Uganda's Upstream Oil and Gas Fiscal Regime

A COMPREHENSIVE COVERAGE

May 2018

CRISTAL ADVOCATES

4th Floor, Padre Pio House, 32 Lumumba Avenue,
P.O. Box 1769, Kampala - Uganda
Tel: +256 (414) 671 274
Email: admin@cristaladvocates.com
www.cristaladvocates.com

Table of contents

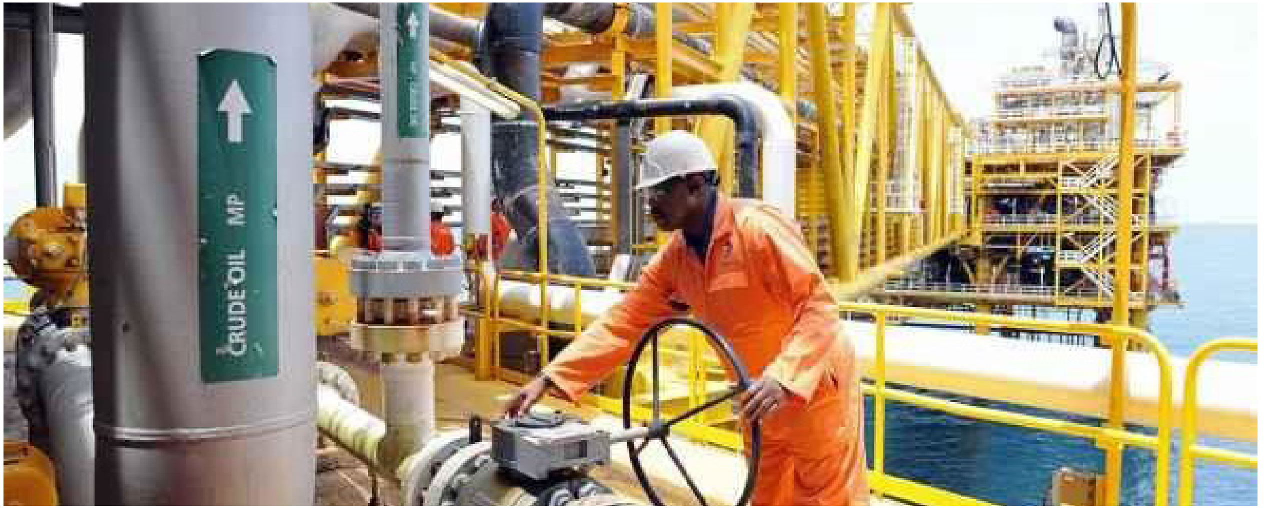
1	Definitions	3
2	Introduction	4
3	Overview of upstream oil and gas fiscal regimes	5
4	A review of Uganda's fiscal regime	11
5	Contacts for this publication	19
6	Contacts us	23

1 Definitions

Unless the context requires otherwise, the following words used in this publication mean:

APT:	Additional Profits Tax;
BIT:	Bilateral Investment Treaty;
BOPD:	Barrel Of Oil Per Day;
CGT:	Capital Gains Tax;
CIT:	Corporate Income Tax;
EACCMA:	East African Community Customs Management Act, 2004;
FDI:	Foreign Direct Investment;
FET:	Fair and Equitable Treatment;
GoU:	Government of Uganda;
IOCs :	International Oil Companies;
ITA:	Income Tax Act;
MIT:	Multilateral Investment Treaty;
MPSA :	Model Production Sharing Agreement;
NOC:	National Oil Company;
OECD:	Organisation for Economic Cooperation and Development;
PEPD:	Petroleum Exploration Development and Production Act, 2013;
PSA:	Production Sharing Agreement;
IDL:	Infrastructure Development Levy;
RRT:	Resource Rent Tax;
RSA:	Risk Service Agreement;
USD :	United States Dollar;
VATA:	Value Added Tax Act

2 Introduction



As Uganda embarks on its defining journey to develop the necessary infrastructure for crude oil production, the importance of fiscal and taxation regimes in attracting and retaining investment cannot be overstated. Fiscal and taxation terms can equally be used to encourage continuing exploration activities to maximize the country's oil and gas potential.

Designing and implementing sound fiscal and taxation systems for the upstream oil and gas sector is very important as it influences the investor's decisions on exploration activities, scale of investment, rate of production, scope of enhanced recovery operations as well as the timing of final abandonment. Fiscal and taxation terms also determine how big a petroleum discovery must be to justify commercial development.

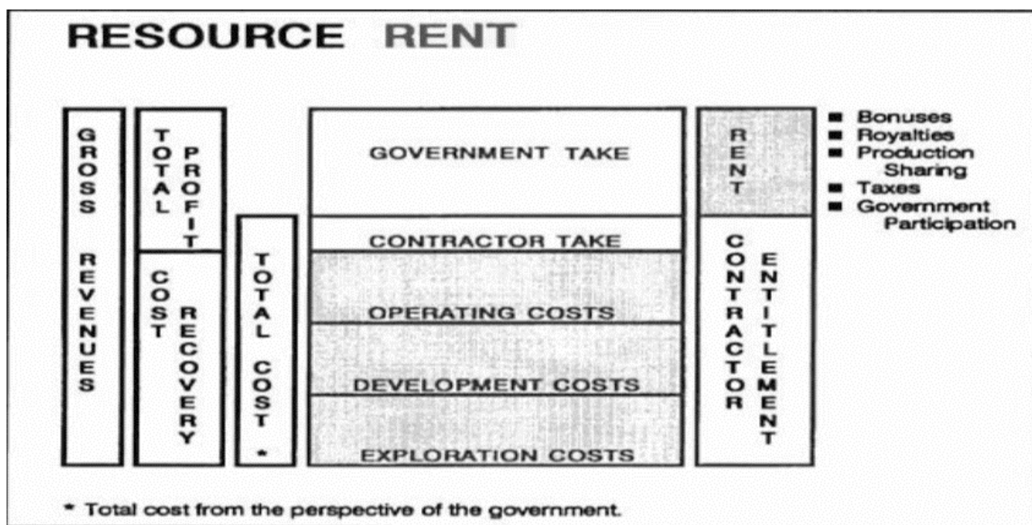
Robust fiscal and taxation regimes must take into account country settings and other trade-offs to create an environment that is competitive enough to address the concerns of the two principal stakeholders, namely the government and the IOCs. Progressive regimes must consider a variety of circumstances that include deep-water, high versus low petroleum prospectivity, different cost environments as well as fluctuations in oil prices. They must have in built flexibility and efficiency all aimed at providing a stable investment environment.

