Cristal Advocates

The East African Crude Oil Pipeline (Special Provisions) Bill, 2021

The proposed fiscal and taxation regime

Cristal Knowledge Series

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1. Introduction

Uganda's Parliament is set to begin debating the provisions of the East African Crude Oil Pipeline (Special Provisions) Bill, 2021 ("EACOP or the Bill"). This follows the gazettement and publication of the official version of the Bill in the 1st October 2021 Uganda Gazette edition. If enacted into law, the EACOP Act will facilitate the seamless implementation of the EACOP project activities in Uganda.

The EACOP project is estimated to cost over $3.5 billion to build. The EACOP project sponsors or owners include French oil major TotalEnergies that holds the majority stake, Uganda National Oil Company ("UNOC"), Tanzania Petroleum Development Corporation ("TPDC") and the China National Oil Offshore Company ("CNOOC"). 60% of the project finance will be debt while 40% will be equity injection. Negotiations to firm up debt financing for the project are in advanced stages with various commercial and sovereign export credit financing agencies involved in these discussions.

In this article, we give an overview of the key fiscal and taxation provisions that will apply to the EACOP project activities as contained in Schedule 2 of the Bill. It is understood that the proposals do not vary materially from the relevant clauses negotiated and included in the various project agreements including but not limited to the Intergovernmental Agreement ("IGA"), the Host Government Agreement ("HGA"), the Shareholders Agreement and the Tariff and Transportation Agreement ("TTA").

2. Supremacy of the EACOP legislation

The fiscal and taxation regime applicable to the EACOP project shall be the regime of taxes and other charges pursuant to Ugandan Law, including the regime for imposing, administering and disputing taxes and other charges, as modified by Schedule 2 of the Bill. Where there is an inconsistency between the application of the provisions of the Schedule 2 on the one hand and the application of the provisions of any other Ugandan Law, on the other hand, the provisions of Schedule 2 shall apply.

3. Pipeline ownership structure

The entire pipeline is to be owned by a Project Company incorporated in the United Kingdom ("UK"). It is understood that branches of the Project Company will be established in Uganda and Tanzania. This had previously been a matter of contention with Uganda demanding that the company is incorporated locally so that it could be considered resident for tax purposes. A compromise position reached was that the management and control of the company would be exercised in Uganda. This way it would also be treated as resident for tax purposes in Uganda despite incorporation in the UK.

Activities carried out in Tanzania (principally the transportation of crude oil) will be attributed to a Tanzanian permanent establishment ('PE') and taxable there. Activities in the UK will be confined to 'routine functions in relation to financing the EACOP Project' which are deemed to relate to a UK PE. Local tax rules in Tanzania and the UK will also need to be considered in determining the tax position in those jurisdictions, of course.

4. Transfer of ownership interest in the Project Company

Any transfer of direct or indirect ownership interest in the Project Company which results in a change of decisive control of the Project Company shall be subject to the prior written consent of the Minister responsible for petroleum activities.

The taxation of a direct and indirect disposal of an interest in the Project Company shall be in accordance with Ugandan Law. 40% of any gains on the direct or indirect disposals of interests in the Project Company will be subject to tax in Uganda under general rules. The balance of the gain shall be attributed to Tanzania and subject to tax there in accordance with domestic legislation.

No tax shall be imposed on a direct or indirect disposal of an interest in a Project Company where the said disposal arises as a result of:

- The enforcement by a finance party, or any agent or trustee of the finance party, of any security in relation to interests in the project company;
- Any transfer of an interest in the project company to the Ugandan state participant;
- Any transfer of an interest in the project company by a shareholder to its affiliate; or
- Any transfer of an interest which occurs within the chain of holding companies between a shareholder and its ultimate parent company where, following such transfer there is no change of the ultimate ownership of such shareholder.

The foregoing provisions ensure that intra-group reorganisation or the enforcement of financing covenants is not absurdly subjected to capital gains tax.

5. Direct owners of the Project Company

There are also some provisions relating to the tax treatment of the direct owners of the Project Company comprising the subsidiaries of Total, CNOOC, UNOC and TPDC. Dividends to the project shareholders will be exempt from Ugandan withholding tax ('WHT'). Ugandan stamp duty will equally not apply to any transfer of shares in the Project Company to these shareholders.

6. Tax holiday

An exemption from corporate income tax ('CIT') is available for the Project Company in respect of tariff income derived from owning and operating the EACOP system for a period of 10 years from the date of first commercial transportation and export of crude. This does not apply to non-tariff income (which might include, for example, interest on cash deposits).

Normal CIT rules, as modified by the proposals in the Bill, apply for the purposes of computing the CIT profit which is exempt. This means, for example, that depreciation of the pipeline and related assets will need to be computed for the period of the tax holiday.

7. Rules for computing corporate income tax

General CIT rules (rather than those specific to upstream activities for the exploration and production of crude oil) are applicable subject to the following provisions:

