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East Africa Oil and Gas Summit

Comparative Review of Tax Policy in East Africa

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Agenda

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Who is PwC

Our Foot Print and Expertise

PwC helps organisations and individuals create the value they're looking for. We're a network of firms in 158 countries with more than 180,000 people who are committed to delivering quality in assurance, tax and advisory services.

PwC is the world's leading advisor to the energy industry, working with exploration, production, downstream and service companies to provide business solutions tailored to the energy sector.

Combining our in-depth understanding of local business, social, cultural and economic issues with deep functional and industry knowledge of our global network, we will ensure that you benefit from ideas that challenge conventional thinking and gain new perspectives .

We have Africa covered with presence in over 21 countries in East, West and Southern Africa

Service provided by PwC

Assurance services

- Financial statement audits
- Joint venture audits
- Risk Assurance
- IFRS reporting

Advisory services

- Transaction Services
- People & Change Services
- Forensic and Investigative Services
- Finance & Accounting Services
- Business recovery Services
- Strategy and Operations Services

Tax Services

- Tax Advisory and Planning Services
- Corporate tax management and process services
- Assessments and appeals
- Transfer Pricing
- Thought leadership and workshop for oil and gas players

Our Oil and Gas Expertise - specifically in East Africa includes:

- Business Start-up and structuring
- Structuring advice on Farm in and Farm out transactions
- Providing lobbying support to entities in the Oil and Gas sector
- Tax compliance and advisory services
- Immigration services
- Transfer pricing

EAC Fiscal Policy Direction

Opportunities for oil and gas companies in East Africa

East Africa Community country partner states are 5 countries with an estimated population of 130 million people. The region has now become an area of interest in the upstream oil and gas industry.

"This is where the centre of the universe is these days!"

- as one of our clients said.

Overview – East Africa Contd…

East Africa has had some recent discoveries of petroleum resources.

No first oil yet, however, gas has been exploited in Tanzania for a number of years.

Three countries dominate East Africa's

- Tanzania- gas
- Uganda- oil in the development phase
- Kenya- Oil and gas in the exploration/appraisal phase
- Rwanda- Methane gas discovery
- Burundi- exploration phase

South Sudan in production phase and Ethiopia/Somalia both in the exploration phase.

GDP trends- Africa looking up

	2011	2010	2009
Global	3.8%	5.0%	(1.0%)
OECD	1.9%	3.1%	(3.4%)
Eurozone	1.7%	1.7%	(4.1%)
Sub-Sahara Africa	5.2%	5.4%	2.8%
EAC	5.9%	5.8%	4.8%
Kenya	4.4%	5.8%	2.6%

- African economies generally performing well
- EAC partner states economic growth bucking the trend
- EAC growth generally driven by primary commodities mainly agricultural and tourism
- Minimal but expected increase in activity in the extractive sector

East African Community- general economic policy direction

- EAC partner states'overriding policy thrust has been to consolidate the economic gains made so far and put the economies onto a firm foundation of high and sustainable growth path by:

  - stepping up investment in the key priority social and economic sectors.
  - planned up-scaling of investment in critical physical infrastructure such as roads, rail, power generation as well as power transmission and distribution systems, and port modernization and expansion
  - Kenya policy thrust driven by constitutional changes in a great part

A few years ago a policy for the extractive industry in general and oil and gas in particular was never in focus but this is now changing with the unfolding discovery of oil and gas in the East African region.

Mineral resources and energy policy still evolving..

- Individual EAC partner state laws requires that agreements for extraction of natural resources should be ratified by Parliament thus production sharing contracts (PSCs) will be impacted.

- Need for harmonisation of PSCs - with applicable domestic requirements especially for Kenya and EAC wide laws.

- Alignment of legislation framework for PSCs e.g. certain fiscal incentive available in the PSC with no enabling legislative provisions.

Policy makers need to prioritise policies to enable oil and gas companies determine their investment plans.

East African Community- fiscal policy will need to reflect oil and gas potential

- As the phasing of the activities move from exploration to production fiscal policies will need to reflect this change. This change should recognise;

- that revenues from hydrocarbons whether direct or tax revenues are transient and not permanent and this will sway depending on the vagaries of world oil prices.

- Several challenges will exist in the implementation of fiscal policy especially with regard to transferring the wealth to the population and curbing public expenditure.

- Tax policy with regard to oil and gas will form a key component of the fiscal policy to be espoused by the states.

