

Tax Alert: East African Crude Oil Pipeline Special Provisions Act, 2021



Agreed Fiscal Regime

On 9 December 2021, Parliament of Uganda passed the East African Crude Oil Pipeline Special Provisions Bill 2021. The Bill was assented to by the President on 20th December 2021 and gazetted as an Act on 24th December 2021 and thereby took effect as law.

The object of this Act is to enable the Intergovernmental Agreement between the Republic of Uganda and the United Republic of Tanzania, the Host Government Agreement signed between the Government of Uganda and the East African Crude Oil Pipeline Company Limited (the Project Company) and to facilitate the development of the East African Crude Oil Pipeline (EACOP) Project.

The Act establishes a separate tax regime for the EACOP Project, level 1 contractors and level 2 contractors. Level 1 contractor is a direct contractor of the Project Company and a level 2 contractor is a direct contractor of a level 1 contractor.

We highlight below the agreed fiscal regime under the EACOP Act, 2021.

Detailed Discussion

1. Application of Arm's Length Principle

The Act provides that the arm's length principle will apply to any transactions between associates regarding the EACOP project except for transactions or arrangements between the Ugandan head office and its permanent establishment in Tanzania.

Implication

The transactions between the companies participating in the EACOP project and their associates are required to be at arm's length save for the transactions between the Ugandan head office and its permanent establishment in Tanzania. The aim is to ensure that the project company and its permanent establishment in Tanzania can trade without restriction on the prices charged between them. However, all other participants will be required to follow the arm's length principle which will enhance the tax base of these companies.

2. Corporation Tax

The Act provides for a 10-year income tax exemption for tariff income earned by the East Africa Crude Oil Company Limited (Project Company) from owning and running the EACOP system. The exemption period commences from the date of first commercial transportation and export of petroleum.

However non-tariff income of the Project Company is subject to income tax during the exemption period.

Despite the exemption, the Act requires the Project Company to compute the chargeable income on both the tariff and non-tariff income separately by taking into consideration the expenses incurred. The exemption applies by way of reducing to zero, the amount of corporate income tax imposed in a fiscal year on the tariff chargeable income during the exemption period.

The Act considers that when calculating the income tax on tariff income and non-tariff income there will be deductible expenses incurred both in the production of the income included in the tariff chargeable income and the non-tariff chargeable income.

The Act provides that in those situations, expenses will be allocated rateably to the tariff/non-tariff chargeable income in the proportion which the tariff/non-tariff chargeable income bears to the aggregate of the tariff chargeable income and the non-tariff chargeable income;

Implication

This implies that the Project Company will have to separate its income between tariff and non-tariff income. The tariff income will be exempt for 10 years and the non-tariff income will attract tax from the start of the project.

However, despite the exemption, the Project Company will be required to determine the chargeable income on both the tariff income and non-tariff income during the exemption period by determining the income and allowable expenses.

The expenses incurred in the generation of tariff and non-tariff income must be separated and where there are expenses incurred in the production of both sets of income, these must be separated rateably.



We understand that the exemption for 10 years is to encourage investment in the Project Company due to the capital-intensive nature of the project.

3. Capital Gains Tax

Under the Act, no gain or loss, or deemed gain or loss arising solely as a result of a change in the direct or indirect ownership of the Project Company in respect of the deemed disposal of the assets of the Project Company is to be included in the chargeable income of the Project Company.

Implication

Where there is a gain or loss (whether deemed or not) due to changes in the direct or indirect ownership of the Project Company, it's not to be considered for corporation tax. This is aimed at encouraging investment in the Project Company.

4. Branch Profit Tax

According to the Act, no branch profits tax is to be imposed on the Project Company on the basis that the Project Company is and remains a resident of Uganda for the duration of the EACOP project.

Implication

Although the Project Company is a company incorporated in England and Wales, for tax purposes it's considered a resident of Uganda on the basis that its management and control and place of management is exercised in Uganda. Therefore, it suffers no branch profit tax like other entities set up as branches in Uganda.