This publication provides an in-depth record of Uganda's upstream oil and gas fiscal regime. Drawing from but not limited to the provisions of the PEDP and the regulations thereunder, the 1999 MPSA, the ITA, the VAT Act and the EACCMA, it provides essential information to all interested stakeholders. Though we understand that a new MPSA has been adopted by the Government of Uganda, it is not yet publicly available and has therefore not been considered in this publication.

3 Upstream oil and gas fiscal regimes

Upstream oil and gas fiscal regimes combine legal and contractual instruments setting out the framework for conducting petroleum operations and the financial approaches to allocate the arising economic rent (wealth) between the government and the IOCs. Economic rent is the difference between the revenues accrued from the production of hydrocarbons and the costs of production including the investor's return on investment.

Illustration of economic rent



Resource rich countries usually depend on IOCs which have the financial means and the technical expertise to exploit the oil and gas resources efficiently. These countries in turn use fiscal tools that include though not limited to taxation, levies, bonuses and royalties to extract the wealth from the sector. The following fiscal tools below are generally applied in the upstream oil and gas sector.

a. Royalties

Royalties are also known as severance or production taxes. They are broadly categorised into two types, namely: specific or ad valorem and are levied on the extraction of natural resources.

Specific royalties are computed as a fixed value amount on the quantity of the resource extracted, while ad valorem are charged as a percentage of the monetary value of the resource. Specific royalties are easy to administer, provide early revenues and are not affected by fluctuations in commodity prices. Government revenues, however, remain stagnant if resource prices increase and do not keep up with inflation. Ad valorem royalties address some of these concerns through valuation based on the prevailing commodity prices.

Royalties are typically taken right off the top of oil and gas petroleum production but there can be variations that take into account defined costs incurred in production to arrive at the net base on which royalties are computed.

Royalties in their traditional form can be regressive and can lead to premature closure of operations if the prevailing prices are insufficient to cover the marginal costs plus the royalty. To alleviate this, some countries have introduced a profit element in their royalty regimes via the sliding scale system or deducting specified costs from the production base on which royalties are computed.

Under the sliding scale system which incorporates both the incremental and slab schemes, royalties rise with the level of production. Both schemes define the production threshold levels and the applicable royalties. The difference between the two is that under the incremental scheme, the higher level of royalty is payable on incremental production while under the slab scheme, the higher level of royalty is payable on the entire production not just on the incremental production.

The deduction method provides that some costs incurred in production can be removed from the gross production in arriving at the net production base on which royalties are computed.

Uganda's upstream oil and gas fiscal regime includes royalties.

b. Resource Rent Tax

This is also known as Additional Profits Tax. APT provides the government with a greater share of natural resource wealth and it distorts investment decisions less. APT arises if the accumulated net cash flow from the oil and gas project is positive.

Resource Rent Tax is categorised into two, namely the R- factor and the rate of return scheme. R factor based APT links taxation to the investment payback ratio also known as the R-factor. R-factor is the ratio of the IOC's cumulative receipts over the cumulative costs including the upfront investment. APT in this case applies when the R-factor exceeds one.

Rate of return APT applies after a target rate of return on the investment is realised. The cumulative positive net cash flow is determined by reference to a discount rate reflecting the opportunity cost of capital in the country's upstream oil and gas sector. When the project cash flows turn positive, the target rate of return is considered realised and APT applies on the profits above this threshold.

Though APT is lauded as a progressive fiscal tool by investors, government revenue stream becomes back-loaded. The government may not receive any revenues at all for less profitable projects that do not achieve the targeted rate of return. Countries rarely rely solely on APT. It is usually supplemented with royalties and standard corporation taxes that provide some early revenues. The practice in most countries is to target APT for only very profitable projects.

Uganda's upstream oil and gas fiscal regime does not provide for resource rent tax. .

c. Brown tax

Brown tax derives from E. Cary Brown proposals in 1948 from whom the name derives. Projects generating positive cash flows are taxed at the applicable rate, but a cash refund is made to the investor when there is a negative net cash flow.

Brown tax entails the highest level of risk to the government. If a project turns out unprofitable, the government may have to make unending cash refunds to the investor if the project generates negative cash flows all through. In practice, Brown tax is rarely applied in its purest form. It is supplemented with royalties and standard corporation taxes.

Uganda does not have brown taxes in its mix of the upstream oil and gas fiscal regime..

d. State participation

Governments may participate directly in upstream oil and gas projects by taking up an equity stake giving an opportunity to share in the upside of the project as well as exercising greater control. Equity participation can

potentially be costly to the government because it has to bear its share of the capital and operational costs related to the project. There are also likely conflicts of interest that may arise given the government's role as regulator which may be inconsistent with its commercial objectives as a shareholder.

Forms of state equity participation

Equity stake	*Discussion*
Paid up equity on commercial terms	The equity stake in a project is acquired at prevailing commercial terms.
Paid up equity on concessional terms	The equity stake in a project is acquired at concessional rates below the market price.
Carried interest	The IOCs initially foot the petroleum expenses which the government reimburses from production proceeds.
Free equity	The government acquires an equity stake in the project freely as the title suggests without making any contribution or payment.

Uganda's upstream oil and gas fiscal regime considers state participation.

e. Auctions

Countries employ different methods of granting petroleum rights. These include informal processes such as first come- first serve or auctions. Auction based processes involve companies submitting their exploration and development plans where the highest paying or scoring bidder based on the criteria set wins the oil and gas rights. Proponents of auctions as a means of granting oil and gas rights contend petroleum blocks are assigned to the party that is best able to use them. Auctions are popular with governments because they generate upfront revenues.

Uganda's upstream oil and gas fiscal regime incorporates the use of auctions and the country had its first competitive licensing round about 2 years ago.

f. Production sharing

Under production sharing, the state as owner of the petroleum resources engages an IOC to find and extract the resource for a share in production. The investor is allowed to recover the exploration, development and production costs incurred in their operations before sharing the remaining production with the government. This however only happens in the event that discovery, development and production occur via what is known as cost oil or cost recovery.

It is common for PSAs to limit the amount of production available each accounting year for cost oil purposes and this is known as the cost recovery limit. If the operating and capital depreciation costs are more than the allowable cost oil, the balance is carried forward and recovered in subsequent periods.