KUT fiscal and tax policy measures

Kenya

Overview of legislative framework in Kenya

In 1986, Petroleum (E & P) Act was revised – introduction of Petroleum Sharing Contracts (PSC's);

In 1986 also, the Income Tax Act was amended to include the Ninth Schedule which specifically addresses the taxation of petroleum companies;

All blocks not licensed over 34 exploration wells (as at August 2012).

Oil and gas discovery in Q2 and Q3 2012 respectively. Kenya now has proven reserves but appraisal for commerciality ongoing

Kenya's oil and gas tax system

Lack of synchrony between the PSC and the some of the applicable tax legislation in Kenya

The key legislation that impact the oil and gas companies are the following:

Ninth Schedule to the Income Tax Act

Value Added Tax Act- special

East Africa Community Customs Management Act (EACCMA)

All these acts have special provisions for transactions involving oil and gas companies

However, there is a need for harmonisation of PSCs and the tax legislation

East African Community- Kenya- fiscal and tax policy measures as it impacts oil and gas

- There is a move to remove the existing VAT remission regime that is available to oil and gas companies, hopefully this will be replaced with a zero-rating regime.

- There is also a move to withhold tax on the gross proceeds on the assignment of rights and sale of assets by oil and gas companies and other companies in the solid minerals sector.

- Draft mineral resources policy that includes tax measures has been done with stakeholder input ongoing.

- Additional tax measures e.g. taxation of capital gains, that impact the oil and gas sector being mooted which are driven by extraneous circumstances such as rising public expenditure

Uganda

Uganda-General principles relating to the taxation of contractors / licensees

- Profit oil is split between the contractor and the government according to the terms of the PSA
- According to the PSA, all taxes and duties shall be paid in accordance with the laws of Uganda
- The contractor's share of the profit oil is subject to taxation at the corporate tax rate of 30%
- The special provisions relating to the taxation of petroleum operations and the PSAs prevail over other parts of the Income Tax Act, in case of any inconsistency

East African Community- Uganda- fiscal and tax policy measures as it impacts oil and gas.

- Intention is to use tax policy such as improved tax administration to promote oil and gas investment in the economy to enable faster growth.
- Tangible measures to establish the Oil and Gas sector, sound legal and regulatory framework, as well as the institutional arrangements for prudent management of the oil resource.
- The Bills presented before Parliament include the following:
  - The Petroleum (Exploration and Production) Bill 2012
  - The Petroleum (Refining, Gas Processing and Conversion, Transportation and Storage) Bill 2012
  - The Public Finance Bill 2012, which contains the framework for management of petroleum revenue
- Assignment of a right is subject to capital gains tax on the assignor as per the income tax act. Some PSAs provide exemption from capital gains tax.

Tanzania

As the industry grows practical tax challenges are emerging

Tanzania's oil and gas tax regime Key challenges

- Conflict between some PSA tax provisions and tax legislation, e.g. scope of VAT Special Relief
- PSA does override the law but provide a basis for seeking a change to the law where its inconsistent with relevant PSA
- No special O&G income tax regime for contractors – 15% withholding tax rate generally applies to services performed by non residents, which makes exploration expensive).
- Timing of VAT refunds

East African Community- Tanzania- fiscal and tax policy measures as it impacts oil and gas.

- Tanzania is already exploiting natural gas thus tax policy changes when effected to amend rates and tax laws for natural gas activities is having immediate impact.

- Assignment of a right is not subject to capital gains tax on the assignor as per the income tax act. Consideration is however taxable in the ordinary course

- Mixed signals as excise duty on oil to be used by oil and gas explorers to no longer enjoy tax exemption

- Exemption from VAT for equipment to be used for the transportation of compressed or natural gas has been proposed

- Increase in excise duty for natural gas usage

Comparison of Indirect tax

Oil and gas tax regime – VAT

Area	Kenya	Tanzania	Uganda
VAT	• Standard rate 16% • VAT Remission applicable on supplies made to oil and gas companies. The proposed VAT bill will make supplies to oil and gas companies 0%	• Standard rate 18% • Special relief from VAT on supplies of goods & services for exploration or prospecting. ***(Procedural requirement)*** • VAT special relief is not available during the "**<u>oil and gas production stage".</u>**	• Standard rate 18% • VAT exemption applies to exploration, development and production equipment

Oil and gas tax regime – Customs

Area	Kenya, Tanzania, Uganda
Import duties	• Rates: 0%, 10%, 25% (as per EAC common external tariff) • raw materials and capital goods qualify for 0%. • Exemption for equipment and inputs, excluding motor vehicles, imported by a <u>licensed company (contractor)</u> for direct and exclusive use in oil, gas or geothermal exploration and development

