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Getting a Good Deal? An Analysis of Uganda's Oil Fiscal Regime

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Abstract

This paper focuses on Uganda's oil fiscal regime but does not cover the oil macroeconomic management aspects of the petroleum fund and oil investment fund established for efficient and effective application of the oil revenues for the socio-economic development of Uganda. The authors focus on the analyzing the main fiscal instruments (e.g. taxes, royalties, dividends) and policies, which have been implemented or are being developed in Uganda in order to manage revenue collection from oil exploration, production and export. The authors also analyse the returns of Uganda's oil fiscal regime in terms of realized and future revenues. Lastly, they critically evaluate and assess the strengths and weaknesses of Uganda's oil fiscal regime in terms of sustainability, effectiveness and expected returns, and conclude that Uganda's fiscal regime will generate maximum revenues to government while encouraging oil sector investments.

1. Introduction

Uganda has discovered large quantities of recoverable oil reserves since 2006. In August 2016, Uganda granted 8 production licenses to a range of joint venture partners, including Tullow Uganda Limited (TUL), China National Offshore Oil Corporation (CNOOC) and Total E&P Uganda Limited (Kazi and Beyeza, 2017). The revenues from these licenses are estimated to be in the region of USD 1.5 Billion a year for the duration of the different oil fields.[1] The relationship between the Ugandan government and the different international oil companies is governed by so-called Production Sharing Agreements (PSAs). PSAs stipulate precisely what proportion the government gets, and how much of production will be retained by the oil company.[2] PSAs regulate the relationship between governments and the oil companies. The oil companies need licences to operate. The government uses the licensing system to grant exclusive rights to companies to explore and extract the oil. Licenses are therefore a key element of PSAs, which are at the heart of the oil fiscal regime.[3]

The key issue to be addressed in the design of fiscal terms is how the investment costs are recovered and the profits shared.[4] The fiscal terms must enable government to maximize returns from its oil resources by encouraging the appropriate levels of exploration and development activities as well as enabling oil companies to build equity while maximizing returns on investment by finding and producing oil in the most cost-effective way.[5] The Center for Energy Economics (2007) posited that the fiscal terms which deliver a fair return to both a government and an investing oil company must discourage unnecessary speculation, limit excessive administrative and compliance costs, and should be flexible to ensure healthy competition and market efficiency. The most common oil sector fiscal regime consists of production sharing, income tax, royalties, annual surface rentals and bonus payments (Sunley et al, 2002).

In this paper, we will analyse the basic fiscal instruments being used or developed by Uganda for oil revenue generation and collection. We will also examine the returns from the fiscal regime in terms of realized and unrealized revenues and critically evaluate and assess the main strengths and weaknesses of Uganda's oil fiscal regime in terms of sustainability, effectiveness and expected revenue returns. The paper will proceed as follows. Section 2 covers Uganda's legal-institutional framework for oil revenue administration. Section 3 provides a systematic overview of the main fiscal instruments and issues associated with oil revenue generation and collection. Section 4 then contains an analysis of the revenues collected so far and also reviews the anticipated oil revenues. Section 5 subsequently analyses the main strengths and weaknesses of Uganda's fiscal oil regime. Section 6 concludes and offers some policy reflections.

2. Legal-Institutional framework for oil revenue administration

The legal framework for Uganda's oil revenue administration is derived from the PSAs, [6] the revenue laws[7], the Upstream law[8], the Midstream law[9], the Public Finance Management Act,

[1] W.B.Kazi & B. Beyeza, Analysis of the Oil Fiscal Regime of Uganda, 77 Bull. Intl. Taxn (2017) Bulletin for International Taxation IBFD (accessed on 8 October 2017)

[2] Global Witness, A good deal better? Uganda's Secret oil contracts explained, September 2014.

[3] Exploration licences give exclusive right to companies to explore for oil within a given timeframe and specific area while production licences give oil companies that have discovered oil the exclusive right to extract the oil in a specific area (see Global Witness, 2014)

[4] W.B. Kazi & B. Beyeza, Supra n. 3.

[5] Ibid

[6] These can be classified into pre-2008 PSA and the 2012 PSAs. This is because Uganda signed its first PSAs before 2008 and others in 2012.

[7] These include the Income Tax Act, Stamp Act, Customs Management Act, VAT Act, Traffic and Road Safety Act

[8] Petroleum (Exploration, Development and Production) Act, 2013

[9] Petroleum (Refining, Conversion, Transmission and Midstream Storage) Act, 2013

2015 (PFMA, 2015), the National Oil and Gas Policy and, the Oil and Gas Revenue Management Policy. These laws define the scope of oil revenues[10] and the manner of how the revenue will be collected, reported and accounted for.

The Uganda Revenue Authority (URA) and the Directorate of Petroleum (DOP) are responsible for the assessment and collection of the tax and non-tax revenues respectively from the oil industry. The Uganda National Oil Company (UNOC) will be responsible for receiving and marketing the government's share of profit oil and the UNOC, as government nominee, has elected to take government's participating interest in all the production licences so far issued at a level of 15% as provided for in the respective PSAs. The Bank of Uganda (BOU) will manage the Petroleum Fund on behalf of government. The Auditor-General's Office is responsible for ensuring that government accounts including the Petroleum Fund is prudently managed and there is value for money in its application. The Petroleum Authority of Uganda (PAU) will monitor and regulate the exploration, development and production activities. All these institutions are mandated with the collection and prudent management of the oil revenues.

3. Overview of fiscal instruments

The oil sector is characterized by substantial economic rents, perverse price uncertainty, information asymmetry, high sunk costs with long production periods and extensive involvement of international oil companies[11]. Gudmestad et. Al. (2010) postulated that oil and gas resources provide an extraordinary rate of resource rent. For these reasons, a special tax regime rooted in the rent theory is needed for the oil sector taking into account these peculiarities (Mazee 2010).https://en.wikipedia.org/wiki/International_Standard_Book_Number

The tax handles for Uganda's upstream oil are royalties[12], cost recovery, production sharing, corporate tax, ring-fencing[13], Capital Gains Tax (CGT)[14], windfall profits tax, Non-tax revenues[15]and indirect taxes. In this paper the authors concentrate majorly on upstream taxes and not the indirect taxes, which are more associated with the midstream and downstream oil operations. The regime delivers 67.5% of "profit oil" to government and 32.5% to oil companies.[16]Uganda's oil fiscal regime emphasizes fiscal responsibility and sustainability (Kazi and Sarker, 2012). The African Development Bank (2009) states that proxies for profit, the internal rate of return and government's take determine which oil fiscal regime a country should adopt. Sunley et al (2012) pointed out that evidence suggests oil fiscal terms endogenously respond to global oil prices.

