TOWARDS A LEGAL FRAMEWORK FOR PREVENTING TAX REVENUE LEAKAGE IN THE UPSTREAM OIL AND GAS INDUSTRY IN TANZANIA

An Analysis of the Concepts, Methods and Options available in a Public Trusteeship Model of Natural Resource Holding

by

Boniphace Luhende (LHNBON001)

Thesis submitted to the Faculty of Law, University of Cape Town in fulfilment of the requirements for the PhD degree

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ABSTRACT

The recent discoveries of natural gas in Tanzania, estimated at about fifty-seven trillion cubic feet (tcf), have sparked tremendous hopes for socio-economic development in the country. While this optimism seems to be supported by conventional wisdom and economic insights, evidence from other oil-rich African countries shows that in spite of the ongoing oil and gas extraction, they are floundering in poverty, corruption and political instability. This phenomenal dichotomy between oil and gas wealth and socio-economic development is referred to as the "resource curse". As this study demonstrates, the "curse" is partly a result of under-taxation.

This study uses the resource curse study to analyze and evaluate tax-related challenges in the Tanzanian upstream oil and gas industry. In doing so, the study identifies three factors that may cause loss of potential tax revenues - referred to as "tax revenue leakage". First, the discretionary tax incentives, such as tax exemptions, lowering tax rates and special tax treatment, result in non-payment of taxes that would have otherwise been payable. Second, the International Oil Companies (IOCs) adopt a variety of techniques, such as transfer pricing, thin capitalization, corporate re-organization tax evasion and treaty shopping to exploit the loopholes or gaps in the tax laws to minimize, reduce or eliminate their tax obligations without being detected or punished. Third, corrupt Government officials willfully fail to collect taxes due, short levy taxes, grant undeserving tax incentives to the IOCs or divert revenues collected for their own account. All these factors demonstrate the close connection between under-taxation, corruption and tax avoidance. As this study argues, in the absence of counteractive measures, the Government will collect only a fraction of potential taxes, thus losing revenues required to finance development projects.

The study establishes that Tanzania counteracts tax avoidance and tax evasion through anti-avoidance legislation. Tanzania also has accountability measures, which impose restraints on the exercise of public power and prevent corruption. The study concludes that although Tanzania has a competitive fiscal regime, anti-avoidance legislation and systems of accountability, the level of Government's tax revenue nevertheless depends on institutional capacity to detect, prevent and penalize tax avoidance schemes and corruption.

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List of Abbreviations

APT	Additional Profit Tax
AU	African Union
Cap	Chapter of the laws
CGT	Capital Gains Tax
CIT	Corporate Income Tax
Commissioner	Commissioner General Tanzania Revenue Authority
DPP	Director of Public Prosecution
EITI	Extractive Industries Transparency Initiative
EWURA	Energy and Water Utility Regulatory Authority
FDI	Foreign Direct Investment
GAAR	General Anti-abuse Rules
GDP	Gross Domestic Product
IOC	International Oil Company
OECD	Organization for Economic Co-operation and Development
PCCB	Prevention and Combating of Corruption Bureau
PSA	Production Sharing Agreement
PURA	Petroleum Upstream Regulatory Authority
R.E.	Revised Edition
SAAR	Specific Anti-abuse Rules
SADC	Southern African Development Community

TEITI	Tanzania Extractive Industries (Transparency and Accountability) Committee.
TPDC	Tanzania Petroleum Corporation
TRA	Tanzania Revenue Authority
UN	United Nations Organization
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax

List of Figures and Tables

Map of oil and gas activities in Tanzania (December 2016)

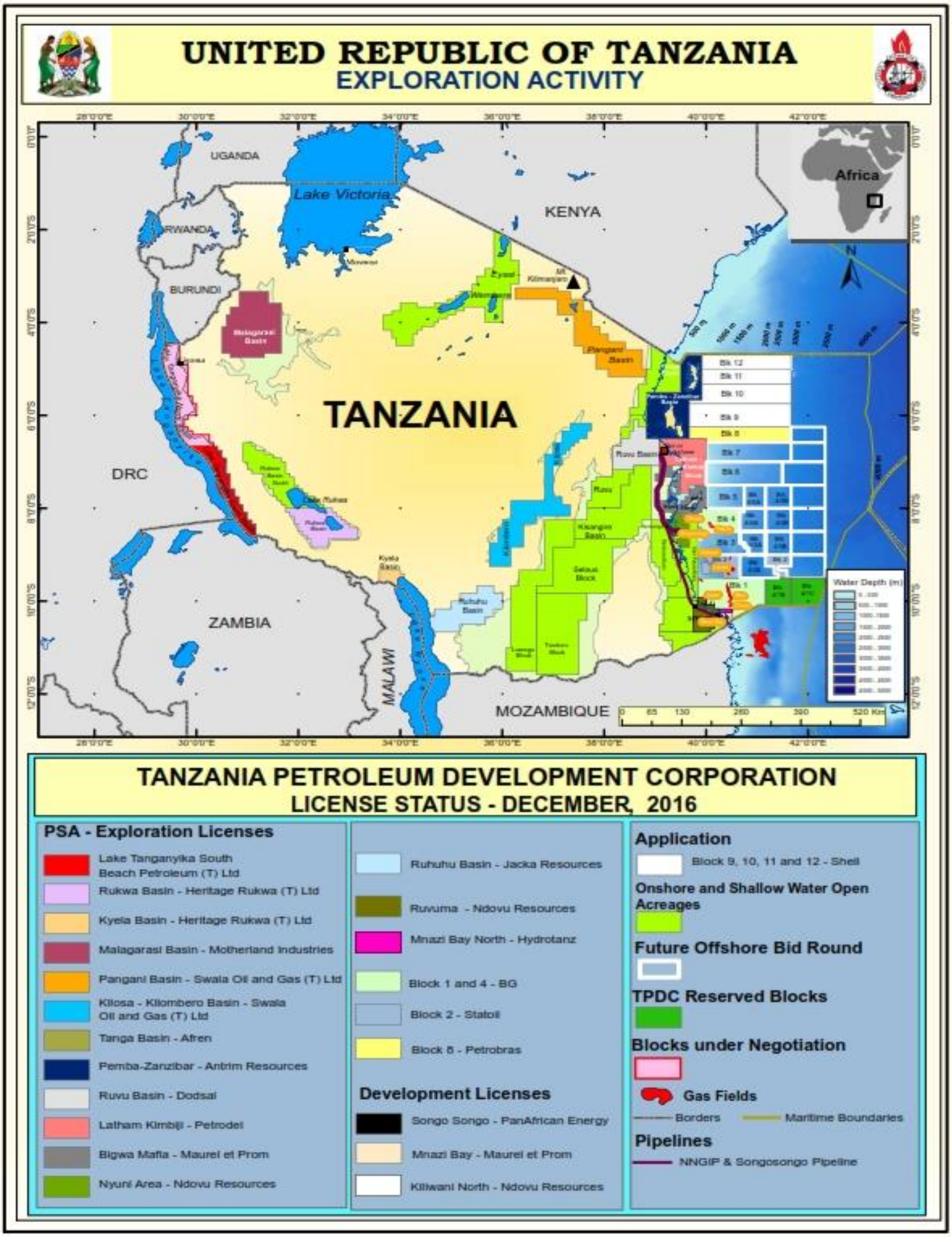

Figure 1: Map of Oil and gas exploration and production activities in Tanzania http://www.tpdc-tz.com/activitymap.php, accessed 28.02.2017.

CHAPTER ONE: GENERAL INTRODUCTION

1 The Paradox of Oil Wealth

The recent discoveries of natural gas in Tanzania, estimated at approximately fifty-seven trillion cubic feet (tcf),[1] have sparked tremendous hopes for socio-economic development in the country.[2] While conventional wisdom and economic insights support this optimism, other oil-rich African countries, such as Nigeria, Angola, Sudan, Equatorial Guinea and Chad, are floundering in poverty, corruption and political instability.[3] This

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[1] According to EWURA by March 2016 the discovery natural gas reserve was at 57.25 trillion standard cubic feet. Information available at http://www.ewura.go.tz/?page_id=70 (accessed on 05 March 2017). Further details on natural gas exploration and discoveries are provided by the Tanzania Petroleum Development Corporation (TPDC) at http://www.tpdc-tz.com/activitymap.php.(last visited on 15 July 2017)

[2] For example, the former Minister for Energy and Minerals Prof. Sospeter Muhongo asserted that natural gas extraction has the potential to increase the per capita income from $500 to $5000 by 2025. See Chatham House *Africa Meeting Summary Tanzania as an Emerging Energy Producer* (2013) 6 available at www.chathamhouse.org (accessed on 13 March 2014).Similarly, the financial simulations show that after commercial production of all fifty seven trillion cubic feet (tcf), the Government will earn about U$S 3 billion annually compared to the current development assistance at U$S 2 billion. See also Baunsgaard, T *United Republic of Tanzania: Selected Issues* IMF Country Report No. 14/121(2014)9 available at https://www.imf.org/external/pubs/ft/scr/2014/cr14121.pdf (accessed on 10 March 2015); Pedersen, RH and Bofin, P *The politics of gas contract negotiations in Tanzania: a review* Danish Institute for International Studies Working Paper 03 (2015) 28 available at http://pure.diis.dk/ws/files/615479/WP_2015_03.pdf. (Accessed on 10 February 2016).

[3] Two methods are used to evaluate development in oil-rich countries namely the level of human development and poverty or per gross domestic product (GDP) compared to other countries. See Davis, GA "Extractive Economies, Growth, and the Poor" in Richards, JP (ed) Mining, *Society, and a Sustainable World* (Verlag Berlin Heidelberg, Springer, 2009) 38. These are example of how countries fail to transform their oil and gas wealth into socio-economic development. See Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all* (2013)14 available at http://appcdn.acwupload.co.uk/wpcontent/uploads/2013/08/2013_APR_Equity_in_Extractives_25062013_ENG_HR.pdf (accessed on 28 February 2017). For the general discussion on the resource curse study see Karl, TL *The Paradox of Plenty: Oil Booms and Petro-States* (California, University of California Press, 1977) 2; Heilbrunn, JR. *Oil, Democracy and Development in Africa* (New York, Cambridge University Press, 2014) 2; Jensen, N and Wantchekon, L "Resource wealth and political regimes in Africa" (2004) 37 *Comparative Political Studies* at 816-818 and Humphreys M, Sachs J and Stiglitz J "Introduction: What is the Problem with Natural Resource Wealth?" in Humphreys M, Sachs J and Stiglitz J (eds.) *Escaping the resource curse* (Irvington, NY: Columbia University Press, 2007) 2-3 UNCTAD *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development* (New York and Geneva, 2007) 93; Shikwati, J "How geological resources can aid Africa's development" in Runge, J and Shikwati J *Geological Resources and Good Governance in Sub-Saharan Africa Holistic Approaches to Transparency and Sustainable Development in the Extractive Sector* (London, Taylor & Francis Group, 2011) 9-10; Buchholz, P and Stürmer, M "An overview of geological resources in Sub-Saharan Africa: Potential and opportunities for tax revenue from the extractive Sector" in Runge, J and Shikwati J *Geological Resources and Good Governance in Sub-Saharan Africa Holistic Approaches to Transparency and Sustainable Development in the Extractive Sector* (London, Taylor & Francis Group, 2011) 20. The disconnect between

phenomenal dichotomy between oil and gas wealth and socio-economic development is referred to as the "resource curse".[4] However, the resource curse proposition is challenged by evidence showing other oil-rich countries, such as Norway, Canada and Australia, and even some from the developing world, such as Chile, have high living standards for their citizens, diversified economies and stable economic growth.[5] This suggests that the supposed "curse" is not to be found in the oil and gas resources as such.[6] Instead, the quality of governance, and the competency of a country's Governmental institutions determine the impact of the presence of oil and gas resources.[7]

1.1 Tax Revenue Leakage and the Resource Curse

From a taxation perspective, the description of the resource curse study has two limbs.[8] First, Governments in most oil-rich countries do not obtain a fair share of resource rents

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oil and gas wealth and socio-economic development resonates with Kapuscinski's argument that the discovery of oil and gas creates an "an illusion of a completely changed life", but the reality is that this illusion is a 'fairy tale' with a "bit of a lie" see Kapuscinski, R *Shah of Shah* (Vintage International, 1992) 35.

[4] The resource curse in theory represents an inverse relationship between extraction of natural resources and socio-economic development. Richard Auty, who coined the phrase "resource curse", argued that most resource rich countries performed worse in terms of socio-economic development and good governance than their counter parties with less endowment. See Auty RM *Sustaining Development in Mineral Economies: The Resource Curse Study* (London and New York, Routledge, 1993) 1. Similary, Sachs, JD and Warner, AM "The Curse of National Resources" 45 *European Economic Review* (2001) 827-838 at 827-831 demonstrate the missing link between resource wealth and economic growth. See also the general discussions by Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all* (2013) 12-16; Ross, ML *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (New Jersey, Princeton University Press, 2012) 1-3; Humphreys et al "Introduction: What is the Problem with Natural Resource Wealth?" (2007)1-5; Ross, ML "The Political Economy of the Resource Curse" (1999) 51 *World Politics* 297-322 at 297-298 and Dell, M "The Devil's Excrement: The Negative Effect of Natural Resources on Development" (2004). 26 (3) *Harvard International Review* at38.

[5] These countries are considered an exception to the resource curse theory. In Africa Botswana has also been able to avoid the resource on its minerals. See Mehlum H, Moene KO and Torvik, R "Cursed by Resources or Institutions?" 29(8) *The World Economy* (2006) 17-20. See also Carmignani, F and Chowdhury, A *Why are natural resources a curse in Africa, but not elsewhere*? (2010) 3-4 available at http://www.uq.edu.au/economics/abstract/406.pdf; (Accessed on 15 April 2014).

[6] Carmignani and Chowdhury *Why are natural resources a curse in Africa, but not elsewhere?* (2010) 3-4; Mikesell, RF "Explaining the resource curse, with special reference to mineral-exporting countries" (1997) 23(4) *Resources Policy*, 191-199 at 191; Torvik, R "Why do some resource-abundant countries succeed while others do not? (2009) 245-250.

[7] Because of weak governance revenues accruing to the Government are wasted, rather than being invested. See Carmignani and Chowdhury *Why are natural resources a curse in Africa, but not elsewhere?* (2010) 3-4. See also Hogan, W Sturzenegger, F and Tai, L "Contracts and Investment in Natural Resources" in Hogan, W and Sturzenegger, F (eds) *The Natural Resources Trap Private Investment without Public Commitment* (Massachusetts, The MIT Press, 2010) 2.

[8] Ross *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (2012) 4.

commensurate with the extracted oil and gas resources.[9] This also explains the reason why despite the oil and gas industry being one of the largest industries in the world and the IOCs amongst the world's richest companies, several African countries in which they operate, such as Nigeria, Angola, Sudan, Equatorial Guinea and Chad, rank amongst the poorest countries in the world.[10] According to this view, there is a one-to-one relationship between the occurrence of resource curse and systemic under-taxation in the oil-rich countries.[11] Accordingly, the resource curse epitomizes the State's failure to discharge its trusteeship duties in the management of its oil and gas resources.[12] Second, the resource curse occurs as the result of mismanagement of revenues obtained from the oil and gas industry. [13] This could be a result of the "Dutch Disease",[14] volatility of oil and gas

[9] See general discussion under Chapter 3, Section 3. See also Ross *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (2012) 4. Calder, J *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014) 51 See also Duruigbo, E "Multinational Oil Corporations, and the Resource Curse in Africa" (2005) 26 (1) *University of Pennsylvania Journal of International Law* 1-67 at 2; Le Billon *Extractive sectors and illicit financial flows: What role for revenue governance initiatives?* (2011) 1; Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all* (2013) 63. It is also argued that between 2008 and 2010 Africa lost $ 38 billion dollars (higher than the total aid received during this period), from tax avoidance alone. See Pfister, M *Taxation for Investment and Development: An overview of policy challenges in Africa* (2009) 10 available at https://www.oecd.org/investment/investmentfordevelopment/43966821.pdf (accessed on 12 December 2016).

[10] The CIA World fact book names top 10 oil producing countries in 2014 to include Nigeria which the largest producer followed by Angola, Algeria, Egypt, Libya, Republic of Congo, Equatorial Guinea, Gabon, South Sudan and Ghana available at https://www.cia.gov/library/publications/the-world-factbook/rankorder/2241rank.html. (accessed on 25 February 2015) See also Africa Progress Report *Equity in Extractives Stewarding Africa's natural resources for all* (2013)1, 14

[11] See Chapter 3 section 3

[12] The title to oil and gas resources vests in the state as a matter trust. Therefore, the Government has the duty to ensure that it obtains an equitable share of the economic benefits arising from oil and gas extraction. See general discussions under Chapter 3 section 3.1 and Chapter 5 section 2.1..

[13] Duong, WN "Partnerships with Monarchs- Two Case Studies: Case One- Partnership with Monarchs in the Search for Oil: Unveiling and Re-examining the Patterns of Third World Economic Development in the Petroleum Sector (2004) 25 *The University of Pennsylvania Journal of International Law* 1171- 1295 at 1242. See also Carmignani and Chowdhury *Why are natural resources a curse in Africa, but not elsewhere?* (2010) 3-4.

[14] This was coined after the discovery of natural gas in the Northern Sea in Netherlands in 1960's, when the revenues from oil and gas led to sharp appreciation of exchange rates, which in turn, rendered local agricultural and other tradable goods very expensive and less competitive. See Humphreys "Introduction: What is the Problem with Natural Resource Wealth?" (2007) 7-8; See Also Bauer, A and Quiroz, J.C "Resource Governance" in Goldthau, A (ed) *The Handbook of Global Energy Policy* (John Wiley & Sons Ltd, Ebook 2013) 246. Ross *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (2012) 4. Another example is Nigeria, which before the discovery of oil was the second producer of cocoa in the world and agriculture contributed about three quarters of total exports but now oil makes about 85% of total exports. See Shaxson, N *Poisoned Wells: The Dirty Politics of African Oil* (New York, Palgrave Macmillan 2007) 18.

commodity prices,[15] "rent seeking" activities[16] and the enclave nature of the oil and gas industry.[17]

In most developing countries, such as Tanzania, International Oil Companies (IOCs) undertake oil and gas extraction in exchange for payment of royalties, taxes and other charges.[18] This in turn, presents an opportunity for the Government to raise a stream of tax revenues, which could then be re-invested, through the public finance system, for the provision of social amenities and infrastructure.[19] Thus, oil and gas extraction has the potential to enhance socio-economic development, economic growth, and eradicate

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[15] Generally, the prices of oil and gas commodities are volatile. This volatility of commodity prices render economic planning for the Government difficult. Usually Government expenditures increase with the price booms but it is difficult to adjust during the downswing of prices. Consequently, Governments are forced to borrow excessively on anticipation of future booms. This results into debt crisis when the commodity prices decline See Omeje, K "Avoiding the Natural Resource Curse: Lessons from Nigeria and Policy Implications" (2013) 42(4) *Africa Insight* 91-103 at 94. See also Bauer and Quiroz "Resource Governance" (2013) 246; Shaxson *Poisoned Wells: The Dirty Politics of African Oil* (2007) 21; Hausmann, R and Rigobon, R "An Alternative Interpretation of the 'Resource Curse': Theory and Policy Implications" in Davis, J.M. Ossowski, R. and Fedelino, A. (ed) *Fiscal Policy Formulation and Implementation in Oil-Producing Countries* (Washington D.C, International Monetary Fund, 2003)16.

[16] It is argued that oil and gas revenues create an impetus for Government officials and rulers to capture and control such revenues. Oil and gas revenues also mean that the Government does not rely on its citizens for taxation. The lack of taxation breaks the links of accountability between the state and the citizenry. This gives leverage to unscrupulous Government officials to act as they please. Consequently, the revenues from oil and gas are diverted by the officials to their own account or deployed in wasteful spending. See Dunning, T *Crude Democracy: Natural Resources Wealth and Political Regimes* (Cambridge, Cambridge University Press, 2008) 1-5; Pegg, S "Can Policy Intervention Beat The Resource Curse? Evidence From The Chad–Cameroon Pipeline Project", (2005) 25 *African Affairs* 105-418 at 312; Ross *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (2012) 6, 31; Dabán, T and Hélis, J *A Public Financial Management Framework for Resource-Producing Countries* (Washington DC, International Monetary Fund (2010) 9; Bauer and Quiroz "Resource Governance" (2013) 247-248; Viluales "The Resource Curse: A Legal Perspective" (2011) 197-198.

[17] Usually, the extraction of oil and gas is labour intensive and creates very few industries. Thus, oil and gas extraction creates a very limited spillover effect in terms of employment. even in Saudi Arabia, which is the largest producer of oil in the world; the sector employs less than one percent of the population. See Ross *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (2012) 6. See also Nakhle, C *Petroleum Taxation Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (New York, Routledge, 2008) 1-3.

[18] See Chapter 2 section 4 and Chapter 5 section 2.5.

[19] The objective of taxation is to raise funds to finance Governmental expenditure. Dorotinsky, W "Exploring Corruption in Public Financial Management" in in J. Edgardo Campos & Sanjay Pradhan *The Many Faces of Corruption Tracking Vulnerabilities at the Sector Level* (Washington DC, World Bank 2007) 272; Calder, J *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014) 51; Desai, D and Jarvis, M "Governance and Accountability in Extractive Industries: Theory and Practice at the World Bank" (2012) 30(2) *Journal of Energy & Natural Resources Law* 101-128 at 103. Luoga, FDAM *A Sourcebook of Income Tax Law in Tanzania* (Dar es salaam, Dar es salaam University Press, 2000) 9; Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 7; Boadway, R and Keen M "Theoretical Perspectives on Resource Tax Design" (2010) 16-18; Morse, G Williams, D and Salter, D *Davies Principles of Tax Law* (London, Sweet & Maxwell, 1996) 4; Idubor R "Appraising Taxation and the Nigerian Oil Industry". (2015) 37 *Journal of Law, Policy and Globalization* at 190.

poverty.[20] However, most developing countries face formidable challenges in the design and implementation of oil and gas fiscal regimes.[21] The next section highlights the three challenges of oil and gas tax regimes in developing countries.

1.2 The Three Challenges of Taxation Regimes

In imposing taxes, the Government faces three challenges. These are: striking the balance between maximizing revenue and attracting investments, addressing tax avoidance, tax evasion and fiscal corruption.[22]

The first major challenge for the Government is how to design a tax regime that ensures revenue maximization whilst simultaneously attracting investments.[23] In general, divergent interests characterize the relationship between the Government and IOCs.[24] While the Government interest is revenue maximization, the IOCs interest is to recover investment costs and obtain a return thereupon.[25] Similarly, the capital intensity and advanced technology required to operate the industry, imply that the Government must strive to attract more investments.[26] It also implies that without these investments, no

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[20] It is argued that resource revenues especially in Western Europe and North America led to accumulation of capital, which was later re-invested in industrialization. It also meant that these countries had sufficient revenue to invest in social services, such as roads, schools and other infrastructure Heilbrunn *Oil, Democracy and Development in Africa* (2014) 6, 14, 147; Ross *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (2012) 2; Daniel, P *Petroleum Revenue Management An Overview* (Washington, World Bank, 2002) 5; Sachs, JD and Warner, AM "The Big Push, Natural Resource Booms and Growth" 59 *Journal of Development Economics* (1999) 43-76 at 43-47. Eifert B, Gelb A and Tallroth NJ *The Political Economy of Fiscal Policy and Economic Management in Oil-Exporting Countries* (Washington DC, World Bank Africa, 2002) 4.

[21] See Chapter 3 section 3.

[22] See Chapter 2 section 34 and Chapter 4 section 3.

[23] Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 136; Duong "Partnerships with Monarchs - Two Case Studies: Case One: Partnerships with Monarchs in the search for Oil: Unveiling and Re-examining the Patterns of 'Third World' Economic Development in the Petroleum Sector" (2004) 1215 &1232; Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 16; Hogan, Sturzenegger and Tai "Contracts and Investment in Natural Resources" (2010) 2.

[24] IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 13 available at https://www.imf.org/external/np/pp/eng/2012/081512.pdf (accessed on 20 March 2014). See also Idubor et al "Appraising Taxation and the Nigerian Oil Industry" (2015) 188.

[25] Christians, A "Sovereignty, Taxation and Social Contract" (2009) 18 *Minnesota Journal of International Law* 99 at 167. IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 13. Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 16; Hogan, Sturzenegger and Tai "Contracts and Investment in Natural Resources" (2010) 1.

[26] Siu et al A *Unitary Taxation in the Extractive Industry Sector* International Centre for Tax and Development Working Paper 35 (2015) 8 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2634008 (accessed on 15 October 2016) Cleeve, E "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?" (2008) 42 (1) *The Journal of*

exploration or extraction can be undertaken.[27] In turn, this would mean loss of revenue-creating opportunies for the Government.[28]

In response to the need to attract investments and maintain the existing ones, Governments offer multiple tax incentives, such as tax exemptions, lowering tax rates and special tax treatment.[29] By offering these fiscal incentives, a Government sacrifices or waives its right to receive the potential tax revenues.[30] Consequently, these tax incentives result in reduction, deferral or non-payment of taxes that would have otherwise been payable.[31] Additionally, in most African countries these tax incentives are not only discretionary, but are also negotiated and granted in the absence of public scrutiny.[32] As a result of the lack of vigilance and oversight mechanisms, most of these fiscal incentives are extremely profligate than needed for attraction of investments.[33] Consequently, these tax incentives deny the Government both current and future revenues.[34]

Developing Areas 135 at 136-137; O'Faircheallaigh, C "Mineral Taxation in Less Developed Countries: Papua New Guinea's Balanced System" (1986) 45 (3) *The American Journal of Economics and Sociology* 291; Mullins, P "International tax issues for the resource sector" in P Daniel, M Keen and C McPherson (eds), *The Taxation of Petroleum and Minerals: Principles, Problems and Practice* (London, Routledge, 2010) 379. Karl, J "FDI in the Energy Sector: Recent Trends and Policy Issues" in Eric De Brabandere & Tarcisio Gazzini (ed) *Foreign Investment in the Energy Sector Balancing Private and Public Interests* (Leiden: Koninklijke Brill NV Vol 2 2014) 13.

[27] See Chapter 3 section 3.1.

[28] See Chapter 2 section 4 and Chapter 5

[29] See Chapter 3 section 3.1.

[30] Guttentag and Avi-Yonah "Closing the International Tax Gap" (2005) 16.

[31] Cleeve "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?" (2008) 138; Tax justice Africa *The Taxation Chain: Understanding the National and International Dimension of Taxation* (2012) 19-20 available at http://www.taxjusticeafrica.net/wp-content/uploads/2015/11/Taxation-Trainning-Module-Two-16-April-2013.pdf (accessed on 30 July 2015) See also Guttentag and Avi-Yonah "Closing the International Tax Gap" (2005) 15.

[32] Tax Justice Africa The Taxation Chain: Understanding the National and International Dimension of Taxation (2012) 20.

[33] It is argued that costs of these incentives outweigh their benefits. See Cleeve "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?" (2008)138-39; IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 14.

[34] CRC Sogema *Tanzania Per Tax Exemptions Study Final Report and Briefing Note* submitted to the Ministry of Finance of Tanzania (2013) 84 http://www.tzdpg.or.tz/fileadmin/documents/external/public_expenditure_review/Reports/PER_Tax_Exemptions_Study_Final_Report_and_Briefing_Note.pdf (accessed on 05 April 2015); Duong "Partnerships with Monarchs- Two Case Studies: Case One- Partnership with Monarchs in the Search for Oil: Unveiling and Re-examining the Patterns of Third World Economic Development in the Petroleum Sector (2004) 1241; It is estimated that tax exemptions leads to loss of revenue between 20% and 30% of the potential revenue See Guttentag and Avi-Yonah "Closing the International Tax Gap" (2005)16.

Second, while taxation is generally viewed as a contribution towards Governmental expenditure, to the IOCs taxes are costs of investment that are to avoided or minimized.[35] To this end, any elimination or reduction of tax liabilities means increased profits, dividends to shareholders and, as well as bonuses to the company's executives.[36] To ensure maximum profits, the IOCs explore the loopholes and gaps in the tax system to minimize or eliminate their tax obligations without being detected or punished.[37] For instance, the IOC may adopt variety of techniques to avoid taxes, such as abuse of double tax treaties, transfer pricing manipulation, and thin capitalization.[38] Moreover, the IOCs may engage in outright criminal conducts, such as fraud, under declaration of profits, non-filing of return and bribes.[39] Because of tax avoidance and tax evasion, Governments in oil-rich countries in Africa lose enormous sums of the "would-be tax revenues".[40]

Against this background, tax avoidance and tax evasion are not unique to the oil and gas industry.[41] Rather, they are currently a global concern. For instance, the exposure by the Panamanian law firm – Mossack Fonseca – showed that the Multi-National Corporations (MNCs) often pay little or no corporate income tax in countries where they operate.[42] Another study also shows that in Africa alone, about $50 billion worth taxable income goes untaxed annually.[43] How does Tanzania, as a new entrant in the oil and gas industry,

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[35] See Chapter 4 section 3.2.

[36] Sikkaa, P and Willmott, H "The dark side of transfer pricing: Its role in tax avoidance and wealth retentiveness" (2010) 21 *Critical Perspectives on Accounting* 342–356 at 344.

[37] See Chapter 4 section 2.2.

[38] See Chapter 3 section 3.2.

[39] See Chapter 3 section 3.3.

[40] Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all* (2013) 64.

[41] Fuest, C Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform (2013)1;

[42] International Consortium of Investigative Journalists *The Panama Papers: Politicians, Criminals and the Rogue Industry That Hides Their Cash* (3 April 2016) see details at https://panamapapers.icij.org/ (last visited on 22 July 2017). See also Readhead, A *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector* (2016) 1 available at http://www.resourcegovernance.org/sites/default/files/documents/nrgi_transfer-pricing-study.pdf (Accesed on 07 February 2017) See also Fuest *Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform* (2013)1; The effective tax rates on foreign profits of Google Inc. and Apple Inc., for example, have been reported to be 3% and 1%, respectively. See also Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 2.

[43] Mosioma, A *Panama Papers and the looting of Africa* (Tax Justice Network – Africa 2016) 8 available at http://www.taxjustice.no/uploads/documents/panama-papers-and-the-looting-of-africa.pdf (accessed on 22 July 2017) See also The Guardian Global *Africa losing billions from fraud and tax avoidance* (02 February 2015) available at https://www.theguardian.com/global-development/2015/feb/02/africa-tax-avoidance-money-laundering-illicit-financial-flows (accessed on 22 July 2017).

protect its revenue base from these evasive techniques without compromising its competitive edge to attract investments? This is one of the questions addressed by this study.

Third, the oil and gas industry is susceptible to corruption.[44] The increased Governmental intervention in the oil and gas industry for regulatory and taxation purposes creates windows of opportunity for corrupt practices.[45] Because of corruption, unscrupulous tax administrators intentionally fail to collect taxes due, short levy taxes, grant tax incentives to unqualified entities or divert revenues collected to their own account.[46] Similarly, corrupt policy makers and legislators may create favourable fiscal terms for IOCs, thus denying the Government massive potential revenues.[47] These corrupt practices are perpetuated by factors, such as uncontrolled discretionary powers to make decisions, concentration of powers in one individual and weak oversight mechanisms imposed on the exercise of public power.[48] In addition, the enormous sums of money involved in the oil and gas industry entice or motivate some Government officials to engage in corrupt practices.[49] Consequently, corruption may lead to loss of Government's potential revenues from oil and gas extraction.[50]

The inference drawn from these challenges – exorbitant tax incentives, tax avoidance, tax evasion, and corruption – is that the extraction of oil and gas resources is neither an

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[44] See Chapter 3 section 3.4 and Chapter 4 section 2.1.

[45] McPherson, C and MacSearraigh, S "Corruption in the Petroleum Sector" in J. Edgardo Campos & Sanjay Pradhan *The Many Faces of Corruption Tracking Vulnerabilities at the Sector Level* (Washington DC, The World Bank, 2007) 197-98; Johnston, D *International Exploration Economics Risks & Contract Analysis* (Tulsa, PennWell Corporation 2003) 150.

[46] Duong "Partnerships with Monarchs- Two Case Studies: Case One- Partnership with Monarchs in the Search for Oil: Unveiling and Re-examining the Patterns of Third World Economic Development in the Petroleum Sector (2004) 1244; McPherson and MacSearraigh "Corruption in the Petroleum Sector" (2007) 197.

[47] Calder, J "Resource tax administration: The implications of alternative policy choices" in Daniel, P Keen, M, McPherson C (eds) *The Taxation of Petroleum and Minerals Principles, Problems and Practice*, (London, Taylor & Francis, 2010) 319. Policy makers and legislators decide the contents of the fiscal policy and law, tax administrators give effect to tax laws and rules. See Mansfield, CY *Tax Administration in Developing Countries: An Economic Perspective* (Washington, International Monetary Fund, 1988) 181-182.

[48] See Chapter 4 section 2.2.1.

[49] See Chapter 4 section 2.1.

[50] The occurrence of the resource curse in Africa is partly attributed to corruption see Magrin G and Van Vliet, G " The Use of Oil Revenues in Africa" in Lesourne, J and Ramsay, WC (ed) *Governance of Oil in Africa: Unfinished Business* (Paris, Institut Français des Relations Internationales, 2009) 103-164 at 105.

automatic blessing nor an immutable curse.[51] Instead, positive results depend on legal framework and administrative capacity to counteract tax revenue leakage.[52] It also implies that, without counteractive measures, the Government collects only a fraction of potential tax revenues.[53] This represents a general view that the extractive industry in Africa is characterized by systemic under-taxation.[54] For example, in Africa generally, the tax per domestic product (GDP) ratio ranges between 10 and 20 percent compared to that of the OECD countries, which ranges between 30 and 40 percent.[55] This trend of under-taxation accordingly manifests itself in the oil and gas industry.[56]

The Government's failure to collect a sufficient share of revenues has far-reaching consequences. Particularly in the oil and gas sector, tax revenue leakage denies the Government funds required for development and thus hinders Government's measures to eradicate poverty.[57] This also partly explains reason why most oil-rich countries in Africa, despite the ongoing extraction of oil and gas, are still floundering in poverty.[58] In

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[51] Mehlum et al "Cursed by Resources or Institutions?" (2006) 17-20. See also Carmignani and Chowdhury *Why are natural resources a curse in Africa, but not elsewhere*? (2010) 3-4 and Ross *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (2012) 3-4.

[52] Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 1.

[53] Calder *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014) 51. See also Duruigbo "The World Bank, Multinational Oil Corporations, and the Resource Curse in Africa" (2005) 2; Le Billon *Extractive sectors and illicit financial flows: What role for revenue governance initiatives?* (2011) 1. It is argued less than half of the potential tax revenues are collected and remitted to the exchequer. See Dorotinsky, W "Exploring Corruption in Public Financial Management" in in J. Edgardo Campos & Sanjay Pradhan *The Many Faces of Corruption Tracking Vulnerabilities at the Sector Level* (Washington DC, World Bank 2007) 272; Mansfield, CY *Tax Administration in Developing Countries: An Economic Perspective* (1988) 181-182; Fjeldstad, O and Tungodden, B "Fiscal corruption: A vice or a virtue?" (2003) 31 (8), *World Development* 1459-1467 at 1459; Fjeldstad, O *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (Bergen, Chr. Michelsen Institute 1999) 1; Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (Washington, The World Bank 2012) 135; Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 6.

[54] Bauer and Quiroz "Resource Governance" (2013) 246. See also the general discussions under Chapter 3 section 3.

[55] Mascagni G, Moore M and Mccluskey R, *Tax revenue mobilization in developing countries: issues and challenges* (2014) 10. See also the data by the World Bank available at http://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS (visited on 22 July 2017). See also Auriola, E and Warltersb, M "Taxation base in developing countries" (2005) 89 *Journal of Public Economics* 625–646 at 625.

[56] For example, while Norway charges an average of 78 cents of the dollar for its oil, Cameroon charges only 12 cents. See Bauer and Quiroz "Resource Governance" (2013) 246.

[57] Although the loss of revenue is difficult to estimate, studies indicate that most developing countries miss out approximately half of the potential tax revenues. See Bauer and Quiroz "Resource Governance" (2013) 244. UNCTAD *Transnational Corporations and Export Competitiveness Report* (2002) 33-34; Dorotinsky "Exploring Corruption in Public Financial Management" (2007) 272.

[58] Africa Progress Panel Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all (2013) 14.

addition, both tax avoidance and tax evasion erode equity in taxation. It means that the IOCs enjoy the protection of the State and the infrastructure at the expense of few honest taxpayers and without contributing.[59] Hence, tax avoidance and tax evasion defeat the very basic function of taxation – contribution towards Governmental expenditures.[60] In view of these challenges, this study examines the measures that counteract tax revenue leakage in the upstream oil and gas industry in Tanzania. The next section discusses the motives for selecting Tanzania as a case study.

2 Background: Oil and Gas Exploration and Production in Tanzania

A number of factors motivated the choice of Tanzania as a case study. For one, Tanzania is new to the oil and gas sector. Exploration for oil and gas in Tanzania commenced in 1952, and natural gas was discovered at Songo Songo Island in 1974 and Mnazi Bay in l982.[61] Nonetheless, commercial extraction only began in 2004 at Songo Songo and in 2006 at Mnazi Bay.[62] In addition, there is one PSA, which is at the development stage and expected to start production soon.[63] Moreover, the construction of a 530 kilometres pipeline, meant to transport natural gas from the producing regions to the commercial capital Dar es Salaam, was completed in 2016.[64] All these facts indicate that Tanzania is an emerging natural gas producer.

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[59] Otusanya, OJ Arowomole SSA and. Adeyeye, GB "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 4 (1) *International Journal Economics and Accounting*. 93–122 at 95.

[60] Luoga *A Sourcebook of Income Tax Law in Tanzania* (2000) 7. Nakhle *Petroleum Taxation Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 8; Morse et al *Davies Principles of Tax Law* (1996) 5. Carnahan, M "Taxation Challenges in Developing Countries" (2015) 2(1) *Asia & the Pacific Policy Studies* 169–182 at 169-170.

[61] TPDC *Exploration history* available at http://www.tpdc-tz.com/upstream.php (accessed on 15 June 2017) See also the National Natural Gas Policy of Tanzania (2013)1; Maro, F *Tanzania Mainland and Zanzibar Island Socio-Economic and Environment Study* Economic and Social Research Foundation (ESRF) (2008) 16-17 available at http://www.tzonline.org/pdf/aupecdissemination.pdf; (Accessed on 25 February 2014).

[62] This was due the lack of reliable market for natural gas at the time of discovery. Tanzania Natural Gas Policy (2013) 1; Pedersen, RH and Bofin, P *The politics of gas contract negotiations in Tanzania: a review* (2015) 8-9.

[63] Development Stage (Kiliwani North-1 in Nyuni Area near Songosongo Islands) Production Stage (Mnazi Bay and Songosongo fields). See Figure 1 and Table 1.1.

[64] TPDC "Exploration history" (2017).

Moreover, Tanzania is one of the poorest countries in the world.[65] Currently, domestic revenues contribute only 63 percent of the total budget and the country is dependent on aid and grants for 12 percent and borrowing for 25 percent.[66] Consequently, Tanzania is heavily indebted with a national debt stock amounting to US$20.94 billion.[67] This indicates that Tanzania, like many other developing countries, is in a dire need for revenue to finance developmental projects and eradicate poverty.[68]

Contextually, the need for domestic revenue is now more relevant than it was in the past where developing countries depended heavily on external sources of revenue, such as foreign aid and grants.[69] Currently, developing countries are finding it difficult to raise revenue from external sources.[70] For example, in Tanzania donor funding has declined from 7% percent of GDP in 2004/5 to 1.2 percent of GDP in 2014/15.[71] In this regard, the discovery and subsequent extraction of natural gas has been hailed as good news to the Tanzanian economy.[72] Revenues from natural gas are expected to contribute to Government coffers and stimulate other sectors of the economy.[73]

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[65] UNDP ranks Tanzania 151 out of 188 countries in human development indicators. See UNDP Human Development Report *Human Development for Everyone (*2016) 204.

[66] The total budget is 29.5 trillion shillings of which domestic revenues (taxes and other sources) is 18.4 trillion shillings (62.3%), donor aid 3.6 trillion shillings (12.2%) and borrowing 7.5 trillion shillings (25.4%) see the National budget speech for the 2016/2017 financial year at page 107 avaialable at http://www.parliament.go.tz/uploads/budgetspeeches/1465399746HOTUBA%20YA%20BAJETI%20YA%20SERIKALI2016.17.pdf (accessed on 10 October 2016)

[67] As of March 2016. See the National budget speech 2016/2017.

[68] IMF *United Republic of Tanzania Selected Issues* (Washington, DC, International Monetary Fund 2016) 15. See also Mascagni, Moore and Mccluskey *Tax revenue mobilization in developing countries: issues and challenges* (2014) 10. See also IMF "Revenue Mobilization in Developing Countries" (2011) 6 available at https://www.imf.org/external/np/pp/eng/2011/030811.pdf (accessed on 15 February 2017) Desai, D and Jarvis, M "Governance and Accountability in Extractive Industries: Theory and Practice at the World Bank" (2012) 30(2) *Journal of Energy & Natural Resources Law* 101-128 at 103.

[69] Mascagni, Moore and Mccluskey, *Tax revenue mobilization in developing countries: issues and challenges* (2014) 8.

[70] Due tough conditionalities and credit worthiness. Taxation is major and stable source of Government revenue Pfister *Taxation For Investment And Development: An overview of policy challenges in Africa online: NEPAD-OECD Africa Investment Initiative* (2009)10 See also Lesage D, McNair D and Vermeiren M "From Monterrey to Doha: Taxation and Financing for Development" (2010) 28 (2): *Development Policy Review* 155-172 at 155-157.

[71] IMF *United Republic of Tanzania:Selected Issues* (2016) 15

[72] Chatham House *Africa Meeting Summary Tanzania as an Emerging Energy Producer* (2013) 6. See also Baunsgaard *United Republic of Tanzania: Selected Issues* (2014) 9 and Pedersen and Bofin *The politics of gas contract negotiations in Tanzania: a review* (2015) 28.

[73] IMF *United Republic of Tanzania Selected Issues* (2016) 15; Mascagni, Moore and Mccluskey, *Tax revenue mobilization in developing countries: issues and challenges (*2014) 10. Sikka, P "Enterprise culture

While there is optimism for revenues from natural gas extraction, the Tanzanian experience with the mining industry has not been particularly positive, and skeptics await a similar experience with oil and gas extraction.[74] By way of contextualizing, Tanzania's mining boom[75] positioned it to be the third largest producer of gold in Africa,[76] and placed it in the higher ranks of non-oil African economies in terms of foreign direct investment (FDI) receipts.[77] However, during this period the total contribution of the mining sector to the Gross Domestic Product (GDP) was only between 1.7 percent and 3.8 percent.[78] It has been argued that one of the reasons for this low contribution was that the mining companies did not pay sufficient taxes.[79] For instance, Resolute Tanzania Limited operated from 1997 to 2012, exported gold and silver worth US$ 1.5 billion, but paid corporate tax only once, three years before it closed its operations.[80] During this period, Resolute Tanzania Limited paid royalties amounting to US$ 47.3 million and other

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and accountancy firms: new masters of the universe" (2008) 21(2) *Accounting, Auditing & Accountability Journal* 268-295 at 273.

[74] Luhende, B *The Tanzanian Mining Taxation Regime and The Right To Development* Unpublished LL.M Dissertation, University of Dar es salaam (2011) 3. See also Moshi, HPB *Opportunities and Challenges for the Extraction of Natural Gas in Tanzania: The Imperative of Adequate Preparedness*, (2013) 9-11; Magai, PS and Márquez-Velázquez, A "Taxation in the Tanzanian gold sector: Overview of impacts and possible solutions" (2013) 30 (2) *Development Southern Africa* at 283-287.

[75] The mining boom is between 2000-2007, see the Presidential Committee of inquiry into the Mining Sector Report "The Bomani report" (2008) at 29-33. Available at http://www.revenuewatch.org/training/resource_center/report-tanzanian-presidential-mining-review-committee-advise-Government-min (Accessed on 29 April 2014).

[76] ICMM Report Tanzania: Building Bridges on Mining Policy The Challenge of Mineral Wealth: using resource endowments to foster sustainable development (2009) at 17. Available at http://www.icmm.com/document/701 (accessed 10 January 2014).

[77] See UNCTAD, Trade and Development Report Transnational Corporations and Export Competitiveness (2008) 108, See also Luhende The Tanzanian Mining Taxation Regime and The Right To Development (2011) 3.

[78] The Bomani Report (2008) 29-33. See also Forster, JJ and Bills, JH, "Comparison of the impact of the fiscal regime on gold projects in Tanzania and Burkina Faso" (2002) 111(3) *Transactions of the Institution of Mining and Metallurgy* 195–199 at 197-198; Hilson, G and Maconachie, R "Good Governance" and the Extractive Industries in Sub-Saharan Africa" (2008) 30(1) *Mineral Processing and Extractive Metallurgy Review* 52-100 at 90.

[79] The Bomani Report (2008) 29-33. See also Forster and Bills "Comparison of the impact of the fiscal regime on gold projects in Tanzania and Burkina Faso" (2002) 197-198. Hilson and Maconachie "Good Governance" and the Extractive Industries in Sub-Saharan Africa" (2008) 90.

[80] Commissioned in 1998 and was officially closed in February 2014.In its 15 years operations, the mine produced 2.2 million troy ounces of gold and 207,803 troy ounces of silver. See the Tanzania Minerals Audit Agency *Annual Report 2014* (2015) 2 available at http://www.tmaa.go.tz/uploads/ANNUAL_REPORT_2014.pdf. (accessed 20 November 2016) Another report quotes the total revenues generated by the mine to be US$ 3.5 billion. This indicates the inconsistency that may occur between the Government and other independent organizations. See Readhead, A *Transfer Pricing in the Extractive Sector in Tanzania* (2016) 9.

Government taxes and levies amounting to US$ 82.5 million.[81] All these payments only amounted to 8.6 per cent of the total revenues generated.[82]

Moreover, evidence shows that Tanzania is not a corruption free country. For instance, the corruption perception index ranks Tanzania as number 116 out of the 176 countries in terms of perceived corrupt practices.[83] The threat of corruption in the extractive industry is real. An example is the case of *Basil P. Mramba & Daniel Yona v R*[84] in which two former Ministers were convicted for abuse of office when granting tax exemptions and occasioning loss to the Government.[85] Similarly, the Government has suspended the top management of Tanzania Petroleum Development Corporation (TPDC) on allegations of violating procurement laws and conflict of interests.[86]

Furthermore, Tanzania has tax-to-GDP ratio of 12.4% compared to an average of 16.8% in Sub Sahara Africa.[87] In addition, while the Tanzania has the tax capacity of 15.2 percent of GDP, the actual tax collections for the period between 2011 and 2013 was only 11.9 percent of the GDP, thus under-taxation by 3.3 percent of the GDP.[88] All these facts indicate that Tanzania has challenges on imposing taxes generally and the complexities of the oil and gas industry may further exacerbate this problem.[89]

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[81] Tanzania Minerals Audit Agency *Annual Report 2014* (2015) 2.

[82] Calculation by the author. Total revenues earned by Resolute is US$ 1.5 billion against revenues reveived by the Government (royalties and taxes) US$ 128.9 million.

[83] Corruption perception index 2016 available at www.transparency.org (accessed on 10 March 2017)

[84] High Court of Tanzania Consolidated Criminal Appeals Nos 96 & 113 of 2015

[85] The contract was signed against the advice by the Government Negotiating Team (GN) and was not vetted by A.G as required by the law. Furthermore, tax exemptions were granted illegally and contrary to the advice given by TRA.

[86] Order dated 26 August 2016 from the Board of Directors Suspended people include the MD James Mataragio, Upstream Sector director Kelvin Komba George Seni, Director of Finance George Seni, Internal audit and procurement. http://ippmedia.com/en/news/board-warps-tpdc-management-directors-suspended (accessed on 18 September 2016)

[87] Tanzania has tax-to-GDP ratio of 12.4% compared to an http://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS (accessed on 05 March 2017) OECD Observer Africa's tax system: A survey available at http://oecdobserver.org/news/fullstory.php/aid/3510/Africa_s_tax_system:_A_survey.html (accessed 22 July 2017). See also Ng'eni, FB, "Tax Administration in Tanzania: An Assessment of Factors Affecting Tax Morale and Voluntary Tax Compliance towards Effective Tax Administration" (2016) *International Journal of Finance and Accounting*, 90-97 at 90; IMF *United Republic of Tanzania Selected Issues* (2016) 17 & 19.

[88] IMF *United Republic of Tanzania Selected Issues* (2016) 24.

[89] Tordo S, Tracy, BS and Arfaa, N *National Oil Companies and Value Creation* (Washington DC, World Bank, 2011) 1.

Similarly, there are several incidences of tax avoidance in the extractive industry generally. For instance, in *African Barrick Gold Plc v Commmissioner General TRA,*[90] a parent company paid dividends to its shareholders in London while its subsidiaries in Tanzania, which were the sole source of income, were declaring losses.[91] Furthermore, the Court of Appeal in *Commissioner General TRA v Pan African Energy Tanzania Ltd* held that there was no provision of the law imposing withholding taxes on services rendered outside Tanzania by a non-resident. [92] In its judgment, the Court indicated that although this lacuna might encourage tax avoidance but it was not for the Court to amend the law. Consequently, the revenue authority failed to collect $ 1.7 million which was the tax assessed d the amount of tax assessed.[93] In addition, the recent $55 billion takeover of the British Gas group by the Royal Dutch Shell has raised serious issues as regards the imposition of capital gains tax. [94] The Tanzania Revenue Authority subjected this transaction to capital gains tax to the tune of $ 502 million. [95] This tax liability is strongly contested by British Gas group.[96]

All these facts indicate that Tanzania is an ideal case study. As such, it is at particular risk to succumbing to the resource curse. On the upside, Tanzania is also particularly well placed to learn from its more experienced counterparts. It thus may be able to respond to identified challenges. Thus, it is imperative to examine and evaluate the Tanzania's oil and gas tax regime to establish how the country responds to these tax-related challenges. It is also important to examine the fundamental principles of oil and gas taxation, identify the major factors causing tax revenue leakage, and explore the remedial measures.

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[90] Tax Revenue Appeals Tribunal Appeal No. 16 of 2015 (unreported).

[91] Dividends were paid back-to-back for four years 2010 to 2014 amounting to U$D 818,431,285, The Tax Tribunal held that this was a tax avoidance scheme and the dividends were subject to payment of withholding taxes.

[92] Civil Appeal No. 15 of 2015.

[93] *Commissioner General TRA v Pan African Energy Tanzania Ltd* (2015).

[94] In this transaction, Royal Dutch Shell acquired 60 percent shares in BG Group. See Erick Kabendera Taxman freezes BG Group's accounts in $500m tax row Posted Saturday, July 9 2016 at 13:14, available at http://www.theeastafrican.co.ke/news/Taxman-freezes-BG-Group-s-accounts-in--500m-tax-row/2558-3287530-rxxb58/index.html (accessed on 22 July 2017). However, at this time BG accounts had only $5 million (1%).

[95] See Erick Kabendera "Taxman freezes BG Group's accounts in $500m tax row" (2016).

[96] Refer to an application between BG Tanzania Ltd v Commissioner General TRA Application No. 21 of 2016.

3 Objectives, Research Question and Significance of Study

The major aim of this study is to examine how Tanzania, as new entrant in the oil and gas industry, protects its revenue base from tax revenue leakage.[97] In doing so, this study analyses and evaluates the legislative and administrative measures meant to close the gaps and loopholes in tax system to counteract tax avoidance, tax evasion and fiscal corruption.[98]

To achieve the aim of the study, this study has the following specific objectives: First, it aims to examine the main legal assumptions underlying the ownership and control of oil and gas *in situ* in Tanzania. Second, it aims to identify the procedures for the grant of exploration and production rights, and institutions mandated to grant these rights. Third, it aims to scrutinize the methods used by the Government to create revenue from the oil and gas industry. Fourth, it aims to identify the factors that cause tax revenue leakages and recommends remedial measures.

This study uses Tanzania as a case study to raise several issues, which are of concern to other oil-rich countries in Africa. These issues need immediate response. In doing so, the study provides a general understanding of how the oil and gas industry operates and how taxes are imposed. The study also identifies the factors that are likely to cause tax revenue leakage and recommends remedial measures. Similarly, the study highlights the circumstances that make it possible for the IOCs to avoid or evade taxes without being detected or punished. In addition, the study identifies the factors that motivate or create the window of opportunity for fiscal corruption in the oil and gas industry. Thus, the study contributes to the existing knowledge and debates on tax-related challenges in the oil and gas industry. For this reason, the study sets Tanzania as a model that can be replicated by other African countries. By using the analytic tools identified in this study, oil rich African countries can estimate the likely financial benefits from oil and gas extraction.[99]

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[97] Mullins "International tax issues for the resource sector" (2010) 388. Martinez-Vazquez, J and Bird, RM "Sustainable development requires a good tax system" in Bird, RM *Development: The Weakest Link? Essays in Honor of Roy Bahl* (2014) 2.

[98] Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all* (2013) 63. See also Pfister *Taxation for Investment and Development: An overview of policy challenges in Afric*a (2009) 5-7 Mullins "International tax issues for the resource sector" (2010) 388.

[99] See Chapter 3 and chapter 4.

In addition to setting out the agenda for reforms by policy makers and legislators, the study also hints out the areas requiring further research.

Generally, the literature on tax revenue leakage in the oil and gas industry has taken a rather disjointed approach. For one, the oil and gas taxation discourse uses the canons of taxation – efficiency, stability, convenience, equity and risk sharing – to evaluate and gauge the efficacy of different fiscal instruments.[100] Conversely, as demonstrated by this study, the occurrence of the resource curse is not a result of lack of legal framework for taxation but rather existence of factors that negate the spirit of tax laws.[101] For instance, developing countries often have fiscal regimes similar to those of developed countries, yet developing countries collect only a portion of the potential taxes.[102] This is an indication that the best fiscal terms do not guarantee optimal revenues to the Government. Instead, the level of Government's revenue depends on how tax laws and the mechanisms for fighting revenue leakages are enforced.[103]

Secondly, the resource curse literature uses an econometric analysis – dependence on the resource revenue, economic growth, poverty levels, peace and stability – to evaluate whether the country benefits from its oil and gas resources.[104] The resource curse study concludes that most Governments have failed to obtain appropriate share of the revenue

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[100] Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008)12-13. See also Mgaya, RBT *Petroleum Taxation: A Critical Analysis of Oil and Gas Fiscal Regime in Tanzania* Msc dissertation Robert Godon University of Aberdeen (2014) 53-58. Avaialable at https://www.academia.edu/8782336/Oil_and_Gas_Fiscal_Regime_in_Tanzania (Accessed on 22 July 2017). , Amoako-Tuffour J and Owusu-Ayim J "An Evaluation of Ghana's Petroleum Fiscal Regime" (2010) 4 *Ghana Policy Journal* 7-34 at 26-29. Alalade, CB *The economic Performance of International Oil Companies in Nigeria* PhD Study, University of Bournemouth (2004) 90 available at http://eprints.bournemouth.ac.uk/457/1/Cornelius_Alalade.pdf (accessed 14 July 2017); Daniel et al *Evaluating Fiscal Regimes For Resource Projects: An Example From Oil Development* IMF Conference On Taxing Natural Resources: New Challenges and New Perspectives (2008) 9; Johnston, D "How to Evaluate the Fiscal Terms of Oil Contracts" in in *Escaping the Resource Curse*, Humphreys et al eds. (New York, Columbia University Press, 2007). 57-65; Humphreys et al "Introduction: What is the Problem with Natural Resource Wealth?" (2007) 2-3; Hogan, L. *International Minerals Taxation: Experience and Issues*, draft paper for IMF Conference on Taxing Natural Resources, (September 25 2008) 15-20. It also notable that another study identifies four factors that influence the design of Government oil and gas fiscal policy these factors include the dependence on oil revenue, stage of development of the oil industry, Government's financial position and the extent of state participation. See Ghebremusse, SZ *Assessing the Petroleum Fiscal Regimes of Nigeria, Ghana, and Cameroon*, LL.M Dissertation, University of Toronto (2014) 10-15.

[101] See Chapter 4 and Chapter 6.

[102] Mansfield *Tax Administration in Developing Countries: An Economic Perspective* (1988) 181-182.

[103] See Chapter 4 section 3 and Chapter 6

[104] General discussion of the resource curse by Ross, ML *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (2012) 1-3

commensurate with the extracted resources.[105] The resource curse discourse identifies corruption as one of the major factors for the occurrence of the resource curse.[106] One of the notable shortcomings of the resource curse discourse is that it gives too little weight on technical aspects of the oil and gas industry.[107] It ignores the fact that the relationship between the Government and the IOC is that of a willing-buyer-willing-seller.[108] For the IOCs, it means they can use every opportunity available to them to reduce their tax obligations. Similarly, the resource curse discourse concentrates on measures such as transparency and governance initiatives.[109] While transparency has the potential to minimize corruption in the oil and gas industry, it has its shortcomings. For instance, transparency measures focus on revenue paid to the Government rather than what ought to be paid.[110] Consequently, the IOCs have been compliant with these transparency initiatives, yet only a fraction of potential tax revenues accrue to the Government.[111]

As indicated by the discussion above, remedial measures to the problem of tax revenue leakage have taken a rather disjointed approach. While the taxation discourse concentrates on measures closing the gaps and loopholes in the law, such as rules on thin capitalization and transfer pricing,[112] the governance measures focus on accountability and transparency.[113] By contrast, this study argues that the channels of tax revenue leakage – exorbitant tax incentives, tax avoidance, tax evasion and fiscal corruption – are interrelated. The unifying factor for these channels is that they all result in reduction or loss of Government potential tax revenues.[114] Since this study aims at identifying

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[105] Calder *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014) 51; See also Mike Pfister Taxation for Investment and Development: An overview of policy challenges in Africa (2009) 10.

[106] Magrin and Van Vliet "The Use of Oil Revenues in Africa" (2009) 105.

[107] Ross *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (2012) 1-3.

[108] Ross *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (2012) 1-3.

[109] See Chapter 4 section 3.1.1.

[110] Tax Justice Network *Taxation and Human Rights* second quarter, volume 2 (2011) 11. Available at http://www.taxjusticeafrica.net/wp-content/uploads/2015/11/Africa-Tax-Spotlight-6th-edition.pdf (accessed on 05 March 2017).

[111] Tax Justice Network *Taxation and Human Rights* (2011) 11.

[112] Jansky, P and Prats, A "International Profit-Shifting out of Developing Countries and the Role of Tax Havens" (2015) 33 (3) *Development Policy Review* at 275.

[113] Chapter 4 sections 3.1 and 3.2.

[114] Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012) 135; Calder, J "Resource tax administration: Functions, procedures and institutions" (2010) 340; Ross *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (2012) 4. Duong "Partnerships with Monarchs- Two Case Studies: Case One- Partnership with Monarchs in the Search for Oil: Unveiling and Re-examining the Patterns of Third World Economic Development in the Petroleum Sector" (2004) 1242.

measures to counteract tax revenue leakage in general, these remedial measures are combined. [115]

This study accepts that taxation should be considered as a process from policy formulation, legislation, and contract negotiation to tax administration.[116] In doing so, this study argues that four factors, namely tax avoidance, tax evasion, tax incentives and fiscal corruption are responsible for revenue leakage.[117]Accordingly, this study concludes that an ideal fiscal regime is the one that closes the gaps and loopholes in the tax system as well as governance measures that limit the windows of opportunity for corrupt practices and creating disincentives to corruption. By taking this approach, this study identifies and addresses issues not dealt with by each individual approaches identified above and hence fills the gap in the literature by examining how technical and governance aspects of oil and gas taxation can be merged.

This study reduces the gaps in insight and responds to the challenges plaguing many oil-rich countries in Africa. It reflects on how to address tax revenue leakage: how are extraction rights granted? How is Government revenues created? How the Government strikes a balance between the need to attract investments and maximization of Government revenue? What are the factors that are likely to cause tax revenue leakage? What are the circumstances that make it possible for the IOCs to avoid taxes without being detected or punished? How does the Government address tax revenue leakage? How effective are these remedial measures?

4 Research Methodology

A conceptual analysis is followed in studying the problems encompassed in the research question. This study uses the resource curse theory to evaluate tax-related challenges in the oil and gas industry. It does so in relation to Africa generally, and draws specific

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[115] The problem of tax revenue leakage requires a global action. See Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 3.

[116] See Chapter 3 section 2.

[117] These factors are identified and discussed by Cobham. However, the Cobham's discussion is generic and this study applies these factors specifically in the upstream oil and gas industry. Cobham, A "Tax evasion, tax avoidance and development finance" (2005) 8-10,16. See also Otusanya "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 103.

lessons for Tanzanian upstream oil and gas industry, specifically. The resource curse study shows the symptoms of the problem, such as poor development, abject poverty, low revenues and slow economic growth.[118] To respond to the challenges raised by the resource curse study, the study examines the fundamental principles of oil and gas taxation. The study describes the upstream oil and gas sector and highlights the tax-related challenges it poses. The description covers issues such as ownership and control, geology, value chain, fiscal instruments, fiscal incentives and classification of fiscal regimes. The aim of this description is to identify factors that may cause loss of potential tax revenues – referred to as "tax revenue leakage". Moreover, the study applies this understanding in the specific context of Tanzania to analyze the regulatory and administrative practice for the upstream sector, on how to grant extraction rights, how to tax and how to strike the balance between attracting investments and maximizing revenues

In addition, the study adapts the Cobham's model of tax revenue leakage to examine how Tanzania counteracts tax revenue leakage.[119] The analysis of Cobham's models identifies three factors underlying the occurrence of tax revenue leakage.[120] First, the existence of gaps and loopholes in the tax system that permits certain transactions to go untaxed.[121] The IOCs usually exploit loopholes and gaps in the tax system to reduce, defer or eliminate their tax obligations.[122] In addition, the IOCs sometimes adopt illegal means, such as non-filing of returns, underreporting transactions and misrepresentation of transactions to evade taxes.[123] Second, certain factors, such as discretionary powers and monopolization of power by one individual, create a window of opportunity for corrupt

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[118] Humphreys et al "Introduction: What is the Problem with Natural Resource Wealth?" (2007) 2-3. See also Hogan, Sturzenegger and Tai "Contracts and Investment in Natural Resources" (2010) 1; Gelb, AH. *Oil Windfalls: Blessing or Curse? (*New York: Oxford University Press 1988) 7-9; Mikesell "Explaining the resource curse, with special reference to mineral-exporting countries" 1997). 191.

[119] The Cobham's channels of tax revenue leakage include income from the underground economy, profit shifting, holding assets offshore, tax competition (exemptions) and non-payment of taxes by taxpayers. See Cobham, A "Tax evasion, tax avoidance and development finance" Working Paper Number 129 (2005) 8-10,16 available at http://www3.qeh.ox.ac.uk/pdf/qehwp/qehwps129.pdf (accessed on 15 August 2014) The modified version of cobham's channels includes five factors namely tax evasion, tax avoidance, fiscal corruption, fiscal incentives and non-payment of taxes due. See Otusanya et al "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 102.

[120] Cobham "Tax evasion, tax avoidance and development finance" (2005) 8-10, 16.

[121].See Chapter 4 section 2.2.2.

[122] See Chapter 3 section 3.2.

[123] See Chapter 3 section 3.3.

practices.[124] Third, factors such as the benefits from corruption and the low probability of being detected and punished motivate Government officials to engage in corrupt practices.[125]

The identification of the nature of the problem of tax revenue leakage facilitates the design the effective counteractive measures. It also helps shape how such remedial measures may succeed in addressing the problem. In the light of the underlying factors for the tax revenue leakage, this study proposes four remedial measures namely closing windows of opportunity for corrupt practices, removing incentives for corruption, closing gaps and loopholes in the tax system and mechanisms for prevention, detection and punishment of tax avoidance and tax evasion.[126] These remedial measures are used as analytic tools to examine and evaluate how Tanzania addresses tax revenue leakage in its oil and gas industry.[127] Each of these tools is firstly examined and analysed in isolation and then applied as a benchmark for evaluating the Tanzanian fiscal framework.

