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The Second Petroleum Licensing Round
A Guide to Uganda's Upstream Oil and Gas Sector

Cristal Energy Series
May 2019

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Disclaimer

This guide presents an overview of some key issues for general guidance only. Detailed advice can be sought from Cristal Advocates.

1. Definitions

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

AGRC	Albertine Graben Refinery Consortium
BBL	Barrels
BCF	Billion Cubic Feet
BN	Billion
BPD	Barrels of oil per day
CIT	Corporate Income Tax
CUL	CNOOC Uganda Limited
DRC	Democratic Republic of Congo
EA	Exploration Area
EACOP	East African Crude Oil Pipeline
EITI	Extractive Industries Transparency Initiative
EPC	Engineering Procurement and Construction
ESIA	Environmental and Social Impact Assessment
E&P	Exploration and Production
FEED	Front End Engineering Design
FID	Final Investment Decision
HSE	Health, Safety and Environment
IOC	International Oil Company
IOR	Improved Oil Recovery
ITA	Income Tax Act
KFDA	Kingfisher Development Area
KPI	Key Performance Indicators
LR	Licensing Round
LST	Local Service Tax
MEMD	Ministry of Energy and Mineral Development
MMBBL	Million Barrels
MoFPED	Ministry of Finance, Planning and Economic Development
MoJCA	Ministry of Justice and Constitutional Affairs
MPSA	Model Production Agreement
NEMA	National Environmental Management Agency
NOGP	National Oil and Gas Policy
NPC	National Pipeline Company (U) Ltd
NRM	National Resistance Movement
PAU	Petroleum Authority of Uganda
PSA	Production Sharing Agreement
QHSSE	Quality, Health, Safety, Security and Environment
RfP	Request for Proposal
RfQ	Request for Qualification
SKEC	SK Engineering and Construction
TEP	Total E&P Uganda B.V
TPDC	Tanzania Petroleum Development Corporation
TUL	Tullow Uganda Limited

TUOP	Tullow Uganda Operations Pty Ltd
UGX	Uganda Shillings
UK	United Kingdom
UNOC	Uganda National Oil Company Ltd
URA	Uganda Revenue Authority
URHC	Uganda Refinery Holding Company Ltd
USD	United States Dollar
VAT	Value Added Tax
WHT	Withholding Tax

2. Introduction

The discovery of potentially commercial crude oil reserves in Uganda in 2006 was a key milestone in the country's economic development. Further exploration and appraisal activities have identified resources of around 6.5 billion barrels of oil, with approximately 1.4-1.7bn barrels recoverable. It is also worth noting that only about 40% of the Albertine Graben where discoveries have been made has been explored so far.

In 2019, we expect to see final investment decisions ("FIDs") on a basin-wide oil development and an export pipeline to the port of Tanga in Tanzania. The engineering design work that will eventually lead to the construction of an oil refinery at Hoima in western Uganda is underway.

The confidence of the Ugandan government in the viability of its oil sector resulted in the decision to launch a formal exploration first licencing round in 2014. Whilst the licencing round was well organised, the timing proved to be unfortunate: the collapse in oil prices which began in 2014 reached its low point in 2015 and the oil and gas industry globally was in a period of drastic retrenchment. The steady recovery in oil prices since 2015 has made Uganda once again an attractive investment destination for the upstream industry and in this context the government launched a new licensing round in May 2019. The second licensing round comes at the time when Uganda is at the cusp of major announcements for the commercialisation of its crude oil discoveries.

This guide aims to provide a brief introduction to the development of the Ugandan oil industry and the regulatory and fiscal framework in which it operates, with emphasis on the rules that will apply to successful participants in the new licensing round. It presents an overview of some key issues for general guidance only and those interested in the sector are recommended to seek detailed advice from the authors.

Cristal Advocates is a Ugandan corporate and commercial law firm offering full scale legal services with an emphasis on tax, energy, infrastructure and business support. Its practitioners have a long history of working with the oil and gas industry both in Uganda and internationally. You can find out more about the firm in section 6.

Cristal Advocates

Kampala

May 2019

3. Overview of the Ugandan oil and gas industry

a. Uganda

Uganda is a landlocked country in East Africa. It is a former British colony and a member of the East African Community. Uganda gained independence from the UK in 1962. The first quarter century of independence was marked by political instability including the brutal military dictatorship of Idi Amin between 1971 and 1979.

A period of instability followed the fall of Amin after a brief war with neighbouring Tanzania. In 1986, the National Resistance Movement ('NRM'), led by Yoweri Museveni, secured power and Museveni was sworn in as president, a position which he retains to this day. President Museveni has presided over a period of stabilisation in the economy and politics of the country. A new constitution was introduced in 1995 followed by a presidential election in 1996 which Museveni won with more than 75% of the votes. He has won four subsequent presidential elections (in 2001, 2006, 2011 and 2016). In 2018, a constitutional amendment was introduced to remove the restriction on persons over 75 years serving as president and it is expected that Museveni will be re-elected in the next presidential election which is due in 2021.

Uganda is a republic and legislative power vests in a democratically elected national assembly. All adults above the age of 18 have the right to vote. The president is the head of state and head of government. The legal system of Uganda is based on English common and customary law. English is widely understood and is used for official purposes. Uganda is diverse and culturally vibrant with a rich wildlife. The population is expanding rapidly and is approximately 41 million of whom nearly 70% are under the age of 25. Tourism and agriculture play an important role in the economy.

Uganda imports the equivalent of approximately 37, 000 barrels per day of refined products (mostly via Kenya) and currently has no domestic oil and gas production or refining capacity. The country's generation capacity is in the region of 1,000 megawatts, a substantial proportion of which is hydropower. Approximately 75% of the population does not have access to the electricity grid.

b. The early years of exploration (1920 – 2006)

Uganda's oil discoveries are all in the Albertine Graben (the area around Lake Albert) which is at the northern end of the western arm of the East Africa Rift System. The presence of hydrocarbons in the area has been known for generations and local fishermen have traditionally used seepages to caulk their boats. The first attempts at exploration were launched in the 1920s and 1930s with geological surveys and the drilling of exploration wells. This effort was interrupted by the Second World War and it wasn't until the 1980s that interest was revived.

The government established a specialist petroleum unit in 1984 and a legislative framework for upstream activities was introduced in 1985 in the form of the Petroleum (Exploration and Production) Act. This law was the basis for a Production Sharing Agreement ("PSA") with the Belgian company, Petrofina, signed in 1991 and covering the entire Albertine Graben. Petrofina's activities were quickly brought to a halt reportedly as a result of concerns over the security situation in the neighbouring Democratic Republic of Congo ('DRC').

In 1997, two junior exploration companies signed new PSAs: Heritage Oil and Hardman Resources. In 2001, Heritage farmed down part of its interests to another, Energy Africa, which was acquired by Tullow Oil in 2004. In 2005, another explorer, Neptune Petroleum (a subsidiary of AIM-listed Tower Resources) signed a PSA for a block north of Lake Albert. Intensive exploration activities culminated in the drilling of the Mputa 1 exploration well in 2006. This established the existence of potentially commercial quantities of oil in Uganda. It also, incidentally, pointed to the hydrocarbon potential of the western shore of Lake Albert, which is the territory of the Democratic Republic of Congo (DRC).

c. Discovery and consolidation (2006 – 2009)

The steady increase in oil prices from the mid-2000s was matched by further exploration success in the area around Lake Albert. In 2007, Tullow Oil further consolidated its dominant position in the basin by acquiring Hardman Resources. The success of Tullow and Heritage stimulated interest from other companies and in 2007, AIM-listed Dominion Petroleum signed a PSA for an exploration block in the Lake Edward area, south of Lake Albert. Continued exploration success established the viability of a basin-wide development for the discoveries around Lake Albert by 2009 and Uganda began to attract the attention of major oil and gas companies.

Meanwhile the government continued to build capacity to manage and regulate the nascent oil industry in the country. A key milestone in its effort was the publication in 2008 of a National Oil and Gas Policy ('NOGP'), laying out a roadmap for creating an oil and gas industry in Uganda.

d. Entry of CNOOC and Total (2009 – 2015)

The financial and technical resources required for a basin-wide development made it inevitable that Tullow and Heritage would not develop their discoveries alone. In late 2009, Heritage put its interests up for sale and in November it was announced that the winning bid had been made by Eni, the Italian super-major. Tullow Oil was entitled to pre-empt the bid and immediately did so. This would give it a 100% interest in the 3 blocks where commercial discoveries had been made, so it was not surprising that Tullow announced its intention to sell two thirds of the interests to Total of France and CNOOC, the Chinese major.

The transactions became the subject of a protracted, and sometimes bitter conflict over taxation, with Heritage taking the position that it was not obliged to pay tax on the significant gains it had realised. This argument was ultimately unsuccessful but not before the matter had reached courts in both Uganda and the UK. Whilst the terms of Tullow's farm-down to Total and CNOOC were finally agreed with the government in early 2012, other significant obstacles remained before development could commence. This uncertainty was exacerbated by the failure of exploration efforts by Neptune/ Tower in the north and Dominion in the Lake Edward area.

The Heritage tax dispute, together with the size of the discoveries and rising oil prices prior to mid-2014 focused attention on Uganda's future as an oil producer and the threats this might pose to established social and political institutions in the country as well as to the environment. Africa provides several examples of the damage that can be done to politics, society and the environment by the mismanagement of hydrocarbon exploitation and Uganda's government was anxious to avoid these. Changes were made in 2010 to tax legislation, to protect the government's share of revenue from production and any future capital gains on transfers of interests. In 2013, a comprehensive suite of laws and regulations began to be introduced to strengthen the legal framework for oil development. A regulatory body, the Petroleum Authority of Uganda ('PAU'), was established along with the Uganda National Oil Company ('UNOC') to manage the commercial interests of the government in upstream, midstream and downstream projects. In 2015, Uganda also took the step of establishing a petroleum fund.

e. The refinery

A major sticking point in discussions between the oil companies and the government was the question of the refinery. The NOGP had laid out a vision for a refinery and petrochemical industry to be developed on the basis of the oil discoveries. Uganda was (and continues to be) dependent on imports of oil products by road from the port of Mombasa in Kenya.