An illustration of the tax clauses of a PSA are visualised in Figure 1, which shows that the government can benefit from oil production through royalties, and profit and corporate taxes on the oil company's profits. This implies that if a project fails, the Government does not suffer any loss but the contractor does. The recoverable costs from production net of royalties are reduced by, the value of cost oil received, with any unrecovered costs carried forward to later

[10]The royalties, taxes, bonus payments, dividends, premiums, and in-kind revenues will be reported on gross basis, indicating all adjustments required in official fiscal documents (oil & gas revenue management policy, 2012).

[11] W.B.Kazi & B. Beyeza, Supra n. 3

[12] In addition to the daily production royalty based on, the 2012 PSAs introduced a new cumulative production royalty (see Article 10 of 2012 PSAs)

[13]W.B. Kazi and T. Sarker, Fiscal Sustainability and the natural resource curse in Resource-Rich Developing Countries: A Case Study of Uganda, 66 Bull. Intl. Taxn. 8 (2012), Journals IBFD

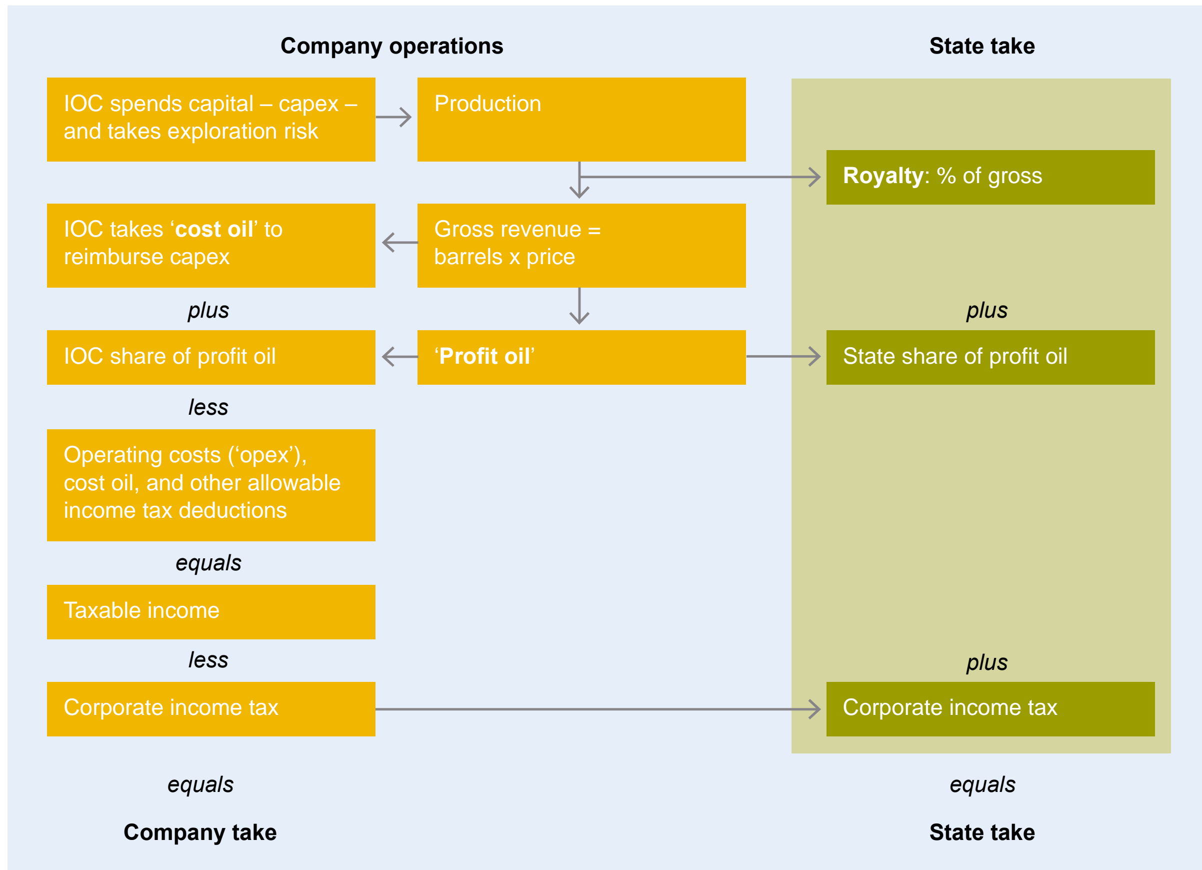
[14]The ITA of Uganda imposes a CGT on gain from the direct or indirect transfer of an interest in a petroleum agreement, and share disposals in a company whose property principally consists directly or indirectly of an interest or interests in immovable property located in Uganda.

[15]Annual surface rentals, signature and discovery bonuses, training fees, and stamp duty are among the non-tax revenues provided for in Uganda's PSAs.

[16]W. B. Kazi & T.K. Sarker, Supra n.24

years until full recovery is made. It should be noted that this is not a tax or any kind of relief like indemnity but is simply the recovery of expenditure incurred by the oil company.

Figure 1: Anatomy of a PSA



Source: OPM (2013a: 24).

PSAs are contractual in nature with the government retaining resource ownership and the approvals of the oil company budgets, work programmes, expenditure, procurement and employment, while the oil company provides finance, equipment and technology required for the exploitation of the oil resource[17]. Thus, the oil produced is shared between government and the company at negotiated production sharing percentages (Kazi and Beyeza, 2017)

3.1. Royalty and Additional Royalty

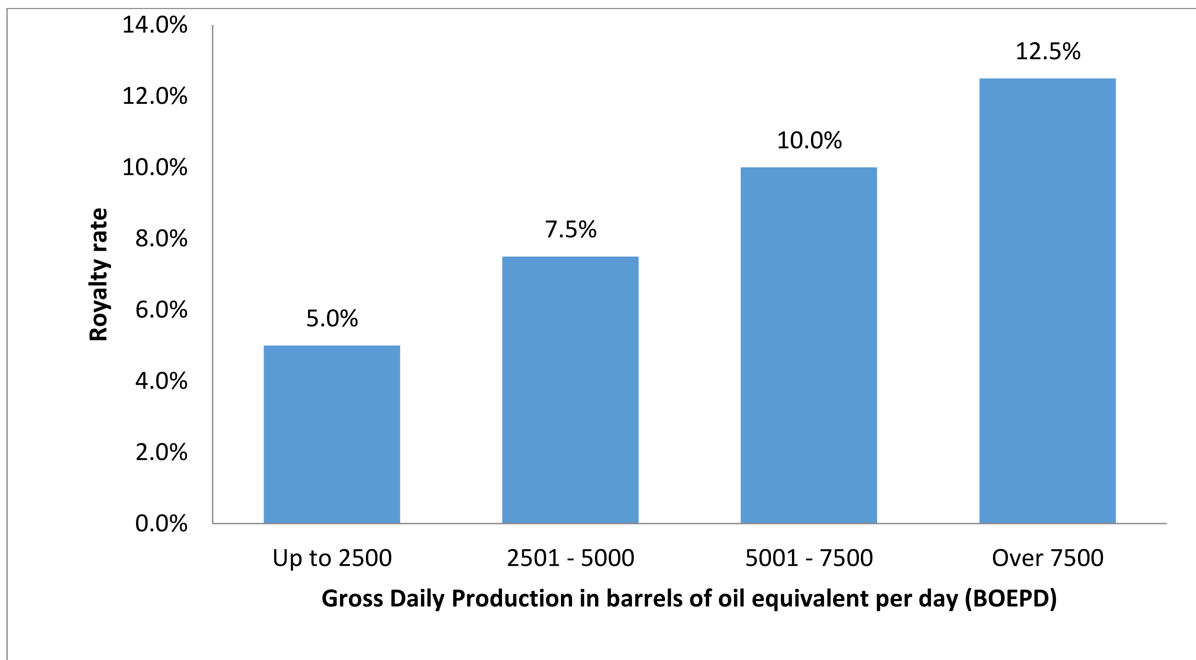
In addition to the single royalty in the pre-2008 PSAs[18] that is based on daily production, the 2012 PSAs contain an additional royalty based on cumulative production which according to Global Witness (2014) is an unusual PSA revenue provision in favour of Uganda. With the additional royalty, revenue will continue to accrue even when oil extraction starts declining because the cumulative royalty it is assessed based on the amount of oil extracted from the time production started. This implies with increased rate of oil production, the rate of royalty

