

# *PA 2015, MPSA 2013*

## Taxation overview

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# *Presenters and Agenda*



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## Taxation provisions:

- Petroleum Act 2015
- Model PSA 2013
- Region (comparison)

## Emerging O&G tax issues:

- Transactions
- Tax appeals
- Legislative developments

# *Petroleum Act 2015*

## Fiscal Regime

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# ***Petroleum Fiscal Regime***

- **Royalty (s 113)** – payable by licence holder and contractor in a manner specified in the Second Schedule
- **Annual Fees (s 114)** (acreage rental, training and research fees) – as may be prescribed in the regulations
- **Bonus Payment (s 115)** (production bonus, signature bonus) – as may be agreed under the terms of the relevant agreement
- **Taxation (s 116)** – in accordance with the provisions of relevant written laws
- **Ring fencing of recoverable costs (s117)** – Offset against production from development area excludes (i) costs iro licence area / block within contract area incurred following commencement of production (ii) midstream costs of “integrated project”

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## ***Royalty on Petroleum – Section 113, 2<sup>nd</sup> Schedule***

- Discharged by licence holder, but borne jointly with Contractor
- No offset for cost recovery
- Onshore / shelf: 12.5%; Offshore: 7.5% (consistent with MPSA 2013)
- Inclusion of royalty rates in legislation = non-negotiable PSA term?
- Despite Schedule title (“Royalty and Profit Share”), there is no reference to profit share, so profit share should remain negotiable

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## ***Payment of Tax – Section 116 (1), (2)*** ***What is the purpose of these clauses?***

***116.-(1) A licence holder, contractor and subcontractor shall pay taxes including corporate tax, capital gain tax and other taxes applicable in Tanzania in accordance with the provisions of relevant written laws.***

***(2) The profits resulting from any direct or indirect assignment, transfer or any other disposal of rights under the petroleum agreement regardless of the beneficiary type of transaction shall be subject to taxes at rates prescribed in the relevant written laws.***

***Is the purpose to expressly make clear that these points are non-negotiable in future PSAs? What about existing PSAs?***

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# ***Payment of tax – Section 116(3) to 116(7)***

## ***Confusing narrative in relation to debt funding***

### **Legislation**

*(3) The agreement in respect of grant of rights shall provide for financing of the petroleum activities with a loan from a third party in accordance with relevant tax laws.*

*(4) The third party is considered a subcontractor and shall be subject to withholding tax on the interest payment on loans.*

*(5) PURA shall, in accordance to the prescribed financing regulations which are in conformity with relevant tax laws, give approval for the percentage of the loan to be used as a portion of the total capital.*

*(6) Cost of any unapproved loan shall not be treated as allowable or deductible for tax purposes.*

*(7) The interest rate for loans shall not exceed the lowest market interest rate available for such loans.*

### **Comment**

Wording implies that there must be debt funding and it must be from a third party. Tax laws do not prescribe how lending should be made but do set debt equity limits that can impact interest deductions.

Not clear what is meant by stating that shall be considered a subcontractor. Any obligation in respect of w/tax is a matter for the tax law.

What is the purpose of this? As noted above the question of excessive debt is dealt with by thin capitalisation provisions, and is a responsibility of TRA. Potential for similar confusion as in mining with regard to remit of TMAA?

Not clear on what basis subsection (6) can override the income tax legislation.

Not clear on what basis subsection (7) can override the income tax legislation, which in any case already has transfer pricing provisions.

## ***Ring fencing – Section 117: What is relevance of reference to “prudent cost and fair return on investment under subsection(3)”***

*117.-(1) The licence holder and contractor holding an exploration licence or more than one developing licence within a contract area shall ring fence recoverable contract expenses.*

*(2) Recoverable contract expenses in a licence area or block within the contract area may be recoverable from petroleum revenue from such development area to the extent that were incurred prior to commencement of petroleum production from such development area.*

*(3) Where the licence holder and contractor undertake an integrated project, all costs incurred by the licence holder and the contractor for the construction and operation of midstream facilities including processing, liquefaction, storage and loading facilities shall not form part of recoverable costs under the production Sharing Agreements.*

*(5)\* The prudent cost and fair return on investment under subsection (3) shall be-*