5 Scope and Delimitations of the Study

Although the challenges facing African countries in managing oil and gas resources cut across the spectrum, this study focuses on Tanzania as a case study. It is important to note at this juncture that Tanzania is a union of two countries namely Tanganyika (now referred as Mainland Tanzania) and Zanzibar.[128] While oil and gas form part of the union matters, each constituent part of the Union has its regulatory framework.[129] This study is confined to Mainland Tanzania. Therefore, reference to Tanzania in this study, unless the context suggests otherwise, means Mainland Tanzania.

Similarly, while the oil and gas industry has three segments, namely upstream, midstream and downstream, this study focuses on the upstream sector only.[130] The reason for this

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[124] See Chapter 4 section 2.2.1.

[125] See Chapter 4 section 2.1.

[126] See Chapter 4 section 3

[127] See Chapter 6.

[128] Article 2 & 4 of the Constitution of Tanzania 1977

[129] These are among the list of 22 union matters enumerated in the First Schedule to the Constitution. Articles 4 & 64(1) of the Constitution vest the National Assembly with legislative powers to all Union Matters and non-union matters for Tanzania mainland

[130] The segments are discussed in Chapter Two.

choice is that the law in Tanzania concerning taxation and regulatory framework separates the upstream operations from midstream and downstream operations.[131] It is in this regard the taxation for upstream and downstream operations are treated differently. In addition, while in theory taxation is defined as compulsory contribution to the Government, in the oil and gas industry, there are several levies, such as royalties, bonuses, profit sharing and dividends, which do not technically qualify as taxes.[132] This study uses the term "fiscal" and "taxation" interchangeably to encompass all tax and non-tax instruments.

The study highlights several factors that may lead to tax revenue leakage and the corresponding responses. There are several remedial measures for tax avoidance but this study focuses only on legislative and administrative measures addressing tax avoidance and tax avoidance. The judicial and international counteractive measures, though highlighted, are beyond the scope of this study. The study also discusses accountability measures, such as transparency, oversight mechanisms and sanctions.

The major constraint to this study is that only two of the twenty-six Production Sharing Agreements (PSAs) which are at the production stage. This implies that the current taxes from the industry are not significant.[133] In addition, the negotiability of certain fiscal terms, such as bonuses, cost recovery, profit sharing, and State participation means that there is no standard rate applicable.[134] It implies that each PSA may have its own specific rate. Furthermore, tax avoidance, tax evasion and corruption are clandestine activities and thus, difficult to establish the actual revenue lost.[135] For these reasons, the study relies on information available in the public domain.

6 Course of Inquiry

The major aim of this study is to examine how Tanzania, as a new entrant in the oil and gas industry, protects its revenue base from exorbitant tax incentives, tax avoidance and

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[131] Section 65 K(4) Income Tax Act 2004.

[132] Nakhle Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow (2008) 12-13.

[133] See Chapter 5 section 2.5.

[134] See Chapter 5 section 2.5.

[135] Otusanya et al "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013) 318.

corruption. The purpose of this introductory chapter is to contextualize the problem. The remainder of this study is divided into three parts. Part I provides a general context of issues and challenges addressed in this study. It deals with conceptualizing tax revenue leakage in the upstream oil and gas sector. To achieve this objective, Part I is divided into three chapters. Chapter 2 provides a general introduction of oil and gas taxation. It describes the formation and occurrence of oil and gas, explains the different terminologies used, examines the question of ownership of oil and gas resources *in situ*, and analyzes the value chain in the oil and gas industry. It also highlights general principles and concepts of oil and gas taxation. It covers issues such as tax-related features of the oil and gas industry, fiscal instruments, the classification of fiscal regimes around the world and fiscal incentives. This theoretical analysis sets the framework for analyzing the Tanzanian oil and gas fiscal regime.

Chapter 3 describes the concept of tax revenue leakages, and then proceeds to analyze the factors that may lead to tax revenue leakages. This analysis forms a basis for evaluating the Tanzanian oil and gas fiscal regime to establish whether it sufficiently responds to the challenges.

Chapter 4 analyses the legal and social context within which tax revenue leakage occurs. The aspects covered include the actors in the tax system, the structural gaps in the tax system, the conducts of the identified actors and their impact on revenue collection. The chapter also identifies five legal measures that can be adopted to counteract tax revenue leakage. These measures aim at closing the window of opportunity for corrupt practices, removing incentives for corruption, closing gaps and loopholes in the tax system, criminalization of tax evasion and administrative measures to prevent, detect and punish tax avoidance and tax evasion.

Part II applies the analytical tools developed under Part I to examine and evaluate the Tanzanian upstream oil and gas taxation. Part II is divided into two chapters. Chapter 5 explores legal framework under which oil and gas operations are carried out in Tanzania. It also analyzes the concept of production sharing agreement (PSA) as mechanism of creating Government revenue in Tanzania. The chapter examines different fiscal and non-fiscal instruments, such as royalties, bonuses, State equity participation, profit-based taxes, production sharing, rental fees as well as indirect taxes. It also highlights tax incentives, such as royalty and tax exemptions, accelerated cost recovery, relief from double taxation and fiscal stabilization. The chapter analyses the legal and institutional framework for tax assessment, tax audits, tax collection and management.

Chapter 6 examines and evaluates remedial measures that have been adopted by the Government of Tanzania to address tax revenue leakage. The remedial measures examined include the anti-corruption regime that criminalizes and sanctions corrupt practices. It also covers oversight mechanisms that close the windows of opportunity for corrupt practices. The chapter also examines the anti-tax avoidance measures that close gaps and loopholes in the tax system as well as the administrative capacity to detect, prevent and punish tax avoidance and tax evasion.

Part III consists of only Chapter 7, which provides a summary of main issues highlighted by the study. It also provides a conclusion on how the Government prevents tax revenue leakage. Finally, it recommends the best way forward.

PART I: CONCEPTUALIZING TAX REVENUE LEAKAGE IN THE UPSTREAM OIL AND GAS INDUSTRY

The first chapter of this study introduced the research problem and question. This part I provides a general understanding of the concept of tax revenue leakage. To contextualize tax revenue leakage in the upstream oil and gas industry, this part is covers three major issues. First, it provides a general understanding of the upstream oil and gas taxation. This covers issues such as geology and occurrence of oil and gas, value chain creation, tax-related features of the oil and gas industry, fiscal instruments and classification of fiscal regimes around the world. Second, it examines the academic discourse on the concept of tax revenue leakage. In doing so, it defines tax revenue leakage and identifies the factors that are likely to cause tax revenue leakage. Third, it analyses the legal and social context within which tax revenue leakage occurs. It also identifies and examines the different options available to counteract tax revenue leakage.

CHAPTER TWO: OIL AND GAS TAXATION: PRINCIPLES AND CONCEPTS

1 Introduction

This chapter provides a general introduction of the upstream oil and gas taxation. It describes the geological and chemical aspects pertaining to the formation and occurrence of oil and gas and the different terminologies used. In addition, the chapter analyzes the value chain in the oil and gas industry. The value chain –processes of search for, extraction of oil and gas, processing, manufacturing and selling of final products– identifies the points at which either *costs* are incurred or a *profit* is made.[1] Thus, the value chain informs the Government on how and to whom the extraction rights should be granted, how to supervise and monitor oil and gas operations and identify incidences where taxes can be imposed.[2]

Likewise, for investors, the value chain helps them to identify not only the timing of the profits and cost recovery, but whether the project, as a whole, is profitable.[3] The chapter also provides a theoretical exposition of the general principles and concepts of oil and gas taxation. It discusses tax-related features of the oil and gas industry, such as ownership of oil and gas resources *in situ*, the concept of economic rents, uncertainties of the oil and gas industry and the involvement of International Oil Companies (IOCs). It also provides a discussion of a variety of fiscal instruments, the classification of fiscal regimes around the world and fiscal incentives.

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[1] Tordo S, Tracy BS, and Arfaa N *National Oil Companies and Value Creation* (Washington DC, World Bank, 2011) 1.

[2] Viñuales, JE "The 'Resource Curse' in Legal Perspective" (2011) 17 *Global Governance* 197-212. at 201; Omorogbe, Y and Oniemola, P "Property Rights in Oil and Gas under Domanial Regimes" in A McHarg, B Barton, B Bradbrook and L Godden (eds), *Property and the Law in Energy and Natural Resources* (Oxford, Oxford University Press 2010) 115; Collier, P "Principles of Resource Taxation for Low-Income Countries" in Daniel, P Keen, M, McPherson C (eds) *The Taxation of Petroleum and Minerals Principles, Problems and Practice*, (London, Taylor & Francis, 2010) 75; Bret-Rouzaut, N and Favennec J *Oil and Gas Exploration and Production Reserves, costs, contracts* (Paris, Editions Technip, 2011) 171

[3] Tordo, Tracy and Arfaa *National Oil Companies and Value Creation* (2011) 1. See also Nathan−MSI Group *Effectiveness and Economic Impact of Tax Incentives in the SADC Region* (2004) 3-5 available at http://pdf.usaid.gov/pdf_docs/Pnacy929.pdf (accessed on 03 May 2015).

The general objective of this theoretical analysis is to establish the basis for evaluating the Tanzanian oil and gas taxation regime and to set the framework for analysis in the later chapters. The discussion on the general features of oil and gas industry follows.

2 General Understanding of the Oil and Gas Industry

The word "petroleum", a generic term for oil and gas, owes its origin from two Greek words *petra* ("meaning rock") and *oleum* ("meaning oil").[4] These oil rocks consist of naturally occurring hydrocarbon-rich fluids ("hydrogen and carbon") and associated non-hydrocarbon substances ("oxygen, nitrogen and sulphur").[5] Geologically, these rocks are formed as a result organic materials that were accumulated and deposited below the earth's surface million years ago, decomposing and forming hydrocarbon.[6] Subsequently, these hydrocarbons were, due to high pressure and temperatures, compressed and transformed into sedimentary rocks containing petroleum.[7]

These sedimentary rocks can be composed of both porous and easily permeable sedimentary layers or tight and impermeable rock made up of extremely small pore sizes.[8] The petroleum produced from permeable rocks is referred to as "conventional" petroleum while the one from impermeable rocks is referred to as "unconventional" petroleum.[9] The

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[4] *petra* (meaning rock) and *oleum* (meaning oil) Hyne, NJ *Nontechnical Guide to Petroleum Geology, Exploration, Drilling, and Production* 2 ed (Tulsa, PennWell Corporation 2001) 1. Even though history shows that, as far as 400 BC, petroleum substances existed and were applied for various uses, however the ground-breaking invention of petroleum as a major energy source occurred in 1859, when Colonel Edwin Drake, struck oil in Titusville, Pennsylvania, USA. See Yergin, D *The Prize: The Epic Quest for Oil, Money and Power* (New York, Simon & Schuster, 1991) 26-31; Petrie, TA *The Oil and Gas Industries- An Overview* (1993) 3, Deutsche Bank *A guide to the oil & gas industry* (2013) available at http://www.wallstreetoasis.com/files/DEUTSCHEBANKAGUIDETOTHEOIL%EF%BC%86GASINDUSTRY-130125.pdf (accessed on 02 June 2015)

[5] Taverne, B *Petroleum, Industry and Governments: A Study of the Involvement of Industry and Governments in the Production and Use of Petroleum* 2 ed (Alphen aan den Rijn Kluwer Law International, 2008) 1. See also Lowe, JS *Oil and Gas Law in a Nutshell* 6th edn (West Publishing, 2014).1

[6] Devold, H *Oil and Gas Production Handbook: An introduction to oil and gas production* (Olso, ABB 2009) 22.

[7] Lowe *Oil and Gas Law in a Nutshell* (2014) 3; Abdel-Aal, H.K *Petroleum and Gas Field Processing* (2003) 18; Devold *Oil and Gas Production Handbook: An introduction to oil and gas production* (2009) 22.

[8] Ratner, M and Tiemann, M *An Overview of Unconventional Oil and Natural Gas: Resources and Federal Actions* Congressional Research Service (2015) 2 available at https://fas.org/sgp/crs/misc/R43148.pdf (accessed 22 February 2017).

[9] Unconventional petroleum is classified as "not occurring naturally" See Ratner and Tiemann *An Overview of Unconventional Oil and Natural Gas: Resources and Federal Actions* (2015) 2. Le Leuch, H "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" in Andreas

tightness and impermeability of sedimentary rocks means that oil and gas can only be extracted by using special methods as opposed to ordinary drilling.[10] The methods of extracting unconventional petroleum, such as hydraulic fracturing are costly and may have negative impacts on the environment.[11] For this reason, it considered very expensive, and thus uneconomical, to extract the unconventional petroleum.[12] In its natural state in the underground reservoirs, petroleum may occur in gaseous form or liquid form.[13] The next section discusses the occurrence of petroleum.

2.1 Crude Oil and Natural Gas

The petroleum occurring in liquid form is referred to as crude oil.[14] The extraction of crude oil begins by lifting up the hydrocarbon substance from the underground petroleum reservoir.[15] Then, these hydrocarbon substances are taken through a refining process to produce different products, such as gasoline, lubricants, kerosene, jet fuel, diesel, residual fuel oils as well as feedstock.[16] The unit used to measure the volumes of crude oil is a barrel (bbl) which is equivalent to 42 U.S gallons or 158.987 litres.[17]

Goldthau (ed) *The Handbook of Global Energy Policy* (John Wiley & Sons, Ltd. Ebook 2013) 141; Inkpen, A and Moffett, MH *The Global Oil and Gas Industry: Management, Strategy and Finance* (Tulsa, PennWell Corporation, 2011) 310.

[10] Since it is impossible to recover unconventional petroleum through ordinary drilling and pumping, the method extraction method used is artificial fracturing of the sedimentary rocks ("source rocks"). See Ratner and Tiemann *An Overview of Unconventional Oil and Natural Gas: Resources and Federal Actions* (2015) 2. See also Gordon, D *Understanding Unconventional Oil* (Washington, D.C: Carnegie Endowment for International Peace 2012) 6.

[11] Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013)141.

[12] Ratner and Tiemann An Overview of Unconventional Oil and Natural Gas: Resources and Federal Actions (2015) 1.

[13] Kirk-Othmer (ed) *Encyclopedia of Chemical Technology* (John Wiley & Sons 2014) 5.

[14] Wheeler, R R. *Oil from Prospect to Pipeline* (4th Ed) (Houston: Gulf Publishing Company (1981) 1. Brock et al *Petroleum Accounting: Principles, Procedures & Issues* (6th ed) (North Texas State University 2007)2.

[15] Hyne *Nontechnical Guide to Petroleum Geology, Exploration, Drilling, and Production* (2001) 7.

[16] Wheeler *Oil from Prospect to Pipeline* (1981) 1-2; Hyne *Nontechnical Guide to Petroleum Geology, Exploration, Drilling, and Production* (2001) 7.

[17] Hyne *Nontechnical Guide to Petroleum Geology, Exploration, Drilling, and Production* (2001) 7. See also Brock et al *Petroleum Accounting: Principles, Procedures & Issues* (2007) 3.

On the other hand, the petroleum occuring in gaseous form is referred to as natural gas.[18] In its natural condition, natural gas may occur simultaneously with crude oil. This type of natural gas is produced as a by-product of crude oil ("associated gas").[19] Conversely, natural gas may occur, as it is the case in Tanzania, alone and independent of crude oil ("non-associated gas").[20] Another form of natural gas is the one occurring in a reservoir that contains a semi-liquid hydrocarbon called condensate.[21] The unit of measurement of volumes natural gas is cubic foot (cft) which is equivalent to 28.3 litres.[22]

For a long time, the gaseous form of natural gas impeded its use as a source of energy.[23] Natural gas, unlike crude oil, was not easily transportable by ship, train or road.[24] In addition, its gaseous form means that it had to converted into liquid form before being transported.[25] The process of converting natural gas into liquid form ("liquefaction") is expensive.[26] This equally hampered by the fact the liquefied natural gas (LNG) could only be transported through pipelines, thus difficult to reach distant markets. [27] In

[18] Chandra, V *Fundamentals of Natural Gas: An International Perspective* (Tulsa, Oklahoma: Pennwell 2006) 3. See also Speight, JG. *Handbook of Offshore Oil and Gas Operations* (Texas, Gulf Publishing Company, 2015) 17 and Brock et al *Petroleum Accounting: Principles, Procedures & Issues* (2007) 2.

[19] Le Leuch, H *Good Practice Note on (Upstream) Natural Gas* (2012) viii, 4, 5 & 18 available at http://www.eisourcebook.org/cms/files/good_practice_note_on_(upstream)_natural_gas.pdf (accessed on 11 May 2014); Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 306.

[20] Le Leuch *Good Practice Note on (Upstream) Natural Gas* (2012) viii & 5, 18; Hyne *Nontechnical Guide to Petroleum Geology, Exploration, Drilling, and Production* (2001)11; Lowe *Oil and Gas Law in a Nutshell* (2014) 1, The reserves of natural gas discovered in Tanzania constitute non-associated natural gas.

[21] Similar to crude oil. Generally, natural gas with condensate is referred to as *wet gas* while natural gas occurring without condensate referred to as *dry gas* Hyne *Nontechnical Guide to Petroleum Geology, Exploration, Drilling, and Production* (2001)11; Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 306.

[22] 1000 cubic feet is (Mcf), one million cubic feet (MMcf), billion cubic feet (Bcf) and trillion cubic feet (Tcf) Condensate contents are measured by barrels per cubic feet of gas (BCPMM). Hyne *Nontechnical Guide to Petroleum Geology, Exploration, Drilling, and Production* (2001) 12-13. See also Chandra *Fundamentals of Natural Gas: An International Perspective* (2006) 7.

[23] Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 335.

[24] Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 335. See also Le Leuch, H *Good Practice Note on (Upstream) Natural Gas* (2012) 3; Brock et al *Petroleum Accounting: Principles, Procedures & Issues* (2007)2.

[25] Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 335

[26] Chandra *Fundamentals of Natural Gas: An International Perspective* (2006) 1. Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 309;

[27] Chandra *Fundamentals of Natural Gas: An International Perspective* (2006) 1.

addition, upon reaching the destination, the LNG must be converted into gaseous form ("regasification") for distribution to end users.[28]

All these factors indicate that, in the past, before developing natural gas fields, it was important for investors to ascertain the presence of markets, and infrastructure for processing and distribution of natural gas to the ultimate consumers.[29] A good example is the discovery of non-associated natural gas, which was rather unexpected, in Tanzania at Songo Songo Island in 1974 and Mnazi Bay in l982.[30] Because of lack of reliable markets in Tanzania and the distance from European and Asian markets, the lack of infrastructure for processing and transportation, commercial production commenced in 2004.[31]

Against this background, the technological advancement, in terms of exploitation, transportation and usage, has made it possible to exploit natural gas economically.[32] Although currently it is possible to exploit natural gas with a profit, it is still important for legislation, taxation, regulation and contracts to take into account the unique features of natural gas.[33] In addition, unlike crude oil, which has spot prices, there no single world reference price for natural gas.[34] As a result, the price of natural gas depends on agreements between producers and buyers or in reference to distant markets ready to purchase that natural gas.[35] This may exacerbate the problem of transfer pricing.[36]

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[28] Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 335.

[29] Influenced by *location* reserves and *type of consumer* Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 335. See also Le Leuch *Good Practice Note on (Upstream) Natural Gas* (2012) 3;11

[30] Tanzania Natural Gas Policy (2013) 1; Pedersen and Bofin *The politics of gas contract negotiations in Tanzania: a review* 03 (2015) 8-9.

[31] Tanzania Natural Gas Policy (2013) 1. See also Pedersen and Bofin *The politics of gas contract negotiations in Tanzania: a review* 03 (2015) 8-9.

[32] Chandra *Fundamentals of Natural Gas: An International Perspective* (2006) 1; Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 303, 319-22.

[33] Le Leuch Good Practice Note on (Upstream) Natural Gas (2012) viii & 18.

[34] Le Leuch *Good Practice Note on (Upstream) Natural Gas* (2012) 15.

[35] Le Leuch *Good Practice Note on (Upstream) Natural Gas* (2012) 15-16.

[36] See Chapter 3 section 3.2.2

2.2 Oil and Gas Value Chain Creation

Generally, oil and gas resources in the subsurface are not valuable until extracted from the ground and transformed into tradable commodities.[37] The processes and activities involved in transforming subsurface oil and gas resources into saleable products are referred to as "value chain creation".[38] These processes and activities are divided into three segments namely the upstream, midstream and downstream segments.[39]

The upstream segment involves the search for oil and gas reservoirs underground or under the seabed, and the ultimate extraction when the deposits are discovered.[40] The midstream segment involves the transportation, refining and conversion of raw oil and gas into finished or semi-finished tradeable goods.[41] Finally, downstream segment involves the distribution and marketing of oil and gas products to final consumers. [42] It is possible for all these three segments to be undertaken by one company ("integrated companies") or each segment is undertaken one specializing firm ("independents"). [43] The diagram below illustrate these processes.

[37] Tordo S, Tracy BS, and Arfaa N *National Oil Companies and Value Creation* (Washington DC, World Bank, 2011).1.

[38] Tordo, Tracy and Arfaa *National Oil Companies and value chain creation* (2011) 1 Tordo S, Johnston D and Johnston D *Petroleum Exploration and Production Rights Allocation Strategies and Design Issues* (Washington DC, World Bank 2009) 1. 'value' is defined as the 'price' customers are ready to pay for see Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 20.

[39] Brock et al *Petroleum Accounting: Principles, Procedures & Issues* (2007) 15; other countries merge the midstream and downstream sectors. See Tordo, Tracy and Arfaa *National Oil Companies and value chain creation* (2011) 2; Dyer E, Reinbott D, and Williams, M "Liquefied natural gas" in Picton-Turbervill, G (ed) *Oil and Gas: A Practical Handbook (*London, Globe Business Publishing Ltd 2009) 116; Kellas, G "Natural gas Experience and issues" in Daniel, P Keen, M, McPherson C (eds) *The Taxation of Petroleum and Minerals Principles, Problems and Practice*, (London, Taylor & Francis, 2010) 165-166; Thorpe, CP *Fundamentals of Upstream Petroleum Agreements* (CPI Antony Rowe, Eastbourne UK, 2008)1.

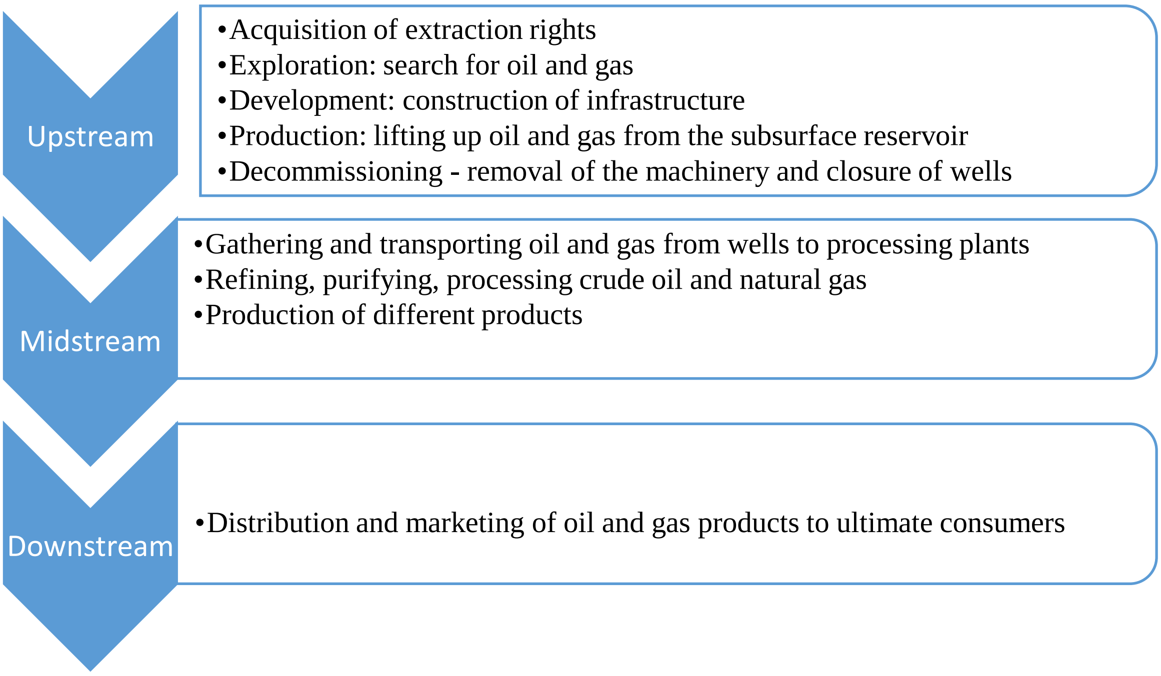
[40] Brock et al *Petroleum Accounting: Principles, Procedures & Issues* (2007) 16 Alramahi, M *Oil and Gas Law in the UK* (West Sussex Bloomsbury Professional Limited 2013)9.

[41] Le Leuch Good Practice Note on (Upstream) Natural Gas (2012) 14.

[42] Brock et al *Petroleum Accounting: Principles, Procedures & Issues* (2007) 17.

[43] Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 20. See also Brock etal *Petroleum Accounting: Principles, Procedures & Issues* (2007) 16.

Figure 1.2 Diagrammatic Representation of oil and gas value chain



3 Tax-Related Features of the Oil and Gas Industry

Generally, the essence of oil and gas taxation is the apportionment of the economic benefits between the Government and the IOCs.[44] A good tax system, at least in theory, must adhere to the canons of taxations: taxes should be certain and not arbitrary, considerable convenience to taxpayers, taxes should be fair and equitable and taxes should be efficient.[45] Certainty entails the stability of fiscal terms or predictability of changes in fiscal terms.[46] For the taxpayers, certainty enables them to understand the

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[44] Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 127.

[45] These qualities have formed the bedrock of the modern tax policy Smith, A *An Inquiry Into the Nature and Causes of the Wealth of Nations* (Pennsylvania State University, Ebook 2005) 777-779. See also Edrey, Y "Constitutional Review and Tax Law: An Analytical Framework" (2007) 56(5) *American University Law Review* at 1193-1194; Morse, Williams and Salter *Davies Principles of Tax Law,* (London: Sweet & Maxwell 1996) 5 and Nakhle, C *Petroleum Taxation Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (New York, Routledge, 2008) 12-13.

[46] Tordo, S *Fiscal Systems for Hydrocarbons Design Issues* (Washington, D.C: The World Bank 2007) 14; Ajayi, O *Resource Taxation as a tool for Development* (2009) 14-16 available at: http://works.bepress.com/oladiran_ajayi/1/.(accessed on 09 January 2014)

applicable tax regime and plan their investment projections accordingly.[47] Similarly, for the Government certainty makes it easy to predict the likely revenues to be collected, thus facilitates expenditure forecasting and budgetary planning.[48]

In addition, a simple tax system makes it easy for tax payers to establish their tax liabilities and also a convenient way of assessing and collecting taxes by tax administrators.[49] Similarly, convenience in a tax system implies that Government to generate revenue only when the investor earns a profit and not when the investor suffers a loss.[50] It also means Government's costs in tax administration and taxpayer's compliance costs are as minimal as possible.[51] Finally, the principle of equity in taxation requires that taxpayers in similar circumstances be treated equally and taxpayers in different circumstances be treated differently.[52] This is congruent with the rule of law that requires equality before the law.[53]

While the canons of taxation provide guidance of an ideal fiscal regime, the oil and gas industry has certain unique features, which call for special attention.[54] For one, there are

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[47] Onorato, WT *Legislative Frameworks Used to Foster Petroleum Development* (1995) 15. See also Nakhle *Petroleum Taxation Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 5.

[48] Nakhle *Petroleum Taxation Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 14. Onorato *Legislative Frameworks Used to Foster Petroleum Development* (1995) 15.

[49] Nakhle *Petroleum Taxation Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 14.

[50] Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 11. See also Morse et al *Davies Principles of Tax Law* (London, Sweet & Maxwell, 1996) 7-8.

[50] Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 11-15.

[51] OECD *Addressing the Tax Challenges of the Digital Economy: OECD/G20 Base Erosion and Profit Shifting Project* OECD Publishing (2014) 30 available http://dx.doi.org/10.1787/9789264218789-en (accessed on 05 August 2016)

[52] Morse, Williams and Salter *Davies Principles of Tax Law* (1996) 6-7. Lencho, T "The Ethiopian Tax System: Excesses and Gaps" (2012) 20(2) *Michigan State International Law Review* 327-380 at 334; Luoga, F "Taxation in the Advent of Democratisation and Transition to Free Market Economy in Tanzania and Concerns on the Rule of Law and Human Rights' 2002 (1) at 25-27, available at *http://elj.warwick.ac.uk/global/02-1/luoga.html* (accessed on 20 March 2014); Vanistendael, F "Legal Framework for Taxation" in Victor Thuronyi (ed), *Tax Law Design and Drafting* Vol. 1 (Washington DC, International Monetary Fund 1996) 5-6; Kaplow, L *The Theory of Taxation and Public Economics* (Princeton, Princeton University Press, 2008) 396-398.

[53] Tamanaha, BZ "The History and Elements of the Rule of Law" *Singapore Journal of Legal Studies* (2012) 233-247 at 233-236.

[54] Nakhle Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow (2008)12-13.

certain factors, such as none-renewability, volatility of price, State ownership of the resources, which distinguish the oil and gas industry from other sectors.[55] In addition, the principle of permanent sovereignty over natural resources (PSONR), which confers a right to each country to determine a fiscal regime that suits the country's political, economic and environmental conditions, makes design fiscal regime country-specific.[56] For these reasons, the ultimate the design of the fiscal regime largely depends on the policy objective the Government aims to achieve.[57] In view of these unique features, the question is whether it is justifiable to have special tax regime for oil and gas industry or just adopt the generally applicable tax system.[58] The next section highlights the oil and gas tax-related characteristics.

3.1 Ownership of Oil and Gas *in situ*

The concept of ownership of oil and gas *in situ* is of paramount importance in the oil and gas taxation.[59] This is because the ownership regime determines persons who can have access to the oil and gas resources.[60] Without this access, no exploration or extraction may be undertaken.[61] In addition, when a person other than the owner undertakes the extraction, the ownership regime determines the methods of apportioning revenues between the owner of the resources and the extractive company.[62] Similarly, the

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[55] Collier "Principles of Resource Taxation for Low-Income Countries" (2010) 75.

[56] The doctrine argues that the resource-rich countries have the right and freedom to dispose of their natural resources, use natural resources for development as well as the right to regulate foreign investments. The doctrine has been incorporated in several UN General Assembly resolutions and the United Nations General Assembly Resolution 3281 (XXIX) *Charter of Economic Rights and Duties of States*, 12 December 1974. For further discussion on the doctrine see Ng'ambi, SP "Permanent Sovereignty Over Natural Resources and the Sanctity of Contracts, From the Angle of Lucrum Cessans" 12 *Loy. U. Chi. Int'l L. Rev.* 153-172 (2015) 154-155. See also Nakhle "Petroleum fiscal regimes Evolution and challenges" (2010) 104 &117.

[57] Nakhle "Petroleum fiscal regimes Evolution and challenges" (2010) 105.

[58] Collier "Principles of Resource Taxation for Low-Income Countries" (2010) 75.

[59] Mahoney Economic Foundations of Strategy (2015) 114.

[60] Mahoney *Economic Foundations of Strategy* (2015) 114; Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013)128.

[61] Omorogbe, Y and Oniemola, P "Property Rights in Oil and Gas under Domanial Regimes" in A McHarg, B Barton, B Bradbrook and L Godden (eds), *Property and the Law in Energy and Natural Resources* (Oxford, Oxford University Press 2010) 114, Le Leuch, "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 128.

[62] Omorogbe, Y *Fiscal Regimes* (2005) 1 A paper Presented at the Nigerian Extractive Industries Transparency Initiative (NEITI) Civil Society Capacity Building Workshop, Presidential Hotel, Port Harcourt, Rivers State, 27th – 28th July 2005, on Thursday 28th July 2005 http://www.nigerianlawguru.com/articles/oil%20and%20gas/FISCAL%20REGIMES.pdf (accessed 8 August 2016) Alford, CJ *Mining Law of the British Empire* (1906) 7; Mahoney *Economic Foundations of*

ownership regime determines the role of the State as the owner of the resource or the regulator or both.[63] For these reasons, the ownership regime influences the design and contents of the fiscal regime.

Generally, ownership of oil and gas in the subsoil may vest in either the individual landowner or the State.[64] The ownership of subsurface oil and gas by the landowner is summarized through the maxim *cuius es solum eius est usque ad coelum et ad inferos (cujus est solum* doctrine).[65] The cujus est solum doctrine implies that the ownership of land "extends from the depth of the earth to the height of the sky".[66] It means that ownership of land carries with it the ownership of all the oil and gas substances in the sub-surface.[67] This system is applied some jurisdictions, such as Australia, as well as

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Strategy (2005) 114; Omorogbe and Oniemola "Property Rights in Oil and Gas under Domanial Regimes" (2010)115; Emel, J et al "Extracting sovereignty: Capital, territory, and gold mining in Tanzania" (2011) 30(2) *Political Geography* 73.

[63] Parra, F *Oil Politics: A Modern History of Petroleum* (New York, I.B. Taurus & Co Ltd 2004) 6; Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 128.

[64] Omorogbe and Oniemola "Property Rights in Oil and Gas under Domanial Regimes" (2010) 118. International Institute for Democracy and Electoral Assistance *Oil And Natural Gas: Constitutional Framework for the Middle East and North Africa* (2014) 27 available at http://www.constitutionnet.org/vl/item/oil-and-natural-gas-constitutional-frameworks-middle-east-and-north-africa (accessed on 16 July 2017). Nakhle "Petroleum Fiscal Regimes: Evolution and Challenges" (2010)121; Ekhator, E O "Public Regulation of the Oil and Gas Industry in Nigeria: An Evaluation," 21(6). (2016) *Annual Survey of International & Comparative Law* 43-91 at 45.

[65] Gonzalez, JJ "Civil Law Treatment of the Subsurface in Latin American Countries" in. Zillman, DN McHarg A, Bradbrook, A and Hernandez, L B (eds) *The Law of Energy Underground: Understanding New Developments in Subsurface Production, Transmission, and Storage* (Oxford, Oxford University Press 2014) 62. See also Aladeitan, L "Ownership and Control of Oil, Gas, and Mineral Resources in Nigeria: Between Legality and Legitimacy" (2013) 38 *Thurgood Marshall Law Review* 159-197 at 161.

[66] The existence of the maxim cannot be traced in the *Juris Corpus Civilis.* See Abramovitch, Y "The Maxim 'Cujus Est Solum Ejus Usque Ad Coelum' as Applied in Aviation" (1962) 8(4) *Mcgill Law Journal* 247 at 249. See also Gonzalez "Civil Law Treatment of the Subsurface in Latin American Countries" (2014) 62. Its origin is attributed to Jewish law, examples are drawn from the Bible Deuteronomy 30: 11- 14, Isaiah 7: 11. See Gray, K "Property in thin Air" (1991) 50 *Cambridge Law Journal* 252 – 307 at 252. Badenhorst PJ & Mostert, H *Mineral and Petroleum Law of South Africa: Commentary and Statutes* (2004) 11; Lowe, JS *Oil and Gas Law in a Nutshell* (2014) 11; Wieland, P "Going Beyond Panaceas: Escaping Mining Conflicts in Resource-Rich Countries through Middle-Ground Policies" (2012-2014) 20 *New York University Environmental Law Journal* 199-276 at 199, 204; the extent of these rights has been challenged for example ownership of the heavens would mean that the landholders has right to control airplanes flying over his or her land.

[67] Badenhorst and Mostert *Mineral and Petroleum Law of South Africa: Commentary and Statutes* (2004) 11; Wieland, P "Going Beyond Panaceas: Escaping Mining Conflicts in Resource-Rich Countries through Middle-Ground Policies" (2014) 204-205; Easo, J "Licences, Concessions, Production Sharing Agreements and Service Contracts" in G Picton-Turbervill (ed) *Oil and Gas: A Practical Handbook (*London, Globe Business Publishing Ltd 2009) 27.

some parts of the USA and Canada.[68] Under this system, the landowners have right to explore and extract oil and gas themselves, leave them unexploited or grant extraction rights to third parties.[69] From the taxation point of view, private ownership system distinqushes between royalties and other levies payable to the landowners and generally applicable taxes,, such as corporate income tax, payable to the Government.[70]

The other system posits that, regardless of the nature of landownership system, oil and gas resources *in situ* are a gift of nature and thus owned by the State on behalf and for the benefit of all citizens.[71] According to this view, unlike agriculture, which requires the planting of seeds before reaping the produce, oil and gas *in situ* are nature's bounty and thus not dependent on any human inventiveness or labour.[72] For this reason, the occupation of soil, does not justify ownership of oil and gas found beneath the land.[73] Instead, oil and gas resources in the subsurface are classified as public property, to be utilized for the benefit of all citizens in the country.[74]

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[68] Ely N and Pietrowski Jr RF "Changing Concepts in the World's Mineral and Petroleum Development Laws" (1976) 15. See also Easo "Licences, concessions, production sharing agreements and service contracts" (2007) 27 and Aalberts RJ and Siedel III, G J *Real Estate Law* (7edn) Mason, OH South-Western Cengage Learning (2008) 31.

[69] Wieland "Going Beyond Panaceas: Escaping Mining Conflicts in Resource-Rich Countries through Middle-Ground Policies" (2014) 206; Badenhorst, PJ "Ownership of Minerals in situ in South Africa: Australian Darning To The Rescue*?*" (2010) 127 *The South African Law Journal* 646 672 at 649. Ely and Pietrowski Jr "Changing Concepts in the World's Mineral and Petroleum Development Laws" (1976) 15; Bret-Rouzaut et al *Oil and Gas Exploration and Production Reserves, costs, contracts* (2011) 171.

[70] Nakhle "Petroleum fiscal regimes Evolution and challenges" (2010) 91. See also Ely and Pietrowski Jr, "Changing Concepts in the World's Mineral and Petroleum Development Laws' (1976) 21. Aalberts and Siedel III *Real Estate Law* (2008) 68.

[71] Veit, PG and Larsen, G *Overlapping Land and Natural Resource Property Rights: A Comparative Analysis from Africa* World Resources Institute, Washington, DC 15 April (2013) 8. See also De Fooz, JHN *Fundamental Principles of the Law of Mines* (1860) 2; Wieland, P "Going Beyond Panaceas: Escaping Mining Conflicts in Resource-Rich Countries through Middle-Ground Policies" (2014) 209.; Omorogbe and Oniemola "Property Rights in Oil and Gas under Domanial Regimes" (2010) 118; Emel, J et al "Extracting sovereignty: Capital, territory, and gold mining in Tanzania" (2011) 72; Nakhle "Petroleum fiscal regimes: evolution and challenges" (2010) 121; Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 128;

[72] De Fooz *Fundamental Principles of the Law of Mines* (1860) 11; Crabbe "Turgot's Brief on *Mines* and Quaries: An Early Economic Analysis of Mineral Land Tenure" (1985) 272;

[73] De Fooz *Fundamental Principles of the Law of Mines* (1860)11 See also Aladeitan, L "Ownership and Control of Oil, Gas, and Mineral Resources in Nigeria: Between Legality and Legitimacy" (2013) 163.

[74] Wieland "Going Beyond Panaceas: Escaping Mining Conflicts in Resource-Rich Countries through Middle-Ground Policies" (2014) 209; see also Schaber, P 'Property Rights and the Resource Curse' (2011) 17 *Global Governance* at 186, The Supreme Court of India held in *Association of Natural Gas v Union of India* (2004) 4 SCC 489 (CB) that "the people of the entire country have a stake natural gas and its benefit has to be shared by the whole country".

Another reason for rejecting private ownership, foresees instances where landowners either lack capital and expertise or are unwilling to undertake the extraction, hence rendering the underground oil and gas resources sterile.[75] Furthermore, since oil and gas resources in oil-rich countries form the "patrimony" of the State politically and economically, it would therefore be unfair to permit a few individual landowners to control and enjoy the benefits of such resources.[76]

State ownership of oil and gas in the subsurface takes two forms namely regalia and domanial systems.[77] Under the regalian system, the Crown reserved the royal right ("*jura regalia"*) to dispose, for the benefit of society, the ownership of subsurface mineral substances including oil and gas.[78] In summary, the regalian system has five major features.[79] First, it espouses a spilt-tenure between the surface of land and the oil and gas it covers.[80] While the landholder has the right to occupy and use the soil the State retains ownership of oil and gas *in situ*.[81] However, the oil and gas estate is created only when the State grants oil and gas rights before that there is only one estate.[82] Second, it permits private ownership of land to co-exist with public ownership of land.[83] Third, oil and gas

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[75] De Fooz JHN *Fundamental Principles of the Law of Mines* (1860) 12. See also Dale, MO *A Historical and Comparative Study of the Concept of Acquisition of Mineral Rights* (LL.D UNISA, 1979) 172; Holland, TM "Mineral, Not Mining, Laws in the British Empire" (1938) 20 (1) *Journal of Comparative Legislation and International Law* 24-28 at 25.

[76] Holland "Mineral, Not Mining, Laws in the British Empire" (1938). 25 exchequer and coinage De Fooz *Fundamental Principles of the Law of Mines* (1860) 13. Aalberts and Siedel III *Real Estate Law* (2008) 66; See Aladeitan "Ownership and Control of Oil, Gas, and Mineral Resources in Nigeria: Between Legality and Legitimacy" (2013) 175-176.

[76] Bastida, AE *Mineral Tenure Regimes in the Context of Evolving Governance Contexts* Unpublished PhD Study, University of Dundee (2004) 25-26; see also Wieland, "Going Beyond Panaceas: Escaping Mining Conflicts in Resource-Rich Countries through Middle-Ground Policies" (2014) 209.

[77] See Gonzalez, JJ "Civil Law Treatment of the Subsurface in Latin American Countries" (2014) 66.

[78] Crabbe "Turgot's Brief on *Mines* and Quaries: An Early Economic Analysis of Mineral Land Tenure" (1985) 266. See also Egede, H "African 'Social Ordering' Grundnorms and The Development of An African Lex Petrolea?" (2016) 141.

[79] De Castro, SM "Acquiring Mineral Rights in the Philippines: Updates On Mining Law and Jurisprudence" (2008-2009) 610-612.

[80] Aalberts and Siedel III *Real Estate Law* (2008) 66; De Castro, SM "Acquiring Mineral Rights in the Philippines: Updates On Mining Law and Jurisprudence" (2008-2009) 610-612.

[81] Egede "African 'Social Ordering' Grundnorms and the development of an African Lex Petrolea?" (2016) 141.

[82] De Castro "Acquiring Mineral Rights in the Philippines: Updates On Mining Law and Jurisprudence" (2008-2009) 610-612.

[83] De Castro "Acquiring Mineral Rights in the Philippines: Updates On Mining Law and Jurisprudence" (2008-2009) 610-612.

in situ, regardless of whether discovered on private or public land belongs to the State.[84] Fourth, only the State can grant authorization to prospect, mine or dispose the oil and gas resources.[85] Fifth, with the exception of a few jurisdictions where the State shares its royalties with landowners, landoweners are generally entitled to compensation only for disturbance of surface rights.[86]

The second form of State ownership is the *domanial system*.[87] The domanial system vests the State with the "direct, absolute, exclusive and inalienable property" of both the oil and gas and the land covering them.[88] It means the absolute title to land vests in the State, while landholders are only entitled to the right to use, occupy and manage the land.[89] In this regard, the State retains the right to either engage in the direct exploitation of oil and gas resources or grant extraction right to extractive companies.[90] It also means that in the event that oil and gas are discovered, landholders are only entitled to compensation for the loss of surface rights.[91] As this study will demonstrate, the Tanzanian oil and gas rights regime falls squarely within the precincts of the domanial system.[92]

As regards to ownership of oil and gas in the sea, States under international law have a general claim of ownership of all natural resources found in the sea and the seabed.[93] A

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[84] Wieland, "Going Beyond Panaceas: Escaping Mining Conflicts in Resource-Rich Countries through Middle-Ground Policies" (2012-2014) 206.

[85] De Castro "Acquiring Mineral Rights in the Philippines: Updates On Mining Law and Jurisprudence" (2008-2009) 610-612. See also Veit and Larsen Overlapping *Land and Natural Resource Property Rights: A Comparative Analysis from Africa* (2013) 9.

[86] For example, under section 98(3) read together with the Ugandan Mining Act 2003 owners or lawful occupiers of land subject to mineral right are entitled to a 3% of the royalties paid to the Government. See also the general discussions by Veit and Larsen Overlapping *Land and Natural Resource Property Rights: A Comparative Analysis from Africa* (2013) 9; Aladeitan "Ownership and Control of Oil, Gas, and Mineral Resources in Nigeria: Between Legality and Legitimacy" (2013) 167-168.

[87] Omorogbe and Oniemola "Property Rights in Oil and Gas under Domanial Regimes" (2010) 115.

[88] The term domanial comes from demanio- Spanish law- means assets owned by the State for the common good of the whole society and important to the economy. Gonzalez "Civil Law Treatment of the Subsurface in Latin American Countries" (2014) 69. See also Omorogbe and Oniemola "Property Rights in Oil and Gas under Domanial Regimes" (2010)120.

[89] Omorogbe and Oniemola "Property Rights in Oil and Gas under Domanial Regimes" (2010) 115.

[90] Gonzalez "Civil Law Treatment of the Subsurface in Latin American Countries" (2014) 69; Egede, H "African 'Social Ordering' Grundnorms and The Development of an African Lex Petrolea?" (2016) 28 *Denning Law Journal* 138-165 at 144.

[91] Omorogbe and Oniemola "Property Rights in Oil and Gas under Domanial Regimes" (2010) 120.

[92] Chapter 5 section 2.1. Also most African countries fall under the domanial system. See Egede "African 'Social Ordering' Grundnorms and The Development Of An African Lex Petrolea?" (2016) 141.

[93] Mitchell, Marcel and Mitchell *What Next for the Oil and Gas Industry?* (2012) 35.

State's claim of ownership arises either from the United Nation Convention on the Law of the Sea (UNCLOS) or on international customary law.[94] The UNCLOS vests coastal States with authority to manage the territorial sea and contiguous zone.[95] In addition, the coastal States have sovereign rights to explore, exploit, conserve and manage all natural resources found in the Exclusive Economic Zone (EEZ).[96] It includes an exclusive right to construct, install and operate structures for purposes of exploration or exploitation of natural resources.[97]

Ideally, under State ownership, oil and gas resources are a common property of all citizens whereby everybody has equal rights to enjoy and benefit from their exploitation.[98] In this regard, State ownership of oil and gas resources is "not proprietary, but fiduciary".[99] The Privy Council in *Attorney General (Quebec) v. Attorney General* (Canada) [100] interpreted the phrase "vest in public" as a conferment of powers in a public body to enable it control, manage properties or discharge its functions efficiently. [101] This implies that the vesting provisions are meant to enable the State, as a trustee of the people it represents, to manage

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[94] International customary law vests the ownership of the sea in the state for those states not party to UNCLOS (e.g. USA). See Mitchell, Marcel and Mitchell *What Next for the Oil and Gas Industry*? (2012) 35.

[95] Article 2(1)&(2) 3 &4(1) (2) of the UNCLOS

[96] 200 nautical miles from the baseline from coastline Article 56art. 57 Article 76(1)77(1), 77(2) of the UNCLOS.

[97] Article 60 of the UNCLOS.

[98] Schaber, P "Property Rights and the Resource Curse" (2011) 186, The Supreme Court of India held in *Association of Natural Gas v Union of India* (2004) 4 SCC 489 Constitution Bench (CB) that 'the people of the entire country have a stake natural gas and its benefit has to be shared by the whole country'.

[99] This is similar to the doctrine of public trust commonly used in environmental law. Under this doctrine, the state is a custodian of natural resources, such as water, air, fauna and flora. The doctrine imposes a duty on the state to manage these resources for the benefit of the nation. See Sax, JL "Public Trust Doctrine in Natural Resource Law: Effective Judicial Intervention" 68 *Michigan L. Rev.* (1970) at 474-785 See also Hossain, Z and Kumar, AP "The New Jurisprudence of Scarce Natural Resources: An Analysis of The Supreme Court's Judgment in Reliance Industries Limited *v.* Reliance Natural Resources Limited (2010) 7 SCC 1" *Indian Journal of Constitutional Law,* 109-110. However, it is notable that natural resources, such as minerals and petroleum do not fall squarely within the ambit of the doctrine. Under Roman law, minerals were not classified as *res publicae* therefore are not part of the doctrine. See Young, C Public Trusteeship and Water Management: Developing the South African concept of public trusteeship to improve management of water resources in the context of South African water law (2014) 120-132 PhD study submitted at the University of Cape Town available at https://open.uct.ac.za/bitstream/item/9720/study_law_2014_young_cl.pdf?sequence=1 (accessed on 24 July 2017) Despite, this shortcoming, we can draw lessons about state custodianship of natural resources from the doctrine of public trust.

[100] [1921] 1 AC 401, 409

[101] Secher, U and Amankwah, HA "Native Title, Crown Property and Resources: Post-Mabo Judicial Interpretations Of Statutory Declarations And Statutory Vesting Provisions" (2003) 9 *James Cook University Law Review* 110-226 at 160-161.

the petroleum resources for the benefits of the whole nation.[102] This also means that the State, as a trustee of the people at large, has a duty and obligation to protect and exploit the resources for the enjoyment and use of the citizens including those yet unborn.[103] Thus, the State must ensure not only optimal exploitation of the resources, but also obtains adequate financial benefits commensurate with the extracted oil and gas.[104]

In the context of taxation, the legal implication of State ownership is that the State acts as both the owner of the resource and the sovereign.[105] The State-as-sovereign exercises its power by imposing taxes on all persons within its territorial boundaries.[106] This implies the general taxes which are applicable not only to the oil and gas industry but to all sectors.[107] The State-as-owner is entitled to payment of rent from the IOCs to

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[102] Secher, U "Implications of the crown's radical title for statutory regimes regulating the alienation of land: 'crown land' v 'property of the crown' post-mabo" (2008) 34(1) *Monash University Law Review* 9-52 at 13; U Secher and H A Amankwah Native Title, Crown Property and Resources: Post-Mabo Judicial Interpretations Of Statutory Declarations And Statutory Vesting Provisions 168 (2003) TRUST: *Reliance Natural Resources Ltd. v. Reliance Industries Ltd* Civil Appeal No. 4273 of 2010 at 206. Veit and Larsen Overlapping *Land and Natural Resource Property Rights: A Comparative Analysis from Africa* (2013) 2. Not power but rather obligations Hossain, Z and Kumar, AP "The New Jurisprudence of Scarce Natural Resources: An Analysis of The Supreme Court's Judgment in Reliance Industries Limited *v.* Reliance Natural Resources Limited (2010) 7 SCC 1" *Indian J. Const. L.,* 109-110. Viñuales, JE "The 'Resource Curse' in Legal Perspective" (2011)10.

[103] Perreira, EG and Talus K ed *African Upstream Oil and Gas: A practical guide to the law and Regulation* (London, Globe Law and Business, 2015) 77. Wenar, L "Property Rights and the Resource Curse" (2008) 36(1) *Philosophy & Public Affairs* 2-32 9-12. Reliance Natural Resources Ltd. v. Reliance Industries Ltd Civil Appeal No. 4273 of 2010 at 10 See also article 1(1) of UNGA 1803, Dec 14 1962; 8.

[104] Viñuales "The 'Resource Curse' in Legal Perspective" (2011)10 .*Reliance Natural Resources Ltd. v. Reliance Industries Ltd* [2010] Civil Appeal No. 4273 of 2010 at 208. Sunley, EM, Baunsgaard, T and Simard, D *Revenue from the Oil and Gas Sector: Issues and Country Experience* (Washington DC, The World Bank (2002)2-3; Parra, F *Oil Politics: A Modern History of Petroleum* (2004) 6; Easo "Licences, Concessions, Production Sharing Agreements and Service Contracts" (2009) 27, Whyte, JD *The Constitution. and Natural resource revenue (*Institute of InterGovernmental Relations, Queens University Research Paper No. 14 1982) 1; *Reliance Natural Resources Ltd. v. Reliance Industries Ltd* [2010] Civil Appeal No. 4273 of 2010 at 204,. 208.

[105] Ambakederemo *How does the resource rent tax balance the interest of the Government and the investor* (2010) at 4-7; Collier P "Principles of Resource Taxation for Low-Income Countries"(2010) 75. Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 128;

[106] Ambakederemo, T *How does the resource rent tax balance the interest of the Government and the investor* (2010) 4-7. Hannesson *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (1998) 109; Keith Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 15; Mclaren, J "Petroleum and Mineral Resource Rent Taxes: Could These Taxation Principles Have A Wider Application?" (2012) 10 *Macquarie Law Journal*. 43 at 46; Sunley et al *Revenue from the Oil and Gas Sector: Issues and Country Experience* (2002) 2-3.

[107] Sunley et al *Revenue from the Oil and Gas Sector: Issues and Country Experience* (2002) 2-3.

undertake the extraction through different fiscal instruments, such as user fees, royalties and bonuses used as compensation for allowing extraction of oil from his land.[108]

In practice, the extraction may be undertaken by the IOCs alone or in partnership with the Government.[109] The dual role of the State - both the owner and the sovereign - requires special rules of taxation.[110] The State has to decide whether to create a special tax system or just use the existing system. In addition, whether to use the existing tax administration structure or create a new one.

3.2 The Concept of Economic Rent

Generally, the oil and gas industry, especially during the price booms, produces exceedingly enormous profits.[111] The difference between the costs of producing oil and gas products and the sale price in the market is referred to as "economic rent".[112] For example, the average costs of producing a barrel of oil ranges between 5 US$ and 30 US$ while its price in the world on July 2008 was 145 US$.[113]This explains the reason why

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[108] Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 5-6; Parra *Oil Politics: A Modern History of Petroleum* (2004) 6, 14-19; Hannesson *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (1998) 109; Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986)15; Mclaren, J "Petroleum and Mineral Resource Rent Taxes: Could These Taxation Principles Have A Wider Application?" (2012) 46; Sunley et al *Revenue from the Oil and Gas Sector: Issues and Country Experience* (2002) 2-3.

[109] Mailey, JR *The Anatomy of the Resource Curse: Predatory Investment in Africa's Extractive* (Washington, D.C Industries Africa Center for Strategic Studies, 2015) 7; Wieland "Going Beyond Panaceas: Escaping Mining Conflicts in Resource-Rich Countries through Middle-Ground Policies" (2014)209; Parra *Oil Politics: A Modern History of Petroleum* (2004) 6; Easo "Licences, concessions, production sharing agreements and service contracts" (2007) 27 Whyte, JD *The Constitution. and Natural resource revenue* (1982) 1.

[110] Omorogbe and Oniemola "Property Rights in Oil and Gas under Domanial Regimes" (2010) 115; Collier "Principles of Resource Taxation for Low-Income Countries" (2010)75.

[111] Omorogbe and Oniemola "Property Rights in Oil and Gas under Domanial Regimes" (2010) 115; Collier "Principles of Resource Taxation for Low-Income Countries" (2010) 75.

[112] Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008)12-13. See also Johnston *International Petroleum Fiscal Systems and Production Sharing Contract* (1994) 5- 6; Kemp, *Petroleum Rent Collection in the World* (1987) 5; Mintz, J *Capturing Economic rents from resources through royalties* (2012) 3; Baunsgaard, T *Primer on mineral taxation* (2001) 5; Kellas, G "Natural gas Experience and issues (2010) 166; Boadway, R and Flatters, F *The Taxation of Natural Resources Principles and Policy Issues* The (Washington DC, World Bank 1993)7 Rozner *Taxing Oil: Issues and Trends* (2009) 1 available at http://archive.resourcegovernance.org/sites/default/files/Rozner%20-%20Taxing%20Oil%20-%20Issues%20&%20Trends.pdf.(accessed on 02 April 2014)

[113] See the US Energy Information Administration (EIA) "Cushing, OK WTI Spot Price FOB from December 1985 to March 2015" Available at

the oil and gas industry is one of the largest industries in the world.[114] In addition, these profit margins ("economic rent") provide justification for the Government to impose special taxes, such as excess profit taxes.[115]

Impliedly, if the Government in countries, such as Tanzania, which owns the oil and gas *in situ*, undertook the extraction it means the Government would take the full amount of rents.[116] However, since the IOCs undertake extraction alone or in partnership with the State, the State as the owner of the resource shares such "economic rents" with the IOCs.[117] For this reason, the mechanisms for sharing the rents influences the grant of extraction rights to IOCs, whether concessional or contractual.[118] The State grants extraction rights to the IOCs based on the promise to share the economic rents through a pre-determined mechanism.[119] Accordingly, the Government usually imposes higher or special taxes, such as excess profit tax and bonuses, to ensure that it captures an equitable share of the economic rent.[120]

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http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RWTC&f=D (09 April 2015). See also Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012)15.

[114] For example in 2009 it accounted about 90% of total world's mineral trade while its by-products make 14.2% of total of the world's commodity trade. Ross *The Oil Curse: How Petroleum Wealth Shapes the Development of Nations* (2012) 3.

[115] Baunsgaard *Primer on mineral taxation* (2001) 5.

[116] In countries like Iraq, Saudi Arabia, and Kuwait, the Government appropriates all the economic rents, and therefore the fiscal regime is rendered reduntant See Nakhle "Petroleum fiscal regimes Evolution and challenges" (2010) 91. Daniel, P and Keen, M "Introduction" (2010) 1; Johnston, D *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994).1, 5-6; In countries will allow private ownership of land, the rent will go to the landholder, see Alalade, CB *The economic Performance of International Oil Companies in Nigeria* (2004) 57; Hannesson, R *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (1998) 109; Daniel Johnston *International Petroleum Fiscal Systems and Production Sharing Contract* (1994) 6; Parra, F *Oil Politics: A Modern History of Petroleum* (2004) 6; Heibrum 'Oil, Democracy and Development in Africa' 97. Nakhle, C "Petroleum fiscal regimes Evolution and challenges" (2010) 91.

[117] Parra *Oil Politics: A Modern History of Petroleum* (2004) 14-19. See also *International Petroleum Fiscal Systems* (1994) 5-6; Hannesson, R *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (Praeger 1998) 110. Baunsgaard *Primer on mineral taxation* (2001) 6.

[118] See section 5 below.

[119] See Chapter 2 section 4 and Chapter 5 section 2.5.

[120] See section 4.1 below.

3.3 Uncertainties

Several uncertainties surrounds the oil and gas industry. For instance, the non-renewability of oil and gas resources implies that extraction depletes the stock.[121] For the IOCs, this implies that they may not be able to recover their investment cost or make a profit while for the State, it implies oil and gas taxation is not a sustainable source of revenue.[122] In addition, the prices of oil and gas products in the market are very volatile.[123] The price volatility is exacerbated by the uncertainties on the quantity and quality of oil and gas deposits in the subsoil, accessibility, and expected extraction costs.[124] All these uncertainties render it difficult to quantify the future cashflows over the life of an oil and gas project.[125]

Furthermore, for countries, which are over dependent on the oil and gas revenues, price volatility means their economies will stand or fall with price of oil and gas.[126] Because of

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[121] IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 12 available at https://www.imf.org/external/np/pp/eng/2012/081512.pdf ; Otto, JM *Mining Taxation in Developing Countries* (2000) 1 available at http://www.congomines.org/system/attachments/assets/000/000/649/original/Otto-UNCTAD-paper-2000-Mining-Taxation-in-Developing-Countries.pdf?1430929506 (accessed on 15 July 2014) . Collier, P "Principles of Resource Taxation for Low-Income Countries" (2010) 75; Van Hoogstraten, J *Theoretical Framework For Financial Flows In The Extractive Sector* (2015) 5 https://www.projectpoder.org/wp-content/uploads/2015/05/05-2015-EN-Theoretical-Framework-for-Financial-Flows-in-the-Extractive-Sector1.pdf (accessed 15 February 2017); Barnett, S and Ossowski, R "Operational Aspects of Fiscal Policy in Oil-Producing Countries" in Davis JM, Ossowski R, and Fedelino A. (ed) *Fiscal Policy Formulation and Implementation in Oil-Producing Countries* (Washington, D.C, IMF 2003) 45.

[122]IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 12. See also Collier "Principles of Resource Taxation for Low-Income Countries" (2010) 75; 5

[123] Volatility results from three factors. First, the oil and gas project cycle, cost recovery postpones early payment of taxes and other levies. Second, the timing of revenue receipts, due to tax incentives and cost recovery, not taxes are paid upfront, instead their paid at a later stage. This implies that revenue will accrue to the state haphazardly and when the economy is not prepared to absorb such revenues. Third, highly volatile nature of oil and gas prices. See Humphreys M, Sachs J and Stiglitz J "Introduction: What is the Problem with Natural Resource Wealth?" in Humphreys et al *Escaping the resource curse* (Irvington, NY: Columbia University Press, 2007) 8-11. For example, the price of a barrel of crude oil stood at 33.8 US$ in January 2004, hit a world record of 144.96 US$ in July 2008, and by March 30 2015 was down to 49.13 US$ (See the US Energy Information Administration (EIA) website: Cushing, OK WTI Spot Price FOB from December 1985 to March 2015. Available at http://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=RWTC&f=D (09 April 2015)

[124] Rozner *Taxing Oil: Issues and Trends* (2009) 2. Blindermann Production Sharing Agreement (1999) 5.

[125] Rozner *Taxing Oil: Issues and Trends* (2009) 2; Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 13, Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994)5.

[126] Kinney, LP *The Natural Resource Curse and Development: The Experiences of Nigeria and Indonesia* at 1, *available at webpages.shepherd.edu/LKINNEY/.../NIGERIAANDINDONESIA.doc (*accessed on 14 July 2014). Nigeria total export earnings were $ 25bn in 1980, $ 10bn in 1983 and $ 8bn in 1984 Shaxson

price volatility, some oil-rich countries tend to increase the fiscal terms during the upsurge of price and grant excessive fiscal incentives during the downswing of prices.[127] The bottom-line is that these uncertainties render it difficult to determine how to share the economic rent between the Government and the IOC.[128]

Moreover, the process of exploration, development and production involves enormous costs [129] Most of these costs are incurred upfront even before the discovery is made or production commences.[130] In addition, when the normal rules of cost recovery are applied, it means that the payback period is too long.[131] The long period of cost recovery (through deductions or amortization) creates a time consistency problem.[132] It means that the amount recovered is not the same as the one invested.[133] In addition, the IOCs are concerned whether the Government will honour its commitments over the lifespan of the project.[134] There are several instances where Governments have intervened, contrary to the PSAs, to expropriate the license or change of fiscal terms.[135] These uncertainties raise

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Poisoned Wells: The Dirty Politics of African Oil (2007) 21*;*Omeje, K "Avoiding the Natural Resource Curse: Lessons from Nigeria and Policy Implications" (2013) 94.

[127] Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 225-26; IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012)10.

[128] Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all* (2013) 63 available at http://app-cdn.acwupload.co.uk/wp-content/uploads/2013/08/2013_APR_Equity_in_Extractives_25062013_ENG_HR.pdf. See also Bauer, A and Quiroz, JC "Resource Governance" in Goldthau, A (ed) *The Handbook of Global Energy Policy* (John Wiley & Sons Ltd, Ebook 2013) 244-263 at 246.

[129] Van Hoogstraten *Theoretical Framework for Financial Flows In The Extractive Sector* (2015) 6. For example, the exploration in deep water well cost over US$ 100 million (while the chance of success is 1 in 20 or less) and between US$ 5 million and US$ 20 million for onshore wells (while the chance of success is 1 in 10 or less). See IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012)12; Babusiaux *Oil and Gas Exploration and Production: Reserves, Costs, Contracts* (2007) 127-130; Hannesson *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (1998) 109.

[130] Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 13, Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 5.

[131] Thorpe, CP *Fundamentals of Upstream Petroleum Agreements* (CPI Antony Rowe, Eastbourne UK, 2008) 10.

[132] See Chapter 2 section 3.3 and Chapter 5 section 2.5.4.3.

[133] It takes 10 years to start generating revenues and production spans for a long time. See IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 10.

[134] IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012)10. Cameron, PD *Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil & Gas Investors*, CEPMLP, University of Dundee (2006) 12; Blindermann *Production Sharing Agreement* (1999) 5.