Uganda's upstream oil and gas fiscal regimes provides for production sharing and cost recovery.

g. Bonus payments

Bonuses are generally made upon the signing of oil and gas contracts hence the term signature bonuses. Bonus payments are typically cash based but can sometimes consist of equipment and technology. Another form of bonus dubbed the production bonus is paid by IOCs to the government when production commences or reaches a particular agreed milestone.

Uganda incorporates bonuses in its mix of the upstream oil and gas fiscal regime.

h. Export taxes

Export taxes are not that prevalent anymore. Levies may be imposed on natural resources exports to restrict global supply with a view to controlling world prices. In other instances, they are imposed to encourage the domestic processing and value addition activities of the natural resources in the country of extraction.

There are no restrictions imposed on the export of hydrocarbons in Uganda but there are domestic market obligations that must be satisfied. IOCs are obliged under the domestic market requirements to supply a designated amount of crude oil prior to exportation.

i. Corporation income taxes

Most countries include upstream oil and gas projects within their standard corporate tax regime though a higher tax rate may be applied to extract more resource wealth. This approach may not require the introduction of a separate tax regime given the stakeholders are already familiar with the legal and operational framework of the corporation tax regime.

In its pure form, standard corporation tax typically applies to the consolidated operations of an organisation.

In upstream oil and gas regimes, the subject of taxation is commonly the operation of individual projects via the ring-fencing arrangement. This means that an IOC operating one project while developing another one cannot for tax reporting purposes consolidate revenues and expenses from the different projects. Ring-fencing is introduced to protect the tax base, which could otherwise be eroded through unremitting deductions.

Uganda applies the standard corporate taxation though with modifications for its upstream oil and gas sector and ring-fencing conditions apply.

j. Import duties

Customs duties are imposed on most goods imported into a country. Though they are usually levied to protect domestic industries, they are one of the most important source of government revenue but can significantly increase the cost of imported raw materials, components and capital goods.

Much of the specialised equipment and consumables used in the upstream oil and gas sector in developing countries is imported.

Uganda is part of the East African Community Customs Union where inputs for upstream oil and gas projects are exempted from import duties.

k. Withholding taxes

Another means of extracting economic rent is the application of withholding taxes on interest, dividends, natural resource payments, royalty payments and specified service payments that are paid to non-resident persons who have sourced income from the resource rich country.

Uganda applies withholding taxes in its mix of the upstream petroleum fiscal tools.

l. Value Added Tax

VAT applies on most items and is principally borne by the final consumer. VAT registered persons can claim

VAT incurred on their inputs for business operations. VAT would thus have little impact on upstream oil and gas projects if the IOCs are registered for VAT usually pegged to production. Petroleum projects however have long lead times between investment and production implying IOCs would have to wait for a number of years to register for VAT when they start production. The VAT cost incurred during the investment phase is significant and can adversely affect project viability and bankability.

Even if special consideration is made for projects at investment stage to register for VAT, there are common delays with processing the VAT refunds in many of the developing countries. It is therefore usually the norm that exploration and development activities in the upstream petroleum sector are relieved from VAT via the exemption and zero rating mechanisms and Uganda has a deemed VAT paid system that is somewhat similar to the zero rating system.

m. Fiscal stabilisation clauses

Investment in the petroleum industry is long term, large scale and upfront, which raises concerns for investors with regard to fiscal changes that might dilute the value of their investments. One safeguard mechanism is the inclusion of stabilisation clauses in project agreements. Stabilisation clauses can restrain a government from unilaterally reviewing the terms of the agreements. They aim at ensuring that the fiscal terms of the agreement executed are not altered to the disadvantage of the investor during the duration of the project.

While stabilisation clauses can seem attractive to the government in the short run as an inexpensive way of minimising investor risk, they may have costs in the long run through limiting government's ability to modify tax and legislative policy.

It is generally understood that Ugandan signed PSAs contain stabilisation clauses.

o. Capital gains taxes

CGT is generally imposed on profits realised on the sale of non-depreciable and non-inventory assets that are purchased at a cost amount lower than the amount realised on sale. Some countries do not tax capital gains at all or tax a limited range of gains. Some countries provide exemption from CGT provided the gains arising from the disposal are reinvested in the country. Farm down transactions in the petroleum sector are usually targeted for capital gains tax in most developing countries including Uganda.

Gains arising on the disposal of business assets are taxed under the corporate income tax regime in Uganda.

p. Annual fees

Most countries require petroleum companies to pay annual rental fees for the acreage held where petroleum activities are undertaken. There can be additional impositions such as training fees to facilitate the transfer of knowledge to local residents.

Uganda's upstream oil and gas fiscal regime provides for annual fees.

q. Stamp duty

Stamp duty is charged on the legal recognition of certain legal documents. In the context of the upstream petroleum industry, the chargeable instruments to which stamp duty could apply can include assignment deeds or other related instruments that confer rights.

Uganda's upstream petroleum fiscal regime provides for stamp duty.

r. Local government taxes

These represent taxes assessed and levied by local authorities to fund a wide range of local authority services. Local governments of areas where the oil and gas projects are located can impose these provincial levies.

Uganda's upstream oil and gas fiscal regime envisions the imposition of local government taxes though under different legislation regulating the operations of Local Governments.

s. Environmental taxes

Environmental taxes are aimed at curbing or reducing the extent and amount of the use or consumption of harmful substances or activities, or depletion of a resource. Uganda's upstream oil and gas legislation regulates the environmental considerations of the upstream oil and gas sector.

t. Local content

Local content generally means the added value brought to a host nation through the activities of the oil and gas industry. Oil companies may therefore be obliged to employ local staff, invest in supplier development, as well as procuring goods and services locally.

Local content is catered for in Uganda's upstream petroleum legislation and the underlying regulations.

4 A review of Uganda's fiscal regime

Uganda's upstream oil and gas fiscal regime incorporates the following tools discussed in detail below.

a. Legal framework for fiscal regimes

The right to explore, develop and produce petroleum is granted under two broad systems, namely the concession and contractual arrangements that consist of PSAs and RSAs.

The concessionary system originated with the very beginning of the petroleum industry in mid-1850's and still predominates in OECD countries. As the term suggests, concessionary systems allow the private ownership of resources which is rooted in the Anglo-Saxon legal tradition. Ownership of the petroleum is vested into the IOC at wellhead subject to the payment of royalties and taxes.

