



State Comptroller of Israel | Annual Report 72a – Part Two | 2021

Ministry of Energy

The Benefits from the Implementation of the Gas Outline

The Benefits from the Implementation of the Gas Outline

Background

In 1999 and 2000 the natural gas reservoirs – Mari-B and Noa were discovered off the coast of Ashkelon. These reservoirs are part of the Tethys Sea project, the size of which is BCM 34 and from which gas was produced until 2019. Additional natural gas reservoirs were discovered between 2009–2013 in Israel's exclusive economic zone, including: "Tamar", "Tamar South-West", "Dalit", "Leviathan", "Karish" and "Tanin". To regulate the State's share in the gas profits, the Petroleum Profits Taxation Law was passed in April 2011 (its name was later changed to the Taxation of Profits from Natural Resources Law 2011), determining that the gas project will pay a levy on Petroleum profits. The share of the State in the gas profits is comprised of royalties imposed on revenues from gas sales, the Petroleum profits levy and income tax that applies to the profits of holders of rights in the gas reservoirs. In view of the limited number of bodies holding rights to search for and produce natural gas, and their need to cooperate due to the high investment costs required, cross ownerships on the gas reservoirs were formed as well as and monopolies of holders of gas rights. From 2011–2015 the Israel Competition Authority acted to reach an agreement with holders of the rights for gas exploration and production regarding the restrictions that would apply on them, in order not to affect the competition in this field. During these years, in the absence of consent and in the absence of regulatory certainty, the Leviathan, Karish and Tanin reservoirs were not developed. Government Decision 476 of 2015 approved "the outline for the increase of natural gas supply from Tamar gas field and fast development of Leviathan, Karish and Tanin and other natural gas reservoirs" (the Gas Outline) as agreed with the rights holders in the gas reservoirs. This framework determined, among other things, the reservoirs development schedule, ensuring redundancy in supplying gas and the structural change concerning ownership of the gas rights and provided holders' regulatory stability.



Key figures

**NIS 4.2
billion**

Revenue from income tax (including additional taxation due to the Israeli Tax Authority assessments) for gas projects, from 2011 to 2018.

**NIS 7.8
billion**

State revenues from gas and Petroleum royalties from 2004 to 2020.

**Only NIS
741
million**

Accumulated amounts from the levy on profits from natural resources between 2011 and June 30, 2021. (Compared to the Bank of Israel forecast of 2013, which stood at over NIS 1.7 billion by the end of 2020).

**NIS 200
billion**

Estimation of the amount to be received from the levy on profits from natural resources until 2064.

**NIS 57.4
billion**

Evaluation of the amount to be received from Petroleum and gas royalties from 2020 to 2064.

2 operators

And a mix of different ownerships in each of the three gas reservoirs.

3 reservoirs

Are expected to produce gas during 2022, the gas will flow to the national gas system through three different systems.

134 BCM

Approved for export to Egypt and Jordan.





Audit actions



From October 2020 to February 2021 the State Comptroller's Office examined the implementation of the Gas Outline and the benefits achieved following its implementation. The first part of the report reflects the findings and recommendations regarding the development of competition in the gas market in view of the affect the competition has on this market due to actions by some of the rights holders of the gas discoveries, the effect of the Gas Outline on the redundancy in supply of gas to the Israeli economy, gas export and the promotion of foreign and security relations. The second part reflects the findings and recommendations regarding the collection processes of oil and gas royalties, the oil profits levy and income tax. As part of the audit, various actions of the Ministry of Energy, the Israel Competition Authority and the Israeli Tax Authority were examined. Supplementary examinations were conducted at the Ministry of Finance,

the Accountant General Department, the Bank of Israel¹, the Ministry of Justice, the Israel Electricity Corporation Ltd. (IEC), the Electricity Authority, the Government Companies Authority and the natural gas production companies.

Key findings

-  **The purchase of gas from other suppliers by IEC following the "Leviathan" agreement** – the Competition Authority did not provide any reference as to whether the agreement between the IEC and the "Leviathan" partnership is a prohibited binding settlement affecting the competition law or does not adhere to the conditions determined by the Gas Outline. Therefore the agreement between IEC and Leviathan came into effect.
-  **The Gas Framework and development of the "Tamar South-West" field** – two years following the mediation agreement between the State and the reservoirs rights holders, the parties are still negotiating the share of the State in the profits from the future sales of the gas produced. The Accountant General Department and the Ministry of Energy are cooperating on matters of the engineering aspects of the reservoir development. At the same time, the audit found that the Accountant General Department has not yet examined the form of supervision over the "Tamar South West reserve", as required by the Outline, because there is no agreement regarding the entity that should be in charge of collecting the State's share.
-  **The State's share in revenues from the gas discoveries – an international comparison** – in December 2018 a team headed by the Ministry of Energy CEO completed an examination of the developments that occurred in the Israeli gas market during the five years since the government decision, and conducted a renewed examination of the supply and demand for natural gas, including resources, reserves and a current and future status of natural gas reservoirs development. However, the audit found that the team did not examine world developments over the years on the subject of taxation and did not examine Israel's position regarding this matter in comparison to the situation in countries of this region in particular and in the world in general.
-  **The handling of gas projects by the Tax Authority** – the Income Tax Assessor for Large Enterprises T-A deals with the Taxation of Profits from Natural Resources Law, and examines cross cutting issues in the gas project. Sometimes those issues affect income tax assessment of all rights holders in the project under examination and for