*(a) determined by PURA; and*

*(b) recovered through mechanisms to be stipulated in the regulation made by the Minister.*

*(5) For purpose of this section “integrated project” means a project prescribed in a single development plan which comprises of development, production, processing, liquefaction, storage, transportation, shipping and marketing of petroleum.*



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# **Payments, Penalties, Security – Section 118 to 121**

## **Legislation**

### **Payment terms**

*118. All payments due to the Government under this Act shall be in an international and freely convertible currency.*

### **Penalty for late payment**

*119. Where a contractor fails to make payment under this Act on or before the time required, such contractor shall be liable to a penalty of a surcharge of two percent of the amount in default for each day of default.*

### **Recovery of payments under this Act**

*120. Payments and taxes under this Act are a debt due to the Government and shall be recovered in accordance with any other relevant written laws.*

### **Security for compliance**

*121. PURA may make arrangements to ensure that a licence holder complies with the provisions of this Act and accept guarantees whether from contractor or otherwise in respect of that compliance.*

## **Comment**

What about guarantee in terms of accounting, filing tax returns and being assessed in foreign currency?

2% per day! Equivalent to a compound annual rate of 1,377% (or 1,405% in a leap year)!!

Again what is the purpose of this as there are tax laws dealing with tax obligations?

More clarity will be required in relation to such guarantees.

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## ***Integrity Pledge – Section 223***

*223.-(1) A licence holder and the contractor who undertakes petroleum or gas activities under this Act shall be required to comply with the integrity pledge.*

*(2) The integrity pledge referred to under sub-section (1) implies the following national requirements-.....*

***(c) desist to engage in any arrangement that undermines or is otherwise prejudicial to Tanzania's tax system;.....***

*(3) The Minister shall make regulations guiding compliance with the integrity pledge.*

*(4) Any person who **fails to comply with integrity pledge** shall breach the conditions of licence or permission to engage in the regulated activity and such **licence or permission shall be deemed to have been withdrawn or cancelled** and the Government shall exercise the right of takeover facilities provided for under this Act.*

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# Payment of capital gain tax – Section 224

## Legislation

*224.-(1) A licence holder and the contractor shall be under obligation to pay capital gain tax in accordance with the Income Tax Act in respect of any corporate reorganization undertaken within or outside the United Republic.*

*(2) Failure to pay the capital gain tax constitute a breach of integrity pledge warranting the Government to take measures against such breath.[should read breach]*

## Comment

There is no capital gains tax. However, income tax is charged on gains of a capital nature. Any taxing right in respect of income tax (including on capital gains) is dealt with by the Income Tax Act. A corporate reorganisation outside Tanzania that does not result in any change in underlying control does not have any tax consequence. (Ideally domestic reorganisations should not result in an income tax charge but in practice TRA do seek to tax these.)

Does this mean that if there is a tax dispute on a technical issue, the PSA holder risks losing their licence?

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# *Model Production Sharing Agreement*

2013 Model – articles relevant to taxation

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## ***Import Duties – Article 23***

- For Contractor and sub-contractors engaged in “Petroleum Operations”, exemption for “*machinery, equipment, materials, supplies, consumable items (other than foodstuffs, cosmetics, personal effects, and alcoholic beverages) and moveable property*” (subject to TPDC certification). No reference to inclusion of vehicles (unlike MPSA 2008 & 2004).
- **Conflict with primary tax legislation:**
  - EACCMA 2004 scope – contractor not sub-contractor; equipment and inputs, but not motor vehicles; exploration and development
  - VAT Act 2014 – contractor not sub-contractor; goods as per EACCMA; exploration or prospecting; grandfathering of predecessor provisions
  - Other – taxes on fuel; railway development levy 1.5%; CPF 0.6%

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## ***Assignment and transfer of rights – Article 27***