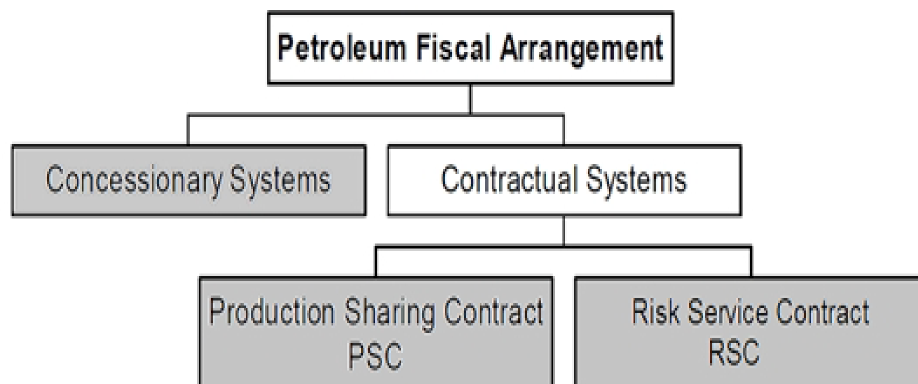
Contractual systems comprise PSAs and RSAs and in both the government retains ownership of the petroleum. PSAs were popularised by Indonesia in the 1960s a period of raging nationalistic hostility towards foreign IOCs and their concessions. PSAs were reluctantly accepted by IOCs and are now the leading system for allocating petroleum rights to oil companies in developing countries.

Under the PSA, ownership and right to exploit the petroleum resources remains with the state but an IOC is hired as a contractor to undertake exploration and exploitation activities. The state retains title and ownership of the petroleum extracted but the IOC is reimbursed costs incurred by way of entitlement to a portion of the oil produced technically referred to as cost oil and an additional share of profit oil. The IOC bears the exploration and development risks and is not compensated in the event of project failure.

RSAs are used in countries where there is opposition to concessions or even PSAs. They represent an arrangement whereby the state hires an IOC both for its technical and financial capability to assume the role of contractor in petroleum exploration and exploitation. RSAs have some resemblance with the PSAs in the sense that the IOC bears the financial risks and is reimbursed for its sunk costs only if it succeeds in commercialising production. The difference lies in the mode of sharing the profit oil.

Under a PSA, the IOC as contractor is entitled to a predetermined share of profit oil. Under RSA, the IOC's cost recovery and profit share are determined according to a mutually agreed upon formula. Payment of the service fee is usually made in cash and not in kind as is the case under the PSA unless there is a buy back clause.

Petroleum regimes



Similar to other developing countries, Uganda has opted for PSAs. The Constitution and the PEDP vest petroleum resources in the government on behalf and for the benefit of the people of Uganda. The government can exploit these resources either via the NOC or by way of contracting the IOCs.

The preference for PSAs by developing countries arises from the ideological belief that the government is in a much stronger position than under a concession to exercise greater control over the natural resource development process though the reality is that both the PSA and the concession can be made equivalent both in control and economic rent allocation.

b. Investment protection

Prior to investing in developing countries, IOCs seek assurance that the risk of unilateral and sudden changes to the law and investment agreements potentially diluting the value of their project can be satisfactorily managed.

One specific feature of the petroleum industry which heightens political risk is that the exploration and development of resources take place where the resources are. Once the investment has been sunk, host governments can renege on their earlier commitments and toughen the fiscal environment. Subsequent increases in petroleum prices can also make an apparently profitable deal under an agreement previously negotiated look unattractive, and this can be a trigger point for government to revise fiscal terms, sometimes to the detriment of the IOCs.

There are three legal techniques which investors seek to mitigate the above discussed political risk or at least limit the resulting economic loss, namely: legislative, contractual and treaty based - all of which are embedded in Uganda's upstream oil and gas fiscal regime.

1. Legislative protection

Legislative support against unilateral revision of petroleum terms is usually by substantive provisions in national legislation setting out guarantees for the protection of a category of investments. The basic criticism of law based protection measures however is that parliament can undo whatever it enacts.

In its quest to attract FDI to petroleum and other capital projects, Uganda has passed legislation that reassures investors of protection. Uganda's constitution guarantees the right of every person to own property either individually or in association with others and in the event of compulsory acquisition, there should be prompt and fair compensation.

2. Treaty based protection

Bilateral and multilateral investment treaties are also used to protect investors. BITs concluded between capital exporting and importing countries set out substantive principles on investment protection, as well as the procedures of investor state arbitration. The umbrella clause, the Fair and Equitable Treatment (FET) standard and the principle of utmost good faith embedded in BITs ensure the provision of additional protection.

The wording of an umbrella clause in a BIT is broad and can be interpreted as elevating every single contractual obligation entered into by a state to the status of a treaty obligation. Premising on the FET standard, it can be argued that if a stabilisation clause has been included in an agreement, there is the expectation that the law will not be changed or that if changed, a renegotiation will follow to rebalance the fiscal position.

Uganda presently has BITs with Denmark, France, Germany, Netherlands, Switzerland and the United Kingdom. More BITs have been signed with China, Belgium and Luxemburg, Eritrea, Nigeria, South Africa and Egypt but are not yet in force.

3. *Stabilisation clauses*

Investors in the petroleum sector are keen to include stabilisation clauses in their investment agreements. These clauses aim at ensuring that future changes in a country's legislation do not vary the terms of the contract as originally concluded. Stabilisation clauses have transformed over time and to date there are four types used in international investment contracts.

Types of stabilisation clauses

Stabilization clause	*Discussion*
Prohibition on unilateral changes	They are also known as intangibility clauses. They ensure that the terms of the investment agreement are neither modified nor abrogated except with the contracting parties' mutual consent.
Freezing clauses	The host state is precluded from changing its legislation in relation to the relevant project. Such clauses are criticized as encroaching on a country's sovereign legislative prerogative.
Allocation of burden	These clauses seek to allocate the fiscal and related burdens created by a unilateral change in the law usually to the NOC or the State.
Balancing clauses	These are sometimes called economic stabilization clauses. They provide for automatic adjustments or negotiations to reinstate the initial economic balance of the investment should there be an amendment to legislation with a fiscal impact to the investment.