¹ The Bank of Israel has been appointed as responsible for investments and management of reservoirs accrued in a fund for the wellbeing of Israel's citizens (the Wealth Fund).



other projects. Dividing the gas reservoirs rights holders between various income tax assessors requires additional resources for training, guidance and findings sharing. It was found that all rights holders in the "Leviathan", "Karish" and "Tanin" reservoirs were grouped under the Income Tax Assessor for Large Enterprises, but not all of the rights holders in the "Tamar" reservoirs were grouped, one of its rights holders is assessed for income tax in Haifa.



Sharing information between the Ministry of Energy and the Tax Authority –

the Taxation of Profits from Natural Resources Law determines four subjects on which the Income Tax Assessor is obliged to consult with the Ministry of Energy commissioner before making decisions that are significant for the levy coefficient or the levy imposed on a petroleum project. Up until the audit completion date the method of sharing information between the Ministry of Energy and the Tax Authority remained unresolved. The Ministry of Energy did not take the necessary steps for sharing information and ensuring cooperation despite being addressed on this matter by the Tax Authority over the years 2016–2020. Moreover, the Ministry of Energy did not provide the Tax Authority with a written document detailing the conditions requiring fulfillment as part of the process of discovery recognition of project, the conditions and procedures for granting holding approval as well as information requested by the Tax Authority regarding one of the holdings. All these may influence the relevant determinations for calculating the levy coefficient and the date and scope of levies the project will actually be required to pay.



The dates of declaring a discovery and granting possession of the gas discoveries –

despite the fact that results of the "Leviathan" drilling were published at the end of 2010, the Ministry of Energy determined the discovery date as January 2014. This required the Tax Authority to examine the possibility of defining a different date for conclusion of the search period rather than the date determined by the Ministry of Energy for rights holders of the gas reservoirs, and required the sorting and classification of the reported results for search expenses and establishment expenses. Incorrect sorting and classification affect State revenues from gas receipts. It should be noted that during the postponement period between 2013–2014 the "Leviathan" rights holders spent hundreds of thousands of NIS that, in their opinion, should be considered as expenses attributed to the search period that are entitled to benefits, until possession is granted according to the Taxation of Profits from Natural Resources Law.



Forecast of Wealth Fund revenues² – opposite to the forecast given in 2013 by the then Bank of Israel Governor for the beginning of the Wealth Fund activities in 2018 (after the accrual of a billion NIS) and the forecast according to which by the end of 2022 the fund will have accumulated approximately USD 3.9 billion, the amount the fund has accrued, as of June 2021 was only NIS 741 million.






² See the Fund for Israeli Citizens Law, 2014 (Fund for Israeli Citizens – Wealth Fund).



Gas reservoirs infrastructures – During 2022 three gas reservoirs are expected to be connected to the Israeli economy through three separate infrastructures, owned by three groups comprised of different ownerships, in order to reduce to some extent the centralization of the gas market and improve redundancies.

Exporting gas – Exporting gas has awarded the State of Israel certain advantages in the regional and international political-security area, and may promote normalization in relations with countries in the region, contributing to Israel's foreign relations.

Key recommendations

-  It is recommended that the Competition Authority examine the contracts regarding gas sales of gas reservoirs submitted for its approval and consider the conditions they include, and whether they contain any breach of the Gas outline or of competition terms, as determined by the Competition law and not exempted by the government decision regarding the Gas Outline.
-  After the agreed order enabling rights holders in Tamar to sell gas from the reservoir separately was being approved in June 2021, the State Comptroller's Office recommends that the Competition Authority monitor quotations by the rights holders for gas sales, and examine all possible actions should any concern arise of price coordination between the rights holders in the "Tamar" and "Leviathan" reservoirs.
-  It is recommended that the Accountant General Department and the Ministry of Energy complete formulating the way for monitoring "Tamar South-West" reservoirs and reach an agreement regarding the appointment of an entity in charge for collecting the State's share. It is further recommended that the Accountant General Department complete the negotiation on all matters pertaining to the implementation of the mediation agreement concerning the proceeds.
-  It is recommended that the Ministry of Energy monitor from time to time the policy accepted worldwide for determining the rate of countries share in gas profits so that it will be prepared in advance to update Israel policy upon completion of the government's commitment for regulatory stability, determined in the Gas Outline as 2025. This should be done with transparency, with combination of additional tools and while maintaining feasibility of exploration for new gas reservoirs and gas production. It is further recommended that the Ministry of Energy and the Tax Authority determine methodology for calculating and publishing annually updated rates of the State's share in the revenues from gas discoveries.
-  It is recommended to establish a joint team of the Tax Authority and the Ministry of Energy (approved by the Minister of Finance) for monitoring the levy and gas profits



coefficient and to complete an agreed procedure for consultations between the Ministry of Energy and the Tax Authority. It is further recommended that this team examine the possibility of determining uniform reporting, as much as possible for both entities, in order to reduce bureaucracy, improve the efficiency of the monitoring process of the share in revenues owed to the State and to prevent gaps and mistakes.