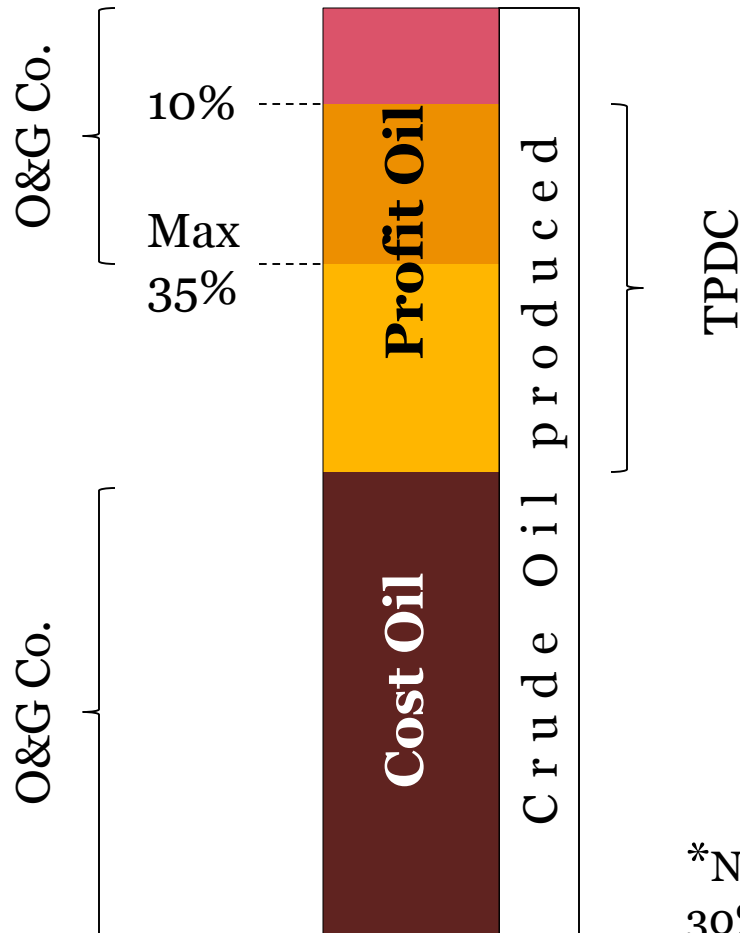
- Consent requirement for direct and indirect transfers and for transactions with affiliates
- Any transfer to a non-affiliate and not subject to stamp duty will attract a **transfer / assignment fee** as follows:
  - 1<sup>st</sup> \$100m of consideration: 1%
  - 2<sup>nd</sup> \$100m of consideration: 1.5%
  - Any amount in excess: 2%
- MPSA 2008 & 2004 – no reference to transfer / assignment fee
- MPSA 2004 – no transfer or related taxes, charges or fees

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## ***Assignment and transfer of rights – Article 27 (n)***

- *“Any assignment or transfer under this Article shall be subject to the relevant tax law, including capital gain tax”.*
- As noted earlier there is no capital gains tax. Instead tax on gains of a capital nature is dealt with by way of income tax.
- Given that it is the governing tax law (in this case, Income Tax Act 2004) that imposes any such liability, and that Article 16 provides for the application of income tax, **what is the purpose of this clause?**