The disruption to supplies as a result of post-election violence in Kenya in 2007/08 was a stark reminder to the vulnerability of Uganda's economy to the interruption of fuel supplies. On the other hand, the International Oil Companies ("IOCs") were not convinced of the economic viability of a refinery of a size commensurate with the local market and were concerned that diverting part of the planned production from an export pipeline to a refinery would damage the economic case for the pipeline.

As it became clear that the IOCs themselves might not invest in the refinery project, Uganda pressed ahead, appointing a financial adviser in 2013 and holding a competitive tender for the project. This resulted in the identification of a Russian consortium led by RTGR Resources (a subsidiary of the Russian conglomerate Rostec) as the successful bidder. Negotiations with the Russian consortium broke down in mid-2016. Attempts were then made to secure a deal with the South Korean consortia SKEC; these too proved unsuccessful.

In 2017, a new consortium, the Albertine Graben Refinery Consortium ('AGRC') came on the scene and in April 2018 signed an agreement to design, finance, construct, operate and maintain a refinery in Hoima, close to Lake Albert. The participants in AGRC comprise Nuovo Pignone (a subsidiary of GE), Saipem, YAATRA Africa and Lionworks Group.

It is expected that UNOC will hold an interest of up to 40% in the project via a subsidiary, Uganda Refinery Holding Company (URHC). Other member states of the East African Community have also been invited to participate and Total's CEO and Chairman Patrick Pouyanne re-echoed Total's willingness to participate in the refinery project with a 10% shareholding during his recent visit to Uganda. Costs of the refinery project are expected to be in the region of USD 3 – 4 billion which will be met by a mix of debt and equity financing using a public-private partnership structure.

f. The export route

The IOCs have consistently argued that the commercial success of oil development in Uganda requires the construction of an export pipeline. The waxy characteristics of the oil discovered in the Albertine Graben (which has a pour point of more than 40 degrees Celsius) means that the pipeline should be heated and insulated. When completed the export pipeline will be the longest such heated pipeline in the world, at just under 1,500 kilometres.

Three main options were considered for the pipeline route: the northern route to Lamu in Kenya, a central route to Mombasa (also in Kenya) and a southern route to the Tanzanian port of Tanga. Congestion in Mombasa made this the least attractive option, and for several years attention focused on the northern route which was to be integrated into the Kenyan government's plan to develop a transport and infrastructure corridor and a port at Lamu.

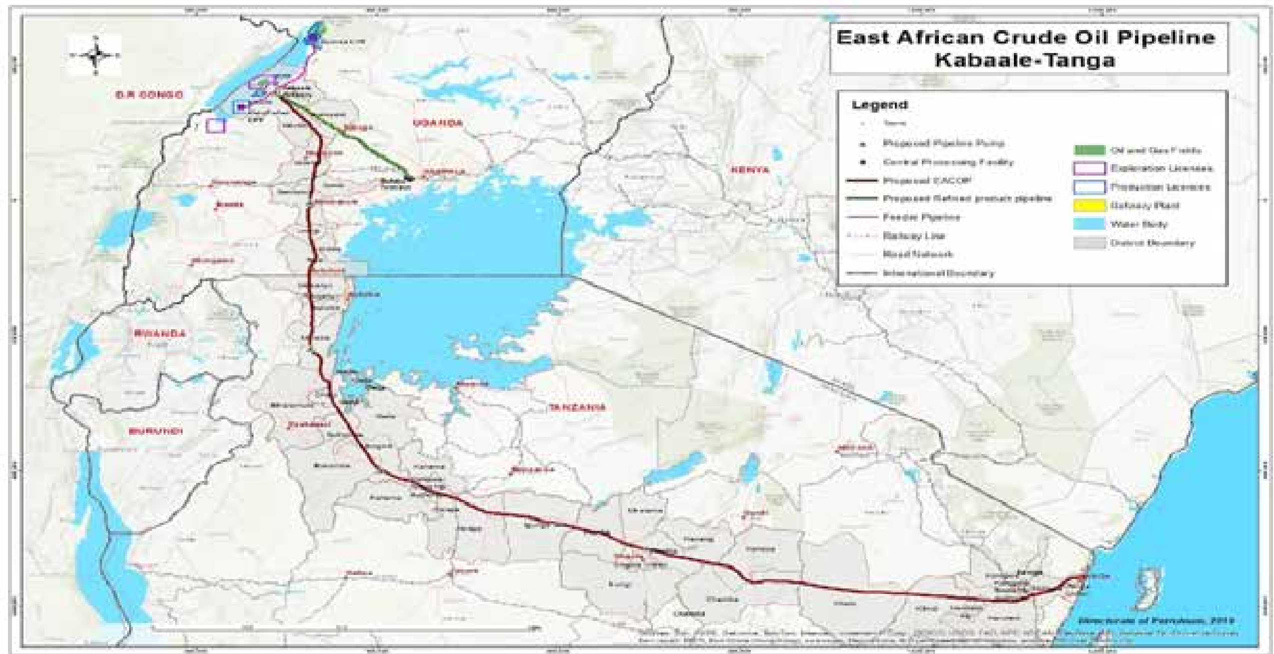
This option was made potentially more attractive by the discovery of commercial quantities of oil in Kenya close to the proposed route in 2012. These factors were ultimately outweighed by security concerns owing to the proximity of the proposed infrastructure to the bases used by the Al Shabab terrorist group in neighbouring Somalia and the fact that the port would be non-operational for almost a months due to the monsoon winds among others. Negotiations with Tanzania resulted in the signing of an agreement between the governments in April 2016 to use the southern route. An inter-government agreement setting out certain regulatory and fiscal matters in relation to construction and operation of the pipeline was signed in May 2017.

The East Africa Crude Oil Pipeline ('EACOP') is expected to cost in the region of USD3.5 billion of which 70% will be financed by financial institutions and the balance by the shareholders: Total, CNOOC, Tullow Oil and the governments of Tanzania and Uganda. Front end engineering design ('FEED') work commenced in early 2017 and was completed in 2018. It will be a 24-inch pipeline with a capacity of 216,000 barrels per day. The final investment decision ('FID') is expected before the end of 2019, coinciding with the FIDs for the Kingfisher and Tilenga projects. Construction will take approximately 3 years.

Shareholders in the pipeline are currently expected to be as follows:

Shareholder	Interest
Total	35%
CNOOC	35%
National Pipeline Company ('NPC')*	15%
Tullow Oil	10%
Tanzania Petroleum Development Corporation ('TPDC')	5%

**a subsidiary of UNOC*



Source: MEMD

g. The first licensing round (2015)

The confidence of the Ugandan government in the viability of its oil sector resulted in the decision to launch a formal exploration licencing round in 2014. Previous licences had been awarded on a 'first come, first served' basis following one on one negotiations. Whilst the licencing round was well organised, the timing proved to be unfortunate: the collapse in oil prices which began in 2014 reached its low point in 2015 and the oil and gas industry globally was in a period of drastic retrenchment. The intention was to licence up to 6 blocks including two stratigraphic licences, but ultimately 3 PSAs were signed in respect of 2 blocks in September and October 2017:

- One PSA for the Kanywataba contract area at the southern end of Lake Albert with Armour Energy Limited of Australia; and
- Two PSAs covering the Ngassa contract area immediately north of the Kingfisher development with Oranto Petroleum Limited of Nigeria.

According to the PAU website, the PSAs include the following key terms:

- An initial exploration period of two years with a possible two year extension.
- A minimum work programme which includes acquisition of seismic data and drilling of at least one well (in the second exploration period).
- A performance guarantee amounting to 50% of the minimum exploration expenditure for the first exploration period.
- Payment of petroleum royalty based on the daily production ranging from 5.5% to 21%.
- State participation by UNOC up to a maximum of 20%.
- Cost recovery limit for petroleum set at 65%.
- A signature bonus together with an annual rental fee and research and training fees.
- Taxes to be paid in accordance with the relevant Ugandan tax law.

h. Field development plans

The basin-wide development plan for the Albertine Graben consists of two principal projects: Kingfisher and Tilenga. The CNOOC operated Kingfisher field was discovered in 2006 and lies on the eastern shore of Lake Albert. The field is believed to contain around 200 million recoverable barrels of low-sulphur, waxy crude. A production licence was awarded for the field in 2012 and the lengthy delay in FID is the result of the ongoing discussion over the refinery and export pipeline. It is understood that development of the field will take approximately 3 years once FID is achieved. The development plan is understood to aim at maximum production of 40,000 barrels per day utilising 20 producing wells and 11 injectors from 4 separate well pads. Some infrastructure, including all-weather roads, has already been constructed.

The Total operated Tilenga project is located at the northern end of Lake Albert contains 8 oil fields split between two PSAs. The field development plan proposes a central processing facility with a capacity of 190,000 barrels per day, 412 wells (including 190 producers) and 35 well pads. The Tilenga plan is complicated by the fact that a significant portion of the development is located within the Murchison Falls National Park, one of the most environmentally sensitive areas in the country. The environmental and social impact assessment ('ESIA') for the Tilenga project was submitted to the National Environmental Management Authority ('NEMA') in 2018 and approved in April 2019.

The total cost of developing the Kingfisher and Tilenga projects is expected to be in the region of USD 8 billion, with first production expected in 2022, assuming FIDs are taken before the end of 2019 as expected.