[17] W.B.Kazi & B. Beyeza, Supra n. 3
[18] For the purposes of this paper, all PSAs signed in 2008 and before are referred to as "pre-2008 PSAs while those PSAs signed in 2012 are referred to as "the 2012 PSAs)

due to Government increases. Royalties will be collected on a monthly basis[19]. The PSAs of Uganda provide for incremental royalties.

Because royalties are deducted from production before cost recovery, they guarantee upfront revenue for government soon after production begins. The royalty on gross daily production will be charged at rates between 5-12.5% (see Figure 2 below) depending on the level of production, while additional royalty on cumulative production will be charged at rates of between 2.5-15% (see Figure 3 below). Thus, Uganda's royalty regime has an in-built profit element[20]. Royalty payments are tiered, so if daily production was 6,000 barrels then the company would pay 5% on the first 2,500, 7.5% on the next 2,500 and 10% on the remaining 1,000[21].

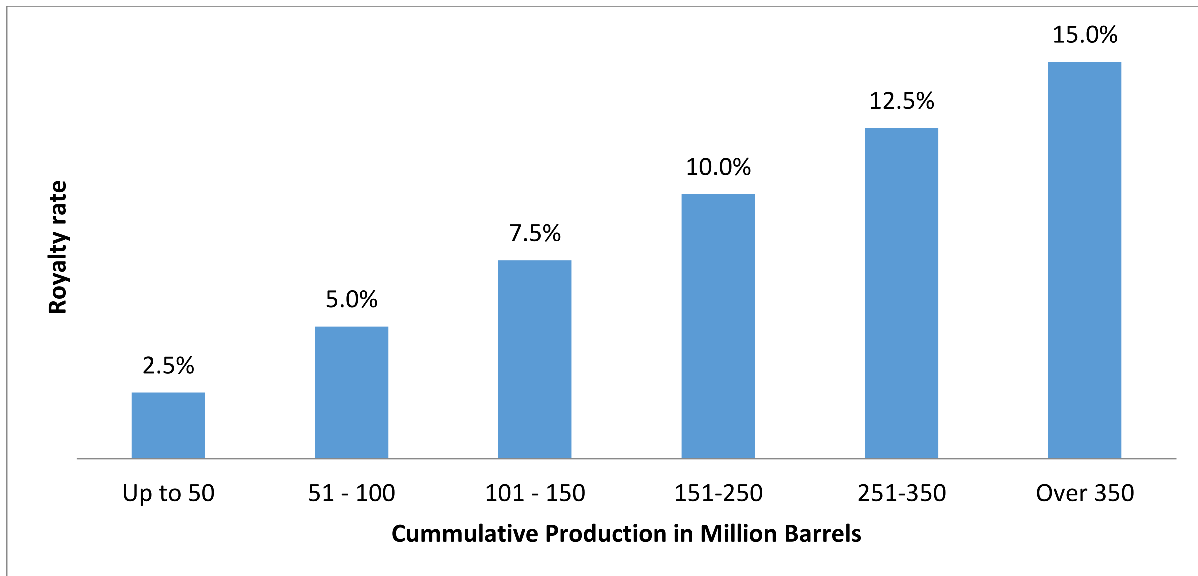
Figure 2: Royalty rates versus gross daily production



Source: Authors, using PSAs Data

[19] See article 10 of the 2012 PSAs, p.26
[20]See Chile, Thailand, e.t.c for details on royalty regimes with some profit element (Sunley et al, 2002). .
[21]Global Witness, 2014Supra n.6

Figure 3: Additional rates on cumulative production



Source: Authors, using PSAs data

3.2. Cost recovery

The recoverable costs are pooled together each year and reduced by the cost oil received. In other words, cost oil refers to an oil company's entitlement to production as cost recovery under a PSA. This means an oil company gets cost oil from which it deducts recoverable cost when commercial oil production has commenced. The Uganda PSAs provide that the amount to be retained as cost oil is 60% of total oil production after deducting royalty. If cost oil is less than the costs available for recovery, any unrecovered costs are carried forward to subsequent years until their full recovery.is completed. However, if cost oil is more than the recoverable costs, the excess of the cost oil forms part of the profit oil.

Note that recoverable costs incurred in respect of licence area can only be offset against oil produced from that area. This practice, called "ring-fencing", prevents companies from recovering costs for areas where no commercially viable oil reserves are found. Therefore, costs for areas where no oil is found are borne by the company. The government must approve recoverable costs before they can be reduced from cost oil. This is likely to raise governance issues such as rent-seeking and corruption, which might ultimately pose a risk of revenue leakage.