[135] Van Hoogstraten *Theoretical Framework for Financial Flows in The Extractive Sector* (2015)5; Otto, *Mining Taxation in Developing Countries* (2002) 1.

several issues on how to design a fiscal regime that is flexible, and how to manage the fluctuaction of prices.[136]

3.4 Involvement of International Oil Companies (IOCs)

Although ownership of oil and gas *in situ* vests in the State, however, since most of these States, including Tanzania, lack capital, technology as well as expertise, the extraction is usually undertaken by International Oil Companies (IOCs).[137] One of the defining characteristics of the IOCs is that the shareholders are not residents in the country where the extractive operations are taking place.[138] In addition, the IOCs may have operations in different countries.[139]

The involvement of IOCs raises a number of complex tax issues. The first issue regards the sharing of taxing rights between the host country and the IOC's country of origin.[140] Since each country has its own tax laws, taxing the IOC entails interaction between domestic and international tax law.[141] In principle, the host country imposes taxes on the IOCs because they generated profits or earned an income from the host country.[142] On the other hand, the country of origin imposes taxes on the IOCs on their worldwide

[136] See the discussions under section 4 below.

[137] Heilbrunn, JR. *Oil, Democracy and Development in Africa* (Cambridge, Cambridge University Press 2014) 14. Collier "Principles of Resource Taxation for Low-Income Countries" (2010) 75. Boadway et al "Theoretical Perspectives on Resource Tax Design" (2010) 23; Stevens, P "Dividing the Spoils" 2008), 64 (5) *The World Today*, at 21; Nakhle, C "Petroleum fiscal regimes: Evolution and challenges" (2010) 94-101; Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 69,70; Muttitt, G "Production Sharing Agreements-Mortgaging Iraq's Oil Wealth" (2006) 28(3) *Arab Studies Quarterly* at 4. Bindemann *Production Sharing Agreements: An Economic Analysis* (Oxford Institute for Energy Studies, 1999)1-10; Yalapan *Legal Nature of the Papua New Guinea Petroleum Arrangement* (2004) 6; Nakhle, C *Petroleum Taxation Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 35-36; Duong, WN "Partnerships with Monarchs- Two Case Studies: Case One- Partnership with Monarchs in the Search for Oil: Unveiling and Re-examining the Patterns of Third World Economic Development in the Petroleum Sector (2004) 25 *The University of Pennsylvania Journal of International Law* 1171- 1295 at 1215 &1232 .

[138] See the discussion of the concept of residence under Chapter 3 section 3.1.3.

[139] IMF Spillovers in International Corporate Taxation (2014) 8.

[140] Reinhold, R "What is tax treaty abuse? is treaty shopping an outdated concept?" (2000) 53 (3) *The Tax Lawyer*) 663-702 at 673; IMF *Spillovers in International Corporate Taxation* (2014) 8.

[141] Kerzner and Chodikoff *International Tax Evasion in the Global Information Age* (2016) 37.IMF *Spillovers in International Corporate Taxation* (2014) 8.

[142] IMF *Spillovers in International Corporate Taxation* (2014) 9.

income because they are its residents.[143] The imposition of taxes on the IOCs by both host country and the country of origin results in double taxation. Double taxation occurs when the IOCs is taxed twice on the same income in both the host country and the country of origin.[144] Consequently, the IOCs are interested to know how they will be relieved from juridical double taxation.[145]

Another related challenge is how to counteract tax avoidance techniques adopted by the IOCs.[146] In practice, the IOCs take advantage of their multinational character to allocate costs and profits amongst their subsidiaries to avoid taxes.[147] Furthermore, the IOCs have a more competitive edge over the Government. For one, the IOCs employ competent lawyers and accountants on global scale.[148] In addition, the IOCs control the market and thus monopolize the industry.[149]

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[143] Three criteria are used to establish residence of a company. First, the country where the IOC is presumed to have its primary location. Second, the country where the company was incorporated. Third, where the company has its effective management. IMF *Spillovers in International Corporate Taxation* (2014) 9-10.

[144] This is referred to as "juridical double taxation" as contrasted with "economic double taxation" where for example a company a pays corporate income tax but still the dividends are subjected to withholding tax in the hands of shareholders. The international taxation discourse is pre-occupied with juridical double taxation. See Johnston, D *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 191. See also Schreiber, U *International Company Taxation: An Introduction to the Legal and Economic Principles* (Berlin, Springer, 2013) 1; UN Committee of Experts on International Cooperation in Tax Matters *Introduction to international double taxation and tax evasion and avoidance* Seventh session Geneva, (24-28 October 2011) 13 Available at http://www.un.org/esa/ffd/tax/seventhsession/CRP11_Introduction_2011.pdf (accessed 05 March 2017).

[145] Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 235-236.

[146] IMF *Spillovers in International Corporate Taxation* (2014) 8. Readhead, A *Preventing Tax Base Erosion in Africa: a Regional Studyof Transfer Pricing Challenges in the Mining Sector* (2016)3. available at http://www.resourcegovernance.org/sites/default/files/documents/nrgi_transfer-pricing-study.pdf (accessed 03 December 2016). See also Chapter 3 section 3.2.

[147] See Chapter 3 section 3.2.2.

[148] Readhead *Preventing Tax Base Erosion in Africa: a Regional Studyof Transfer Pricing Challenges in the Mining Sector* Natural Resource Governance Institute (2016) 3

[149] Historically, the so called seven sisters namely BP (then Anglo-Persian Oil Company), Gulf Oil, Texaco, Standard Oil of California, Royal Dutch Shell, Standard Oil of New Jersey and Standard Oil Company until the late 1960's the controlled more than 80% of the oil and gas reserves in the world. See Mitchell, J Marcel V and Mitchell B *What Next for the Oil and Gas Industry?* (2012) 42. See also Yergin, D *The Prize: The Epic Quest for Oil, Money and Power* (New York, Simon & Schuster, 1991) 503-506;; Al-Attar, A and Alomair, O "Evaluation of upstream petroleum agreements and exploration and production costs" (2005) 29 (4) *OPEC Review* 243-266 at 245.

The unique features of the oil and gas industry discussed above require sector-specific tax system. [150] In view of these unique features, the question is whether the industry should be taxed differently. The discussion of fiscal regimes follows.

4 Mechanisms for Capturing Resource Rent –Fiscal Instruments

In designing an oil and gas fiscal regime, the Government wants to achieve three policy objectives. [151] First, division or apportionment of the economic rent between the Government and the IOC.[152] This is equally important for the IOCs whose decision whether to make an investment depends so much on the expected return from the investment.[153] Accordingly, the Government is constrained to strike a balance between encouraging the IOCs to make more investments and ensuring that the country obtains fair share of the revenues commensurate with the extracted resources. [154]Second, the Government aims at attracting more investments in the industry and thus grants a variety of tax incentives.[155] Third, the Government wants to exert control over the exploration and production activity. [156] This aims at controlling the flow of revenues, [157]ensuring

[150] Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 136.

[151] Other objectives include economic development (jobs creation, industrialization)

[152] Alalade *The economic Performance of International Oil Companies in Nigeria* (2004) 80, 90. Johnston, D *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 17. IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 13; Khan, K.I.F "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 22 (1) *Journal of World Trade* 67–88 at 69. Baunsgaard, T *Primer on mineral taxation* (2001) 6; Le Leuch, H "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 127.

[153] Le Leuch, H "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" in Goldthau, A (ed) *The Handbook of Global Energy Policy* (John Wiley & Sons, Ltd. Ebook 2013) 135

[154] Le Leuch, "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 136.

[155] Le Leuch, "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 136; Alalade, CB *The economic Performance of International Oil Companies in Nigeria* PhD Study, University of Bournemouth (2004) available at http://eprints.bournemouth.ac.uk/457/1/Cornelius_Alalade.pdf (accessed 14 July 201780. Siu et al, *Unitary Taxation in the Extractive Industry Sector* International Centre for Tax and Development Working Paper 35 (2015) 8 available at file:///C:/Users/Bon/Downloads/SSRN-id2634008.pdf Dongkun, L and Na, Y "Assessment of fiscal terms of international petroleum Contracts" (2010) 37(6) *Petroleum Exploration and Development* 756-762 at 757-758.

[156] Alalade *The economic Performance of International Oil Companies in Nigeria* (2004) 80.

[157] Christians "Sovereignty, Taxation and Social Contract" (2009) 170.

efficient extraction and supply for security and strategic grounds.[158] The discussion of these levies and taxes follows.

4.1 Ownership-Based Levies

Generally, given the high costs involved in exploration and development of gas wells, IOCs would prefer to start paying taxes and levies after recovering some of these costs.[159] However, most Governments, as the owners of the resource, require a certain portion of the resources produced (rents) be shared with them regardless of whether a profit has been made.[160] The following paragraphs describe and discuss the applicability of these levies.

4.1.1 Bonuses

Bonuses are single lump sum payments payable upon on occurrence of events, such as signing of contract, discovery of oil or commercial production of oil.[161] Signature bonus and discovery bonus are undesirable for investors as they are paid upfront before the project makes any profit.[162] For this reason, bonuses also discourage small companies without access to large financial resources.[163] For the Government, the payment of bonuses constitutes a source of revenue that may be used to meet the administrative costs for operating the industry.[164] Even though payment of bonuses ensures that the Government obtains early revenue, the fact that the bonuses are tax deductible, means

[158] Alalade *The economic Performance of International Oil Companies in Nigeria* (2004) 57.

[159] Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 68.

[160] Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 37. Hannesson *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (1998)112;

[161] IMF, *Fiscal Regimes for Extractive Industries: Design and Implementation* **(**2012) 18. they can be set in legislation or negotiated, Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 42. It is meant to share the rewards of a production well or a bonanza. Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 52

[162] IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* **(**2012) 18. Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 42. Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 71.

[163] Johnston *International Exploration Economics Risks & Contract Analysis* (Tulsa, PennWell Corporation, 2003) 153.

[164] Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 71. Calder *Resource tax administration The implications of alternative policy choices* (2010) 320.

that they will be offset against future tax liabilities.[165] Therefore, bonuses constitute an early form of payment of taxes.

4.1.2 Royalties

Royalty refers to payment for the right to use another's property for purposes of gain.[166] In the oil and gas industry context, the owner of the oil and gas *in situ* claims compensation for the irreplaceable loss resulting from exploitation of non-renewable resources.[167] The royalty is payable immediately after the commencement of commercial production of oil and gas.[168] The payment of royalties is determined by reference to either the volume of production ("per-unit royalty") or gross revenue ("ad-valorem royalty").[169] Under the per-unit royalty the Government collects its share at wellhead while the ad-valorem royalty is charged based on the price of oil or gas at wellhead, shipment point or point of delivery. [170] The rate of royalty payable may be fixed by the law or subject to negotiations.[171]

For the Government, royalties have two major advantages. First, unlike profit-based taxes, which are difficult to administer, royalties are easy to administer.[172] This is because royalties are based on unit produced or revenue generated without deducting the costs of

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[165] Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 236. IMF, *Fiscal Regimes for Extractive Industries: Design and Implementation* **(**2012) 18. Tordo, S *Fiscal Systems for Hydrocarbons Design Issues* (2007) 42. Not deductible in Tanzania See Section 12(1) (a)&(b) of the Income Tax Act 2004.

[166] Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 21.

[167] Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 227; Sunley et al *Revenue from the Oil and Gas Sector: Issues and Country Experience* (2002) 2-3; Idubor et al "Appraising Taxation and the Nigerian Oil Industry" (2015) 193; Aalberts, RJ and Siedel III, G J *Real Estate Law* (7edn) Mason, OH South-Western Cengage Learning (2008) 67.

[168] Aalberts and Siedel III *Real Estate Law* (2008) 68.

[169] Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 95. Blinn etal International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects (1986) 230. Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 22.

[170] Blinn etal *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 227, 230, 231.

[171] Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues"(2013) 132.

[172] Hannesson *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (1998) 111; Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 95; Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 228.

production.[173] Second, the fact that royalties are payable as soon as production commences and are not tied to profits, guarantees upfront revenues to the Government.[174] However, for income tax purposes, royalties are treated as a credit ("credited royalties") akin to advance income tax or as an expense ("expensed royalty") which is an allowable deduction when calculating income tax.[175] This implies that the early royalties paid are offset against future incomes generated by the IOC.[176]

Although royalties guarantee early Government revenues, the fact that they are payable regardless of whether a profit has been made, make them very unpopular with the IOCs.[177] To address the regressive nature of royalties, most Governments charge a very low rate of royalties, ranging between one and fifteen per cent.[178] Similarly, the Government may levy a lower royalty for high cost fields, such as deep water offshore projects and vice versa.[179] The other available policy option is the adoption of a progressive or sliding scale royalty, which increases or decreases with the rate of production.[180]

From the IOCs viewpoint, the charging of royalties may lead to pre-mature closure or non-development of marginal fields.[181] Marginal fields, whose operational costs are higher than the revenues, cannot be operated in a regime that charges royalties.[182] This is

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[173] Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 37; Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 228.

[174] Profits may take 5 years. Hannesson *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (1998) 112; Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 37.

[175] Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 231.

[176] Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 95-96.

[177] Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 228; Nakhle, C "Petroleum fiscal regimes: Evolution and challenges" (2010) 95, Tordo, S *Fiscal Systems for Hydrocarbons Design Issues* (2007) 38; Johnston, D *International Exploration Economics Risks & Contract Analysis* (2003) 154.

[178] Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 54.

[179] Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 230.

[180] Blinn *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 228.

[181] Nakhle "Petroleum fiscal regimes Evolution and challenges" (2010) 96. See also Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 54; Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 68.

[182] Zero out production happens when the marginal costs of operating an oil and gas project equals the revenue obtained from sales of the products. See Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 38. See also Hannesson *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (1998) 112: Blinn et al *International Petroleum Exploration and Exploitation Agreements:*

exacerbated by the fact that cost fields pay the same royalty as low cost fields.[183] Consequently, both the Government and the IOCs may lose the potential revenues from these marginal fields.[184] To ensure that marginal fields remain productive, countries, such as Norway and the UK do not levy royalties for projects in marginal fields.[185]

4.1.3 Production Sharing

In situations where the Government enters into a contract with the IOCs, agreeing the methods of sharing the economic rent through sharing the produce or value of production based on a pre-determined formula.[186] Under the production-sharing contract, the investor bears all the costs and risks of exploration and development.[187] If the project is successful, the IOC is given a part of production as an entitlement for cost recovery, while the remainder production is split between the Government and IOC at a pre-determined share.[188] The rate of share for the parties may fixed or progressive.[189] Although this form of sharing rent is not a tax *per se*, but it represents a form of non-tax instrument.[190]

4.1.4 Excess Profit Tax

Generally, certain factors, such as chemical composition or the sharp increase in oil and gas prices that lead to creation of exceptionally big profit margins.[191] Governments as the owners of the resource envision this situation; therefore want to capture as large a

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Legal, Economic and Policy Aspects (1986) 228; Nakhle "Petroleum fiscal regimes Evolution and challenges" (2010) 96.

[183] Blinn etal *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 228.

[184] Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 68. See also Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 54 Hannesson *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (1998)112.

[185] Hannesson *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (1998) 112.

[186] Sunley et al *Revenue from the Oil and Gas Sector: Issues and Country Experience* (2002) 7; See also Baunsgaard, T *Primer on mineral taxation* (2001)12.

[187] Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 99-101; See also Bindemann *Production Sharing Agreements: An Economic Analysis* (1999) 1.

[188] Bindemann *Production Sharing Agreements: An Economic Analysis* (1999) 1. See also Chapter 5 section 2.5.

[189] Bindemann *Production Sharing Agreements: An Economic Analysis* (1999) 1.

[190] Barma et al *Rents To Riches? The Political Economy of Natural Resource–Led Development* (2012) 124.

[191] Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 22. Blinn etal *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 240, Nakhle "Petroleum fiscal regimes: evolution and challenges" (2010)96; Boadway et al *The Taxation of Natural Resources Principles and Policy Issues* (1993) 6.

proportion as possible of the excess profit generated.[192] To capture these excess profits, Governments impose excess or additional profit tax. [193] The excess profit tax is charged, in addition to the normal corporate income tax, when the profits earned by the IOC exceed the reasonable return set by the Government. [194] The excess profit tax was introduced for the first during the price boom in the 1970 and 1980. [195] The justication for charging excess profit tax is that super normal profits (above normal market level) accrue to the IOC but "not caused" by the IOC.[196]

There are two bases for charging excess profit tax. [197] The first is the investment payback ratio. Under this aspect, the excess profit tax is charged when the IOC has earned a payback on investment that exceeds certain predetermined limits. [198] The second basis is the rate of return or cash flow obtained by the IOC. [199] Excess is charged only when the IOC has earned positive cash flows.[200] In practice, excess profit tax is normally not payable during early years of production.[201] This is because it takes time for the IOC to

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192 Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 132,

193 This special tax has different names. For example, in Norway (Special Petroleum Tax), the UK (Petroleum Revenue Tax), and the US (the Windfall Profit Tax). See Nakhle, C *Petroleum Taxation Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 28. See also Blinn etal *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 240, Nakhle "Petroleum fiscal regimes: evolution and challenges" (2010)96; Boadway et al *The Taxation of Natural Resources Principles and Policy Issues* (1993) 6. In Tanzania is referred to as Additional Profit Tax (APT).See Chapter 5 section 2.5.4.4.

194 Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 132. See also OECD *Addressing the tax challenges of the digital economy* (2014) 33 and Sunley et al *Revenue from the Oil and Gas Sector: Issues and Country Experience* (2002) 6 Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 78

195 Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 132.

196 Aldazosa, ARV "Windfall Profits Tax on Oil and Gas: US and Latin American Approach" (2009) 37(1) *Intertax* 74-80 at 74, 76.

197 Baunsgaard *Primer on mineral taxation* (2001) 8. Naazneen H. Barma Rents To Riches? The Political Economy of Natural Resource–Led Development (2012) 130.

198 Baunsgaard *Primer on mineral taxation* (2001) 8.

199 Baunsgaard *Primer on mineral taxation* (2001) 8.

200 Nakhle "Petroleum fiscal regimes Evolution and challenges" (2010) 97. Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 78.

201 Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 241; Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012) 131.

earn positive cash flows. For the IOC, the excess profit tax is considered a balanced tax payable only where the IOC has earned exceedingly high returns. [202]

For the Government, excess profit ensures that the Government obtains its share from the supernormal profits earned by the IOC.[203] It also means flexibility, as no amendments to the tax laws are required during the price booms.[204] However, there are challenges, especially for developing countries, in the design and implementation of the excess profit tax. For example, most IOCs are reluctant to disclose their preferred rate of return.[205] Given the information asymmetry, it is extremely difficult for the Government to choose the appropriate discount rate of rate of return that would guarantee payment of excess profit tax.[206] In addition, the excess profit tax, like corporate income tax, is affected by different tax avoidance schemes adopted by the IOCs.[207] If it is difficult to collect profit-based taxes, such as corporate income tax, then, it will be even more difficult to collect excess profit taxes.[208] In view of these challenges, it is considered extremely difficult for developing countries to enforce excess profit tax.[209]

4.2 General Taxes

As discussed in the preceding paragraphs, oil and gas taxation entails both industry-specific levies as well as general taxes.[210] The general taxes imply that the IOCs will be subjected to the same tax rates like any other business. The most common forms of generally applicable taxes is the corporate income tax (CIT), capital gains tax, and

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[202] Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 241, Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 79.

[203] Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 242.

[204] Barma *Rents To Riches? The Political Economy of Natural Resource–Led Development* (2012) 131. Blinn, et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* **(**1986) 242.

[205] Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 79.

[206] Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012)131.

[207] Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012)131.

[208] Barma et al *Rents to Riches?* The Political Economy of Natural Resource-led Development (2012)131. See also Chapter 3 section 3.2.

[209] Barma et al Rents to Riches? The Political Economy of Natural Resource-led Development (2012) 131.

[210] See Chapter 2 Section 4.

withholding taxes The next section discusses in detail these different forms of general taxes and the rules of their applicability.

4.2.1 Corporate Income Tax

Corporate income tax (CIT) is usually imposed both corporate level as well as in the hands of shareholders. [211] The CIT being a profit-based tax implies that no tax is payable where the project does not generate any profits. Profits are calculated as the difference between the gross revenue and the deductible investment and operational costs. [212] In addition, the Government may decide to impose special rate of CIT for oil and gas industry or use the general tax rate.[213] The IOCs consider CIT as the best mechanisms for sharing economic rent. [214] Moreover, the payment of CIT qualifies for tax credit in the OICs' home countries, thus relieves the problem of double taxation.[215]

The Government faces several challenges in managing CIT. First, the determination of gross revenue, which is dependent on oil and gas prices, is very difficult.[216] The difficulty arises from the price volatility in the world market.[217] It is also because IOCs, in view to reduce their tax liability, devise different techniques, such as transfer pricing to reduce their gross revenues.[218] Second, the IOCs devise a variety of techniques, such as transfer pricing and thin capitalization to "gold plate" their deductible expenses. [219] Third, the tax

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211 Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008)22.

212 Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 96; Le Leuch, H "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013)132.

213 Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 96; Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 39. Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 231; Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 132.

214 Hannesson *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (1998) 112, Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 75. Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 96.

215 Blinn et al International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects (1986) 233.

216 Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 233-34.

217 Bauer and Quiroz "Resource Governance" (2013) 246. Rozner *Taxing Oil: Issues and Trends* (2009) 2. Blindermann *Production Sharing Agreement* (1999) 5.

218 See Chapter 3 section 3.2.2. See also Blinn et al International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects (1986) 235.

219 See Chapter 3 section 3

incentives, such as accelerated depreciation have the effect of lowering taxable income.[220] To this end, the combination of these factors implies that no or low corporate tax will be payable to the Government.[221] This may be partly the reason why most IOCs, despite being among the richest companies in the world, do not pay CIT in the countries where they operate.[222] The non-payment of CIT means that certain entities enjoy protection by the State and benefit from other social services without making their due contribution.[223] On this basis, the sole dependency on CIT as the source of State revenue has been challenged.[224] To ensure that every entity pays taxes, some countries have introduced a special tax for companies that do not make profits for two consecutive years.[225]

4.2.2 Withholding tax

The IOC may engage several subcontractors, who are non-residents in the host country, to provide services and goods.[226] It may also involve financiers and owners of intellectual propery.[227] Since all these entities receive income that has a source in the host country, the the host country will have a right to impose taxes on such income.[228] However, since the recipients of income do not have a place of business nor tangible assets in the host country it is difficult to subject them to income tax.[229] To ensure that the non-residents

[220] See Chapter 3 section 3.1.2.

[221] This because the deductible expenses are usually higher during the ealy stages of production and thus no profit is earned by the IOC during this period. See Nakhle "Petroleum fiscal regimes Evolution and challenges" (2010) 96.

[222] Fuest *Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform* (2013) 1.

[223] Theoretically, taxes are imposed in exchange for provision of public services and social services, such as security, defence, infrastructure and health care. Taxes are also used to support Government expenditure. See Luoga, FDAM *A Sourcebook of Income Tax Law in Tanzania* (Dar es salaam, Dar es salaam University Press, 2000) 7; Nakhle, C *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 8; Morse, Williams and Salter *Davies Principles of Tax Law* (1996) 4.

[224] See Chapter 4 section 3.3.1.

[225] Tanzania has introduced a special tax on business turnover namely Alternative Minimum Tax (AMT). See Chapter 5 section 2.5.4.2.

[226] See section 3.4 above.

[227] Markle, K *Tax Haven Use Across International Tax Regimes* (2011) 7.

[228] IMF *Spillovers in International Corporate Taxation* (2014) 9.

[229] Tanzania Revenue Authority (TRA); Daurer and Krever "Choosing Between the UN and OECD Tax Policy Models: An African Case Study" (2014) 22 (1) *African Journal of International and Comparative Law* 1–21 at 9. See also OECD *Addressing the tax challenges of the digital economy* OECD Publications (2014) 35.

pay taxes, the Government imposes withholding taxes.[230] The withholding tax places an obligation on the resident taxpayer to deduct and withhold taxes on income earned by non-residents.[231] The common forms of payments subject to withholding tax include interests, dividends, and rental income, technical services offered by non-residents, royalties, and branch remittance.[232] Unlike corporate income tax, where taxpayers deduct their expenses, there are no deductions for withholding taxes. This explains the reason why withholding tax rates are usually lower than corporate income tax.[233]

4.2.3 Capital Gains Tax

It is common in the oil and gas industry for the petroleum right or interests in the petroleum right to exchange hands from one investor to another.[234] In this process, large premiums or capital gains accrue to investors.[235] For instance, share transfers or petroleum rights transfers may create profits for the transferor, which are taxable.[236] The gains are usually attributed to factors, such as the discovery of new deposits, geological features of the deposits or increases of oil and gas commodity prices, which lead to an appreciation of the value of petroleum right.[237] The increase in the value of petroleum right means that transfer of such right gives holder rights a substantial gain on the original capital investment.[238] The same applies to the shares or interests in the petroleum right, which are deemed to derive their value from the petroleum right ("underlying assets") held by the IOC.[239] While these gains are not taxable in other jurisdiction, in countries,

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[230] Daurer and Krever "Choosing between the UN and OECD Tax Policy Models: An African Case Study" (2014) 9.

[231] Daurer and Krever "Choosing Between the UN and OECD Tax Policy Models: An African Case Study" (2014) 9.

[232] First Schedule to the Income Tax Act 2004.

[233] Usually, do not exceed 10 percent OECD *Addressing the tax challenges of the digital economy* OECD Publications (2014) 36.

[234] Cameron, PD and Stanley, MC *Oil, Gas, and Mining: A Sourcebook for Understanding the Extractive Industries* (Washington DC, The World Bank, 2017) 163.

[235] Cameron, PD and Stanley, MC *Oil, Gas, and Mining: A Sourcebook for Understanding the Extractive Industries* (Washington DC, The World Bank, 2017) 163.

[236] See Chapter 2 section 4.2.3 and Chapter 3 section 3.2.1.

[237] E.G one mining company had its market capitalization increase from $A 10 M to $A 1 B within two years. See OECD *Mobilising Resource Revenues From The Mining Sector: Tackling Leakages And Building On The OECD/g20 actions on BEPS* (2016) 2

[238] Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 34.

[239] Burns, Le Leuch and Sunley "Taxing gains on transfer of interest" (2017) 174. See Daniel *International Taxation Issues for Extractive Industries* (2014) 7.

such as Tanzania they are subject to capital gains tax.[240] The capital gains tax is imposed on the transfer or disposal of right. Generally, the host country claims the right to impose tax because the gains have a source in the host country.[241] Alternatively, the host country may claim that the petroleum right as an immovable property which is subject to corporate income tax or capital gains tax.[242]

One of the most important elements in the design and implementation of capital gains tax relates to the structure of transfer of the petroleum rights. The easiest form to tax is the direct transfer of interests, which involves the transfer of the whole or part of the right itself.[243] By contrast, the indirect transfer of petroleum right or an interest in petroleum right poses several hurdles in the implementation of CGT.[244] The indirect transfer may take the form of a farm out arrangement where the holder of a petroleum right transfer a percentage interests in the right to another in exchange for cash or future commitments.[245] The IOCs may decide to farm-out where it does not have sufficient capital to undertake the extraction singlehandedly or where the company wants to diversify the risk.[246] Similarly, shareholders of the company holding petroleum right may dispose their shares in the company.[247]

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[240] For example no capital gains tax is payable on transfer of interests in Norway. For example, in Mozambique in 2013 the seller of 28.5% of shares of a company holding 70% in of a petroleum right worth $ 4.2 billion accepted that tax was payable. Burns, Le Leuch and Sunley "Taxing gains on transfer of interest" (2017) 163.

[241] Burns, Le Leuch and Sunley "Taxing gains on transfer of interest" (2017) 174; IMF *Spillovers in International Corporate Taxation* (2014) 29.

[242] Burns, Le Leuch and Sunley "Taxing gains on transfer of interest" (2017) 170.

[243] Uganda in 2010 entire 50% interests in a PSA worth $ 1.45 billion. It was confirmed in 2015 that stamp duty and capital gains were payable. Uganda in 2012 sale of one third interests in three blocks each for $ 2.9 billion. Resolved that the seller was liable to pay $ 250 million. Burns, Le Leuch and Sunley "Taxing gains on transfer of interest" (2017) 160-162

[244] Burns, Le Leuch and Sunley "Taxing gains on transfer of interest" (2017) 163.

[245] The act of another company acquiring interest in the project is referred to farm in. Burns, Le Leuch and Sunley "Taxing gains on transfer of interest" 180. Daniel *International Taxation Issues for Extractive Industries* (2014) 7. Duong, WN "Partnerships with Monarchs- Two Case Studies: Case One- Partnership with Monarchs in the Search for Oil: Unveiling and Re-examining the Patterns of Third World Economic Development in the Petroleum Sector (2004) 1228-29.

[246] Jahn F, Cook M and Graham M *Hydrocarbon Exploration and Production* (Amsterdam, Elsevier BV 2003) 14-15.

[247] Burns, Le Leuch and Sunley "Taxing gains on transfer of interest" (2017) 160..

Daniel, P "International Taxation Issues for EI" (Natural Resource Charter Annual Conference Oxford: June 12, 2014) 7 https://resourcegovernance.org/sites/default/files/nrc2014_Philip_Daniel_NRC-EIInternationalTaxation_20140612.pdf (Accessed on 05 February 2017)

While direct transfer are easily taxable, the indirect transfers are subject to several limitations, such as change of control.[248] The major challenge with indirect transfers is that it is difficult to detect transactions occurring abroad and those, which involve non-resident taxpayers.[249] Even when these transactions are discovered, it is difficult for the tax authority reach the non-resident transferor.[250]

In addition, the fact that capital gains tax is usually calculated as difference between the sale price of an asset and its acquisition costs, creates problems where there is consideration other than cash.[251] For instance, where the right is transferred before commercial discovery, parties may agree to pay cash up front and contingent interests in case any commercial discovery is made.[252] There are challenges on treatment of future commitments.[253]

4.2.4 Indirect taxes

The upstream oil and gas sector may also be subjected to several indirect taxes.[254] One of the most common forms of indirect taxes is Value Added Tax (VAT). In most countries including Tanzania, VAT is usually charged on the destination of petroleum products.[255] This means that no VAT is charged on exported oil and gas commodities.[256] In addition, VAT is also charged on imported machinery and equipment. However, to attract investments, most countries exempt all machinery and equipment used in the exploration or production of gas from VAT.[257] Similarly, the machinery and equipment used in the

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[248] Burns, Le Leuch and Sunley "Taxing gains on transfer of interest" (2017) 163.

[249] Burns, Le Leuch and Sunley "Taxing gains on transfer of interest" (2017) 160.IMF *Spillovers in International Corporate Taxation* (2014) 30.

[250] IMF *Spillovers in International Corporate Taxation* (2014) 30; Cui, W *Taxation of non-residents' capital gains* (2015) 125 Burns et al "Taxing gains on transfer of interest" (2017) 174.

[251] Lee Burns, Honoré Le Leuch and Emil M. Sunley "Taxing gains on transfer of interest"160. Guj, P, Bocoum, B Limerick, J, Meaton, M and Maybee, B *How to Improve Mining Tax Administration and Collection Frameworks: A Sourcebook* (Washington DC, World Bank, 2013) 72. Daniel, P International Taxation Issues for Extractive Industry (2014) 15.

[252] Referred to as "overriding royalty" Lee Burns, Honoré Le Leuch and Emil M. Sunley "Taxing gains on transfer of interest" 162, 180.

[253] Daniel *International Taxation Issues for Extractive Industry* (2014) 15.

[254] Sunley et al *Revenue from the Oil and Gas Sector: Issues and Country Experience* (2002) 10

[255] Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 41- 42

[256] Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 41- 42; See also Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012) 132.

[257] Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 41.

exploration or production of gas are usually exempted from import duties.[258] The other forms of indirect taxes include excise duty, stamp duty, local Government levies and payroll taxes [259]

4.3 Non-Tax Instruments

As discussed in the preceding paragraphs the Government devises different mechanisms to capture a fair share of the economic rents. These mechanisms include both tax and non-tax instruments. The next section highlights the non- tax instruments applied in the oil and gas industry.

4.3.1 State Equity Participation

Apart from charging taxes, the host State may decide to participate directly in the oil and gas project.[260] The State participation is motivated by the need to have more control over the activity of the IOC, technology transfer and maximizing revenues from the oil and gas extraction.[261] The Government may acquire direct interest by purchasing shares in the IOC.[262] The challenge with direct equity participation is that it diverts the much-needed public funds away from social amenities.[263] In another form of State equity participation, the IOC pays for the Government's equity participation ("carried interests").[264] This payment may be considered as loan to the State Government and is setoff against the

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[258] Otto *Mining Taxation in Developing Countries* (2000) 3; *Barma et al Rents to Riches? The Political Economy of Natural Resource-led Development* (2012) 132.

[259] See Chapter 5 sections 2.5.6 and 2.5.7. See also Otto, JM *Mining Taxation in Developing Countries* (2000) 13; Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 41.

[260] IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* **(**2012) at 18. Boadway et al *The Taxation of Natural Resources Principles and Policy Issues* (1993) 6.

[261] Baunsgaard *Primer on mineral taxation* (2001) 13; Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 237; Johnston *International Exploration Economics Risks & Contract Analysis* (2003) 156.

[262] IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* **(**2012) 21. Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 85.

[263] Kuwimb, MJ *An Examination of Papua New Guinea's Petroleum Law and policy* LLM Dissertation, University of Wollongong (1997) 201-202 available at http://ro.uow.edu.au/cgi/viewcontent.cgi?article=3580&context=theses (accessed 15 March 2015).

[264] Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 67 IMF Fiscal Regimes for Extractive Industries: Design and Implementation **(**2012) 21.

Government taxes.[265] The carried interests approach is the most preferred system by developing countries.[266]

4.3.2 Rental and Bidding Fees

The Government as the landowner charges rental fees for all persons using its land. In respect of upstream oil and gas, rental fees are payable based on the land covered by an exploration or production license.[267] Usually, the rental fees involve nominal sums of money.[268] Apart from using the rental fees to cover some administrative costs, the Government uses the rental fees to encourage the IOC to engage in effective exploration operations.[269] For example, rental fees are used to discourage IOCs from holding big areas without engaging in exploration. The Government also charges bidding fees and information fees[270]

5 Fiscal regimes classification

As discussed in the preceding paragraphs, the State devises different mechanisms for rent collection.[271] All these fiscal and non-fiscal instruments have been clustered into two systems namely concessionary and contractual regimes. The discussion of these fiscal systems follows.

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[265] IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* **(**2012) 21.

[266] Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 66-67 See also Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 85.

[267] Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 132; Also named as rent, land use fee, surface rental or occupation fee – Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 72; Hannesson, R *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (1998) 111.

[268] See Chapter 5 section 2.5.5 regarding the rental fees charged in Tanzania.

[269] Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 42; Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 236.

[270] See Chapter 5 section 2.5.5 Tanzania information fee is paid for geological and geophysical data Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 73.

[271] Also the whole of Chapter 2 discusses the principles of taxation (rent collection)

5.1 Concessionary System

Under the concessionary system, the Government transfers to the IOC an exclusive right to explore and produce petroleum [272] The IOC undertakes to develop and extract petroleum products at its own risk and expense.[273] When production commences, the IOCs will be liable to pay royalties, income tax and special petroleum tax.[274] The concessionary system is applied in countries, such as the UK, US, Brazil, Australia Canada.[275] One of the major advantages of the concessionary system is that all the fiscal terms are fixed in a statute leaving no room for negotiations.[276] This ensures not only equal treatment of all licensees, but also limits the room for corrupt practices by Government officials.[277] The concessionary system also does not use stabilization clauses. Therefore, the legislature may enact laws that alters or affects the terms of the concession.[278]

5.2 The Contractual System

Unlike the concessionary system, under the contractual system the Government retains the ownership of oil and gas in situ as well as after production. .[279] The IOC is engaged

[272] Also known as tax & royalty regime see Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 21-23;see also Blake et al "Comparing petroleum fiscal regimes under oil price uncertainty" (2006)97; Bret-Rouzaut et al *Oil and Gas Exploration and Production Reserves, costs, contracts* (2011) 193-94; Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 95; Parra *Oil Politics: A Modern History of Petroleum* (2004) 8-9; Abrahamson *Tolley's International Taxation of Upstream Oil and Gas* (Tolleys, 2014)19-20.

[273] Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 3. See also Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 94; Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 30-35.

[274] Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 132. Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 95.

[275] Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 93; Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) at 30-35; Abrahamson *Tolley's International Taxation of Upstream Oil and Gas* (2014) 19.

[276] Onorato *Legislative Frameworks Used to Foster Petroleum Development* (Washington, The World Bank, 1995) 4, Perreira et al *African Upstream Oil and Gas: A practical guide to the law and Regulation* (2015)11. Nakhle "Petroleum fiscal regimes: evolution and challenges" (2010) 93-94 Johnston D, Johnston D and Rogers, T *International Petroleum Taxation for the Independent Petroleum Association of America* (2008) 1.

[277] Cameron, PD and Stanley, MC *Oil, Gas, and Mining: A Sourcebook for Understanding the Extractive Industries* (2017) 69.

[278] Parra *Oil Politics: A Modern History of Petroleum* (2004) 9.

[279] Blake et al "Comparing petroleum fiscal regimes under oil price uncertainty" (2006) 97; Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 23; Yalapan *Legal*

as contractor and operates at its own risk and expense. [280] The IOC will only be reimbursed for its costs if oil or gas is discovered. [281] One of the most common contractual arrangements is the Production Sharing Contract (PSC). Under the PSC, the IOCs are compensated through a share of production.[282] In addition, the Government imposes other levies, such as royalties, corporate income tax, bonuses as well as equity participation. [283] The major setback of the PSC system is that certain fiscal terms are subject to negotiations.[284] This increases the potential corruption risk.[285]

The other forms of contractual arrangement include service contracts and risk service contracts. Under a *Service Contract*, the IOC bears all the risks for agreed fixed fee in cash or in kind. [286] By contrast, under *Risk Service Agreement,* the exploration and development costs are borne by the State and the IOC is contracted to supply services and technical expertise, such as consulting, engineering, construction, operational and

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Nature of the Papua New Guinea Petroleum Arrangement (2004) 7; Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 134.

[280] Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* 2008) 30-35; Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 98-99; Bindemann *Production Sharing Agreements: An Economic Analysis* (1999) 1. Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 21-23; Blake et al "Comparing petroleum fiscal regimes under oil price uncertainty" (2006) 97.

[281] Bret-Rouzaut and Favennec *Oil and Gas Exploration and Production Reserves, costs, contracts* (2011) 202; Blake et al "Comparing petroleum fiscal regimes under oil price uncertainty" (2006) 97; Abrahamson *Tolley's International Taxation of Upstream Oil and Gas* (2014) 21.

[282] Hogan, Sturzenegger and Tai "Contracts and Investment in Natural Resources" (2010) 11. See also Nakhle, C "Petroleum fiscal regimes: Evolution and challenges" (2010) 99-101; Bindemann *Production Sharing Agreements: An Economic Analysis* (1999) 1; Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 83. Bret-Rouzaut and Favennec *Oil and Gas Exploration and Production Reserves, costs, contracts* (2011) 200; Ogunleye, T A "A Legal Analysis of Production Sharing Contract Arrangements in the Nigerian Petroleum Industry" (2015) 8(5) *Journal of Energy Technologies and Policy* 1-10 at 6-7; Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 133.

[283] Abrahamson *Tolley's International Taxation of Upstream Oil and Gas* (2014) 23-26. See also Hogan Sturzenegger and Tai "Contracts and Investment in Natural Resources" (2010) 11.

[284] Perreira et al *African Upstream Oil and Gas: A practical guide to the law and Regulation* (2015) 11-12. See also Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013)130

[285] See Chapter 3 section 3.4.

[286] Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 102, Bindemann Production-Sharing Agreements: An Economic Analysis (1999) 10, Nakhle Petroleum Taxation: Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow (2008) 35-36. Easo "Licences, concessions, production sharing agreements and service contracts" (2007) 38.

managerial services.[287] In return, the Government pays a service fee to the IOCs for services offered.[288]

6 Conclusion

The chapter briefly highlighted oil and gas industry-specific features that inform the design of oil and gas tax regimes. In doing so, the chapter provided a general overview of the value chain in the oil and gas industry. The understanding of the oil and gas value chain helps to identify at which point a profit is made, taxes are imposed and is thus important for policy formulation. The chapter also highlighted tax-related features of the oil and gas industry, mechanisms for the creation of Government revenues as well as the different fiscal systems around the world. In this regard, the chapter identified the role of Government in the grant of rights, supervision and monitoring of the industry and imposition of taxes. While these discussions have highlighted the design of an ideal fiscal regime, several factors impede the Government's ability to collect tax revenues. As argued in Chapter one, although most oil-rich countries in Africa have fiscal regimes that are similar to their counterparts in developing countries, but these African countries are not able to obtain a fair share of revenues from oil and gas extraction. For this reason, the next chapter examines the challenges Governments face when implementing oil and gas fiscal regimes.

[287] Bindemann *Production-Sharing Agreements: An Economic Analysis* (1999) 10. See also Easo "Licences, concessions, production sharing agreements and service contracts" (2007) 38. Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 127, 134.

[288] Nakhle "Petroleum fiscal regimes: Evolution and challenges" 102; Bindemann *Production Sharing Agreements: An Economic Analysis* (1999) 10; Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 85.

CHAPTER THREE: THE CONCEPT OF TAX REVENUE LEAKAGE

1 Introduction

The previous chapter discussed a variety of fiscal terms adopted by the Government to raise revenues from oil and gas operations. The design of fiscal terms, which includes tax base, tax rate and mechanisms for calculating the taxes payable, is just one of the important components of the oil and gas taxation framework.[1] Another important component is tax administration. Tax administration entails the system of assessing taxes payable, auditing tax returns and collecting taxes due.[2] While the fiscal terms create an obligation to pay taxes, tax administration entails the enforcement of such fiscal terms and the actual collection of the taxes due.[3] Accordingly, tax administration is as "significant as the fiscal terms themselves".[4]

This chapter provides an analysis of the interaction between fiscal terms and tax administration. The aim of this analysis is to identify factors that are likely to cause leakage of tax revenues. This chapter first describes the concept of tax revenue leakages, then proceeds to analyze the causative factors for the tax revenue leakage. This analysis forms a basis for evaluating the Tanzanian oil and gas fiscal regime to establish how Tanzania responds to the problem of tax revenue leakage. The next section examines the concept of tax revenue leakage.

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[1] Calder J "*Resource tax administration: The implications of alternative policy choices"* in Daniel, P Keen, M, McPherson C (eds) *The Taxation of Petroleum and Minerals Principles, Problems and Practice*, (London, Taylor & Francis, 2010) 319. See also Kasriel, K and Wood, D *Upstream Petroleum Fiscal and Valuation Modeling in Excel*: *A Worked Examples Approach* (West Sussex, John Wiley & Sons Ltd 2013) xi.

[2] Calder *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014) 51 37. See also Holland, D and. Vann, RJ "Income Tax Incentives for Investments" in Victor Thuronyi (ed) *Tax Law Design and Drafting* Volume 1 (Washington DC, International Monetary Fund, 1996) 988.

[3] Holland and Vann "Income Tax Incentives for Investments" (1996) 988. See also Collier, P *The Plundered Planet: Why We Must- and How We Can-Manage Nature for Global Prosperity* (New York, Oxford University Press, 2010) 60. Guj et al *How to Improve Mining Tax Administration and Collection Frameworks*: *A Sourcebook* (2013) 88.

[4] Holland and Vann "Income Tax Incentives for Investments" (1996) 988.

2 What is Tax Revenue Leakage?

As discussed in preceding chapter, one of the major policy objective is maximizing tax revenues while attracting new investments and maintaining the existing ones.[5] To achieve this objective, the Government formulates policies which are subsequently codified into laws.[6] Once enacted into law, the Government sets up institutional framework for interpretation of such laws and ultimate assessment and collection of taxes due.[7] It is a noteworthy aspect that these three aspects of oil and gas fiscal system – tax policy, tax laws and tax administration – are interrelated.[8] For example, poorly drafted tax laws result into multiple interpretations and thus create loopholes for tax avoidance and tax evasion.[9] Likewise, with a poor tax administration, even the best tax laws will not produce the expected outcomes.[10] Equally, where tax administrators divert the collected tax revenues, the exchequer will miss out the potential revenues.[11]

Assuming that the tax policy, tax laws and tax administration are all intact, and then it is possible to predict the likely Government tax revenues from the oil and gas industry. This assumption is based on the fact that it is possible to estimate the revenues, rates of productions as well as profits.[12] Similarly, with financial modeling it is possible to forecast revenue or cash flows from the oil and gas productions.[13] Based on these estimated revenue streams, it possible to calculate the expected profit-based taxes as well as the dividends from Government equity participation.[14] Further to that, several levies,

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[5] See Chapter 2 section 4.

[6] Both the Petroleum Code and tax laws. See Tanzanian oil and gas fiscal regime under Chapter 5 section 2.5.

[7] This in addition to other administrative functions, such as registration of taxpayers. See Calder *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014) 51 37.

[8] Bird RM, "Administrative Dimensions of Tax Reform" (2004) *Asia-Pacific Tax Bulletin* 134-150 at 135; Enahoro, JA and Olabisi, J "Tax Administration and Revenue Generation of Lagos State Government, Nigeria" (2012) 3 (5) *Research Journal of Finance and Accounting* 133-139 at 133

[9] Calder *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014) 21. See also the general discussion under Chapter 4 section 2.2.2.

[10] Bird "Administrative Dimensions of Tax Reform" (2004) 136.

[11] McPherson and MacSearraigh "Corruption in the Petroleum Sector" (2007) 197.

[12] See Chapter 2 section 4.

[13] Li, Y et al "Cash flow forecast for South African firms" (2014) 5(1) *Review of Development Finance* 24-33 at 25-27; Kasriel, K and Wood, D *Upstream Petroleum Fiscal and Valuation Modeling in Excel*: *A Worked Examples Approach* (2013) xi.

[14] See Chapter 5 section 2.5.

such as bonuses and rental fees involve once- off payments and thus can be estimated with higher certainty.[15]

While it is possible, based on fiscal instruments, to forecast the likely cash flow from the oil and gas industry, several factors impede on the Government ability to collect such revenues.[16] For one, the IOCs (taxpayers) may not comply with the provisions of the law and thus the expected taxes will not be collected.[17] Non-compliance entails the failure by taxpayers to discharge their tax obligations.[18] For instance, taxpayers may deliberately decline to file tax returns, under-declare or conceal taxable income.[19] The other form of non-compliance is the "use the tax law to get a tax advantage that Parliament never intended".[20] Consequently, non-compliance results in significant loss of tax revenues.[21]

The non-compliance of taxpayers and the tax administrators' ineptitude result in a significant difference between the potential tax revenues and the actual revenues collected (referred to as the "tax gap").[22] While the tax gap concept considers non-compliance by taxpayers as the major source for loss of tax revenues, there are other factors may lead to

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[15] See Chapter 2 section 4.

[16]. Hindriks J, Keen M, and Muthoo A "Corruption, Extortion and Evasion" in Abed GT and Gupta S *Governance, Corruption and Economic Performance (*Washington, D.C. IMF 2002)396-436 at 396-398. See also Otusanya et al "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013) 312.

[17] Otusanya et al "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013) 312. Slemrod, J and Yitzhaki, S "Tax Avoidance, Evasion, and Administration" in *A.*J Auerbach and M. Feldstein (ed) *Handbook of Public Economics, Volume 3 (Elsevier Science B. V2002*) 1426.

[18] Kirchler, E *The Economic Psychology of Tax Behaviour* (New York, Cambridge University Press, 2007) 21.

[19] See Chapter 3 section 3.3 . See also Degl'Innocenti, DG and Rablen, MD "Income Tax Avoidance and Evasion: A Narrow Bracketing Approach" (2016) Public Finance Review 1-23 at 2; Kirchler, E *The Economic Psychology of Tax Behaviour* (2007) 22.

[20] Her Majesty Revenue and Customs Department *Tackling tax avoidance* (2011) 5,7 available at https://www.gov.uk/Government/uploads/system/uploads/attachment_data/file/197112/Tackling_tax_avoidance.pdf (05 February 2017).

[21] Degl'Innocenti and Rablen "Income Tax Avoidance and Evasion: A Narrow Bracketing" (2016) 2.

[22] Alm, J and Soled JA *Whither The Tax Gap?* (2016) 2,4. See also Her Majesty Revenue and Customs Department *Tackling tax avoidance* (2011) 7 and Internal Revenue Service (IRS) "The Tax Gap" available at *https://www.irs.gov/uac/irs-the-tax-gap* (accessed on 25 July 2017); Doran, M "Tax Penalties and Tax Compliance" 46 *Harvard Journal on Legislation*. 111-161 (2009) 112; Raczkowski, K "Measuring the tax gap in the European economy" (2015) *21 Journal of Economics & Management* 58-72 at 59. See also Toder, E What Is the Tax Gap? *TAX NOTES*, October 22, (2007)1; Mazur, MJ and Plumley, AH *Understanding the Tax Gap* National Tax Journal, Vol. 60, No. 3, Tax Policy—Unfinished Business (September, 2007) 569; Dubin, JA *The Causes and Consequences of Income Tax Noncompliance (*New York, Springer 2012) 5; Doran, M "Tax Penalties and Tax Compliance" (2009) 46 *Harvard Journal on Legislation* 111-161 at 112.

significant loss of tax revenues. [23] For instance, the Government may deliberately exempt certain activities from taxation or imposes lower tax rates. [24] In addition, the loss of tax revenue may result from the inability of the tax authority to interpret the tax laws correctly and thus fail to collect the appropriate amount of taxes.[25] Moreover, unscrupulous tax officials may extort or accept bribes and short-levy taxes due or granting tax incentives to undeserving recipient as well as diverting the collected revenues to the own accounts.[26]

As discussed above, by focusing on non-compliance of taxpayers, the tax gap analysis takes a rather narrower approach in explaining loss of potential tax revenue. Conversely, the tax revenue-leakage approach takes a comprehensive approach in describing the factors that may lead to loss of potential tax revenues, and thus fills this gap.[27] According to this view, five channels may contribute to loss of potential Government revenues namely tax evasion, tax avoidance, fiscal corruption and fiscal incentives. [28] This approach arguably take a wider than the "tax gap" approach discussed above. Literally, leakage is defined as "the loss of fluid through a hole in a vessel".[29] Contextually, this study adopts the concept of tax revenue leakage to mean the existence of gaps or loopholes in the tax system that permit the loss of Government tax revenue. [30] It also includes, in addition to non-compliance by taxpayers, the conduct of tax collectors, the Government's policy and competence of tax authorities.[31]The next section highlights the channels of tax revenue leakage.

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[23] For example, fiscal corruption and tax incentives discussed below.

[24] See section 3.1 below.

[25] Kirchler *The Economic Psychology of Tax Behaviour* (2007) 21; Otusanya et al "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013) 318. Calder *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014) 17.

[26] Otusanya et al "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013) 312.

[27] See Cobham, A "Tax evasion, tax avoidance and development finance" Working Paper Number 129 (2005) 8-10,16 available at http://www3.qeh.ox.ac.uk/pdf/qehwp/qehwps129.pdf (accessed on 15 August 2014) See Otusanya et al "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 102.

[28] Cobham "Tax evasion, tax avoidance and development finance" (2005) 8-10,16 Otusanya et al "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 102.

[29] Oxford English Dictionary http://www.oed.com/view/Entry/106657?redirectedFrom=leakage#eid

[30] Otusanya et al "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 103.

[31] Cobham, A "Tax evasion, tax avoidance and development finance" (2005) 8-10, 16 and Otusanya, OJ Arowomole SSA and. Adeyeye, GB "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 4 (1) *Int. J. Economics and Accounting*. 93–122 at 103.

3 Channels of Tax Revenue Leakage

Although policy makers cannot predict with certainty whether the fiscal instruments will bring the expected returns, it is possible to identify the risk factors.[32] The risk factors include non-compliance by the IOCs tax incentives, and fiscal corruption.[33] The discussion of these factors follows.

3.1 Tax Incentives

Generally, oil and gas *in situ* does not have value until extracted and reduced into tradeable commodities.[34] Since most oil-rich countries, lack capital and expertise or are not ready to take the risks associated with oil and gas exploration, they grant exploration or production rights to IOCs.[35] It is noteworthy that investment in the petroleum industry is arguably one of the riskiest ventures.[36] The oil and gas industry involves high investment costs, geological uncertainty and commodity price volatility.[37] In fact, not every exploration results in discovery of oil or gas.[38] In addition, there is a risk of

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[32] Cobham, A "Tax evasion, tax avoidance and development finance" (2005) 8-10,16. See also Guttentag, J and Avi-Yonah, R S. "Closing the International Tax Gap" in M. B. Sawicky (ed) *Bridging the Tax Gap: Addressing the Crisis in Federal Tax Administration*, (Washington D.C, Economic Policy Institute, 2005) 14.

[33] While the general pattern in taxation discourse is that tax avoidance and tax evasion are treated as the major source of tax revenue leakage, Cobham attempts to bring in other two factors. These factors are tax exemptions and fiscal corruption. See Cobham, A "Tax evasion, tax avoidance and development finance" (2005) 8-10,16. See also Otusanya et al "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 103.

[34] Tordo National Oil Companies and value chain creation (2011) 1.

[35] Le Leuch, H "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" in Goldthau, A (ed) *The Handbook of Global Energy Policy* (John Wiley & Sons, Ltd. Ebook 2013) 135

[36] Nakhle, C *Petroleum Taxation Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (New York, Routledge, 2008) 13, Johnston, D *International Petroleum Fiscal Systems and Production Sharing Contracts* (Tulsa, Oklahoma PennWell Corporation 1994). 5 Idubor et al "Appraising Taxation and the Nigerian Oil Industry" *Journal of Law, Policy and Globalization* Vol.37, (2015) 190; Thorpe, CP *Fundamentals of Upstream Petroleum Agreements* (CPI Antony Rowe, Eastbourne UK, 2008) 9.

[37] IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 13 available at https://www.imf.org/external/np/pp/eng/2012/081512.pdf (accessed on 25 June 2014) Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1st ed) (New York, Barrows Company Inc., 1986) 60. 226-27; Khan, K.I.F "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 22 (1) *Journal of World Trade* 67–88 at 60. Otto, JM *Mining Taxation in Developing Countries* (2000) 1.

[38] Dry holes or not commercially viable Blindermann *Production Sharing Agreements: An Economic Analysis* (1999) 5.

expropriation or change of fiscal terms by the Government.[39] Moreover, most developing countries, such as Tanzania have a poor infrastructure, and thus making investment difficult.[40] In addition, most oil-rich countries compete with each other to attract more investments.[41] Since investors are interested in making profits, they normally invest in countries where tax rates are low.[42] In this regard, the tax incentives, such as tax holidays and reduced tax rates directly reduce the cost of investment.[43]

To attract investments and maintain the existing ones, most African countries, including Tanzania, grant several investment incentives.[44] The most common form of investment incentives are tax incentives.[45] The proponents of tax incentives argue that the incentives are necessary to attract investments.[46] The incentives respond to competition and compensate for the poor investment climate.[47] Moreover, before granting tax incentives, the Government weighs the trade-offs between the costs and benefits of such incentives.[48] The attracted investments, in turn, create a spillover effect to the socio-economy through

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[39] Cameron *Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil & Gas Investors* (2006) 23; *Blindermann Production Sharing Agreements*: *An Economic Analysis* (1999) 5.

[40] Cleeve, E "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?" (2008) 42 (1) *The Journal of Developing Areas* 135 at 136.

[41] Cleeve "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?" (2008) 136.

[42] Rozner *Taxing Oil: Issues and Trends* (2009) 2; Centre for Sustainability in Mining and Industry (CSMI) *Granting Mineral Rights: A Good Practice Note* (2010) 4; Nakhle *Petroleum Taxation, Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (2008) 5; Bindemann *Production-Sharing Agreements: An Economic Analysis* (Oxford Institute for Energy Studies, 1999) 5. Zee et al "Tax Incentives for Business Investment: A Primer for Tax Policy Makers in Developing Countries" (2002) 458-459. Hogan, W Sturzenegger, F and Tai, L "Contracts and Investment in Natural Resources" (2010) 1.

[43] Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 43.

[44] Cleeve "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?" (2008) 137; See also Holland and Vann "Income Tax Incentives for Investments" (1996) 989; Hines Jr, JR "Tax Sparing and Direct Investment in Developing Countries" in Hines Jr. JR (ed) *International Taxation and Multinational Activity* (Chicago, the University of Chicago Press, 2001) 39-71 at 40.

[45] Tax incentives are defined as "fiscal measures that are used to attract local or foreign investment capital to certain economic activities or particular areas in a country". Nathan−MSI Group *Effectiveness and Economic Impact of Tax Incentives in the SADC Region* (2004) 1-4. http://pdf.usaid.gov/pdf_docs/Pnacy929.pdf

[46] Nathan−MSI Group *Effectiveness and Economic Impact of Tax Incentives in the SADC Region* (2004) 3-5.

[47] If similar investment is made in another country has the potential to earn a higher return. See Barma NH, Kaiser K, Le TM and Viñuela L *Rents to Riches? The Political Economy of Natural Resource-led Development* (Washington, The World Bank 2012) 132; Zee HH, Stotsky, JG and Ley, E "Tax Incentives for Business Investment: A Primer for Tax Policy Makers in Developing Countries,'' (2002) 30 (9) *World Development* 1497–1516, at 1498.

[48] Cleeve "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?" 138.

increased Government revenue, job creation, and infrastructure development.[49] According to this view, certain investments may not take place without tax incentives, thus the Government may lose potential benefits from such anticipated investments.[50]

The opponents of tax incentives argue that although these incentives have the potential to attract investments, the incentives given by the African countries are more exorbitant than necessary for attraction of investment.[51] Worse still, these incentives are granted as "gifts to investors" even in respect of highly profitable projects that would occur anyway.[52] Another challenge of these tax incentives is that they usually deviate from the general principles of taxation, and thus reduce, waive or defer the payment of would-be taxes.[53] In practice, most of these incentives are granted on a project-to-project basis and thus create administrative hurdles for the tax authority.[54] It requires the creation of mechanisms to verify the eligibility of IOCs on an individual basis as well as monitoring compliance with the terms of such incentives.[55] It is also notable that these incentives are prone to abuse by the IOCs. Example of such abuses include forming a new company to

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[49] Cleeve "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?" 138; Nathan−MSI Group *Effectiveness and Economic Impact of Tax Incentives in the SADC Region* (2004) 1-3; James *Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications*(Washington, D.C.: World Bank Group, 2013) v, 3; Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 43; Zee et al "Tax Incentives for Business Investment: A Primer for Tax Policy Makers in Developing Countries" (2002) 1497-1498.

[50] Nathan−MSI Group *Effectiveness and Economic Impact of Tax Incentives in the SADC Region* (2004) (3-2) Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 43. James, *Incentives and Investments: Evidence and Policy Implications* (2013) 3

[51] exceed international standards Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all* (2013) 1 available at http://app-cdn.acwupload.co.uk/wp-content/uploads/2013/08/2013_APR_Equity_in_Extractives_25062013_ENG_HR.pdf (accessed on 28 February 2017) Nathan−MSI Group *Effectiveness and Economic Impact of Tax Incentives in the SADC Region* (2004) 3-5.

[52] IMF Survey "To offer or not to offer tax incentives —that is the question" (2002) 181. See also Holland and Vann "Income Tax Incentives for Investments" (1996) 988.

[53] Rozner *Taxing Oil: Issues and Trends* (2009) 2. See also Cleeve "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?" (2008) 138; James *Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications* (2009) 3 Tax Justice Africa *The Taxation Chain: Understanding the National and International Dimension of Taxation* (2012) 24 available at http://www.taxjusticeafrica.net/wp-content/uploads/2015/11/Taxation-Trainning-Module-Two-16-April-2013.pdf; IMF "To offer or not to offer tax incentives —that is the question" (2002) 31 (11) IMF Survey 181-183; negates or reduces the effective tax rates, thus creating a new tax rate or complete waiver of tax liability. See Cobham, A "Tax evasion, tax avoidance and development finance" (2005) 8-10,16.

[54] Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 43; Zee et al "Tax Incentives for Business Investment: A Primer for Tax Policy Makers in Developing Countries" (1497); James *Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications* (2013) 43.

[55] James *Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications* (Washington, D.C.: World Bank Group, 2013) 31.

continue benefiting, shifting profits from incentive holders to non-incentive holders, or entering into sale and leaseback agreements for depreciated equipment.[56] Thus, efficiency of tax incentives depends on the capacity of the Government to vet the eligible projects as well as preventing abuse of tax incentives granted.[57]

It is further argued that some tax incentives are discretionary and granted through Ministerial fiat, and thus lack effective checks and balances.[58] This practice arguably opens up windows of opportunity for corrupt practices.[59] To sum up, the tax incentives imply that the Government sacrifices or waives its rights to receive tax revenues. This in turn, implies loss of tax revenues, which would have otherwise been received by the Government.[60] For these reasons, the opponents of tax incentives argue that revenue forgone through tax incentive exceeds the benefits received through the attracted investments.[61]

Despite these shortcomings, the competition among countries for FDI and poor investment climate, make the use of incentives inevitable.[62] In principle, IOCs consider taxation as a cost to investments and thus one of the factors that influence investment decisions. Usually, IOCs will prefer to invest in countries with favourable tax rules. As it is demonstrated in this study, the problems are not the tax incentives *per se* but rather the legal framework within which such incentives are granted. The next section highlights a

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[56] Farnsworth, K and Fooks, G "Corporate Taxation, Corporate Power, and Corporate Harm" (2015) 54(1) *The Howard Journal* 29; See also Nathan−MSI Group *Effectiveness and Economic Impact of Tax Incentives in the SADC Region* (2004) (3-5); Cleeve "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?" (2008) 139. Holland and Vann "Income Tax Incentives for Investments" (1996) 989.

[57] Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 43; Zee et al "Tax Incentives for Business Investment: A Primer for Tax Policy Makers in Developing Countries" (2002) 1498; Holland and Vann "Income Tax Incentives for Investments" (1996) 999-1000.

[58] James Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications (2013) 4, 43.

[59] James Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications (2013) 4, 43.

[60] Zee et al "Tax Incentives for Business Investment: A Primer for Tax Policy Makers in Developing Countries" (2002) 1498; Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 70.

[61] Holland and Vann "Income Tax Incentives for Investments" (1996) 989; Cleeve "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?" (2008) 138-39 IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 14: Mascagni G, Moore M and Mccluskey R, *Tax revenue mobilization in developing countries: issues and challenges* (2014) 15.

[62] Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012)132.

variety of tax incentives and evaluates how they contribute to leakage of Government tax revenues.

3.1.1 Royalty and Tax Exemptions

The first form of tax incentives may entail a complete elimination of an obligation to pay taxes. For instance, most Governments do not charge duties on exports.[63] In other instances, with the view to address price volatility, the Government may waive the obligation to pay certain taxes or levies during the downswing of oil and gas prices.[64] This is usually applicable to production-based levies, such as royalties.

Second, it involves the suspension of an obligation to pay certain taxes for a specified period.[65] The common tax relief in this category is the relief from paying taxes, such as VAT and import duty for imported equipment and machinery used at the exploration or development stage.[66] It means the investors do not pay any tax during this period. The suspension of tax obligations may also take the form of a tax holiday. Under a tax holiday, the investors are permitted to retain all their earnings (not to pay taxes or royalties) for a specified period.[67] This form of tax incentive aims at attracting investments in new oil and gas ventures.[68]

Third, tax incentives may entail reduction or lowering of tax rates, such as withholding tax reduction or corporate tax reduction.[69] It may also cover reduced rate for import duty and VAT on equipment and capital goods.[70] A tax rate reduction does not eliminate the tax obligation. Instead, requires the investors to pay a lesser amount of tax. All these forms of tax and royalty exemptions means that the Government sacrifies an enormous sum of potential tax revenue. Thus, the lack of vigilance in granting these tax exemptions

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[63] To ensure competitiveness in the world. See Otto *Mining Taxation in Developing Countries* (2000) 3.

[64] Otto Mining Taxation in Developing Countries (2000)3.

[65] Holland and Vann "Income Tax Incentives for Investments" (1996) 990.

[66] Otto *Mining Taxation in Developing Countries* (2000) 3. See also Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 11. Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012)133. Baunsgaard *Primer on mineral taxation* (2001)11.

[67] Otto Mining Taxation in Developing Countries (2000) 13.

[68] IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012)10-14.

[69] IMF "To offer or not to offer tax incentives —that is the question" (2002) 181-183.

[70] IMF "To offer or not to offer tax incentives —that is the question" (2002) 181-183.

as well as weak monitoring systems makes tax exemptions one of the major channels for tax revenue leakage.