Uganda has included stabilisation clauses in its MPSA to assure investor protection from political sovereign actions once the investment has been sunk. The stabilisation clause in Uganda's 1999 MPSA takes the form of an intangibility clause. The PSA cannot be amended, modified or supplemented except by an instrument in writing signed by the parties.

It is also generally understood that many of the Ugandan signed PSAs contain an economic stabilisation clause.

c. Farm down of petroleum interests

The petroleum sector extensively uses farm down techniques which involve the assignment of part or all of the petroleum interests to a third party. The third party, called the "farmee", may reimburse the "farmor" all or part of their sunk exploration costs and also commits to fund certain costs associated with future exploration work as outlined in a work programme.

Assignments help raise finances but also manage exploration and development risks in the sector. Countries that place onerous requirements on the assignment of petroleum interests can potentially discourage FDI in the sector.

Assignments provide the opportunity for big IOCs to collaborate with smaller oil companies that could have already played a key role in de-risking the acreage in place but are constrained by resources and expertise to go it alone that the bigger players possess.

Uganda's upstream oil and gas legislation and the MPSA both provide that the Minister may not unreasonably withhold consent to any proposed assignment which is standard industry policy practice. The MPSA does not however provide for exemption from the application of transfer taxes on the assignment of interests. The following taxes presently apply on the assignment of rights in Uganda.

Tax type	*Discussion*
Income Tax	Gains arising on the direct and indirect disposal or assignment of PSA interests are subject to income tax at the corporation tax rate of 30%. A strict reading of the ITA is that the value of future work obligations under a carry are also included in the consideration for the farm outs which impedes the full development of the sector.
Stamp duty	Unless exempted, every instrument relating to property situated or to any matter or thing done or to be done, in Uganda, is chargeable with stamp duty whether at the ad valorem or nominal rate.

d. Royalty payments under the PSAs

Royalties represent a charge that is levied by the resource owner on the extraction of natural resources. Royalties are favoured by the government because they are easy to administer, collect and also provide a first tranche of payment as soon as production commences to help in meeting the demands of an expectant population.

Royalties can however be unpopular with IOCs and are criticised as insensitive to costs, front end loaded, not being related to project profitability and with the potential to cause production to become uneconomic prematurely. IOCs find royalties palatable only if they are designed in a manner that links them to profitability of the project. Royalty rates in practice tend to range from zero to 20% but anything above 15% is considered as excessive.

Uganda's 1999 MPSA provides an ad valorem sliding scale incremental type of royalty as shown in the table below.

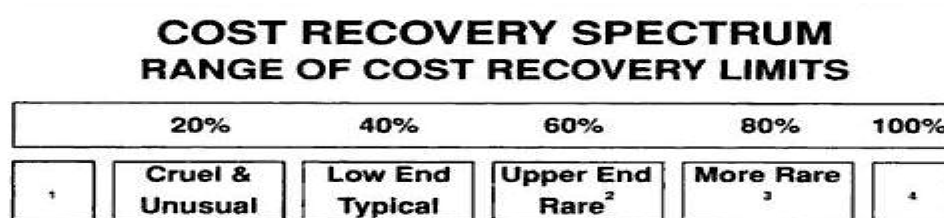
Gross Total daily production in barrels	*Royalty*
> 2500	5%
< 2500<5000	7.5%
< 5000<7500	10%
<7500	12.5%

e. Cost recovery under the PSAs

Exploration and development expenses are typically borne by the IOC which forfeits the right to be reimbursed in the event discovery and development fail. IOC's then pay royalties on gross production, if applicable. After deduction of the royalties, the IOC is entitled to a predetermined share of production for their exploration, development and production costs known as cost oil. The remainder of the production dubbed profit oil is then shared between the government and IOC at a pre-specified share.

Cost recovery is an ancient concept based on the principle of 'the one who put up the capital should at least get their investment back." Not all costs incurred by the IOC are cost recoverable and in some instances the cost oil can be taxable. The commonest costs recoverable include unrecovered costs from previous years. Additional costs can include operating costs which, in fact, are the most significant expenses once exploration and development costs have been recovered.

Cost recovery spectrums



As illustrated above, countries typically place a limit on the amount of oil that can be taken as cost oil in an accounting year. This allows the government a guaranteed share of profit oil because a certain percentage of production will always come through in the profit oil split. Countries with a cost recovery cap usually permit companies to carry forward in the next period the unrecovered costs which can be utilised then.

Cost recovery is also usually ring-fenced around the contract or development area whereby costs associated with a particular block or license can only be recovered from revenues generated from within that block or license. The more generous the cost recovery limit is, the longer time span for the government to realise its take.

Uganda's MPSA sets out costs that a contractor can recover in respect of their petroleum operations consistent with the foregoing discussion and also prescribes indicative cost recovery limit. There is an annual cost recovery cap of 50% with the remainder carried forward to the following year until recovered. Cost recovery is additionally ring fenced to the particular PSA and capital expenditure can only be recovered at the rate of 20% per annum.

f. Allocation of profit oil under the PSAs

Oil remaining after deducting royalties and cost recovery is referred to as profit oil. Profit oil is split between the IOC and the government, according to the terms of the PSA. While evaluating the competitiveness and attractiveness of the profit oil split, IOCs review the geological potential of the country and how it balances with other fiscal terms and the cost of doing business. For this reason, governments may not be entirely responsible for determining the appropriate division of profit oil since the IOCs define what the market can bear. The split of profit oil in most countries ranges from just under 15% to 55% for the IOCs.

The split of profit oil can be constant or based on a scale linked to cumulative or daily production rates. Some countries have progressive split systems linked to project profitability defined by the rate of return or r- factors.

Conventional PSAs are criticised for their inflexibility in the face of ever changing costs and prices. PSAs are ordinarily aimed at sharing production and not profit. To mitigate this shortcoming, some countries develop a family of PSAs adapted to different conditions in the country and these can be based on water depth, geographical location, maturity of basin or field and water depth. However, proliferation of contract types can lead to increased complexity.

Another way of introducing flexibility in the profit oil share is through the use of rate of return (ROR) or r factors, the effect of which is that effective government take increases as the project ROR rises. The elements of determining the r- factor vary from country to country. The profit oil spilt is thus premised on the r- factor ratio as is set out in the PSA.

The IOC's share of profit oil is usually, but not always, taxable. In some PSAs, the government pays the IOC's

corporation tax from its share of profit oil; these are called taxpaying PSAs. In some countries, the government has the option to purchase a certain portion of the IOC's share of production at a price lower than the market price: a provision known as the domestic market obligation.