- The taxable or chargeable income of the Project Company in Uganda shall comprise the chargeable income in respect of the tariff income from owning and operating the EACOP system and any other non-tariff chargeable income.
- The tariff chargeable income shall not be subject to CIT during the first 10 years of the project but this does not apply to the non-tariff chargeable income.
- The Project Company shall calculate the tariff chargeable income and the non-tariff chargeable income separately for each year of income.
- Accounting information and tax returns are to be prepared in US dollars. Tax payments are however to be made in Uganda Shillings.
- Income and expenses for the tariff chargeable income are to be allocated between Uganda and Tanzania on the basis of an allocation percentage (40% in respect of Uganda and 60% in respect of Tanzania). Agreement on the income and expenses allocation formula between Uganda and Tanzania took protracted negotiations and was only closed out by President Museveni and the late Tanzanian President John Pombe Magufuli.
- Income and expenses allocated to the Tanzanian PE will be excluded from the calculation of profits subject to CIT in Uganda. This is an exception to the normal rule that a resident company is taxable on its worldwide income and gains, with any foreign CIT being potentially offset against Ugandan tax via a foreign tax credit.
- A foreign tax credit will be available for any CIT applied by a foreign jurisdiction. Any credit in excess of applicable Ugandan CIT may be carried forward for offset in a later period.
  Tax depreciation in respect of capital expenditure is computed at 5% per annum on a straight-line basis.
- Required contributions to the decommissioning fund are deductible.
- Losses brought forward from a prior year may be offset to a limit of 70% of the taxable income of the year, calculated prior to the offset of that loss. Any surplus loss may be carried forward against profits of the following year, subject to the same limit.
- Branch profits tax is not applicable to the Project Company.
- Normal transfer pricing rules apply in respect of transactions with affiliates including foreign PEs of the Project Company.

8. Application of WHT

The EACOP Bill contemplates the following treatment in respect of WHT.

- Dividends paid by the Project Company to its shareholders are exempt from WHT.
- Tariffs payable to the Project Company are exempt from WHT.
- The import of goods into Uganda for direct and exclusive use of the EACOP project is exempt from WHT.
- Payments for the purchase of assets for the direct and exclusive use of the EACOP project are also exempt from WHT.
- Supplies of petroleum for the EACOP Project are exempt from WHT.
- Interest payable to shareholders and other affiliates by Level I contractors or the Project Company will be subject to 10% WHT. Level 1 contractors are those entities or persons that provide goods and/or services under a contract with the Project Company. This includes EPC contractors during the construction phase.
- Interest payable by the Project Company or Level 1 contractors to other lenders or financial institutions which are affiliates will be exempt from WHT.
- Payments to non-residents for technical services provided directly and exclusively for the EACOP project will be subject to 5% WHT. This includes insurance and re-insurance, equipment rental and management payments.
- Payments attributed to the Tanzanian PE of the Project Company are not subject to Ugandan WHT.

- For the purposes of applying WHT to interest, any capitalised interest shall be treated as unpaid and WHT will only fall due when actual payment to the lender is made.

9. Value Added Tax ('VAT')

The Bill provides for a broad principle that VAT should not be an economic cost to the project. This is to be achieved as follows:

- Transport and incidental services provided by the Project Company are zero rated, meaning that no VAT will be charged on invoices issued, but the Project Company will be entitled to recover Ugandan input VAT it incurs.
- Goods and services imported by the Project Company, Level 1 and Level 2 Contractors are not subject to VAT. Level 2 Contractors are those contractors providing goods/services to a Level 1 Contractor.
- Imports and exports of petroleum will not be subject to VAT.
- VAT will not apply to any supplies or deemed supplies between the Project Company's head office in Uganda and its PEs in Tanzania and the UK.

The Bill envisions using an adapted version of the VAT accounting used by upstream and mining companies. Under this mechanism VAT charged on supplies made for the purposes of the EACOP project by a Level 1 Contractor to the Project Company or by a Level 2 Contractor to a Level 1 Contractor, is deemed (rather than actually) paid. This way, Level 1 and 2 contractors are able to register for VAT purposes and be entitled to a claim of any input VAT and arising refunds if they are in a VAT refundable position.exempt from WHT.

10. Customs and other taxes

It is a principle arising from the provisions of the bill, that customs duties (including customs processing fees), excise and similar taxes should not be an economic cost to the EACOP project.

- Customs and import duties will not apply to the equipment and materials used in construction of the EACOP (apart from motor vehicles).
- Motor vehicles which are imported temporarily for use in the project will also be exempt.

There are various detailed implementation provisions including the requirement of the Project Company to submit a list of the main categories of goods which as at the date of the final investment decision of the EACOP Project are expected to be imported for the direct and exclusive use of the EACOP Project as equipment, inputs or engineering plant. The Bill also envisions that circumstances under the temporary importation regime would apply to motor vehicles for the direct and exclusive use of the EACOP Project period.

11. Other fiscal provisions

The other fiscal provisions for the EACOP project include:

- The stamp duty payable on any instrument effecting any grant, conveyance or transfer or acquisition of any land rights in relation to the EACOP Project is not to exceed UGX 500,000.
- The stamp duty chargeable on various financing instruments is capped at UGX 10,000.
- Expatriate employees of the Project Company and level 1 contractors who are not ordinarily resident in Uganda are exempted from remitting Uganda Social Security contributions to the extent they are enrolled in comparable social security schemes in their countries.

12. Administration and compliance

The Bill provides a certification mechanism so that parties may obtain government confirmation that transactions are eligible for the benefit of the exemptions and reliefs outlined above in relation to WHT, VAT, customs and excise duties. However, the certification process will take time, so eligible participants can effectively 'self-assess' their entitlement, subject to the possibility of challenge on a subsequent tax audit.

It is important to note that the provisions of the Bill, when enacted, will have a retroactive effect in relation to 'early project activities' which covers any EACOP-related work carried out since 1 January 2016. Early project activities means any project activities carried out prior to the Final Investment Decision in relation to the EACOP project in terms of technical and social studies and any preparation works including access roads and camps among others.

13. Conclusion

Significant effort has been expended by both the Government and International Oil Companies to come up with a comprehensive and elaborate fiscal and taxation regime in the EACOP Bill. In light of the enduring past sector tax disputes both parties were keen to have unequivocal streamlined provisions in the law.

The exemptions and reliefs for the EACOP project are more generous in comparison to the upstream oil and gas project. The reliefs and exemptions granted were aimed at ensuring that tax does not impose an extra financial burden for the project to be commercially viable.

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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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.

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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.

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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.

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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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