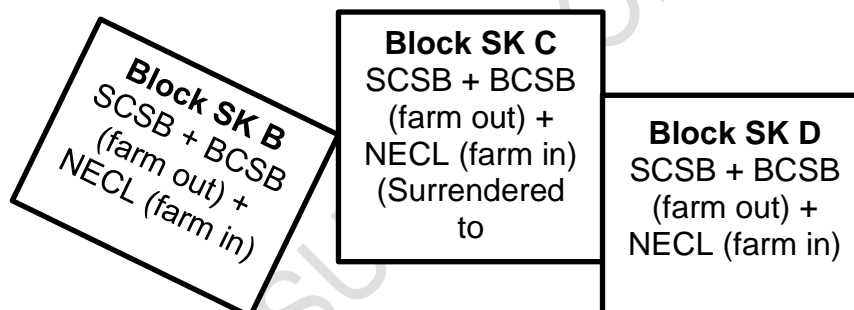
If SCSB and BCSB enter into a new petroleum agreement, Block E which is contiguous with SCSB/NECL – Block SK B, SK C and SK D PSC, then Block SK E is eligible to apply for contiguity as it meets the provisions of subparagraph 2(4)(a)(i) of the PITA. This is because the contractors who entered into the original petroleum agreement are the same parties although there has been a change in the composition of the existing partnership.

- 9.6 In the event of the surrendering of the right of any operating area in the petroleum agreement to PETRONAS or MTJA for a partnership that carries out petroleum operations within the contiguous area, then the petroleum operations in the operating area are still treated to be contiguous and carried out under one petroleum agreement.
- 9.7 Referring to subparagraph 2(4)(a)(ii) of the PITA, the agreement area contiguous with other blocks shall be treated as being contiguous even though part of the agreement area has been surrendered to PETRONAS or MTJA.

Example 11

Same facts as Example 10.

On 30.04.2022, Block SK C PSC was surrendered to PETRONAS.



Blocks SK B PSC and Block SK D PSC are still treated contiguous even though Block SK C PSC has been partially or entirely surrendered to PETRONAS based on subparagraph 2(4)(a)(ii) of the PITA. Therefore, petroleum operations carried out under Block SK B PSC and SK D PSC would still be treated as petroleum operations under one petroleum agreement.

10. Disclaimer

The examples in this PR are for illustration purposes only and are not exhaustive.

**Director General of Inland Revenue,
Inland Revenue Board of Malaysia.**