Uganda's MPSA provides a schedule for the split of profit oil whose indicative figures are shown in the table below.

Profit oil split

Production BOPD	*Government take*	*Contractor take*
Production> 5,000	50%	50%
Production <5,000>10,000	55%	45%
Production<10000>20,000	60%	40%
Production<20,000>30,000	65%	35%
Production<30,000>40,000	75%	25%
Production<40000	85%	15%

g. Bonus and other payments under the PSAs

Bonuses and annual payments also extract rent from the upstream oil and gas sector. Bonuses are paid to the government at various stages in the petroleum cycle. Signature and discovery bonuses are received prior to project development, whereas production bonuses are paid when production commences or reaches certain production milestones.

Uganda's PEPD provides for bonus, rental and training payments. Such payments are front end loaded. They are also not linked to project profitability. Whilst they provide the government with upfront revenues that are easily collected, they can discourage investment if excessive, especially in marginal fields. Most tax regimes allow for bonuses to be tax deductible since they are a cost of doing business. Bonus payments are usually not allowed for cost recovery under PSA rules though are deductible for income tax purposes.

Uganda's MPSA provides for the following payments set out below.

Item	*First Exploration*	*Second Exploration*	*Third Exploration*	*Development/Commercial production*
Annual fees	USD 2.5 per km	USD 5 per km	USD 7.5 per km	USD 500 per km
Training fees	USD 200,000	USD 200,000	USD 200,000	USD 200,000

h. Government participation

There are strong views in resource rich countries that resource exploitation activities should not be left entirely in the hands of foreigners. For this reason, governments usually co-invest alongside the private investors as a means of asserting greater operational control and direction in the exploitation of petroleum resources. Excessive government participation is however not popular with IOCs for a variety of reasons including the potential of reducing entitlement to the petroleum sharing and unwarranted government sway in technical and working committee meetings.

Government participation, however, carries risks. If the government bodies are not efficiently staffed as well as robustly supervised, there is the potential likelihood of slowing project development, decreasing the revenue accruing to the state, as well as potential corruption issues.

Uganda's MPSA gives the government leeway to elect to participate in petroleum projects from the development stage. The government can take a maximum interest of 20% in a projects for which the IOCs carry up to production stage. The costs incurred by the IOCs in carrying the government through the development stage are recoverable from the government share of the cost oil when production commences.

i. Local content in the PSAs

Local content is the value added brought to a host nation including its regional and local areas through the activities of the petroleum industry. This could be realised through work force development via employment and capacity building of local workforce, developing supplies and services locally, as well as procuring supplies and services locally.

Strategies devised by countries to achieve local content include simple contractual requirements that favour the use of local goods and services, imposition of training obligations, and preferential regulation and taxation of local companies over foreign. Contractual or legal provisions may prescribe that technology transfer is included in the bidding parameters and the criteria for the acquisition of petroleum rights. Incentives may similarly be provided to foreign investors who re-invest their profits domestically as a strategy of anchoring local content.

Uganda's local content requirements presently derive from the PSA, PEPD and the Local Content Regulations thereunder and the contractual arrangements set out in the PSAs. Contractors and their subcontractors must endeavour to employ Uganda citizens as well as providing them with the necessary experience and expertise through the course of their contract.

The IOCs must also to give preference to goods and services produced by Ugandan citizens and Ugandan companies and where not available provided in conjunction with Ugandan companies or citizens.

j. Fiscal terms under the Income Tax Act

Uganda's income tax regime for the upstream oil and gas sector does not materially differ from the income tax regime applicable to other business operations but there are some modifications to take into account the peculiar features of the upstream oil and gas industry.

Income Tax terms

Issue	*Discussion*
Rate of tax	CIT rate of 30% is applicable on the sector taxable profits
Farm down transactions	Refer to section 4 (c) above
Tax losses	Tax losses may be carried forward indefinitely though the law is being re-vised to provide for income tax at the rate of 0.5% of the annual turnover if a business has tax losses carried forward for 7 successive years.
Ring-fencing	Expenditure incurred by a contractor in a license area can only be offset against income derived from the same license area. The same applies to tax losses incurred in the license area which can be utilized against income derived from the same license area.
Deductible costs	Prescribed categories of capital and revenue expenses are deductible for tax purposes but capped to the cost oil recoverable each year. This means that oil companies will commence paying taxes in the year oil production com-mences regardless of whether they are profitable or not which is contrary to the general principles of income taxation.

Issue	*Discussion*
Withholding taxes	IOCs are obliged to withhold tax at prescribed rates on a number of payments made to resident and non-resident persons
Natural resource income	Similar to Kenya and Tanzania, Uganda taxes natural resource income. Natural resource payments attract withholding tax at the rate of 15%when made to non-resident persons. Some of the transactions that fall within the realm of natural resource income include, among others, overriding royalties and production payments which are popular techniques for financing the development of oil and gas operations.

k. Fiscal terms under the Value Added Tax Act

IOCs in Uganda may register for VAT at exploration and development stages even before they embark on production. VAT registration though laudable may not solve the issue of timely refund of VAT repayments which continues to challenge many developing countries revenue bodies.

Uganda additionally operates a deemed VAT paid regime providing that whilst inputs for petroleum operations are charged VAT at the standard rate of 18%, the IOCs need not expend cash as the VAT charged is deemed to be paid under the law. The vendors to the IOCs similarly need not remit the VAT charged to the government but their ability to recover the input VAT they suffer in providing supplies to the IOCs is not affected.

Petroleum operations are defined under the VATA to mean authorised operations under a petroleum agreement for petroleum exploration, development, production and export, including planning, installation, transportation of petroleum, storage or decommissioning and for the construction of a pipeline or petroleum refinery.

l. Fiscal terms under the EACCMA, 2004

Uganda is part of the East African Community Customs Union and thus uses the same legislation applicable to all the East African countries namely Uganda, Tanzania, Rwanda Burundi and South Sudan with respect to customs matters. The EACCMA, 2004 exempts all machinery and inputs imported by licensed oil and gas companies and their subcontractors for direct and exclusive use in oil and gas exploration and development from import duty. This tax policy stance taken by Uganda is laudable and consistent with the position adopted by many other countries that exempt extractive projects from import duties.

m. Infrastructure Development Levy

The Finance Act 2015 introduced a levy known as the Infrastructure Development Levy paid on selected goods imported into Uganda. The levy is at the rate of 1.5% of the customs value of goods and is payable at the time goods are imported.