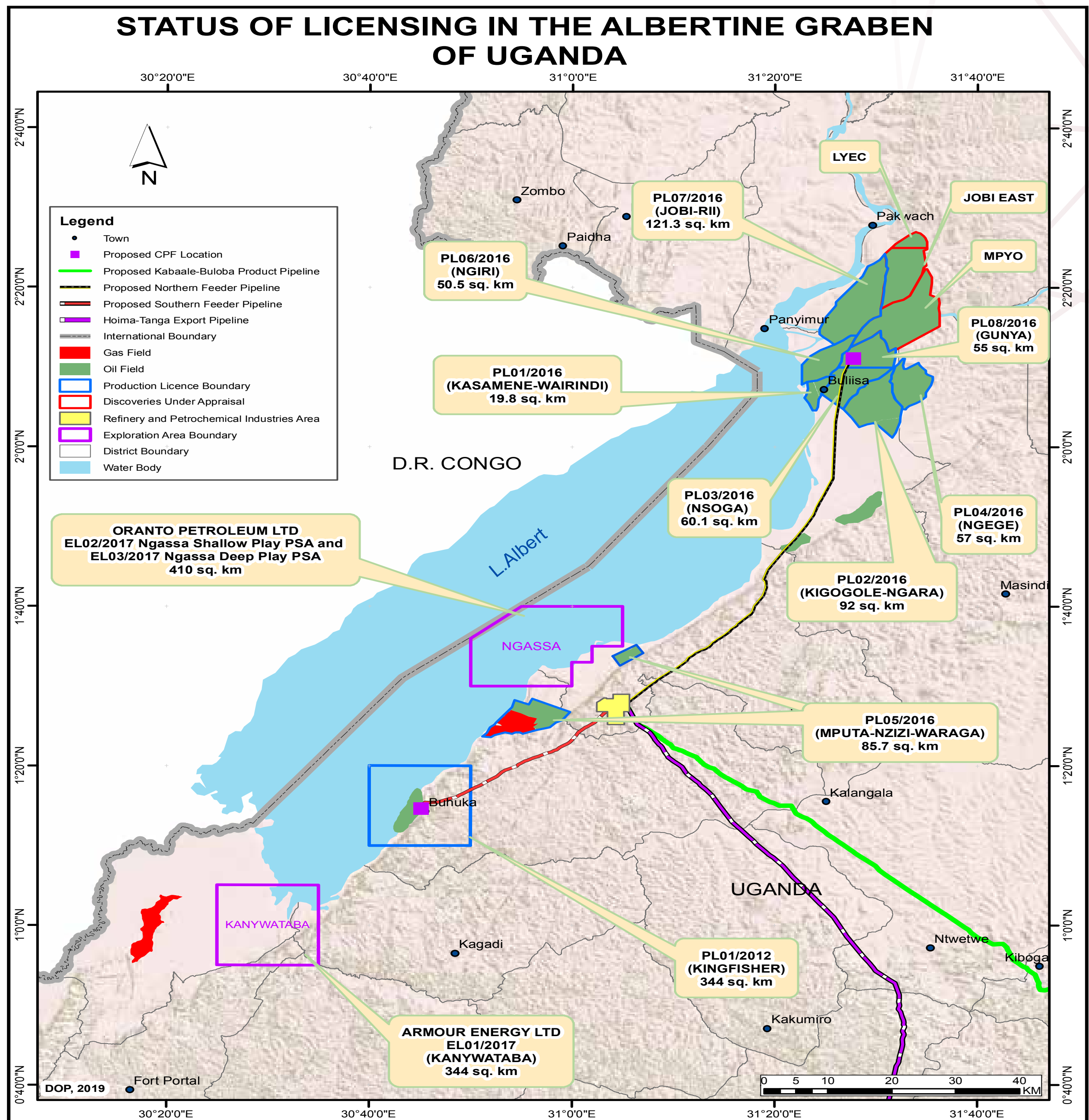
Major contracts including FEED, drilling, logistics and EPC for the export pipeline have all been advertised and substantially evaluated awaiting FID before approval and subsequent award.

i. The Tullow farm-down

In January 2017, Tullow announced its intention to sell part of its interest in the Tilenga and Kingfisher projects to Total in exchange for a mixture of cash and deferred consideration which would substantially meet its share of development costs. This transaction was subject to both government consent and the right of CNOOC under the relevant joint operating agreements to exercise pre-emption. CNOOC duly elected to acquire 50% of the interests to be transferred. Government consent has delayed pending resolution of the tax treatment of the transaction, a discussion which is reportedly about to be resolved.

On completion of the Tullow farm-down interests in Uganda's upstream project will be as follows:

<table>
<tr><th>Project</th><th>Interests</th></tr>
<tr><td>Tilenga – development</td><td><table><tr><td>CNOOC</td><td>44.12% (37.5%)</td></tr><tr><td>Total (operator)</td><td>44.12% (37.5%)</td></tr><tr><td>Tullow Oil</td><td>11.76% (10%)</td></tr><tr><td>UNOC*</td><td>0% (15%)</td></tr></table>*UNOC is likely to acquire 15% under the terms of the PSA; the equity interests after the exercise of this right are shown in brackets</td></tr>
<tr><td>Kingfisher – development</td><td><table><tr><td>CNOOC (operator)</td><td>44.12% (37.5%)</td></tr><tr><td>Total</td><td>44.12% (37.5%)</td></tr><tr><td>Tullow Oil</td><td>11.76% (10%)</td></tr><tr><td>UNOC*</td><td>0% (15%)</td></tr></table>*UNOC is likely to acquire 15% under the terms of the PSA; the equity interests after the exercise of this right are shown in brackets</td></tr>
<tr><td>Kanywataba – exploration</td><td>Armour Energy (operator) 100%</td></tr>
<tr><td>Ngassa – exploration</td><td>Oranto Petroleum (operator) 100%</td></tr>
</table>



Source: MEMD

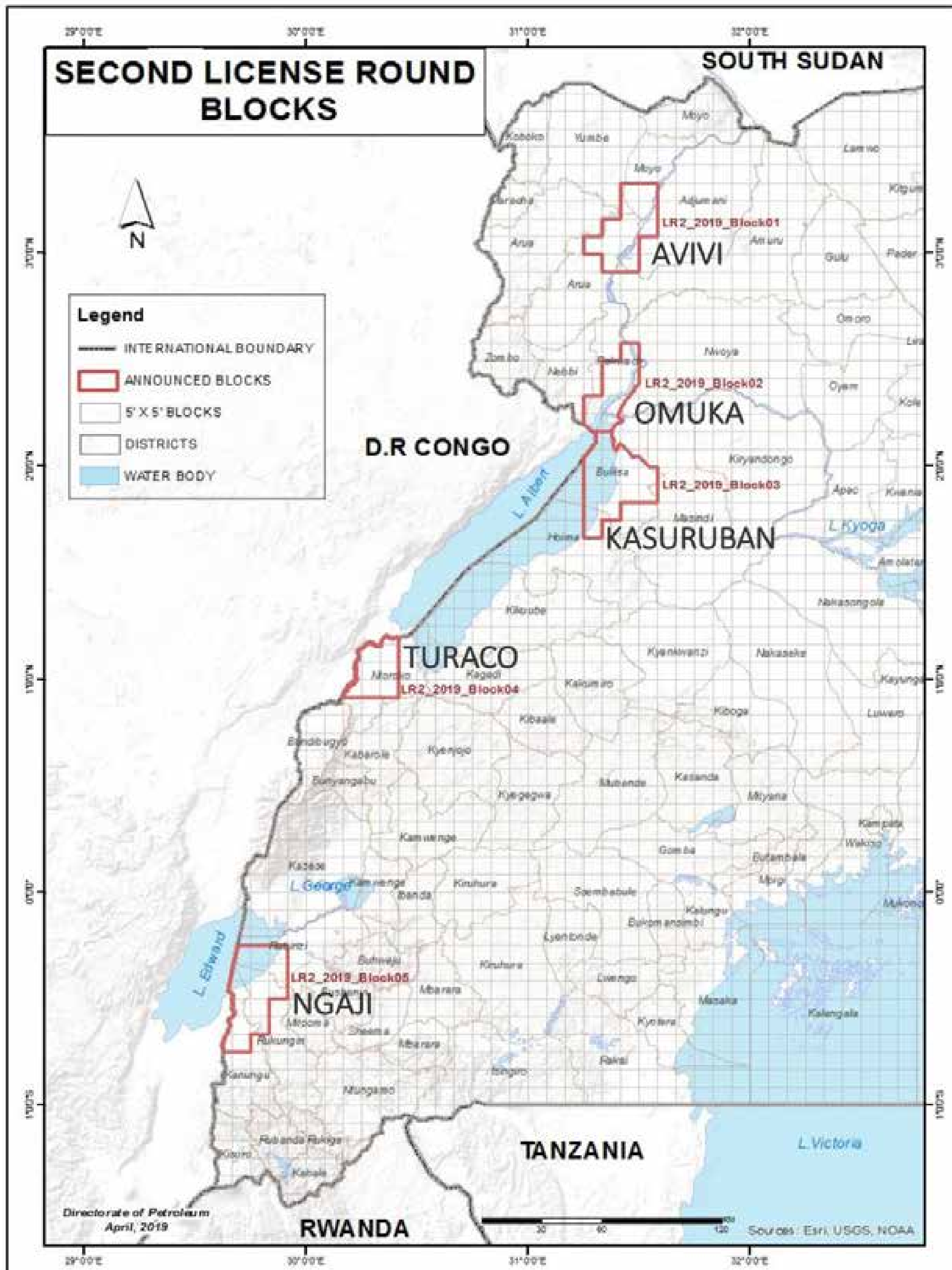
j. Next steps

The critical next steps in the development of Uganda's oil are the FIDs on the key elements of the project: the Tilenga and Kingfisher developments, the EACOP and the refinery. The field developments and pipeline are inextricably linked: neither can move ahead without the other elements. Currently we expect the decisions to be taken before the end of 2019 and this is critical as preparation for the 2021 elections may start to impact the government's ability to move the project forward if the date slips beyond the end of the year. Though government is committed to the refinery development, its FID may come after the upstream and pipeline FIDs as its final structuring and financing is yet to be firmed up.