3.1.2 Accelerated Cost Recovery

Since the exploration and development costs are incurred before production commences or income is earned, the tax system has mechanisms of recovering these costs against future incomes.[71] In principle, the operating costs recovered in the year within which they are incurred. By contrast, the costs for acquisition of equipment and the exploration costs are recovered by dividing the costs of acquisition over the expected useful life of, such assets or the expected life span of the well. [72] Strict adherence to these accounting rules means that the time taken to recover the costs will be too long.[73] This is contrary to the IOC's motive for investment, which requires the recovery of investment costs as soon as practicable.[74] It also creates a time consistency problem, as amount to be recovered is not the same as the one invested.[75]

To deal with the time inconsistency, the State offer higher costs recovery than the one contained in the tax laws. [76] It implies the deviation from accounting principles of depreciation or amortization.[77] Since profit is dependent on costs of production, the higher the cost of production the lower the profit. [78] By allowing accelerated cost recovery, the Government defers the payment of profit-based taxes, such as corporate

[71] Otto Mining Taxation in Developing Countries (2000)3.

[72] depreciation (for physical assets) or amortization (for intangible drilling costs) Tordo, S *Fiscal Systems for Hydrocarbons Design Issues* (2007) 11.

[73] For example, the useful life is 25 years and above. See Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 11.

[74] Walron, G and Kumar, R *Options for Developing Countries in Mineral Development* (New York, St. Martin's Press 1986) 107.

[75] IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 10. It takes 10 years to start generating revenues and production spans for a long time; Walron and Kumar *Options for Developing Countries in Mineral Development* (1986) 107.

[76] Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 11; Blinn K et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 235; Holland and Vann "Income Tax Incentives for Investments" (1996) 993; James *Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications* (2013) 42.

[77] Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 11; Blinn, et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) (235).

[78] Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 225-26.

income tax and additional profit tax.[79] In addition, accelerated cost recovery poses a transfer pricing risk.[80] The Government needs to follow up to ensure that only the actual costs are recovered.[81]

3.1.3 Reliefs from Double Taxation

The IOCs, being multinational corporations, are subject to taxation in more than one country.[82] Under international taxation, the jurisdiction to tax arises from the relation between the State and the taxpayer.[83] This relationship is established by looking at the country where the oil and gas operations take place ("source country") and the IOC's country of origin ("country of residence").[84] In principle, source country has jurisdiction to impose taxes on the IOC in respect of income that has source in that country ("territorial principle").[85] By contrast, most the countries of residence exercise jurisdiction to impose taxes on their residents on their worldwide income ("worldwide principle").[86] The tax implication of these principles is that the IOC's income is subject to tax in both the country of origin and the country where the operations are taking place ("double

[79] Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012) 133; IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012)10-14.

[80] See Chapter 3 section 3.2.2.

[81] See Chapter 5 section 2.5.4.

[82] Daurer, V and Krever, R "Choosing Between the UN and OECD Tax Policy Models: An African Case Study" (2014) 22 (1) *African Journal of International and Comparative Law* 1–21 at 2.

[83] Reinhold, R "What is tax treaty abuse? (is treaty shopping an outdated concept?)" (2000) 674; OECD *Addressing the tax challenges of the digital economy* OECD Publications (2014) 34.

[84] Keen, M and Mullins, P "International corporate taxation and the extractive industries Principles, practice, problems" in Daniel, P Keen, M Świstak, A and Thuronyi V *International Taxation and the Extractive Industries* London (Tayor & Francis Ebooks 2017) 13.

[85] Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 14; Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 191; OECD *Addressing Base Erosion and Profit Shifting* OECD Publishing (2013) 33; IOC is considered resident because of domicile, residence, incorporation or place of management (34) OECD *Addressing the tax challenges of the digital economy* (OECD Publications 2014) 34.

[86] Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 14. OECD *Addressing Base Erosion and Profit Shifting* (2013) 33-34; OECD *Addressing the tax challenges of the digital economy* OECD Publications (2014) 34. Kerzner and Chodikoff *International Tax Evasion in the Global Information Age* (2016) 46.

taxation").[87] The existence of double taxation has the impact of lowering profits thus deterring investments.[88]

To eliminate the effect of double taxation, both the host country and the country of origin enter into double tax agreements to share their taxing rights.[89] The double tax reliefs take four forms. First, the income taxable in the source country is exempted from income taxation in the country of residence.[90] Second, the source country agrees to impose lower rates of taxes for IOCs on interests, royalties and dividends than those set in the domestic tax laws. [91] Third, the income taxes paid in the source country are credited against income taxes in the country of residence[92] Fourth; taxes paid in the source country are deducted against income taxes in the country of residence. [93]

While the double tax reliefs have the potential to attract investment, several challenges exist in respect to their implementation. For capital importing countries, commonly African countries including Tanzania, it means sacrificing some tax revenues.[94] This is because there is no reciprocity in trade between these countries. [95] Apart from sacrificing

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[87] Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 14 See also IMF *Spillovers in International Corporate Taxation* (2014) 9.; Daurer and Krever "Choosing Between the UN and OECD Tax Policy Models: An African Case Study" *African Journal Of International And Comparative Law* 22.1 (2014)2; Kerzner and Chodikoff *International Tax Evasion in the Global Information Age* (2016) 47; Schreiber, U *International Company Taxation: An Introduction to the Legal and Economic Principles* (Berlin, Springer, 2013) 12.

[88] Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 191.

[89] Daurer and Krever "Choosing Between the UN and OECD Tax Policy Models: An African Case Study" (2014): 2. Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 13; Kerzner and Chodikoff *International Tax Evasion in the Global Information Age* (2016) 44.

[90] Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 196; Daurer and Krever "Choosing Between the UN and OECD Tax Policy Models: An African Case Study" (2014) 2.

[91] Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 25 See Daurer and Krever "Choosing Between the UN and OECD Tax Policy Models: An African Case Study" (2014) 8; IMF *Spillovers in International Corporate Taxation* (2014) 25.

[92] The tax credit means that the IOC will is permitted to deduct the income tax paid abroad against any profits Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 235-36. See also Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 14; Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 192, 196.

[93] Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 196.

[94] Daurer and Krever "Choosing Between the UN and OECD Tax Policy Models: An African Case Study" (2014) 2. IMF *Spillovers in International Corporate Taxation* (2014) 25. See also IMF *Spillovers in International Corporate Taxation* (2014) 25.

[95] IMF *Spillovers in International Corporate Taxation* (2014) 26.

the right to tax, the IOCs may also abuse these reliefs from double taxation.[96] Similarly, the advantages offered by tax treaties, such as reduced tax rates and tax credits create an impetus for tax planning.[97] Sometimes the IOCs engage in treaty shopping to take advantage of the most generous provisions of treaties.[98]

3.1.4 No Ring Fencing

Given the finite nature of the resources, the Government policy may encourage IOCs to engage in many exploration projects. To encourage new investments in the exploration of oil and gas, Governments may permit the exploration costs to be offset against the profit earned by the IOC from its other operations.[99] This deviates from the ring fencing rules, which treat different projects owned by the one taxpayer as separate and distinct projects from each other.[100] Thus, by dispensing with the ring fencing rules, costs and income of different projects are consolidated at firm's level.[101] The consolidation of books of accounts at the firm's level, though attracts fresh investments in exploration and development of oil and gas resources, defers or lowers profit-based revenues.[102]

The non-ring fencing is problematic in a number of ways. First, under the contractual system, each project is subject to individually negotiated contracts, thus taxed differently.[103] This creates an administrative burden to tax administrators due to lack of consistency in the application of tax rules.[104] Similarly, where the stabilization clauses are applicable, means the investor is able to shift the tax burden from more profit-making

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[96] See Chapter 3 section 3.2.4.

[97] Baker, P *Improper Use of Tax Treaties, Tax Avoidance and Tax Evasion* Paper No. 9-A (2013) 3. See also IMF *Spillovers in International Corporate Taxation* (2014) 30;

[98] Daniel *International Taxation Issues for Extractive Industries* (2014) 7. IMF *Spillovers in International Corporate Taxation* (2014) 26. See also general discussion under section 3.2.4.

[99] Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 11. Sunley, EM, Baunsgaard, T and Simard, D *Revenue from the Oil and Gas Sector: Issues and Country Experience* (Washington DC, The World Bank (2002) 5; Blinn et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 233, Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 76.

[100] Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 69.

[101] Otto *Mining Taxation in Developing Countries* (2000)15-16; N Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012)129; Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 69.

[102] Otto Mining Taxation in Developing Countries (2000) 16.

[103] Otto Mining Taxation in Developing Countries (2000) 15.

[104] Otto Mining Taxation in Developing Countries (2000) 15.

projects to loss making ones.[105] More importantly, by allowing non-ring fencing, the Government is sure of missing out the payment of excess profit tax.[106] Since the excess profit tax is based on surplus profit, the consolidation of books of accounts from more than one project means no excess profit will be created.[107]

3.1.5 Fiscal Stabilization

Generally, investors are interested in understanding the tax base and tax rates, and certainty in their applicability.[108] This is congruent with long-term nature of oil and gas investments. However, there are several risk factors in the oil and gas industry, such as volatile commodity price, resource nationalism, change of fiscal regime and long lag of time for return on investments. [109] Considering these risks, the IOCs have limited confidence for their operations in the developing countries.[110] The IOCs fear that the State may change the fiscal terms applicable to an agreement or concession.[111]

To be in a safe position, the IOCs request a fiscal stability clause in the concessions or license. [112] These clauses restrict Government's discretionary powers to increase taxes or tax rates during the subsistence of the concession. [113] The stability clauses provide a guarantee that the tax laws will not be changed or modified over a specified period or the life span of the project. [114] Alternatively, where such changes are imminent, they should

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[105] Nathan−MSI Group *Effectiveness and Economic Impact of Tax Incentives in the SADC Region* (2004) 3-5; Le Billon *Extractive sectors and illicit financial flows: What role for revenue governance initiatives?* (2011) 7.

[106] See Chapter 2 section 4.1.4.

[107] See Chapter 2 section 4.1.4 and Chapter 5 section 2.5.4.4.

[108] Holland and Vann "Income Tax Incentives for Investments" (1996) 988; Walron et al *Options for Developing Countries in Mineral Development* (1986) 107-108.

[109] Walron et al Options for *Developing Countries in Mineral Development* (1986) 107-108; Blindermann Production Sharing Agreements: *An Economic Analysis* (1999) 5.

[110] Most developed countries do not provide for fiscal stabilization clauses see Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues"(2013)141. See also Nakhle "Petroleum Fiscal Regimes: Evolution and Challenges" (2010) 114.

[111] Parra, F *Oil Politics: A Modern History of Petroleum* (New York, I.B. Taurus & Co Ltd 2004) 11. Blindermann *Production Sharing Agreement*: *An Economic Analysis*

(1999) 5.

[112] Parra Oil Politics: A Modern History of Petroleum (2004) 11.

[113] Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 139.

[114] Referred to as 'freezing clauses' Blinn, et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) l; Blindermann *Production Sharing Agreement* (1999) 5.

subject to mutual consent between the Government and the IOCs.[115] While stabilization clauses are a common practice in developing countries, no such clauses exist in developed countries.[116] For developing countries, stabilization clauses limit the legislative powers of the parliament to amend or alter the fiscal terms.[117] This, in turn, has the potential to deny the Government its ability to receive future tax revenues even during commodity price boom.[118]

3.2 Tax Avoidance

As discussed in the preceding paragraphs, potential taxes may not be collected in the tax administration process.[119] In practice, IOCs look at taxation as a cost to investment that has to be "managed or avoided".[120] For this reason, any elimination or reduction of taxes means increased profits, dividends to shareholders and bonuses to the executives.[121] To achieve this objective, the IOCs devise variety of techniques to exploit gaps and loopholes in the tax system to reduce, defer or eliminate their tax obligations.[122] The gaps and loopholes in the law may be a result of poor draftsmanship, genuinely negotiated contracts or corruption.[123] This is also possible because tax statutes are capable of multiple

[115] Referred to as "equilibrium clauses" Tordo Fiscal Systems for Hydrocarbons Design Issues (2007) 14.

[116] Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues"(2013) 141

[117] Cameron *Stabilisation in Investment Contracts and Changes of Rules in Host Countries: Tools for Oil & Gas Investors* (2006) 22. Barma et al Rents to Riches? The Political Economy of Natural Resource-led Development (2012) 140 Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues"(2013) 141

[118] Ogunleye, TA "A Legal Analysis of Production Sharing Contract Arrangements in the Nigerian Petroleum Industry" (2015) 8(5) *Journal of Energy Technologies and Policy* at 6-7.

[119] Cobham, A "Tax evasion, tax avoidance and development finance" (2005) 8-10,16. See also Otusanya "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 103.

[120] Sikkaa et al "The dark side of transfer pricing: Its role in tax avoidance and wealth retentiveness" (2010) 344.

[121] Sikkaa et al "The dark side of transfer pricing: Its role in tax avoidance and wealth retentiveness" (2010) 344.

[122] See Chapter 3 section 3.

[123] Le Billon *Extractive sectors and illicit financial flows: What role for revenue governance initiatives?* (2011) 6. obnoxious fiscal terms

interpretations.[124] This provides an opportunity for the IOCs to shop around the best interpretation, usually the one against the spirit of the tax statute.[125]

The process of taking advantage of the gaps and loopholes in the law to minimize tax liability is referred to as "tax avoidance".[126] Tax avoidance is defined as "the art of dodging taxes without breaking the law".[127] Under tax avoidance schemes, taxpayers arrange their transactions in such a way that they are able to obtain tax advantages, benefit or reduction not intended by the Parliament.[128] It arises from the fact that taxpayers are permitted to arrange their affairs so that they can pay as low as possible taxes.[129] The next section discusses the techniques that may be used by the IOCs to avoid the payment of taxes.

3.2.1 Indirect Transfer of Petroleum Rights or Interests in Petroleum Rights

As discussed previously, it is relatively easy to impose capital gains taxes on direct transfer of petroleum right or direct sale of interests in petroleum right.[130] The difficulties in taxing indirect transfer of petroleum rights or interests in petroleum rights creates a window of opportunity for the IOCs to avoid payment of capital gains tax. In doing so, the IOCs ensure that the license is held through a conglomerate of foreign companies.[131]

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[124] Otusanya, OJ "The role of multinational companies in tax evasion and tax avoidance: The case of Nigeria" (2011) 319. See Palan R, Murphy R, Chavagneux C. *Tax havens: how globalisation really works*. (London: Cornell University Press; 2010) 30.

[125] Otusanya, OJ "The role of multinational companies in tax evasion and tax avoidance: The case of Nigeria" (2011) 319. Janeba E. "Corporate income tax competition. Double taxation treaties and foreign direct investment" (1995) 56(2) *Journal of Public Economics*; 311-325 at 312-314.

[126] Contrasted with tax evasion, discussed under section 3.3 below, which involves outright criminal conducts, such as non-filing of tax returns.

[127] *Mc Dowell v. Commercial Tax office* (1985) 154 ITR 148 SC.

[128] Brown, KB. "Comparative Regulation of Corporate Tax Avoidance: An Overview" (2012) 1.

[129] Prebble et al "Does The use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law?: A Comparative Study (2010) 23; Brown KB. "Comparative Regulation of Corporate Tax Avoidance: An Overview" (2012) 2. See also *Gregory v. Helvering*, 293 U.S. 465 (1935) and "there is not even a patriotic duty to increase ones taxes" and in the UK the case of *Duke of Westminster v IRC* (1936) A.C 1.

[130] See Chapter 2 section 4.2.3

[131] A good example is Mauritanian gold project, sold in Bahamas at $ 4 billion, no CGT was paid See Michael Keen and Peter Mullins "International corporate taxation and the extractive industries Principles, practice, problems" (2016) 28-29 See also Guj et al *How to Improve Mining Tax Administration and Collection Frameworks A Sourcebook* (2013) 74; Burns et al "Taxing gains on transfer of interest" (2017) 172; IMF *Spillovers in International Corporate Taxation* (2014) 28. See Chapter 2 section 4.2.3 for a detailed discussion.

As a result, during the transfer of interests in the petroleum right both the transferor and transferee are non-residents.[132] This renders it difficult for the revenue authority to detect the transaction and, thus fails to collect tax due.

For example, company Y holder of a petroleum right in country A is a subsidiary of company X resident in country B.[133] Company X is also a subsidiary of Company Z resident in country C. So when company Z transfers its shares in company X, though capital gains may be generated, no capital gains tax will be payable in country A.[134] This is because the transaction occurs abroad and between non-resident taxpayers.[135] For this reason, the holding of a petroleum right through a "multi-tiered corporate structure" renders it difficult for the host country to detect the transaction and even where detected still difficult to collect the capital gains taxes due.[136]

3.2.2 Transfer Pricing Manipulation

The IOCs are normally integrated entities with subsidiary companies all over the world.[137] These IOCs take advantage of the different tax rates between one country and another to shift profits from high-tax to low-tax jurisdiction.[138] The most common technique used

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[132] IMF et al *Discussion draft The Taxation of Offshore Indirect Transfers—A Toolkit* (2017) 27 available at http://documents.worldbank.org/curated/en/689091501488467178/pdf/117797-REVISED-Consultation-Draft-Indirect-Offshore-Transfers-July28-003.pdf (accessed on 04 August 2017)

[133] A good example is Mauritanian gold project, sold in Bahamas at $ 4 billion, no CGT was paid. See Burns et al "Taxing gains on transfer of interest" (2017) 164; IMF *Spillovers in International Corporate Taxation* (2014) 11. See also Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 28-29.

[134] IMF *Spillovers in International Corporate Taxation* (2014) 29-30. Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 33. Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 28-29. See also IMF *Spillovers in International Corporate Taxation* (2014) 28.

[135] Burns et al "Taxing gains on transfer of interest" (2017) 173.

[136] Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 34; Cui, W *Taxation of non-residents' capital gains* (2015) 110; IMF *Spillovers in International Corporate Taxation* (2014) 30.

[137] Ostwal, TP and Vijayaraghavan, V "Anti-avoidance Measures" (2010) 22(2) *National law School of India review* at 90. Baunsgaard, T *Primer on mineral taxation* (2001) 21; Calder, J Transfer pricing – special extractive industry issues (2017) 80.

[138] Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all* (2013) 65; Bernard, JT and Weiner R J "Multinational Corporations, Transfer Prices, and Taxes: Evidence from the U.S. Petroleum Industry" in Razin, A and Slemrod, J (eds) *Taxation in the Global Economy* (Chicago, Chicago University Press, 1990) 123; IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 37.; IMF *Spillovers in International Corporate Taxation* (2014) 11.

by the IOCs is transfer-pricing manipulation.[139] Transfer pricing occurs when related companies make an intra-company transactions (usually cross-border transactions) whose price is pre-determined for purposes of reducing taxable profits.[140] In doing so, the IOCs will set a high prices for goods to claim high amount of deductions while the undervaluing the cost of products to reduce the taxable income.[141] Conversely, if unrelated parties were involved in a transaction, then the price would have reflected the business purpose.[142]

The related-party transactions may involve tangible property, machinery, rental or leasing of property, intangible property rights, technical or finance services as well as oil and gas products.[143] In practice, a constituent part of the IOC usually charge higher royalties than the prevailing market rates for the use of intellectual property rights, such as franchise, patents and copyrights by its sister companies in the host country.[144] In turn, these royalties increases the operating costs and thus reduce the taxable profits.[145] Likewise, loans from sister companies bear higher interest rates than the domestic rates and therefore increase the deductible expenses.[146] Moreover, the IOCs purchase machinery and equipment through its intermediaries instead of purchasing directly from suppliers

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[139] Haufler, A and Schjelderup, G "Corporate Tax Systems and Cross Country Profit Shifting" (2000) 52(2) *Oxford Economic Papers* 306-325 at 308-312.

[140] Involves internal transactions for goods or services among related parties, normally out of market price KPMG *Global Transfer Pricing Review* (2011) 4; Urquidi, J. "An Introduction to Transfer Pricing" (2008) 3(1), *New School Economic Review* at 27-28; Shay "An overview of transfer pricing in extractive industries" (2016) 43; Readhead, A *Preventing Tax Base Erosion in Africa: a Regional Studyof Transfer Pricing Challenges in the Mining Sector* (2016) 1 available at http://www.resourcegovernance.org/sites/default/files/documents/nrgi_transfer-pricing-study.pdf(accessed on 20 November 2016) KPMG *Global Transfer Pricing Review* (2011) 4.

[141] UN Department of social and economic affairs, *An Introduction to Transfer Pricing* available at http://www.un.org/esa/ffd/wp-content/uploads/2011/06/20110607_TP_Chapter1_Introduction.pdf at 2

[142] Shay "An overview of transfer pricing in extractive industries" (2016) 44.

[143] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 90. Baunsgaard *Primer on mineral taxation* (2001) 21. Readhead *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector* (2016) 8 IMF *Spillovers in International Corporate Taxation* (2014) 11. KPMG *Global Transfer Pricing Review* (2011) 4.

[144] IP is mostly used to shift artificially taxable income patents, trademarks. See Markle, K and Robinson L *Tax Haven Use Across International Tax Regimes* (2012) 7 Available at https://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Events/conferences/symposia/2012/markle.pdf (accessed 10 June 2017)

[145] European Commission "Anti-Tax Avoidance Package" (2016) 5 available at https://tax.thomsonreuters.com/wp-content/landingpages/anti-tax-avoidance-package/Special-Report-European-Commission-Presents-Anti-Tax-Avoidance-Package.pdf (accessed 27 July 2017)

[146] IMF *Spillovers in International Corporate Taxation* (2014) 11. See also Calder *Transfer pricing – special extractive industry issues* 80

and therefore pays a price which is inclusive of service fees.[147] In a similar pattern, the IOC sells the oil and gas products to its subsidiary company at a lowest price than the prevailing market rate so as to reduce the taxable income.[148] In addition, the parent company offers multiple administrative and advisory services, charging management fees for which the economic or commercial value is difficult to establish.[149] All these arrangements increase the deductible costs for the IOCs and consequently reduces the taxable profits. Thus, there is a higher transfer pricing risk is in respect of profit-based taxes, such as corporate income tax, excess profit tax as well as dividends from equity participation than on production-based levies, such as royalties.[150]

While transfer pricing is singled out as one of the major sources of tax revenue leakage, several factors mitigate the impact of transfer pricing.[151] For instance, the machinery used by the IOC can be physically investigated.[152] In addition, the commodities produced can be weighed and measured.[153] Furthermore, price of commodities is visible through the international exchanges such the London Metal Exchange and the Petroleum Agency reporting prices.[154] This implies that the transfer pricing risk is manageable provided that there legal and institutional mechanisms to audit and verify all transactions undertaken by the IOC.[155]

3.2.3 Thin Capitalization

Generally, profit-bases taxes, such as corporate income tax are only payable when there is profit.[156] Since profit is calculated as the difference between revenues and deductible

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[147] Readhead Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector (2016) 8. IMF Spillovers in International Corporate Taxation (2014) 11.

[148] Shay "An overview of transfer pricing in extractive industries" (2016) 43 Calder *Transfer pricing – special extractive industry issues* (2017) 80.

[149] These fees are calculated based on a pre-determined formula, such as a percentage of total revenues or sales. Readhead, A *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector* (2016)40. Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 19.

[150] Calder "Transfer pricing – special extractive industry issues" (2017) 80.

[151] Readhead *Preventing Tax Base Erosion in Africa: a Regional Studyof Transfer Pricing Challenges in the Mining Sector* (2016) 1; Calder *Transfer pricing – special extractive industry issues* (2017) 81.

[152] Calder "Transfer pricing – special extractive industry issues" (2017) 81.

[153] Calder "Transfer pricing – special extractive industry issues" (2017) 81.

[154] Calder "Transfer pricing – special extractive industry issues" (2017) 81.

[155] Calder "Transfer pricing – special extractive industry issues" (2017) 81.

[156] See Chapter 2 sections 4.2.1 and 4.2.3.

costs, interests on debts qualify as one of the deductible costs.The fact that interest expenses increases tax deductions and thus lowering the profits, incentivizes IOCs to rely heavily on debt financing.[157] The excessive reliance on debt financing over equity financing is referred to as "thin capitalization".[158]

In practice, the IOC may operate in a high-tax jurisdiction, but financed through loans from its subsidiary or parent company located in a low-tax jurisdiction.[159] In this regard, the IOC does not borrow directly but uses intermediaries as conduits.[160] In this lending arrangement, the intermediaries charge interests that are higher than the prevailing domestic lending rates.[161] Sometimes these interest rates are twice as much compared to domestic rates.[162] The sole purpose is to benefit from deductibility of interests from profit-based taxes.[163] Consequently, the IOCs will report higher deductible costs and thus reducing the taxable profits. This partly explains the reasons why despite the fact that oil and gas business generate enormous revenue, the IOCs pay less or no profit based taxes in countries where they operate.[164]

3.2.4 Treaty Shopping

Generally, the major objective of double tax treaties is to encourage investments across countries. However, some of the double tax treaties create loopholes for tax avoidance.[165] The IOCs usually shop around the tax treaty network in view to obtain undue tax

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[157] Mullins "International tax issues for the resource sector" (2010) 391; IMF *Spillovers in International Corporate Taxation* (2014) 30. This also poses a transfer pricing risk see Readhead *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector* (2016) 41. OECD *Addressing Base Erosion and Profit Shifting* (2013) 38. Keen "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 19.

[158] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 87. See also Barnes "Limiting interest deductions" (2015) 164.

[159] OECD Addressing Base Erosion and Profit Shifting (2013) 40; IMF Spillovers in International Corporate Taxation (2014) 11 and 30.

[160] IMF Spillovers in International Corporate Taxation (2014) 11.

[161] Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 19.

[162] Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 19. Readhead *Preventing Tax Base Erosion in Africa: a Regional Studyof Transfer Pricing Challenges in the Mining Sector* (2016) 8.

[163] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 87.

[164] See the general discussion under Chapter 3 section 3 on the channels of tax revenue leakage.

[165] Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 11.

benefits.[166] It entails the selection of the most favourable tax treaty for purposes of avoiding taxes.[167] This form of abuse of tax treaty is referred to as "treaty shopping".[168] This permits IOCs with little or no business connection with the country party to a double tax treaty to enjoy such benefits.[169] Thus, tax benefits accrue to entities not intended by the double tax treaty. [170] For instance, the IOC from country A, forms a conduit company in country B to take advantage of the tax treaty between country B and C.[171] Under normal circumstances, countries B and C did not anticipate country A to benefit from the provisions of their tax treaty.[172] For this reason, bilateral tax treaties instead of being a treaty with one country, becomes "a treaty with the whole world".[173]

In addition, tax treaties may offer unitended benefits to the IOCs. [174] As discussed in the preceding paragraphs, the major aim of double tax treaties is to relieve the IOCs from double taxation. However, the existence of tax havens negates this objective. Since the tax havens already charge low or nil taxes to its residents, the IOCs are automatically relieved of the tax burden in the country of origin. [175] For this reason, there is no need to enter into a double tax treaty with a tax haven. However, some oil-rich countries have entered into double tax treaties with tax havens. This implies that taxable income escapes taxation under both the host country and the country of residence ("non-double

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[166] Cui *Taxation of non-residents' capital gains* (2015) 143; IMF *Spillovers in International Corporate Taxation (*2014) 11. IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 37 Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 19.

[167] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 81-83.

[168] Reinhold "What is tax treaty abuse? (is treaty shopping an outdated concept?)" (2000) 66. See Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 81-83.

[169] IOC from a third country obtain access to the benefits between the contracting states Cooper, GS "Preventing tax treaty abuse" (2015) 281-282. See also Ostwal et al "Anti-avoidance Measures" (2010) 81-83. IMF *Spillovers in International Corporate Taxation* (2014) 14

[170] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 81-83.

[171] IOC from a third country obtain access to the benefits between the contracting states. See Cooper, GS "Preventing tax treaty abuse" (2015) 281-282 See also Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 81-83.

[172] Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 26.

[173] Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 26.

[174] Results into unintended consequences. OECD *Addressing Base Erosion and Profit Shifting* (2013) 38. See Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 81-83.

[175] Palan et al *Tax Havens: How Globalization Really Works* (2010) 30.

taxation").[176] Consequently, both the host country and the country of residence lose enormous sums of money from the would-be taxes.[177] In essence, the oil-rich country is one that loses enormous sums of the would-be taxes from tax treaty abuse.[178]

3.3 Tax evasion

As discussed in the preceding paragraphs, one of the IOC's major objective is profit maximization.[179] The IOCs adopt several techniques to realize this objective. Apart from taking advantage of grey areas in the tax laws, the IOCs may engage in outright criminal activity for circumventing the liability to pay taxes.[180] While taking advantage of the grey areas in the tax laws is referred to as tax avoidance, tax minimization through criminal means is referred to as tax "evasion".[181] The element of criminality is the main distinction between tax avoidance and tax evasion.[182] Taxpayers may engage on tax evasion singlehandedly or in collusion with tax administrators.[183] The discussion of how taxpayers may engage in tax evasion follows.

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[176] Palan et al *Tax Havens: How Globalization Really Works* (2010) 30. See also OECD *Addressing Base Erosion and Profit Shifting* (2013) 33. Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 11.

[177] The untaxed profits are sheltered in the tax havens. See Le Billon *Extractive sectors and illicit financial flows: What role for revenue governance initiatives?* (2011)6.

[178] It estimated that in 2011 alone, tax treaties with Netherlands cost developing countries about €770 million. Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 26.

[179]Christians, A "Sovereignty, Taxation and Social Contract" (2009) 18 Minnesota Journal of International Law 99 at 167. IMF Fiscal Regimes for Extractive Industries: Design and Implementation (2012) 13. Johnston International Petroleum Fiscal Systems and Production Sharing Contracts (1994) 16; Hogan, Sturzenegger and Tai "Contracts and Investment in Natural Resources" (2010) 1.

[180] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 61; Brown (ed.) *A Comparative Look at Regulation of Corporate Tax Avoidance* (2012) 1.

[181] See the general discussions on the difference between tax avoidance and tax evasion. The general view is that the nomenclature does not matter rather the final outcome- loss of revenues. Brown *A Comparative Look at Regulation Of Corporate Tax Avoidance* (2012) 1. Merks, P Tax "Evasion, Tax Avoidance and Tax Planning" (2006) 34 (5) *Intertax* 272-273.

[182] Fjeldstad, O "Controlling fiscal corruption Theoretical approaches and illustrations from Tanzania" (Bergen, Chr. Michelsen Institute 1999) 2; Pyle, DJ *Tax Evasion and The Black Economy* (New York, Palgrave Macmillan 1989) 4; Otusanya "The role of multinational companies in tax evasion and tax avoidance: The case of Nigeria" (2011) 319. Merks "Tax Evasion, Tax Avoidance and Tax Planning" (2006) 272-73

[183] Fjeldstad "Controlling fiscal corruption Theoretical approaches and illustrations from Tanzania' (1999) 2. Le Billon *Extractive sectors and illicit financial flows:What role for revenue governance initiatives?* (2011) 7.

3.3.1 Instigated by the International Oil Companies

The IOCs may engage in tax evasion singlehandedly and without knowledge of the tax administrators. The IOCs may engage in conducts, such as non-filing of tax returns, non-declaration or under-declaration of taxable income or falsification of transactions, parallel accounting abuse of fiscal incentives and general trade mispricing.[184] The major intention of the taxpayer is to defraud the Government of its revenue.[185] Tax evasion occurs because of the laxities in the tax system whereby the tax evasion is not easily detectable.[186] This arises from the complexity of the industry, and the expertise of IOCs as compared to the tax administrators enables the IOCs to devise sophisticated techniques to evade taxes without easily being detected.[187] Sometimes even, where evasion is detected, the sanctions imposed are too lenient to enforce deterrence. [188]

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[184] Brown "Comparative Regulation of Corporate Tax Avoidance: An Overview" (2012) 1. Merks "Tax Evasion, Tax Avoidance and Tax Planning" (2006) 272-273; Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (1999) 2. OECD *Corruption In The Extractive Value Chain: Typology Of Risks, Mitigation Measures And Incentives* OECD Publications (2016) 78-79; McPherson and MacSearraigh "Corruption in the Petroleum Sector" in J. Edgardo Campos & Sanjay Pradhan *The Many Faces of Corruption Tracking Vulnerabilities at the Sector Level* (Washington DC, The World Bank, 2007) 206; Tanzi, V and Shome, P "A Primer on Tax Evasion (Washington DC, IMF, 1993) 2.by claiming reliefs not entitled or legible. Le Billon *Extractive sectors and illicit financial flows: What role for revenue governance initiatives?* (2011) 7; Tanzi, V *Corruption, Complexity and Tax Evasion* (2017) 11 available at https://www.business.unsw.edu.au/About-Site/Schools-Site/Taxation-Business-Law-Site/Documents/Wednesday_AM_Vito_Tanzi.pdf (accessed on 16 July 2017) Otusanya et al "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013) 313.

[185] Fjeldstad "Controlling fiscal corruption Theoretical approaches and illustrations from Tanzania" (1999) 2; Brown (ed.) *A Comparative Look at Regulation of Corporate Tax Avoidance* (2012) 1.

[186] Barma *Rents To Riches? The Political Economy of Natural Resource–Led Development* (2012) 119; Africa Progress Report *Equity in Extractives Stewarding Africa's natural resources for all* (2013) 65; Minh Le et al "Tax Compliance and Sources of Revenue Leakage: Conceptual Framework and Assessment' in Shukla PG *Tax Reform in Vietnam: Toward a More Efficient and Equitable System* (Washington DC, World Bank, 2011) 61; IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 10; Generally, taxpayers are permitted to arrange their affairs in such a way that they can, as much as possible, reduce their tax liabilities (lesser amount) Prebble and Prebble "Does The Use Of General Anti-Avoidance Rules To Combat Tax Avoidance Breach Principles Of The Rule Of Law? A Comparative Study" 23; Brown (ed.) A Comparative Look At Regulation Of Corporate Tax Avoidance (2012) 2. See also U.S. (Gregory v. Helvering, 293 U.S. 465 (1935) and UK Duke of West Minister v IRC (1961) HCA 90.

[187] U4 Anti-Corruption Resource Centre *Corruption in Tax Administration* (2010) 2 available at http://www.u4.no/publications/corruption-in-tax-administration/ (accessed 21 February 2017) McPherson and MacSearraigh "Corruption in the Petroleum Sector" (2007) 210.

[188] Barma *Rents To Riches? The Political Economy of Natural Resource–Led Development* (2012) 119; U4 Anti-Corruption Resource Centre *Corruption in Tax Administration* (2010) 2; Minh Le et al "Tax Compliance and Sources of Revenue Leakage: Conceptual Framework and Assessment" (2011) 61.

The probability of detection and the subsequent sanctions shape the taxpayers' decision whether to engage in tax evasion.[189] In practice, taxpayers usually calculate the likely consequences of their decisions - gains or losses.[190] In doing so, the taxpayers weigh the benefits of evasion (such as value of money saved) against the risk of detection and punishment.[191] For this reason, the lack of strong mechanisms for detection and lenient punitive measures perpetuates tax evasion. [192] Consequently, taxable income goes untaxed and thus the Government losses enormous sums of tax revenues.[193] This, in turn, implies failure of the Government to provide social services. [194]

3.3.2 Collusion between IOCs and Tax Administrators

It is notable that collusion occurs where the taxpayer and the tax administrators are driven by "narrow self-interests".[195] The taxpayers are interested in profit maximization while the colluding tax administrators are motivated by the desire for self-enrichment. In this arrangement, the taxpayers weigh the value of money saved through evasion against the risk of detection and punishment. [196] Similarly, tax administrators weigh the gains from corruption (compared to their emoluments), against the probability of detection and ensuing sanctions.[197] While the possibility of higher rates of detection and severity of penalties have the potential to curb tax evasion, in most developing countries, including

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[189] Allingham, MG and Sandmo, A "Income Tax Evasion: A Theoretical Analysis" (1972) 1 *Journal of Public Economics* 323-338 at 324

[190] Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (1999) 4.

[191] Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (1999) 8;

[192] Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (1999) 7.

[193] Pyle *Tax Evasion and The Black Economy* (1989) 130. It is argued that tax administration is not as risky as the design of fiscal terms. See Calder, J "Resource tax administration: Functions, procedures and institutions" (2010) 340; Duong, WN "Partnerships with Monarchs- Two Case Studies: Case One-Partnership with Monarchs in the Search for Oil: Unveiling and Re-examining the Patterns of Third World Economic Development in the Petroleum Sector (2004) 1242

[194] Pyle, DJ *Tax Evasion and The Black Economy* (New York, Palgrave Macmillan 1989) 145.

[195] Fjeldstad "Controlling fiscal corruption Theoretical approaches and illustrations from Tanzania" (1999) 4.

[196] Fjeldstad "Controlling fiscal corruption Theoretical approaches and illustrations from Tanzania" (1999) 4,8; Otusanya et al "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013) 312.

[197] Fjeldstad "Controlling fiscal corruption Theoretical approaches and illustrations from Tanzania" (1999) 8;

Tanzania, there is sheer lack of capacity and political will to detect and punish tax evasion. [198]

In practice, some of the conduct of taxpayers cannot take place without assistance of tax administrators. In collusion with the IOCs, the tax administrators may charge taxes below the rate prescribed by law, grant untitled tax relief or exemptions or not charging taxes at all.[199] The overall intention is to defraud the Government and accordingly reduce the tax liability.[200] Although corruption and tax evasion are mutually exclusive, is clear that corruption facilitates tax evasion.[201] Consequently, only a portion of taxes due to the Government is collected. [202] It means the Governments lose the much-needed revenues to finance their developmental projects.

3.4 Fiscal Corruption

Simply defined, corruption is the use of public power or position by a public official to gain private benefits.[203] It involves the exchange of favours between the public official and the giver of the bribe or favour.[204] In this arrangement, the giver of a bribe obtains an

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[198] Barma *Rents To Riches? The Political Economy of Natural Resource–Led Development* (2012) 135. See also Fjeldstad 'Controlling fiscal corruption Theoretical approaches and illustrations from Tanzania' (1999) 7.

[199] McPherson and MacSearraigh "Corruption in the Petroleum Sector" (2007) 200. Tanzi *Corruption, Complexity and Tax Evasion* (2017) 11 Barma *Rents To Riches? The Political Economy of Natural Resource–Led Development* (2012) 135. Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007) 76; Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (1999) 3. SK. and Moene, KO "Controlling Fiscal Corruption" (1999) 27 (7) *World Development* 1129-1140 at 1129; OECD *Corruption In The Extractive Value Chain: Typology Of Risks, Mitigation Measures And Incentives* (2016) 77.

[200] Fjeldstad "Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania (1999) 2. Le Billon *Extractive sectors and illicit financial flows: What role for revenue governance initiatives?* (2011)7;

[201] Cerqueti R and Coppier, R "Tax revenues, fiscal corruption and "shame" costs" (2009) Economic Modelling 26' at 1239.

[202] Barma *Rents To Riches? The Political Economy of Natural Resource–Led Development* (2012) 135.

[203] Defined as "the abuse of public power for private gain" by the World bank. See World Bank *Helping Countries Combat Corruption: The Role of the World Bank* (Washington DC, The World Bank, 1997) 8. See also O'Higgins, E R. "Corruption, Underdevelopment, and Extractive Resource Industries: Addressing the Vicious Cycle" (2006) 16 (2) *Business Ethics Quarterly* at 236; Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (1999) 2. Tanzi *Corruption around the World: Causes, Consequences, Scope, and Cures* (Washington International Monetary Fund 1998) 564; Standing, A *Corruption and the extractive industries in Africa Can combatting corruption cure the resource curse?* (2007) 3-4 available at https://issafrica.s3.amazonaws.com/site/uploads/Paper153.pdf (also known as the grabbing hand of the state) (accessed on 20 August 2016).

[204] See World Bank Helping Countries Combat Corruption: The Role of the World Bank (1997) 9-10.

advantage or benefit, which it is not otherwise entitled to receive.[205] Similarly, the receiver of a bribe obtains, to the detriment of the Government, an "artificial benefit" from the giver of a bribe.[206] For instance, IOCs pays taxes at lower rate than the one provided for in the tax law and the Government official obtains illicit money from this transaction.[207] In this context, fiscal corruption occurs when public officials break the law or abuse their position to obtain an advantage from the IOC in exchange for favourable tax treatment.[208] It also entails diversion or misuse of collected tax revenues.[209] The next section discusses the main types of fiscal corruption.

3.4.1 Policy Corruption

As discussed in the preceding chapters the oil and gas fiscal system entails both rule making and enforcement of tax laws. As regards to rule making, the law usually vest politicians and techno-bureaucrats with powers to formulate fiscal policies affecting the oil and gas industry. These policies may be of general applications or on a project-to-project basis. To obtain favourable tax treatment, the IOCs usually influence policy and law making.[210] While policy influence is sometime done through legitimate lobbying, quite often IOCs create close ties with policy makers or legislators in exchange for bribes or kickbacks.[211]

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[205] O'Higgins "Corruption, Underdevelopment, and Extractive Resource Industries: Addressing the Vicious Cycle" (2006) 236; Otusanya et al "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013) 313.

[206] O'Higgins, E R. "Corruption, Underdevelopment, and Extractive Resource Industries: Addressing the Vicious Cycle" (2006) 236

[207] OECD *Corruption In The Extractive Value Chain: Typology Of Risks, Mitigation Measures And Incentives* (2016) 38-39 items, such as cost recovery, profit sharing formulas, and taxation) McPherson and MacSearraigh "Corruption in the Petroleum Sector" (2007) 203.

[208] Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (1999) 3; OECD *Corruption In The Extractive Value Chain: Typology Of Risks, Mitigation Measures and Incentives* (2016) 77; Standing *Corruption and the extractive industries in Africa Can combatting corruption cure the resource curse?* (2007) 5&7. Nigeria have stolen at least US$50 billion from oil revenues since the mid 1960s; Li, J. "Counteracting corruption in the tax administration in transitional economics: a case study of China" (1997) 51 *Bulletin of the International Bureau of Fiscal Documentation* 472–492. at 475.

[209] Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007) 75.

[210] The situation where private interests control decision-making is referred to as is "political capture" see OECD *Corruption in the Extractive Value Chain: Typology Of Risks, Mitigation Measures And Incentives* (2016) 38. See also Le Billon *Extractive sectors and illicit financial flows: What role for revenue governance initiatives?* (2011)3.

[211] Mc Pherson and Mac Searraigh "Corruption in the Petroleum Sector" (2007) 198.

The lack of transparency exposes the tax system to maneuvers by politicians and techno-bureaucrats who are consequently captured by the IOCs.[212] Because of corruption, corrupt policy makers may formulate tax policies that favour certain oil companies[213] The most affected aspects of the industry include foreign investment policies, tax exemptions or holidays, price controls, award of exclusive rights, special accounting procedures and special industry incentives.[214] Since the policies and laws establish the basis for charging taxes and other levies, a lopsided fiscal system will not produce the desired outcome.

3.4.2 Administrative Corruption

Generally, tax administrators offer a variety of services to taxpayers, assess and collect taxes and enforce the tax laws.[215] Similarly, the law vests Ministers with powers to grant concessions and tax exemptions.[216] Both tax administrators and Ministers may extort bribes from the IOCs on the promise of a grant of favourable tax treatment.[217] Similarly, the tax administrators may collude with the IOCs to defraud the Government by short levying taxes payable, granting undeserving reliefs or exemptions or writing off tax debts.[218] Collusion may also involve underreporting of production volumes, overstating operating costs, under-invoicing the value of sales or use inappropriate pricing benchmark in contracts.[219] In addition, tax collectors may steal or divert the collected

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[212] Barma Rents To Riches? The Political Economy of Natural Resource–Led Development (2012) 122.

[213] Tax policy formulation and implementation deals with "who pays tax, on what base and at what rate" See Calder "Resource tax administration: The implications of alternative policy choices" (2010) 319 Policy makers and legislators decide the contents of the fiscal policy and law, tax administrators give effect to tax laws and rules Mansfield, CY *Tax Administration in Developing Countries: An Economic Perspective* (Washington, International Monetary Fund 1988) 181-182; Gillies, A *Fuelling Transparency and Accountability in the Natural Resources and Energy Markets*, 14th International Anti-Corruption Conference 10-13 November 2010 - Bangkok, Thailand at 3. Sikkaa et al "The dark side of transfer pricing: Its role in tax avoidance and wealth retentiveness" (2010) at 344. Tanzi *Corruption, Complexity and Tax Evasion* (2017) 11.

[214] Mc Pherson and Mac Searraigh "Corruption in the Petroleum Sector" (2007) 198.

[215] Pashev, K. *Corruption and Tax Compliance: Challenges of Tax Policy and Administration* (Centre for the Study of Democracy, Sofia 2005) 17.

[216] Guttentag and Avi-Yonah "Closing the International Tax Gap" (2005) 17.

[217] Mc Pherson and Mac Searraigh "Corruption in the Petroleum Sector" (2007) 198. OECD *Corruption in the Extractive Value Chain: Typology Of Risks, Mitigation Measures And Incentives* (2016) 77 Standing, "Corruption and the extractive industries in Africa Can combatting corruption cure the resource curse?" (2007) 5 Fjeldstad, "Controlling fiscal corruption Theoretical approaches and illustrations from Tanzania" (1999) 9; Otusanya et al "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013 313.

[218] OECD Corruption in the Extractive Value Chain: Typology of Risks, Mitigation Measures And Incentives (2016) 77; Martinez-Vazquez et al Fighting Corruption in the Public Sector (2007 79.

[219] McPherson and MacSearraigh "Corruption in the Petroleum Sector" (2007) 205-207.

revenues from the treasury for personal uses.[220] In doing so, the tax collectors may falsify tax receipts or create their own tax collecting receipts.[221] This demonstrates a one-to-one correspondence between corruption and revenue leakage.[222]

These types of conduct by tax administrators and politicians demonstrate the relationship between tax evasion and corruption in the tax administration.[223] Because of corruption, most developing countries lose enormous sums of the would-be tax revenues to private hands.[224] For this reason, corruption erodes the tax base, by reducing the amount of Government revenues, and thus impedes the effective provision of services.[225] Consequently, corruption is considered as one of the major hindrances to the endeavours to achieve socio-economic development.[226]

4 Conclusion

The general observation throughout this study is that African countries, such as Tanzania have fiscal regimes which are similar in many ways to those of their counterparts in developed countries. However, despite these similarities, only a fraction of potential tax revenues accrue to the Government in oil-rich countries in Africa. In view of these tax-related challenges, this chapter has highlighted the channels that are likely to cause tax revenue leakage in the oil and gas industry. In doing so, the chapter discussed the different actors and techniques used to avoid or evade taxes. Because of these factors only a fraction of potential taxes may accrue to the Government. The chapter also highlighted the different techniques used by the IOCs to evade and avoid taxes. In addition, it highlighted the deliberate Government policy to give tax incentives which erode the tax base. The chapter also argue that the benefits arising from tax incentives are often

220 Otusanya et al "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013) 313.

221 Tanzi *Corruption, Complexity and Tax Evasion* (2017) 11.

222 Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007) 77.

223 Cerqueti and Coppier 'Tax revenues, fiscal corruption and "shame" costs (2009) 1239.

224 It is estimated that about more than half of the taxes are lost through corruption Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (1999) 1; Martinez-Vazquez et al Fighting Corruption in the Public Sector (2007) 76.

225 Martinez-Vazquez et al Fighting Corruption in the Public Sector (2007) 77.

226 Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (1999) 1.

exaggerated while their costs are grossly overestimated. The challenges ensuing from these factors need special remedial measures. In this regard, the next chapter further unpacks the concept of tax revenue leakage with the view to identify the appropriate remedial measures as well as examining the viability of such remedial measures.

CHAPTER FOUR: MEASURES ADDRESSING TAX REVENUE LEAKAGE: A FRAMEWORK FOR ANALYSIS

1 Introduction

The preceding chapter highlighted the challenges developing countries, such as Tanzania, face when imposing taxes in the oil and gas industry. These challenges include the different techniques used by the IOCs to avoid or evade taxes, fiscal corruption as well as the lack of prudence in granting tax incentives. Moreover, the discussion revealed how these factors cause tax revenue leakage. In view of these challenges, this Chapter adopts the theoretical framework discussed under Chapter 3 to examine the different options, methods and measures available to counteract tax revenue leakage. This discussion is relevant as it highlights the nature of the problem and informs how best the Government can protect its revenue base from tax revenue leakage. The next section dissects the nature of the problem of tax revenue leakage. The understanding of the nature of the problem is useful in identifying the appropriate remedial measures as well as creating the proper environment for such remedial measures to function properly.

2 Nature of the Problem

The major negative consequence of tax revenue leakage is that the Government fails to collect tax revenue commensurate with the extracted oil and gas.[1] The failure to collect an adequate share of revenues has devastating impacts on developing countries, such as Tanzania. It implies that the Government loses the much-needed revenue required to fund

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[1] Fjeldstad, O "Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania" (1999) 1. See also Otusanya et al "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 103. Dell, M "The Devil's Excrement: The Negative Effect of Natural Resources on Development" (2004). 26 (3) *Harvard International Review* 38-41 at 40. Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all* (2013)65 available at http://app-cdn.acwupload.co.uk/wp-content/uploads/2013/08/2013_APR_Equity_in_Extractives_25062013_ENG_HR.pdf; Le Billon, P *Extractive sectors and illicit financial flows: What role for revenue governance initiatives?* Chr Michelsen Institute (2011)1 available at https://www.cmi.no/publications/file/4248-extractive-sectors-and-illicit-financial-flows.pdf; Minh Le et al "Tax Compliance and Sources of Revenue Leakage: Conceptual Framework and Assessment (2011) 62.

social goods and infrastructure.[2] This may partly be the reason why, despite the ongoing extraction of oil and gas in most African countries, these countries remain poor.[3] For this reason, the failure to collect the potential taxes perpetuates poor development, poverty and slow economic growth.[4] It also implies that tax evaders enjoy the protection of the State without contributing to the fiscus and do so at the expense of honest taxpayers.[5] This is contrary to the principle of equity, which requires taxpayers in similar economic position to pay the same amount of tax.[6]

The previous Chapter identified four channels of tax revenue leakage, namely exorbitant tax incentives, tax avoidance, tax evasion and fiscal corruption. These channels demonstrate how the Government loses tax revenues from the oil and gas industry. In principle, tax revenue leakage occurs because there are factors that motivates both the IOC and tax administrators to act they way they do. In addition, it is possible for the IOCs

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[2] Raczkowski, K "Measuring the tax gap in the European economy" (2015) 58; Farnsworth, K and Fooks, G "Corporate Taxation, Corporate Power, and Corporate Harm" (2015) 54(1) *The Howard Journal Vol* at 34. Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012) 135 Guttentag et al "Closing the International Tax Gap" (2005)14. Kirchler, E *The Economic Psychology of Tax Behaviour* (New York, Cambridge University Press, 2007) 103; McPherson, C and MacSearraigh, S "Corruption in the Petroleum Sector" in J. Edgardo Campos & Sanjay Pradhan *The Many Faces of Corruption Tracking Vulnerabilities at the Sector Level* (Washington DC, The World Bank, 2007) 205; Fjeldstad, O and Tungodden, B "Fiscal corruption: A vice or a virtue?" (2003) 31 (8) *World Development* 1459-1467 at 1459; Chand, SK. and Moene, KO "Controlling Fiscal Corruption" (1999) 27 (7) *World Development* 1129-1140 at 1129 Charles Mc Pherson and Stephen Mac Searraigh 'Corruption in the Petroleum Sector' (2007) 206. (affects public spending); Corruption, it is regarded as "the single greatest obstacle to economic and social development" O'Higgins, E R. "Corruption, Underdevelopment, and Extractive Resource Industries: Addressing the Vicious Cycle" (2006) 16 (2) *Business Ethics Quarterly* at 238;);Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007) 78; Minh Le et al "Tax Compliance and Sources of Revenue Leakage: Conceptual Framework and Assessment" (2011) 62; Otusanya, OJ "The role of multinational companies in tax evasion and tax avoidance: The case of Nigeria" *Critical Perspectives on Accounting* 22 (2011) 316–332. Carnahan, M Taxation Challenges in Developing Countries (2015) 2(1) *Asia & the Pacific Policy Studies* 169–182 at 169-170

[3] See Chapter 1 section 1.2.

[4] Cobham, A. *Tax Evasion, Tax Avoidance and Development Finance* (2005) 8-10,16, Bauer, A and Quiroz, JC "Resource Governance" in Goldthau, A (ed) *The Handbook of Global Energy Policy* John Wiley & Sons, Ltd. Ebook(2013) 244. Otusanya, OJ "The role of multinational companies in tax evasion and tax avoidance: The case of Nigeria" (2011) 22 *Critical Perspectives on Accounting* 316–332 at 317. Spicer, MW. "New Approaches to the Problem of Tax Evasion" (1975) 3 *British Tax Review* 152-154 *at* 152 Otusanya et al "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013) 312.

[5] Farnsworth and Fooks "Corporate Taxation, Corporate Power, and Corporate Harm" (2015) 25; Spicer, "New Approaches to the Problem of Tax Evasion" (1975) 152.

[6] Otusanya, OJ "The role of multinational companies in tax evasion and tax avoidance: The case of Nigeria" (2011) 22 *Critical Perspectives on Accounting* 316–332 at 317; Kaplow, L *The Theory of Taxation and Public Economics* (Princeton, Princeton University Press, 2008) 396-398.

and tax administrators to do away with Government's tax revenue due to existence of gaps and loopholes in the tax system. The next section discusses these elements in detail.

2.1 Motivating factors

Generally, tax administration involves two actors, namely the taxpayers (the IOCs) and the tax administrators.[7] Both cases involve a human element which creates a risk of "dishonesty and malpractice" in the assessment and collection of taxes.[8] The risk is aggravated by the fact that both taxpayers and colluding tax administrators have divergent interests from those of the Government.[9] For one, the colluding tax administrators are motivated by their self-interests and thus want to divert collected taxes to their account.[10] In fact, such tax administrators are enticed by the get-money-quick syndrome and the benefits accruing from corrupt transactions.[11] In doing so they exort bribes or collude with IOCs to short-levy taxes or grant tax incentives to unqualified entities. It is notable, however, that before engaging in corrupt practices, the unscrupulous tax administrators weigh the level of personal gains against the probability of detection and the severity of the penalty.[12] According to this view, corruption thrives where there is low probability of detection, prosecution and weak penalties.[13]

Similarly, the sole objective of companies is maximization of profits.[14] For this reason, taxes are considered as a cost of investment that should be reduced every time there is an

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[7] Otusanya, OJ Arowomole SSA and. Adeyeye, GB "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 4 (1) *Int. J. Economics and Accounting*. 93–122 at 103.

[8] Hindriks J, Keen M, and Muthoo A "Corruption, Extortion and Evasion" in Abed GT and Gupta S *Governance, Corruption and Economic Performance (*Washington, D.C. IMF 2002)396-436 at 396-398.

[9] Martinez-Vazquez, et al *Fighting Corruption in the Public Sector* (Emerald Group Publishing Limited, 2007) 20, 81.

[10] Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007) 81.

[11] Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007) 81; Fjeldstad, O "Fighting Fiscal Corruption: Lessons from the Tanzania Revenue Authority" (2003) 23 *Public Admin. Dev.* 165–175 at 169. Warioba Commission Report (1996) 78-79. Chand et al "Controlling Fiscal Corruption" (1999) 1129

[12] Becker, G.S "Crime and Punishment: An Economic Approach" (1968) 76(2) *Journal of Political Economy* pp. 169-217 at 207.Fighting Corruption in the Public Sector (2007) 22-23.

[13] Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007)80-83.

[14] Sikkaa, P and Willmott, H "The dark side of transfer pricing: Its role in tax avoidance and wealth retentiveness" Critical Perspectives on Accounting 21 (2010) 342–356 at 344; Otusanya OJ, Ajibolade, SO and Akerele, EK "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013) 310.

opportunity.[15] In the same regard, company officials and directors want to reduce the company's operating costs so that they can obtain bonuses or promotions. The bottomline is that the IOC will utilize any available opportunity to lower or eliminate a tax liability.

2.2 Structural Gaps in the Tax System

The discussion of channels of tax revenue leakage also identifies the structures within which the tax system operates.[16] These structures include the whole tax system from legislative drafting to the procedures for assessment, collection and payment of taxes.[17] The structures also take into account the global economy, which influence the way oil companies operate.[18] The most important aspect in the global economy relates to the company's general mission of profit making.[19] The discussion also reveals the gaps in the tax system through which tax revenue leaks. The discussion these gaps follow.

2.2.1 Window of Opportunity for Corrupt Practices

The law vests certain administrative powers to techno-bureaucrats and politicians, such as granting licenses, negotiating contracts, granting fiscal incentives, assessing and collecting taxes.[20] In the discharge of their functions, these techno-bureaucrats and politicians interact with the taxpayers (IOCs).[21] While the holders of public powers are expected to discharge their obligations according to the law, deviations from the law may

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[15] Sikkaa, P and Willmott, H "The dark side of transfer pricing: Its role in tax avoidance and wealth retentiveness" Critical Perspectives on Accounting 21 (2010) 344.

[16] Otusanya et al "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 103.

[17] See Chapter 3 section 3

[18] Schreiber, U *International Company Taxation: An Introduction to the Legal and Economic Principles* (Berlin, Springer, 2013) 17.

[19] Sikkaa, P and Willmott, H "The dark side of transfer pricing: Its role in tax avoidance and wealth retentiveness" (2010) 21 *Critical Perspectives on Accounting* 342–356 at 344

[20] Tanzi, V. "Corruption and the budget: problems and solutions" in Arvind, K. J. (ed.), *Economics of Corruption*. Boston, MA: Kluwer Academic. 1998).114; Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007)78. Tanzi, V *Corruption around the World: Causes, Consequences, Scope, and Cures* (Washington International Monetary Fund 1998) 567. Mc Pherson, C and Mac Searraigh, S "Corruption in the Petroleum Sector" (2007) 197; Calder, J *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014) 18.

[21] Tanzi, V *Corruption around the World: Causes, Consequences, Scope, and Cures* (Washington International Monetary Fund 1998) 567.

occur.[22] The deviations from the law occur because certain officials representing the Government have their own-self-interests, which diverge from that of the Government.[23] One of the commonest forms of deviation is corruption.[24]

While the decision to engage in or refrain from corrupt practices is a matter of individual's choice, there are certain factors that open windows of opportunity for corrupt practices.[25] Where this window of opportunity does not exist, even corrupt Government officials are automatically restrained from engaging in any corrupt transactions.[26] Three factors create a window of opportunity for corruption in the oil and gas industry.[27] First, while the law bestows discretionary powers on techno-bureaucrats and politicians to make tax-related decisions, there are weak mechanisms of checks and balance on exercise such powers.[28] Usually, few techno-bureaucrats and politicians monopolize the decision-making process and implementation of Government policies and laws.[29] Since there are no effective systems of monitoring of the exercise of powers, such as the anti-corruption bureau or internal mechanisms, it means that the holders of powers act the way they please.[30]

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[22] The federalist papers Quoted in Schedler, A "Conceptualizing Accountability" in Schedler A, Diamond, L & Plattner, M *The Self-Restraining State: Power and Accountability in new Democracies* (Colorado, Lynne Rienner Publishers, 1999) 13-27 at 13.

[23] Rose-Ackerman, S *Corruption and Government: Causes, Consequences, and Reform* (Cambridge, Cambridge University Press 1999) 3, 186 &226;

[24] McPherson and MacSearraigh "Corruption in the Petroleum Sector" (2007) 197.

[25] McPherson and MacSearraigh "Corruption in the Petroleum Sector" (2007) 197.

[26] Martinez-Vazquez, et al Fighting Corruption in the Public Sector (2007) 86.

[27] Martinez-Vazquez, et al Fighting Corruption in the Public Sector (2007) 23.

[28] McPherson and MacSearraigh "Corruption in the Petroleum Sector" (2007) 197; Martinez-Vazquez et al *Corruption, Fiscal Policy, And Fiscal Management Fiscal Reform In Support Of Trade Liberalization* (2006) http://pdf.usaid.gov/pdf_docs/Pnadh108.pdf (accessed 05 June 2016) 3 Corruption = Monopoly + Discretion - Accountability Le Billon, P *Extractive sectors and illicit financial flows: What role for revenue governance initiatives?* (2011)3. Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012) 135 Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (1999) 15; Chand and Moene "Controlling Fiscal Corruption" (1999) 1129; Chand et al "Controlling Fiscal Corruption" (1999) 1129; IMF Survey 'To offer or not to offer tax incentives —that is the question (2002) Fjeldstad "Fighting Fiscal Corruption: Lessons from the Tanzania Revenue Authority" (2003) 169; Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007) 23; Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (Bergen, Chr. Michelsen Institute 1999) 15.

[29] Tanzi *Corruption around the World: Causes, Consequences, Scope, and Cures* 1998) 567; Martinez-Vazquez, et al Fighting Corruption in the Public Sector (2007) 23.

[30] OECD *Corruption In The Extractive Value Chain: Typology of Risks, Mitigation Measures And Incentives* OECD Publications (2016) 15, 16, 17. Tanzi *Corruption around the World: Causes, Consequences, Scope, and Cures* (1998) 567. Tanzi *Corruption, Complexity and Tax Evasion* (2017) 10-11.

Second, the law does not specify eligibility criteria to guide the tax officials (or politicians) in the grant of tax incentives [31] In addition, there is no requirement to report on the impelementation of tax exemptions. [32] All these shortcomings leave the door open for unscrupulous Government officials to accept bribes and short-levy taxes or divert Government revenues on their own account.[33]

Third, there is sheer lack of transparency in the administrative procedures for grant of licenses as well as the grant of tax incentives. [34] Usually, the concession agreements are not available in the public domain. [35] In addition, there is no requirement to publicize the process for grant of such tax exemptions. Even when these tax exemptions are granted, there is no requirement report how the recipient of such tax incentives comply with the law.[36] Consequently, the lack of transparency facilitates diversion or embezzlement of collected revenues by tax administrators to their personal accounts.[37]

2.2.2 Gaps and Loopholes in the Tax System

As discussed in the preceding chapter, the IOCs may devise different techniques to reduce or eliminate their tax liabilities. These techniques usually entail taking advantage of the gaps and loopholes in the law to minimize or eliminate tax liability.[38] This is possible because in many developing countries, for example, there are deficiencies in the rules on treatment capital gains in developing countries.[39] One of the extreme cases is where the law is silent on the indirect transfer of shares occurring abroad.[40] Even where the law

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[31] Cleeve "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?"(2008) 42(1) *The Journal of Developing Areas* 138.

[32] Fjeldstad "Fighting Fiscal Corruption: Lessons from the Tanzania Revenue Authority" (2003) 169. act as they please Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (1999) 15.

[33] See Chapter 3 section 3.4.

[34] Fjeldstad "Controlling fiscal corruption Theoretical approaches and illustrations from Tanzania" (1999) 15.Tanzi *Corruption around the World: Causes, Consequences, Scope, and Cures* (1998) 567.

[35] Tanzi *Corruption around the World: Causes, Consequences, Scope, and Cures* (1998) 575

[36] Tanzi *Corruption around the World: Causes, Consequences, Scope, and Cures* (1998) 576

[37] OECD *Corruption In The Extractive Value Chain: Typology Of Risks, Mitigation Measures And Incentives* (2016) 77, 93. Mc Pherson and Mac Searraigh "Corruption in the Petroleum Sector" (2007) 197

[38] See Chapter 3 section 3.2.

[39] Burns et al "Taxing gains on transfer of interest" (2017) 160. Guj et al *How to Improve Mining Tax Administration and Collection Frameworks: A Sourcebook* (Washington DC, World Bank, 2013) 74.