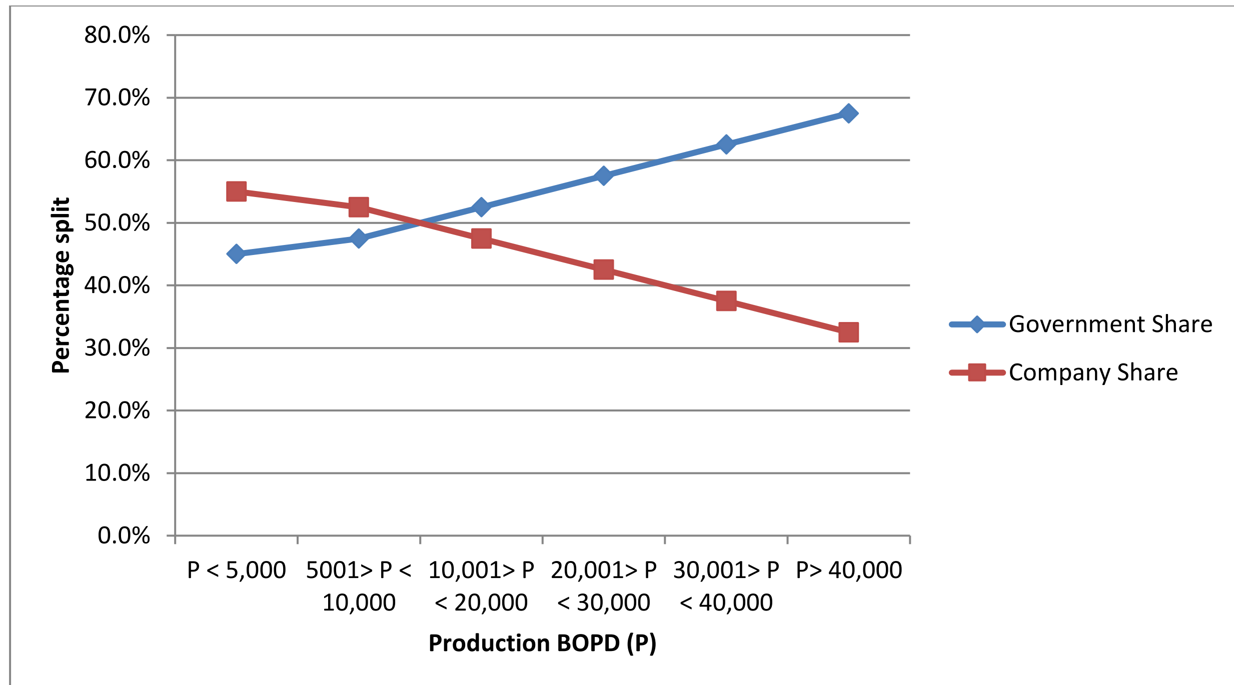
3.3. Production sharing

Once the company deducts 60% from total production as cost recovery after royalty, what remains is profit oil. The size of profit oil depends on the international price of crude oil, the project's internal rate of return and also the size of any surplus of cost oil over the amount needed for cost recovery.

According to the 2012 PSAs, the government's share of profit oil will be 67.5% and 32.5% for the company at peak production. The share of profit oil due to government will be received and marketed by UNOC. The profit oil split will depend on the level of production; for example, as production increases so will the government's share, while company share will decline (see Figure 4 below). The negotiated profit split ratios between government and the oil companies

give PSAs a built-in flexibility which helps offset differences between basins and licensed areas.[22]

Figure 4: Oil profit distribution between the Government and oil companies



. Source: Compiled by authors using percentages in 2012 PSAs, p32.

3.4. Income Tax

Prior to 2008, there was no specific taxation regime provision for oil operations in ITA, though the PSAs contained some tax provisions. In 2008, Part IXA containing a specific tax code in in relation to petroleum operations was inserted in the 1997 ITA through the Income Tax (Amendment) Act of 2008.[23] This issue of whether the ITA or PSA was the one applicable in the context of taxes, was prominent during the CGT disputes, as oil companies urged the tax clauses of PSA took precedence over the ITA when it came to the taxation of oil operations; including the transfer of an interest in an oil license (see TAT ruling in Tullow v URA, 2014). The amendment was meant to clarify the ambiguity as well as plug the potential tax loopholes in the taxation of oil operations. In the provisions, it is stated that in the event of an inconsistency between Part IXA of ITA, and PSAs as well as other provisions of the ITA, Part IXA takes precedence.

The profit oil share of the company attracts 30% corporate tax in accordance with ITA. And any distributions of company profits (dividends) after corporate tax will attract 15% withholding tax in the hands of the shareholder. The ITA thus provides for a comprehensive set of income tax rules that accords with the commercial principles under which the oil sector operates. These provisions clarify and provide certainty on how oil sector activities will be treated for income tax purposes.

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[22] W.B.Kazi & B. Beyeza, Supra n. 3

[23] In addition to providing for the taxation of upstream petroleum operations, this part of ITA also has special provisions dealing with taxation of mining operations.

3.5. Ring-fencing

Corporate tax is a key element of an oil PSA imposed on the 'taxable income' of a contractor computed on a block-by-block basis. The costs incurred in respect of one block cannot be used to reduce income from other blocks (see above).

Ring fencing bars consolidation of income and deductions for tax purposes across various t oil activities and projects undertaken by the same taxpayer. 'Ring-fence' applies to both income and expenditures. By ring-fencing tax accounts of individual blocks in accordance with the provisions of the PSAs, corporate tax deferral is effectively curtailed (Kazi & Beyeza, 2017). This measure helps to streamline oil taxation in order to secure government revenues.

3.6. International tax issues in the oil sector

In the context of the oil sector, the size of the corporate tax base depends on the amount of contract costs incurred and any profit shifting practices adopted by the oil multinational companies (MNCs) (Kazi & Beyeza, 2017). In this section, we focus on the practices used by MNCs to shift profits and reduce their corporate tax base in order to minimize their tax liabilities.

Thin capitalization

Thin capitalization rules prevent financing structures with high debt-equity ratios. Interest expense is tax deductible while dividend is not, hence high debt to equity can reduce taxable profits and hence tax payable. Sunley et al (2002) stated thin capitalization affects interest deductibility and corporate tax base. Under this rule, interest payments of thinly capitalized companies are disallowed and taxed as constructive dividends in some countries.

In Uganda, interest deductible is restricted to the foreign debt to foreign equity ratio of 1.5:1 (Kazi & Beyeza, 2017). The excess amount of interest is disallowed for corporate tax purposes. However, unlike in the UK and other countries, Uganda does not treat the disallowed interest portion as a constructive dividend, and therefore does not impose withholding tax on it. Note that if interest deductibility is not restricted, MNCs would use excessive loan finance in order to utilize the interest thereon to shift profits to associated companies domiciled in tax havens. The therefore measure limits tax avoidance through use of low-taxed interest payments in line with base erosion and profit shifting (BEPS) project of the Group of 20 countries (G20) and Organization of Economic Co-operation and Development (G20/OECD).

Transfer pricing

Companies seek to minimize taxable profits through transfer pricing (Sunley et al, 2002). Transfer pricing can be used to shift profits between tax jurisdictions in related party oil transactions.[24] Baunsgaard (2014) stated that transfer pricing risks in the oil sector can be minimized through use of joint venture structures, standard output measures and prices. Observable physical operations, standardized measurements and benchmarking using international prices can assist in mitigating transfer risk (Kazi & Beyeza, 2017). Uganda's transfer pricing regulations enacted in 2011 and the information exchange provisions in the DTAs are means designed to address tax avoidance using cross-border transactions.[25] The transfer pricing regulations like the 2012 PSAs require that related party transactions be reported at arm's length (i.e. the price that would be charged to an independent company for the same services or goods under similar conditions). They call for a comparability analysis to

[24] Such transactions may involve use of hedging instruments, leasing of equipments, plant and machinery, intra-group loans high technical service fees and high management fees pay outs (See Kazi &Beyeza, 2017).