In early 2019, Uganda signalled its commitment to transparency in the collection of revenues from the oil and gas industry by applying to join the Extractive Industries Transparency Initiative ('EITI').

k. Second licensing round

Buoyed by the progress being made, the Ugandan government announced a new licensing round in May 2019. The following blocks are being offered under the new round:



Source: MEMD

- LR2_2019_Block01 (Avivi) covering the districts of Obongi, Adjumani, Amuru and part of Arua and with area coverage of 1026km2
- LR2_2019_Block02 (Omuka) covering the districts of Nebbi, Nwoya and Buliisa with area coverage of 750km2
- LR2_2019_Block03 (Kasuruban) covering the districts of Buliisa, Hoima and Masindi and with area coverage of 1285km2
- LR2_2019_Block04 (Turaco) covering the districts of Ntoroko and with area coverage of 635km2
- LR2_2019_Block05 (Ngaji) covering the districts of Kanungu, Rukungiri and Rubirizi and with area coverage of 1230km2

Following the announcement, potential applicants will have four months to prepare and submit their expressions for qualifications upon which the qualified applicants will be issued the RfP, after which bid evaluation and negotiation with successful applicants will take place. Negotiations, the award of exploration licences and signing of PSAs is intended to be achieved by the second part of 2020. It should be noted that the Avivi and Ngaji blocks were previously explored by Neptune and Dominion respectively and relinquished without any discoveries by then.

UNOC notes on its website that it is planning to acquire exploration licences with a view of increasing the resource base of the country and presents long term strategic partnerships and joint ventures in exploration as an investment opportunity (https://unoc.co.ug/exploration-new-ventures). It is understood that in line with section 53 of the Upstream Act, the Pelican and Kisinja exploration blocks have been reserved for the UNOC. UNOC entered into a memorandum of understanding with CNOOC on 5th September 2018 seeking to work together to explore some of UNOC's oil blocks. It is therefore likely that UNOC will work with CNOOC on one of the blocks but also partner with another IOC for the other block. This presents yet another opportunity for the oil companies to acquire exploration acreage in Uganda.

I. Overview of the licensing process

The planned schedule of activities for the licensing round will be as follows:

Activity	Date
Publication of notice of RfQ	22nd May, 2019
Closing date for receipt of applications for qualification	20th September, 2019
Evaluation of expressions of applications for qualification	23rd September -1st November 2019
Display of qualified applicants	7 – 8th November 2019
Issue of RfP to qualified applicants	11-15th November 2019

After the qualified applicants have been issued with an RfP, the following activities would follow:

- Data room visitation and data purchase .A data room would ordinarily be put in place from where the applicants would view the available data packages for the announced blocks to enable the potential bidders to evaluate the blocks and gain an understanding of the areas in consideration for purchasing data for the preparation for bidding;
- Bidders' conference;
- Field visits;
- Receipt and opening of proposals;
- Evaluation of proposals;
- Due diligence and notification of preferred, alternate preferred and unsuccessful bidders. This notification would mark the end of the RfP stage and then negotiation of the PSA's and issuance of licence would follow.

The evaluation procedure for the bids would be in accordance with the bidding documents and the 2013 Act.

- The evaluation of the bids would be based on information submitted by the bidders in two (2) phases; namely the preliminary evaluation and a detailed technical evaluation;
- Preliminary evaluation would be undertaken to ascertain the bidders' compliance with submission of documents and information;
- A detailed technical evaluation would be undertaken to assess the bidder's technical, financial and health, safety

- and environmental (HSE) capability as well as bidders proposals on work program, national content, signature bonus and royalty. A pass mark of x% would then be adopted for purposes of determining the preferred bidders and alternate preferred bidders.

In determining the bidders technical capabilities, the following broad issues would be considered:

- Operational environment: This would evaluate assets in other countries where they operate (both offshore and onshore;
- Geophysical and geological: This would cover seismic interpretation, hydrocarbon play analysis, geological modelling, and risk analysis;
- Reservoir management: This would cover among others reservoir simulation, experience in oil and gas production and production management and IOR;
- Technology: This would covering drilling and well technology, field development, production technology and pipeline and transportation technology;
- Key staff experience: This would covering managerial, technical and operational and HSSE staff.

In appraising the bidders proposed work programme, a technical evaluation of the block including the regional studies and geological understanding, interpretation and mapping and prospect evaluation and risk assessment – 3D seismic reprocessing, wells and well tests and others in the different exploration periods would be considered.

The financial evaluation would consider the bidders financial capacity and financial viability determining solvency, liquidity and financial leverage. This would involve reviewing the audited financial statements, details of the financing plan, parent funding arrangements if applicable and the details of third party funding arrangements (conventional loans, shareholder loans agreements, parent company loan agreements etc. if applicable and details of funds committed to execution of work programs and other obligations including those overseas. Key financial ratios in terms of current assets/current liabilities, total debt/shareholder funds and net worth/commitments would also be considered.

In terms of national content, every bidders would prepare a national content plan that would be evaluated against the following;

- Strategy for employment of Ugandans
- Strategy for training of Ugandans
- Strategy for utilization of goods and services obtainable in Uganda
- Proposal for technology transfer
- Proposal for research and development in Uganda

Every bidder would as a minimum also be required to submit an HSE plan for the block applied for that would be expected to contain:

(a) Health and Safety Plan

(b) Environmental Plan, and

(c) HSE track record.

On top of that, two guarantees including a performance guarantee and a parent guarantee in case of subsidiaries would be required. The performance guarantee would be in the region of about 50- 80% of the minimum work obligations for the first exploration period.

At the end of the bidding process, the government may negotiate and issue a licence to one company or even oblige two bidding companies to work together in exploring a single block. The government has previously noted that joint operations bring significant benefits from sharing technical experience, costs and technology amongst parties in the partnership. Here the parties would be requested to agree on a JOA before negotiating the PSA.

4. The regulatory framework

a. Key policy and legislative developments

As in many countries, ownership of mineral resources in Uganda (including hydrocarbons) lies with the state rather than landowners under the constitution. The NOGP of 2008 outlines the government's vision for realising the benefits of the country's petroleum resources and envisages clearly defined roles for the management of the oil and gas industry in Uganda:

- Policy matters are dealt with primarily by the Ministry of Energy and Mineral Development (MEMD)with assistance of other arms of government where required (e.g. the Ministry of Finance, Planning and Economic Development plays a key role in fiscal policy affecting the industry) and supervision by the cabinet and parliament.
- A new regulatory body, the Petroleum Authority of Uganda ('PAU') was created to monitor and regulate the industry.
- A national oil company (UNOC) was established to hold and manage the commercial interests of the state in oil and gas projects, including rights to acquire equity interests in PSAs.

In 2013 the 1985 Petroleum (Exploration and Production) Act was replaced by a new Petroleum (Exploration, Development and Production) Act (referred to below as 'the 2013 Act' or simply 'the Act') to implement the key proposals of the NOGP, including the creation of the PAU and UNOC. This is the main law governing upstream activities and confirms the government's right to administer petroleum resources on behalf of the country. Also in 2013, the Petroleum (Refining, Conversion, Transmission and Midstream) Act was passed to provide the framework for operation of other parts of the hydrocarbon value chain. Regulations have been introduced to operationalise various parts of these two laws.

b. The role of PAU

The PAU was established under the 2013 Act. It is responsible for monitoring and regulating the upstream industry in Uganda and has oversight of the refining, gas conversion, transportation and storage of petroleum. Its board of directors was appointed by the president in 2015 and the executive director is Ernest Rubondo, formerly leading the Petroleum Exploration and Production Directorate of the Ministry of Energy, who was appointed in 2016.

The PAU is the principal interface between the industry and the government. The responsibilities of PAU include:

- Advising the Minister of Energy on the award of exploration and production licences.
- Review of submissions from licensees including budgets and work programmes, geoscientific reports and engineering studies, field development plans, annual reports on resources, procurement and audits.
- Supervision of reserve estimation and measurement of petroleum for the purposes of determining royalties, etc.
- Advising the Minister in negotiation of PSAs, advised on the Inter-government Agreement ('IGA') with Tanzania and is advising on the Host Government Agreement ('HGA') between the investors and the government in respect of EACOP.
- Administration of production sharing agreements ('PSAs').
- Ensuring optimal use of facilities and recovery of petroleum.
- Promotion of national content.

c. The role of UNOC

UNOC was also established under the 2013 Act. It was incorporated in Uganda as a limited liability company in 2015 and is 100% owned by the state. The company is responsible for managing the state's commercial interests in the oil and gas sector including upstream, midstream and downstream. It is mandated to hold the government's 15% interest in the production licences which have been awarded in respect of the Tilenga and Kingfisher projects. It is understood that UNOC will be carried through the development phase of the projects and will not be required to reimburse any costs incurred prior to FID.

In September 2018, UNOC and CNOOC signed a memorandum of understanding agreeing to jointly target new exploration opportunities in Uganda. CNOOC will assist UNOC in developing its capacity and it is envisaged the two companies will also cooperate on projects outside Uganda.

UNOC has two locally incorporated subsidiaries focusing on midstream and downstream activities: Uganda Refinery Holding Company Limited ('URHC') and the National Pipeline Company Limited ('NPC'). URHC will hold the state's equity interest of up to 40% in the Uganda refinery and will also take the key role in promoting the 29sqkms industrial park to be constructed within the same area as the refinery. NPC will hold the state's equity interest of up to 15% in the EACOP and will also develop, manage and operate terminals for storage of petroleum products. Currently NPC manages a 30 million litre storage terminal at Jinja and plans to develop a 240 million litre facility in Kampala and other similar terminals around the country along with a regional network of product distribution pipelines. Strategic partners are being sought for these projects.

d. Entry requirements

The 2013 Act empowers the Minister of Energy to enter into 'Petroleum Agreements' with third parties for the purposes of carrying out activities under the Act. The form of agreement used is a production sharing agreement (PSA) along conventional lines. A party to a PSA would also be required to obtain an exploration licence and, if a commercial discovery is made, a production licence to carry out activities. Licensees may consist of more than one corporate entity and unincorporated joint ventures are commonly used by international oil companies ('IOCs') operating in Uganda. Further comments on Uganda's model PSA are provided below.