[40] Tanzania for a long time the Income Tax Act 2004 did not have a provision on taxing the indirect transfer of rights. Attempts by TRA to collect capital gains were rejected by the court. See *Afrika Mashariki Gold Mines Limited v. Commissioner General* (2005)1 TTLR 37 and *JSC Atomredmetzoloto v Commissioner*

provides for capital gains, the actual collection of capital gains has been center of controversy between the Government and the IOCs.[41] Because of these gaps, sometimes-large amounts of gains obtained from transfers of petroleum right go untaxed. [42]

In addition, double tax treaties may create gaps that permit even companies from States not parties to the treaties to benefit. [43] The tax treaties with tax havens may result into non-double taxation.[44] In addition, insufficient rules on transfer pricing makes it easy for the IOCs to use their subsidiary companies to shift profits among from high-tax jurisdiction to low tax-jurisdiction.[45] The existence of tax havens also facilitates tax avoidance.[46] The low tax rates in tax havens incentivize the IOC to shift their incomes

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General, Tax Revenue Appeals Tribunal at Dar Es Salaam Income Tax Appeal No. 17 of 2013 (Unreported). In Peru the acquisition of shares in oil Company *Petrotech Peruana the law was silent on the imposition of capital gains, and therefore the transaction was untaxed. Similarly, the case of Vodafone Int'l Holdings B.V. vs Union of India*, [2012] 341 ITR 1 (SC), Indian Revenue authority could not collect capital gains tax become the Income Tax Act did not impose such tax on indirect transfer of shares. In Uganda, the Ugandan Revenue Authority could not collect capital gains tax on indirect transfer of shares because the tax treaty gave an exclusive right to the Netherlands impose taxes on such transactions. See the discussions in IMF *Discussion draft The Taxation of Offshore Indirect Transfers—A Toolkit* (2017) 26-28 available at http://documents.worldbank.org/curated/en/689091501488467178/pdf/117797-REVISED-Consultation-Draft-Indirect-Offshore-Transfers-July28-003.pdf (accessed on 04 August 2017).

[41] This has become a major concern as large gains were achieved by sellers in transactions in exploration projects, for example, in Ghana, Mozambique and Uganda. See Burns et al "Taxing gains on transfer of interest" (2017) 160.

[42] Usually no capital gains tax is paid to the oil-rich host country for these transactions .A good example is Mauritanian gold project, sold in Bahamas at $ 4 billion, no CGT was paid See Keen, M and Mullins, P "International corporate taxation and the extractive industries Principles, practice, problems" in Daniel, P Keen, M Świstak, A and Thuronyi V *International Taxation and the Extractive Industries* London (Tayor & Francis Ebooks 2017) 28-29.

[43] Abuse of double tax treaties, treaty shopping or stripping, the IOCs erode the tax base, reduce WHT or write them off completely IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 37. These treaties are not beneficial for LDC due to negligible outward investments of their own; Tanzania Tax Justice Coalition *Double Taxation Agreements A Gain or Loss to Tanzania?* (2016) 10. Rozner, S *Taxing Oil: Issues and Trends* (2009) 2-3 available at http://archive.resourcegovernance.org/sites/default/files/Rozner%20-%20Taxing%20Oil%20-%20Issues%20&%20Trends.pdf; 235-36.

[44] Jansky P and Prats A "International Profit-Shifting out of Developing Countries and the Role of Tax Havens" (2015,) 33 (3) *Development Policy Review* at 271.

[45] Different corporate tax rates between one jurisdiction and another incentivizes companies to shift profits from high to low-tax jurisdiction (which charge low or nil corporate taxes). See Bernard et al "Multinational Corporations, Transfer Prices, and Taxes: Evidence from the U.S. Petroleum Industry" (1990) 123; Keen, M and Mullins, P "International corporate taxation and the extractive industries Principles, practice, problems" in Daniel et al *International Taxation and the Extractive Industries* Tayor & Francis Ebooks (2016) 18; IMF Spillovers in International Corporate Taxation (2014) 11.

[46] Jansky and Prats "International Profit-Shifting out of Developing Countries and the Role of Tax Havens" *Development Policy Review* 33 (3) (2015) 271, 274; Kerzner DS and Chodikoff DW *International Tax Evasion in the Global Information Age* (Palgrave Macmillan E-book, 2016) 62; See also OECD *Harmful Tax Competition: An Emerging Global Issue* (1998) 19-22 Nakhle "Petroleum Fiscal Regimes: Evolution and Challenges" in Daniel et al (eds), *The Taxation of Petroleum and Minerals: Principles, Problems and Practice* (London, Routledge, 2010) 104 &117.

and profits from high-tax jurisdictions to the tax havens.[47] In addition, the strict confidentiality observed by tax havens impedes the initiative among nations to cooperate in tax matters.[48] Consequently, it becomes difficult, due to lack of information, to tax cross-border transactions.[49]

2.2.3 Asymmetry of Information

Generally, the oil and gas industry is complex. Its complexity ranges from geological features to volatility of commodity prices.[50] While for the Government, this complexity makes oversight and regulation of the industry difficult, it makes easy for the IOCs to manipulate tax rules.[51] This is because the IOCs are well equipped with skilled work force, expertise and experienced than the Government.[52] Moreover, the IOCs operate all over the world and have capacity to hire the best experts and professional firms compared to the Government.[53]

Information asymmetry usually has big impacts to the new entrants, such as Tanzania, which do not have any prior experience in the industry.[54] In practice, the IOCs usually take advantage of this knowledge gap to avoid taxes without being detected or punished.[55] Using this knowledge gap, the IOCs also pressurize developing countries to grant tax

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[47] double non-taxation Jansky et al "International Profit-Shifting out of Developing Countries and the Role of Tax Havens" (2015) 274

[48] Tax havens deny requests for exchange of tax information. see Jansky et al "International Profit-Shifting out of Developing Countries and the Role of Tax Havens" (2015) 274. See also Kerzner DS and Chodikoff DW *International Tax Evasion in the Global Information Age* (2016) 62; OECD *Harmful Tax Competition: An Emerging Global Issue* (1998) 19-22. Abebe et al *The United Nations' Role in International Tax Policy A Research and Policy Brief for the Use of the NGO Committee on Financing for Development* (2012) 30.

[49] UNCTAD *Trade and Development Report, 2014 Chapter VII Fiscal Space for Stability and Development: Contemporary Challenges* (New York and Geneva, United Nations 2014) 171

[50] See Chapter 2 section 2.

[51]Gillies, A "Fuelling Transparency and Accountability in the Natural Resources and Energy Markets" 14th International Anti-Corruption Conference 10-13 November 2010 - Bangkok, Thailand at 1.

[52] Bauer, A and Quiroz, JC "Resource Governance" in Goldthau, A (ed) *The Handbook of Global Energy Policy* (John Wiley & Sons Ltd, Ebook 2013) 244-263 at 246. See also Guttentag, J and Avi-Yonah, RS. "Closing the International Tax Gap" in M. B. Sawicky (ed) *Bridging the Tax Gap: Addressing the Crisis in Federal Tax Administration*, (Washington D.C, Economic Policy Institute, 2005) 17. IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 10. Lan Mo, PL *Tax Avoidance and Anti-Avoidance Measures in Major Developing Economies* (London, Praeger Publishers, 2003) 78.

[53] IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 10. Guttentag et al "Closing the International Tax Gap" (2005) 17.

[54] Le Leuch "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 140.

[55] See Chapter 3 sections 3.2 and 3.3.

incentives. The arguments put forward include the lack of infrastructure, political risks and poor markets. [56] The costs of tax incentives are not well understood. [57]

2.2.4 Weak Mechanisms for Prevention, Detection and Punishment

The IOCs deploy different techniques to avoid taxes, such as transfer pricing, thin capitalization, treaty shopping, and corporate re-organization.[58] Alternatively, the IOCs may engage in outright criminal conducts, such as concealment of income or under-declaration of taxable income, false invoicing and underreporting production.[59] Under both tax avoidance and tax evasion, the IOCs may act alone or in collusion with tax administrators. The lack of effective administrative mechanisms to detect, prevent and punish tax avoidance and tax evasion schemes, implies that the IOCs can act in a manner they please without easily being detected or punished.[60]

As regards to the Government officials, they may extort or accept bribes in the exchange for short levying of taxes due or granting exemptions to non-qualifying IOCs. These Government officials may also divert the collected tax revenues to their own account. [61] In this regard, the lack of anti-corruption strategy facilitates corruption.[62] There are usually weak mechanisms for detection, prosecution and punishment of corruption. [63]

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[56] Holland, D and. Vann, RJ "Income Tax Incentives for Investments" in Victor Thuronyi (ed) *Tax Law Design and Drafting* Volume 1 (Washington DC, International Monetary Fund, 1996) 987.

[57] See Chapter 3 section 3.1.

[58] See Chapter 3 section 3.2.

[59] OECD *Corruption In The Extractive Value Chain: Typology Of Risks, Mitigation Measures and Incentives* (2016) 78-79. See also McPherson, C and MacSearraigh, S "Corruption in the Petroleum Sector" (2007) 206.

[60] Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012) 119; Le Billon *Extractive sectors and illicit financial flows: What role for revenue governance initiatives?* (2011)7; 11; Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all* (2013) 63, 65; Minh Le et al "Tax Compliance and Sources of Revenue Leakage: Conceptual Framework and Assessment" (2011) 61; Pfister, M *Taxation for Investment and Development: An overview of policy challenges in Africa* (2009) 5-7 Mullins, P "International tax issues for the resource sector" in P Daniel, M Keen and C McPherson (eds), *The Taxation of Petroleum and Minerals: Principles, Problems and Practice* (London, Routledge, 2010) 388. Fjeldstad "Controlling fiscal corruption Theoretical approaches and illustrations from Tanzania" (1999) 15

[61] Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007) 77.

[62] Fjeldstad *Controlling fiscal corruption: Theoretical approaches and illustrations from Tanzania* (1999) 15 Africa countries are characterized by weak mechanisms of restraints on the use of public power Stefan Fighting Corruption in Africa – A Comparative Study of Uganda and Botswana (2009) 26; Fjeldstad "Fighting Fiscal Corruption: Lessons from the Tanzania Revenue Authority" (2003) 169. act as they please Fighting Corruption in the Public Sector (2007)23

[63] Tanzi *Corruption around the World: Causes, Consequences, Scope, and Cures* (1998) 567.

Sometimes this is a result of opaque and cumbersome administrative procedures for penalizing public officials. [64]

3 Distilling Remedial Measures

The recurrent theme in the above discussions is that tax revenue leakage results from corrupt practices by the Government officials and non-compliance of tax laws by the IOCs. The discussions also indicate that corruption arises because there are factors that open windows of opportunity for corrupt practices.[65] When the window of opportunity is open, the Government officials are enticed to engage in corruption due to low probability of detection or low punishment and the potential gains from corruption.[66] In light of these factors facilitating the occurrence of fiscal corruption, the anti-corruption strategy must address the factors that leave the door open for corrupt practices as well as the factors that induce or motivate Government officials to engage in corrupt practices.

Similarly, the IOCs are motivated by the need to maximize profits. In doing so, the IOCs devise a variety of techniques to reduce or eliminated their tax obligations. In addition, the IOCs may engage in outright criminal activities, such as forgery to reduce their tax liability. The conducts of the IOCs are influenced by the existence of gaps and loopholes in the tax system, as well as the asymmetry of information between the Government and the IOCs.[67] In view of these techniques, the remedial measures must aim to control and manage the conducts of the IOCs to ensure compliance with tax laws. The next section identifies the remedial measures and analyses them one by one.

3.1 Closing Window of Opportunity for Corrupt Practices

Generally, fiscal corruption occurs partly because there are factors that create a window of opportunity of such corrupt practices. These factors may include secrecy in Government affairs and the lack of oversight mechanisms in the exercise of public power. For this reason, it is not the individual Government officials, but rather the governance

[64] Tanzi *Corruption around the World: Causes, Consequences, Scope, and Cures* (1998) 574.
[65] See section 2.2.1 above.
[66] See section 2.2.1 above.
[67] See section 2.2.3 above.

system that encourages corruption.[68] Flowing from this analysis, the appropriate remedy is to close the windows of opportunity for corrupt practices. Therefore, anti-corruption strategy must address the way decisions are made. [69]

Under governance schemes, Government officials are given discretion to make certain decisions. While discretion intends to enhance efficiency and efficacy, in absence of oversight mechanisms, such discretion may be abused.[70] To prevent abuse of discretion, the governance systems must ensure that Government officials act within the confines of the law.[71] This is all about accountability.

The concept of accountability, coined from the field of accountancy, entails the external constraints on the exercise of public powers.[72] The constraints relate to the procedures (such as consultation or publication) to be followed when making decisions. [73] The constraints also aim to ensure the substance of the decision complies with the letter of the law.[74] These constraints when properly exercised have the potential to limit or minimize opportunities for corrupt practices.[75] The next section provides a discussion of these mechanisms of constraint on the exercise of public power.

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[68] See section 2.2.1 above.

[69] Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007) 12,24.

[70] Apaza, C *Public management challenge* (2011) 48 https://www.american.edu/spa/publicpurpose/upload/Public-Management-Challenge-Ensuring-Accountability-and-Controlling-Corruption.pdf. (accessed 08 August 2016).

[71] The federalist papers argue that if men were angels then Government was not necessary and if angels were to govern then need for external or internal control of Government will vanish. Quoted in Schedler, A "Conceptualizing Accountability" in Schedler A, Diamond, L & Plattner, M *The Self-Restraining State: Power and Accountability in new Democracies* (Colorado, Lynne Rienner Publishers, 1999) 13-27 at 13.

[72] In the field of accountancy, accountants had an obligation to explain to their employers how and why they conducted certain transactions. The same analogy applies to the the oil and gas industry where the Government is deemed to hold the resources on behalf of the people. Carmen Apaza *Public management challenge* (2011) 48. There is also the concept in administrative law dealing with administrative action of Government official. This concept provides for remedial, through judicial review, to all parties aggrieved by the decision of the respective Government officials. See Pope, J *TI Source Book: Confronting Corruption: The Elements of a National Integrity System* (Transparency International 2000) 169-171. However, this study examines only measure that prevent abuse of power.

[73] Apaza Public management challenge (2011) 48.

[74] Apaza Public management challenge (2011) 48.

[75]. Apaza *Public management challenge* (2011) 48.

3.1.1 Transparency

Transparency refers to openness in decision making by the Government and access to information relating to such decisions by the citizens.[76] It entails the openness of information, dissemination of information or such is easily accessible to the public.[77] Transparency places an obligation on the Government to collect, maintain, and disseminate information related with oil and gas extraction to the people it represents.[78] A similar duty is imposed on IOCs to keep records and where necessary transmit the same to the Government.[79] This enhances disclosure of the nature and structure of oil and gas operations.[80]

Several methods may be used to disseminate information to the public, such as publication in a website or newspapers or depository. However, certain information may be excluded from being publicized.[81] In this case, the law specifies the criteria for classifying certain information, such as commercial information, as a confidential.[82] The availability and accessibility of information, such as the oil and gas concessions, tax incentives and revenues collected helps citizens monitor the conduct of IOCs and Government officials.[83] In doing so, transparency enhances the right to information and

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[76] Veit, PG. and Excell, C "Access to Information and Transparency Provisions in Petroleum Laws in Africa: A Comparative Analysis" in Grant, JA, Nadège Compaoré, W.R., and Mitchell, M. I. (ed) *New Approaches to the Governance of Natural Resources: Insights from Africa* (New York, Palgrave Macmillan 2015) 70. See also Oliver, RW *What Is Transparency?* **(**New York, McGraw-Hill Companies, 2004) 3

[77] It means active disclosure of information by the the Government. See Oliver, RW *What Is Transparency?* **(**New York, McGraw-Hill Companies, 2004) 3; UNCTAD *World Investment Report 2002 Transnational Corporations and Export Competitiveness* (Geneva, UNCTAD, 2002) 46.

[78] The type of information include the licenses granted, tax incentives, beneficial ownership, and revenue collected Veit et al "Access to Information and Transparency Provisions in Petroleum Laws in Africa: A Comparative Analysis" (2015) 86; Schedler, A "Conceptualizing Accountability" in Schedler A, Diamond, L & Plattner, M *The Self-Restraining State: Power and Accountability in new Democracies* (Colorado, Lynne Rienner Publishers,1999) 13-27 at 14. national security protection and privacy

[79] Veit et al "Access to Information and Transparency Provisions in Petroleum Laws in Africa: A Comparative Analysis" (2015) 70

[80] Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 22.

[81] Veit et al "Access to Information and Transparency Provisions in Petroleum Laws in Africa: A Comparative Analysis" (2015) 70.

[82] Veit et al "Access to Information and Transparency Provisions in Petroleum Laws in Africa: A Comparative Analysis" (2015) 86.

[83] Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all* (2013) 54 African Development Bank *Oil and Gas in Africa* (2009) 112-13. Tanzi "Corruption around the World: Causes, Consequences, Scope, and Cures" (1998) 575

empowers the citizens to hold their leaders to account.[84] All these facts indicate that transparency negates the conditions conducive for corruption to flourish. In doing so, transparency reveals mismanagement of resources and corruption and thus enhances accountability.[85] Similarly, transparency makes it difficult for the IOCs to circumspect the loopholes in the law or take undue advantage of tax exemptions.[86] Therefore, transparency is proactive in preventing the occurrence of corruption.[87] By contrast, other measures, such as sanctions, which come after the fact, and thus reactive.[88]

The transparency initiatives emerged as a response sheer corruption in the oil and gas industries. Several NGOs argued that transparency had the potential to fight corruption, enhance prudent management of resource revenues and eradicate poverty.[89] For example, the Extractive Industry Transparency Initiative (EITI), launched in 2002, calls for the member countries to verify the revenue received by the Governments against taxes paid IOCs.[90] In addition, the reconciliation exercise and dissemination of findings is conducted by representatives from the Government, companies and civil society.[91]

Although transparency has the potential to limit or minimize corrupt activities, it has its limitations. For instance, the publication of revenue collected shows how much is

[84] Africa Progress Panel *Africa Progress Report: Equity in Extractives Stewarding Africa's natural resources for all* (2013) 54 Standing, A *Corruption and the extractive industries in Africa Can combatting corruption cure the resource curse?* (2007) 17; Veit et al "Access to Information and Transparency Provisions in Petroleum Laws in Africa: A Comparative Analysis" (2015) 86.

[85] McPherson, C "National Oil Companies: Ensuring Benefits and Avoiding Systemic Risks"in in Andreas Goldthau (ed) *The Handbook of Global Energy Policy* John Wiley & Sons, Ltd. Ebook (2013) 152.

[86] Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012)136.

[87] See Chapter 4 section 3.3.1

[88] See Chapter 4 section 3.4

[89] Such as the Global Witness and - the campaign 'Publish What You Pay'. See Lehmann V, "Natural Resources, the Extractive Industries Transparency Initiative, and Global Governance" (2015) 5-6 available at https://www.stimson.org/sites/default/files/Commission_BP_Lehmann.pdf (accessed on 20 July 2017) Hilson, G and Maconachie, R "The Extractive Industries Transparency Initiative: Panacea or White Elephant for Sub-Saharan Africa?" in in Richards, JP (ed) Mining, *Society, and a Sustainable World* (Verlag Berlin Heidelberg, Springer, 2009) 473-474; Corrigan, CC "Breaking the resource curse: Transparency in the natural resource sector and the extractive industries transparency initiative" (2013) *Resources Policy* at 3; McPherson, C "National Oil Companies: Ensuring Benefits and Avoiding Systemic Risks" (2013) 152..

[90] Hilson, G and Maconachie, R "The Extractive Industries Transparency Initiative: Panacea or White Elephant for Sub-Saharan Africa?" in in Richards, JP (ed) Mining, *Society, and a Sustainable World* (Verlag Berlin Heidelberg, Springer, 2009) 469; Short, C "The development of the Extractive Industries Transparency Initiative" (2014) 7(1) *Journal of World Energy Law and Business* 8-15 at 10.

[91] Short, C "The development of the Extractive Industries Transparency Initiative" (2014) 7(1) *Journal of World Energy Law and Business* 8-15 at 10.

collected and does not indicate the revenue that ought to be collected. Furthermore, disclosure of information alone does not guarantee accountability. Instead, success depends on whether the citizens are able to understand the information and act accordingly.[92] It also depends on the existence of political environment to demand for accountability.[93] There are instances where the publication and disclosure of revenues has not created any accountability.[94]

Similarly, the disclosure of corrupt transactions does not guarantee punishment of the corrupt officials.[95] The punishment of offenders depends on the existence of laws criminalizing corruption and the corresponding anti-corruption agencies. It also requires a political will and commitment to prosecute corrupt officials especially those engaged in grand corruption. For these reasons, transparency must be complemented with institutions of restraints, such as anti-corruption agencies and the judiciary. These challenges also imply that transparency is not a standalone solution in the fight against corruption in the oil and gas industry.[96]

3.1.2 Oversight and Control over the Exercise of Public Power

The oil and gas endowment usually creates a desire for Government officials to divert as much as possible revenues to their personal accounts.[97] These Government officials are able to divert these revenues because there is lack of oversight mechanisms on the exercise of public powers. To minimize chances for corrupt practices, the law must ensure diversification power, such as multiple authorizations in the grant of oil and gas rights or tax exemptions.[98]

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[92] McPherson "National Oil Companies: Ensuring Benefits and Avoiding Systemic Risks" (2013)152.

[93] Corrigan, CC "Breaking the resource curse: Transparency in the natural resource sector and the extractive industries transparency initiative" (2013) *Resources Policy* at 4. McPherson "National Oil Companies: Ensuring Benefits and Avoiding Systemic Risks" (2013)152.

[94] McPherson "National Oil Companies: Ensuring Benefits and Avoiding Systemic Risks" (2013)152; Lehmann V, "Natural Resources, the Extractive Industries Transparency Initiative, and Global Governance" (2015) 9

[95] Standing, A "Corruption and the extractive industries in Africa Can combatting corruption cure the resource curse?" (2007) 17.

[96] See Chapter 1 section 3.

[97] Bauer, A and Quiroz, JC "Resource Governance" in Andreas Goldthau (ed) *The Handbook of Global Energy Policy* (John Wiley & Sons, Ltd. Ebook 2013)247-248.

[98] Stiglitz "Dealing with Oil Corporations: What Is the Role of the State?" (2007) 26.

One of the oversight mechanisms in the oil and gas industry is the creation of watchdog institutions, such as the office of the Controller and Auditor General and anti-corruption bureau.[99] The function of these watchdog institutions is to ensure that those vested with public power act according to the mandate given.[100] In other instances, any agreements granting rights to exploit natural resources may require parliamentary ratification by the parliament.[101] Similarly, delegation of tax law-making powers must be limited to administrative issues only while the basic concepts of taxes like tax base and tax rate remain the prerogative of the legislature.[102] This limit the negotiations of fiscal terms to only within certain limited parameters.[103]

3.2 Removing Incentives for Corruption

As discussed in the preceding chapters, several factors, such as low probability of detection, low or no penalties for corruption and non-prosecution of corruption cases induce or motivate Government officials to engage in corrupt practices.[104] Since the unscrupulous Government officials usually weigh the benefits from corruption against the risks of arrest and prosecution, imposition of strong penalties deters potential offenders.[105] Therefore, higher probability of detection and ultimate imposition of severe penalties, is a disincentive to corrupt Government officials.[106] The penalties may include

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[99] Functions of the CAG generally under the National Audit Office Act; Tanzi *Corruption around the World: Causes, Consequences, Scope, and Cures* (1998) 575. See also Oliver, RW *What Is Transparency?* **(**New York, McGraw-Hill Companies, 2004) 44-47.

[100] Barma, NH.and Radon, J "How to Negotiate an Oil Agreement" in Humphreys M, Sachs JD and Stiglitz JE (eds), *Escaping the Resource Curse*) New York, Columbia University Press (2007) 99; Hackman, NA *Was Ghana Right in Choosing Royalty Tax System For The Oil Sector?* (2010) 16 available at http://www.danquahinstitute.org/docs/OilSectorUnderScrutiny.pdf (accessed on 20 March 2015). Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012) 135.

[101] Article 268(1) of the Constitution of Ghana 1996; Article 13 of the Constitution of Tunisia 2014 and Article 71 (1) (a) of the Constitution of Kenya 2010,)

[102] Article 174(2) of the Constitution of Ghana 1992. See also Zolt, EM "Tax incentives: protecting the tax base" (2015) 481.

[103] Vanistendael, F "Legal Framework for Taxation" *Tax Law Design and Drafting*, in Victor Thuronyi (ed), *Tax Law Design and Drafting* Vol. 1 (Washington DC, International Monetary Fund 1996) 2.

[104] The other factors, such as low wages are beyond the scope of this study

[105] Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007) 12. Kenneth John Ball 1951, 35 Cr. App.R. 146. crime is chosen for its benefits Otusanya et al "The effect of fiscal corruption on economic development and sustainability in developing economies: the case of Nigeria" (2013) 318.

[106] Fighting Corruption in the Public Sector (2007) 114; Tanzi *Corruption around the World: Causes, Consequences, Scope, and Cures* (1998) 570; Becker, G.S "Crime and Punishment: An Economic Approach" (1968) 76(2) *Journal of Political Economy* pp. 169-217 at 207

administrative measures, such as job dismissal or criminal prosecution (fines, imprisonment or both).[107] The implementation of these penal sanctions depends on the institutional frameworks for sanctioning any deviation from public duties, such as the police, anti-corruption bureau, prosecuting authorities and courts.[108]

While penalties have the potential to deter potential offenders, their major weakness is that they come into play where damage has already occurred. For this reason, it is not a preventive measure. Rather a reaction to law breaking. The best option is to close the windows of opportunity for corrupt practices. When the door is closed, Government officials though may have the motive to engage in corruption, they will not find the opportunity to do so.[109]

3.3 Closing Gaps and Loopholes in the Tax System

The IOCs usually devise a variety of techniques to minimize or reduce their tax liability.[110] In doing so, IOCs arrange their transactions in such a way that they are able to obtain tax advantages, benefit or reduction not intended by the law.[111] This happens because tax statutes, like any other statutes, are open to multiple interpretations.[112] The multiple interpretations provide an opportunity for the IOCs to shop around the best interpretation. [113]

Since tax avoidance is a global issue, there are several international initiatives to curb tax avoidance on cross border transactions. The most common international response to tax

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[107] Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007) 117-118.

[108] Schedler "Conceptualizing Accountability" (1999) 14.

[109] Martinez-Vazquez et al *Fighting Corruption in the Public Sector* (2007) 13.

[110] See Chapter 3 section 3.2.

[111] Brown KB "Comparative Regulation of Corporate Tax Avoidance: An Overview" (2012)1. Otusanya, OJ "The role of multinational companies in tax evasion and tax avoidance: The case of Nigeria" (2011) 22 *Critical Perspectives on Accounting* 316–332 at 319; McBarnet, D. "After Enron will 'whiter than white collar crime still wash?"(2006); 46:10 *Journal of Criminology* 91–109.

[112] Otusanya, OJ "The role of multinational companies in tax evasion and tax avoidance: The case of Nigeria" (2011) 19. See also Hanno DM and Violette GR. An analysis of moral and social influences on taxpayer. (1996) 8 *Behavioural Research in Accounting* 57–75 at 58-60.; Palan R, Murphy R, Chavagneux C. Tax havens: how globalisation really works. (London: Cornell University Press; 2010) 30.

[113] Otusanya, OJ "The role of multinational companies in tax evasion and tax avoidance: The case of Nigeria" (2011) 319; Janeba, E. Corporate income tax competition. Double taxation treaties, and foreign direct investment" (1995) 56(2) *Journal of Public Economics* 311-325 at 312-314. taxpayers choose between different legal alternatives with different tax consequences see Vanistendael, F "Legal Framework for Taxation" (1996) 44.

avoidance is cooperation in taxation matters.[114] This cooperation entails information sharing agreements contained in the Tax Information Exchange agreements (TIEAs). The TIEA seeks to crack down secrecy rules and set a standard for effective exchange of information.[115] Tax cooperation also involves the provision of mutual assistance, whether for purposes of sharing information or for reasons related to double taxation.[116]

In addition, there other international measures counteracting transfer pricing, such as the OECD Transfer Pricing Guidelines and UN Transfer pricing manual.[117] Similarly, the G20-OECD base erosion and profit shifting (BEPS) project 2015 addresses treaty abuse, such as the limitation on benefit rule.[118] Finally, there are also international initiatives to blacklist tax havens. The banishing of tax havens means that countries will deny treaty benefits companies, which are associated with tax havens. However, all these international initiatives are beyond the scope of this study. For this reason, the following discussions highlight the different measures at domestic level, which is the focus of this study.

3.3.1 Anti-tax Avoidance Legislation

Since the IOCs usually take advantage of the ambiguities or lacuna in the tax statutes to obtain benefits not intended by the legislature, the legislative measures aim to close such gaps. In closing these gaps and loopholes, the legislative measures have been the enactment of general anti-abuse rules (GAAR) and specific anti-abuse rules (SAAR).[119] While the SAAR deal with known techniques of tax avoidance, the GAAR entail general blanket provisions that aim to cover every attempt to circumspect tax law.[120] The GAAR

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[114] OECD Tax Co-operation 2010: Towards a Level playing field, (OECD Publishing 2010) 13-16 http://dx.doi.org/10.1787/taxcoop-2010-en (accessed 15 March 2017).

[115] Kerzner and Chodikoff *International Tax Evasion in the Global Information Age* (2016) 64; See also OECD *Harmful Tax Competition: An Emerging Global Issue* (1998) 19-20.

[116] Abebe et al *The United Nations' Role in International Tax Policy A Research and Policy Brief for the Use of the NGO Committee on Financing for Development* (2012) 30 available at http://www.ngosonffd.org/wp-content/uploads/2010/11/UN-Role-in-International-Tax-Policy-2012.pdf (accessed on 15 March 2017).

[117] Readhead *Preventing Tax Base Erosion in Africa: a Regional Studyof Transfer Pricing Challenges in the Mining Sector* (2016) 8.

[118] Keen and Mullins "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 11.

[119] The GAAR entails extensive and purposeful interpretation while the SAAR seal off specific tax avoidance techniques see Vanistendael, F "Legal Framework for Taxation" (1996) 46.

[120] It entails a one-fits-all approach.

is based on an assumption that it is impossible for the legislature to foresee each and every technique for tax avoidance likely to be adopted by the IOCs in the future.[121]

The GAAR is applicable in situations where the law is silent on a specific transaction. For instance, the GAAR is invoked where a taxpayer enters into artificial transactions whose sole intention is to obtain tax benefits.[122] The tax authority has powers to cancel tax benefits and proceed to issue a new assessment that increases tax liability.[123] One of the major weaknesses of GAAR is that is not self-executing and thus, its efficacy depends on administrative capacity of the tax authority to detect undue tax benefits and invoke the GAAR.[124]

Moreover, the fact that GAAR is catchall provisions, leads to uncertainty and thus contrary to the rule of law, which requires that the law should be predictable.[125] In addition, the tenets of good taxation also require that taxpayer should understand the applicable law in advance so that they can arrange their affairs accordingly.[126] The GAARs, apart from creating uncertainties, may lead to denying benefits, which are otherwise clearly stipulated in the law.[127] Despite its shortcomings, the GAAR is a step forward in curbing tax avoidance.

Since the techniques used by the IOCs to avoid taxes, such as transfer pricing, thin capitalization, treaty shopping, and corporate re-organization are already known, the SAAR address these specific techniques.[128] The SAAR take several forms. First, the response against transfer pricing has been the imposition of the arm's length principle.[129]

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[121] *Federal Commissioner of Taxation v Hancock* (1961) HCA 90.

[122] Waerzeggers, C and Hillier, C "Introducing a general anti-avoidance rule (GAAR)—Ensuring that a GAAR achieves its purpose" (2016) 2-3.

[123] Waerzeggers and Hillier "Introducing a general anti-avoidance rule (GAAR)—Ensuring that a GAAR achieves its purpose,"(2016) 1-2

[124] Waerzeggers and Hillier "Introducing A General Anti-Avoidance Rule (GAAR) Ensuring That A GAAR Achieves Its Purpose" (2016) 1.

[125] Ostwal, TP and Vijayaraghavan, V "Anti-avoidance Measures" (2010) 22(2) *National law School of India review at* 73-74.

[126] Tordo S *Fiscal Systems for Hydrocarbons Design Issues* (Washington D.C, World Bank 2007) 14.

[127] Brown KB. "Comparative Regulation of Corporate Tax Avoidance: An Overview" (2012) 9.

[128] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 22 75. Jansky and Prats "International Profit-Shifting out of Developing Countries and the Role of Tax Havens" (2015) 275, Vanistendael, F "Legal Framework for Taxation" (1996) 53.

[129] Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 10, 14

The arm's length principle requires that all transactions between or among constituent entities of the IOCs must reflect the market value.[130] The arm's length principle in essence aims at creating neutrality between the IOCs and its related parties.[131] It also aims at establishing a fair basis upon which countries can exercise their taxing rights.[132]

There are five ways to determine the whether a transaction is at arm's length or not. The first one compares the price used by the IOCs and the prevailing market price for the same item in an open market.[133] The second method considers the price of that may be obtained if the same item was sold to an unrelated party. The third method adds the costs incurred by the supplier to establish whether the transaction had any economic substance. The fourth method compares the profit margins that would have arisen if the transaction were between unrelated parties. The fifth methods combines the profits earned by related parties and divide between them as if it was a transaction between unrelated parties.[134]

At an international level, OECD Transfer Pricing Guidelines are applicable in more than 100 countries.[135] Similarly, the UN created its own Transfer Pricing Manual for non-OECD countries. The UN Manual gives a special attention to developing countries, which are importers of capital.[136] At the national level, the law imposes a burden on the IOCs to prove whether a transaction involves a transfer pricing arrangement.[137] In addition, the

[130] It should be as if it is between unrelated parties. See Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 13, 19. Readhead *Preventing Tax Base Erosion in Africa: a Regional Studyof Transfer Pricing Challenges in the Mining Sector* (2016) 8. IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012)37; Bernard, JT and Weiner R J "Multinational Corporations, Transfer Prices, and Taxes: Evidence from the U.S. Petroleum Industry" in Razin, A and Slemrod, J (eds) *Taxation in the Global Economy* (Chicago: Chicago University Press 1990) 123. IMF *Spillovers in International Corporate Taxation* (2014) 31 United Nations *Practical Manual on Transfer Pricing for Developing Countries* (New York, United Nations, 2013) 26-27.

[131] Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 13.

[132] Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 13.

[133] Shay "An overview of transfer pricing in extractive industries" (2016) 57. United Nations *Practical Manual on Transfer Pricing for Developing Countries* (2013) 15.

[134] United Nations *Practical Manual on Transfer Pricing for Developing Countries* (, 2013) 16; Shay "An overview of transfer pricing in extractive industries" (2016) 57.

[135] OECD "OECD Transfer Pricing Guidelines" available at http://www.oecd.org/tax/transfer-pricing/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations 20769717.htm (04 August 2017)

[136] Readhead Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector (2016) 6.

[137] IMF Fiscal Regimes for Extractive Industries: Design and Implementation (2012) 37.

Government may impose approval requirements for all advanced pricing agreements (APAs).[138]

Second, to limit thin capitalization, the law places a ceiling on the level of debt-financing ("debt-to-equity-ratio").[139] IOC that exceeds the debt-equity ratio will not be entitled to deductions. Similarly, there may be a requirement that interests charged on loans from foreign lenders should not exceed the domestic lending rates.[140] Another option is the imposition of earning stripping rule, which restricts the deductions of interests, to a certain percentage of the IOC's total income in every financial year.[141] For example, interests deductions in a given financial year may be limited to a ratio of 30 percent or 50 percent of the gross revenues before tax earned.[142] By limiting these deductions, it means that there will be taxable income for the respective financial years and thus the IOC be liable to profit based taxes. The earning stripping rule may provide a cover when debt-equity ratio fails.[143]

Third, to curb treaty shopping, the law introduces a "limitation on benefit" (LOB) provision. The "limitation on benefit" (LOB) provision aims at ensuring that the benefits of tax treaty apply to only entities owned by the resident of the other treaty country.[144] Residence must be established in both form and substance.[145] For this reason, it must be proved that the entity has substantive presence in the country of residence, such as

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[138] Mullins "International tax issues for the resource sector" (2010) 390.

[139] Mullins, P "International tax issues for the resource sector" (2010) 391; OECD *Addressing Base Erosion and Profit Shifting* (2013) 38. Blinn, et al *International Petroleum Exploration and Exploitation Agreements: Legal, Economic and Policy Aspects* (1986) 235; Calder, J *Resource tax administration The implications of alternative policy choices* in Daniel et al (eds) *The Taxation of Petroleum and Minerals Principles, Problems and Practice*, (London, Taylor & Francis, 2010) 321.; IMF *Spillovers in International Corporate Taxation* (2014) 30.

[140] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 88.

[141] IMF *Spillovers in International Corporate Taxation* (2014) 30. OECD *Addressing Base Erosion and Profit Shifting* (2013) 38; Ault HJ and Arnold BJ "Protecting the tax base of developing countries: an overview" (2015) 10, 14.

[142] Barnes "Limiting interest deductions" (2015) 167.

[143] Readhead *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector* (2016) 40.

[144] Reinhold, R "What is tax treaty abuse? (is treaty shopping an outdated concept?)" (2000) 664 limitation on benefits and beneficial ownership rule Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 27; Cooper "Preventing tax treaty abuse" (2015) 291.

[145] Reinhold "What is tax treaty abuse? (is treaty shopping an outdated concept?)" (2000) 677.

engagement in active business.[146] It must also be proved that the entity is owned by persons who are residents in the country party to the double tax treaty (beneficial ownership).[147] The "limitation on benefit" (LOB) also denies benefits under the treaty companies that already benefiting from a tax haven or those not taxed in country of residence.[148] It is notable that these rules are self-executing. The efficacy of these rules depends on the administrative capacity to detect and prevent treaty shopping.[149]

Fourth, to limit the abuse of consolidated books of account, the Government imposes ring-fencing rules. The ring fencing rules treat each block (where the IOC operates more than one blocks) as separate and independent of each other for tax purposes.[150] The aim for this restriction is to limit profit-making projects from being used to offset tax liability of loss-making projects.[151]

Fifth, to tax indirect transfer it is assumed that the shares value of the IOC is equal to the value of the petroleum rights it holds.[152] For this reason, the IOC is deemed to have made a transfer when its underlying ownership changes by certain prescribed percentages.[153] Similarly, the shareholders of the IOC are deemed to have made a gain when they sell their shares.[154] In addition, where the transaction occurs abroad and between non-residents, the IOC is treated as an agent of such non-resident persons.[155] If the IOC, as an agent of the non-resident persons, fails to collect the capital gains tax, it will be liable

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[146] IMF *Spillovers in International Corporate Taxation* (2014) 27; Cooper, GS "Preventing tax treaty abuse" (2015) 292; Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 29.

[147] Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 29; Reinhold "What is tax treaty abuse? (is treaty shopping an outdated concept?)" (2000) 678; Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 27.

[148] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 84-85. Reinhold, R "What is tax treaty abuse? (is treaty shopping an outdated concept?)" (2000) 664, 679.

[149] Keen et al "International corporate taxation and the extractive industries Principles, practice, problems" (2017) 28.

[150] Otto *Mining Taxation in Developing Countries* (2000)15-16, Mafwenga, HM *Mineral Tax Clinic: The Reflection of Old and New Fiscal Regimes for Effective Tax Auditing in Tanzania* (2012) 122; Khan, K.I.F "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 22 (1) *Journal of World Trade* 67–88 at 76.

[151] Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012) 129.

[152] Burns et al "Taxing gains on transfer of interest" (2017) 172.

[153] Burns et al "Taxing gains on transfer of interest" (2017) 163,178.

[154] Burns et al "Taxing gains on transfer of interest" (2017) 172.

[155] Cui *Taxation of non-residents' capital gains* (2015) 129; Burns et al "Taxing gains on transfer of interest" (2017) 178.

to pay the same.[156] Likewise, the Petroleum law may provide for cancellation or withdrawal of petroleum right if no capital gains tax is paid (revocation of license).[157] To ensure that the Government controls the transfer of rights, the Petroleum law obliges the IOC to notify the Minister for petroleum and obtain an approval before any transfer is effected.[158]

Sixth, to ensure that the loss-making IOCs also contribute to the Government's expenditure, Governments have introduced alternative minimum tax (AMT). The AMT is usually imposed on companies declaring perpetual losses within a specified period. The AMT is charged based on a turnover or book earnings of the IOCs and thus easy to administer. Currently, AMT has been adopted in more than 30 countries including Tanzania.[159] Finally, the law may also set a cap for management service relative to the total operating costs or total revenues.[160] In addition, the income tax code imposes withholding taxes for all outbound payments.[161]

3.3.2 Judicial Measures

Generally, tax statues are capable of multiple interpretations. As discussed in the preceding paragraphs, the challenge arises from the fact that the legislature cannot foresee all the tax avoidance schemes.[162] Consequently, the tax statutes may have gaps or loopholes, which permit taxpayers to obtain tax advantages not intended by the legislature.[163] The question what does the court do when confronted with a situation where there is an ambiguity in the law or the law silent on certain tax avoidance scheme?

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[156] IMF *Spillovers in International Corporate Taxation* (2014)30; Daniel, P "International Taxation Issues for EI" (2014) 16; Burns et al "Taxing gains on transfer of interest" (2017) 178.

[157] IMF *Spillovers in International Corporate Taxation* (2014) 30.

[158] Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 34. Daniel, P "International Taxation Issues for EI" (2014) 16

[159] IMF *Spillovers in International Corporate Taxation* (2014) 36.

[160] Readhead Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector (2016) 40.

[161] Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 10, 14.

[162] See section 2.2.2 above.

[163] See section 2.2.2 above.

Largely, the interpretation of tax statutes ought to be aligned to the general schemes of statutory interpretation.[164] However, there are certain aspects, which may complicate the interpretation of tax statutes.[165] The first hurdle arises from the principle of legality, which requires that taxes to be imposed by clear words of a statute.[166] This implies that taxpayers have the right to arrange their transactions so as the pay as minimum tax as possible.[167] Therefore, under the principle of legality the court cannot read into tax statutes words creating an obligation to pay taxes.[168] In the cases of *Levene v I.R.C*[169] *IRC v. Duke of Westminster*[170] and *Gregory v. Helvering*[171] the courts adopted a literal approach and thus held that the taxpayer is entitled to take advantage of the provisions of the law so as to pay a minimal tax as possible. Similarly, the Court of Tanzania in *Commissioner General TRA v Pan African Energy Tanzania Ltd*[172] held that since the law did not impose withholding taxes on services rendered outside Tanzania by a non-resident; the Court too, could not create that obligation. The Court further held that although this gap may create room or leeway for tax avoidance, it was not for the Court to fill that gap, but rather the solution is to amend the law. [173]

The danger of literal interpretation is that most taxpayer would engage in pre-ordained transactions that are meant to avoid taxes.[174] This defeats and militates against the very core of taxation.[175] In addition, equity in taxation would dictate that taxpayers in equal

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[164] Freedman, J "Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament" (2007) 123 *Law Quarterly Review* 52-90 at 63

[165] Bowman, SW "Interpretation of Tax Legislation: The Evolution of Purposive Analysis" (1995) 43 (5) *Canadian Tax Journal* 1167-1189 at 1167.

[166] Vanistendael, F "Legal Framework for Taxation" *Tax Law Design and Drafting*, V Thuronyi (ed), International Monetary Fund (1996) 5-6. See also Freedman "Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament" (2007) 56; article 138(1) of the Constitution of Tanzania.

[167] See section 2.2.2 above.

[168] Lee, N "A purposeful Approach to the Interpretation of Tax Statutes" (1999) 20(2) *Statute Law Review* 124-143 at 126. See also Freedman "Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament" (2007) 63-65; Bowman "Interpretation of Tax Legislation: The Evolution of Purposive Analysis" (1995) 1167

[169] (1928) AC 217. The taxpayers have the freedom to structure their transactions in, such as way that they fall outside the scope of tax statutes.

[170] [1936] AC 1.

[171] 293 U.S. 465 (1935)

[172] Civil Appeal No. 15 of 2015, Court of Appeal of Tanzania, (Unreported).

[173] Civil Appeal No. 15 of 2015, Court of Appeal of Tanzania, (Unreported).

[174] See Chapter 3 section 3.2.

[175] Objective of taxation is to support Government expenditure Idubor et al "Appraising Taxation and the Nigerian Oil Industry" *Journal of Law, Policy and Globalization* Vol.37, (2015) 190

circumstances should pay same taxes.[176] It aims at ensuring consistency in interpretation of tax statutes. This rule also rejects the purposeful approach. Because of this controversy, it is left to the court to decide the style and approach to statutory interpretation. [177]

Although the courts under the doctrine of separation of powers do not have the mandate to legislate, the question is what the courts should do when words of tax statutes have gaps and loopholes that permit certain taxable transactions to go untaxed. Can the courts fill the gaps in the law? In practice courts have intervened, to limits certain interpretations or transactions, from abusing the provisions of the law. [178] A good example involves the US, which does not have the general anti-avoidance provision.[179] The US has developed judicial doctrines, which are applicable alongside the SAAR. [180]

In practice, the courts, especially in the UK, have in number of instances stripped off tax avoidance schemes through purposeful interpretation [181] In doing so, the court may reject any transaction that does not serve a business purpose or the one that is not commercially justifiable ("business purpose doctrine"). [182] For example, the case of W.T. *Ramsay Ltd. v. Inland Revenue Commissioners,* the court looked at overall effect of the transactions rather than individual transactions, thus denied a tax-planning scheme.[183] In addition, the court may concentrate on the economic or social reality of the transaction rather than the literal wording of the statute ("substance over form doctrine").[184] For example, in *Furniss v. Dawson*[185] the court based its decision on whether the series of transactions (which

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[176] Morse, Williams and Salter *Davies Principles of Tax Law* (1996) 6-7. Lencho, T "The Ethiopian Tax System: Excesses and Gaps" (2012) 20(2) *Michigan State International Law Review* 327-380 at 334; Luoga, F "Taxation in the Advent of Democratisation and Transition to Free Market Economy in Tanzania and Concerns on the Rule of Law and Human Rights' 2002 (1) at 25-27, available at http://elj.warwick.ac.uk/global/02-1/luoga.html (accessed on 20 March 2014); Vanistendael, F "Legal Framework for Taxation" in Victor Thuronyi (ed), *Tax Law Design and Drafting* Vol. 1 (Washington DC, International Monetary Fund 1996) 5-6; Kaplow, L *The Theory of Taxation and Public Economics* (Princeton, Princeton University Press, 2008) 396-398.

[177] Vanistendael "Legal Framework for Taxation" (1996) 34-35.

[178] Vanistendael "Legal Framework for Taxation" (1996) 45.

[179] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010)75.

[180] Cooper "Preventing tax treaty abuse" (2015) 287; Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 75.

[181] Brown KB "Comparative Regulation of Corporate Tax Avoidance: An Overview" (2012) 21.

[182] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 64.

[183] Vanistendael "Legal Framework for Taxation" (1996) 40.

[184] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 64.

[185] [1984] AC 474

looked like one) had any commercial or business purpose other than avoiding taxes.[186] The court may use this approach to strip off sham transactions, re-characterize transactions, and regard a series of transactions as one or a single transaction as several ones.[187] Furthermore, the court may pierce the corporate veil in instances where corporate structure has been used for "illegal, improper or fraudulent purposes".[188]

3.4 Criminalization of Tax Evasion

Tax evasion is conscious decision by taxpayers to minimize tax liability and maximize profits.[189] Tax evasion may involve conducts, such as submission of false accounts or documents, parallel accounting, misreporting or non- reporting of taxable income, false invoicing.[190] Since these conducts involve the breaking the law, they are criminal offences per se.[191] These offences may be provided in tax code itself or in the general penal code.

Tax evasion is equated to gambling, if successful enormous gains are made, and if not huge penalties are imposed.[192] For this reason, tax evaders weigh the benefits of tax evasion against the risk of audits, detection and punishment.[193] It also implies that tax evasion flourishes where there is low probability of detection or low penalties.[194] According to this view, the higher probability of detection and the threat of severe penalties have the potential to deter tax evasion.[195]

The law creates several offences, such as defective returns, destruction of records, perjury, interfering with tax investigation.[196] It also entails commission of inchoate

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[186] Vanistendael "Legal Framework for Taxation" (1996) 40

[187] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 65-69.

[188] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 72.

[189] Kirchler, E *The Economic Psychology of Tax Behaviour* (2007) 105.

[190] Vanistendael "Legal Framework for Taxation" (1996) 44.

[191] Merks "Tax Evasion, Tax Avoidance and Tax Planning" (2006) 272-273.

[192] Kirchler *The Economic Psychology of Tax Behaviour* (2007) 105.

[193] Becker, G.S "Crime and Punishment: An Economic Approach" (1968) 76(2) *Journal of Political Economy* pp. 169-217 at 207.

[194] Raczkowski "Measuring the tax gap in the European economy" (2015) 21 *Journal of Economics & Management* 58-72 at 61. Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (2012) 135.

[195] Kirchler *The Economic Psychology of Tax Behaviour* (2007) 109.

[196] Lan Mo *Tax Avoidance and Anti-Avoidance Measures in Major Developing* (2003) 78.

offences, such as conspiracy to commit tax evasion. There other offences related to books of accounts and records keeping, such as false or deceptive entry of data or an omission to enter certain data. These offences are prosecuted in conventional courts like any other offences. The penalties include administrative penalties, such as fines, forfeiture of income, double payment of the evaded or cancellation of tax incentives.[197] The other penalties include imprisonment, fines or confiscation of property acquired through tax evasion. Generally, penalties are used as the measure to deter undesired behavior.[198]

3.5 Abolition of Discretionary Tax Incentives

While tax incentives are a necessary component in the attraction of new investments and maintenance of the existing ones, they are only temporary measures.[199] These tax incentives do not address the real bottlenecks to investment.[200] Thus, instead of granting tax incentives, the Government should strive to improve the investment climate by removing all obstacles to investment, such as provision of adequate physical infrastructure and enhance administrative capacity.[201]

Where the Government considers it necessary to grant tax incentives, needs to put safeguards. For one, the law should abolish all discretionary tax incentives, instead all types of tax incentives should be provided in the law.[202] Specifically, the eligibility criteria, types of tax incentives and procedures for grant of such tax incentives must be clearly spelt out in the law.[203] In addition, the procedures for grant of tax incentives must

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[197] Kirchler The Economic Psychology of Tax Behaviour (2007) 22.

[198] Kirchler The Economic Psychology of Tax Behaviour (2007) 105.

[199] Holland and Vann "Income Tax Incentives for Investments" (1996) 987.

[200] Failed to rectify the bootlenecks nor overcome systemic problems, such as poor physical infrastructure Holland and Vann "Income Tax Incentives for Investments" (1996) 987-988; Cleeve "How Effective Are Fiscal Incentives to Attract FDI to Sub-Saharan Africa?" (2008) 138-39; Zee et al "Tax Incentives for Business Investment: A Primer for Tax Policy Makers in Developing Countries" (2002) 1498.

[201] James *Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications* (Washington, D.C.: World Bank Group, 2013) vi; Holland and Vann "Income Tax Incentives for Investments" (1996) 987; Zee et al "Tax Incentives for Business Investment: A Primer for Tax Policy Makers in Developing Countries" (2002) 458. Nathan−MSI Group *Effectiveness and Economic Impact of Tax Incentives in the SADC Region* (2004) (3-6) http://pdf.usaid.gov/pdf_docs/Pnacy929.pdf

[202] Zolt "Tax incentives: protecting the tax base" (2015) 480; James *Incentives and Investments: Evidence and Policy Implications* (2013) vi; Calder, J *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014) 18

[203] James Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications (2013) 46.

be transparent by publicizing the list of applicants and ultimate recipient of tax incentives.[204] There must be a further requirement for such recipients to report on how they have utilized such tax incentives.[205] Similarly, the parliament should intervene by requiring that tax incentives as part of the "tax expenditure budget", presented to parliament, which indicate how much revenue is forgone through incentives.[206]

Finally, the law should provide for retrospective withdrawal of benefits under tax incentive once fraud is detected and require subsequent payment of the taxes avoided.[207] Similarly, the law should set a limit on the duration of tax incentives.[208] Tax incentives should only applicable for a specified period and in view to address certain externalities. Therefore, such tax incentives should cease to apply once such externalities are addressed.

3.6 Mechanisms for Prevention, Detection and Punishment of Tax Avoidance and Tax Evasion

Several administrative measures can be used to prevent, detect and punish tax avoidance and tax evasion. First, the law may vest tax authority or other Government agencies with authority to investigate and audit IOCs transactions.[209] These audits and investigation help the tax authority to establish whether there are attempts to avoid or evade taxes. In addition, information collected during the audits form the basis for the tax authority to invoke the general anti-avoidance rules (GAAR).

Second, the law may impose an obligation on the IOCs to obtain approvals from the tax authority before making certain transactions. The transactions requiring approval include indirect transfer of rights, corporate re-organization and transfer of money abroad. Similarly, the law may impose an obligation of the IOCs to report certain transactions,

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[204] James Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications (2013) 40.
[205] Zolt "Tax incentives: protecting the tax base" (2015) 480.
[206] Zolt "Tax incentives: protecting the tax base" (2015) 480-81.
[207] Zolt "Tax incentives: protecting the tax base" (2015) 480.
[208] Zolt "Tax incentives: protecting the tax base" (2015) 480.
[209] IMF Spillovers in International Corporate Taxation (2014) 36.

especially those involving related parties. These approvals make it easy for the tax authority to detect and prevent any tax avoidance scheme before it materializes.

Third, the law may impose administrative penalties for non-compliance with tax laws. These penalties include reassessment of additional taxes, imposition of a penalty or interests for late payment, fine for non-filing of tax returns.[210] The implication of these administrative sanctions is that non-compliance attracts additional costs to the IOCs.

Sharing of information between or among countries.[211] Countries usually enter into specific Tax Information Exchange Agreements.[212] These agreements facilitates the exchange of information.[213] The strengthening of public institutions, like the justice system and oversight bodies, to enforce these rules.[214]

4 Conclusion

This chapter analyzed the social context within which tax revenue leakage occurs. The analysis identified four elements namely the actors in the tax system, structural gaps in the tax system, conduct of the identified actors and impact of tax revenue leakage. It is in view of these elements, the suggested remedial measures have been developed. The remedial measures include, closing the windows of opportunity for corrupt practices, removing incentives for corruption, closing the gaps and loopholes in the tax system, criminalization of tax evasion and enhancement of administrative capacity to detect, prevent and punish tax avoidance and tax evasion. However, the implementation of these issues depends on the existence of the laws and institutional mechanisms to enforce them. For this reason, before deploying these remedial measures it is important to have an understanding of the Tanzania tax system. In that regard, the next chapter describes the tax system for upstream oil and gas sector in Tanzania. In addition, next chapter applies

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[210] Hannesson *Petroleum Economics: Issues and Strategies of Oil and Natural Gas Production* (Praeger 1998) 111.

[211] IMF *Spillovers in International Corporate Taxation* (2014) 30.

[212] Baker, P *Improper Use of Tax Treaties, Tax Avoidance and Tax Evasion* Paper No. 9-A May 2013

[213] Ring, D "Transparency and Disclosure" in Trepelkov A, Tonino H and Halka, D (eds) *United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries* (United Nations, New York, 2015) 497-565 at 497-499.

[214] Bauer and Quiroz "Resource Governance" (2013) 244.

the principles of taxation discussed in chapter 2, to examine how the Government balance the competing interests- maximizing revenues whilst simultaneously attracts investments.

PART II: ADDRESSING TAX REVENUE LEAKAGE IN THE UPSTREAM OIL AN GAS INDUSTRY IN TANZANIA: LAW AND PRACTICE

Part I of this study examines and analyzes the concept of tax revenue leakage. The discussion shows that the extraction of oil and gas has the potential to create streams of Government revenue.[1] However, the discussion also reveals that several factors impede the Government's ability to collect taxes. These factors include exorbitant tax incentives, tax avoidance, tax evasion and fiscal corruption.[2] Part I also identified remedial measures to counteract tax revenue leakage.[3]

Part II uses the theoretical framework developed under Part I to examine and evaluate the Tanzanian upstream oil and gas tax regime. To contextualize the challenge of tax revenue leakage, this part starts with a general discussion of the Tanzanian oil and gas tax regime.[4] It covers issues, such as the legal framework for taxation that highlights legal assumptions underlying the ownership of the oil and gas *in situ*, the mechanism for grant of oil and gas rights, the fiscal terms and fiscal incentives. It also highlights tax administration covering issues, such as the procedure for assessment, collection and recovery of taxes, the administrative powers, management and control of non-compliance as well as the transmission of revenues. Finally, this part examines the measures adopted in Tanzania to counteract tax revenue leakage.[5] It also highlights the deficiencies in such remedial measures.

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[1] See Chapter 2, section 4.
[2] See Chapter 3, section 2.
[3] See Chapter 4, section 3.
[4] See Chapter 5, section 2.
[5] See Chapter 6.

CHAPTER FIVE: ANALYSIS OF THE TANZANIAN UPSTREAM OIL AND GAS TAX SYSTEM

1 Introduction

This chapter examines the oil and gas fiscal regime in Tanzania.[1] It applies the broad conceptual framework identified under chapters 2, 3 and 4 to analyse the concept of production sharing agreement (PSA) as a mechanism of creating Government revenue in Tanzania.[2] The aim is to analyse how Tanzania addresses the problem of tax revenue leakage. In doing so, the chapter highlights a variety of fiscal and non-fiscal instruments used by the Government of Tanzania to collect revenues from the upstream oil and gas industry. Additionally, the chapter highlights ownership of oil and gas *in situ*, the procedures and methods for grant of rights and competent authorities mandated to implement Government policies, their roles and functions. The chapter further analyses the legal and institutional framework for tax assessment, tax audits, tax collection and management.[3] The interpretation and enforcement of tax laws and contractual provisions is of paramount importance as it ensures that taxes are assessed and paid "timely, consistently and appropriately".[4] The next section explores the legal framework for oil and gas exploration and production in Tanzania.

2 Legal Framework for Taxation

The legal basis for taxation in Tanzania is engrained in the Constitution. The Constitution provides explicitly that taxes can only be levied pursuant to a statute enacted by the Parliament or any other legally established mechanism.[5] This aims at ensuring that taxes are only levied for purposes of supporting Government's expenditures, nothing more

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[1] PSA is used alongside the general taxation system. Throughout this chapter the use of term 'taxation' refers to both tax and non-tax instruments under the PSA system

[2] The general discussion on PSAs is provided under Chapter 2, Section 5.

[3] Tax administration entails the enforcement of tax laws – the interpretation of laws to assess tax payable, auditing tax returns and collecting taxes. See Calder, J *Administering Fiscal Regimes for Extractive Industries:A Handbook* (Washington DC, International Monetary Fund, 2014) 37.

[4] Holland, D and. Vann, RJ "Income Tax Incentives for Investments" in Victor Thuronyi (ed), *Tax Law Design and Drafting* Volume 1 (Washington DC, International Monetary Fund 1996) 988.

[5] Article 138 (1) of the Constitution of the United Republic of Tanzania 1977 (2005 version)

nothing less.[6] Pursuant to this constitutional requirement, there are three organs vested with powers to impose taxes and levies in the oil and gas industry. First, the Union Parliament, which has authority over all union matters in Tanzania and over all non-union matters concerning Mainland Tanzania.[7] Currently, all matters pertaining to mineral and oil resources, income tax, custom duty and excise duty fall under the ambit of the Union Parliament.[8] In addition, the Union Parliament enacts laws that charge rental fees, license fees, and bonuses.[9] Second, the House of Representatives has authority to enact laws imposing taxes in Zanzibar in respect of non-union matters and any ancillary matters in its mandate.[10] The taxes and levies falling under the authority of the House of Representatives include Value Added Tax (VAT), stamp duties, port service charges, trade licenses and property tax.[11] Third, local Government authorities have a mandate to raise revenue imposition of levies and other charges within their local jurisdictions.[12]

The primary policy objective for oil and gas taxation is to enable the Government to capture an appropriate share of the rents while simultaneously ensuring investors recover their costs of investments and the return thereof.[13] To this end, the Government aims at creating an appropriate fiscal regime, which does not depart from the best oil and gas industry practices.[14] In doing so, the policy requires the fiscal regime to be predictable to

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[6] Lencho, T "The Ethiopian Tax System: Excesses and Gaps" (2012) 20(2) *Michigan State International Law Review* at 335; Nakhle, C *Petroleum Taxation Sharing the Oil Wealth: A study of petroleum taxation yesterday, today and tomorrow* (New York, Routledge, 2008).10; Bunbury, H "Control of Public Expenditure in Great Britain" (1948) 26 *Taxes* at 726.

[7] Articles 4(3) and 34(1) of Constitution of the United Republic of Tanzania 1977 (2005 version).

[8] These are among the list of 22 union matters enumerated in the First Schedule to the Constitution. Articles 4 &64(1) of the Constitution vest the National Assembly with legislative powers to all Union Matters and non-union matters for Tanzania mainland.

[9] Petroleum Act 2015.

[10] Article 138 (2) of the Constitution, gives Zanzibar House of Representative mandate to impose taxes on non-union matters in Zanzibar. Section 3 of Zanzibar Revenue Board Act 1996, Act No. 7 of 1996, (Revised Edition of 2013) see also http://www.zanrevenue.org/index.php/about-us/profile (Accessed on 04 April 2015) Article 4(3)- Exercise of authority in the United Republic, article 34(1) executive powers,

[11] Section 5(1) of the ZRB Act, the schedule lists downs seven types of taxes VAT, stamp duty, hotel levy, port charges, property tax, trade licenses and petroleum levy.

[12] Article 145 & 146 of the Constitution of the United Republic of Tanzania 1977 establishes local Government authorities and stipulate their functions, article 154 of the Constitution delegates power to the authority to impose taxes. Section 18 of the Local Government Financial Act, Cap 290 (R.E 2002), permits Local Government Authorities to charge 0.3% levy on the turnover of all companies operating in their jurisdiction.

[13] Ministry of Energy and Minerals *The National Petroleum Policy of Tanzania (*draft – 2, April 2014) 23 Available at http://www.tpdc-tz.com/wp-content/uploads/2015/04/National-Petroleum-Policy.pdf (10 February 2017)

[14] The National Petroleum Policy of Tanzania (2014) 24

enable investors to arrange their affairs and predict the corresponding tax obligations.[15] It is a further policy requirement that all fiscal terms must be contained in the law except where the law permits certain terms to be negotiated.[16] Finally, the policy aims at enhancing capacity and competence of the tax revenue authority in the interpretation and collection of taxes as well as counteractive measures against tax avoidance and tax evasion.[17]

In light of these policy objectives, the Petroleum Act 2015, as a general framework law, defines "petroleum" as any naturally occurring hydrocarbon or mixture of more hydrocarbons in gaseous, liquid or solid form.[18] By this definition, the Petroleum Act 2015 excludes from its purview all those hydrocarbons that do not occur naturally in the reservoir ("unconventional petroleum").[19] In addition, the Petroleum Act 2015 defines crude oil as hydrocarbon in liquid form and natural gas as hydrocarbons in a gaseous state at wellhead.[20] Natural gas found in Tanzania is the one that occurs independent of crude oil ("non-associated natural gas").[21] Although the Petroleum Act 2015 regulates the upstream, midstream, downstream sectors, the Act treats each sector as a separate business for tax purposes.[22] The next section examines factors that influence the design of oil and gas fiscal regime in Tanzania.

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[15] The National Petroleum Policy of Tanzania (2014) 24.

[16] The National Petroleum Policy of Tanzania (2014) 24.

[17] The National Petroleum Policy of Tanzania (2014) 24 This is in alignment with international best practices which require the fiscal regime must address deductible costs, transfer of rights and counteracting tax avoidance and tax evasion. See Le Leuch, H "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" in Goldthau, A (ed) *The Handbook of Global Energy Policy* (John Wiley & Sons, Ltd. Ebook 2013)140.

[18] Section 3 of the Petroleum Act, 2015 (Act No.21 of 2015)

[19] See Chapter 2 section 2.

[20] Section.3 of the Petroleum Act, 2015.

[21] Contrasted with natural gas that occurs together and in contact with crude oil in the reservoir ("associated gas"). See Chapter 2 section 2.1.

[22] Section 2 (a)&(b) of the Petroleum Act, 2015.

2.1 Ownership of Oil and Gas in *situ*

The Petroleum Act 2015 provides that "the *entire property* in and *control over petroleum* in any land to which this Act applies are *vested in the United Republic of Tanzania"*.[23] Historically, the vesting of ownership of oil and gas resources in Government in Tanzania is a legacy of German[24] and British[25] colonialism.[26] As regards ownership of oil and gas resources in the seabed, the Territorial Sea and Exclusive Economic Zone Act 1989 domesticates the United Nations Convention on the Law of the Sea of 1982.[27] The Act vests Tanzania with sovereign rights to regulate the exploration for, exploitation and management of natural resources found in the seabed of the territorial sea, continental shelf and exclusive economic zone (EEZ).[28]

[23] Section 4(1) Petroleum Act 2015. Similarly, section 4(1) of the repealed Petroleum (Exploration and Production) Act 1980 (Act No. 27 of 1980) vested the "entire property in and control over petroleum" in the United republic of Tanzania.