5. Disposals of interests in the Project Company by a Project Participant

A project participant means each investor, operator, contractor, shipper, finance party and off taker. Under the Act, a direct or indirect disposal of an interest in the Project Company must be taxed in accordance with the Ugandan law and must consider the allocation percentage to determine the tax. Further, the Act exempts from tax, a direct or indirect disposal of an interest in the Project Company where the said disposal of interest arises as a result of;

- a. enforcement by a finance party,
- b. transfer of an interest in the Project Company to the Ugandan state participant,
- c. transfer of an interest in the Project Company by a shareholder to its affiliate; or
- d. any transfer of an interest 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 project company or any other person acting on its behalf must notify the Commissioner General of the Uganda Revenue Authority upon becoming aware of the direct or indirect disposal of an interest together with submission of the necessary documentation.

Implication

Disposal of interests in the Project Company by a project participant attracts tax at 30% as per Section 79 (g) and (h) of the Income Tax Act except for the scenarios highlighted above. However, in determining the tax, the allocation percentage in terms of ownership of the interests must be considered.

6. Domestic and Foreign Tax Credits

According to the Act, a domestic tax credit can be offset against any domestic income tax imposed on a project participant and any excess credit may be refunded on application within 60 days if the domestic tax credit exceeds the total corporate income tax for that year.

Further, the Act provides that foreign tax credit can be offset against any foreign income tax, including the foreign equivalent of any withholding tax or branch profits tax with the excess credit carried forward indefinitely for use against corporate income tax on foreign source income in a subsequent fiscal year.

Implication

Both the domestic and foreign tax credits will be used by the project participants to offset domestic and foreign income tax respectively. The excess domestic tax credit may be refunded within 60 days by Uganda Revenue Authority on application whereas the excess foreign tax credit must be carried forward indefinitely for use against corporate income tax on foreign source income.

7. Exclusion of Part IXA of the Income Tax Act

The EACOP Act states that the provisions of Part IXA of the Income Tax Act (Special provisions for the Taxation of Petroleum Operations) shall not apply to the Project Company in respect of the EACOP project.

Implication

The Project Company will be subject to the agreed fiscal regime under Schedule 2 of the EACOP Act and not Part IXA of the Income Tax Act which provides for the taxation regime of licensees and their contractors. This is because the agreed fiscal regime under the EACOP Act has been created specifically for the EACOP Project and its provisions are dissimilar from those of Part IXA of the Income Tax Act in as far as the tax reliefs and rates of tax are concerned.

8. Withholding tax on interest payments

The Act provides that Withholding Tax (WHT) on payments of interest to a finance party that is a shareholder of the Project Company or its affiliate other than an affiliated financial institution is 10%. The Act provides that no withholding tax will arise on payments of interest to any other finance party.

Implication

Under the Income Tax Act, withholding tax on interest payments to residents and non-residents is 15%. The EACOP Act reduces this interest to 10% where the financing party is a shareholder of the Project Company or its affiliate and reduces it to zero in any other case.

9. Withholding tax on technical services

Under the Act, payments made to non-residents by the Project Company and level 1 contractors for supply of technical and other services provided directly and exclusively for the EACOP project, will attract withholding tax of 5%.

WHT of 5% shall also apply on any payment of premium for insurance or re-insurance, any payment for use or right to use, including the rental or hire, of any industrial, commercial or scientific equipment or other tangible moveable property, or any payment of management charges.

Implication

Under the Income Tax Act, payments to non-residents for technical services, management charges and re-insurance premium attract withholding tax of 15% and 10 percent respectively. Ugandan source service contracts also attract withholding tax of 15%. However, the rate of withholding tax is reduced from 15% to 5% for supply of technical services and management services to the Project Company and the level 1 contractor by a non-resident. WHT also reduced from 10% to 5% on any payment for re-insurance premium.