Petroleum companies engaging in upstream operations are not exempted from this levy which has the potential to adversely affect the project economics of petroleum projects.

n. Local government levies

Depending on the area of operation, local government authorities may levy, charge and collect fees, taxes, rents and rates that are set out in the Local Government's Act.

5 Contacts for this publication

Denis Yekoyasi Kakembo
(Author)
dkakembo@cristaladvocates.com
+256 751 834 168

Denis leads the firm's energy and tax practice. He is qualified both as a Lawyer and Chartered Accountant and is a UK trained energy, tax and investment professional with vast experience serving various industries but notably the energy sector in Sub Saharan Africa.

Prior to joining Cristal Advocates, Denis had worked for close to 10 years with Deloitte, an international audit and professional services firm where he started his career and rose to senior managerial positions.

At Deloitte, he lived and worked in Uganda, Kenya, Tanzania and the United Kingdom for over 6 years and subsequently became the firm's Chief of Staff for the Energy and Resources Industry practice seeing him play a lead advisory role on several projects in Uganda, Kenya, Tanzania, Mozambique, Rwanda, South Sudan, Somalia and Ethiopia.

Denis is widely published and a regular commentator in the local, regional and international media and speaker at various conferences regarding the taxation and financing of energy projects as well as the protection of large capital projects within the framework of international investment law.

Education

- Masters of Laws in Petroleum Taxation and Finance with distinction - *University of Dundee, UK*
- Certified Public Accountant (Uganda) - *ICPAU*
- Certified Chartered Accountant ("ACCA") - *ACCA*
- Post Graduate Diploma in Legal Practice - *Law Development Center, Uganda*
- Bachelor of Laws Degree - *Makerere University, Uganda*

Professional bodies

- Association of Certified Chartered Accountants
- Institute of Certified Public Accountants of Uganda

Experience statement

» Course facilitator at the Strathmore University on the taxation, risk management and the financing of upstream petroleum projects

» Key team member on a World Bank funded consultancy undertaking an institutional review of Kenya's Petroleum Institutions

» Client service manager who served a portfolio of energy sector clients in Kenya

» Client service manager on several transfer pricing documentation services to companies in Kenya, Uganda and Tanzania

» Client service manager for the Oil and Gas Association of Tanzania providing tax advisory assistance including interface with government agencies in Tanzania

» Client service manager for the Kenya Oil and Gas Association providing tax advisory assistance including interface with government agencies in Kenya

» Team leader on a project that outlined options for managing VAT in Uganda's emerging oil and gas sector. This paper formed the basis for reviewing Uganda's VAT extractive sector regime

» Led the team that prepared a technical paper for submission to the Ugandan tax authorities to clarify the taxation of subcontractor activities in the upstream oil and gas sector

- Team leader on various legal, tax and financial due diligence assignments of the financial and tax affairs of Production Sharing Agreement holders in Uganda, Ethiopia, Kenya and Tanzania
- Account manager managing the relationship and overseeing the provision of tax and compliance services in Uganda, Kenya, Tanzania and Mozambique to a major oilfield services company
- Preparation of VAT, customs and withholding tax manuals for major upstream oil and gas companies in Tanzania and Kenya
- Managing the corporate re-organisation of 2 major upstream oil and gas companies in Tanzania
- Transactional advisory services relating to the assignment of drillship and the incidental services contracts thereof for 2 major upstream operators in Tanzania
- Facilitator at several international tax trainings
- Team Leader on various legal, tax and financial due diligences for several downstream petroleum companies
- Transactional advisory services including liaison with the Tanzania Revenue Authority, Kenya Revenue Authority and Uganda Revenue Authority on several tax matters
- Assisting one of the upstream Operator obtain a Government Notice from the Ministry of Finance via the Tanzania Petroleum Development Corporation for exemption from fuel levy and excise duty in respect of the fuel they are using for their exploration and prospecting activities
- Transactional advisory services and overseeing the entire importation supply chain to ensure compliance of the importation of the drill ship and other related equipment for other service providers for ongoing drilling campaigns for major upstream Operators in Tanzania and Kenya
- Engagement manager on assignments providing transaction advisory support on the disposal and acquisition of Production Sharing Contracts (PSC) interests in Kenya, Tanzania, Ethiopia, South Sudan and Uganda
- Account manager serving a portfolio of clients in the insurance, banking , serving and manufacturing sectors providing tax and compliance services in Uganda, Kenya and Tanzania
- Team leader on structuring , set up, taxation and financing of solar and wind power projects in Kenya and Tanzania
- Managing a portfolio of clients in the power sector in Uganda, Kenya and Tanzania ■

Dickens Asiimwe Katta
dasiimwe@cristaladvocates.com
+256 772 370 021

Dickens leads the oil and gas practice at the firm. Though his core practice is in oil and gas, he also has experience in local and international arbitration, mergers and acquisitions, private equity, energy, project development and finance, infrastructure, construction and real estate law.

Prior to joining Cristal Advocates, Dickens worked as the Company Secretary of the Uganda Refinery Holding Company Limited (URHC), a company that represents government's interests in the refinery project as well as managing the petro based industrial park.

Dickens also served as the Company Secretary of the Uganda National Oil Company (UNOC), a company that represents the government's commercial interests in Uganda's oil and gas sector from its inception until September 2016.

Dickens was also instrumental in UNOC's formation and its initial period of operation where he also served as its Head of Contracts, Negotiations and Advisory until May 2018.

Prior to joining UNOC, Dickens was Legal Counsel at the Petroleum Directorate of the Ministry of Energy and Mineral Development (MEMD) for a period of 5 years where he was tasked with the evaluation of oil and gas and infrastructure transactions, negotiation of Production Sharing Contracts, Memorandas of Understanding (MOU's), host government agreements and joint venture agreements. He was also part of the team that put together the upstream and midstream petroleum laws and the associated regulations.

Education

- Master of Laws - Petroleum Law and Policy - Merit - *University of Dundee, UK*
- Post Graduate Diploma in Legal Practice - *Law Development Center, Uganda*
- Bachelor of Laws Degree - *Makerere University, Uganda*
- Certified Project Control Specialist Training (EPC) – *IFP France*

Professional bodies

- Association of International Petroleum Negotiators - AIPN
- East Africa Law Society
- Uganda Law Society

Experience statement

Dickens' professional experience includes executive level management, strategic program management, complex financial structuring experience, training/ employee development, resource and budget forecasting, organizational development and employee relations. Particularly in the oil and gas sector, he has been instrumental and accomplished the following below.