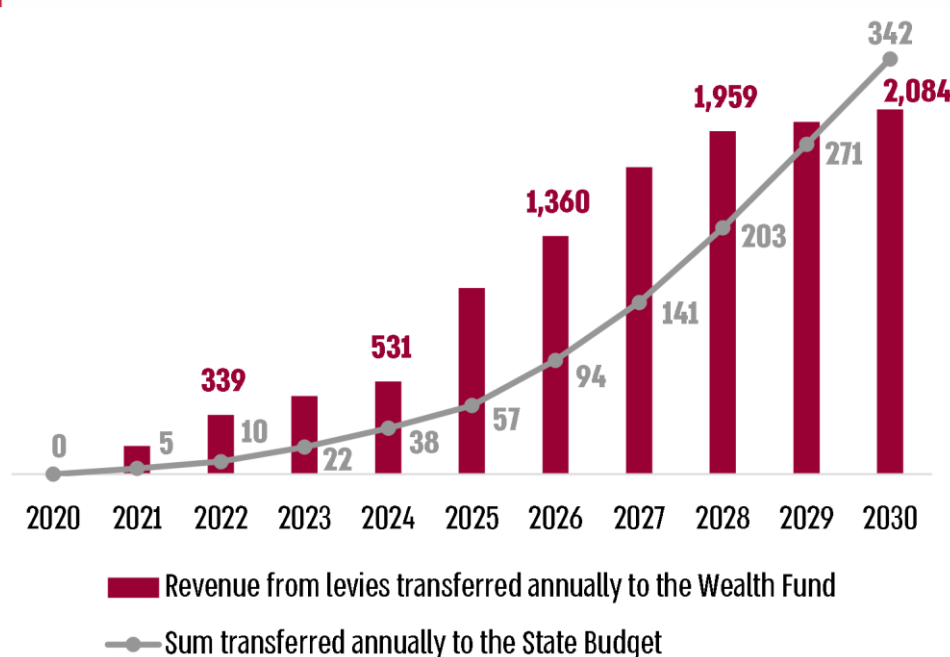
It is recommended that the Ministry of Energy recognize a discovery and determine the possession date according to the earliest possible date when commercial production becomes feasible, independently of the actual date of submission of documents, and no later than the date of submitting the application for discovery and possession. This date matches the reduction in the project's financial and engineering risk level, as described in the explanation to the Taxation of Profits from Natural Resources Law.



The Tax Authority should complete its examination of all matters pertaining to resolving the collection of taxes on nature profits, in view of the disparities discovered and accumulated experience, including examination of the search period. Amending the regulation will decrease the differences of opinion between the projects rights holders and the State and will reduce the possibility of postponing tax payments.



The forecast of revenues from the levy on profits from natural resources and the funds that will be transferred to the State budget, every year, until 2030 (in millions of USD dollars)



The source: data of the Tax Authority as presented to the special committee for supervising the fund for management of State revenues from the levy on gas and oil profits, July 28, 2020, processed by the State comptroller's office.

Summary

The natural gas economy is facing major challenges and has several regulators. In face of the variety and complexity of the issues at hand, the large amounts in question and the effect each of these issue have on other relevant issues, it is highly important that the various regulators formulate rules of cooperation between them. Despite over a decade have passed since the discovery of the natural gas reservoirs, the main regulators responsible for developing the gas economy and maintaining the State's financial interests, have not succeeded in formulating an agreed and coordinated work procedure that will contribute to assuring an appropriate share of the State from the gas production.



The findings raised in this report indicate that some of the objectives for which the Gas Outline was formulated have been achieved. Three gas reservoirs have been developed and during 2022 three separate entries connected to the national gas system are expected to operate, in addition to the LNG import buoy. Moreover, an additional operator will begin supplying gas to the economy, thereby reducing cartelization. This will greatly improve redundancies on the gas market. However, during the audit period according to the principles determined in the Gas Outline, there are still cross holdings between the rights holders of the gas reservoirs and there is one operator for both reservoirs, which may affect the sections in the competition law that have not received exemption within the Gas Outline. As of June 2021, the sum of NIS 741 million (as of 2019 – NIS 474 million) has been accrued in the Wealth Fund, compared to the Bank of Israel forecast delivered in 2013, according to which an amount of NIS 1.7 billion was expected to accumulate by the end of 2020.

The gas economy has significant effect on the economy, industry, on energetic security and on Israel's political resilience. Therefore, the Ministry of Energy, the Tax Authority, the Competition Authority and others must cooperate in the relevant areas, in order to ensure utilization of the potential inherent in this resource, including the need to increase the wealth of the public funds.