# Recovery of Costs and Expenses and Production Sharing – Article 12 - Oil

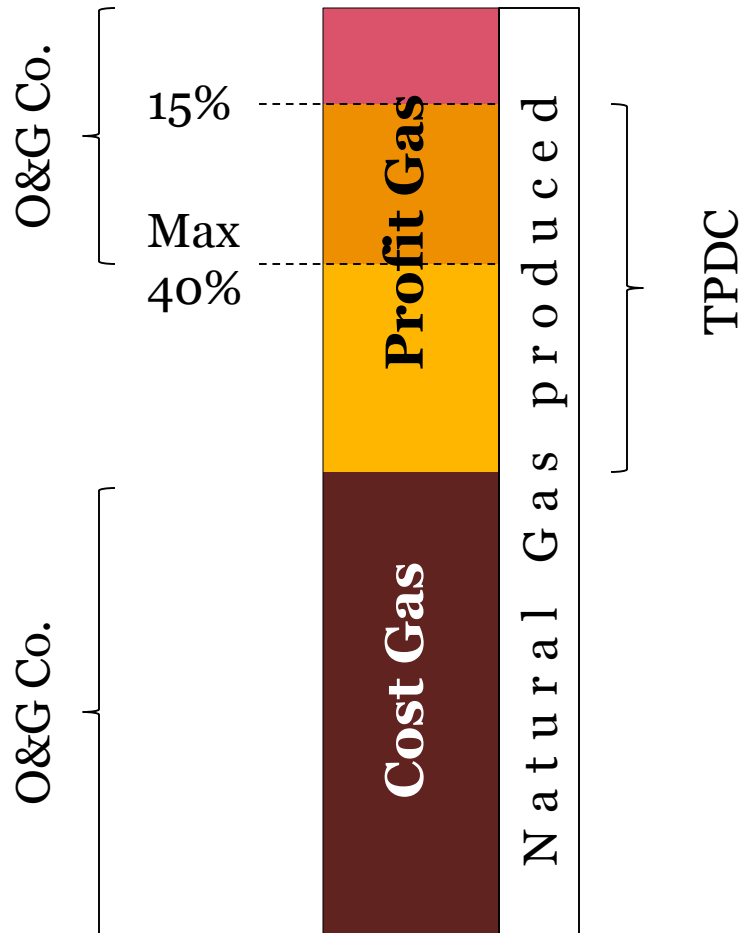


- Expenses recovered against “Cost Oil” (up to 50% of production in calendar year)
- “Profit Oil”\*:
  - Contractor share: 35% - 10%
  - TPDC share: 65% - 90%
- Allocation depends on tranches of daily total production (BOPD) – the higher the BOPD, the lower the Contractor share

\*Note: PA 2015 Bill had shown contractor share of 30% - 50%, but Act did not include reference to this.



# Recovery of Costs and Expenses and Production Sharing – Article 12 - Gas



- Expenses recovered against “Cost Gas” (up to 50% of production in calendar year)
- “Profit Gas”:
  - Contractor share: 40% - 15%
  - TPDC share: 60% - 85%
- Allocation depends on tranches of daily total production (MSCFGPD) – the higher the MSCFGPD, the lower the Contractor share

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## ***Royalty – Article 16(c)***

- Royalty under MPSA 2013 (and PA 2015):
  - Discharged by TPDC, but borne jointly with Contractor
  - No offset for cost recovery
  - Onshore / shelf: 12.5%; Offshore: 7.5%
- Comparison – predecessor MPSAs:
  - 2010 addendum (offshore gas) – 5% borne by TPDC
  - MPSA 2008 (art. 14) – 12.5% borne jointly
  - MPSA 2004 (art. 14) – 12.5% or 5% borne just by TPDC

# Offshore Gas – overview: royalty and profit share

- **Royalty** – 7.5%
- **Profit share** – as per the table below:

Gas in MMSCFD	Government Share	Contractor Share
0 – 149	60%	40%
150 – 299	65%	35%
399 – 449	70%	30%
450 – 599	75%	25%
600 - 749	80%	20%
750 - and above	85%	15%

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## ***Taxation – Article 16 (a) and (b)***

- Taxes applicable to Contractor include:
  - Income tax “*as provided for under the provisions of the Law*”
  - Subject to article 23, import duties “*at the rates specified from time to time*”
  - Taxes, duties, fees and other imposts for service rendered; rent due to Government
  - Local taxes “*not in excess of those generally applicable*”
  - Stamp duties, registration fees, licence fees & other minor imposts
- Broadly consistent narrative in MPSA 2013, 2008 and 2004; by contrast under MPSA 1995 TPDC bore the income tax cost
- **Issue / concern: lack of explicit stabilisation**

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## *Additional Profits Tax – Article 17*

- Applies where cash flows exceed a set % return (thresholds: 20% on 1<sup>st</sup> tranche, 30% on 2<sup>nd</sup> tranche)
- Tax rate:
  - 25%: 1st tranche (“First Accumulated Net Cash Position”)
  - 35%: 2nd tranche (“Second Accumulated Net Cash Position”)
- MPSA 2004 – no APT article

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# *Regional comparison*

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# *East Africa incl. Mozambique*

## **Similarities:**

- **Indirect tax:** Tax rates (Customs Duty (EAC 0-25%, Mz 0-20%) and VAT (16% - 18%)) and scope of exemptions
- **Corporate tax:** Tax rates (EAC 30%, Mz 32%); accelerated tax depreciation; anti-avoidance provisions (ring-fencing by contract area, transfer pricing, thin capitalisation limits)
- **Transactions:** New provisions to charge income tax on indirect transfers of ownership