» Facilitating at several oil & gas workshops and conferences
» Participated in developing Uganda National Oil Company's strategic plan while a company secretary of Uganda National Oil Company and its subsidiaries
» Participated in the negotiations for the backing-in of the Uganda National Company Ltd into the existing Joint Operating Agreement between Total E&P, CNOOC and Tullow Oil
» Led the Uganda National Oil Company (UNOC) team that negotiated the Tanzanian Host Government Agreement for the East African Crude Oil Pipeline
» Put in place different negotiation strategies for UNOC and in turn drafted, reviewed and negotiated contracts and/or agreements on behalf of the Uganda National Oil Company (UNOC) and ensured that UNOC and its subsidiaries achieved the Company's desired risk allocation position
» Was secretary to the Government team that negotiated the Uganda Refinery Project Agreements namely the; Project Frame work Agreement, Implementation Agreement, Shareholders Agreement and the Escrow Agreement with Lead Investor
» Part of the team that developed the new Model Production Sharing Agreement (PSA) and the Joint Venture Agreement (JVA)
» Was secretary to the Ministerial team and attended Parliament, Cabinet, workshops and benchmarking exercises to support the Minister during the making of the Upstream and Midstream Petroleum Laws
» Participated in the making of the attendant Petroleum Regulations
» Offered legal advisory during the acquisition and the implementation of the Resettlement Action Plan for the 29sqkm of the Petro based Industrial Park and the Refined Products Pipeline to Buloba
» Secretary to the Government negotiation team that negotiated the 2014 Memorandum of Understanding (MoU) on the Sustainable Development of the Petroleum Resources in the Contract Areas in the Albertine Graben
» Part of the support team for the successful Heritage Vs The Republic of Uganda Arbitration proceedings
» Part of the investigative and negotiation team for the selection of the Crude Oil Pipeline Route from Hoima to the East African Coast
» Participated in the evaluation and due diligence processes of several complex infrastructure and oil and gas projects including the Uganda Refinery selection process as Secretary and the first ever Uganda's competitive petroleum licensing round
» Worked on significant Government inquiries and investigations - was secretary to the Karuma Hydro Power dam project review commission
» Part of the Technical team that evaluated and reviewed IOC's field development plans leading to the issuance of eight (8) production licences ■

Francis Tumwesige Ateenyi
ftumwesige@cristaladvocates.com
+256 702 540 936

Francis heads the firm's dispute resolution practice. He is an advocate with wide expertise in oil and gas, infrastructure and dispute resolution.

He has been part of teams advising on projects in Uganda, Tanzania, Mozambique and South Africa. He specializes in compliance, national content, health and safety and dispute resolution.

His commitment to excellence and client satisfaction remains a hallmark of his practice.

He has previously worked with Kiiza, Tumwesige, Ssemambo Advocates and Advocates Coalition for Development and Environment (ACODE) and undertook a traineeship with the Oil and Gas division of Webber Wentzel in Johannesburg, South Africa.

Education

- Masters of Laws in Petroleum Taxation and Finance with distinction - *University of Dundee, UK*
- Post Graduate Diploma in Legal Practice - *Law Development Center, Uganda*
- Bachelor of Laws Degree - *Makerere University, Uganda*

Professional bodies

- Uganda Law Society
- East Africa Law Society

Experience statement

» Advised an oil and gas company on setting up upstream operations in Uganda including advising on provisions of PSCs.
» Advised a number of oil industry service providers on setting up business in Uganda.
» Advised and trained energy and infrastructure companies and civil society organisations on National and Local Content requirements.
» Retained as the Legal Adviser to SMEC, a firm contracted by the Ministry of Energy and Mineral Development (MEMD) to design the master plan for the oil and gas Industrial Park in Kabaale, Hoima.
» Attached to the energy department of Webber Wentzel, where among others he participated in a due diligence reviews of the petroleum legal and contractual frameworks for Uganda, Kenya, Tanzania and South Sudan including laws, policies and model PSCs.
» Reviewed and edited the report of the field study on the environmental compliance of oil and gas waste management facilities in the Albertine region of Western Uganda and compiled a briefing paper of the same title.
» Represented numerous clients in complex commercial and civil litigation in Uganda's superior courts ■

John Teira
jteira@cristaladvocates.com
+256 704 493 997

John leads the public policy and advocacy practice. He offers a unique blend of public and private sector experience.

Prior to joining Cristal ,John worked as a Private Secretary to the President of the Republic of Uganda. During this time, he participated in several public and private sector engagements that included advising and coordinating activities relating to oil and gas as well as infrastructural projects of national significance.

He also participated in the formulation and implementation of several government programmes under the auspices of the National Development Plan (Vision 2040), giving him key insights in the current and future investment potential of Uganda.

Prior to appointment as a Private Secretary to the President, John had worked with Shonubi Musoke & Company Advocates and the Post Bank Uganda Limited.

John is a board member to the Uganda Agribusiness Initiative and Darce Consult Limited and Vine Air Limited.

Education

- Post Graduate Diploma in Legal Practice - *Law Development Centre, Uganda*
- Bachelor of Laws (Honors) - *Makerere University, Uganda*
- Diploma in Law (First Class) - *Law Development Centre, Uganda*
- Basic Philosophy of Public Service Administrative Communication - *Uganda Management Institute, Uganda*

Professional bodies

- Uganda Young Professionals Association ■

Cristal Advocates

'Total Solutions'

Energy | Tax | Infrastructure | Business Support

Contact us:

Address: P.O. Box 1769,
Kampala,
Uganda

Delivery: Cristal Advocates
Padre Pio House, 4th Floor,
32 Lumumba Avenue,
Kampala,
Uganda

Telephone: +256 414 671 274
Email: admin@cristaladvocates.com
Website: www.cristaladvocates.com

Denis Yekoyasi Kakembo
Team Leader
Energy and Tax Practice
+256 751 834 168

John Teira
Team Leader
Public Sector Practice
+256 704 493 997

Francis Tumwesige Ateenyi
Team Leader
Dispute Resolution
+256 702 540 936

Dickens Asiimwe Katta
Team Leader
Oil and Gas Practice
+256 702 370 021