[24] After Berlin Conference, Tanganyika (now Mainland Tanzania together with Rwanda and Burundi) was placed under German colonial rule forming the German East Africa (German: Deutsch Ostafrica) from 1895-1919. See Coulson, A *Tanzania: A Political Economy* (2nd edn) (Oxford, Oxford University Press, 2013) 12, 62-65. The German Imperial Decree 1895 declared all land in German East Africa as crown land whose ownership, vested in the German Empire. In addition, Imperial Ordinance for the African and South Seas Possession with Exception of German South West Africa 1891 Section 1, Decree No.64 of 1891 debarred landholders from engaging in any prospecting, extraction or utilization of minerals except by express authorization from the Governor.

[25] After the WWI Tanganyika was placed under the British rule as a mandate territory. Rwanda and Burundi were held under the French. The British ruled from 1920-1961. Article 8(1) &(3) of The *Tanganyika Order in Council 1920* and later section 2 (section 3) Land Ordinance 1923 26th January 1923, declared all land, whether occupied or unoccupied, to be public lands, whose title vested in the Governor. In addition, workings of mines required permission from the Governor. This position has been maintained to date. In a similar fashion, section 4(1) of the Land Act 1999, declares all lands in Tanzania are public lands, and title to public lands vests in the President as a trustee of the people of Tanzania. Interestingly, while only the President who grants the rights to occupy and use land, such grants by the President under section 2 & 22(2) does not confer to holders "any rights to mines, minerals, or gas". Moreover, the Mineral Oil Mining Ordinance 1922 (No. 14 of 1922 of 14th July 1922) and later Section 3 of the Mining (Mineral Oil) Ordinance) 1958(No. 12 Of 1958) 23rd May 1958) read "entire property in and control of all minerals oil in their natural condition," whether on public or private land, vested in the in Governor in trust for the Crown.

[26] This marked the new beginning whereby "property and sovereignty merged into one entity" and creation of a "landlord state". See Shivji, IG. *Where is Uhuru: Reflections on the Struggle for Democracy in Africa* (Dar es Salaam, Pambazuka Press, 2009) 106. See also Emel, et al "Extracting Sovereignty: Capital, Territory, and Gold Mining in Tanzania" (2011) 30 *Political Geography* at74.

[27] Chapter 238 (Act No. 3 of 1989). The Convetion was signed on December 10 1982 and ratified on September 30 1985

[28] The Territorial Sea and Exclusive Economic Zone Act defines the EEZ as a marine zone not exceeding 200 nautical miles from the baseline from which the breadth of the territorial water is measured (section 7), the EEZ is similar to the 'continental shelf' under the Petroleum Act 2015 (section 3).

In property law context, vesting of the title in the State is not ownership *per se*.[29] Instead; the Government holds the title to the resources on *behalf and in trust* for the people of Tanzanian.[30] For example, the Privy Council in *Attorney General (Quebec) v Attorney General (Canada)*[31], interpreted the term "vest in public" to mean that a public body is conferred powers to control and manage interests in land, to facilitate or enable it to discharge its public functions efficiently.[32] Therefore, statutory vesting of the title is merely "a fiction expressive in legal shorthand of the importance to its people that the State has power to preserve and regulate the exploitation of an important resource".[33] It also implies that title to the resources vests in State to enable the oil and gas resources to be utilized for the benefit of the whole nation.[34]

In the Tanzanian context therefore, the State, as an agent of the people it represents, is duty bound to ensure that the extraction of oil and gas resources is undertaken for the benefit of current and future generations.[35] This duty echoes the constitutional obligation of the Government to utilize national resources for eradication of poverty, illiteracy and diseases.[36] Therefore, it is the Government's duty to ensure not only optimal exploitation

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[29] See Chapter 2 section 3.1.

[30] Section 4(1) of the Petroleum Act 2015 and sections 4(2) and 5(3) of the Natural Wealth and Resources (Permanent Sovereignty) Act 2017. See also Idubor et al "Appraising Taxation and the Nigerian Oil Industry" (2015) 37 *Journal of Law, Policy and Globalization* at 189. and Veit, PG and Larsen, G Overlapping *Land and Natural Resource Property Rights: A Comparative Analysis from Africa* (Washington DC, World Resources Institute, 2013) 2.

[31] [1921] 1 AC 401, 409

[32] Secher, U and Amankwah, HA "Native Title, Crown Property and Resources: Post-Mabo Judicial Interpretations of Statutory Declarations and Statutory Vesting Provisions" (2003) 9 *James Cook University Law Review* 110-226 at 160-161; Secher, U "Implications of the crown's radical title for statutory regimes regulating the alienation of land: 'crown land' v 'property of the crown' post-mabo" (2008) 34(1) *Monash University Law Review* 9-52 at 12.

[33] Secher and Amankwah "Native Title, Crown Property and Resources: Post-Mabo Judicial Interpretations of Statutory Declarations and Statutory Vesting Provisions" (2003) 168 See Secher "Implications of the crown's radical title for statutory regimes regulating the alienation of land: 'crown land' v 'property of the crown' post-mabo" (2008) 12.

[34] Secher "Implications of the crown's radical title for statutory regimes regulating the alienation of land: 'crown land' v 'property of the crown' post-mabo" (2008) 13.

[35] Section 251(b) Petroleum Act 2015; Section 6(1) of the Natural Wealth and Resources (Permanent Sovereignty) Act 2017, (Act No.6 of 2017)

[36] Article 9(c) and (i) of the Constitution of the United Republic of Tanzania 1977. See also section 6 of the Natural Wealth and Resources (Permanent Sovereignty) Act 2017.

of the resources, but also to ensure that it receives adequate economic benefits (through royalties, taxation and Government participation) from their exploitation.[37]

2.2 Tax-related Implications of State Ownership of Oil and Gas *in situ*

From the taxation perspective, the vesting of the title in State has several legal implications.[38] For one, the Government has the right and discretion to exploit the resources itself or to grant rights to extractive companies.[39] However, given the lack of capital and technology the Government enters into partnership with the IOCs.[40] In this regard, the Petroleum Act 2015 identifies the entities to which licenses may be granted and sets up the terms and conditions such operations may be undertaken.[41]

Moreover, the Government monitors, supervises and regulate the field operations undertaken by the IOCs.[42] In view of these regulatory functions, the Petroleum Act 2015 identifies the Minister of Energy and Minerals as a general overseer of the oil and gas industry.[43] The Minister monitors policy formulation and implementation, granting of licenses to explore and produce oil and gas, and enters into PSAs on behalf of the Government.[44] Similarly, the Petroleum Act 2015 designates the Tanzania Petroleum Development Corporation (TPDC) as the National Oil Company.[45] TPDC deals with technical and commercial aspects, such as participation in the industry, holding

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[37] Inkpen, A and Moffett, MH *The Global Oil and Gas Industry: Management, Strategy and Finance* (Tulsa, PennWell Corporation, 2011) 41. See sections 113, 116 &218 of the Petroleum Act 2015.

[38] See Chapter 2 section 3.1.

[39] Section 4(2) Petroleum Act 2015. See the discussions by Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 51.

[40] Section 5(4) of the Natural Wealth and Resources (Permanent Sovereignty) Act 2017.

[41] Section 45 of the Petroleum Act 2015.

[42] Section 5(4) of the Natural Wealth and Resources (Permanent Sovereignty) Act 2017

Inkpen and Moffett *The Global Oil and Gas Industry: Management, Strategy and Finance* (2011) 50; Onorato, WT and Park, J 'World Petroleum Legislation: Frameworks that Foster Oil and Gas Development' 39 *Alta. L. Rev.* 70 (2001-2002) 76.

[43] Section 5 Petroleum Act 2015.

[44] Section 5(1)(a)-(c) Petroleum Act 2015. The Minister is assisted by the Commissioner for Petroleum Affairs, who is a chief advisor on all policy, regulatory, planning and routine administrative matters in the oil and gas sector. see Section 6 of the Petroleum Act 2015.

[45] Section 8(1) Petroleum Act 2015. The Government's share in the TPDC at all times must be at least fifty-one percent (section 8(2)). TPDC is established under the Tanzania Petroleum Corporation (Establishment) Order (GN No. 140 of 1969). Its functions under this Order include the promotion and monitoring of oil and gas exploration, development and production of oil and gas, trading in petroleum products and advising the Government on petroleum production data.

Government interests in all the oil and gas agreements, research and development as well as marketing Government oil.[46] The TPDC also serves a commercial player, promoter of national capacity and fiscal agent through equity participation and representative of Government in PSAs.[47]

Another institution is the Petroleum Upstream Regulatory Authority (PURA) that regulates and monitors the oil and gas upstream sector for Mainland Tanzania.[48] Its other functions include advising the Minister on the grant, suspension or cancelation of rights as well as negotiations of PSAs (or similar arrangements).[49] PURA also audits, approves and keeps records of costs incurred by the IOC.[50] In addition, the Petroleum Act designates the Energy and Water Utilities Regulatory Authority (EWURA) as the regulator of midstream and downstream oil and gas sectors.[51] The EWURA has power to grant, suspend or revoke licenses as well as determining and enforces tariffs and rates applicable in the midstream or downstream-regulated activities.[52] In addition, EWURA determines and enforce tarrifs, rates, charges and fees payable by a licensee in respect of regulated activity.[53]

Another noteworthy aspect is that the State acts as both the owner and the sovereign.[54] The State-as-sovereign exercises its power by imposing taxes on all persons within its territorial boundaries.[55] The State-as-owner of the resource is entitled to payment of rent akin to the absentee property owner from tenants.[56] The dual role of the State – as owner

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[46] Section 8(1) 9(1)(b) Petroleum Act 2015. Generally, the roles of the NOC include a commercial player, fiscal agent, promoter of national capacity and development agency. See McPherson, C "National Oil Companies: Ensuring Benefits and Avoiding Systemic Risks" in Goldthau, A (ed) *The Handbook of Global Energy Policy* (John Wiley & Sons, Ltd. Ebook 2013) 147-150.

[47] McPherson, C "National Oil Companies: Ensuring Benefits and Avoiding Systemic Risks" (2013) 147-150.

[48] Section 11(1) Petroleum Act 2015.

[49] Section 12(1)(a)(i)-(iii) of the Petroleum Act 2015.

[50] Section 12(2)(c) of the Petroleum Act 2015.

[51] Section 29(1) of the Petroleum Act 2015.

[52] Section 29(2) (a) & (b) of the Petroleum Act 2015.

[53] Section 29(2) of the Petroleum Act 2015.

[54] Section 4(1) of the Natural Wealth and Resources (Permanent Sovereignty) Act 2017 proclaims of sovereignty over natural resources while section 5(1) provides that resources are inalienable and remain the property of the people of Tanzania.

[55] See Chapter 2 section 3.1

[56] Johnston, D *International Petroleum Fiscal Systems and Production Sharing Contract* Tulsa, Oklahoma PennWell Books (1994) 5-6.

and sovereign – provides the justification for combination of taxes and non- tax instruments in the oil and gas industry.[57] Tanzania uses the production sharing system as a method of obtaining tax revenues.[58] The next sections highlight and evaluate the tax and non-tax instruments used in Tanzanian PSA system.

2.3 Production Sharing Agreement (PSA) System

The Petroleum Act 2015 clearly stipulates the Minister can only grant extraction license to the TPDC.[59] In turn, TPDC looks for partners with whom to enter into a PSA.[60] Then, the Minister enters into a PSA with TPDC and its partners.[61] For this reason, the PSA is a tripartite contractual arrangement involving the Government (owner of the resource), TPDC (licensee) and Oil Company (contractor).[62] The PSA serves as a mechanism for creation of Government revenues from the oil and gas industry.[63] In its original form, the PSA resembles landowner-sharecropper relationship in agriculture where the sharecropper tills the land on promise to share the produce with the landowner, so does the PSA operate. [64]

Under the PSA, the IOCs undertake the exploration and extraction of the oil and gas at their costs and expense on promise that if petroleum is discovered will be entitled to recover the exploration costs and a share of the oil produced.[65] The IOCs also undertake to make certain payments to the Government, such as bonuses, rental fees, royalties,

[57] See Chapter 2 section 4.

[58] See Chapter 2 section 5.

[59] Sections 43(1)&(2) and 44(1) of the Petroleum Act 2015.

[60] Section 44(4) of the Petroleum Act 2015.

[61] Sections 47(1)&(2), 44(4) and 45 (a)& (b) of the Petroleum Act 2015 and section 5(4) of the Natural Wealth and Resources (Permanent Sovereignty) Act 2017.

[62] Model PSA 2013: See also TPDC website at http://www.tpdc-tz.com/tpdc/legal_fiscal.php

[63] It also works as a mechanism of licensing, a partnership between the IOC and the Government and serves other Government objectives, such as knowledge transfer, local procurement of goods.It also delinates the rights and obligations of the parties. See Ogunleye, T A "A Legal Analysis of Production Sharing Contract Arrangements in the Nigerian Petroleum Industry" (2015) 8(5) *Journal of Energy Technologies and Policy* at 1. Le Leuch, H "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 127.

[64] The nature of PSA as adopted originally in Peru and modified in Indonesia is discussed under Chapter 2 Section 5.2. See also Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 22.

[65] Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 22.

production sharing income tax and special petroleum tax.[66] These elements make the PSAs resemble and replicate the normal tax system.[67] Currently, there are 24 PSAs signed in Tanzania as indicated in table 1.1 below of which two are at production stage and one at the development stage.

Table 1.1: List of existing Production Sharing Agreements (PSAs)

S/N	Year	Name of Contractor	Country of Origin	License Area	Location	Activity Level
1	1997	Antrim Resources	Canada	Pemba & Zanzibar	Onshore	Force Majeure
2	2001	PanAfrica Energy	United Kingdom	Songosongo	Onshore	production
3	2004	Maurel et Prom	France	Mkuranga	Onshore	Exploration
4	2004	Maurel et Prom	France	Mnazi Bay	Onshore	Production
5	2005	Ndovu Resources	Australia	Ruvuma	Onshore	Exploration
6	2005	Brtitish Gas	United Kingdom	Block 1	Offshore	Development
7	2006	Petrodel	United Kingdom	Kimbiji & Latham	Onshore	Exploration
8	2006	Afren	United Kingdom	Tanga	Onshore	Exploration
9	2006	Ophir Energy	South Africa	East Pande Lindi	Onshore	Exploration
10	2006	Brtitish Gas	United Kingdom	Block 3	Offshore	Exploration
11	2006	Brtitish Gas	United Kingdom	Block 4	Offshore	Exploration
12	2007	Dominion Oil & Gas	United Kingdom	Block 7	Offshore	Exploration
13	2007	Statoil	Norway	Block 2	Offshore	Exploration
14	2007	Dodsal Resources	United Arab Emirates	Ruvu/Bagamoyo	Onshore	Exploration
15	2008	HydroTanz	India	North Mnazi Bay	Onshore	Exploration
16	2008	Beach Petroleum	Australia	South Lake Tgyk	Onshore	Exploration
17	2011	Motherland Home	India	Malagarasi	Onshore	Exploration
18	2011	Heritage Oil Plc	United Kingdom	North Lake Rukwa	Onshore	Exploration
19	2011	Heritage Oil Plc	United Kingdom	Kyela	Onshore	Exploration
20	2012	Swala Energy	Australia	Pangani	Onshore	Exploration
21	2012	Swala Energy	Australia	Kilosa & Kilombero		Exploration
22	2012	Petrobras	Brazil	Block 8	Onshore	Exploration
23	2012	Ndovu Resources	Australia	Nyuni-New PSA	Onshore	Exploration
24	2012	Jacka Resources	Australia	Ruhuhu	Onshore	Exploration

Source: TPDC 2016

[66]. Chapter 2, Section 5.2.

[67] Ogunleye "A Legal Analysis of Production Sharing Contract Arrangements in the Nigerian Petroleum Industry" (2015) 1.

2.4 Contracting Procedures

Since the State relies on private entities to extract its oil and gas resources, the licensing system plays an important role in the oil and gas value chain.[68] In the process of granting extraction rights, the Government aims at, inter alia, obtaining an IOC with the requisite expertise, technology and capital to undertake the extraction.[69] In addition, and more importantly, agreeing on the mechanism for sharing economic benefits between the IOC and the Government.[70]

In Tanzania, the pre-licensing stage commences with nomination of blocks to be licensed. This is followed by a preliminary assessment of nominated blocks with a view to ascertain the coordinates and preparing a checklist of records, data, maps and other relevant information.[71] Then, PURA undertakes an evaluation of geological and geophysical data of blocks (acreage) to be licensed.[72] This evaluation helps PURA to rank blocks according to their prospectivity.[73] At this stage, PURA also prepares data packages, which are used by the prospective investors to assess the prospectivity of the block under license.[74] Thereafter, PURA prepares a model PSA, used as the basis for preparing the tender documents, spells out the rights and obligation of TPDC, Government and IOCs.[75]

The model PSA contains technical, commercial, fiscal and legal aspects.[76] It also contains negotiable terms, such as work program, bonuses and production sharing, as well as fixed

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[68] Sunnevag, KJ "Designing auctions for offshore petroleum lease allocation" (2000) 26 *Resources Policy* 3-16 at 3.

[69] Sunnevag "Designing Auctions for Offshore Petroleum Lease Allocation" (2000) 3.

[70] Sunnevag "Designing Auctions for Offshore Petroleum Lease Allocation" (2000) 3.

[71] Information from TPDC by one Kelvin Komba Director of the Upstream Sector 2016.

[72] Provide geological description, such as stratigraphy/structure plays; prospect maps from the interpretation, describe source rock structure, provide an estimate of potential volumes, conduct an econometric analysis based on the Model PSA.

[73] Most prospectivity with Chances of Success (COS) between 30% and 40%; Medium prospectivity with COS between 20% and 30%; Low prospectivity with COS between 10% and 20%.

[74] Tanzania National Audit Office *Performance Audit on the Management of Process of Awarding Exploration and Development Contracts and Licences for Natural Gas* (2016) 15-16 http://www.nao.go.tz/?wpfb_dl=183 (accessed on 15 July 2016)

[75] Tanzania National Audit Office *Performance Audit on the Management of Process of Awarding Exploration and Development Contracts and Licences for Natural Gas* (2016) 15-16.

[76] For example, the terms of the Model PSA includes parties, operational aspects, royalties and taxation, environmental issues as well as commercial aspects. See the contents of Model PSA 2013 at http://www.tpdc-tz.com/psa_agreement.php (accessed 20 July 2017).

terms, such as royalties and taxes.[77] Currently, the law requires that such Model PSA to be approved by the Cabinet.[78] However, the Model PSA has been in use since 1989 as a benchmark for negotiating the terms of PSAs.[79] Since 1989, five prototypes of Model PSA have been developed in the years 1989, 1995, 2004, 2008 and 2013.[80] Once the preparatory stages are complete, PURA invites potential investors in a bidding round.There are two ways of offering extraction rights to prospective companies: through direct negotiations and competitive tendering.[81]

2.4.1 Competitive Tendering

Once the pre-licensing stage is complete, PURA circulates a tender inviting all prospective investors in both local and international newspapers of wide circulation.[82] This invitation for tender includes information, such as the block name, area and location.[83] The tender also indicate the rules to be complied with by the bidders, the criteria used to evaluate bidders against each other and the applicable criteria for selecting the winner.[84] In addition, bidders are required to pay non-refundable bidding fee of US$ 50,000, mandatory purchase of bid round data package (BRDP) deep offshore blocks at US$ 750,000 per package and BRDP for offshore US$ 350,000 (non-refundable) and

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[77] Information provided by Mr. Simon Kenyeli a geologist at the Ministry of Energy and Minerals; See Table 1.2; IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 38 available at https://www.imf.org/external/np/pp/eng/2012/081512.pdf (accessed on 20 March 2014)

[78] Section 47(3) &(4) of the Petroleum Act 2015. This was not a requirement under the Petroleum (Exploration and Production) Act 1980.

[79] Sehel, BMA "Tanzania" in Pereira EG & Talus, K *African Upstream Oil and Gas: A Practical Guide to the Law and Regulations* London: Globe Law Business (2015) 514.

[80] http://www.tpdc-tz.com/legalservice.php (20 July 2017) See also Sehel "Tanzania" (2015) 514.

[81] Sunnevag "Designing auctions for offshore petroleum lease allocation" (2000) 4; Fraser "Licensing resources tracts: A comparison of auction and discretionary systems" (1991) 271; Kretzer, UMH "Allocating oil leases: Overcapitalization in licensing systems based on size of work programme" (1993) 19(4) *Resource Policy* 299-311 at 299; Kretzer, UMH "Exploration prior to oil lease allocation: A comparison of auction licensing and allocations based on size of work programme" (1994) 20(4) *Resource Policy* 211- 294 at 235. Le Leuch, H "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues"(2013)131.

[82] Section 48(1)& (2) of the Petroleum Act 2015, the Minister is required to make Regulations providing for guidelines on the conduct of the tendering process.

[83] See TPDC Invitation for Bids Tender No. PA/031/2013-14/PSA/01 for PSA Application Proposals For Hydrocarbon Exploration to Seven (7) Blocks in Tanzania Deep Offshore Basin and Lake Tanganyika North Block; see also IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 38.

[84] Tanzania National Audit Office Performance Audit on the Management of Process of Awarding Exploration and Development Contracts and Licences for Natural Gas (2016) 15-16.

mandatory 2D SPAN data at US$ 3.375 per package.[85] Bidders are allowed to apply as individuals or consortium and for the all blocks, but only one block is awarded.[86] Since 2000, when TPDC adopted competitive bidding, four licensing rounds have been taken.[87] The major advantage of competitive tendering is that the IOCs to compete with each other and the Government just select the highest bidder. [88]

After the deadline for submission of tender application, the tender documents are opened in public in presence of all tenderers. Subsequently, the Government grading team evaluates the bidders to ascertain compliance with the terms of the tender and selecting the winner.[89] The first level of evaluation, which involves a preliminary examination, aims at identifying bidders who complied with the instructions.[90] The second level of evaluation comprises of a detailed examination of the bidders profile to establish the terms of the offer such as the work program, technical and financial capacity and fiscal terms.[91] The winner of the tender, who meets the criteria specified in the tender document or the qualified bidder, is then invited for negotiations based on the latest Model PSA. [92]

2.4.2 Direct Negotiations

There are two scenarios where the Government may dispense with requirement for tendering and thus engage in direct negotiations with the IOCs. The first, is when the

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[85] See TPDC Invitation for Bids Tender No. PA/031/2013-14/PSA/01.

[86] TPDC Invitation for Bids Tender No. PA/031/2013-14/PSA/01.

[87] Before that it used to be based on first-come-first served basis The first licensing round, which was conducted in June 2000 to April 2001 and involved 6 offshore blocks, attracted only one bid, which subsequently awarded one block. The second licensing round between June 2001 to July 2002 and involved 11 offshore blocks and two bids were received. The third licensing round conducted between May 2004 to May 2005 involved 7 offshore blocks, attracted three bids all of which were accepted. The fourth licensing round conducted in October (June?) 2013 to May 2014 involved North Lake Tanganyika block (onshore) and 7 offshore blocks, attracted 21 bids but only 5 responded after evaluation. See Tanzania National Audit Office *Performance Audit on the Management of Process of Awarding Exploration and Development Contracts and Licences for Natural Gas* (2016) 18-19.

[88] Johnston, D *International Exploration Economics Risks & Contract Analysis* (Tulsa, PennWell Corporation, 2003) 152.

[89] From the Ministery of Energy and Minerals and Petroleum Upstream Regulatory Authority (PURA) Section 49(2)&(3) Petroleum Act 2015

[90] See See Tanzania National Audit Office Performance Audit on the Management of Process of Awarding Exploration and Development Contracts and Licences for Natural Gas (2016) 18-19.

[91] Section 51 of the Petroleum Act 2015 provides the eligibility criteria to include minimum work and expenditure amount, financial resources available to them, technical and industrial competence and experience to carry the operation, proposals with respect to the training and employment of citizens of Tanzania Information from TPDC & MEM

[92] Section 49(2)&(3) of the Petroleum Act 2015.

Minister, through a notice in the Government gazette, reserves certain blocks either for public interest or to be awarded directly to the NOC.[93] The second is where the licensing rounds have failed to attract potential bidders.[94] The greatest challenge with this closed-door system is that it does not pre-define the criteria for the awarding of rights, nor make them known to the license applicants.[95] This system also lacks transparency and limits competition among applicants.[96] Moreover, the use of discretionary powers may create opportunities for corrupt practices.[97]

2.4.3 Negotiations and Signing of PSA

The Government Negotiating Team conducts the negotiation of a PSA. The law requires the Government Negotiating Team to be composed of members from different disciplines.[98] The Model PSA serves as the basic document for negotiating terms for exploration and production of petroleum. The negotiating team has a mandate only to deal with terms, which are negotiable, such as work program, Government participation, bonuses and profit oil split.[99] The other fiscal terms, such as corporate income tax and royalties, are not subject to negotiations.[100]

Once the terms are agreed, the TPDC applies for exploration license from the Minister 30 days before the PSA is signed and is attached as an annexure to the license.[101] When granted, *the exploration license*, grants exclusive right to the IOC to explore for oil and gas in the licensed block. [102] The exploration license covers forty blocks (and can extend

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[93] Section 50 of the Petroleum Act 2015. One block has already been reserved. See Petroleum (Reservation of Block 4/1B and 4/1c for the National Oil Company) Notice 2016 GN No 184/2016

[94] Section 48(3) the Petroleum Act 2015.

[95] Le Leuch, H "Recent Trends in Upstream Petroleum Agreements: Policy, Contractual, Fiscal, and Legal Issues" (2013) 131.

[96] Tordo, Johnston and Johnston Petroleum Exploration and Production Rights Allocation Strategies and Design Issues (2009) 14.

[97] Tordo, Johnston and Johnston Petroleum Exploration and Production Rights Allocation Strategies and Design Issues (2009) 14.

[98] Section 37(2) of Public Procurement Act 2011 & Section 49(2)&(3) of the Petroleum Act 2015.

[99] See section 2.5 below.

[100] See section 2.5 below.

[101]See Tanzania National Audit Office Performance Audit on the Management of Process of Awarding Exploration and Development Contracts and Licences for Natural Gas (2016) 17.

[102] Section 51(2)(b) & 51(3) Section 55(1)&(2) This is contrasted with the reconnaissance permits are non-exclusive, may be issued to different persons on the same area, and are valid for three years (section 34(4)) Petroleum Act.

to eighty blocks),[103] valid for four years (and can be extended for a further period of five years).[104]

After successful negotiations, TPDC forward a draft-negotiated document for approval processes to Government where the Minister will then sign the Agreement. The signing of PSA paves way for exploration operations to commence. If exploration is successful, the registered holder of an exploration license (TPDC) may request for the development license to the Minister.[105] The development license, valid for 25 years, is subject to extension of a further period of 20 years,[106] entitles the holder to carry out development operations, and the recovery of oil and gas from the reservoir.[107] However, before commencing any production operations, the holder of a development license must obtain an annual production permit from the Minister.[108] The next section discusses the fiscal instruments contained in the PSAs.

2.5 Fiscal Terms

In Tanzania, upstream and downstream sectors are treated as separate operations for tax purposes.[109] As regards to the upstream sector, which is the focus of this study, the Tanzanian fiscal system adopts a typical PSA system under which the IOC bears all the costs and risks of exploration and development.[110] In this regard, the fiscal elements constitute terms meant to generate Government revenue, as well as compensating the IOCs for risk taken and capital invested.[111]

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[103] Section 51(2)(b) & 51(3) of the Petroleum Act 2015.

[104] Section 56(a)&(b) of the Petroleum Act 2015.

[105] Section 66 of the Petroleum Act 2015.

[106] Section 73 of the Petroleum Act 2015.

[107] Section 72 of the Petroleum Act 2015.

[108] Section 76 (1) (a) of the Petroleum Act 2015.

[109] Section 65 K(4) Income Tax Act 2004. See also Kellas, G "Natural gas Experience and issues" in Daniel, P Keen, M, McPherson C (eds) *The Taxation of Petroleum and Minerals Principles, Problems and Practice*, (London, Taylor & Francis, 2010) 169.

[110] Bindemann, K *Production Sharing Agreements: An Economic Analysis* (Oxford Institute for Energy Studies ,1999)1.

[111] Salih, MS and Salih, RS "Strategy of Oil Contract Negotiation" (2015) 9 (6) *International Journal of Business and Social Science)* 168-175.169, 171 and Kellas, G "Natural gas Experience and issues" in Daniel, P Keen, M, McPherson C (eds) *The Taxation of Petroleum and Minerals Principles, Problems and Practice*, (London, Taylor & Francis, 2010) 169. Nakhle, C "Petroleum fiscal regimes: Evolution and challenges" (2010) 99-101; Bindemann *Production Sharing Agreements: An Economic Analysis* (1999) 1;

Under the Tanzanian PSA system, the apportionment of revenues between the Government and the IOCs entails a five-layer process as summarized under Table 1.2 below.[112] First, immediately after the commencement of production the Government charges royalty on gross production from the contract area.[113] Second, the contractor receives a share of production for costs recovery.[114] The partion of the produce given to the contractor as reimbursement for costs incurred during the exploration, development and production stage is referred to as "cost oil or gas".[115] The cost oil or gas resembles and replicates the deductions under conventional income tax system.[116] Third, the balance portion of oil or gas after deduction of royalties and cost recovery referred to as "profit oil/gas" is split between the Government and IOCs at a pre-specified ratio.[117] Fourth, the IOC pays corporate income tax on its share of profit oil in accordance with the income tax laws.[118] Fifth, if the share of profit oil exceeds a certain pre-determined threshold, it will be subjected to additional profit tax (APT).[119]

Table 1.2 Summary of Fiscal Terms contained in 24 Existing PSAs

s/n	Name of contractor *	Royalties	Cost Oil	Gvt Share of Profit Oil	CIT	State Equity participation	APT	Bonuses	Tax incentives
1	PSA 1	5%	70%	Oil 30-60% Gas 30-50%	30%	Max. 20%	No	No	Capital goods exempted from taxes
2	PSA 2	12.5%	60%	Oil 35-55% Gas 55-80%	30%	Negotiable	No	No	Capital goods exempted from taxes

Khan, K.I.F "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 22 (1) *Journal of World Trade* 67–88 at 83.

112 This is a typical feature of the PSA in its original form as applied in Indonesia. See Chapter 2 section 5.2.However, this approach excludes the indirect taxes, such as import duties, local Government rates, and stamp duties as well as dividends from equity participation. These fiscal terms are also discussed under item 2.5.5, 2.5.6 and 2.5.7 of this Chapter.

113 Section 113(1) of the Petroleum Act 2015. This is also reflected under Articles 12(e) and 16(c) of the Model PSA 2013

114 Article 12 (a) of Model PSA 2013; Bindemann *Production-Sharing Agreements: An Economic Analysis* (1999)1.

115 Article 12 (a) of the Model PSA 2013.

116 See Chapter 2 section 4.2.1. See also Ogunleye "A Legal Analysis of Production Sharing Contract Arrangements in the Nigerian Petroleum Industry" (2015) 1 and Khan, K.I.F "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 22 (1) *Journal of World Trade* 67–88 at 83.

117 Article 12 (g)(i)(a) of the Model PSA 2013 Bindemann *Production-Sharing Agreements: An Economic Analysis* (1999) 1.

118 Sections 116(1) and 224(2) of the Petroleum Act 2015.

119 Article 17 of Model PSA 2013, A detailed discussion on these fiscal instruments is provided for under section 2.5.4.4 of this Chapter.

									Stabilization clause
3	PSA 3	12.5%	60%	Oil 35-55% Gas 50-75%	30%	Negotiable	No	No	Capital goods exempted from taxes Stabilization clause
4	PSA 4	12.5%	50%	Oil 50-62% Gas 50-62%	30%	Max. 20%	No	No	Capital goods exempted from taxes
5	PSA 5	12.5%	65%	Oil 50-70%	30%	Negotiable	Yes	No	Capital goods exempted from taxes
6	PSA 6	5%	65%	Oil 40-70%	30%	Max. 15%	No	No	Capital goods exempted from taxes Stabilization clause
7	PSA 7	12.5%	60%	Oil 40-60% Gas 37-60%	30%	Max. 15%	No	No	Capital goods exempted from taxes Stabilization clause
8	PSA 8	5%	75	Oil 40-65	30%	Max. 50%	Yes	No	Capital goods exempted from taxes
9	PSA 9	12.5%	50%	55-75 45-70	30%	Max. 25% for oil Max. 20% for gas	No	No	Capital goods exempted from taxes - Stabilization clause
10	PSA 10	12.5%	60%	40-65 45-70	30%	Max. 20%	No	No	Capital goods exempted from taxes - Stabilization clause
11	PSA 11	12.5%	50%	40-60%	30%	Max. 15%	Yes	No	Capital goods exempted from taxes - Stabilization clause
12	PSA 12	5%	72.5 %	42.5-62.5%	30%	Max. 15%	No	No	Capital goods exempted from taxes - Stabilization clause
13	PSA 13	5%	72.5 %	42.5-62.5%	30%	Max. 15%	No	No	Capital goods exempted from taxes - Stabilization clause
14	PSA 14	5%	70%	40-60%	30%	Max. 12%	No	No	Capital goods exempted from taxes - Stabilization clause
15	PSA 15	5%	70%	25-62.5%	30%	Max. 20%	Yes	No	Capital goods exempted from taxes - Stabilization clause
16	PSA 16	12.5%	50%	35-65%	30%	Max. 15%	No	No	Capital goods exempted from taxes - Stabilization clause
17	PSA 17	12.5%	50%	35-65%	30%	Max. 15%	No	No	Capital goods exempted from taxes - Stabilization clause
18	PSA 18	5%	75%	42.5-65%	30%	Max. 50%	Yes	No	Capital goods exempted from taxes
19	PSA 19	5%	70%	30-52.5%	30%	Max. 10%	No	No	- Capital goods exempted from taxes No taxes on transfer of rights - stabilization c
20	PSA 20	TPDC pays royalty	75%	45-75%	30%	Max. 20%	Yes	No	- No ring fencing - No WHT on dividends - Capital goods exempted from taxes
21	PSA 21	12.5%	60%	50-70%	30%	Max. 20%	Yes	No	Capital goods exempted from taxes
22	PSA 22	12.5%	50%	50-70% 45-70%	30%	Max. 20%	No	No	Capital goods exempted from taxes

23	PSA 23	12.5%	50%	45-70%	30%	Max. 20%	No	No	Capital goods exempted from taxes
24	PSA 24	12.5%	50%	45-70%	30%	Max. 20%	No	No	Capital goods exempted from taxes

Source: Compiled by the author from the 24 PSAs availed to him on condition that the real identities of IOCs should not be disclosed.

Table 1.2 above provides a summary of the fiscal terms as contained in each individual PSA. However, this summary does not contain the details of each fiscal term and leaves out other indirect taxes. The next section highlights and examines one by one these fiscal elements as well as other indirect taxes function.

2.5.1 Royalties

The license holder (TPDC) and the contractor are obliged to pay royalties to the Government in respect of gross volume of oil and gas produced at the delivery point.[120] This is also known as gross revenue royalty ("ad-valorem royalty").[121] Royalties are calculated based on gross revenues prior to any deductions available to the IOCs.[122] The rate of royalty for onshore projects is 12.5 percent and 7.5 percent for offshore of the total crude oil or gas produced.[123] It is notable that before the enactment of the Petroleum Act 2015 royalties were negotiable and for that reason royalty for offshore projects was 5 percent.[124] The reason for this distinction is that exploration and development cost and risks in the deep sea are much higher compared to onshore and shallow waters.[125] In addition, the payment of royalty can be either by cash or in kind as specified in the

[120] Section 113(1) of the Petroleum Act 2015.

[121] The other common forms of royalties are volume of production (per unit royalty) or a sliding scale tied to commodity price. See Nakhle, C "Petroleum fiscal regimes: Evolution and challenges" (2010) 95; Agalliu, I *Fiscal sytem comparative Assessment of the federal oil and gas fiscal systems report* U.S Department of Interior, Bureau of Ocean Management (2011) 48 available at https://www.energy.senate.gov/public/index.cfm/files/serve?File_id=d174971c-4682-4d96-b194-a85fa2b86774 (accessed on 05 May 2015).

[122] Section 113 (1) of the Petroleum Act 2015.

[123] Section 113(2) read together with the Second Schedule to the Petroleum Act 2015. This remedies a mischief under Petroleum (Exploration and Production) Act 1980 under section 81 which did not provide for the method of calculating royalty

[124] See Table 1.2.

[125] Agalliu Fiscal sytem comparative Assessment of the federal oil and gas fiscal systems report (2011) 48.

PSAs.[126] Failure to pay royalties attracts sanctions, such as prohibition of removal of petroleum produced or dealing in any petroleum from the development area.[127]

Royalty payments have a number of advantages to the Government. For one, royalties are simple to administer because their base is gross production,[128] which is easy to calculate, collect and monitor the royalty payable.[129] Moreover, the fact that the royalty is attached to gross production makes it simple to estimate the amount payable.[130] This also implies that royalties are not susceptible to tax avoidance as compared to profit-based taxes.[131] Additionally, the royalty payment, as opposed to profit-based taxes, provides early revenue to Government because it is chargeable as soon as the production starts.[132] Despite these advantages, charging royalties may be undesirable in certain circumstances. For instance, charging royalties for marginal project, where the operating costs are equal to the revenues, may lead to premature closure of such projects.[133] Furthermore, until June 2017 royalties paid were tax-deductible, implying that the payment are just an advance payment of corporate tax.[134] However, with the most recent amendments, royalties are no longer deductible for tax purposes.[135] While this new enactment has the potential to widen the tax base, it will not be applicable to existing PSAs due to stability clauses.

2.5.2 Cost Oil or Gas

The PSA has clauses that provide that after the deduction of royalties from the gross production, the contractors and TPDC (in case of joint operations),[136] are entitled to

[126] Section 113(2) of the Petroleum Act 2015.

[127] Section 113(3) of the Petroleum Act 2015.

[128] Nakhle "Petroleum fiscal regimes: Evolution and challenges" (2010) 95.

[129] Tordo Fiscal Systems for Hydrocarbons Design Issues (2007) 37.

[130] However, this is not always the case, due to the volatility of petroleum prices in the world market. Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 37.

[131] See Chapter 3 sections 3.2 and 3.3.

[132] Tordo Fiscal Systems for Hydrocarbons Design Issues (2007) 37.

[133] Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 38; Nakhle "Petroleum Fiscal Regimes: Evolution and Challenges" (2010) 95,

[134] Section 65N of the Income Tax Act 2004.

[135] Section 65N (1) of the Income Tax Act 2004 as amended by section 36 of the Written Laws (Miscellaneous Amendments) Act, 2017

[136] Joint operations means the Petroleum operations in respect of which TPDC has elected to contribute expenses or carried interests- MPSA interpretation.

recover operating expenses from the remaining portion of oil and gas ("cost oil or gas").[137] As indicated under table 1.2 above, the PSAs place a ceiling on cost recovery between 50 and 75 percent of the gross revenue less royalties. In addition, the PSAs contain rules on treatment of unrecoverable costs, [138] recoverable costs [139] and classification of unrecoverable costs.[140] While the cost oil or gas resembles the deductions under income tax system, the Income Tax Act 2004 has its own rules of deductibility of capital and operational costs.[141] The non-alignment of the cost recovery rules under the PSA and those under the Income Tax Act 2004 creates parallel rules.[142] However, in cases of variance or inconsistency between the rules under PSA and those under the Income Tax Act 2004, the provisions of the law prevail.[143]

2.5.3 Profit Oil or Gas

In terms of Model PSAs, after deducting royalties and cost oil from the gross production, the remainder production (referred to as profit oil) is shared between the contractor and TPDC on predetermined rates.[144] In practice, the rates of share of profit oil are subject to negotiations and this explains the reasons why each PSA may have its own rate of production sharing.[145] During the bidding process, the Government sets the threshold

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[137] Article 12 (a), Model PSA 2013 Bindemann *Production-Sharing Agreements: An Economic Analysis* (1999)1.

[138] Carried forward until fully recovered or after termination of the PSA, article 12(b) & (e) (iv) Model PSA 2013.

[139] Exploration costs: These are all expenses related to the process of search for oil and gas in the contract area (section 2.1 (a)-(g) Model PSA). Section 2.2(a)- (f); development expenses: These are costs incurred in the process of analyzing the productivity of the reservoir and creating the infrastructure for production. Section 2.3; operating expenses: These are expenses incurred during the commercial production phase. Section 2.4 service costs These are costs incurred to support, directly or indirectly, the oil and gas operations Section 2.5(a); general and administrative costs These included expenditures related to main office, field office and general administrative activities, such as supervisory, accounting and employee relations services.

[140], such as annual charges, costs of arbitration, fines and penalties; costs incurred because of willful misconduct or negligence; signature bonus and production bonus; Article 12 (b) and Section 3.2 of the ANNEX "D" to the Model PSA 2013.

[141] Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 83.

[142] See Chapter 6 section 6.5.

[143] See also *Tullow Uganda Ltd & Another v. Uganda Revenue Authority* TAT Application No. 4 of 2011, Uganda Tax Appeals Tribunal at 68 (Unreported), where it was held that "[a] contract cannot override a statute". See also the decision of the Tax Revenue Appeals Tribunal in *Geita Gold Mine v the Commissioner General* Appeal No. 4 of 2012 (unreported).

[144] Article 12 (g)(i)(a), Model PSA 2013. Section 3 of the Petroleum Act 2015 definition.

[145] See Table 1.2.

parameters within which profit oil or gas can be shared in the Model PSA.[146] Therefore, it is upon the contractor to bid either above or below the threshold set in the Model PSA.[147] Currently, the PSAs use a sliding scale pegged on daily production tranches on the share of profit oil or gas.[148] The rates of shares differ depending on whether production is onshore or offshore and whether the produce is oil or gas. As indicated under Table 1.2 above, the lowest share of profit oil or gas the Government receives is 25 percent while the highest is 80 percent.

2.5.4 Income and Profit-based Taxes

The license holder (TPDC), contractor (IOCs) and subcontractors are all obliged to pay taxes in accordance with the provisions of written laws.[149] The following section discusses different methods of charging income tax in Tanzania.

2.5.4.1 Income and profit-based taxes

In Tanzania, profits from companies are taxed both at the corporate level as well as in the hands of shareholders.[150] Thus, while the company pays corporate income tax, the dividends distributed to shareholders are subject to withholding taxes.[151] Similarly, income earned by a non-resident corporation with permanent establishment in Tanzania is liable to corporate income tax in the same way as that of a resident person.[152]

Since corporate income tax is profit-based, it is payable only where the IOC has generated a profit. Under the Income Tax Act 2004, profit is calculated as the difference between gross revenues and the allowable deductions.[153] Therefore, the first stage in establishing

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[146] Refer to section 2.4.3 above. See also Mgaya, RBT *Petroleum Taxation: A Critical Analysis of Oil and Gas Fiscal Regime in Tanzania* Msc dissertation Robert Godon University of Aberdeen (2014) 35.

[147] Refer to section 2.4.3 above. See also Mgaya, RBT *Petroleum Taxation: A Critical Analysis of Oil and Gas Fiscal Regime in Tanzania* (2014) 35.

[148] See Table 1.2. See also Article 12 (g) &(h) Model PSA 2013.

[149] Section 116(1) of the Petroleum Act 2015 and section 65K (1)(a) of the Income Tax Act 2004. however, in terms of the PSA signed with Pan African Energy signed in 2001, though the contractor has an obligation to pay corporate income tax, such tax when paid is refundable from the TPDC share of profit oil. See Table 1.2.

[150] Section 53(1) of the Income Tax Act 2004. See also Schreiber, U *International Company Taxation: An Introduction to the Legal and Economic Principles* (Berlin, Springer, 2013) 1.

[151] Section 54(1)(a) of the Income Tax Act 2004.

[152] Section 4(1)(a)-(c) of the Income Tax Act 2004.

[153] General discussion on corporate income tax under Chapter 2 section 4.2.1. See also Part III of the Income Tax Act 2006. (“cost recovery”).

the tax payable is to calculate the gross revenues arising from oil and gas operations. In calculating gross revenues, each petroleum right is treated as a separate and independent business activity and thus ring fenced from other businesses or petroleum rights held by the IOC.[154] Also revenues from upstream activities are accounted separately from midstream and downstream activities.[155] For this reason, the accounts and tax returns for each petroleum right (PSA) are prepared independent of other businesses.[156]

The gross revenue in the upstream oil and gas industry is the aggregate of income from the disposition of petroleum obtained from the license area, sale of data or information, revenue from disposal of rights or interests as well as contractor's share cost oil and profit oil/gas.[157] It also includes other classes of revenues earned in the course of doing business, such as service fees, incomings for trading stock, gains from the realization of business assets or liabilities, revenue derived from realization of depreciation assets and amounts derived from the restrictive agreements to conduct business.[158]

While the law requires the gross revenues to be calculated based on market value, in practice such calculation or declaration poses serious transfer pricing risks.[159] This is the case particularly for cross-border transactions.[160] In fact, the price fluctuation of oil and gas commodities renders it difficult to monitor the pricing of commodities.[161] Moreover, the IOCs may enter into agreements with related parties to sell products at a lower price than the market price.[162] To avert this transfer pricing risk, the law requires that arrangements between related parties must be at arm's length.[163]

154 Sections 65K(4)(b) and 65K(a) Section 65K(4)(a) of the Income Tax Act 2004. Under section 65Q when realized before production treated as an investment assets and the rules for taxing income from investments apply accordingly

155 Section 65K (4) (a)&(b) of the Income Tax Act 2004.

156 Section 65K (4)(b) of the Income Tax Act 2004. This a typical "ring fencing" provision.

157 Section 65M (2) (2) of the Income Tax Act 2004.

158 Section 8 (2) (a)-(h) of the Income Tax Act 2004.

159 Section 65 Q (5)&(6) of the Income Tax Act 2004.

160 See Chapter 3 section 3.2.2.

161 See Chapter 2 section 3.3.

162 See Chapter 3 section 3.2.2.

163 Section 65K (5) Income Tax Act 2004.

As regards to cost recovery, there are two methods for the IOCs to recover their costs in Tanzania namely deductions and depreciation.[164] First, expenditures giving benefits of less than twelve months to the taxpayers deducted in financial year incurred while expenditures giving benefits to the taxpayer of more than twelve months are recoverable based on either their useful life or the lifetime of the oil and gas well.[165] The former are referred to as deductions while the latter are referred to as depreciation or amortization.[166]

Generally, recoverable expenditures are only the ones incurred wholly and exclusively for the production of income. [167] For this reason, the law specifies that certain expenditures are not deductible. The non-deductibe expenditures include gifts to public or charitable organizations, depreciable allowance, bonuses paid, and excess costs on the decommissioning fund. [168] Furthermore, certain expenses, such as bribes and expenditure incurred in corrupt practices, fines and similar penalties are not deductible for tax purposes.[169] Taking into account these restrictions, the deductible expenses are limited to royalties and annual fees paid, operating expenses, interests on debts as well as amounts set aside for decommissioning fund and unrelieved losses.[170]

It is also notable that capital expenditure relating to oil and gas exploration and production are amortized at the rate of 20 percent straight line.[171] This implies that these costs may be recovered within five years of commercial production. Similarly, the capital expenditures associated with other equipment, plants and machinery are depreciated at

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[164] Annual wear and tear allowance for depreciable assets owned and used by the IOC or amortization of intangible assets. Section 11 of Income Tax Act 2004 provides for general rules on deductibility of expenses.

[165] Section 11 (4) Income Tax Act 2004. Including those incurred in respect of natural resource prospecting, exploration and development

[166] See Chapter 3 section 3.2.2.

[167] Section 11(2) of the Income Tax Act 2004.

[168] Section 12(1) (a)&(b) of the Income Tax Act 2004.

[169] Section 11(4) of the Income Tax Act 2004.

[170] Section 65N (1) (a)-(c) of the Income Tax Act 2004.

[171] Section 17 of the Income Tax Act, read together with the Third Schedule to the Act- Class 4 " natural resource exploration and production rights and assets in respect of natural resource prospecting, exploration and development expenditure"- Straight line means.

the rate of 37.5 percent,[172] 25 per cent[173] and 12.5 per cent,[174] depending on how the depreciable assets are classed.

Generally, cost recovery is of paramount importance to the IOCs and the Government alike. To the IOCs, it determines the timing for recovering investment and operating expenses while to the Government it determines the time when profit-based taxes are payable.[175] It is for this reason that tax is considered as a cost to investment as it impedes on capacity to recover the costs.[176] Contextually, the IOCs devise different techniques that increase the deductible expenditures, such as borrowing from related parties at a very high interest than the prevailing market rates.[177] This practice, in turn, increases the deductible expenditures and thus lowers the taxable profits.[178]

In addition, deductibility of costs encourages "gold plating" of expenditure or excessive expenditures by the IOCs knowing that would be recoverable.[179] The common techniques used include the use of intellectual property rights from related parties, usually located in low-tax jurisdictions, and pay high royalties.[180] It may also involve the payment of exorbitant management fees to parent companies.[181] All these factors indicate how it is important for the Government to control and manage the costs incurred by the IOCs.[182]

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[172] Section 17 of the Income Tax Act 2004, read together with the Third Schedule to the Act.

[173] Section 17 of the Income Tax Act 2004, read together with the Third Schedule to the Act.

[174] Section 17 of the Income Tax Act 2004, read together with the Third Schedule to the Act-Including assets not included in other classes.

[175] Since CIT is profit based, and that the higher the costs the lower the profits, and consequently low or no corporate tax payableflow of tax revenue Blindermann *Production Sharing Agreement* (1999) 14. Ashong, M *Cost Recovery In Production Sharing Contracts: Opportunity For Striking It Rich Or Just Another Risk Not Worth Bearing?* 7-11 available at http://docshare01.docshare.tips/files/26761/267613664.pdf (accessed on 28 July 2014).

[176] Sikkaa et al "The dark side of transfer pricing: Its role in tax avoidance and wealth retentiveness" (2010) 344.

[177] See Chapter 3 section 3.2.3 . See also Huizinga J, Laeven L, and Nicodème G Thin Capitalization Rules and Multinational Firm Capital Structure (Washington DC, International Monetary Fund 2014) 3: OECD Thin Capitalisation Legislation A Background Paper For Country Tax Administrations (2012) 3. See

[178] OECD *Thin Capitalisation Legislation A Background Paper For Country Tax Administrations* (2012) 3; Huizinga et al *Thin Capitalization Rules and Multinational Firm Capital Structure* (2014) 3.

[179] See Chapter 3 section 3.2.3.

[180] Ostwal, T.P and Vijayaraghavan, V "Anti-avoidance Measures" (2010) 22(2) *National law School of India review* at 90.Baunsgaard, T *Primer on mineral taxation* (2001)21.

[181] Ostwal and Vijayaraghavan "Anti-avoidance Measures" (2010) 90. Baunsgaard *Primer on mineral taxation* (2001) 21.

[182] Readhead Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector (2016) 8.

Once the profit has been established, taxes are paid at two levels. First, the IOC pays corporate tax, at the rate of 30 per cent of net profits obtained from the upstream oil and gas operations. [183] Second, dividends distributed to shareholders are taxed, in the form of withholding tax, at the rate of 10 percent.[184] Conversely, where the IOC operates a foreign branch with permanent establishment the repatriated income is subject to withholding tax at the rate of 10 percent.[185] This tax is payable regardless of whether the income has been actually repatriated.[186]

2.5.4.2 Alternative minimum tax (AMT)

It is also noteworthy that strict adherence to the profitability as the basis for charging corporate income tax does not work in favor of the Government.[187] For instance, given the capital intensity in the oil and gas industry, it takes a long time for the IOC to start earning a profit and pay corporate income tax.[188] This implies that the IOC will have the protection of the State and use of social services without making its due contribution. To ensure that the extractive companies also contribute to the Governmental expenditures, Tanzania charges an alternative minimum tax (AMT).[189] The AMT is payable by all companies that do not declare a profit for five consecutive years. [190] The AMT is calculated at 0.3 percent of gross revenues.[191]

2.5.4.3 Withholding taxes

Generally, in Tanzania non-residents pay income tax only in respect of income that has its source in Tanzania.[192] Given that non-residents without permanent establishment in

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[183] Section 65K(1)&(2) of the Income Tax Act 2004 read together with paragraph 3(6) *First Schedule to the Act.* The only exception where a company is listed on the Dar es Salaam Stock Exchange (DSE), where 30 percent shares or more are issued to the public, are taxed at the rate of 25 percent see Sections 66 & 67 read together with item 3 paragraph 2 of the First Schedule to the Income Tax.

[184] First Schedule to the Income Tax Act 2004.

[185] Sections 4(1)(b) &(6) and 72 (1) of the Income Tax Act read together with paragraph 3(3) of the First Schedule to the Act. The repatriated income is calculated by taking the net costs of PE (together with market value of capital contributed to the P.E by the owner) plus the net income minus costs (and unrelieved loss)

[186] Sections 4(1)(b) &(6) and 72 (1). of the Income Tax Act 2004.

[187] See Chapter 2 section 4.2.1.

[188] See Chapter 2 section 4.2.1.

[189] IMF Spillovers in International Corporate Taxation (2014) 36.

[190] Sections 3 & 4(1) (a) of the Income Tax Act 2004.

[191] Sections 3 & 4(1)(a) read together with item 3(3) of the First Schedule to the Income Tax Act 2004.

[192] Sections 6, 66 & 67 read together with item 3 paragraph 2 of the First Schedule to the Income Tax 2004.

Tanzania cannot be compelled to file returns and account for their income, the only way to tax their income is through withholding tax.[193] In addition, the charging of withholding tax aims to discourage payments to non-residents as a means of shifting profit to lower tax jurisdictions.[194]

Dividends distributed by a resident corporation are taxed in the hands of the company's shareholders in the form of a final withholding tax.[195] In addition, withholding tax is chargeable on service fees payable to non-resident suppliers.[196] Similarly, transmitting or delivering service in Tanzania irrespective of the place of performance is subject to withholding taxes.[197] In addition, financiers' petroleum activities are considered as subcontractor and are therefore subject to withholding tax on the interest payment.[198] The other payments subject to withholding tax are royalties for use of intellectual property, branch remittance and rental income.[199]

In principle, withholding tax places an obligation on a resident person to retain a specified amount of tax when making payment to non-resident persons.[200] It means the obligation to tax reporting and payment is shifted to the resident person.[201] The basis for charging withholding tax on income earned by non-residents in Tanzania is the source principle. The source principle was cemented in *Tullow Tanzania Bv v. Commissioner General*,[202] where the Board held that payments made by a resident person to a non-resident person who has no permanent establishment in Tanzania are subject to withholding tax.[203] The types of transactions subject to withholding tax and the corresponding tax rates are as follows: interests at 10 percent; dividends at 10 percent; rental income 10 percent;

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193 Sections 6 (1) (b) of the Income Tax 2004. OECD *Addressing Base Erosion and Profit Shifting* (2013) 33-34.

194 OECD Addressing Base Erosion and Profit Shifting (2013) 33-34.

195 Section 54(1)(a) of the Income Tax Act 2004.

196 Section 83(1) of the Income Tax Act 2004.

197 Section 3 of the Income Tax Act 2004.

198 Section 65 of the Petroleum Act 2004.

199 First Schedule to the Income Tax Act 2004.

200 TRA Withholding Tax available at http://www.tra.go.tz/index.php/withholding-tax (06 March 2015)

201 ACCA http://www.accaglobal.com/content/dam/acca/global/PDF-students/2012/sa_apr11_f6sgp_withholding.pdf

202 Tax Revenue Appeals Board, Income Tax Appeal Case No. 10 of 2011

203 Sections 6 (1) (b), 69 (i) and 83 (1) (b) of the Income Tax Act 2004.

royalties at 15 percent; technical services offered by non-residents at 15 percent and branch remittance at 10 percent.[204]

2.5.4.4 Additional Profit Tax

The Model PSA provides for payment of Additional Profit Tax (APT) calculated each calendar year depending on the real rate of return earned by the IOC on the net cash flow from the development area in question.[205] The Act defines APT as a tax imposed on additional gains due to higher price or lower cost of production.[206] APT is similar to Resource Rent Tax which is payable only when the contractor has recovered its costs and positive cash flows are generated at a specified threshold.[207] Under the Model PSAs, where in any calendar year the First Accumulated Net Cash Position (FANCP) is positive, APT is charged at the rate of 25 percent. Similarly, where Second Accumulated Net Cash Position (SANCP) is positive, the APT is charged at the rate of 35 percent.[208] With the exception of Model PSA 2004, APT is contained in the Model PSAs 1995, 2008 and 2013.[209] Where APT is due, it is payable in cash at such time and manner in which the Commissioner of Income Tax may require.[210] Currently, only 7 of 24 PSAs have an obligation for the IOC to pay APT.[211] The reason for this omission is that APT was not contained in any law and thus negotiable.

2.5.4.5 Capital Gains Tax

The Petroleum Act 2015 imposes an obligation on the IOCs to pay capital gains in respect of any profit made out of any direct or indirect assignment, transfer or any other disposal of rights under the PSAs regardless of the beneficiary type of transaction.[212] The taxable gains entail the difference between the incomings from realization of petroleum right and the cost of acquisition of such right.[213] The petroleum right is defined as an exploration

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[204] Extracted from the First Schedule to the Income Tax Act 2004.
[205] Article 17 Model PSA 2013.
[206] Section 3 of the Income Tax Act 2004.
[207] Article 17 Model PSA 2013. See also Chapter 2 section 4.1.4.
[208] Article 17 Model PSA 2013.
[209] Not covered under the Model PSA 2004.
[210] Article 17(e) Model PSA 2013.
[211] See Table 1.2 above.
[212] Section 116(2) & Section 224(1) of the Petroleum Act 2015.
[213] Section 36(1) of the Income Tax Act 2004.

licence or a development licence.[214] It also includes the interest of a contractor under a PSA in respect of exploration or development license on a contract area [215] as well as data or information relating to petroleum operations.[216]

Capital gains tax is payable where there is realization of petroleum right, which is deemed to a domestic asset.[217] The gains from the realization of petroleum right are calculated as the difference between the incomings from realization of petroleum right and the cost of acquisition of such right.[218] This implies that the IOC will be entitled to deductions of the cost incurred in the process of acquiring the petroleum. Once the gains are established, the applicable tax rate is 30 percent.[219] For instance, in 2013 Ophir Energy Plc sold 20 per cent of its shares in blocks 1, 2 and 3 at price of US$ 1.288 million.[220] This transaction was treated as disposal of business assets (not investment assets), thus subject to corporate income tax.[221] From this transaction, Ophir Energy Plc paid corporate tax at the rate of 30% amounting to shillings 361 billion.[222]

Capital gains tax is also payable on gains from indirect sale of shares. An indirect sale of shares is treated as a change of underlying ownership of the entity.[223] The change of underlying ownership must be in respect of more than 50 percent of the company's holding as compared with that ownership at any time during the three years.[224] Similarly, in farm out arrangement the petroleum right is deemed an investment asset if realized

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[214] Section 3 of the Income Tax Act 2004.

[215] Section 3 (a)-(b) of the Income Tax Act 2004.

[216] Section 3 (a)-(b) of the Income Tax Act 2004.

[217] Sections 3 and 39 of the Income Tax Act, a domestic asset includes shares and security

[218] Section 36 (1)& 37 of the Income Tax Act 2004.

[219] Item 6 of the First Schedule to the Income Tax Act 2004.

[220] TEITI "Sixth Report of the Tanzania Extractive Industries Transparency Initiative for the year ended 30 June 2014" (2015) 15.

[221] Not involved in production yet.

[222] TEITI "Sixth Report of the Tanzania Extractive Industries Transparency Initiative for the year ended 30 June 2014" (2015) 16.

[223] Section 56 Income Tax Act. See also Bajungu, CE "Capital Gains Taxation and Indirect Sales: Experience, Challenges and Remedial Efforts In Tanzanian Perspective" UN Annual Tax Meeting 10th Sessions in Geneva (27/10/2014 - 31/10/2014) 3 available at http://www.un.org/esa/ffd/tax/tenthsession/PresentationBajungu.pdf (accessed on 15 September 2016)

[224] Section 56(1) Income Tax Act 2004, see also E&Y *Global oil and gas tax guide* (2013) 511.

before the commencement of production.[225] Here capital gains tax is payable as a single instalment rate is 30 per cent at the time of realisation of the petroleum right or receipt of the proceeds of realisation.[226]

The imposition of capital gains tax has always posed serious challenges to the TRA. For many years, the Income Tax Act 2004 did not have a provision imposing CGT on indirect transfer of interests in a petroleum right. Because of this anomaly, all attempts by TRA to impose taxes on gains accrued from transfer of shares were futile.[227] The imposition of CGT was effected in 2012 when the definition of asset was extended to include shares.[228] In terms of section 56(1) of the Income Tax Act 2004, the transfer of shares, directly or indirectly, create taxable gains subject to capital gains tax. Even after the amendment of the Income Tax Act, still the payment of capital gains tax is far from being easy. This is because quite often the transactions take place abroad. [229] The challenge is how to enforce taxes on a transaction that occurred abroad, and that involves non-residents.[230] The most recent example is the contested tax liability in the transaction that the Royal Dutch Shell acquired 60 percent stake in British Gas (BG) Group in a deal worth $ 55 billion.[231] While the Tanzania Revenue Authority (TRA) subjected this transaction to capital gains tax amounting to $ 502 million, BG group argues that no capital gains were realized.[232]

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[225] Section 65Q (2) Income Tax Act 2004. Under section 3 farm out arrangements is defined as a transfer of part of the right in return for consideration and includes an obligation on the transferee to meet future expenditure.

[226] Sections 90 and 65 Q of the Income Tax Act 2004.

[227] *Afrika Mashariki Gold Mines Limited v. Commissioner General* (2005] 3TTLR 1 and *Afrika Mashariki Gold Mines Limited v. Commissioner General* [2005]1 TTLR 37 it was held the gains obtained from transfer of shares abroad were not taxable in Tanzania *JSC Atomredmetzoloto v Commissioner General*. Tax Revenue Appeals Board at Dar es salam, Income Tax Appeals No. 26 & 27 of 2011 (unreported) It was held although the transaction had resulted into change of underlying ownership of Mantra (Tanzania) Limited, but the Income Tax Act 2004 did not include shares as an asset that attracts capital gains taxThe transaction took place in 2010 while the law was amended in 2012.

[228] Finance Act 2012 (Act No. 8 of 2012)

[229] Mafwenga, HM *Mineral Tax Clinic: The Reflection of Old and New Fiscal Regimes for Effective Tax Auditing in Tanzania* (2012) 135.

[230] The transaction took place in 2010 while the law was amended in 2012.

[231] Erick Kabendera Taxman *freezes BG Group's accounts in $500m tax row* Posted Saturday, July 9 2016 at 13:14This gives Shell 16 percent shares in the proposed LNG project.

[232] $ 850 million allocated to Tanzanian unit and already spent $ 1.5 billion. TRA issued a garnishee order to freeze the BG Group's accounts. BG filed an application to TRAB challenging this garnishee order refer to *BG Tanzania Ltd v the Commissioner General* Application No. 21 of 2016.

2.5.5 Bonuses, Rental fees and Service fees

The contractor is obliged to pay to the NOC signature and production bonuses as may be agreed in the PSA.[233] Bonuses are single (or installment-based) lump sum payments triggered by events, such as the signature of an exploration and production agreement or start of production.[234] Currently, none of the 24 PSAs contains an obligation to pay bonuses because this requirement was only introduced by the Model PSA in 2013.[235] The Model PSA 2013 provides for payment to the Government a signature bonus at the rate of 2.5 million US$ and a production bonus at 5 million US$.[236] Given that bonuses are paid upfront before the project makes any profit, they increase the risk of escalating sunk costs (exploration and development costs).[237] Furthermore, bonus payment is not tax-deductible and not included in the cost of the petroleum right nor depreciated.[238] To mitigate this risk, it is advisable that when charging bonuses, to levy lower royalties, taxes, share of the production or reduce Government equity in the project.[239] However, as indicated under Table 1.2 above, none of the 24 PSAs imposes an obligation to pay bonuses.