The Act provides that the primary method of awarding exploration licences will be a process of competitive bidding, though direct applications will be entertained 'in exceptional circumstances' which include, 'enhancement of the participating interest of the State in the promotion of national interest', which perhaps implies special treatment for UNOC.

Applications for exploration licences must be supported by information regarding the applicant including details of its financial position and technical experience, work and expenditure commitments offered and an undertaking to provide specified training and employment of Ugandan citizens. An applicant which is a body corporate should indicate where it is incorporated and provide details of its directors (or equivalent) and any beneficial owner of more than 5% of the issued share capital (or equivalent). There is no requirement for applicants to be Ugandan legal entities or to have any minimum level of Ugandan ownership. Foreign legal entities may be required to incorporate local companies or register branches in Uganda in practice. Applicants are required to provide security for performance of their obligations under the licence and insurance in respect of activities under the licence.

Exploration licences may be issued for a period of up to 2 years and may be renewed twice for additional periods of up to 2 years. It does not appear that an exploration licence could be extended beyond 6 years. The holder of an exploration licence that has made a discovery has the exclusive right to apply for a production licence. These are issued for a period of up to 20 years and may be renewed for a period of up to 5 years. The Act provides for further extension at the discretion of the Minister. Entitlement to future production under a production licence may be used as security for financing subject to Ministerial consent.

e. National content

A key objective of the Ugandan government as laid down in the NOGP in 2008 is to maximise the economic benefits of the oil industry, not only via the state's share of revenue, but also via the involvement of Ugandan individuals and businesses in the supply chain. The 2013 Act recognises this by requiring the parties to a PSA, and their direct and indirect subcontractors to exercise preference for goods and services which are provided by Ugandans in Uganda. Where goods and services required by the project are not available in Uganda, the Act requires the provider of those goods or services to enter into a joint venture with a Ugandan company, which must hold at least 48% of the joint venture. Ugandan providers of goods and services should meet relevant HSE requirements and need to be approved by the Minister of Energy. Further details are provided in the National Content Regulations which were issued in 2016. These reflect the requirements of the Act itself but add crucial detail. Most importantly a definition of 'Ugandan company' is provided; this must:

- be incorporated in Uganda;
- provide value addition in Uganda;
- use locally available materials;
- have at least 70% Ugandan employees; and
- be approved by PAU.

It is not necessary to satisfy any minimum local shareholding requirements. This is an important point recognising the

fact that such requirements would put strain on the limited capital currently available in Uganda and that minimum shareholding requirements in other jurisdictions have led to artificial structures and 'rent seeking' rather than actually promoting the participation of local business in the industry.

The Regulations specify certain services that may only be procured from Ugandan individuals, business and companies. These include hotel accommodation, catering, transport, security, clearing and forwarding.

The Regulations require the PAU to establish a national supplier database which will provide information on all Ugandan and international businesses which are approved under the Regulations.

f. Assignment of interests

A critical issue for the upstream industry is the fiscal and regulatory regime for transfers of interests, e.g. in the case of a farm-down to bring in new capital and know-how to develop a discovery. The 2013 Act provides that no transfer of a licence interest can be implemented without the consent of the Minister of Energy. This applies not only to any direct transfer of interests, but also indirect transfers as a result of a direct or indirect change of control of a licence holder. 'Control' is widely defined. It is also stated that a transferor should 'fulfil any other financial obligations under the Laws of Uganda', which will clearly include payment of any tax considered to be due in relation to the transaction.

In practice it will be necessary to agree the tax treatment of any direct or indirect transfers with the Uganda Revenue Authority ("URA") before Ministerial consent is given and this may result in delays: as mentioned above the tax consequences of Tullow's 2017 farm-down to Total and CNOOC took more than 2 years to resolve. We discuss the tax treatment of transfers of interest in the next section.

g. Decommissioning

The holder of a production licence is required to establish a fund to meet decommissioning costs of each development area and any other related facilities. This must be done at the earliest of:

- aggregate production reaches 50% of the recoverable reserves;
- 5 years prior to the expiry of the licence; or
- on issuance of a notice of surrender by the licence holder.

Once the fund has been established the licence holder is required to make payments into the fund on a quarterly basis. The amount of the payments is to be determined by PAU and will be treated as cost recoverable operating expenditure. Any shortfall in the fund available to meet decommissioning costs is to be made up by the licence holder, whilst any excess accrues to the government.

Decommissioning plans must be provided to the PAU for review and approval no sooner than four years, but a least two years prior to the termination of use of relevant facilities.

h. Overview of the model PSA

Historically, Uganda did not have a readily available model PSA and those signed in practice exhibited considerable variation in the terms provided. Some of the older ones incorporated tax exemptions and other provisions which were inconsistent with prevailing legislation. This led to disputes with licensees and criticism of the officials responsible.

In 2018, a new model PSA ('MPSA') was approved by the cabinet and we understand that this is intended to form the basis for all future PSA negotiations. Our view is that the authorities during negotiations with potential licensees are highly unlikely to agree any departure from the terms set out, though negotiable areas are identified in the MPSA as highlighted below.

The following is a brief overview intended for general guidance only. Aspiring licensees should seek specific advice from the authors.

A copy of the MPSA can be downloaded from the UNOC website: https://www.unoc.co.ug/wp-content/uploads/2018/06/MPSA.pdf

Article/Annex	Subject	Comments
1	Definitions	The MPSA contains a standard list of definitions. Worth noting is the definition of delivery point which includes the intake valve of a pipeline or refinery in Uganda. This means that expenditure beyond that point (e.g. refining, transportation) will not be cost recoverable. It is also worth noting that IOCs are referred to in the MPSA as licensees rather than contractors, the term often used in PSAs/PSCs.
2	Participating interests	This sets out the initial participating interests of the parties comprising the licensee and requires submission of a JOA meeting specified requirements. The liability of parties comprising the licensee is joint and several.
3	Responsibilities and grant of rights	An exploration or production licence, as appropriate, is issued at the same time a PSA is signed. An exploration licence may have a duration of up to 2 years with 2 possible extensions each of up to 2 years. The duration of a production licence is not specified, though the 2013 Act stipulates a maximum duration of 20 years. The MPSA mentions 2 successive extensions may be given, not exceeding 5 years each.
4	Exploration work programme	The licensee is to commence exploration activities within 2 months of the date the PSA is signed. Minimum work programmes and expenditure obligations for each exploration period are negotiable. The licensee is required to submit a performance guarantee in respect of 80% of the minimum expenditure obligation. In certain circumstances, licensees are required to pay any shortfall in expenditure to the government.
5	Work programmes and budgets	Annual work programmes and budgets should be submitted for review and approval by PAU at least 60 days prior to beginning of the relevant calendar year.
6	Discovery, development and production	In the event of a commercial discovery, the licensee may apply for a production licence to be granted in respect of the Development Area within the exploration block. The MPSA envisages the possibility to fast-track a discovery via an early production scheme, to meet domestic market requirements. Production forecasts are to be submitted for government approval on an annual basis.
7	Records, reports and data	This article simply refers to the requirements set out in the legislation and regulations.
8	Bonuses	A negotiable signature bonus is envisaged. Production bonuses are specified: once cumulative production reaches 50 million boe a payment of USD 5 million is due, with additional payments of USD 3 million for every additional 25 million boe.
9	Royalty	Royalty for oil is at flat rates determined by the daily production volume. These rates are negotiable subject to minimum amounts specified in the MPSA, ranging from 2.5% for production of 5,000 bopd or less, to 15% when production exceeds 40,000 bopd. Production volumes exclude water, sediment or any hydrocarbons reinjected. Royalty rates in respect of gas production are not specified and are to be negotiated. Royalty may be taken in cash or in kind at the government's discretion.

<table>
<tr><td>10</td><td>State participation</td><td>The government must notify the licensee within 120 days of the application for a production licence whether it wishes to participate directly or via a nominee (UNOC presumably).
State participation will not exceed 20%, but the MPSA wording suggests that the amount is at the discretion of the state rather than fixed in the PSA.
The State or its nominee are carried through development, costs being repaid out of that party's share of cost petroleum.</td></tr>
<tr><td>11</td><td>Cost recovery</td><td>Cost recovery is limited to 65% of hydrocarbon production after deduction of royalty. Defined exploration, development and operating costs (including payments into a decommissioning fund) are 100% recoverable subject to this limit. Any excess may be carried forward for recovery in a later period.
Contract areas are ring fenced: costs related to one area may not be recovered from production from a different area.
Where the licensee consists of more than one party, entitlement to cost recovery is allocated in accordance with respective interests in the licence. This conflicts with disproportionate cost sharing arrangements commonly used in farm-downs and development carries. It may also make any 'sole risk' activities problematic.</td></tr>
<tr><td>12</td><td>Production sharing</td><td>Profit oil or gas is shared for a calendar year based on an R factor calculated as at the end of the previous year for the licensee. Where the licensee is more than one party, the profit oil or gas is shared in accordance with the respective interests.
The R factor is calculated to 3 decimal places by dividing the cumulative net revenue (X) by the cumulative capital expenditure (Y). X is the sum of cost recovery and profit petroleum plus other credits required under Annex B, less recoverable operating costs. Y is the total of recoverable exploration and development costs.
Though not fixed, the profit split is calculated in accordance with the following formula:
<table>
<tr><th>R-factor</th><th>Licensee's share (%)</th><th>Government share (%)</th></tr>
<tr><td>1.0 or less</td><td>50</td><td>50</td></tr>
<tr><td>Between 1.0 and 3.0</td><td>50 – (25x(R-1)/2)</td><td>100 – Z
(where Z is the licensee's share)</td></tr>
<tr><td>More than 3.0</td><td>25</td><td>75</td></tr>
</table>
Profit split is to be calculated prospectively for each calendar quarter with a 'true-up' and any necessary adjustments after the end of the year.
The government may elect to take its share in cash or in kind.</td></tr>
<tr><td>13</td><td>Taxation</td><td>The licensee is subject to tax in accordance with the tax laws in effect in Uganda (see next chapter).
Any tax disputes must also be resolved in accordance with the Ugandan legislation dealing with objections and appeals.</td></tr>
<tr><td>14</td><td>Valuation and measurement of petroleum</td><td>The market price of crude oil production is to be determined monthly based on arm's length sales prices FOB at the agreed point of export (presumably the port of Tanga if transit is via EACOP) less the transportation tariff from the delivery point. In the case less than 50% of such sales are arm's length the government will determine the market price based on a basket of similar crudes, or another basis to be agreed.
Crude oil volumes and quality must be measured at the delivery point by the licensee.</td></tr>
</table>