Comparison of tax rates in EAC and across various countries in Africa for oil and gas companies

VAT, Customs Duty, surface rentals and stamp duty

	Mozambique	Angola	Ghana	Kenya	Tanzania	Uganda	South Sudan
VAT on sale	No	No	No	0%	No	0%	No
Import duty	Depends	No	No	No*	No*	No*	
Surface (rental) royalties	N/A	Yes	Yes	Yes	N/A	N/A	N/A
Stamp Duty	Depends	Yes	Yes	Depends	Depends	Depends	

* East African Community Customs Management Act confers an exemption for oil and gas companies

Corporation Tax, royalties and other taxes

	Mozambique	Angola	Ghana	Kenya	Tanzania	Uganda	South Sudan
Rate for oil and gas companies	32%	50%	35%	37.5%* 30%	30%	30%	15%
Oil royalty	10%	N/A	4%-12.5%	N/A	12.5%	12.5%	12.5%
Gas royalty	6%	N/A	N/A	N/A	12.5%	N/A	
Petroleum income tax	N/A	20% 70%	N/A	N/A	N/A	N/A	N/A

* Applicable for a non-resident branch

Withholding Tax

	Mozambique	Angola	Ghana	Kenya	Tanzania	Uganda	South Sudan
Dividends	20%	0%	8%	10%	10%	15%	No
Interest	20%	0%	8%	10%	10%	15%	7%
Royalties	10%	10%	10%	10%	15%	15%	15%
Services fees	10%	5.25%	5%.	5.625% /12.5% .	15%	15%	15%
Dividends	20%	0%	8%	10%	10%	15%	No

EAC - what should the tax system be?

What is " mineral taxation"?

Likely answer from Government official:

"income taxes and Government royalties"

Likely answer from Industry representative:

"that portion of the project's total revenues that ends up in the Government's hands"

Unique characteristics of oil and gas industry

High risk

Price taker

Cyclical profits

Finite life

Capital intensive

Remote locations

Restoration and reclamation

Reliance on subcontractors

Tax regime can recognise relatively high risk

Permit investor to reap a reward commensurate with the risk

Oil prices set by global market place and cyclical → regime more attractive if minimises taxes not based on profits, and provides adequate / indefinite loss carry forward

Provide certainty of tax rules

Avoid front-loading the tax costs

Tax regime can recognise capital intensive nature

Allow the enterprise to generate sufficient after tax cash flow in the early years of production to service project debt, thereby reducing lender's project risk

Minimise imposition of customs duties, VAT and similar upfront costs that are a function of capital investment.

The exploration, development and production of the petroleum deposits require heavy capital investment. Imposing taxes at these stages hamper growth of the sector. There is likely to be an opportunity to raise tax revenue at the Value- Add stage and subsequent sale of petroleum

Avoid the imposition of taxes on capital expenditure

Royalties (share of production) – a double edged sword

Historically the most important instrument for taxing mineral extraction

Attractive to Government as ensures up-front revenue stream

If too high

- Can deter investment by increasing marginal cost
- Risk making it unprofitable to develop marginal reserves

Other considerations

Remote location → need generous tax depreciation for infrastructure costs

Restoration & reclamation → tax relief for funds put aside for purposes of site reclamation and closure

Objectives of the mineral taxation system

Fair participation by state

Stable over time

Transparent and provides even playing field for all

Easy to understand and administer

Internationally competitive

Objectives met?

Fair participation by state	More needs to be done
Stable over time	Happening; however, needs to be better
Transparent and provides even playing field for all	Lacking
Easy to understand and administer	Needs working on
Internationally competitive	Not yet; also regional focus required

Conclusion

Similar tax policy across EAC

- Oil and gas policies revisions on going
- No specific tax regime for the upstream oil sector in all the individual countries
- There is enhanced assertiveness now that there is certainty as to the existence of hydrocarbon resources
- Although most of the EAC countries are in the exploration and/or development phase the tax policy is increasingly being amended to remove exemptions and fast track the taxation of transactions within this sector
- The policy thrust is the same: amendments to the tax rates and tax legislation to create an advantage to the revenue authorities and to improve revenue collections to the exchequers
- Other measures also being used to pile pressure on the oil and gas companies for example, increase in signature bonuses, enforcement of minimum work time timelines and minimum exploration spend and other tough line stance in PSC negotiations

The focus on revenue generation by the governments could prove a disincentive to this upcoming sector