TPDC, as a license holder, is obliged to pay annual rental fees in respect of both exploration and development licenses.[240] These surface fees aim is to discourage license holders from holding on to blocks without exploring them.[241] The rates of rental fees until 2013 have been US$ 4, US$ 8 and US$ 16 per square kilometer in respect of initial exploration period, first extension period and second extension period respectively. The current charges are US$ 50, US$ 100 and US$ 200 per square kilometer in respect of

[233] Section 115(1) &(2) of the Petroleum Act. For purposes of this section-
(a) “production bonuses” means bonus payable on commencement of production; and
(b) "signature bonus" means a single non- recoverable lump sum payment by contractor to the Government upon signing of agreement or any other related agreement.

[234] IMF *Fiscal Regimes for Extractive Industries: Design and Implementation* (2012) 18. they can be set in legislation or negotiated, Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 42.

[235] It has been introduced by Model PSA 2013 and since then no PSA has been signed.

[236] Article 11 (c) Model PSA 2013.

[237] IMF Fiscal Regimes for Extractive Industries: Design and Implementation (2012) 18. Tordo Fiscal Systems for Hydrocarbons Design Issues (2007) 42.

[238] Section 65P of the Income Tax Act 2004.

[239] Tordo Fiscal Systems for Hydrocarbons Design Issues (2007) 42.

[240] Article 11 (a) MPSA 2013. Difference with royalties Section 3& 114(2)(a) Petroleum Act 2015; It includes the training and research fees (section 114(2)(b).

[241] Tordo Fiscal Systems for Hydrocarbons Design Issues (2007) 42.

initial exploration period, first extension period and second extension period respectively. In practice, the IOCs reimburse TPDC for any rental fees paid.

2.5.6 Local Government Taxes

Local Government authorities have autonomy in their geographical jurisdiction to impose taxes, levies, fees and charges.[242] These powers are exercisable through making by-laws prescribing those taxes or levies.[243] Currently, all companies, including those in the oil and gas industry, are supposed to pay to the local Government authorities in which they operate a 0.3 percent levy of their business turnover.[244]

2.5.7 Indirect Taxes

Several indirect taxes apply to the upstream oil and gas industry. As regards import duties, Tanzania, as a member of the East African Customs Union, uses three-tariff bands to charge import duty:[245] The zero percent rate applies to raw materials and capital goods, the 10 per cent rate applies to semi-finished goods and the 25 per cent rate applies to finished final consumer goods.[246] Given that a typical oil and gas project involves a bulk of materials and equipment, which are imported,[247] incentives are provided for the oil and gas industry. Currently, the East Africa Community Customs Management Act exempts from import duty all materials and equipment destined to oil and gas exploration and prospecting operations.[248]

[242] Section 18 of the Local Government Finances Act Cap 290 (R.E 2002).

[243] The power to make by law can be traced under article 97(5) of the Constitution of Tanzania which permits the parliament to delegate its legislative powers to other bodies or Government agencies.

[244] Local Government authorities are established under article 154 of the Constitution which delegates power to the authority to impose taxes under the Local Government Finances Act, Cap 290 (R.E 2002)(see sections 6,7&8) and the Urban Authorities (Rating) Act, CAP 289, R.E 2002.

[245]This is according to the Common External Tariff (CET) within the East African Community as provided for under the East African Community Customs Management Act, 2004 (Revised Edition 2009) section 110 and the Protocol on the Establishment of the East African Community Common Market signed in November 2009. No export taxes.

[246] Section 110 East African Community Customs Management Act, 2004 (Revised Edition 2009), article 12(1) of the Protocol of the Establishment of the East African Customs Union 2004.

[247] Tordo Fiscal Systems for Hydrocarbons Design Issues (2007) 41.

[248] Section 114 of the East African Community Customs Management Act, 2004 read together with item 30 of the Fifth Schedule to the Act (As amended by Legal Notice No. EAC/9/2009).

Every business entity that has a turnover of 100 million shillings is required to register for VAT.[249] Generally, VAT is charged on domestic and imported goods and services at the rate of 18 percent and 0 percent for all exports and those listed under the first schedule to VAT Act.[250] A VAT system is a credit invoice consumption tax implemented on a destination principle whereby a VAT registered trader pays VAT on taxable goods or services purchased (input tax) and charges VAT on taxable goods or services sold by her (output tax).[251] The registered trader then pays to the revenue authority an excess of output tax over input tax or recovers the excess input tax over output tax from TRA.[252] Since natural gas equipment and products are VAT exempt, licensed companies for oil and gas exploration, prospecting and production are entitled to a refund of any VAT paid as input tax.[253]

Excise duty is a specific tax designed to raise extra revenue, discourage consumption of some environmentally or socially detrimental goods and impose extra taxes on a selection of luxury goods.[254] Excise duty is charged on the ex-factory price or the import price. Oil and gas companies at the production stage are liable to excise duty of 0.45 shillings per cubic feet of natural gas produced.[255]

Similarly, stamp duty is charged for listed instruments, which are either executed in the Mainland Tanzanian or executed outside Mainland Tanzanian but related to any property, matter or thing to be done in Mainland Tanzania.[256] These documents relate to conveyances, leases, share issues and transfers, and debentures. Stamp duties are charged at an ad valorem rate of up to 1 percent of the total amount of the transaction.[257]

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[249] Section 19(1) of the Value Added Tax Act 2015.

[250] It was introduced by section 23 of the Finance Act 2009 (Act No. 14 of 2009) the previous under section 18 of Value Added Tax Act 1997 the rate was 20%.

[251] VAT is not a union tax; it means Zanzibar has its own VAT regime TRA

[252] This means that VAT is paid by the final consumer of taxable goods or services.

[253] Section 46 (b) of the Finance Act 2012 amends the Second Schedule to the Value Added Tax Act

[254] Ministry of Finance other taxes http://www.mof.go.tz/index.php?option=com_content&view=article&id=42:other-tra-taxes&Itemid=57

[255] Section 124(1) read together with the First Schedule to the Excise (Management and Tariffs) Act, Cap. 147 as amended by s.26 of the Finance Act 2014, Act No.6 of 2014. s. 15 of the FINANCE ACT 2016 (Act No.2 of 2016) amends the 4th schedule to the Excise (Management and Tarrif) Act Cap. 147 LNG and PNG Tshs 0. 45 per cubic feet.

[256] Stamp Duty Act, Cap. 189 (R.E 2002).

[257] Section 5 of the Stamp Duty Act, Cap. 189 (R.E 2002) read together with the First Schedule to the Act. However, the Model PSA imposes the stamp duty based on consideration of up to US$100 million – 1%; additional consideration up to US$200 million – 1.5% of the additional amount; and • additional

In addition, a skills and development levy is charged from every employer who has employed more than four employees and is set at the rate of 4.5% of the total gross monthly emoluments (wage bill).[258]The law requires that 2% to be remitted directly to the Vocational Education and Training Authority to enhance vocational skills to the workforce required by employers in Tanzania. [259]

2.5.8 Government Equity Participation

The Government, through the TPDC, can obtain participating interest in a license or contract or in joint venture.[260] In all partnership arrangements, TPDC is required to maintain a minimum of twenty-five percent participating interests.[261] However, the TPDC has authority to decide on a lesser or higher percentage.[262] The TPDC share of contract expenses may be paid directly or the Contractor may advance, by way of loan, up to 100 per cent of unpaid amount of TPDC's share of contract expenses.[263] Such a loan, which bears interest at the rate of London Interbank Offered Rate (LIBOR) plus one percent for the period it remains unpaid, is recoverable from TPDC's cost oil.[264] This means the Government avoids the requirement to make cash payments upfront, thus saving money for provision of social services, reducing risks and administrative complexities.[265] It is notable however, that TPDC must exercise this option within 30 days of discovery. It also means that TPDC may waive its right to acquire participating interests. Currently, TPDC has varying participating interests ranging between 10 and 50 percent in both cash calls and carried interest as indicated under Table 1.2.[266] This means

consideration in excess of US$200 million – 2% of the additional amount. See Article 27(h) Model PSA 2013.

[258] Section 14 (2) of the Vocational Education and Training Act, Cap 82 (R.E 2002) as amended by section 102 Finance Act 2016 (Act No.2 of 2016).

[259] Section 14 of the Vocational Education and Training Act, Cap 82 (R.E 2002).

[260] Section 218(1) of the Petroleum Act 2015.

[261] Section 44(5) of the Petroleum Act 2015.see Article 10 (b)(i) of MPSA 2013, participating interest means the proportion of production cost each party will bear and the proportion of production each party will receive.

[262] Section 44(5) of the Petroleum Act 2015.

[263] Article 10 (b)(i)&(ii) of the Model PSA.

[264] Article 10 (b)(iii) of the Model PSA.

[265] Khan "Petroleum Taxation and Contracts in the Third World-A Law and Policy Perspective" (1988) 85 Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 66-67.

[266] TPDC officials were not ready to disclose the actual participating interest TPDC has in the two PSAs at production and the one PSA at development stage.

the TPDC, in addition to its share as owner of the resource, is entitled to a share of profit oil obtained by the contractor on pro-rata basis.[267]

3 Tax Incentives

Investment in petroleum is arguably one of the riskiest ventures.[268] For this reason, it is the Government's policy to ensure that it attracts investments.[269] In addition, Tanzania faces stiff competition from its neighbour Mozambique that has more than thrice the natural gas deposit as compared to Tanzania .[270] In view of the need to mitigate these risks and create a competitive advantage, Tanzania offers several tax incentives. The next section discusses the different forms of tax incentives.

3.1 Types of Tax Incentives

Tax incentives granted in Tanzania take several forms. The first form is the accelerated cost recovery. While the exploration costs and the costs of the equipments are recovered based on their useful life or life cycle of the project, accelerated cost recovery is an exception to this rule.[271] Currently, Tanzania capital expenditure relating to oil and gas exploration and production are depreciated at the rate of 20 percent straight line.[272] This means that the investor is able to recover the costs within a period of five years.[273] Conversely, if conventional rules of accounting were applied, it would have taken fifteen to twenty years for the investor to recover such cost.[274] While accelerated depreciation

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[267] Article 12 (i) MPSA 2013

[268] Nakhle *Petroleum Taxation Sharing the Oil Wealth: A study of Petroleum Taxation Yesterday, Today and Tomorrow* (2008) 13, Johnston *International Petroleum Fiscal Systems and Production Sharing Contracts* (1994) 5.

[269] Walron et al Options for Developing Countries in Mineral Development (1986) 107.

[270] The proven reserves in Mozambique stands at 160 tcf compared to 57 tcf found in Tanzania. The Citizen Reporter *Dar, Maputo in battle for gas investors* Friday, August 5, 2016 Available at http://www.thecitizen.co.tz/News/1840340-3332254-k74jsrz/index.html (accessed 18 January 2017)

[271] Otto Mining Taxation in Developing Countries (2000) 13, Tordo Fiscal Systems for Hydrocarbons Design Issues (2007) 11.

[272] Class 4 " natural resource exploration and production rights and assets in respect of natural resource prospecting, exploration and development expenditure"

[273] The challenge with this rule is that it assumes that all the costs will be recovered with five years. The question is what happens if the costs are not recovered with five years?

[274] Otto Mining Taxation in Developing Countries (2000)13, Tordo Fiscal Systems for Hydrocarbons Design Issues (2007) 11.

has the potential to attract investments, for the Government it implies that the deductions are higher, thus low or no taxable income during this five-year period.[275] It means the payment of profit-based taxes is deferred until such time when the investor has recovered a substantial amount of exploration and production costs.

Second, investors in the oil and gas industry are exempted from import duty and VAT for equipment used in exploration of oil and gas.[276] There is also an avenue for investors to apply to the Minister of Finance for an exemption from stamp duty.[277] Although tax exemptions are meant to attract FDI and compensation for poor infrastructure, in practice these exemptions have the potential to erode the tax base. [278] It implies that the Government waives its right to collect the would-be-taxes. Moreover, it is argued that tax exemptions alone cannot be used to cover for poor investment climate.[279]

Third, the investor at production stage can apply to the Minister of Energy and Minerals for an exemption to pay royalties.[280] The Minister has powers, after advice by PURA followed by publication in the Gazette, to amend, vary or alter the rate of royalties payable.[281] The aim for this remission is to mitigate the negative impact of a downswing of prices to the IOCs because royalties are production-based and thus regressive. [282] However, the Petroleum Act does not specify the circumstances under which such exemption or waiver to pay royalties may be granted.[283] In addition, the Act is silent as whether the royalty so deferred is supposed to be paid at a future date.[284] These powers

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[275] See section 2.5.4 above. See also chapter 2 section 4.2.1.

[276] Section 33 of Finance Act 2011 amends paragraph 8 of the Third Schedule to Value Added Tax Act; East African Community Customs Management Act (2004) – 2009 Edition

[277] Section 16 of the Stamp Duty Act.

[278] Crc Sogema *Tanzania Per Tax Exemptions Study Final Report and Briefing Note* submitted to the Ministry of Finance of Tanzania (2013) 1 http://www.tzdpg.or.tz/fileadmin/documents/external/public_expenditure_review/Reports/PER_Tax_Exemptions_Study_Final_Report_and_Briefing_Note.pdf (accessed 11 November 2016).

[279] Crc Sogema *Tanzania Per Tax Exemptions Study Final Report and Briefing Note* (2013) 1.

[280] Section 113(4) of the Petroleum Act 2015.

[281] Section 113(4) of the Petroleum Act 2015.

[282] Otto Mining Taxation in Developing Countries (2000)3.

[283] Under normal circumstances it should specify issues like price fluctuation or marginal projects

[284] Section 113(4) of the Petroleum Act 2015.

are equivalent to powers to grant tax exemptions and in absence of restrictions; they may equally be abused.[285]

Fourth, certain fiscal elements, such as bonuses, production sharing, and Government equity participation are subject to negotiation.[286] The negotiability of these fiscal terms gives flexibility to the IOCs and it is thus possible to negotiate lower rates. While this negotiability of fiscal terms is advantageous to the IOCs, it creates loopholes for corruption and abuse of powers.[287]

Fifth, Tanzania provides a guarantee to investors that any change of legislation, which materially affects fiscal benefits afforded to the contractor, be negotiated, and parties agree to amend the contract as near as practicable to such benefits as existed under the original agreement.[288] In fact the PSA once signed becomes binding upon the Government of Tanzania and will not be affected by future legislation.[289] The fiscal incentives covered in the PSA will cease to have effect only when the time expires or the IOC decides to waive the right to benefit from such incentives.[290] Overall, the net effect of these stabilization clauses is to limit the legislative powers of parliament to amend or alter the fiscal terms pertaining to oil and gas projects under the PSA.[291] Hence, the Government's hands are tied and it cannot, even where market changes occur, effect any changes to the fiscal terms without mutual consent from the IOC.

Sixth, Tanzania has signed double tax agreements (DTAs) with nine countries namely Sweden, Canada, Denmark, Finland, Norway, India, Italy, Zambia and South Africa.[292] Since most of the treaties are old and signed in the 1960s, 1970s and 1980s, their relevance may have been overtaken by events.[293] In the same connection, Tanzania is

[285] Tax exemptions discussed Chapter 6 sections 6.1 and 6.2.

[286] Section 7 of the Petroleum Act.

[287] See Chapter 4 section 2.2.1.

[288] Referred as equilibrium clause Article 30 Model PSA 2004. See also Tordo *Fiscal Systems for Hydrocarbons Design Issues* (2007) 14. However, the Natural Wealth and Resources Contracts (Review and Re-negotiation of Unconscionable Terms) Act 2017 restricts the application of stability clauses.

[289] Section 143 of the Income Tax Act 2004

[290] Section 143(1)(a) (i)&(ii) of the Income Tax Act 2004.

[291] Tordo Fiscal Systems for Hydrocarbons Design Issues (2007) 14.

[292] Tanzania Revenue Authority "Double Taxation Agreements" http://www.tra.go.tz/index.php/double-taxation-agreements (accessed on 27 July 2017)

[293] Tanzania Tax Justice Coalition Double Taxation Agreements A Gain or Loss to Tanzania? (2016)12.

currently negotiating nine new DTAs with the Netherlands, Mauritius, United Kingdom, United Arab Emirates, Kuwait, Iran and China.[294] The terms of DTAs, which oblige Tanzania to exempt an income or a payment from tax or subject income or a payment to a reduced tax, prevail over the provisions of the Income Tax Act 2004.[295] The DTAs in Tanzania address the relief from double taxation, the prevention of fiscal evasion and the reciprocal administrative assistance in tax enforcement. [296]

However, the major challenge of DTAs is that they may create a window of opportunity for unqualified firms to enjoy benefits under the treaty.[297] In addition, some of the IOCs may abuse the terms of DTAs to avoid taxes. In view of these challenges, the benefits under DTAs are only applicable to an entity that qualifies, as per the terms of the agreement, resident of the other contracting State.[298] In addition, the 50 percent or more of the underlying ownership of the entity must be held by entities or individuals who are residents of the other contracting State. [299]

3.2 Process and Procedure for grant of Tax Incentives

In Tanzania, tax incentives are granted through three processes. First, tax incentuves may be granted at the time of signing the PSA and thus contained in the PSA as indicated under Table 1.2. These incentives will be effective once the PSA is registered in the Register of Tax Agreements.[300] The second one is an automatic process whereby the incentives are inbuilt in the tax laws or Petroleum Act. The law usually specifies the type of investments that qualify and sets up the form of tax incentives used. [301] It includes terms, such as import duty reduction, and reliefs from VAT. However, the tax incentives do not have an automatic application. It requires the qualifying IOCs to apply to Minister of Finance who determines whether the IOC qualifies for grant of such tax incentives.[302]

[294] Tanzania Tax Justice Coalition Double Taxation Agreements A Gain or Loss to Tanzania? (2016) 12.
[295] Section 128(1) &(4) of the Income Tax Act 2004.
[296] Section 128 (6)(a) &(b) of the Income Tax Act 2004.
[297] See Chapter 3 section 3.2.4.
[298] Section 128(5)(a) of the Income Tax Act 2004.
[299] Section 128(5)(a) of the Income Tax Act 2004.
[300] Section 143(2) &(3) of the Income Tax Act 2004.
[301] Zolt "Tax incentives: protecting the tax base" (2015) 470.
[302] Zolt "Tax incentives: protecting the tax base" 476.

This is arguably the best approach because it limits the use of discretionary powers by the Minister.

The third process relates to discretionary tax exemptions. The Minister of Energy and Minerals has powers to reduce the rate of royalties or waive the obligation to pay royalties.[303] Similarly, the Minister of Finance has powers to reduce, alter and waive an obligation to pay stamp duty,[304] excise duty[305] and income tax.[306] Likewise, before amendments, the Minister of Finance had powers to grant VAT and import duty exemptions.[307] It is also notable that the Minister responsible for local Government authorities has powers to exempt any person from taxes payable to local Government authorities.[308]

The trigger mechanism for this type of incentive is an application by the qualifying IOC to the respective Minister.[309] Upon receipt of the application, the respective Minister has discretion to accept or reject the application. If the application is accepted, then the Minister will cause the acceptance and grant of specific tax exemption to be published in the Government gazette.[310] The major challenge of the discretionary tax exemptions is that they lack transparency, thus create a window of opportunity for corrupt practices.[311] In addition, most of these incentives are open-ended and no criteria given, and thus susceptible to corruption.[312] Table 1.3 below summarizes the various types of tax exemptions granted through Government Notices.

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[303] Section 113(4) of the Petroleum Act 2015; James, S *Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications* (Washington, D.C, World Bank Group, 2013) 4.

[304] Section 16 of the Stamp Duty Act.

[305] Section 128 of the Excise (Management and Tariff) Act (Cap 147)

[306] Section 10 of the Income Tax Act 2004. Previously section 15 (1) of the Income Tax Act 1973

[307] Section 10 of repealed Valued Added Tax Act 1997 (abolished under the new Valued Added Tax Act 2014) and the section 7 of Customs Tariff Tax Act (now section 114 EAC Customs Management Act only the Council of Ministers can grant such exemption).

[308] Section 13(5) of the Local Government Finances Act 1982

[309] Usually through TRA or TPDC.

[310] Section 113(4) of the Petroleum Act 2015.

[311] James *Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications* (2013) 5.

[312] James *Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications* (2013) 4.

Table 1.3: Tax Exemptions granted through Government Notices

Year	GN No.	Type of Tax exempted	Extent of Exemption	Who is exempted	Goods/Services/Type of income exempted	Start time	End time
1998	9	Sales tax remission	Total remission	Investors in Petroleum and Gas Exploration	Machinery, equipment, materials, supplies and motor vehicle	20 June 97	End of exploration phase
1998	10	Customs tariff remission	Total remission	Investors in Petroleum and Gas Exploration	Machinery, equipment, materials, supplies and motor vehicle	20 June 97	End of exploration phase
1998	11	Excise tariff remission	Total remission	Investors in Petroleum and Gas Exploration	Machinery, equipment, materials, supplies and motor vehicle	20 June 97	End of exploration phase
2001	238	Skill and development levy	Total remission	Songosongo project-AES Tz Services Ltd,	Levy for expatriate employees during construction phase	01-Nov-01	End of construction phase
2001	239	Income tax	Total remission	Songosongo project - Songas Ltd	Withholding tax on dividends on first five years profits	01-Nov-01	Five years after the Commercial Operations Date
2001	241	Stamp duty	Total remission	Songosongo project - Songas Ltd	Transfer of gas turbines and issue of debenture with Commonwealth Development Corporation	01-Nov-01	Once off transaction
2001	243	Import duty	Total remission	Songosongo project - AES Tanzania Services Ltd, Ocelot International Tanzania Ltd, Pan African Energy Tanzania Ltd, Songas Ltd	Machinery, vehicles, pipes, materials equipment, spare parts, fuel, office supplies, other supplies for one year, once off fuel amount	01-Nov-01	End of construction phase
2001	244	Excise Duty	Total remission	Songosongo project - AES Tanzania Services Ltd, Ocelot International Tanzania Ltd, Pan African Energy Tanzania Ltd, Songas Ltd	Machinery, vehicles, pipes, materials equipment, spare parts, fuel, office supplies, other supplies for one year, once off fuel amount	01-Nov-01	End of construction phase
2001	245	Value Added Tax	Total remission	Songosongo project - AES Tanzania Services Ltd, Ocelot	All goods and services	01-Nov-01	End of construction phase

				International Tanzania Ltd, Pan African Energy Tanzania Ltd, Songas Ltd			
2001	246	Local Government taxes	Total remission	Songosongo Project	All property, transactions and products	01-Nov-01	No limit, unless change of use occurs
2010	335	Income tax	Total remission	Songas Ltd	Income earned by expat employees	20 Mar 2010	25 July 2010
2013	344	Excise Duty	Total remission	BG International	All fuel imported for use in oil and gas exploration	1 Jan 2013	31 December 2013
2013	345	Excise Duty	Total remission	BG International	All fuel imported for use in oil and gas exploration	1 Jan 2013	1 Jan 2013

Source: Compiled by the author from different Government Notices for the period between 1995 and 2016.

4 Tax Administration

Generally, the level of Government's revenue from the oil and gas industry depends on efficiency of the tax administration. Tax administration entails the system of assessment of tax payable, auditing tax returns and collecting taxes.[313] Tax administration ensures that tax laws are properly enforced and the compliance is guaranteed.[314] According to this view, an efficient tax system is the one that fights tax avoidance and limits opportunities for corruption or collusion by tax administrators and taxpayers.[315] For this reason, an efficient tax administration ensures the Government obtains its rightful share of the revenues from oil and gas extraction.

The upstream oil and gas fiscal regime in Tanzania involves a multiple tax and non-tax instruments.[316] The multiplicity of these fiscal and non-fiscal instruments implies that multiple Government agencies are involved in the assessment and collection of Government revenue. For one, the administration of generally applicable taxes involves a three-tier framework namely the union Government taxes, non-union taxes in Zanzibar

[313] Calder Administering Fiscal Regimes for Extractive Industries: A Handbook (2014) 17.
[314] Calder Administering Fiscal Regimes for Extractive Industries: A Handbook (2014) 17.
[315] African Development Bank *Oil and Gas in Africa* (2009) 112-13.
[316] See section 2.5 above.

and local Government taxes.[317] In that regard, the Tanzania Revenue Authority (TRA) is designated to assess, collect and account for all central (union) Government taxes,, such as corporate income tax, payroll taxes, withholding taxes, capital gains tax, value added tax (VAT), additional profit tax (APT), excise duties, stamp duties, custom duties, and skill and development levy.[318] In addition, TRA collects, on behalf of local Government authorities and remits to them, the local Government service levy.[319] As regards to non-union taxes and duties in Zanzibar, the Zanzibar Revenue Board (ZRB) is designated assesses and collects taxes, such as Value Added Tax (VAT), stamp duties, port service charges, trade licenses and property tax.[320]

In addition, the Ministry of Energy and Minerals assesses and collects different charges and rates payable under the Petroleum Act 2015, such as royalties, annual rental fees and signature and production bonuses.[321] Finally, the Tanzania Petroleum Development Corporation (TPDC), collects and remits to the Consolidated Fund, the Government's share of profit oil and Government's dividend from its participating interests in the oil and gas operations.[322] The next section discusses the procedures for assessment, collection and recovery of taxes.

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[317] Article of 4 of the Constitution of Tanzania 1977

[318] This study is limited to upstream sector, which involves exploration, development and production of oil and gas. The other sectors are midstream (marketing and distribution) and downstream (gathering, compression and processing) are beyond the scope of this study. Therefore, only taxes applicable to the upstream sector are covered. Section 2, 3&5(1) Tanzania Revenue Authority Act (Cap. 399), Revenue is defined to include all taxes under the laws set out in the First Schedule these laws include the Income Tax Act 2004, the East African Community Customs Management Act, Value Added Tax Act, Stamp Duties Act, Road Fuel Act and Land Act. Section 15 of the Tax Administration Act gives power to TRA to administer tax laws under the TRA Act. VAT is not a union tax.

[319] Local Government authorities are established under article 154 of the Constitution which delegates power to the authority to impose taxes under the Local Government Financial Act, Cap 290 (R.E 2002)(see sections 6,7&8) and the Urban Authorities (Rating) Act, CAP 289, R.E 2002. The Finance Act 2016 TRA collects service levy.

[320] Section 5(1) of the ZRB Act, the schedule lists downs seven types of taxes VAT, stamp duty, hotel levy, port charges, property tax, trade licenses and petroleum levy. operational since July 1998 Section 3 of Zanzibar Revenue Board Act 1996, Act No. 7 of 1996, (Revised Edition of 2013) see also http://www.zanrevenue.org/index.php/about-us/profile (04-04-2015)

[321] Section 84(1) Article 11 (a) MPSA 2013. Article 11 (c) Model PSA 2013, provides for payment to the Government a signature bonus at the rate 2,500,000 US Dollars and a production bonus at 5,000,000 US Dollars

[322] Article 135(1)&(2) of the Constitution of Tanzania 1977 and Section 11 of the Public Finance Act Cap. 348 (R.E 2002).

4.1 Procedure for assessment, collection, payment and recovery of taxes

In practice, tax administration involves the enforcement of tax laws to assess tax payable, auditing tax returns and collecting taxes.[323] It entails the procedures for assessing tax or royalty payable, the manner and place of payment taxes due, the recovery of taxes due and transmission of the taxes collected.[324] However, the fact that oil and gas taxation involves both tax and non-tax instruments, complicates tax administration.[325] For example, non-tax revenues, such as bonuses, rental fees and dividends are usually once-off payments, thus do not follow the tax assessment procedures.[326] Similarly, royalties and production sharing payments, though paid by installments, differ significantly from the procedures of tax payments.[327] Furthermore, non-tax instruments do not only fall out of the purview of the general tax legislation but also administered by institutions that are not ordinarily tax authorities.[328]

Despite these challenges, most of the non-tax instruments are easy to administer. This is because they either are once-off payments or based on productions, which are easily verifiable.[329] By contrast, profit-based taxes, such as corporate income tax and additional profit tax (APT) which depend on other several factors, such as revenues and costs.[330] What is more is that most of these transactions occur abroad and thus out of control of the tax authority in the host country.[331] For this reason, the following discussion is limited to tax instruments, such as corporate income tax, additional profit tax, VAT, withholding tax and capital gains tax.

[323] Calder *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014) 37.
[324] Calder Administering Fiscal Regimes for Extractive Industries: A Handbook (2014) 17.
[325] Calder Administering Fiscal Regimes for Extractive Industries: A Handbook (2014) 17.
[326] Calder Administering Fiscal Regimes for Extractive Industries: A Handbook (2014) 17.
[327] Calder Administering Fiscal Regimes for Extractive Industries: A Handbook (2014) 17.
[328] For example, royalties and rental fees are collected by the Ministry of Energy and Minerals. Similarly, Government share of profit oil, dividends from equity participation are collected by TPDC.
[329] Calder Administering Fiscal Regimes for Extractive Industries: A Handbook (2014) 17.
[330] Factors considered in the design of profit-based taxes.
[331] See Chapter 2 section 3.2.2.

4.1.1 Assessment of Tax

All resident taxpayers have an obligation to register with TRA and be issued with Taxpayers Identification Number (TIN).[332] Similarly, these resident taxpayers are obliged to register for VAT when they attain a threshold of 100 million shillings on sales.[333] The taxpayers are also obliged keep records of books of accounts according to international standards of accounting.[334] Properly kept records assist the Commissioner General to make an assessment or to be filed in support of a tax return.[335]

Generally, there are four modes of making a tax assessment. The first mode is self-assessment, where taxpayers file their tax returns indicating their tax liabilities.[336] The tax return must be accompanied with books of accounts, audited by an accredited accounting firm, containing income statement, cash flow and profit or loss account.[337] There are several risk factors at this stage, such as filing of incorrect or false documentation, under-declaring taxable income or the execution of a tax avoidance scheme.

The taxpayer is obliged to file returns within six months after the end of the year of income.[338] After receiving the returns, the Commissioner General for TRA may accept them or make adjustments.[339] If the Commissioner accepts the return, the tax assessment becomes final and the assessed taxes are due and payable.[340] Alternatively, if the Commissioner General is of the view that the self-assessment is incorrect or contains inadequate information, the Commissioner General may issue an adjusted assessment.[341] Before issuing an adjusted assessment, the Commissioner General may call for more

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[332] Section 22 of the Tax Administration Act 2015.

[333] Section 28 of the Value Added Tax Act 2014 and Regulation 11 of the Value Added Tax (General) Regulations 2015.

[334] The records are maintained for a minimum period of five years Section 35(1) (2) & (3) of the Tax Administration Act 2015.

[335] Section 35(1) of the Tax Administration Act 2015.

[336] Includes statements of income and profits. It is also referred to as the original assessment. Sections 46(1)-(2) and 37 of the Tax Administration Act 2015.

[337] Section 46(1)-(2) of the Tax Administration Act 2015.

[338] Section 91(1) of the Income Tax Act 2004.

[339] Section 46(1)-(2) of the Tax Administration Act 2015.

[340] Tax Administration Act 2015.

[341] Sections 48(2)(a-b) & 48(3) of the Tax Administration Act 2015.

information or conduct a special tax audit.[342] The purpose of audit is to verify volumes, prices, capital expenditures and operating expenditures.[343]

Moreover, in instances where the taxpayer fails to file a return within the prescribed time, the Commisssioner General has powers to use his best judgment, based on reasonably available information, to issue a jeopardy assessment.[344] The jeopardy assessment may also be issued because of special tax audit. [345] The jeopardy assessment implies that tax is payable or has become payable regardless of whether that person is obliged to file a return.[346] Furthermore, the Commissioner may also issue an *additional assessment* where taxes were short-levied because of incorrect information or an interpretation with which the Commissioner does not agree.[347]

When the Commissioner General has made a final decision on the tax payable, the taxpayer is served with the notice of assessment.[348] The notice of assessment indicates the name of the taxpayer and Taxpayer's Identification Number (TIN), the Commissioner's assessment of tax payable, reasons for the assessment, date taxes are due, and the procedure for objecting the assessment.[349] Issuance of notice of assessment triggers the payment process. The next section discusses the payment and recovery procedures.

4.1.2 Manner of Payment and Recovery of Tax

Immediately after the issuance of notice of assessment, tax becomes due and payable. Under normal circumstances, the taxpayers have an obligation to file a statement of estimated income at the beginning of every financial year.[350] Based on this estimated income, the taxpayer pays provisional taxes every three months referred to as advanced

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[342] Sections 41(1), 45(1)-(2) of the Tax Administration Act 2015; Gordon, RK "Law of Tax Administration and Procedure" in Thuronyi, V (ed), *Tax Law Design and Drafting* Vol. 1 (Washington DC, International Monetary Fund 1996). 105-106.

[343] Tordo S, Tracy BS, and Arfaa N *National Oil Companies and Value Creation* (Washington DC, World Bank, 2011).7-9.

[344] Section 40(3) (47(1) (a-b) of the Tax administration Act 2015.

[345] Section 45(1)-(2) of the Tax Administration Act 2015.

[346] Can only be done within five years sections 47(1)(a)&(b) (2)48(5) of the Tax Administration Act 2015.

[347] Section 48 (5) of the Tax Administration Act 2015.

[348] Section 49(1) of the Tax Administration Act 2015.

[349] Section 49(1)&(2) of the Tax Administration Act 2015.

[350] Section 46 (1) of the Tax Administration Act 2015.

payments. All payments of taxes and levies payable to the Government are required to be in international and freely convertible currency.[351]

The final tax return is filed within six months after the end of the financial year. At this stage, the tax payable is only the difference between the provisional taxes already paid and the final tax liability. Payment of tax is required to be made according to the time prescribe in specific tax laws or as indicated in the notice of assessment.[352] The taxes due are payable at any tax office or bank (cash or bank).[353] This creates a risk of diversion of tax revenues, such as creation of special accounts owned by tax administrators and issuance of forged receipts. For instance, corrupt Government officials may willfully fail to collect taxes due, short levy taxes, grant undeserving tax incentives to the IOCs or divert revenues collected for their own account.[354]

Where the taxpayer fails to make payment of taxes within the time limit prescribed by the notice of assessment or the specific tax law, such tax becomes a debt due to the Government and is recoverable in court of competent jurisdiction.[355] Similarly, payments and levies prescribed in the Petroleum Act are debts due to the Government and are recoverable in accordance with any other written laws.[356] The tax recovery measures include creating a charge over assets,[357] sale of charged assets,[358] and restraint of tax defaulters,[359] recovery from third parties,[360] and recovery from agents of non-residents.[361] All these measureas ensure that taxes due are collected.

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[351] Section 118 of the Petroleum Act 2015.
[352] Section 54 (i)(ii) of the Tax Administration Act 2015.
[353] Section 56 (1) of the Tax Administration Act 2015 (Act No. 10 of 2015).
[354] See Chapter 3 section 3.4.2
[355] Section 59 of the Tax Administration Act 2015.
[356] Section 120 of the Petroleum Act 2015. Such taxes are also recoverable through summary procedure under Order XXXV of Civil Procedure Code (Cap 33).
[357] Section 61 of the Tax Administration Act 2015.
[358] Section 62 of the Tax Administration Act 2015.
[359] Section 63 of the Tax Administration Act 2015.
[360] Section 65 of the Tax Administration Act 2015.
[361] Section 69 of the Tax Administration Act 2015.

4.1.3 Dispute Settlement Mechanisms

In instances where the taxpayer is aggrieved by the notice of assessment issued by the Commissioner General, the taxpayer may object that assessment.[362] The objection is filed with the Commissioner General. Starting at the departmental level has the advantage that certain anomalies and errors in the assessment can be rectified easily by the tax authority that issued the assessment.[363] However, it also creates windows of opportunity for corrupt practices. The response to objection may be that no tax is payable. How does or should the fiscal authorities guard against abuse of power? The response by TRA has been the separation of officials making assessments and officials dealing with objections.[364]

In the notice of objection, the taxpayer must indicate the grounds thereof.[365] In addition, the objection must be supported with the payment of taxes not in dispute or one third of the assessed tax, whichever is greater.[366] The requirement to make a tax deposit aims at preventing tax revenues to be tied up in litigation (which may be vexatious). [367] After receiving an objection, the Commissioner General may accept the grounds adduced by the taxpayer and amend the assessment accordingly or refuse to amend the assessment.[368] If the Commissioner accepts an objection, he serves a notice of final assessment to the objector.[369]

Where the Commissioner General refuses to amend the assessment in accordance with the objection, the objector is served with a notice of refusal to amend the assessment.[370] If the taxpayer responds, the Commissioner will consider the response and give a decision whether to amend the assessment or maintain the previous position. Then, the

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[362] Section 12(1) of the Tax Revenue Appeals Act Cap 408 R.E 2006; and section 51 (1) Tax Administration Act 2015.
[363] Gordon *Law of Tax Administration and Procedure* (1996) 105.
[364] Fjeldstad "Fighting Fiscal Corruption: Lessons from the Tanzania Revenue Authority" (2003) 169.
[365] Section 12(2) of the Tax Revenue Appeals Act (Cap 408 R.E 2006.)
[366] Section 12(3) of the Tax Revenue Appeals Act.
[367] Gordon *Law of Tax Administration and Procedure* (1996) 105.
[368] Section 13(1) of the Tax Revenue Appeals Act; Section 52(1) of the Tax Administration Act 2015.
[369] Section 13(2) of the Tax Revenue Appeals Act; Section 52(3) of the Tax Administration Act 2015.
[370] Section 13(3) of the Tax Revenue Appeals Act.

Commissioner serves the objector with a final assessment together with the notice of assessment.[371]

A taxpayer aggrieved by the notice of tax assessment issued by the Commissioner General (after refusing to accept an objection), may appeal to the Tax Revenue Appeals Board (TRAB).[372] The TRAB is a quasi-judicial body with jurisdiction to entertain all disputes of civil nature arising from the administration of all revenue laws by TRA.[373] The use of the Board avoids the backlog of cases in the conventional courts. The Board has its own rules of procedure. All appeals from the Board lie to the Tax Revenue Appeals Tribunal (TRAT).[374] Similarly, appeals from the decisions of the Tribunal on the point of law lie to the Court of Appeal of Tanzania.[375] At this stage, there are two corruption risks. First, who and how the decision to appeal incase where the TRAB rules in favour of the taxpayer is made. Second, there is a possibility of lawyers colluding with taxpayers to mishandle the case, such as deliberate failure to adduce strong evidence or call the right witnesses.[376]

4.2 Administrative Powers

Generally, the interpretation and enforcement of tax laws requires institutions with mandate to assess and collect taxes.[377] Tax administration ensures that tax laws are properly enforced and compliance is ensured.[378] To achieve these objectives, these institutions must be vested with powers to administer tax laws.

4.2.1 Powers of the Commissioner General and other Tax Officers

The law vests the Commissioner General with general powers to administer tax laws. These powers include the power to issue private or class rulings which set out the TRA's

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[371] Section 13(6) of the Tax Revenue Appeals Act Cap 408 R.E 2006;

[372] Other decisions that can be challenged include calculation of refunds, refusal to make any refunds s 14(1) Tax Revenue Appeals Act Cap 408 R.E 2006; Section 53(1) Tax Administration Act 2015.

[373] Section 7 of the Tax Revenue Appeals Act Cap 408 R.E 2006.

[374] Section 16(4) of the Tax Revenue Appeals Act Cap 408 R.E 2006.

[375] Section 25(1) of the Tax Revenue Appeals Act Cap 408 R.E 2006.

[376] See Chapter 3 section 3.4.2.

[377] Calder *Administering Fiscal Regimes for Extractive Industries: A Handbook* (2014) 37.

[378] Holland and Vinn "Income Tax Incentives for Investments" (1996) 988.

interpretation of tax law affecting a transaction or arrangement sought to be entered by a specified private taxpayer or a class of taxpayers.[379] The issued rulings, even when erroneous or wrong, are binding on the Commissioner.[380] There is the risk that private ruling may be in favour of certain taxpayers. This raises the question of the accountability of the exercise of the power to issue private tax rulings.

Furthermore, the Commissioner General has the discretion to make certain decisions affecting the interpretation of tax laws. The discretionary powers are incidental to the powers to administer tax laws generally. These powers enable the Commissioner (TRA) to act without interference or approval from other organs of the State, such as the Ministry of Finance.[381] For this reason, discretionary powers enable a quick and timely prevention of tax avoidance and tax evasion.[382] In this regard, the Commissioner General uses best judgment or takes actions, which are necessary for the assessment or collection of taxes. For example, the Commissioner General has powers to adjust tax assessments,[383] remit in whole or in part, penalties and interests,[384] and to refund of taxes paid in excess.[385] Furthermore, the Commissioner decides which taxpayer should be audited or investigated and when such audits should take place.[386] In addition, since the Commissioner has powers to decide all objections to the tax assessments, he has discretion to settle tax disputes amicably and decide the terms thereof.[387] Similarly, the Commissioner has discretion whether to litigate a tax dispute or settle it amicably. It is also notable that some of powers of the Commissioner General may be delegated to tax officers.[388]

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[379] Section 11(1) of the Tax administration Act 2015; Section 131(1) Income Tax Act 2004.

[380] However, the binding nature of the ruling depends on full disclosure of all material facts by the taxpayer and that the arrangement occurs as prescribed in the ruling. Section 11(2) & (4)(a) of the Tax administration Act 2015.

[381] OECD *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series* (2008) 15.

[382] OECD *Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series* (2008) 15.

[383] Section 46 (2) of the Tax administration Act 2015.

[384] Section 70 of the Tax administration Act 2015.

[385] Sections 71&72 of the Tax administration Act 2015.

[386] Section 45(1) of the Tax administration Act 2015.

[387] Sections 51 and 52 of the Tax administration Act 2015 and section 12 and 13 of the Tax Revenue Appeals Act.

[388] Section 16(1) of the Tax administration Act 2015.

The Commissioner may also compound the offences and order that taxpayer pay the money specified.[389] The compounding of an offence cannot be done unless the taxpayer admits in writing to the offences.[390] The law also permits the Commissioner to publicize the names of all tax offenders who failed to pay taxes, who are convicted of tax crimes and repeat offenders.[391] The publication should indicate their names and addresses, offence, time, amount involved or any fine or sentence meted.[392]

The vesting of these powers in the Commissioner can be viewed as necessary for administration of tax laws. In vesting some powers there is a presumption that in the exercise of such powers the Commissioner cannot change or negate the effect of the tax laws intended by the legislature.[393] However, this may not always be the case. For this reason, it is important for the law to provide for safeguards in the exercise of such powers.[394]

4.2.2 Powers of the Minister to Grant Tax or Royalties Exemptions

As discussed in the preceding chapters, in Tanzania the rate of royalties and taxes payable are fixed in the statutes, thus not subject to negotiations.[395] In spite of fixing the rates for royalties and taxes in the statutes, different laws permit the Minister to modify or vary the tax rates for specific taxpayers.[396] The major objective of these powers is to allow the Minister, where it seems to be in the interests of the nation, to alter or vary the tax rates, without necessarily going through the legislative process.[397]

The modification of tax laws takes different forms. First, the Petroleum Act 2015 delegates power to the Minister of Energy and Minerals, through an order published in

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[389] Section 92 (1) &16 of the (4) Tax Administration Act 2015.

[390] Section 92 (2) (a) of the Tax Administration Act 2015.

[391] Section 97 (1) of the Tax Administration Act 2015.

[392] Section 97 (1) of the Tax Administration Act 2015.

[393] Kitchen, R.C "Negative Lawmaking Delegations: Constitutional Structure and Delegations to the Executive of Discretionary Authority to Amend, Waive, and Cancel Statutory Text" (2012-2013) 40 *Hastings Constitutional Law Quarterly* 525 at 525-526.

[394] See Chapter 4 sections 3.1 and 3.5

[395] See section 2.5.1 and 2.5.4.1

[396] Section 114(3) of the East African Customs Management Act 2004; Section 16(1) of the Stamp Duty Act; Section 113(2) of the Petroleum Act 2015.

[397] Section 113(2) of the Petroleum Act 2015.

the Gazzette, to amend, alter or vary the rates of royalties.[398] Similarly, the Minister of Finance has the same discretionary powers under the Stamp Duty Act[399] and excise duty.[400] The effect of these discretionary powers is that the relevant Minister can reduce or vary the statutory tax rates. Thus, negating the effect of tax laws. [401] It also means that the relevant Minister has powers to to override an Act of Parliament or negate the effect of an Act of Parliament. This is referred to as negative delegated legislation.[402]

Similarly, the Minister of Finance has power to remit any interests or penalty imposed by any law. [403] This power is exercised after consultation with the Commissioner General of TRA and the amount remitted cannot exceed 50 percent of the interest payable by that person.[404] As the Warioba Commission reported, in some instances the Minister abused these discretionary powers.[405] The case of *Mramba & Yona v. R* provides another vivid example of the abuse of Ministerial powers to grant tax exemptions.[406]

The uncontrolled delegation of tax law making powers is problematic. For one, it weakens the rule of law as Minister varies laws enacted by the parliament.[407] Furthermore, defeats the intention of the legislature to impose taxes. It also creates free riders in the society, those who enjoy public services at the expense of honest taxpayers. It shifts the burden of financing the Government to a section of taxpayers contrary to principle of equity in taxation, which requires that taxpayers in the same position should be treated equally.[408]

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[398] Section 113 (4) of the Petroleum Act.

[399] Section 16 of the Stamp Duty Act, Cap. 189 R.E 2006.

[400] Section 128 of the Excise (Management and Tariff) Act (Cap 147)

[401] See Chapter 6 section 6.1

[402] See Chapter 6 section 6.1

[403] Section 125(1) of the Income Tax Act 2004.

[404] Section 70(1) of the Tax Administration Act 2015.

[405] Warioba Commission Report (1996) 78-79, 307.

[406] High Court of Tanzania, Consolidated Criminal Appeals Nos 96 & 113 of 2015 (unreported).

[407] See Chapter 6 section 6.1.

[408] Otusanya, OJ Arowomole SSA and. Adeyeye, GB "An examination of tax leakages in Government tax revenues: the case of Nigeria" (2013) 4 (1) *International Journal Economics and Accounting*. 93–122 at 95.

4.3 Managing Taxpayer's Non-compliance

Taxpayers have an obligation to file tax returns timely, reporting a correct tax liability and timely payment of taxes due. Failure to discharge these obligations means that taxpayers unnecessarily withhold Government's revenue. For example, late payment of taxes implies un-authorized borrowing of Government money.[409] To discourage this type of conduct and to ensure compliance, all deviations from tax laws, such as late payment, under-reporting of tax obligations or failure to file returns, are sanctioned by imposition of penalties and fines.[410]

These sanctions take different forms. For one, they involve the imposition of administrative penalties, as opposed to criminal penalties. There are penalties for the failure to file returns within the prescribed time limit,[411] failure to produce documents,[412] filing misleading or false statements,[413] aiding or abetting tax evasion,[414] and failure to pay royalties.[415]. These penalties aim at deterring non-compliant taxpayers as well as ensuring compliance. [416]

It also involves criminalization of certain conducts. There are offences, such as the failure to pay taxes, [417] using or making false and misleading statements, [418] impeding tax

[409] Gordon "Law of Tax Administration and Procedure" (1996) 105.

[410] Sections 75 -80 of the Tax Administration Act 2015.

[411] 2.5% of the amount of tax assessable.see section 78 of the Tax Administration Act 2015.

[412] 10 currency points section 77(2) Tax Administration Act 2015.

[413] Section 79 of the Tax Administration Act 2015, without reasonable excuse 50% of the shortfall and where it is intentional or reckless 75% 77(2) (a)&(b) .

[414] Penalty is 100% of the tax shortfall Section 80 Tax Administration Act 2015.

[415] Leads to prohibition the removal or dealing with petroleum until payment has been made. Section 113(3) Petroleum Act 2015.

[416] Gordon "Law of Tax Administration and Procedure" (1996) 117-130.

[417] Attracts a fine (if the tax exceeds 50 currency points) , of not less than half the amount and not more than 100 currency points or imprisonment not less than 3 months not more than 6. Section 83 of the Tax Administration Act 2015.

[418] If undetected leading to underpayment of tax, attracts a penalty of less than 50 currency points and not more than 200 currency points, 1 year or 2 years or both Section 84 (3) (a-b) of the Tax Administration Act 2015. See also Section 234 (b) of the Petroleum Act 20m or 5years or both.

administration,[419] and evading tax or recovering tax.[420] The general rule is that where an offence is committed by a body corporate, unless where there is proof that there was a degree of care or due diligence had been exercised, the manager is deemed to have committed that offence.[421] Similarly, it involves imposition of interests for understating the tax payable[422] and the late payment of taxes assessed.[423] The imposition of interests is aimed at discouraging taxpayers from withholding Government money unnecessarily. For this reason, interest rate is usually higher than the lending rates in the market. The imposition of high interest rates on unpaid taxes acts as a deterrent factor.[424]

4.4 Transmission and Transfer of Revenues Collected

Before the enactment of the Oil and Gas Revenue Management Act 2015, oil and gas revenues were handled like any other Government revenue and receipts.[425] However, the Oil and Gas Revenue Management Act 2015 establishes the Oil and Gas Fund.[426] The Fund aims at ensuring transparency and accountability in the collection, allocation and spending of oil and gas revenues. [427] It also aims to ensure the revenues are applied for sustainable development of the oil and gas industry and for the benefit of the present and future generations.[428] The Fund is divided into the Revenue Holding Account and the Revenue Saving Account.[429] The revenue streams flowing into the Revenue Holding

[419] Includes conducts such fraud or undue force whose penalty is equal to twice the amount sought to be evaded or recovered or 200 currency points whichever is greater or 2 years or 4 years or both Section 85(2)(a) of the Tax Administration Act 2015.

[420] Dealing with documents or assets that have information or measurements, which are false, misleading in material particular, refusal to produce documents uses, keeps or provides any false or unjust scale weighing or measuring instruments. Section 85 (3) (c), (g) & (l) Tax Administration Act 2015.

[421] Section 88(1) of the Tax Administration Act 2015. See also section 236 (1) of the Petroleum Act 2015.

[422]Statutory interest rate for all the time it remains unpaid sections 75 and 76(1) of the Tax Administration Act 2015.

[423] Instalment payer shall be liable to interest for every month at compound interests at 8% of the tax that would have been payable sections 75(1)&(4) and 76 of the Tax Administration Act 2015.

[424] Gordon, RK "Law of Tax Administration and Procedure" (1996) 110.

[425] All revenues and other moneys, raised or received for the purpose of the Government, must be paid into a single all-in-one account, namely the "Consolidated Fund" article 135(1)&(2) of the Constitution, Section 11, Public Finance Act Cap. 348 (R.E 2002).

[426] Section 8(1) of the Oil and Gas Revenue Management Act 2015.

[427] Section 251(a)&(b) of the Petroleum Act 2015.

[428] Section 251(b) of the Petroleum Act 2015; Tsalik, S *Caspian Oil Windfalls: Who Will Benefit?* (Caspian Revenue Watch, 2003) 1-2; Daniel *Petroleum Revenue Management An Overview* (2002) 34.

[429] Section 8(2) of the Oil and Gas Revenue Management Act 2015 (Act No 22 of 2015.)

Account include royalties, Government profit share, taxes, dividends from NOC for Government's equity interests, signature bonus, training fees, rental fees and any other revenue that may be specified by the Minister.[430]

TPDC retains all the surface rentals, signature bonuses and training fees (under supervision by Treasury Registrar).[431] The Act requires all the collection, deposit and disbursement of oil and gas revenues into the Fund to be done in a transparent and accountable way.[432] The records of oil and gas revenues and expenditure must be published by the Minister in the Gazette.[433] Public information must also be published online on the website of the Government and Ministry of finance.[434] The records of revenue and expenditure are subject to parliamentary scrutiny.[435]

5 Conclusion

This chapter evaluated the Tanzania oil and gas fiscal regime applicable to the upstream sector. The discussions demonstrate that the Tanzanian fiscal regime is line with the elements of PSA.[436] The fiscal instruments include royalties, profit-based taxes, production sharing arrangement, Government equity participation as well as the indirect taxes. The chapter also discussed the tax administration system as well as the tax incentives. The elements of tax administration highlighted include grant of rights, negotiation of fiscal terms, enforcement and revenue collection. The discussions in this chapter have also raised a number of issues in relation to tax revenue leakage. Several gaps exist in the Tanzania tax system that may permit leakage of tax revenues. The next chapter discusses, in line with remedial measure identified under chapter 4, the different mechanisms adopted by the Government of Tanzania to counteract tax revenue leakage.

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[430] Section 3&9 of the he Oil and Gas Revenue Management Act 2015.

[431] Section 17(1)(e)(ii) of the Oil and Gas Revenue Management Act 2015.

[432] Section 18(1)&(2)& (3) The Oil and Gas Revenue Management Act 2015 the rules of Public Finance apply and the Powers of the Governor, Minister or officials are accordingly regulated.

[433] Section 18(4) of the Oil and Gas Revenue Management Act 2015.

[434] Section 18(5) of the Oil and Gas Revenue Management Act 2015.

[435] Section 18(6) of the Oil and Gas Revenue Management Act 2015.

[436] See Chapeter 2, Section 5.

CHAPTER SIX: CRITICAL EVALUATION AND ANALYSIS OF MECHANISMS ADDRESSING TAX REVENUE LEAKAGE IN TANZANIA

1 Introduction

The previous chapter highlighted how Government revenue is created from the oil and gas industry in Tanzania. In doing so, the chapter has also identified the potential risks for leakage of tax revenues, such as tax evasion, tax incentives, tax avoidance and fiscal corruption. As discussed in Chapter 4, there are certain factors, such as discretionary powers and lack of oversight mechanisms that open the window of opportunity for corrupt practices.[1] In the same vein, the low probability for detection, lenient punishment and potential benefits from corrupt transactions entice Government officials to engage in corrupt practices.[2]

Moreover, the existence of loopholes and gaps in the tax system facilitates tax avoidance and tax evasion.[3] Furthermore, the knowledge gap between the International Oil Companies and the Government officials makes it easy for the IOCs to evade or avoid taxes without being detected or punished.[4] In view of these factors facilitating tax revenue leakage, chapter 4 developed the remedial measures to include anti-corruption measures that close the windows of opportunity for corrupt practices and remove incentives for corruption.[5] The other remedial measure entails anti-tax avoidance legislation that closes gaps and loopholes in the tax system, criminalizes tax evasion and enhances administrative capacity to detect, prevent and punish tax avoidance and tax evasion.[6] This chapter applies the remedial measures developed under Chapter 4 as a benchmark to

[1] See Chapter 4 Section 2.2.1.
[2] See Chapter 4 Sections 2.1 and 2.2.4.
[3] See Chapter 4 Section 2.2.2.
[4] See Chapter 4 Section 2.2.3.
[5] See Chapter 4 Section 3.
[6] See Chapter 4 Section 3.

examine and evaluate measures adopted by the Government of Tanzania to address and remedy tax revenue leakage. The next section examines the anti-corruption regime.

2 Anti-corruption Regime

In Tanzania, like any other developing country, corruption is not a new phenomenon.[7] This is not surprising because corruption itself is as old as human civilization.[8] The first anti-corruption regime in Tanzania was instilled during the British colonial rule in 1930.[9] This structure was retained, with minor modifications, by the independent Government in 1961.[10] Since its independence from the British colonial rule, Tanzania has had several anti-corruption measures. These measures include the enactment of the anti-corruption laws as well as establishment of the anti-corruption agency.[11] Despite these initiatives, corruption continues to strive in the country.[12]

In order to contain rampant corruption in the public sector, the Government of Tanzania formed a Presidential Commission of inquiry into corruption matters in 1996 ("Warioba Commission").[13] The Warioba Commission was tasked to identify the typologies, causes and sources of corruption and suggest the corresponding remedial measures.[14] In its report, the Commission demonstrated how public servants and political leaders solicited and accepted bribes, received presents and commissions for brokering deals between the Government and their allies.[15] The report further revealed that tax assessors solicited and accepted bribes during tax assessments, while officials in the Ministry of Finance granted

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[7] For example, the corruption perception index ranks Tanzania as number 116 out of the 176 countries in terms of perceived corrupt practices. See Corruption perception index 2016 available at www.transparency.org (accessed on 10 March 2017)

[8] Tanzi, V *Corruption around the World: Causes, Consequences, Scope, and Cures* (Washington International Monetary Fund 1998) 559.

[9] Prevention of Corruption Ordinance 1930 and amended in 1958. See http://www.pccb.go.tz/index.php/about-pccb/historical-background (accessed on 20 February 2017)

[10] PCCB "Historical background" (2017).

[11] See PCCB "Historical background" available at http://www.pccb.go.tz/index.php/about-pccb/historical-background

[12] See Corruption perception index 2016.

[13] The United Republic of Tanzania *the Presidential Commission of Inquiry against Corruption* (referred to as the Warioba Commission) Report (1996) 78-79.

[14] Warioba Commission Report (1996) 2-4.

[15] Warioba Commission Report (1996) 78-79.

tax exemptions illegally and helped taxpayers to evade taxes.[16] Similarly, the officials at the Ministry of Energy and Minerals accepted bribes before granting mineral rights or they underestimated the value of mineral exports.[17] The report further revealed that the corrupt officials in the office of the Attorney General signed contracts against the national interests or gave legal opinion in favour of those giving bribes.[18]

As regards to the causes of corruption, the Commission reported that pervasive corruption thrived in the country due unchecked discretionary powers, low probability for detection and lenient punishment for corrupt practices.[19] To address corruption, the Warioba Commission recommended the enhancement of checks on the exercise of public powers, criminalization of all corrupt practices as well as the enhancement of the institutions for prevention, detection and punishment of corrupt practices.[20] These recommendations culminated into the establishment of a Ministry of State for Good Governance in 1997, adoption of the National Anti-Corruption Strategy and Action Plan (NACSAP) in 1999 and later the enactment of the Prevention of Combating of Corruption Act in 2007.[21] One of the notable features of the Act is that it increased the number of offences from 5 to 25.[22] It also noteworthy that Tanzania has signed and ratified the UN Convention against Corruption,[23] the AU Convention on Preventing and Combating Corruption[24] and the SADC Protocol against Corruption.[25] The next section examines how the anti-corruption measures, as suggested by the Warioba Commission, apply to the oil and gas industry.

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[16] Warioba Commission Report (1996) 78-79. 57, 307.

[17] Warioba Commission Report (1996) 2, 50, 55.

[18] Warioba Commission Report (1996) 2, 50.

[19] Warioba Commission Report (1996) 137.

[20] Warioba Commission Report (1996) 137.

[21] PCCB "Historical background" available at http://www.pccb.go.tz/index.php/about-pccb/historical-background. See also Law Reform Commission of Tanzania *Report on the Review of Legislation Relating to Corruption* (Ministry of Justice and Constitutional Affairs 2004) 17-20

[22] The Prevention of Corruption Act 1971 had only four offences under sections 4, 6, 7, 8 and 10. By contrast the Prevention and Combating of Corruption Act 2007 has 25 offences from section 15 to 39.

[23] 9 December 2003 and 25 May 2005 see https://www.unodc.org/unodc/en/treaties/CAC/signatories.html

[24] 5 November 2003 ratified 22 February 2005

[25] 14 August 2001 20 August 2013

2.1 Criminalizing and Sanctioning Corrupt Practices

The Prevention and Combating of Corruption Act is general anti-corruption framework law.[26] The Act aims at enhancing and promoting good governance and eliminating corruption. In doing so, the Act criminalizes corrupt transactions, such as soliciting, accepting or attempting to obtain any advantage as an inducement to discharge public duty.[27] Similarly, a person who gives, or promises to give any advantage to a public official is liable for the offence of involvement in corrupt transaction.[28] In addition, the Act makes it an offence for public officials to live above the lawful income or to own properties that are disproportionate to lawful income.[29] In this regard, public servants are obliged to declare their status of wealth and debts every year.[30]

There other laws, in addition to the Prevention and Combating of Corruption Act, such as the Public Leadership Code of Ethics Act imposes an obligation on public leaders to act with honesty, sobriety and uphold highest possible ethical standards.[31] In doing so, the Public Leadership Code of Ethics Act criminalizes misuse of public power for personal gains, misappropriation of public funds and negligence in discharge of public duties.[32] Likewise, the Public Procurement Act criminalizes bribery. [33]

Furthermore, the Tax Administration Act 2015 makes it an offence for tax officers to ask for or take any payment in order to facilitate any act or thing that is meant to defraud the Government of any tax related benefit or payment of tax.[34] This offence attracts a fine or imprisonment of not less than 1 year or 5 years or both.[35] Likewise, the Petroleum Act 2015 makes it an offence for all public officers in charge of the oil and gas industry to

[26] Chapter 329 of the Laws of Tanzania (Revised Edition 2002); Preceded by the Prevention of Corruption Act (PCA) Cap 329 (RE 2002

[27] Section 15(1) (a) of the Prevention and Combating of Corruption Act.

[28] Section 15(1)(b) of the Prevention and Combating of Corruption Act.

[29] Section 27(1)(a)&(b) of the Prevention and Combating of Corruption Act.

[30] Section 27(1)(a)&(b) of the Prevention and Combating of Corruption Act.

[31] Section 6(a), Under section 4 of the Public Leadership Code of Ethics Act (Cap 398), public leaders include the Commissioners for tax at the Tanzania Revenue Authority, Ministers, Directors of parastatals such as TPDC.

[32] Section 6(i)-(f) of the Public Leadership Code of Ethics Act (Cap 398).

[33] Section 83 of the Public Procurement Act 2011.

[34] Section 87(1) (a)&(b) of the Tax Administration Act 2015 200 currency points.

[35] Section 87(3) of the Tax Administration Act 2015.

acquire an interest in a license for petroleum operations.[36] It also prohibits acquiring economic interest, participating interests or shares in any entity carrying on operations in Tanzania or economic interests or participating interest in a body corporate that provide goods or services to a license holder.[37] These offences are punishable by a fine of 50 million shillings or 5 years imprisonment or both.[38] In addition, there is a duty on the IOC to adopt, according to the Prevention and Combating of Corruption Act, anti-bribery and anti-corruption policies and measures in its corporate organization.[39] These measures include prohibition of payments, gifts, promises or advantage to any public official, political parties and candidates for office.[40]

The Prevention and Combating of Corruption Bureau (PCCB), as its name suggest, is the lead institution in the prevention and combating of corruption in Tanzania.[41] The major function of the PCCB is to prevent and combat corruption in public sector.[42] In doing so, PCCB has power to investigate, and subject to approval from the Director of Public Prosecution (DPP), prosecute corruption-related offences.[43] In the discharge of its functions, PCCB has powers to request public officials to give account of their public property.[44]

Moreover, the Public Leadership Code of Ethics Act establishes the Ethics Secretariat.[45] The Secretariat has three duties namely receiving and verifying declarations made by public leaders, receiving complaints from the public regarding breach of the Code and making inquiries into suspected breach of the Code.[46] Another notable development is the establishment of the Corruption and Economic Crimes Division of the High Court

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[36] Section 249 of the Petroleum Act 2015.

[37] Section 249(1)(a)&(b) of the Petroleum Act 2015.

[38] Section 249(2) of the Petroleum Act 2015.

[39] Article 34 Model PSA 2013. See also section 23 of the Petroleum Act 2015.

[40] Article 34 Model PSA 2013.

[41] Cap 329 of the Laws of Tanzania (R.E 2002); Preceded by the Prevention of Corruption Bureau established in 1991

[42] Section 7 of the Prevention and Combating of Corruption Act.

[43] Section 7(e) of the Prevention and Combating of Corruption Act

[44] Section 26(1) of the Prevention and Combating of Corruption Act

[45] Section 18 of the Public Leadership Code of Ethics Act.

[46] Article 132 of the Constitution of the United Republic of Tanzania 1977 and section 18 (2) Public Leadership Code of Ethics Act

which is a clear indication of Government's seriousness to deal with corruption.[47] This special division has jurisdiction over corruption and economic offences where the value of money involved is more than one billion shillings.[48] The offences covered include misappropriation of the proceeds of the 'Oil and Gas Fund',[49] refusal to produce documents or providing false information to PURA or the Tanzania Extractive Industries (Transparency and Accountability) Committee.[50] It is expected that the court will be able to dispose of grand corruption cases expeditiously.[51]

2.2 Transparency

Generally, corruption thrives where secrecy is formalized in the conduct of public affairs.[52] Secrecy or opacity makes it easy for unscrupulous officials to engage in corrupt practices without being detected or punished.[53] For this reason, one of the measures to prevent and alleviate corruption is to enhance transparency in public sector. Transparency has the potential to limit abuse of power and corrupt practices as it empowers citizens to hold their Government to account and monitor the conduct of IOCs to ensure compliance with the law.[54] Transparency also enhances the right to access to information.[55] In this regard, the Tanzania Extractive Industries (Transparency and Accountability) Act 2015 deals with transparency in the extractive industry.[56]

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[47] Section 3 of the Economic and Organised Crime Control Act, (Cap. 200) as amended by s 6 of the Written Laws (Miscellaneous Amendment) Act, 2016 No.6

[48] Section 3(a)&(b)3(3) of the Economic and Organised Crime Control Act.