[25] These regulations are yet to be up dated to bringing them in line with the 2017 OECD TP regulations which take into account the BEPS action points 8-10 and 13 of the G20/OECD project.

ensure technical service fees paid to an associated company are at arm's length. Global Witness (2014) observed that comparability analysis may be difficult to make in practice because there are relatively few comparable providers of technical services in East Africa, besides it being hard to determine the services rendered.

Treaty shopping

Treaty shopping allows unintended use of tax treaties by third country residents. This practice leads to loss of tax revenues in the source state; hence the anti-treaty shopping domestic law provisions. The anti-treaty shopping provision is contained in section 88 (5) of ITA, but it is only section 88(5) overrides any provisions of DTAs.[26] This section was restructured following Heritage's attempt to re-domicile from the Dominican Republic to Mauritius in order to avoid CGT on the sale of its oil interests to TUL because the DTA between Mauritius and Uganda exempts capital gains from tax. The domestic tax law criteria non-resident entities must fulfil in order to access DTA benefits such as reduced tax rate or an exemption was clarified to put limits to treaty shopping and curtail revenue leakage. Non-resident entities other than publicly listed companies will not access Ugandan treaty benefits unless: (a) they receive the income in a capacity other than that of a beneficial owner; (b) if they do not have a full and unrestricted ability to enjoy that income and to determine its future uses; and (c) they do not possess economic substance in the country of residence (EY Global Tax Alert Library, 2017).

The above is a radical departure from the earlier limitation of benefit (LoB) rule that restricted the DTA benefits application in Uganda only to resident persons of the other contracting state where 50% or more of the underlying ownership of that person was held by resident individuals of that other contracting state for purposes of the DTA.

The anti-abuse provisions cannot operate effectively if not supplemented by the exchange of information[27]with other tax jurisdictions. Uganda is signatory to the OECD Convention on Mutual Administrative Assistance in tax matters (MAAC). This means It can now request for information about taxpayer operating in 104 countries to facilitate audits and investigations of MNCs, including those involved in oil sector.

3.7. State participation

Under the 2012 PSAs, Uganda will get 15% of the oil company's share of profit oil under state participation provisions should government opt to exercise its right to participate in oil development and production. Indeed, through the UNOC, government elected to take its participating interest in all the eight production licences so far issued at a level of 15% in accordance with the PSAs (Kazi & Beyeza, 2016). The oil companies will meet Government's costs but the companies are entitled to recover these costs, including interest at the London Inter-Bank Offer Rate (LIBOR), out of the cost oil.

The government is therefore entitled to a proportion of the oil produced and saved from each contract area equal to its 15% interest in the joint venture assets (The 2012 PSAs). UNOC will dispose of the state's share of profit oil at a price determined by the Multi-institutional committee[28] and remit the sales proceeds to the Petroleum Fund operated and managed by BoU (PFMA, 2015).

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[26]Uganda has DTAs with Denmark, UK, South Africa, Mauritius, India, Zambia, Netherlands, Norway and Italy.
[27]On 4th November 2015, Uganda became the 95th country to sign the Convention on Mutual Administrative Assistance in tax matters (MAAC). The deposit of the instrument of ratification was done on 25th May 2016 and the MAAC came into force in Uganda as law on 1st September 2016. Uganda also ratified African Tax Administration Forum (ATAF) Agreement on Mutual Assistance in tax Matters
[28] The committee includes officials from the MFPED, MEMD, URA, and any other specialized agencies to be determined by the Finance Minister; the value of oil produced is a function of a price and the quantities. The quantities to be produced within a given period will be agreed between the Energy Ministry and the oil companies.

Uganda will be responsible for paying any taxes arising out of its share in the Joint Venture, and it will get its share of its participating interest directly or indirectly in the form of dividends taxable at 15% withholding tax. The government's role as a regulator and shareholder (owner) in these oil licenses raises governance issues of conflicts of interest and corruption which may lead to revenue leakage. Given the level of institutional maturity in Uganda, it might be wise for government to focus on taxing and regulating oil activities for now and leave the oil operations to companies.

3.8. Capital Gains Tax (CGT)

Capital Gains Tax (CGT) is imposed on a gain made on the assignment or transfer of an interest in an oil license from one contractor to another (see s.89G (a) of ITA). The determination of a gain on disposal of an interest in an oil license is governed by the provisions of the ITA.

Taxable gains arise on disposal of business assets such as company shares or commercial property and an interest in an oil license either directly or indirectly.[29] An indirect transfer takes the form of the sale of shares in a company whose assets are principally immovable property located in Uganda. It often involves non-resident shareholders selling their interests to a resident company. Because of the difficulty of collecting taxes from non-residents, the CGT is paid by the resident oil company acting as an agent of the non-resident company. For example, the CGT of USD 449m on the Heritage's transfer of its assets to TUL was paid by TUL acting as agent of Heritage.

It should be noted that CGT is not a reliable revenue source because it arises only when a business asset is transferred or assigned. Besides, it is difficult to determine the cost base of an oil interest in case the interest in question is being transferred to a third owner. For instance, one of the issues contested when TUL disposed of the interest it had acquired from Heritage to Total E&P and CNOOC was the determination of the cost base. In practice, the cost base is the base price paid for the interest plus incidental costs of the disposal. The incidental costs include contingent, guarantee and commitment fees, stamp duty on acquisition, legal fees and signature bonuses. Should the costs not yet recovered by the transferor under the cost recovery clauses be part of the cost base of the asset? These are pertinent issues that must be clearly addressed if government is to get its fair share of revenue on any transfer of an oil interest.

As a result of the CGT disputes, the current PSAs clearly provide that a transfer of an oil interest shall attract CGT in accordance with the ITA, and that tax disputes in relation to the PSAs shall be handled in accordance with the dispute resolution mechanisms stipulated under the Laws of Uganda (see 2012 PSAs). Global Witness (2014) maintains that the Uganda-Heritage arbitration in London over the CGT assessment relating to the 2010 farmdown to TUL was far from settled.

3.9. Oil-related Nontax revenues (NTRs)

Non-Tax Revenues (NTRs) are an important source of revenue for government during the pre-production phase of oil. These NTRs include bonuses, annual surface rentals, training and development fees, proceeds from sale of oil data and sale of oil refinery feasibility study report. The NTRs are assessed and collected by DOP of the Energy Ministry.