15	Pipeline transportation	The licensee has the right to export crude oil produced and, if required, may construct a pipeline for this purpose (though we expect that any available capacity in EACOP would be utilised in priority). A pipeline project must be held in a separate entity. Transportation costs beyond the delivery point (including tariffs and costs of constructing and operating a pipeline) are not recoverable. The government or its nominee may elect to pay tariffs in kind in respect of transport of their share of crude oil.
16	Marketing and lifting	Where the government or its nominee takes its share under 9, 10 and 12 in kind, it will collect this at the delivery point and may require the licensee to assist with marketing. The licensee may purchase the government's share. The licensee must propose detailed arrangements regarding lifting, storage, etc., at least 12 months prior to the start of commercial production.
17	Domestic requirements	Refineries in Uganda have the right of first refusal in respect of crude oil production at a market price (as defined) The government has the right to acquire licensee's share of production to meet domestic market requirements, or in the event of national emergency.
18	Natural gas	Any associated gas may be used for production purposes (e.g. reinjection or power generation). Additional amounts can be flared (subject to restrictions in the 2013 Act) or reinjected. The government may elect to acquire the gas for its own use at zero cost. In the event of a discovery of non-associated gas, the exploration period will be eligible for a third extension of up to 2 years and the government and licence holder will negotiate specific terms based on the MPSA for production of that gas.
19	Training, research and employment	Licensees are required to pay training and research fees to the government. During the exploration phase the amount is USD 200,000 per year, which increases to USD 300,000 in the development phase and USD 400,000 after the commencement of production. The licensee may be required to provide secondment opportunities for government personnel in Uganda or internationally, at its own expense. It is also required to submit proposals for training of government employees at its expense as part of annual work programmes.
20	Title to assets	Title to any land acquired by the licensee will pass to the government free-of-charge immediately on purchase subject to the licensee's right of use rent-free until the termination of the PSA. Title to physical assets acquired by a licensee for petroleum operations may pass to the government or its nominee (presumably UNOC) at is discretion on the earlier of the termination of the PSA and the date the cost is fully recovered or depreciated for tax purposes. This is subject to the licensee's right to exclusive use of the assets free-of-charge during the life of the PSA.
21	Foreign exchange control	The licensee is subject to current foreign exchange controls, reporting and other procedures. Uganda's foreign exchange control regime has been fully liberalised so this is not onerous.

22	Assignment	A licensee cannot assign any of its rights or obligations under a PSA without ministerial consent. This includes assignments to affiliates. In the case of an assignment to an affiliate both parties remain jointly and several liable for all obligations under the PSA. In the case of assignment to a third party, the assignee must provide an unconditional undertaking in respect of such obligations and bank or parental guarantee or insurance bond.
23	Danger to persons, property or environment	HSE issues are critical in the upstream industry and environment concerns are particularly significant in Uganda given the sensitivity of the areas around Lake Albert. The licensee is required to consult with PAU and other relevant bodies and conduct operations in accordance with the relevant Uganda laws and international best practice. In the event of a breach the government may take remedial action itself and seek reimbursement from the licensee of costs it incurs.
24	Dispute resolution	Disputes (except those relating to tax or HSE issues) may be referred to international arbitration in London under UNCITRAL rules. The determination of the R factor, or market value of petroleum, may be submitted for expert determination at the election of either party.
25	Force majeure	A relatively standard force majeure article is included.
26	Annual acreage rentals	Rentals are set at USD 20 per square kilometre for the first exploration period, increasing to USD 30 in the second and USD 50 in the third. The rental in respect of an area subject to a production licence is USD 1,000 per square kilometre.
27	Termination	The PSA expires on expiry, surrender or cancellation of the related exploration or production licence. Subject to article 25, in the event of a breach of the terms of the PSA which is not remedied within stipulated time limits, the PSA and related licences may be terminated by the government.
28	Accounting and audits	Accounting records must be maintained in Uganda in accordance with Annex B, IFRS and industry best practice. Records must be in both USD and UGX, but in the event of a conflict USD records will prevail.
29	Notices	Notices issued by the licensee to the government must be sent in English to the Permanent Secretary at the Ministry of Energy. They may be sent via email.
30	Applicable law	The PSA is governed by Ugandan law. It should be noted that unlike civil law jurisdictions, the Minister is empowered under the 2013 Act to sign a PSA on behalf of the government, but the PSA is not a law per se. This article contains an economic stability provision. Where there is a change in law which 'substantially and adversely alters the economic benefit accruing to the licensee', the licensee has 36 months to notify the government. Changes to HSE laws are excluded. The parties must then discuss the economic impact of the law change and agree changes to the contract to restore the licensee's economic 'benefit' at the effective date of the PSA. The licensee must comply with the law changes pending settlement of the matter. If the parties are not able to agree, the matter may be submitted to arbitration under article 24. The article explicitly states that the government is permitted to introduce an additional profits tax to tax excess profits. This is presumably intended to capture economic rent arising from increasing oil prices.

31	Entire agreement and amendments	A standard provision is included.
32	Waiver	A standard provision is included.
33	Confidentiality	A standard provision is included. It should be noted that PSAs currently in effect in Uganda are confidential, though some have leaked into the public domain in the past.
34	Disclaimer	A standard provision is included.
A	Description and map of contract area	An industry standard annex is included.
B	Accounting and financial procedure	The MPSA contains an extensive, and fairly standard accounting procedure which also sets out reporting and record keeping requirements in detail. Some features are worth noting: • Records are to be maintained in both USD and UGX, but payments will be made in USD unless otherwise specified in the 2013 Act and Regulations (a term which is not actually defined but presumably refers to regulations made under that Act). • Accounting records are to be prepared on an accrual basis. • There are no rules in respect of calculation of income (or other) taxes. These are all found in the Income Tax Act (see next chapter). • All transactions should be recorded on the basis of arm's length values, except service charges from affiliates of the licensee which should be charged at cost. • No costs are recoverable if incurred without PAU approval. • Recoverable overhead charges in the exploration period are limited to 1% of contract expenditure, but there are no similar percentage limits on recoverable costs in the development and operation phase. • Tariffs for transport beyond the delivery point are not cost recoverable. (NB article 14 provides a net-back mechanism in determining market prices.) • Interest and other financial charges incurred on loans raised to finance development (including loans from affiliates) are cost recoverable provided the interest rate doesn't exceed LIBOR and the loan does not exceed 50% of the total financing. No other financing costs are recoverable. • Acreage rentals are cost recoverable but bonuses, royalties, state's share of production and taxes are not. • Payments into the decommissioning fund are cost recoverable.
C	Form of the performance guarantee (the "Guarantee")	This relates to the bank guarantee relating to the minimum work programmes and expenditure obligations set out in article 4.

5. The fiscal framework

a. Introduction

In contrast to many other jurisdictions and older PSAs in Uganda itself, the model PSA contains no provisions directly affecting the application of taxes to a licensee. Under article 13, licensees are required to pay tax in accordance with the prevailing tax laws and regulations. These apply separately to each taxpayer comprising the licensee in the case of a joint venture.

The URA is responsible for the administration of the tax system and all required tax payments are reported and paid to it. The Tax Procedures Code Act of 2014 provides details of rules for conduct of tax objections and appeals.

b. Corporate income tax ('CIT')

Principles of computation

The legislation governing the taxation of upstream activities in Uganda is the Income Tax Act ('ITA'). Part IX A includes modifications to the general CIT rules applicable to upstream and mining activities.

The general rate of CIT is 30%. The rates applicable to licensees and mining companies are separately identified in the ITA. These are currently also 30%, but the fact that they are separately identified suggests they might be changed in the future without impacting the rate applicable to other businesses.

The basis for calculating CIT is the IFRS financial statements of a taxpayer which will include proceeds from sale of both cost and profit petroleum. In general CIT returns should be prepared in Ugandan shillings but a foreign currency (e.g. US dollars) may be used with permission of the URA. Expenses incurred in the production of income are deductible subject to specific disallowances (e.g. entertaining, book depreciation). There is effectively a ring fence on a contract by contract basis as excess tax deductions may only be carried forward for offset against income of the same contract area. There is no provision for fiscal consolidation of companies under common control.

Though the rules for cost recovery and tax deduction are different, the amount of tax deductions permitted in any year of income may not exceed the cost oil for the period. Any excess deductions may be carried forward to offset income of a later period on a FIFO basis. Given the 65% cap on cost oil, this has a potentially significant impact on project economics and has proved controversial.