The reduced tax regime is to encourage non-residents to participate in the EACOP project due to the high level of skills and expertise which may not be readily available in the local market that will be required to complete the project.

10. Withholding tax on dividends

The Act provides that no withholding tax shall be imposed on payments of dividends by the Project Company including any taxes which would have been imposed by Section 83 (1) or Section 118 of the ITA and any interest or penalties in respect of such taxes.

Implication

Normally, dividend pay outs attract WHT of 15% under the Income Tax Act. However, to attract investors in the Project Company and in a bid to make the project feasible, no WHT is due on dividends. This is aimed at attracting investment in the Project Company and ensuring a quick return on the investments made.

11. Other Withholding Tax considerations

The Act provides that no withholding tax should arise on;

- a. Payments to the Project company of tariff from owning and operating the EACOP system;
- b. The import of goods into Uganda including Section 119 (3) of the ITA for the direct and exclusive use of the EACOP project;

- c. Payments for purchase of an asset including Section 118B of the ITA for the direct and exclusive use of the EACOP project;
- d. Payments for the supply of petroleum for the EACOP project;
- e. Payments made, or deemed to be made, by the Ugandan head office to the Tanzanian permanent establishment in connection with project activities; or
- f. The amount of any payment allocated to the Tanzanian permanent establishment.

Implication

The above exemptions are to ensure that the project participants have sufficient cash reserves to invest and participate in the EACOP project. This is due to the capital-intensive nature of the EACOP project. Therefore, there is no withholding tax on payments of tariff, import of goods into Uganda, purchase of assets, supply of petroleum and payments made to the Tanzanian permanent establishment.

12. Value Added Tax Considerations

The EACOP Act provides that;

- a. The supply of transportation and incidental services by the Project Company through the EACOP system be a zero-rated supply.
- b. No VAT be imposed on the import of goods and services provided directly and exclusively for the EACOP project by the Project Company, a level 1 contractor or a level 2 contractor.
- c. No VAT is imposed on any import, sale for export or export of petroleum; and
- d. No VAT is imposed on supplies or deemed supplies between the Project Company and the Tanzanian permanent establishment, or Project Company and the United Kingdom permanent establishment.



Implication

VAT exemption on imported services (that are directly and exclusively for the EACOP project) will be such a relief to taxpayers since VAT on imported services is a cost borne by the recipient of the services.

The aim of this Act is to reduce the costs related to the EACOP Project and its products hence the reason for charging zero VAT on transport and incidental services of the Project Company. In the VAT Act, the export of goods including petroleum is zero-rated and yet the EACOP Act makes such an export exempt from VAT.

Deemed VAT

The Act further provides that VAT is deemed paid on taxable supplies for goods and services made to the Project Company and a level 1 contractor in respect of the EACOP Project in accordance with Section 24 (5) of the VAT Act.

Implication

VAT charged by a level 1 contractor to the Project Company for the supply of goods and services will not be paid since the VAT is deemed paid. Similarly, the VAT charged by a level 2 contractor to the level 1 contractor for the supply of goods and services will not be paid to URA since it is deemed paid. This will ensure that the cash flows of the contractors will not be constrained by the monthly VAT declarations.

13. Import, Customs and Excise Duty

According to the EACOP Act, no customs or import duties is to be imposed on equipment and inputs, and engineering plant excluding motor vehicles, capital goods and temporary importation of any motor vehicles that are for the direct and exclusive use in the EACOP Project except for motor vehicle registration fees.

Further, the Act provides that customs, import, export or excise duties will not be an economic cost to the EACOP project.

Implication

The above exemptions are to ensure that the project participants have sufficient cash reserves to invest and participate in the EACOP project. This is due to the capital-intensive nature of the EACOP project. Therefore, no customs or import duties or excise duties are to be imposed on equipment and inputs, engineering plant, capital goods and the temporary importation of motor vehicles for the direct and exclusive use in the EACOP project.