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[29]"Business asset" means an asset which is used or held ready for use in a business, and includes any asset held for sale in a business and any asset of a partnership or Company. For capital gains purposes business asset excludes trading stock and a depreciable asset (see ITA);

The 2012 PSAs provide for the collection of USD300,000 in signature bonuses and USD2,000,000 as discovery bonus. The annual surface rental of USD7.50 per square kilometre for an area under an exploration licence is collectable; while it is USD500 per square kilometre for an area under a production licence. The company exploring oil is required to pay USD37,500 half yearly and on grant of a production licence USD200, 000 annually to cater for oil related training and development of Ugandans[30].Stamp duty is also collectable on the registration of oil contracts and performance security (e.g. insurance bonds and bank guarantees) and on transfers of oil interests at the rate of between 0.5 -1.5%. NTRs motivate oil companies to rapidly explore and develop oil in a licensed block and they are easy for government to administer and for companies to comply with.[31]

4. An analysis of Uganda’s oil revenues: Looking back and looking ahead

The oil sector will generate a significant amount of revenue streams for Uganda. Oil revenues will be collected in either cash or in kind (Kazi & Beyeza, 2017). The organs mandated to assess and collect oil sector revenues in Uganda are URA, DOP and UNOC (PFMA, 2015). The in-kind revenues will be collected by UNOC and disposed of in manner provided for under the PFMA, 2015. The revenues must be transparently collected in a coordinated manner using streamlined revenue collection and reporting systems. Oil receipts collected by each organ shall be transmitted to the Petroleum Fund under BoU. In the next two sub-sections, we will examine how much oil revenue has been collected since 2001, and how much revenues can be realistically expected to flow to the Government in the future.

4.1. Revenues collected

There are currently 40,385 barrels of the non-flared crude oil from well testing in stock.[32] The government plans to sell this crude oil on a competitive basis. Taking the June 2017 international crude oil price of USD 60.43 per barrel as the benchmark, then government would earn USD2,440,466 from selling this stock of oil. Even before Uganda’s oil begins to flow, the country has collected substantial revenue from capital gains on transfers of interests in oil licenses. For instance, CGT of USD 449m[33] was collected when TUL bought out Heritage’s interest while the CGT of USD 467m[34] payable arose when TUL sold 66.67% of its interests to Total E&P and CNOOC. But the CGT amounts sparked off tax disputes between government and the oil companies, partly because of the interpretation and application of the provisions of PSAs in the context of the ITA. In particular article 23 of pre-2008 PSAs. TUL claimed that the clause 23 exempted them from CGT, a claim which was disputed by government (see TAT ruling in Tullow v URA, 2014). The amount excludes corporate tax and royalty which will start flowing in when commercial production starts.

The total revenues received over the 2001/02-2013/14 amount to USD630,068,004 (see Table 1). The amount comprises CGT on transfer of Heritage interest to TUL, stamp duty on the farm-down of part of the interests of TUL to Total E&P and CNOOC and oil-related NTRs and

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[30]The government personnel that have so far benefited from this training are officials of BoU, URA, Energy Ministry, Finance Ministry and officials of any other government agency concerned with oil exploitation.

[31] W.B.Kazi & B. Beyeza, Supra n. 3

[32]It is stored at Ngiri-2 and Kasamene-1 well sites as well as Tangi camp (see. MEMD annual report 2014)

[33] See W.B. Kazi & T.K. Sarker, 2012.

[34]The figure was arrived at after the TUL took URA to TAT on grounds that the transaction was exempt from CGT under article 23.5 of the model PSA of 1993 The contention was the interpretation of Article 23.5 of the EA2 PSA in light of the ITA (see TAT ruling in Tullow v URA, 2014). At the time of writing this paper, it was not clear if the had been collected by URA.

interest income from investing stamp duty monies in short term money market deposits (see Table 2).[35]

Table 1: Oil revenues collected

Revenue handle	Amount (in USD)	Percent of gross revenue
CGT	449,424,960	71%
Stamp duty	171,000,000	27%
Interest (in 2013 & 2014)	403,044	0%
Oil related NTRs (FY2001/02– FY2013/14)	9,339,625	1%
Total	630,167,629	100%

Source: BoU Annual Reports 2001/2016 & MEMD Annual Reports 2013&2014

The table indicates that oil-related NTRs form a small portion (1%) of the revenues while CGT forms a bigger part (71%) followed by stamp duty at 21%. This serves to indicate that the tax administration systems and procedures and the tax laws must be streamlined and strengthened and staff should be well equipped with skills in valuation of oil, cost audits, cost monitoring and apportionment to avert the possible loss of revenues due to inflation of costs by the oil companies. The CGT revenue balances were deposited on the Oil tax Fund in BoU.[36] Table 2 gives a breakdown of the NTRs of USD 19,701,000 received from oil companies from training fees, ground rental fee, surface rental fees, signature bonuses, permit fees, sale of data, and license fees.

The stamp duty of USD 171m collected on the sale of TUL's interests to Total E&P and CNOOC was invested in short-term money market deposits and yielded interest of USD 156,700 (2014) and USD 246,344 (2013). The USD 72m from TUL tax settlement was used to finance investment projects in the year (BOU, 2016).

[35] Oil-related NTRs comprise of signature bonuses, annual surface rentals, sales of oil data, sales of oil refinery feasibility study report, training fees and permit fees.

[36]The Oil Tax fund was renamed the Petroleum Fund following the enactment of the PFMA, 2015.balances on Oil Tax Fund with BoU in Million Uganda shillings were as follows: 1,192,710, 1,585,051, 1,606,244, 1,607,814, 119,057, and 245,531 respectively for financial years ended June 30, 2011, June 30, 2012, June 30, 2013, June 30, 2013, June 30, 2014, June 30, 2015 and June 30, 2016 (see BoU Statistical Abstracts).

Table 2: Non-tax revenues generated from oil companies between 2002 and 2015

YEARS	Non-Tax Revenue ('000 Us$)	*Cumulative NTR ('000 US$)*
2002	128	*128*
2003	62	*190*
2004	800	*990*
2005	491	*1,481*
2006	355	*1,836*
2007	657	*2,493*
2008	406	*2,899*
2009	783	*3,682*
2010	733	*4,415*
2011	1,221	*5,636*
2012	329	*5,965*
2013	2,863	*8,828*
2014	8,256	*17,084*
2015	2,617	*19,701*

Source: 2015 Statistical Abstract, MEMD, p.40

4.2. Anticipated revenues from the oil sector

The upstream oil revenues sources are royalties, 'profit oil', corporate tax, bonuses, annual surface rentals and other fees. The 2012 PSAs provide for a possibility of collecting windfall profits taxes in cases of a rise in oil prices, which adds to the amount of revenues potentially collectable from the oil sector. However, no environment taxes are provided for under the PSAs.

Asymmetric information, volatile prices, massive sunk costs and the long production periods make the forecasting of oil revenues very difficult. Nonetheless, the authors attempt to make forecasts of the revenues expected from Uganda's oil project. We here below first review the oil revenue forecasts for Uganda so far made by analysts in order to inform our choice of model to use to make our oil revenue estimates for the purposes of this paper.