Exploration expenditure

Exploration expenditure may be fully depreciated in the year incurred. Where this is incurred prior to the generation of income the deduction will be carried forward and may be used to offset income in a later period subject to the limitation mentioned in the previous section.

Development expenditure

A deduction for tangible and intangible development expenditure is given via straight-line depreciation over the lesser of 6 years and the expected live of the project. Expenditure incurred prior to the start of commercial production is treated as incurred on the date that it commences. Where commercial production starts part-way through a tax year, the deduction available for that tax year is proportionately reduced.

Decommissioning expenditure

A contribution to the decommissioning fund established under a PSA is deductible in the tax year it is made. Decommissioning expenditure that is not met out of the fund is deductible in the tax year incurred. Interest income accruing on the fund and amounts withdrawn to meet decommissioning costs are non-taxable and no deduction is given for costs that withdrawals from the fund are used to meet.

Losses

Part IXA does not recognise the concept of a tax loss per se, but excess deductions may be carried forward to offset future income on a FIFO basis without any time limit, as noted above.

Financing

There are no special rules in the ITA regarding the deduction of interest and other finance charges by licensees. The general rules limit the deduction of interest costs by a taxpayer which is a member of a group to no more than 30% of profits calculated for tax purpose before deduction of interest and tax depreciation. A group is defined as companies with common underlying ownership. This is potentially onerous for upstream activities as high levels of debt are common, e.g. in project financing, and potentially less generous than the equivalent cost recovery rules. It should be noted that the 2019 Finance Bill includes a proposal to abolish this limitation for banks and insurance companies and there is also a strong case for some relaxation in the case of companies involved in the oil and gas industry.

Transfer pricing

In addition to specific rules in the PSA applying to cost recovery and sales of production to affiliates, the ITA includes an anti-avoidance provision applicable to transfer mispricing. Uganda also has detailed regulations on transfer pricing. Further comments can be found here http://cristaladvocates.com/mdocs-posts/managing-transfer-pricing-in-uganda/.

Branches

Where a licence interest is held by a branch of a foreign legal entity, an additional tax of 15% will apply to the profits of the branch which are deemed to be repatriated in the year. This is in lieu of the withholding tax applicable to dividends. The taxable amount is the value of the opening net assets of the branch, plus the after-tax profits of the year, less the closing net asset value.

Proposed change in the 2019 Finance Bill

Legislation proposed to come into effect on 1 July 2019 includes a provision that requires that taxpayers (mainly companies, we expect) will be required to pay income tax equivalent to 0.5% of 'gross turnover' if they have carried forward losses for a consecutive period of 7 years. The tax will apply in the eighth year and each subsequent year of loss carry forward. The term 'gross turnover' is defined in section 2 of the ITA and includes not only revenue from regular business activities but also gains on disposals of capital assets.

This is likely to impact businesses which require significant up-front capital investments which may not fully utilise loss pools resulting from tax depreciation for several years after commencing operations. Companies involved in large, capital-intensive infrastructure projects such as pipelines, refineries and hydropower projects may be affected. It is not clear that this will apply to licensees operating under a PSA as they will have taxable profits for CIT purposes in every tax year after commencement of commercial production because of the cap on tax deductions discussed above.

Details of other proposed changes can be found in our finance bill commentary http://cristaladvocates.com/mdocs-posts/ugandas-proposed-tax-changes-for-the-year-2019_2020/

Returns and administration

As noted above, each party comprising the licensee under a PSA and exploration or production licence, is a separate taxpayer for CIT purposes and must report separately to the URA. Annual CIT returns for most taxpayers should be submitted within 6 months of the end of a tax year, though different rules are provided for licensees and mining companies (see below). The tax year is usually a calendar year, though a different year end may be used with the URA's permission. Audited financial statements should accompany the return in the case of all but the smallest companies.

Part IX A of the ITA includes provisions relating to the reporting of 'petroleum revenues' which comprise:

- CIT;
- Government share of profit oil/gas;
- Signature bonuses;
- Annual acreage rentals;
- Royalties;
- Proceeds from sales of the government's share of production on its behalf; and
- Any other duties or fees payable to the government under the terms of the PSA (which presumably includes production bonuses as these are not separately identified).

Licensees are required to make the following returns and payments in respect of all petroleum revenues:

- A return should be provided at least 30 days prior to the start of the tax year including estimates of petroleum revenue payments expected for each quarter of the coming year.
- This return should be updated on a quarterly basis. The act also requires returns to be made on a monthly basis in respect of provisional payments of petroleum revenue, though the information these should contain is not clear.
- Provisional payments of any petroleum revenues (including CIT) should be made quarterly in USD.
- A consolidated return in respect of all petroleum revenues (including CIT) should be made within 90 days of the end of each year of income.
- The URA may require the operator to provide returns in respect of the joint venture, as a whole.

Penalties are provided for delays to returns and payments or submission of incorrect information. These are significantly higher than those applicable to companies outside the extractive sector.

c. Withholding tax ('WHT')

Like most emerging economies, Uganda collects a large proportion of income tax via withholding at source.

Part IX A includes specific WHT for non-resident contractors in respect of payments from licensees in respect of mining or petroleum operations. The rate is 10% and this is a final tax, so a contractor which has established a branch in Uganda is not required to include such payments in calculating any CIT due for the tax year. The charge extends to recharges to a licensee by a non-resident affiliate if that affiliate has made payments to a non-resident contractor.

Part IX A also applies a specific WHT to 'participation dividends' paid by a licensee which is a Ugandan resident company. The rate is 15%. A 'participation dividend' is a dividend paid to a non-resident company holding at least 10% of the voting interest in the licensee.

The definition of Ugandan source income in the ITA includes, 'a natural resource payment in respect of natural resource taken from Uganda'. The applicable rate of WHT is 15% in relation to a payment to a non-resident. The ITA defines a natural resource payment as either:

i. *'a payment, including a premium or like payment, made as consideration for the right to take minerals or living or non-living resource from the land; or*

ii. *a payment calculated in whole or in part by reference to the quantity or value of minerals or a living or non-living resource taken from the land.'*

We understand that this is primarily aimed at overriding royalties or similar payments, but care needs to be taken to understand the potential impact on certain types of financing arrangements and purchases and sales of interests in PSAs.

The WHT rates in respect of other types of payments are summarised below:

Payment category	Resident rate	Non-resident rate
Dividends (note1)	10%/15%	15%
Interest (note 2)	0%/15%/20%	15%
Royalties	N/A	15%
Management fees	6%	15%
Professional fees	6%	15%
Imported goods (note 3)	6%	N/A
Goods and services provided to government and designated persons (note 4)	6%	N/A
Rents and premiums	N/A	15%
Uganda source service contracts	N/A	15%
Shipping, air transport, cargo, road transport	N/A	2%
Cable, radio, optical fibre, satellite communication	N/A	5%
Public entertainment, payments to sportsmen and women	N/A	15%
Re-insurance premiums	N/A	10%

Notes

1. The 10% rate applies where a dividend is paid by a company listed on the Uganda Securities Exchange to a resident individual.
2. 20% WHT applies to interest on treasury bills. No WHT applies to interest paid by an individual, to a financial institution or by a resident company to a resident affiliate. In all other circumstances the rate is 15%.
3. Import WHT is effectively an advance payment of income tax by the importer which must be paid before goods can be cleared for import, but subsequently may be offset against tax due on profits for the relevant year. Compliant taxpayers may be exempted by the URA.
4. Applicable to payments exceeding in aggregate UGX 1 million. Compliant taxpayers may be exempted by the URA.

A small number of double tax treaties are in force and these provide for reduced rates of WHT where the beneficial owner of the income is tax resident in the treaty partner jurisdiction:

Treaty country	Dividends	Interest	Royalties	Technical fees
Denmark	10%/15%	10%	10%	10%
India	10%	10%	10%	10%
Italy	15%	15%	10%	10%
Mauritius	10%	10%	10%	10%
Netherlands	0%/5%/15%	10%	10%	0%
Norway	10%/15%	10%	10%	10%
South Africa	10%/15%	10%	10%	10%
UK	15%	15%	15%	15%
Zambia	0%	0%	0%	0%

Notes

- Rates of WHT on dividends vary under some treaties depending on the proportion of share capital held by the recipient.
- WHT applies to 'technical fees' (as defined) where the recipient provides services but does not create a permanent establishment in Uganda.

d. Value Added Tax ('VAT')

Uganda introduced VAT in 1996 and principles applicable under the VAT Act are in most respects consistent with international norms.

Companies engaged in exploration and/or development activities often encounter VAT problems in emerging markets because they incur significant amounts of input tax which they are not able to reclaim from the government, either because they don't have a legal right to do so (eg because they cannot register for VAT), or because the tax authorities do not have sufficient funds available to meet repayment claims, even though a legal right to repayment exists. This problem is often not resolved when export oriented projects reach the production stage, because exports under most VAT systems are zero rated, meaning excess input VAT is still an issue.

Uganda has adopted a creative approach to resolve some of these issues:

- Licensees or companies engaged in construction of a pipeline or refinery may apply to the URA to be VAT-registered even though they do not make taxable supplies in excess of the annual registration threshold (which is currently around USD 40,000).
- A system of deemed VAT payment is applied to supplies of goods and services to licensees solely and exclusively for the purposes of petroleum operations. This means that whilst VAT is accounted for by the supplier and the customer, no cash payment to or repayment from the URA is required.

Uganda has taken a novel approach to the application of VAT to imported services. In most jurisdictions VAT is accounted for on such services via a reverse charge mechanism where the customer accounts for both output and input tax on the taxable value. Under Uganda's VAT rules, the customer is not usually entitled to a credit for the reverse charge VAT, even

if other types of input VAT it incurs are creditable. Licensees are not subject to this restriction and may take a credit for any reverse charge VAT that they incur.

Imports of machinery, spares and equipment by a licensee for use in petroleum operations are exempt from import VAT subject to approval by a competent authority being the Ministry of Energy and Mineral Development.

