Cristal Advocates

Uganda set to revise oil laws

A path for progress

Cristal Knowledge Series | September 2021

1. Introduction

A bundle of laws reinforcing the country's regulatory framework for the seamless execution of Uganda's oil project will shortly be gazetted and tabled before Uganda's Parliament for deliberation and enactment. This follows the recent approval by Cabinet of the East Africa Crude Oil Pipeline (EACOP) Bill, 2021, the Income Tax (Amendment) Bill, 2021 and the Public Finance Management (Amendment) Bill, 2021. The proposed changes in the law will streamline the country's oil and gas legal regime facilitating the effective implementation of the various project agreements that the Government of Uganda ("GoU") and the International Oil Companies ("IOCs") have concluded in the past couple of months. In the first of a series of articles, we highlight the proposed amendments in the Income Tax (Amendment) Bill, 2021 ("the ITA").

2. Breakthrough with negotiations

A major milestone for Uganda's oil project was achieved in April 2021 when both the GoU and IOCs struck agreement on many outstanding issues that had been a subject of protracted disagreement. The proposed amendments in the ITA record positions of compromise on income tax matters between the GoU and IOCs following the dramatic implosion of relationship between these two principal stakeholders in 2019. Largely fuelled by lingering differences on several tax matters, the IOCs had temporarily ceased active oil project development activities until all these issues were conclusively resolved.

3. 2017 Tax changes

The timing of payment of income taxes by the IOCs became a matter of contention when the Income Tax Act was amended in 2017. In line with this amendment, the IOCs would begin paying income taxes at the onset of oil production regardless of whether they were in a profitable position or not. Though this law would fast-track government revenues, the IOCs considered the change unnecessary given the range of alternative fiscal tools at government disposal to maximise early oil revenues. In addition to traditional tax revenues, the government also earns royalties, bonuses and rental payments and a share of the crude oil produced from petroleum operations. According to the IOCs, the early fiscal payments to the government as highlighted above were sufficient for government to raise enough revenues to meet its citizenry expectations without imposing onerous income tax impositions in the early project years that would delay the IOCs' recoupment of sunk project costs.

Income taxes are ordinarily imposed on profits. Companies in other sectors are allowed a full deduction of their annual business costs in determining their income tax liability. The IOCs contended that denying them full deduction of their annual business expenses as espoused by the 2017 amendment capping the same to their annual cost oil entitlement departed materially from the normal principles of income taxation and international benchmarks.

The IOCs were further concerned that unless revisited the 2017 amendment would delay Uganda's oil project final investment decision ("FID") because front loading income tax payments when the IOCs were not strictly in a profitable position just after incurring significant field development costs would stretch further the project payback period. The shorter the payback period, the more commercially viable a project is.

4. 2021 ITA amendment

The text of the 2021 amendment to the ITA reiterates the position of the law in line with the 2017 amendment to the Income Tax Act. It however clarifies that the deductible costs for tax purposes for Contract Area 1, Contract Area 2 and Contract Area 3 A would be capped to the annual cost oil entitlement for the IOCs in accordance with the respective applicable oil agreements (PSAs). Contract Area 1, 2 and 3A are the oil blocks being jointly developed by Total, the China National Offshore Oil Corporation ("CNOOC") and the Uganda National Oil Company ("UNOC").

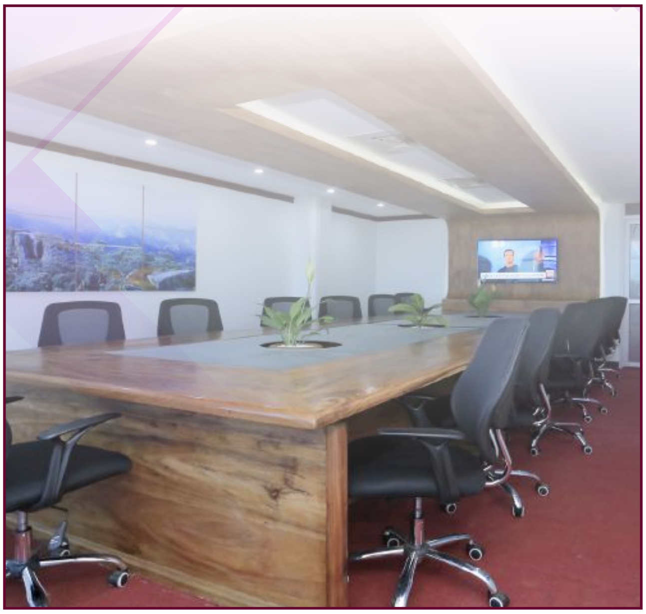
Whereas the proposed change in the law does not do away with the possibility of the IOCs paying income tax at the onset of oil production, it is understood that there will be reduced income tax burden on the IOCs in the early project years. This is because it is speculated that both the GoU and IOCs agreed to relax the underlying cost recovery caps in the respective PSAs to arrive at a win-win position that would enable the project achieve the requisite investment hurdles marks to reach FID. As requested by the IOCs, this revision in the law improves the commercial viability of Uganda's oil project through accelerated project payback period and recoupment of sunk project costs.

5. Tax sweetener

To make amends for reduced income taxes in the early years of Uganda's oil project as a result of the amendment in the law, the ITA further proposes to introduce a windfall tax that will see the government earn more tax revenues during periods of high crude oil prices. The Income Tax (Amendment) Bill introduces a windfall tax to be charged where the international oil price is 75 per barrel or more on any day of a year of income. Windfall taxes in the extractive sector represent special taxes designed to capture part of the extra profits created when international prices of commodities soar.

6. Conclusion

The Income Tax (Amendment) Bill, 2021 records some of the several compromises reached between the IOCs and the GoU geared towards fast tracking Uganda's oil production. The proposed changes in the Income Tax Act improve project economics thereby enabling Uganda's oil project reach FID. Both the IOCs and GoU are commended for adopting a long term view of Uganda's oil project hence narrowing their several areas of disagreement to enable the project take off. Uganda's oil project is not only going to be a game change for the country alone but the East African region as well.



Contacts for this Publication

Denis Yekoyasi Kakembo

dkakembo@cristaladvocates.com

+256 751 834 168

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. ■

Lilian Arinda

larinda@cristaladvocates.com

Lilian is a Legal Associate at Cristal Advocates. She holds a Bachelor of Laws Degree from Makerere University and a Post Graduate Diploma in Legal Practice from the Law Development Centre. She is undertaking the Post Graduate Diploma in Tax and Revenue Administration from the East African School of Taxation. ■

CRISTAL
'total solutions'

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

Contact us

Cristal Advocates
32 Lumumba Avenue
4th Floor, Padre Pio House
Lumumba Avenue

P.O. Box 1769 Kampala, Uganda
Tel: +256 (414) 671 274
Email; admin@cristaladvocates.com
www.cristaladvocates.com