Global Witness (2014) reported that the cumulative royalty would bring in an additional of 1-2% government take. This could translate to between USD27 million and USD190 million with a 10% 'discount rate'[37] for one license area alone depending on oil prices and field size and potentially far more if larger oil fields are discovered or long-term oil prices rise. The Global Witness forecasts were based on the two PSAs for EA1 and Kanywataba Prospect Area that TUL and Uganda in February, 2012. Global Witness (2014) used a conservative starting oil price of USD80 per barrel[38] and estimated that Uganda would receive between 80% and well over 90% of revenues. In their analysis, they compared the fiscal terms in 2012 PSAs[39]with those in the pre-2008 PSAs to conclude that improved 2012 PSAs fiscal terms would increase government take by around 1-2%. It also estimated that oil production from blocks EA1, 2 and 3A would earn Uganda roughly between USDUSD15bn and USD21bn with a 10% discount rate in revenues over the lifetime of the project; about USD3.3bn per year over a 20-year period based on the oil volumes and changes in oil prices.

Henstridge and Page (2012) used oil prices and the production time horizon assumptions to make the first forecasts for Uganda's oil revenues and estimated that between 86% and 99%

[37]Investors and governments value money now more than money in the future. They therefore apply a 'discount rate' to projected future revenues in order to calculate the value of those returns to them at the present time. This does not affect the actual revenues received. A 10% discount rate is fairly standard for the industry.
[38] This price is inflated at a very standard rate of 2.5% and the prices quoted in the various studies as reference points also use standard inflation methodologies.
[39] These PSAs were signed in February 2012 between TUL and Uganda in February 2012 for EA1 and the Kanywataba Prospect Area' located in EA 3A; these licensed areas are jointly owned by TUL, CNOOC and Total.

of the net present value of the combined investments would accrue to the government from various revenue streams[40].Oxford Policy Management (OPM) (2013a) study estimates that oil revenue is expected to account for 17% of baseline government revenue over the 30-year oil production period. These findings reflect both the significant project size and Uganda's current low tax collection rates.[41] Over the first 10 years of production, new oil revenues are expected to account for 2% of GDP if prices declined by 25%, and 6.9% of GDP if prices increased by 25%. In absolute terms, Uganda's oil revenues would be USD2.6 billion over the first 10 years of production. This will represent 31% of GDP reflecting the country's relatively narrow tax base and low tax collection rates.

Global Witness (2014) quoted the World Bank's predicted revenue of USD3bn per year near oil peak production for Uganda while the Oxford Centre for the Analysis of Resource Rich Economies (Oxcarre) predicted that the Government would receive USD20bn for its oil over the life of the project with a 7% discount rate. According to Global Witness, these estimates were most likely based on lower rates of production that reflected the smaller finds at the time. While putting their estimates in perspective, Global Witness reported that in 2013 GDP was about USD21bn, while the government budget was about USD4.4bn. Using the World Bank's Commodity Market Review Report quoted crude oil price of USD 60.43 per barrel (June 2017) and the 1.4billion recoverable reserve, the authors estimated that Uganda's oil revenues from the Albertine Graben project would amount to USD43.4 billion (not discounted) over a 30-year period.[42] Clearly with the production of oil, Uganda's GDP, budget and revenues will potentially increase and socio-economic infrastructures will be provided to the people of Uganda absent corruption.

5. Uganda's oil fiscal regime: Strengths and weaknesses

You cannot tell if a PSA presents a good or bad deal simply by reading it.[43] The oil fiscal terms must be modelled to determine the revenues that government will reap assuming the PSAs are publicly available. Platform et al (2010), analysed the fiscal terms of some PSAs signed by Uganda with oil companies before February 2008 (hereafter the pre-2008 PSAs) and greatly criticized the deals Uganda had signed, stating that the PSA represented a bad financial deal for Uganda. In contrast, Global witness (2014) based on an analysis of two PSAs signed by Uganda and oil companies in February 2012 (hereafter the 2012 contracts) said Uganda had achieved a better financial deal in the 2012 PSAs compared with the ones in the pre-2008 PSAs. In what follows, we examine the main strengths and weaknesses of Uganda's oil fiscal regime.

5.1. Strengths of Uganda's oil fiscal regime

The 2012 PSAs provide that Uganda will resolve any tax disputes either through the court system or arbitration within Uganda. The 2012 PSAs provides for 'joint and several liability', implying all joint venture partners in a licensed area will be liable in the case of contractual breaches by any one of them. For instance, any taxes due from a partner can be recovered from other joint venture partners. This safeguards government revenues and also indemnifies the paying partners from potential lawsuits by the partner that is liable for paying the taxes. For instance, Heritage's CGT liability was recovered from TUL after a protracted and costly legal battle, but TUL was later sued by Heritage for non-settlement of its debt.

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[40] W.B.Kazi & B. Beyeza, Supra n. 3
[41] In 2009 Uganda's total revenue expressed as a share of GDP was only 12.5 per cent (IMF 2013a)
[42]The authors also assumed42 an average royalty rate of 8%, cost oil of 60%, state share of profit oil of 65% and corporate tax at 30%. We also assumed that the amount of oil produced throughout the 30-year period would be uniform. This revenue comprises royalty, additional royalty state share of profit oil and corporation tax but excludes the dividend on 15% of equity share, NTRs and CGT.
[43]Global Witness, 2014Supra n.6

Stabilisation clauses insulate companies against regulatory changes that impact project profitability and thus provide assurance to the oil companies who meet upfront costs and risks that they will recoup their investment without government having to impose undue regulatory burdens on them by encouraging companies to undertake oil sector investments. For instance, the pre-2008 PSAs' stabilization clauses provide that in the event of changes in the financial terms resulting in extra compliance costs, Uganda would compensate the oil companies.

However, the 2012 PSAs' stabilization clauses are limited to taxes and stipulate that any ITA changes that impact the oil company's profitability substantially and adversely will call for an "in good faith" re-negotiation of PSA terms so as restore and/or maintain the company's profitability prior to the change. The clauses also permit government to impose windfall taxes on additional profits resulting from increased global oil prices. Thus, Uganda's fiscal regime for oil is responsive to macroeconomic changes and will thus generate additional revenues from windfall profits taxes for state.

Given Uganda's experience with tax disputes, the 2012 PSAs provide in clear terms that companies will pay CPT on transfer of their interests in oil licenses thereby provide certainty on CGT. [44] These PSAs also provide for settlement, in Ugandan courts and/or for use of local arbitration mechanisms, any tax disputes relating to the PSAs. The CGT clause will help Uganda avoid the kinds of costs and difficulties encountered during the previous tax disputes and preserve future revenue from transfer of interests. Note however, that CGT is only payable when a company sells a part, or all, of its interests in a licensed area, making it hard to rely on CGT as predictable revenue source since it is difficult to predict if and when companies will transfer their interests.

The fiscal regime provides for daily and cumulative production royalties. Thus, as overall cumulative production rises, so will government revenue from this additional royalty. The cumulative production royalty is a rare revenue clause of PSA which will generate more revenue for Uganda based on the magnitude of the oil produced in a given licensed area. Royalties can secure up-front revenue stream[45] from day one of production and has an element of progressivity i.e. the rate increase as production increases.