## **Differences (Tanzania):**

- Income tax on non-resident sub-contractors: no special basis (cf Kenya and Uganda)
- Government share of production / gross revenue (production share / royalty)
- **Overall take under MPSA 2013 a lot higher than neighbours** – [Wood Mackenzie 2014 report](#) on development economics for 400mmbbl deep water oil discovery showed a Government take of 96% (and investor IRR of 13%), as compared to 61% / 29% respectively for Kenya, and 65% / 30% respectively for Mozambique

# *Emerging Tax Issues*

## Transactions



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# *Asset disposals*

## **Corporate income tax**

TRA have confirmed that license interest is a “Business Asset”

- Gain on disposal taxed at 30%;
- Asset tax base = written down value of exploration and development expenditure;
- Instalment tax?

## **Farm-out carry**

- Commitment to fund future costs - to be brought into tax?
- If so, how is value to be determined (discounted)?

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# Asset disposals

## VAT – transfer of a going concern

- VAT Act 2014 refers to transfer of “*economic activity*”;
- TRA view that disposal of part of license does not qualify as transfer of going concern despite wide definition of economic activity: “...*an activity carried on continuously or regularly by a person, which involves or is intended to involve the supply of goods, services, or immovable property, including...*” **or** “...*an activity carried on in the form of a business, profession, vocation, trade, manufacture, or undertaking of any kind, whether or not the activity is undertaken for profit...*”

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## ***Indirect disposal – section 56***

*Where the **underlying ownership** of an entity changes by more than **fifty percent** as compared with that ownership at any time during the previous **two years**, the entity shall be treated as **realising** any assets owned and any liabilities owed by it immediately before the change.*

- Intention of Finance Act 2012 amendment: to tax disposals of entities where sold indirectly through overseas share disposal
- Looks to change in ultimate ownership
- Deemed realization of assets and liabilities at mkt value immediately before change
- Notification requirement to TRA
- Does not extend to stamp duty, but note transfer / assignment fee under MPSA 2013

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## *Indirect disposal – section 56*

### **Issues include:**

- Listed companies
- 50% change in underlying ownership -> realise 100% of assets (even if have minority shareholders)
- No transaction materiality threshold in relation to value attributable to Tanzania - whether in absolute or proportionate terms
- Interaction with taxation of direct disposals
- Mergers

# *Emerging Tax Issues*

## Tax cases

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## *Interaction with PSAs*

- **Wentworth** case (VAT on transfer of interest)
- **Geita Gold Mining** case (fuel levy)

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# ***Withholding Tax on Services***

## **Income Tax Act 2014**

- Source rule – explicit reference to place of performance of service

## **Tulow case (2013)**

- TRAT found in favour of TRA (that withholding tax should apply to payments to non-residents even if service performed overseas)

## **PanAfrican Energy case (2015)**

- TRAT ruled in favour of Pan African that withholding tax should only be due where the service is provided in Tanzania.
- Quote:- *“Tulow case was made without due consideration of the provisions of section 69(i)(i).”*

**Court of Appeal hearing awaited**

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## ***Expenditure incurred outside Tanzania***

### **PanAfrican Energy case:**

- TRA sought to disallow expenditure on services provided outside Tanzania by a non-resident on which taxpayer had not withheld tax
- TRA sought to disallow expenditure arguing that it had no “source” in Tanzania, resulting in a foreign source loss that cannot be claimed against domestic source income in Tanzania.
- TRAB found in favour of taxpayer that these expenses were an expense of the business in Tanzania (a domestic business).



## ***Development expenditure (class 4) – timing of tax depreciation deduction – PanAfrican Energy case***

- **TRA position:** depreciation allowance not available until the asset is brought into use as Section 17 requires the asset to be “*owned and employed by the person during the year of income*”.
- **Taxpayer position:** asset is deemed to be employed by virtue of Schedule 3, para 1(3): “*To the extent not otherwise provided, expenditure incurred by a person wholly and exclusively in the production of the person's income from a business in respect of natural resource prospecting, exploration and development shall be treated as if it were incurred in **securing the acquisition of an asset that is used by the person in that production.***”
- **Board ruling:** in favour of TRA – one dissenting opinion
- **Issue:** Development expenditure can be incurred 5-10 years before being brought into use, so TRA’s review of additions to tax depreciation pool could be many years after it is incurred.