14. Transit Fee

The Act provides that no transit fee or any other charge of a similar nature shall be imposed on the EACOP project, the petroleum transported or the sale or export of petroleum.

Implication

This is aimed at reducing costs on the Project to enable a good return on investments made due to the capital-intensive nature of the Project.

15. Stamp Duty

The Act provides that no stamp duty is chargeable on any instrument of transfer of shares in the Project Company that is incorporated in the United Kingdom.

The Act also limits the stamp duty on any transfer or other acquisition of land rights in relation to the EACOP Project to UGX 500,000.

Stamp duty on an instrument entered into by the Project Company as security for any financing agreement or an instrument effecting the transfer, novation, assignment or sub-participation of any interest of a finance party in a financing agreement is limited to UGX 10,000.

Implication

This is also aimed at reducing costs on the Project and enable a smooth flow of business.

16. National Social Security Fund

The Act exempts the Project Company's, level 1 contractors and their respective employees who are not ordinarily resident in Uganda from making contributions to NSSF. However, for the exemption to apply, the Project Company's or level 1 contractor's employees must be enrolled in a social security, retirement or pension scheme in the country where these employees are ordinarily resident and must apply to NSSF for this exemption as per Section 15 of the NSSF Act.

It's important to note that this exemption is only applicable during the construction phase of the EACOP Project.

Implication

The Project Company, level 1 contractor and their respective employees who are not ordinarily resident in Uganda and are enrolled in a social security, retirement, or pension scheme in the country where these employees are ordinarily resident are exempted from NSSF during the construction phase of the EACOP project.

17. Other taxes and charges

The Act provides that local government rates, trade licence fees, investment licenses, fees for issuance, maintenance or renewal of project authorisations shall not exceed a total of USD 100,000 per calendar year.

Implication

This is also aimed at reducing costs on the Project and enabling a smooth flow of business.

18. Control Mechanism

To efficiently administer the above provisions on WHT, VAT, Import, Customs and Excise Duties, the Act provides for the following control mechanism that shall apply to a payment, supply, import, export or any other transaction:

An EACOP transaction may be made by the project company without any formal certification of its entitlement to the benefits provided in this Act.

However, the Act provides that other project participants, prior to an EACOP transaction, shall request in writing that the Commissioner General of the URA issue a certificate that their transaction is an EACOP transaction and therefore should benefit from the above fiscal regime. The request includes a formal application, a contract showing which EACOP transaction will be made by the contractor and a confirmation by the Project Company that the EACOP transaction is covered by the Act.

The Commissioner General is required to either issue the certificate or issue a decision refusing the issuance of the certificate within 15 business days.

Where the Commissioner General renders a decision refusing the issuance of a certificate, or neither issues nor renders a decision of refusal within 15 business days, the project participant may refer the matter to an independent expert in line with the Host Government Agreement. The independent expert will determine whether the relevant transaction is an EACOP transaction.

If the independent expert determines that it is an EACOP transaction, the Commissioner General will without delay issue a certificate to the relevant project participant in respect of the EACOP transaction.

The certificate will cease to have effect in Uganda upon the expiry of the certificate, which shall be a date no later than the latest of-

- a. the 12 months anniversary of the date of issue of the certificate and
- b. the estimated end date of the relevant agreement under which the EACOP transaction occurs.

Where there is an EACOP transaction which is not covered by a certificate upon its commencement, but which meets the requirements of an EACOP transaction and as a result tax is incurred on it -

- a. the Commissioner General of Uganda Revenue Authority may subsequently upon request, issue a certificate covering such EACOP transaction
- b. a full refund or full set-off or credit of that tax upon application by the relevant holder of such a certificate,

Implication

Whereas the Project Company can benefit from the agreed fiscal regime of the EACOP Act without any formal certification, other project participants are required to obtain a certificate from the Commissioner General confirming that their transactions are EACOP transactions and can benefit from the agreed fiscal regime under the EACOP Act.



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