It should be noted that domestic sales of crude oil (e.g. to the refinery) will be subject to VAT at the standard rate of 18% under current rules. Current VAT rules apply VAT exemption to the following, which are subject to excise tax:

- Motor spirit (gasoline or petrol);
- Kerosene;
- Gas oil (diesel);
- Jet fuel; and
- Residual oils used in thermal power generation for the national grid.

Unless some legislative changes are made, this will create a significant VAT cost for the refinery as it will incur input VAT on the crude that it acquires (and other costs including construction), but most of the sales that it makes will be exempt from VAT, so the input VAT incurred will simply be an additional cost for the business. It is not clear whether the Uganda government intends to make any law changes to address this, though it would seem to create a significant threat to the viability of the project.

e. Customs duty

Uganda is part of the East African Community ('EAC') and subject to the EAC Customs Management Act 2004. Imports are generally subject to duties of up to 25% and import VAT at 18% must also be paid on the value of goods imported, including applicable customs duty. As noted above, imports of machinery, spares and equipment by a licensee for use in petroleum operations are exempt from import VAT subject to approval by a competent authority and this relief is also available for customs duty purposes.

There are no export duties relevant for licensees.

f. Excise tax

Excise tax is applied by the Excise Duty Act of 2014. Sales of the following are subject to excise tax at various rates and exempt from VAT:

- Motor spirit (gasoline or petrol);
- Kerosene;
- Gas oil (diesel);
- Jet fuel; and
- Residual oils used in thermal power generation for the national grid.

g. Stamp duty

The Stamp Duty Act of 2014 imposes stamp duty on legal instruments at varying flat and ad valorem rates.

h. Payroll taxes

Employers are obliged under the ITA to withhold tax from employee remuneration at progressive rates (from 0% to 40%). The maximum rate of tax applies to income exceeding approximately USD 32,000 per annum. Most benefits in kind are taxable. Residents are taxable in their worldwide income and gains, whilst non-residents are taxable on Ugandan-source income and gains only.

Employers are also responsible for collection of contributions to the National Social Security Fund ('NSSF'). The contribution is 15% of cash emoluments, 10% being payable by the employer and 5% by the employee. The employer contribution is deductible in computing CIT. Contributions are invested on behalf of the employee who may reclaim the balance in their account on retirement or permanently leaving Uganda. Theoretically foreign employees may be exempted from

NSSF contributions if they contribute to a similar scheme in their home jurisdiction, but this is difficult to apply in practice.

Local service tax ('LST') is a levied by the local authority where a taxpayer resides on employment income. The employer is responsible for collection of LST. The maximum rate is approximately USD 30 per year.

i. Acquisitions and disposals of interests in PSAs

Asset transactions

Gains arising on asset disposals are subject to CIT along with other income at the normal rate of 30%.

The ITA provides specific rules for farm-out transactions, i.e. when a licensee disposes of an interest in PSA wholly or partly in exchange for the transferee undertaking work commitments in respect of the part of the interest retained by the transferor. In such cases, for the purposes of calculating the CIT implications, the consideration received by the transferor includes the value of that work plus any cash consideration. Cash proceeds are treated as a recoupment of past costs and taxable in the period that they arise as is any excess consideration over past costs.

Apart from this the ITA provides limited guidance on the taxation of direct disposals of PSA interests, though the general principle is that proceeds will be taxed subject to available reliefs in the form of past exploration and development costs. The operation of the de facto ring fence means that gains may only be reduced by unrelieved prior costs arising from the same contract area.

It is not clear that the transferee would be able to take any deduction for reimbursement of past costs, or other payments for an interest in a PSA or licence. Costs of work commitments undertaken on behalf of the transferee would be deductible as exploration or development costs, as the case may be. It is worth remembering that a licence holder's allocation of cost recovery petroleum is limited to its share in the licence: disproportionate cost oil sharing is not contemplated under the provisions of the MPSA.

A transfer of an interest in a PSA/licence would generally be treated as a taxable supply subject to 18% VAT. The VAT legislation includes exemption for the transfer of a business (or part of a business) as a going concern, though it is not clear whether this applies to transfers of PSA interests.

An instrument effecting the transfer of a PSA/licence interest would potentially be subject to stamp duty at nominal rates.

Share transactions

In the case of a share disposal, CIT may apply to the transaction in two ways:

- Gains on the disposal may be subject to tax at 30% where they arise from the transfer of shares in a company which principally derives its value directly or indirectly from immovable property located in Uganda (which includes interests in PSAs); and
- The entity in Uganda may itself be deemed to dispose of its assets and liabilities at market value, realising any latent gains and triggering tax at 30% on those if the underlying control of the entity changes by more than 50% in a three-year period. In this case the deemed disposal would also result in s step-up (or down) in the tax basis of the assets and liabilities.

It is possible that one transaction may trigger tax in both ways, effectively resulting in double taxation. Share transactions therefore require careful consideration to minimise the risk of this.

Where there is a change in the underlying ownership of a licensee, the licensee is required to notify the URA immediately in writing and if the person making the disposal is non-resident, the licensee itself become liable as agent for any tax which is triggered as a result.

Share transactions are exempt from VAT.

Stamp duty will apply to the disposal of shares in a Uganda legal entity. The applicable rate is 1.5 percent of the consideration on the disposal of shares.

6. About Cristal Advocates

We are a corporate and commercial law firm offering full scale legal services but with an emphasis on tax, energy, infrastructure and business support. We have a multi-disciplinary team of lawyers, accountants and other professionals with local, regional and global exposure enabling us to provide total business solutions through integrated service offerings.

Our team offers cutting edge creative solutions to modern day business challenges in a timely manner and with the highest levels of professionalism. Our customer-centric philosophy is hinged on being a reliable service provider offering efficient and commercially viable solutions in our areas of practice.

Our Values

- Integrity
- Commitment
- Accountability
- Passion
- Adaptability
- Collaboration and Team Work
- Humility

Service offerings

- Energy & Infrastructure
- Tax
- Business support
- Company Secretarial & Trustee Services
- Employment
- Public Law & Policy Advocacy
- Banking and Finance
- Dispute Resolution
- School of Professional Excellence

Cristal Advocates accepts no responsibility for any loss occasioned to any person acting or refraining from acting as a result of material contained in this publication. Further advice should be taken before relying on the contents of this publication.

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Denis is the Managing Partner at Cristal Advocates where he also leads the energy and tax practice. He is qualified both as a Lawyer and Chartered Accountant with vast experience serving various industries in Sub Saharan Africa. Before joining Cristal Advocates, he had worked for close to 10 years with Deloitte and Touche 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 Group seeing him play a lead advisory role in Uganda, Kenya, Tanzania, Mozambique, South Sudan, Somalia and Ethiopia.

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

He holds a Master of Laws degree in Petroleum Taxation and Finance from the University of Dundee in the United Kingdom, a Post Graduate Diploma in Legal Practice and a Bachelor of Laws degree from Makerere University. ■

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Bill is a Senior Advisor with Cristal Advocates. He has concentrated on working with energy companies with a particular focus on cross border transactions and M&A since 1989 and is a leading global energy and tax practitioner with wide international experience. Between 1986 and 1998, he worked in London with the UK tax authorities and Big Four accounting firms. From 1998 to 2004, he was based in Kazakhstan working across the Caspian region with Deloitte. He was in the region at the time it was developing its infrastructure for crude oil production with international investment following the collapse of the Soviet Union.

From 2004 to 2008, he worked in Russia where he led Deloitte's oil and gas industry group and established Deloitte's office in Sakhalin. He moved to East Africa in 2009 leading Deloitte's energy and resources industry group in Uganda, Kenya, Tanzania, Rwanda, Ethiopia and Mozambique. He was initially based in Kampala, Uganda later relocating to Dar es Salaam, Tanzania. Bill returned to the UK in 2014 supporting Deloitte UK teams working on outbound projects investing in Africa and was a key member of Deloitte UK's energy and resource practice until his retirement from the firm in September, 2018.

Bill is a graduate of Oxford University and completed his inspectors' training with the UK Inland Revenue in 1989. ■

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John leads the public policy and advocacy practice at the firm and combines unique public and private sector experience.

Prior to joining Cristal Advocates, he had 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. John had earlier worked with the Post Bank Uganda Limited and Shonubi Musoke and Co. Advocates.

He holds a Bachelor of Laws degree from Makerere University and a Post Graduate Diploma in Legal Practice from the Law Development Centre and various other qualifications. ■

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Dickens leads the oil and gas practice at Cristal Advocates. He has an in depth appreciation of Uganda's oil and gas sector having served as the maiden Company Secretary of the Uganda National Oil Company (UNOC) and the Uganda Refinery Holding Company Limited (URHC). UNOC represents the Government of Uganda commercial interests in the oil and gas sector while URHC represents government interests in the refinery project as well as managing the petrol based industrial park.

Dickens was instrumental in UNOC's formation and initial period of operation and 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 playing key legal advisory roles on the negotiation and implementation of PSAs, Joint venture and other oil and gas agreements. He was also part of the team that shepherded the process of enacting the current Ugandan oil and gas Legislations and Regulations including the local content requirements.

He is a certified project control specialist (IFP) and holds a Master of Laws Degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom, a Post Graduate Diploma in Legal Practice and a Bachelor of Laws degree from Makerere University. ■

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Francis leads the litigation and dispute resolution practice at the firm. He is an Advocate of the High Court of Uganda with 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 regulatory compliance, national content, health and safety and dispute resolution.

He joined Cristal Advocates from Kizza, Tumwesige, and Ssemambo Advocates. He previously worked with the Advocates Coalition for Development and Environment (ACODE). He also undertook a traineeship with the oil and gas division of Webber Wetzel in Johannesburg, South Africa.

He holds a Master of Laws degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom and various other qualifications. ■

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