Bonuses are a one-off payment to the state by the company. A signature bonus payment is made to government on signing a PSA, while discovery bonuses are paid when oil has been found. The signature bonuses due to Uganda are USD 0.3m[46]and USD 0.2m[47] and the discovery bonus is USD 2m for both licensed areas. Bonuses contribute a small portion of government revenues but they motivate companies to speed up oil exploration. To put this in perspective, a total of USD500, 000 was collected in signature bonuses when the 2012 PSAs were signed in February 2012 and USD 2m in discovery bonus when oil was found in February 2013, thereby guaranteeing government upfront revenue.

Under the PSAs, oil companies meet exploration and development, costs but they begin to recoup these costs when oil begins to flow. While the cost oil of 60% of production is high by international standards, it will help companies to recoup their investments fairly faster, and thus encourage investments in oil the sector in Uganda (Global Witness, 2014). The "ring-fencing" bars companies from recovering costs incurred in licensed areas where neither oil is found yet nor commercially exploitable oil has been found, and thus it enables government to generate revenues from those areas where oil has been discovered and production is taking

[44]The Government of Uganda is involved in two tax disputes with Tullow Oil; one over VAT and another over the capital gains tax assessment for the sale to Total and CNOOC. Tullow maintains that their PSA for EA 2 exempts them from capital gains tax, a point which the Government disputes. The Government of Uganda – Heritage Oil arbitration in London over the capital gains tax assessment relating to the 2010 farm down to Tullow oil is still ongoing (see Global Witness, 2014).

[45] Royalties generaterevenue for government as soon as production commences,

[46] See clause 9 of PSA between Uganda and TUL for the Kanywataba Prospect Area February, 2012

[47] See clause 9 of PSA between Uganda and TUL for Exploration Area 1 (EA1) February, 2012

place. Ring-fence therefore helps government to counter tax avoidance and evasion through manipulating transfer prices.

In view of the foregoing, Uganda's oil fiscal regime encourages investments, guarantees government revenues and ensures sustainability. The royalty and production sharing regimes have an element of progressivity, making the fiscal regime responsiveness to current prices, and the inherent risks of the oil industry. The NTRs are to administer and comply with.

The implementation of PSAs is simple since they consolidate all fiscal elements on oil exploration and development in a single document. Through corporate tax both government and oil companies share the risks of oil production and development. The oil company pays tax when it has taxable profits and any carried forward tax losses are offset against future taxable income as a deduction. The corporate tax paid in Uganda will be available for offset against tax payable to home country of the oil company. However, corporate tax base can easily be through transfer pricing, thin capitalization and treat shopping.

5.2. Weaknesses of Uganda's oil fiscal regime

Cumulative royalty may lead companies to opt out of the project early because it may reduce profit that the company expects as companies pay higher royalty rates even while production is falling. Royalties enable companies to make minimum payments for the oil extracted. Kazi & Beyeza (2017) observe that developing countries find it hard to cope with mundane processing and reporting thereby hindering effective filing and payment enforcement while the IMF (2012) indicated that the administration of royalties involves frequent assessments, no annual tax returns and no reconciliation to corporate tax returns making it inefficient. Annual surface rentals generate minimal revenues but they can encourage companies to explore and develop contract areas and/or to relinquish their rights in a contract area. These would help isolate the incompetent investors.

The royalties discourage investments by increasing the marginal cost of oil extraction Royalties are never claimed as foreign tax credits against the home country's income tax assessed. The corporate income tax and the PSAs are hard to administer since they require specialized skills in cost audits and valuation and experience in negotiating PSAs respectively which are lacking in Uganda. The Uganda's fiscal regime offers is loaded with exemptions such as VAT on imports, which are hard to administer and may aid tax evasion and avoidance

6. Conclusion and policy options

Uganda's fiscal regime is very competitive and ensures certainty and stability and there will not be need for frequent revisions in fiscal terms. Uganda's PSAs have clauses on taxation, royalty and additional royalty, cost recovery, signature and discovery bonuses, annual surface rentals, CGT and windfall profits tax. This kind of fiscal regime generates government revenues both in the pre-production state and in the production stage. International oil companies will be able to recoup their investments and make profits in the production stage. Uganda's oil fiscal regime combines upfront government revenue with a sufficiently high return on capital for the oil companies. A combination of corporate tax, royalty regime and production sharing regimes generate government revenues without distorting incentives to invest in oil exploration and development.

Uganda secured significant additional revenues in the 2012 PSAs with the adoption of a new cumulative production royalty in addition to the existing daily production royalty. In 2014, Global Witness analysed the fiscal terms in both the pre-2008 PSAs and 2012 PSAs and concluded that the government of Uganda would potentially receive additional revenues from the cumulative production royalty and the levying of windfall taxes, if global oil prices increased over and above what was expected. Unlike corporate tax and PSAs, the oil-related NTRs are easy to administer since they do not require specialized skills in oil valuation, cost audits, cost

allocations and apportionment (Kazi & Beyeza, 2017). The oil production is yet to start but oil revenues from both NTRs and CGT have already flown into Government's account.[48]

We could not empirically ascertain the effectiveness and sustainability of key fiscal instruments for the oil sector such as corporate tax, royalties and production sharing whose collection is dependent on oil flow. The tax regime in place remains a work in progress. However, it is clear that Uganda has successfully negotiated more favourable fiscal terms by securing a higher share of revenue. The fiscal regime presents a good deal for Uganda because if Government opts to introduce a new windfall tax, government revenue would go up without eating into the anticipated company profits. If oil prices rise above what is expected, or project costs are significantly less than predicted, then Uganda would receive significant additional revenues through royalties.[49]

Based on the information available, it appears that government has done enough preparatory work in terms of putting in place the necessary legal and institutional framework, including staff training and enhancing the capacities to deal with intricacies of assessing, collecting and managing oil revenues. Moreover, Uganda's oil fiscal regime appears to be flexible and progressive enough to allow lessons learned during its implementation to further help in refining it without having to re-negotiate the regime as the profitability of oil companies increases.

Uganda should however optimize production recovery rates through the oil licensing regime. Uganda should publish the oil PSA fiscal terms to assist in tracking state revenues and in making reliable and accurate forecasts of expected revenue from the sector. TUL, CNOOC and Total are registered and listed on the stock market in the US, EU and Norway, whose new rules will require publishing detailed breakdown of the payments they make to governments, and so it will be much more difficult for Uganda to hide under the national and corporate confidentiality veil. Uganda's Government should start publishing disaggregated oil sector data to promote good governance and avert white collar crimes in the sector.

[48] Petroleum revenues means tax charged on income derived by a person from petroleum operations, government share of production, signature bonus, surface rentals, royalties, proceeds from sale of a Government share of production, and any other duties or fees payable to the Government from contract revenues under the terms of a petroleum agreement.

[49] Global Witness, Supra n. 6

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