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## ***Permanent establishment – Odjfell case***

- TRA argued that the rig owner did not have a permanent establishment (“PE”) and so was subject to withholding tax at 15% on gross payment (instead of 30% on taxable profit).
- The Tax Revenue Appeals Board supported the taxpayer’s contention that they had a PE, and so that 15% w/tax did not apply, for following two reasons:
  - The entity was using substantial machinery in the drilling exercise, and
  - It had established a place of business at its branch office.

# *Emerging Tax Issues*

## Legislative developments

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## ***Withholding Tax – Technical Services***

- Scope: payments by the extractive sector (mining, oil & gas) to resident providers of “technical services” and management fees.
- Definition: *“technical service’ in respect of mining, oil and gas operations, means services in respect of earthmoving, engineering and construction and includes geological, geotechnical and metallurgical services, seismic survey, data interpretation, drilling or any such services”*.
- Rate = 5%
- A final tax (i.e. the basis for taxation of such entities is 5% of turnover instead of 30% of taxable profit).

### **Issues**

- Scope of charge
- Branches – interaction with branch remittance tax (“tax on repatriated income”)

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# Ring fencing

## Deduction of expenses - section 11(4)

*“In the case of mining or petroleum operations, **where separate and distinct** mining or petroleum operations are carried on by the same person in a different mining area or **petroleum contract area**, determination of allowable deduction for each mining area or petroleum contract area shall be treated separately”*

## Loss relief - section 19(2)(d)

*“a person may deduct an unrelieved loss... in case of loss incurred on petroleum operations, only in calculating the person’s income derived from **contract area**;”*

## Issue

A conflict between the two provisions as regards treatment of a single economic project (i.e. where not separate and distinct)?

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## ***Transfer pricing***

An area of increased focus following publication of regulations in 2014. Likely to give rise to tax disputes.

### **Advance Pricing Agreements (“APAs”)**

Regulations provide for Advance Pricing Agreements, but TRA reluctant at this stage. Recent workshop facilitated by PwC between TRA, MoF and private sector to discuss APAs. Discussion led by PwC UK tax partner (ex HMRC) who discussed experience of APA programme in UK and other jurisdictions, and how such experience might be relevant to TRA. Noted that probably greater prospects of bilateral than unilateral APA, but requires treaty in place (eg Norway)

### **Examples of possible TP issues**

- Management charges from related parties
- Bareboat lease costs
- Debt funding - interest rates – deemed interest on interest free loans

# PwC Africa Oil and Gas Tax Guide 2015

## Oil and Gas Tax Guide for Africa 2015



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### **Oil and Gas Tax Guide for Africa 2015**

A quick guide to oil and gas tax regimes in some of Africa's fastest growing countries.

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#### Of further interest

Worldwide Tax Summaries

Oil and Gas Tax Guide for the Middle East 2015

# *PwC Africa Oil & Gas Review 2015*

Energy, Utilities & Mining

## Publications

The Africa Oil & Gas Survey

SA Mine

Mine

The gas equation

Fit for \$50 oil in Africa

## Global Publications

## Africa Oil & Gas review 2015

### From fragile to agile

As oil prices plunged late in 2014, the industry response has been far-reaching, leading to reductions in headcount and other cost cutting measures. Capital budgets have been cut, and frontier exploration activity has waned. While response to such a drastic move in commodity price was certainly necessary, we have seen that the most successful organisations are taking time to re-set, re-strategise and plan for the upturn in prices, which will inevitably come. Africa should be no exception as many of the frontier exploration plays lie on this continent. At PwC, we have termed this opportunity as moving from 'fragile to agile'.

This review of developments in the African oil & gas industry is our fourth in a series of similar reviews. It represents the experience and views of industry players across Africa, including international oil companies operating in Africa, national oil companies, oilfield service companies, independent oil companies and industry commentators, who have provided vital insight into the latest developments impacting the industry in this region in the last 12 months in the major and emerging African oil & gas markets.



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