[49] Section 21 of the Oil and Gas Revenues Management Act, 2015 (Act No. 22 of 2015) together with the First Schedule to the Economic and Organised Crime Control Act.

[50] Sections 239 and 240 of the Petroleum Act; section 23 & 24. of the Tanzania Extractive Industries (Transparency and Accountability) Act 2015 read together with the First Schedule to the Economic and Organised Crime Control Act.

[51] Objectives of establishing the special division of the court.

[52] See Chapter 4 section 2.2.1.

[53] See Chapter 4 section 2.2.1.

[54] Veit, PG. and Excell, C "Access to Information and Transparency Provisions in Petroleum Laws in Africa: A Comparative Analysis" in Grant, JA, Nadège Compaoré, W.R., and Mitchell, M. I. (ed) *New Approaches to the Governance of Natural Resources: Insights from Africa* (New York, Palgrave Macmillan 2015) 86.

[55] UDHR article 19, African Charter article 9 and The Declaration of Principles on Freedom of Expression in Africa (Article IV[1]).

[56] Act No. 16 of 2015.

In addition, there is general obligation to ensure that all regulatory and taxation functions in the oil and gas industry are conducted in a transparent and accountable manner.[57] This obligation applies also to the Minister of Energy and Minerals who has a duty to ensure the sustainability of transparency in the industry.[58] Moreover, the Petroleum Act 2015 requires that the process of entering into PSAs must be transparent and through a competitive tendering process.[59] The invitations for tender must be published widely in Newspapers of wide circulation.[60] Similarly, the grant of tax incentives must be publicized in the Government gazette.[61]

In addition, it imposes a duty on the Government to collect, maintain and disseminate information.[62] A similar duty is imposed on IOCs to keep records and where necessary transmit the same to the Government.[63] In this regard, PURA is obliged to establish and maintain a registry of all oil and gas agreements, licenses, permit authorization and their respective change in interests.[64] The registry is required to contain updated records pertaining to the PSA, such as status of applications for grant of rights, tax exemptions and incentives, transfers of rights, beneficial owners, work program and financial commitments.[65]

In addition, it sets up the mechanisms for disclosure and dissemination of information. Specifically, under the Tanzania Extractive Industries (Transparency and Accountability) Act 2015, all agreements, including PSAs signed in the past, are required to be disclosed.[66] The first form of disclosure entails the publication, by the Minister, on

[57] Section 5(1)(f)) of the Petroleum Act 2015.

[58] Section 5(1)(f)) of the Petroleum Act 2015.

[59] Sections 48(1), 84 & 91; This information includes details of all agreements, licenses and permits in their current form, exemptions, variations or suspension of conditions of license, the assignment and approved arrangement in respect of a license and permits. Section 91 (1)(a) (b)&(c) (d) Section 48(1), the Minister is required to make Regulations providing for guidelines on the conduct of the tendering process section.48(4).

[60] Section 48(2) of the Petroleum Act 2015.

[61] Section 16 of the Stamp Duty Act, section 113(4) of the Petroleum Act 2015, section 128 of the Excise (Management and Tariff) Act (Cap 147) and section 10 of the Income Tax Act

[62] Sections 16(a) and 27(1) of he Tanzania Extractive Industries (Transparency and Accountability) Act, 2015.

[63] Section 89 of the Petroleum Act 2015.

[64] Section 84(1) of the Petroleum Act 2015.

[65] Section 84(2) and 91(1)(a)(b)&(c) of the Petroleum Act 2015.

[66] Section 27(1) of he Tanzania Extractive Industries (Transparency and Accountability) Act, 2015.

website or wide circulating media, all concessions, contracts and licenses relating to extractive industry companies.[67] It may also contain information about individual names and shareholders who own interests in the extractive industry companies.[68] The other form of disclosure entails information that is kept confidential but can be accessed by the citizens upon an application and payment of prescribed fees.[69] Similarly, the Oil and Gas Fund, requires that all the records of oil and gas revenues (collection, deposit and disbursement of oil and gas revenues)[70] must be published simultaneously in the Government gazette[71] as well as on the website of the Government and Ministry of finance.[72] The publication of the revenues accruing to the Government from the extraction of oil and gas resources, limits opportunities for corruption or collusion by tax administrators and the oil companies.[73] Publication also makes it easier for the public to demand sustainable management and fair distribution of the revenues.[74]

Moreover, the law establishes the Tanzania Extractive Industries (Transparency and Accountability) Committee (TEITI).[75] The major function of the Committee is to investigate, reconcile and publish of all tax payments made by the IOCs and the corresponding revenue receipts by Government entities.[76] The TEITI Committee is obliged to publish the independent reconciler report.[77] The TEITI Committee has an obligation to liase with the Minister of Energy and Minerals to ensure the publication, in

[67] Section 16(a) of the Tanzania Extractive Industries (Transparency and Accountability) Act, 2015.

[68] Section 16(b) of the Tanzania Extractive Industries (Transparency and Accountability) Act, 2015 However, information about beneficial ownership of IOCs (name, year of incorporation, directors) can be accessed freely at the registrar of companies (Business Registration and Licensing Authority BRELA

[69] Section 91 (1) (2) of the Petroleum Act 2015.

[70] Section 18(1),(2)&(3) of the Oil and Gas Revenues Management the rules of Public Finance apply and the Powers of the Governor, Minister or officials are accordingly regulated.

[71] section 18(4) of the Oil and Gas Revenues Management Act, 2015.

[72] Section 18(5) of the Oil and Gas Revenues Management Act.

[73] African Development Bank *Oil and Gas in Africa* (2009) 112-13.

[74] African Development Bank *Oil and Gas in Africa* (2009) 112-13.

[75] Section 4(1) of the Tanzania Extractive Industries (Transparency and Accountability) Act, 2015.

[76] Section 10(2) (e) (f) (h) of The Tanzania Extractive Industries (Transparency and Accountability) Act, 2015.

[77] Section 16(d) and 17(5) of the Tanzania Extractive Industries (Transparency and Accountability) Act, 2015.

a website or media with the widest circulation, all PSAs as well as the beneficial ownership of all extractive companies.[78]

It is also notable that the Act classifies certain information as confidential, which can only be accessed after mutual consent; there is no criteria for such exclusion.[79] The only exception is when the TEITI Committee decides that certain information, which is confidential, should not be disclosed.[80] Furthermore, the Whistleblower and Witness Protection Act 2015 obliges the Government to protect whistleblowers and witnesses who disclose information for public good.[81] In addition, the Act requires the State to investigate and take measures to remedy any wrongdoing that has been reported.[82] The Act creates a mechanism where good citizens may report any wrongdoing in the public sectors. The issues covered include where any public official has broken the law or likely to break the law[83] or where in a public institution there is misappropriation, squander of public resource or abuse of office.[84] Such disclosure may be made in orally, in writing or sign language.[85] This enhances transparency and accountability.

2.3 Oversight Mechanisms

As discussed in Chapter 5, the fiscal regime establishes institutions mandated to deal with granting of licenses, participation in the industry, regulating the industry, and revenue collection and management. In the discharge of their functions, officials in these institutions have wide powers, such as granting extraction rights, negotiating PSAs, granting tax exemptions or waiving the payment of royalties, assessing and collecting taxes, remitting of penalties and interests.[86] Moreover, these Government officials are obliged to enhance public scrutiny,[87] make decisions according to the law, in the interests

[78] Section 16(1)(a)&(b) of the Tanzania Extractive Industries (Transparency and Accountability) Act, 2015.
[79] Section 27(1) of the Tanzania Extractive Industries (Transparency and Accountability) Act, 2015
[80] Section 27(2) of the Tanzania Extractive Industries (Transparency and Accountability) Act, 2015.
[81] Section 9 of the Whistleblower and Witness Protection Act, 2015.
[82] Section 8 of the Whistleblower and Witness Protection Act, 2015.
[83] Section 4(1)(b) of the Whistleblower and Witness Protection Act, 2015.
[84] Section (1)(d) of the Whistleblower and Witness Protection Act, 2015.
[85] Section 5(1) of the Whistleblower and Witness Protection Act, 2015.
[86] See Chapter 5 sections 2.2 and 4.2.
[87] Section 6(b) of the Public Leadership Code of Ethics Act (Chapter 398 Revised Edition 2002).

of the public.[88] However, there is no guarantee that these officials will adhere to the law. In fact, there are several instances where Government officials have deviated from the law.[89] For instance, the Warioba Commission indicated that there was abuse of ministerial powers to grant tax exemptions.[90] The report noted that tax exemptions were granted illegally to non-qualifying firms or more items were tax-exempt than needed.[91] The exemptions granted were also not easily verifiable thus opening up a window for investors to misuse such exemptions.[92] The report concluded that although the aim of tax incentives was attracting investments, evidence showed that investors abused the privilege.[93] In addition, the Mramba's case is another example of abuse of power when granting tax exemptions.[94]

To control the exercise of power, there are several mechanisms for checks and balance. Particularly, the Presidential Oil and Gas Advisory Bureau advise the Cabinet on all strategic matters pertaining to the management of an oil and gas economy.[95] In the discharge of his duties in respect of strategic investment decisions, the Minister for Energy and Minerals must seek guidance and directives from the Cabinet.[96]

In addition, the Petroleum Act 2015, unlike its predecessor the Petroleum (Exploration and Production) Act 1980, curtails the discretionary powers of the Minister of Energy and Minerals to sign oil and gas agreements (PSAs).[97] Currently, all the oil and gas agreements are firstly negotiated by the Petroleum Upstream Regulatory Authority (PURA), approved by the cabinet before being signed by the Minister for Energy and Minerals.[98] Furthermore, the most recent amendments to the Petroleum Act 2015, the

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[88] Section 6(c) of the Public Leadership Code of Ethics Act .

[89] See the case of Mramba & Yona v R, High Court of Tanzania, Consolidated Criminal Appeals No. 96 & 113 of 2015.

[90] The Warioba Commission *Report* (1996) 307 see also Florens Luoga "Taxation in the Advent of Democratisation and Transition to Free Market Economy in Tanzania and Concerns on the Rule of Law and Human Rights' *Law, Social Justice & GlobalDevelopment Journal (LGD)* (1) (2002) at 19.

[91] The Warioba Commission Report (1996) 2, 55-57.

[92] The Warioba Commission Report (1996) 307-308.

[93] The Warioba Commission (1996) 307-308.

[94] High Court of Tanzania Consolidated Crim Appls Nos 96 & 113 of 2015).

[95] Section 7 of the Petroleum Act 2015.

[96] Section 5(2)& 5(3(a) of the Petroleum Act 2015.

[97] Section 44(4) of the Petroleum Act 2015.

[98] Sections 12(1)(a), 43(2), 47(1)(a)&(2) of the Petroleum Act 2015.

PSAs now require the approval of the National Assembly before becoming effective.[99] This new requirement is inline with the practice in other, such as Kenya and Ghana that require ratification of any contract or concession granting licence to explore natural resources.[100] Moreover, the Petroleum Act sets the rate of royalties in the law unlike its predecessor, the Petroleum (Exploration and Production) Act 1980, under which the rate of royalty was negotiable.[101]

Similarly, the National Assembly has powers to review both existing and future PSAs.[102] In this regard, all newly signed PSAs must be reported to National Assembly within 6 days of the next sitting.[103] Further to that, where the National Assembly reviews the existing PSAs, and if finds them containing unconscionable terms may pass a resolution directing the Government to review such PSAs.[104] Subsequently, the Government issues a 30 days' notice to the IOC of intention to review the identified unconscionable terms.[105] The law requires such negotiations to be concluded within 90 days unless the Government grants a further extension.[106] In the event that no consensus is reached, such unconscionable terms will be expunged by operation of the law.[107] In addition, the Minister for Justice and Constitutional affairs has been give powers to make regulations prescribing the parameters of negotiations of PSA as well as the code of conduct for members of Government negotiation team.[108] These regulations, once promulgated, will have the potential to curtail the discretionary powers of the members of the Government negotiation team and thus close down the window of opportunity for corrupt practices.[109]

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[99] Section 47(6) of the Petroleum Act as amended by the Written Laws (Miscellaneous Amendments) Act 2017

[100] Article 71 (1) (a) of the Constitution of Kenya 2010 and 268 (1) of the Constitution of Ghana 1992.

[101] Section 113(1) read together with the second schedule to the Petroleum Act 2015. See Table 1.2 shows different rates of royalties for IOCs

[102] Section 12 of the Natural Wealth and Resources (Permanent Sovereignty) Act 2017, sections 4(1) and 5(3) of the Natural Wealth and Resources Contracts (Review and Re-Negotiation of Unconscionable Terms) Act 2017 referred to as the Review and Re-Negotiation of Unconscionable Terms Act 2017.

[103] Section 5(1) of the Review and Re-Negotiation of Unconscionable Terms Act 2017.

[104] Section 5(2) of the Review and Re-Negotiation of Unconscionable Terms Act 2017.

[105] Section 6(1) of the Review and Re-Negotiation of Unconscionable Terms Act 2017.

[106] Section 6(4) of the Review and Re-Negotiation of Unconscionable Terms Act 2017.

[107] section 7of the Review and Re-Negotiation of Unconscionable Terms Act 2017

[108] Section 8(2) of the Review and Re-Negotiation of Unconscionable Terms Act 2017.

[109] See section 6.2 below.

The Minister of Finance's power to remit any interests or penalty imposed by any law, exercised after consultation with the Commissioner General of TRA and the amount remitted cannot exceed 50% of the interest payable by that person.[110] Similarly, the Ministerial power to grant tax exemptions under section 10 or to vary an exemption to reduce person's tax liability or remit tax under section 125 of the Income Tax, shall be exercise only with approval of the cabinet and for purposes of alleviating effects of an emergence.[111] In this regard, the law is not only very particular on the criteria for grant of tax exemptions under the Income Tax Act 2004 but also requires approval of such exemptions by the cabinet.

Similarly, the Value Added Tax Act 2014 has taken away the Ministerial powers to grant exemption from payment of VAT.[112] Because of this enactment, the only exemptions available to the IOCs are the ones specified in VAT Act. [113] Moreover, the VAT Act 2014 specifies that the Minister of Finance may only grant VAT exemptions only in respect of imports by the Government or the supply of goods to the Government used to provide reliefs to a community plagued by a natural calamity or disaster. [114]

The Minister of Minerals and Energy is required, in every financial year, to provide the National Assembly with a report on the implementation of activities under the Petroleum Act 2015.[115] Similarly, the records of the revenue and expenditure of the oil and gas fund are subject to annual parliamentary scrutiny.[116] In addition, the Petroleum Act 2015 separates between regulatory and commercial functions. While the TPDC deals with commercial aspects, the PURA is a regulatory body. This prevents potential conflict of interests where the TPDC acted as both the regulator and the partner in oil and gas operations.[117]

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[110] Section 70(1) of Income Tax Act as amended by s 56 of the Finance Act 2016 (Act No. 12 of 2016).

[111] Catastrophe or life, property, public health as well as safety. Regulation 3(1) (a)&(b) of the Income Tax Regulations 2004 (G.N 464 5/11/2004).

[112] Section 6(1)(a)&(b) of the Value Added Tax Act 2014 (Act No. 10 of 2014).

[113] Section 6(1) (a)&(b) of the Value Added Tax Act 2014.

[114] Section 6(2) Value Added Tax Act 2014.

[115] Section 19 of the Petroleum Act 2015.

[116] Section 18(6) of the Oil and gas revenue management Act 2015.

[117] McPherson, C "National Oil Companies Evolution, Issues" (2003) 8 available at http://siteresources.worldbank.org/INTOGMC/Resources/NOCPaperMcPherson.pdf (accessed 27 July 2017

The EITI Committee, was established with a mandate to reconcile the payments, made by the IOCs and received by the Government. In the discharge of its functions, the Committee has power to call for information and records from both the IOCs and the Government entities. [118] The Committee may contract an independent and reputable accounting firm to reconcile and verify payments made by extractive industry companies and revenues received by the Government. [119] In the event that discrepancies are discovered by the reconciler, the report is forwarded to the Controller and Auditor General who will conduct an investigation, before publishing the results.[120] This prevents diversion of collected revenues by the Government officials.

3 Anti-tax Avoidance Legislation

Generally, IOCs main objective is profit making. This motivates IOCs to utilize every available opportunity to reduce or eliminate their tax liabilities. To achieve this objective, the IOCs devise different techniques, such as transfer pricing, thin capitalization, corporate reorganization, treaty shopping and controlled foreign corporations to avoid taxes.[121]

The threat for tax avoidance in Tanzania is real. For one, there are several reported incidences of tax avoidance schemes in the extractive industry. [122] For instance in *Commissioner General TRA v Pan African Energy Tz Ltd*[123] the Court of Appeal of Tanzania held that since the law is silent on the charging of withholding tax for services rendered outside Tanzania by non-resident, the court too, cannot create such a tax obligation.[124] The Court further held that, even though this lacuna may create room or leeway for tax evasion, it is not for the Court to fill the gap; instead, the solution is to

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[118]Section 10(2)(c) of the Tanzania Extractive Industries (Transparency and Accountability) Act, 2015.

[119] Section 17 of the Tanzania Extractive Industries (Transparency and Accountability) Act, 2015.

[120] Section 18(1) &(2) of the Tanzania Extractive Industries (Transparency and Accountability) Act, 2015.

[121] Chapter 3 section 3.

[122] Oil and gas industry is at the nascent stage, only two PSAs out 26 are at production stage. thus no substantial payment of taxes.

[123] The Company is engaged in E&P, distribution and marketing at Songosongo in Lindi and operates gas processing plant Songas Ltd Civil Appeal No. 15 of 2015, Court of Appeal of Tanzania, (Unreported).

[124] The controversy was regarding the interpretation of ss. 6(b),69(1)(1) & 83(1)(c) Income Tax Act 2006.

amend the law.[125] Because of this lacuna, the Government could not collect the taxes assessed amounting to 3.6 billion shillings.[126]

Similarly, in *African Barrick Gold Plc v. Commmissioner General TRA*[127], the tax Tribunal held that the Mining Company had engaged in tax avoidance scheme. The facts of this case showed that African Barrick Gold Plc, a company incorporated and has HQ in London, has three subsidiary companies conducting mining operations in Tanzania.[128] Although the tax returns of the three subsidiaries in Tanzania showed loss making, in Initial Public Offer (IPO) document in London indicated that ABG had generated from income from its Tanzanian subsidiaries and declared dividends to its shareholders back-to-back for four years 2010,2011,2012 and 2014 amounting to U$D 818,431,285. The Tribunal held that African Barrick Gold Plc was liable to pay withholding taxes amounting to $41,250,426 in respect of dividends paid to shareholders abroad.

Furthermore, in the most recent scenario, the Royal Dutch Shell acquired 60 percent stake in British Gas (BG) Group in a deal worth $ 55 billion.[129] The Tanzania Revenue Authority subjected this transaction to capital gains tax amounting to $ 502 million. However, BG group argues that no capital gains were realized.[130] TRA issued a garnishee order to freeze the BG Group's accounts.[131] The BG Group is disputing this assessment and the case is now pending before the Tax Revenue Appeals Boards.[132]

Another cause of concern is that, Mauritius, which is characterized as a tax haven, is the third country sending FDI to Tanzania.[133] Further to that, IOCs in Tanzania, such as Ophir Energy Plc Group of Companies has 86 subsidiaries all over the world of which 22 are

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[125] Tax Revenue Appeals Tribunal Appeal No. 16 of 2015.

[126] Tax Revenue Appeals Tribunal Appeal No. 16 of 2015.

[127] Tax Revenue Appeals Tribunal Appeal No. 16 of 2015.

[128] Bulyanhulu Gold, North Mara, Pangea Minerals Ltd (Tulawaka and Buzwagi Gold Mines).

[129] Erick Kabendera Taxman *freezes BG Group's accounts in $500m tax row* Posted Saturday, July 9 2016 at 13:14 This gives Shell 16 percent shares in the proposed LNG project.

[130] $ 850 million allocated to Tanzanian unit and already spent $ 1.5 billion

[131] Accounts have only $ 5 million which is equivalent to 1 percent of the alleged tax liability.

[132] *BG Tanzania Ltd v Commissioner General TRA*, Tanzania Tax Revenue Appeals Board Application no. 21 of 2016.

[133] Tanzania Bureau of Statistics *Tanzania Investment Report 2014: Foreign Private Investment* (2015) 17 available at http://www.nbs.go.tz/nbs/takwimu/trade/Tanzania_Investment_Report_2014.pdf (accessed on 20 December 2015). See also Tax Justice Coalition *Double Taxation Agreements Tanzania Gain or Loss to Tanzania?* (2016) 21.

incorporated in Jersey, 13 in British Virgin Island, 3 in Bermuda and 3 in Delaware.[134] This increases the possibility that some of the IOCs may use tax havens as conduit for tax avoidance.[135] As indicated under Chapter 4 of this study one of the remedies for tax avoidance is, through legislation, closing the gaps and loopholes in the tax system.[136] The next section examines the anti-tax avoidance legislation adopted in Tanzania.

3.1 Specific Anti-Tax Avoidance Rules (SAAR)

As the names suggests SAAR, unlike GAAR, addresses specific "known" schemes of tax avoidance. Therefore, the application of the rules are limited and the tax authority does not have discretionary powers.[137] The following section highlights the SAAR provisions in the Tanzania oil and gas tax regime.

3.1.1 Arm's Length Principle (ALP)

Tanzania has adopted the arm's length principle as per standards set by the OECD and UN Model Tax Conventions.[138] The general provision dealing with transfer pricing is section 33 of the Income Tax Act 2004 and is complemented by the Transfer pricing Regulations.[139] In case of any gaps in the Regulations, then both the OECD and UN guidelines apply. Under section 33 of the Income Tax Act 2004 and the Transfer Pricing Regulations, all commercial or financial transaction between associated entities must take place on the same terms as if such transaction had taken place between independent persons.[140] For this reason, the arrangements between separate petroleum rights including

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[134] These are famous tax havens. See Ophir "Annual Report and Accounts 2016" Appendix A, pp 143-146 available at https://cdn-ophir-energy.azureedge.net/wp-content/uploads/2017/04/Ophir-Annual-Report-2016-Web.pdf (accessed on 01 August 2017)

[135] See the detailed discussion on tax avoidance techniques under Chapter 3 section 3.2.

[136] See Chapter 4 section 3.3

[137] PwC General Anti-avoidance rule (2007) https://www.pwc.com/cz/cs/danove-sluzby/danova-politika/assets/gaar-general-anti-avoidance-rule-en.pdf

[138] Msike, C and Mabula E "UN-ATAF Workshop on Transfer Pricing Madagascar Tanzania Case Study" (14-17 November 2016) 4 http://www.un.org/esa/ffd/wp-content/uploads/2016/11/2016TP_Tanzania_CountryPresentation-en.pdf (accessed on 15 September 2016)

[139] Income Tax (Transfer Pricing) Regulations, G.N 27 of 2014

[140] Under both the Income Tax Act and Income Tax (Transfer Pricing) Regulations, arm length principle means: whereby commercial or financial transaction between associates is taking place on the same terms as if such transaction had taken place between independent persons under comparable conditions and circumstances.

the segments (Upstream, midstream or downstream) operated by an IOC as are treated as though are conducted by associated persons.[141]

There is also a general obligation for taxpayers, when dealing with associated persons, to quantify, apportion and allocate amounts to be included or deducted in calculating income in accordance with the arm's length principle.[142] For example, intragroup transactions on intellectual property rights must demonstrate that they confer economic benefit or commercial value to the business and that the price charged is at arm' length.[143] Similarly, the charge for intra-group service must be justifiable and in accordance with arm's length principle.[144] In addition, where the IOC intends to enter an advanced price arrangement, such IOC must apply to the Commissioner to ascertain whether such arrangement complies with arm's length principle.[145] Moreover, the Petroleum Act 2015 requires the price of oil and gas products for purposes of establishing the royalties payable must be at arm's length and in conformity with international best practices.[146]

Where the Commissioner is of the view that a transaction between associate persons is not at arm's length, adjustments can be made to reflect the arm's length principle.[147] Similarly, contravening of the transfer pricing regulations is a criminal offence with a penalty of 100 percent penalty of the tax underpaid. [148]

3.1.2 Ring fencing Rules

Given the capital-intense nature of the oil and gas industry, allowing expenditures from one contract area to be deducted against income from another contract area may lead to

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[141] Section 65K (5)(a)-(c) of the Income Tax Act (Cap 332).

[142] Section 33 (1) of the Income Tax Act (Cap 332); Regulation 4(1) of The Income Tax (Transfer Pricing Regulations) 2014; The transfer pricing methods of related party transactions include comparable uncontrolled price, resale price, cost plus, profit split, transactional net margin method or any other appropriate method determined by the Commissioner. In all these methods, priority is given to traditional transaction method. Regulation 5(1) (a)-(f) &(2) The Income Tax (Transfer Pricing Regulations) 2014.

[143] State the value the benefit the intangible asset expected to generate Regulation 10(1) &11 The Income Tax (Transfer Pricing Regulations) 2014.

[144] Regulation 10(1) &(2) of the Income Tax (Transfer Pricing Regulations) 2014.

[145] Regulation 12 of the Income Tax (Transfer Pricing Regulations) 2014.

[146] Section 165(1) of the Petroleum Act 2015.

[147] Rre-characterize the source and type of any income, loss, amount or payment; or apportion and allocate expenditure) section 33 (2)(a)&(b) the Income Tax Act and Regulation 4(2) of the Income Tax (Transfer Pricing Regulations) 2014.

[148] Regulation 4(5) of the Income Tax (Transfer Pricing Regulations) 2014.

tax base erosion.[149] Therefore, ring fencing is the isolation of taxable operations owned by one entity for tax purposes.[150] The ring-fencing rule restricts losses incurred in the loss-making contract area to be offset against the profit-making contract area.[151] If one IOC owns two or more oil and gas operations, each of these operations is treated as separate and independent of each other.[152] Therefore, for purposes of establishing the tax liability of the IOC, costs, income and loss from one operation (petroleum right) cannot be combined with those of other operations.[153] In fact, under the Income Tax Act 2004, each petroleum right (exploration or development license) constitutes a separate petroleum operation.[154] In that regard, each petroleum rights is treated as a business for exploration, development and delivery points identified in the PSA.[155]

In addition, the Income Tax Act 2004 requires the license holder and contractor holding more than one license to ring fence the recoverable contract expenses.[156] Expenses are recoverable from the revenues in so long as they relate to the contract areas from which such revenue has been derived.[157] Costs incurred by the license holder and contractor (integrated project) in respect of construction and operation of midstream facilities (processing, liquefaction, storage and loading facilities) do not form part of recoverable expenses under the PSAs.[158]

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[149] Mafwenga, HM *Mineral Tax Clinic: The Reflection of Old and New Fiscal Regimes for Effective Tax Auditing in Tanzania* (2012) 124.

[150] Otto *Mining Taxation in Developing Countries* (2000)15-16, Mafwenga, HM *Mineral Tax Clinic: The Reflection of Old and New Fiscal Regimes for Effective Tax Auditing in Tanzania* (2012) 122.

[151] Mafwenga, HM *Mineral Tax Clinic: The Reflection of Old and New Fiscal Regimes for Effective Tax Auditing in Tanzania* (2012) *125*

[152] Section 11(4) of the Income Tax Act Article 12 (c)-(d) MPSA see also Otto *Mining Taxation in Developing Countries* (2000) 15-16.

[153] Otto Mining Taxation in Developing Countries (2000) 15-16.

[154] Section 65K (1) of the Income Tax Act.

[155] Sections 65L (4)(a)-(c) and 65K of the Income Tax Act.

[156] Section 117(1) of the Income Tax Act.

[157] Section 117(2) of the Income Tax Act.

[158] Section 117(3)&(5) Income Tax Act 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.

3.1.3 Rules on Realization of Petroleum Right

Generally, the transfer of rights, irrespective of the beneficiary type of transaction, is subject to capital gains tax.[159] Section 56 of Income Tax Act 2004 provides where the underlying ownership of a resident company or permanent establishment changes by more than 50 percent is deemed to have realized an asset and subject to capital gains tax. For this reason, section 56 is an anti-tax avoidance provision targeting IOCs selling shares through holding companies abroad.[160] It is also refered as a deeming provision under which a resident is deemed to have realized an asset immediately before change of control in the asset.[161] Similarly, the Petroleum Act imposes an obligation on the IOC to pay capital gains in respect of any profit made out of any direct or indirect assignment, transfer or any other disposal of rights under the PSAs regardless of the beneficiary type of transaction.[162] To ensure that capital gain tax is paid, any transfer of interest will only be valid if approved by the Minister (TPDC) and endorsed by the Commissioner for Income Tax certifying that tax has been paid or no tax is payable.[163]

3.1.4 Anti-treaty Shopping Rules

In Tanzania, an IOC wanting to enjoy the benefits of double taxation treaties to which Tanzania is a party, must fulfill three requirements.[164] First, the IOC must qualify as a resident of the other contracting State.[165] This requirement addresses those IOCs, which do not have any physical presence in the other contracting State, but want to benefit from the tax treaties.[166] Second, even where residence in the other contracting State is established, at least 50 percent of underlying ownership of the IOC must be held by individuals who are resident of the other contracting State.[167] This provision aims at counteracting abusive application of the provision of double taxation treaties. For

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[159] Section 56 of the Income Tax Act.

[160] See Chapter 3 section 3.2.1. See also Cope, CW and Jain, P, "Taxation of indirect share transfers: Recent development in India and related policy considerations" (2015) *Tax Management International Journal* at 2.

[161] IMF Discussion draft The Taxation of Offshore Indirect Transfers—A Toolkit (2017) 44.

[162] Section 116(2) of the Petroleum Act 2015.

[163] Article 27(a) Model PSA 2013

[164] All these requirements are provided for in the Tanzanian Income Tax Act.

[165] Section 128(5)(a) of the Income Tax Act.

[166] See the discussion of treaty abuse under section 3.2.4 of Chapter 3.

[167] Section 128(5)(a) of the Income Tax Act.

instance, some of the IOCs just form a conduit company in the contracting State just for the sake of benefitting from the provisions of double taxation treaties.[168] Third, the IOCs must not be benefitting from other forms of reliefs in the country of residence or in another tax haven.[169] The enforcement of these rules is hindered by the existence of some tax havens, which are not willing to share tax-related information with other countries.[170]

3.1.5 Limits on Debt Financing

The financiers who provide financing for petroleum activities are considered as sub-contractors, and are thus subject to payment of withholding taxes in respect of interests received on loans.[171] Furthermore, there is a requirement that loans from non-resident financier should not exceed the domestic lending rates.[172] To ensure implementation of this rule, PURA reviews and approves the amount and percentage of loans to be used in oil and gas operations. In doing so, PURA determines the debt-equity ratio for financing any oil and gas project.[173]

The debt-to-equity-ratio as proposed by PURA must be designed according to financing regulations and must be aligned to tax laws.[174] The concept of debt-to-equity-ratio, introduced in 2010, provides that the total amount of interest that an entity may deduct for the year of income should not exceed the sum of interest equivalent to debt-to-equity ratio of 7 to 3.[175] Under this rule, the IOC's debt should not exceed 70 percent of its operating capital. Any interest expense on the amount in excess of 70 percent is not tax-deductible.[176]

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[168] See Chapter 3 section 3.2.4.

[169] Section 128(5)(a) of the Income Tax Act.

[170] Ault and Arnold "Protecting the tax base of developing countries: an overview" (2015) 3. Surprisingly, Tanzania is not a signatory to the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information. See OECD report available at http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/MCAA-Signatories.pdf (accessed on 11 August 2017)

[171] Section 128(5)(a) of the Income Tax Act.

[172] Section 116(7) of the Petroleum Act 2015.

[173] Section 116(5) of the Petroleum Act 2015.

[174] Section 116(3) &(5) of the Petroleum Act 2015.

[175] Section 12(2) of the Income Tax Act.

[176] Section 116(6) of the Petroleum Act 2015.

Similarly, all arrangements for debt financing must be approved by PURA.[177] The approval requirement is mandatory, and where there is non-compliance all costs in respect of unapproved loans are not allowable or deductible expenses for tax purposes.[178] In addition, where the loan comes from the related party, the IOC has the duty to prove that the interests charged are at arm's length and the interests charged thereon does not exceed lowest domestic lending rates.[179] Moreover, where the Commissioner General has a reason to believe that any rate of interests imposed is not at arm's length, the Commissioner General may make adjustments by imputing the interest rate.[180]

3.2 General Anti-Tax Avoidance Rules (GAAR)

Where the Commissioner is of the view that there exists a scheme by the taxpayer that is intended solely for obtaining undue tax benefit, may subject that scheme to tax assessment as if no such scheme exists.[181] The decision by the Commissioner is deemed to be an assessment as per the tax laws, and accordingly becomes payable immediately.[182] Furthermore, the law vests the Commissioner with powers to adjust the company's tax returns if he is satisfied (of the opinion) that the taxpayer has engaged in a tax avoidance scheme. If no adjustments are made, an enormous sum of money will be lost in the hands of a taxpayer. The Commissioner invokes these powers to counteract any tax avoidance or reduction. It restores the taxpayer to the original position as if no tax avoidance existed.[183] This general anti-tax abuse provision under section 35 has been applied with approval of the *Tribunal in the case of Tanzania Leaf Tobacco.*[184]

In addition, where the Commissioner is of the view that a transaction between associated persons is not at arm's length, adjustments can be made to reflect the arm's length principle. These adjustments may entail re-characterization of the source or type of any

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[177] Section 116(6) of the Petroleum Act 2015.

[178] Section 116(6) of the Petroleum Act 2015.

[179] Regulation 14 of the Income Tax (Transfer Pricing Regulations) 2014 and Section 116(6) of the Petroleum Act 2015.

[180] Regulation 14 of the Income Tax (Transfer Pricing Regulations) 2014.

[181] To prevent that tax benefit. Section (8)(1) of the Tax Administration Act 2015.

[182] Section (8)(2) of the Tax Administration Act 2015.

[183] Section 35(1) of the Income Tax Act 2004.

[184] Tax Revenue Appeals Board, at Dar es salaam, VAT Appeal No. 60 of 2012 (Unreported).

income, loss, amount or payment, reapportionment and reallocation of claimed expenditures.[185] Contravening of the transfer pricing regulations is a criminal offence with a penalty of 100 percent penalty of the tax underpaid. [186] Similarly, the Commissioner General for TRA, if he has a reason to believe that any price including the rate of interests imposed is not at arm's length, the Commissioner General may make adjustments by imputing the interest rate or adjusting the price. [187]

4 Criminalization of Tax Evasion

In addition, the IOCs may engage in outright criminal conduct, such as non-declaration of income, forgery, under-invoicing and double accounting. These types of conducts amount to tax evasion. Tax evasion is a criminal offence liable to criminal prosecution.[188] Tax evasion is classified under three heads. First, it relates to evasion of assessment. The evasion of assessment involves conducts that aim at defeating a tax assessment. It includes offenses, such as using or making false and misleading statements.[189] It also covers the offence of aiding or abetting tax evasion.[190] This covers professionals, such as lawyers, accountants and engineers who, in the course of their professional duties, may aid tax evasion. [191] There are also general offences under the Penal Code, such as forgery,[192] conspiracy to commit an offence[193] and cheating.[194] The second head relates to evasion of payment, which entails offences, such as the failure to pay taxes.[195] Third,

[185] Sections 33 (2)(a)&(b) 71(2) of the Income Tax Act; Regulation 4(2) The Income Tax (Transfer Pricing Regulations) 2014, G.N 27 of 2014.

[186] Regulation 4(5) of the Income Tax (Transfer Pricing Regulations) 2014.

[187] Regulation 14 of the Income Tax (Transfer Pricing Regulations) 2014.

[188] Failure to comply with tax law provided for is an offence under section 82 of the Tax Administration Act 2015.

[189] if undetected leading to underpayment of tax, attracts a penalty of less than 50 currency points and not more than 200 currency points, 1 year or 2 years or both section 84 (3) (a-b) Tax Administration Act 2015. See also section 234 (b) of the Petroleum Act 20m or 5 years or both

[190] Section 89 of the Tax Administration Act 2015.

[191] Section 89 of the Tax Administration Act 2015.

[192] Section 333 of the Penal Code (Cap.16 R.E 2002).

[193] Sections 384-386 of the Penal Code.

[194] Section 304 of the Penal Code.

[195] Attracts a fine (if the tax exceeds 50 currency points) , of not less than half the amount and not more than 100 currency points or imprisonment not less than 3 months not more than 6. Section 83 of the Tax Administration Act 2015 (Act No. 10 of 2015).

evasion relates to impeding the tax administration,[196] and evading tax or recovering tax.[197] Generally, where an offence is committed by a body corporate, unless where there is proof that there was a degree of care or due diligence had been exercised, the manager is deemed to have committed that offence.[198]

The Tanzania Revenue Authority has a special unit namely the Department of Tax Investigations. The Department deals with criminal tax investigation, gathering of evidence, in-depth tax audits to uncover tax evasion schemes. If the Department of Tax Investigations, is satisfied that a tax crime has been committed, it will recommend prosecution to the Director of Public Prosecution (DPP). In Tanzania, all public prosecutions are conducted by the office of the DPP.[199] Since tax evasion is criminal offence, the prosecution is conducted in normal courts like any other criminal offences.[200]

The Tax Administration Act criminalizes several types of taxpayer's conduct, such as the fraudulent evasion of payment of tax; obtaining a remission, rebate or refund when not entitled to; making false statement or false representation to get any tax benefit; counterfeit or falsifies documents used for tax purposes; omission or failure to make declaration, return, accounts or documents that are true or correct or acquiring, keeping, possessing, concealing or dealing with any fiscal receipt or document which is false or incorrect.[201]Upon conviction, such person will be liable for payment of twice the amount of tax evaded or imprisonment to a term not exceeding three years.[202] Arguably, this penalty is severe and thus has the potential to deter any potential tax evaders.[203]

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[196] includes conducts such fraud or undue force whose penalty is equal to twice the amount sought to be evaded or recovered or 200 currency points whichever is greater or 2 years or 4 years or both s 85(2)(a) Tax Administration Act 2015.

[197] dealing with documents or assets that have information or measurements, which are false, misleading in material particular, refusal to produce documents uses, keeps or provides any false or unjust scale weighing or measuring instruments.s 85 (3) (c), (g) & (l) Tax Administration Act 2015 (Act No. 10 of 2015).

[198] Section 88(1) of the Tax Administration Act 2015. See also s 236 (1) of the Petroleum Act 2015.

[199] Section 9 of the National Prosecutions Service Act 2008, (No 27 of 2008).

[200] The Criminal Procedure Act (Cap 20 R.E 2002) is the general law that regulates the arrests, investigation, prosecution and sentencing of accused persons in Tanzania.

[201] Section 84(1) of the Tax Administration Act 2015.

[202] Section 88B (1) &(2) of the Tax Administration 2015.

[203] See Chapter 4 section 2.2.4.

5 Administrative Measures for Preventing, Detecting and Punishing Tax Avoidance

The existence of effectiveness of anti-tax avoidance and evasion depends on the tax administration. An efficient tax administration is the one which has the capacity to detect, prevent and punish tax avoidance and tax evasion.[204] For instance, through tax audits, the tax administrators may be able to detect undeclared or under-declared taxes.[205] In Tanzania, there are several institutions with mandate to enforce tax-related laws.

First, the law imposes an obligation on the IOC to keep and maintain records. The IOC is obliged to keep proper and accurate records in relation to the drilling operations and the results thereof, quality and quantities of oil and gas in the reservoir.[206] It is also a requirement to keep records of quantities of oil and gas processed, pumped to field storage and refineries and that consumed in Tanzania.[207] Similarly, the Tax Administration Act 2015 imposes an obligation on the companies to disclose the identities of contractors and subcontractors as well as the work done.[208] Failure to disclose attracts a fine of 25 percent of the quantum payable.[209] Likewise, the Petroleum Act 2015 introduces an integrity pledge for all IOCs in Tanzania prohibiting them from undermining, prejudicing the country's financial and monetary system or inhibiting economic objectives.[210] This is taken as a general obligation against tax avoidance and tax evasion schemes.

Second, EWURA prescribes, both domestic and exports, rates, tariffs, charges of oil or gas produced in Tanzania.[211] In addition, EWURA sets the terms and conditions for conducting the regulated activity.[212] Generally, the prices of oil and gas products throughout the supply chain are governed by market forces subject to EWURA Act and

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[204] See generally Chapter 4. See also O'doherty, M "Thinking and Learning in the Tax Evasion Game" (2014) 35(3) Fiscal Studies, 297–339 at 298.

[205] O'doherty "Thinking and Learning in the Tax Evasion Game" (2014) 35 298.

[206] Section 89(1) (a)-(h) of the Petroleum Act 2015.

[207] Section 89 (1) (i)-(j) of the Petroleum Act 2015.

[208] Section 44 (1)&(2) of the Tax Administration Act 2015.

[209] or 4000 currency points Section 44 (3) of the Tax Administration Act 2015.

[210] Section 224 of the Petroleum Act 2015.

[211] Section 163(3)&(4) of the Petroleum Act 2015.

[212] Section 163(3)&(4) of the Petroleum Act 2015.

the Fair Competition Act.[213] The domestic natural gas price to be determined based on the strategic nature of the project to be undertaken by the Government.[214] Such pricing of oil and gas products must conform to the methods prescribed by EWURA and in accordance with international best practices.[215] The process of determining tariffs is required to consider factors, such as cost recovery and return on capital.[216] In doing so, EWURA may permit deviation from the tariffs, rates and charges prescribed in the Act.[217] The supply of gas to end-users and buyers shall be governed by negotiated commercial agreements.[218]

Third, both PURA and TRA have power to audit the IOCs' books of account. The Commissioner General of TRA has powers to audit or investigate the IOC's tax affairs to ascertain compliance or non-compliance with tax laws or existence of tax payable.[219] In doing so, the Commissioner has power to access any information, vessel, premises, or documents.[220] Furthermore, the Commissioner General of TRA has powers to request information and details from the registrar of companies for purposes of carrying out a tax investigation.[221] Similarly, PURA has the mandate to audit all matters relating to assessment and collection of oil and gas revenues.[222] In addition, PURA audits the costs on exploration, development, production, and sale of oil and gas.[223] It also requires that petroleum produced measured according to the standard set by both the Weights and Measures Act.[224] These audits ensure that the Government obtains an appropriate share of profit oil and royalties. In discharge of its regulatory function, PURA may visit and inspect any sites, plants, offices or warehouses connected with petroleum operations,

[213] Section 166 of the Petroleum Act 2015.

[214] Section 98 of the Petroleum Act 2015.

[215] To be prescribed in the Regulations. See Section 165(1) of the Petroleum Act 2015.

[216] Section 163(7) of the Petroleum Act 2015.

[217] Section 163(8) of the Petroleum Act 2015.

[218] Section 163(9) of the Petroleum Act 2015.

[219] Section (45(1)-(2) of the Tax Administration Act 2015.

[220] Section 42(1) of the Tax Administration Act.

[221] Section 458 (6) Companies Act (Cap 212) as amended by section 6 of the Finance Act 2016 (Act No.2 of 2016).

[222] Section 13(2)(a) of the Petroleum Act 2015, before the enactment of the Petroleum Act this was done by TPDC.

[223] Section 13(2)(b) of the Petroleum Act 2015.

[224] Article 14 Model PSA, (CAP 340).

which directly or indirectly controlled by the IOC.[225] Arguably, the existence of an audit provision means the Government controls and monitors the investor's records on expenditures and profits.[226]

Fourth, there are several measures to enhance administrative capacity in addressing tax avoidance and tax evasion. One of the notable measures is the establishment of an International Tax Unit (ITU) within Large Taxpayers Department of TRA in 2011.[227] The ITU is dedicated to managing transfer pricing and double taxation agreements. In the same connection, TRA has subscribes to the transfer pricing database namely Orbis since 2014.[228] This pricing database is used for benchmarking prices, thus an effective tool to counteract transfer-pricing manipulation.[229] Moreover, Tanzania is a member of several global initiatives, such as the Multi-lateral Convention on Mutual Administrative Assistance in tax matters, OECD global forum on the exchange of information and transparency as well as African Tax Administrators Forum (ATAF).[230] All these measures enhance cooperation in tax matters.

Fifth, there is a requirement that any transfer of rights or interests in respect of a license must be approved by the Minister of Energy and Minerals.[231] An application for an approval of the transfer of an instrument made to the Minister must be endorsed by the Commissioner for Income Tax certifying that tax has been paid or no tax is payable.[232] The non-compliance with approval requirement renders the transfer invalid.[233] Even where the transaction occurred abroad, the resident entity is deemed to have realized its

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[225] Section 13(2)(b) of the Petroleum Act 2015.

[226] The Boston Consulting Group *Benchmarking report* (2012) 23 available at http://www.petroleum.nic.in/sites/default/files/benchmark.pdf (accessed on 18 March 2014)

[227] Msike, C and Mabula E "UN-ATAF Workshop on Transfer Pricing Madagascar Tanzania Case Study" (14-17 November 2016) 3 http://www.un.org/esa/ffd/wp-content/uploads/2016/11/2016TP_Tanzania_CountryPresentation-en.pdf (accessed on 15 September 2016)

[228] Msike and Mabula "UN-ATAF Workshop on Transfer Pricing Madagascar Tanzania Case Study" (2016) 7.

[229] Msike and Mabula "UN-ATAF Workshop on Transfer Pricing Madagascar Tanzania Case Study" (2016) 7.

[230] Msike and Mabula "UN-ATAF Workshop on Transfer Pricing Madagascar Tanzania Case Study" (2016) 8.

[231] Section 86(1)(a) of the Petroleum Act 2015.

[232] Section 86(2) (e) & 86(3) of the Petroleum Act 2015 Article 27(a) Model PSA 2013.

[233] Section 86(1)(a) of the Petroleum Act 2015.

assets before the underlying ownership changes.[234] For that reason, the tax assessment is served to the resident entity and the tax payable will be recovered accordingly.[235]

6 Critical Evaluation of Measures Addressing Tax Revenue Leakage in Tanzania

The preceding chapters have highlighted several measures adopted in Tanzania to combat tax revenue leakage. The discussions also revealed that despite these measures there are still incidences of corruption, tax avoidance and tax evasion being reported. This partly demonstrates that there are still flaws in the legal framework that create a window of opportunity for unscrupulous officials and taxpayer to evade taxes. The next section highlights the major pitfalls in the Tanzanian oil and gas fiscal regime that permit leakage of tax revenues.

6.1 Negative Delegation of tax-law Making Powers

The Minister of Finance has discretionary powers to amend, waive or vary a tax liability (grant tax exemptions), under the Stamp Duty Act[236] and excise duty.[237] In addition, the Minister of Energy and Minerals has powers to amend alter or waive royalties.[238] Similarly, the Minister responsible for local Government authorities has powers to exempt any person from taxes payable to local Government authorities.[239] The net effect of these discretionary powers – also known as negative legislative delegation – is to alter the intention of the legislature to impose taxes.[240] The exercise of these discretionary powers remove the existing tax obligations or introduces new ones with less

[234] Section 56 of the Income Tax Act., The underlying ownership is defined as membership interests in a body corporate section 3 of the Act.

[235] As per the procedures provided for under the Tax Administration Act 2015.

[236] Section 16(1) of the Stamp Duty Act.

[237] Section 128 of the Excise (Management and Tariff) Act (Cap 147)

[238] Section 113(2) of the Petroleum Act 2015.

[239] Section 13(5) of the Local Government Finances Act 1982

[240] Kitchen, RC "Negative Lawmaking Delegations: Constitutional Structure and Delegations to the Executive of Discretionary Authority to Amend, Waive, and Cancel Statutory Text" (2012-2013) 40 *Hastings Constitutional Law Quarterly* 525 at 525-526. The author argues that negative lawmaking delegation occurs when the Executive's exercise of delegated powers negates (by waiver or exemption) the legal force or effect of the statutory text for specific persons, projects or categories of activities. It may entail amendments of tax rates, waiver of tax obligation or cancellation of tax obligation.

obligations.[241] Moreover, these discretionary tax exemptions subjects the taxing powers to lobbying and privileging.[242] These exemptions may result into unjustified preferential treatment of certain taxpayers, which are contrary to the principle of equity in taxation.[243] The preferential treatment of certain taxpayers also ignores the principle of rule of law, which accords all people equal treatment before the law.[244]

Despite the fact that the laws grant Ministerial powers to grant exemptions or waivers from payment of taxes and royalties, the law does not describe the circumstances under which the power may be exercised.[245] In addition, the law does not set the limits of such exemptions in terms of the time and the amount of tax exempted. [246] The law also does not provide the criteria to be taken into account when granting such tax exemption, such as who qualifies, why, and for how long.[247] Furthermore, there is no obligation to table the tax exemptions for parliamentary scrutiny. [248]

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[241] See Chapter 5 section 4.2.

[242] In the case of *Geita Gold Mining Limited v. Commissioner General*, Tax Revenue Appeals Tribunal at Mwanza, Appeal No. 4 of 2012 (unreported).

[243] Tamanaha, BZ "The History and Elements of the Rule of Law" *Singapore Journal of Legal Studies* (2012) 233-247 at 243.

[244] Tamanaha, BZ "The History and Elements of the Rule of Law" (2012) 243.

[245] For example under section 10 of Income Tax Act 2004, exemptions only in respect of reliefs for addressing natural calamities.

[246] Ongwamuhana, K *Tax Compliance in Tanzania: Analysis of Law and Policy affecting Voluntary Tax Payer Compliance* (Dar-es-Salaam, Mkuki na Nyota Publishers, 2011) 17-18. See also Luoga, F "Taxation in the Advent of Democratisation and Transition to Free Market Economy in Tanzania and Concerns on the Rule of Law and Human Rights" *Law, Social Justice & GlobalDevelopment Journal (LGD)* (1) (2002) 21. Under section 10 of Income Tax Act 2004, The Minister is only required to publish the list of exempted person or classes of income in the Government Gazzete. Peter W. Hogg "Can The Taxing Power Be Delegated?' 2002) *Supreme Court Law Review* at 306-307, Argues that the legislature can, within prescribed limits, delegate its taxing powers, however, delegation of taxing powers reduces democratic control of taxation i.e imposed, increased or reduced secretly with open debates like ones in parliament. See also Vanistendael, F "Legal Framework for Taxation" *Tax Law Design and Drafting*, in Victor Thuronyi (ed), *Tax Law Design and Drafting* Vol. 1 (Washington DC, International Monetary Fund 1996) 2.

[247] For example under section 10 of Income Tax Act Cap 332 (R.E 2006), The Minister is only required to publish the list of exempted person or classes of income in the Government Gazzete. See Ongwamuhana *Tax Compliance in Tanzania: Analysis of Law & Policy affecting Voluntary Tax Payer Compliance* (2011) 17-18; Luoga, F "Taxation in the Advent of Democratisation and Transition to Free Market Economy in Tanzania and Concerns on the Rule of Law and Human Rights" (2002) 21.

[248] James Effectiveness of Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications (2013) 43.

Overall, the unregulated delegation of tax law-making powers may create revenue leakages and encourage corruption.[249] These discretionary tax exemptions explain partly why Tanzania has the highest tax exemptions per GDP ratio in East Africa.[250] Moreover, there are incidences of abuse of powers by the Minister when granting tax exemptions.[251]

While the Constitution of Tanzania is silent of delegation of taxing power,[252] the Constitutions of Greece, for example, takes an extremist position that the legislature cannot delegate the power to impose taxes to the Executive.[253] Similarly, the Constitution of Ghana take a median position by permitting delegation of administrative issues while the basic concepts of taxes like tax base and tax rate remain the prerogative of the legislature.[254]

6.2 Unguided Exercise of Discretionary Powers

Under the Tanzanian oil and gas fiscal regime certain levies, such as bonuses, production sharing and additional profit tax (APT) are subject to negotiations.[255] Despite the fact that the law vests Government officials with considerable power and discretion to decide how much revenues the Government may obtain, the law does not provide guidance or

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[249] CRC Sogema *Tanzania Per Tax Exemptions Study Final Report and Briefing Note* submitted to the Ministry of Finance of Tanzania (2013) 37, 40, 43 http://www.tzdpg.or.tz/fileadmin/documents/external/public_expenditure_review/Reports/PER_Tax_Exemptions_Study_Final_Report_and_Briefing_Note.pdf (accessed on 05 April 2015). See also Tanzania Episcopal Conference (TEC) *The One Billion Dollar Question How Can Tanzania Stop Losing So Much Tax Revenue* (2012) 12 available at http://www.policyforum-tz.org/files/ONEBILLIONDOLLARQUESTION.pdf (accessed on 18 March 2014)

[250] Twaweza "Tanzania's Tax Exemptions: Are they too high and making us too dependent on foreign aid?"(2010) 7 available at http://twaweza.org/uploads/files/Tax%20Exemptions.PDF (accessed on 20 July 2017)

[251] See Warioba Commission Report (1996) 78-79. 57, 307. Mramba & Yona case a good example in natural resource sector. See also Luoga, F, "The Viability of Developing Democratic Legal Frameworks for Taxation in Developing Countries: Some Lessons from Tanzanian Tax Reform Experiences" (2003) 18. See also *Mramba & Yona v Republic* High Court of Tanzania Consolidated Criminal Appeals No. 96 & 113 of 2015(unreported).

[252] The Constitution of Tanzania does not provide for delegation of taxing powers.

[253] Constitution of Greece 1975 (with Amendments through 2008), Article 78 (4) "The object of taxation, the tax rate, the tax abatements and exemptions and the granting of pensions may not be subject to legislative delegation." See also Vanistendael "Legal Framework for Taxation" (1996) 2.

[254] Constitution of Ghana 1992 (with Amendments through 1996), article 174 (2) "Where an Act, enacted in accordance with clause (1) of this article, confers power on any person or authority to waive or vary a tax imposed by that Act, the exercise of the power of waiver or variation, in favour of any person or authority, shall be subject to the prior approval of Parliament by resolution".

[255] See Chapter sections 2.5.3, 2.5.4.4 and 2.5.5.

procedure on how to conduct negotiations.[256] For instance, the Petroleum Act, 2015 does not identify the negotiators nor stipulate their mandate.[257] However, recently the the Minister of Justice and Constitutional Affairs has been vested with powers to promulgate Regulations prescribing for the parameters of negotiations as well as the code of conduct for members of the the Government negotiation team.[258] Thus, in the past, the law did not create any oversight mechanism to control the powers of negotiator. [259]

The negotiability of certain fiscal terms, though it ensures flexibility, gives too much discretionary powers to Government officials.[260] In the absence of transparency and oversight mechanisms, these discretionary powers may be subject to abuse.[261] Similarly, the fact that the Government deals with each IOC on individual basis creates inequality among the participants, and leads to a lack of uniformity and consistency in the fiscal regime.[262] This makes it difficult for tax administrators to assess and collect taxes due.[263] In addition, the existence of stability clauses means that once agreed, the Government cannot alter these terms unilaterally.[264] The unchecked negotiations of these fiscal terms also open up windows of opportunity for arbitrary and corrupt practices by Government

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[256] Pedersen, RH and Bofin, P *The politics of gas contract negotiations in Tanzania: a review* Danish Institute for International Studies Working Paper 03 (2015) x, 19, 21 .available at http://pure.diis.dk/ws/files/615479/WP_2015_03.pdf (accessed on 10 February 2016).

[257] There is no mention of negotiator nor the negotiation process.

[258] Section 8(2) (a)&(b) of the Natural Wealth and Resources Contracts (Review and Re-negotiation of Unconscionable Terms) Act 2017.

[259] Radon J "The ABCs of Petroleum Contracts: License-Concession Agreements, Joint Ventures, and Production-sharing Agreements" in S Tsalik and A Schiffrin (eds), *Covering Oil: A Reporter's Guide to Energy and Development* (New York, Open Society Institute, 2005) 99; Hackman, NA *Was Ghana Right in Choosing Royalty Tax System For The Oil Sector?* (2010) 16 available at http://www.danquahinstitute.org/docs/OilSectorUnderScrutiny.pdf (accessed on 20 March 2015).

[260] Perreira, EG and Talus K ed *African Upstream Oil and Gas: A practical guide to the law and Regulation* (London, Globe Law and Business, 2015)11-12; Cameron, PD and Stanley, MC *Oil, Gas, and Mining: A Sourcebook for Understanding the Extractive Industries* (Washington DC, The World Bank, 2017) 69.

[261] See the case of Mramba.

[262] Cameron and Stanley *Oil, Gas, and Mining: A Sourcebook for Understanding the Extractive Industries* (2017) 69.

[263] Cameron and Stanley Oil, Gas, and Mining: A Sourcebook for Understanding the Extractive Industries (2017) 69.

[264] Cameron and Stanley Oil, Gas, and Mining: A Sourcebook for Understanding the Extractive Industries (2017) 81.

officials.[265] Moreover, negotiations complicate tax administration as each project may have its own fiscal terms. [266]

It is also notable that there is lack of pre-defined criteria for grant of such incentives.[267] The law is silent on, whom and under what circumstances, qualifies for grant of such exemptions.[268] The law also does not indicate the clearly the forms of tax incentives envisaged and how they are going to be granted. [269] Similarly, there is no clear policy on the objects for grant of tax incentives for example targeting new investments or enhancing specific sectors.[270] All these anomalies not only make the tax incentives open-ended, but also subject to abuse. For instance in *Basil P. Mramba & Daniel Yona v R*[271], the Minister of Finance had granted tax exemptions against the advice by the Government Negotiating Team (GNT) and TRA and without approval by Attorney General as required by the law.

6.3 Limited Transparency

While Tanzania has laws prescribing for transparency in the oil and gas industry, several deficiencies exist. For one, while the Ministers are obliged to publish the said exemptions in the Government gazette,[272] the procedure and applications for grant of tax incentives are not publicize.[273] For this reason, the public does not know about any impending applications for grant of tax incentives. In addition, unlike the normal newspapers and other media outlets, the Government gazette is not easily accessible to the public and thus

[265] Perreira and Talus *African Upstream Oil and Gas: A practical guide to the law and Regulation* (2015) 11. Onorato, WT *Legislative Frameworks Used to Foster Petroleum Development* (Washington, The World Bank, 1995) 4, Cameron and Stanley *Oil, Gas, and Mining: A Sourcebook for Understanding the Extractive Industries* (2017) 69.Tanzania Episcopal Conference (TEC) *The One Billion Dollar Question Question: How Can Tanzania Stop Losing So Much Tax Revenue* (2012) 12.

[266] Cameron and Stanley Oil, Gas, and Mining: A Sourcebook for Understanding the Extractive Industries (2017) 69.

[267] See Chapter 5 section 3.2.

[268] See Chapter 5 section 3.2

[269] Zolt "Tax incentives: protecting the tax base" (2015) 468.

[270] Zolt "Tax incentives: protecting the tax base" (2015) 468.

[271] See the case Mramba v R cited above.

[272] Section 113(4) Petroleum Act 2015.

[273] See Chapter 5 section 3.2

subject to wider public scrutiny.[274] This lack of public scrutiny opens up windows of opportunity for corrupt practices. [275]

Although the law provides that certain information may be treated as confidential, there are no criteria to guide the Minister is making such classification.[276] This has the potential to defeat the transparency intentions.[277] Furthermore, the law does not provide a remedy where the disclosure of information is denied by the Government. This may pre-empt the intention of the legislature to have access to information relating to oil and gas operations. In other jurisdictions, citizens denied information have recourse to the courts of law.[278]

In addition, the involvement of several institutions, such as TRA, TPDC, Ministry of Energy and Minerals as well as local Government authorities in revenue collection, has the potential to undermine transparency.[279] It may facilitate diversion or embezzlement of collected revenues.[280] Generally, a good tax administration requires a streamlined tax administration code with the procedures of assessments and filing of tax returns, payment and recovery of taxes, investigations and audits and dispute settlement mechanisms.[281]

6.4 Existence of Gaps in the Tax System

The discussions under above indicate that there are loopholes or gaps in the tax system that permit revenue leakage. For instance, due to stabilization clauses, the PSAs once signed and registered in the Register of Tax Agreements attain the status of a tax

[274] These are Government's publications with very limited circulation.

[275] See for example the case of Mramba cited above.

[276] The justification may be potential harm to commercial interests. However, this justification should not override public interests. Veit et al "Access to Information and Transparency Provisions in Petroleum Laws in Africa: A Comparative Analysis" (2015) 86.

[277] Veit et al "Access to Information and Transparency Provisions in Petroleum Laws in Africa: A Comparative Analysis" (2015) 70.

[278] For example, in South Africa, the Promotion of Access to Information Act 2 of 2000 provides for internal appeals under sections 74-77 and applications to court under sections 78-82.

[279] Lack of proper coordination Barma et al *Rents to Riches? The Political Economy of Natural Resource-led Development* (Washington, The World Bank 2012) 119.

[280] OECD *Corruption in the Extractive Value Chain: Typology of Risks, Mitigation Measures and Incentives* OECD Publications (2016) 77, 93. available http://www.oecd.org/dev/Corruption-in-the-extractive-value-chain.pdf Dabán and Hélis Public Financial Management Framework for Resource-Producing Countries (2010) 23-24.

[281] Calder, J *Administering Fiscal Regimes for Extractive Industries: A Handbook* Washington: International Monetary Fund (2014) 37; Dabán, T and Hélis, J *A Public Financial Management Framework for Resource-Producing Countries* (Washington DC, International Monetary Fund, 2010) 23-24.

agreement.[282] These stabilization clauses limit the future legislative powers to amend the fiscal terms.[283] It means that it is difficult to rectify the unseen consequences, such as incentives granted based on poorly drafted laws. Similarly where the benefits are exorbitant in terms of both quantity and period.[284] For this reason, even the recent amendments by the Petroleum Act 2015 and the Finance Act 2016 cannot have effect until when renegotiation has taken place.[285] Consequently, this denies the Government the right additional revenues which would have otherwise been payable had these laws taken effect.[286] It is also notable that the courts have been reluctant to close gaps in tax laws and thus permits transactions to go untaxed. For instance, the Court in *Commissioner General TRA v Pan African Energy Tz Ltd*[287] held that, even though there was a lacuna in the law, which might create room or leeway for tax evasion, it was not for the Court to fill the gap; instead, the solution is to amend the law.[288]

Moreover, there are still grey areas relating to imposition of capital gains tax for indirect transfers of rights. Although section 56 of the Income Tax Act 2004 aims at capturing the indirect transfer of rights or shares, it is difficult to tax transactions taking place abroad and in countries not parties to tax treaties that Tanzania has signed.[289] This difficulty arises due to lack of information about the transactions. Moreover, the rate of change of underlying ownership is too high. In practice, most restructuring does not go beyond 50 percent. It also means that section 56 does not capture indirect transfers resulting to change of underlying ownership by 50 percent.[290] Likewise, while “farm” in and “farm out” transactions are subject to capital gains tax in Tanzania, the Income Tax Act 2004 does not provide for the mechanisms for the valuation of shares, deductibility of

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[282] Section 143 of the Income Tax Act 2004

[283] Barma et al Rents To Riches? The Political Economy of Natural Resource–Led Development (2012) 140; Cameron, PD and Stanley, MC Oil, Gas, and Mining: A Sourcebook for Understanding the Extractive Industries (2017) 81.

[284] See Chapter 5 section 3.

[285] See the discussions on the legal implications of stabilization clauses under Chapter 3 section 3.1.5.

[286] Ogunleye “A Legal Analysis of Production Sharing Contract Arrangements in the Nigerian Petroleum Industry” (2015) 6-7.

[287] The Company is engaged in E&P, distribution and marketing at Songosongo in Lindi and operates gas processing plant Songas Ltd Civil Appeal No. 15 of 2015, Court of Appeal of Tanzania, (Unreported).

[288] Civil Appeal No. 15 of 2015, Court of Appeal of Tanzania, (Unreported).

[289] Bajungu “Capital Gains Taxation and Indirect Sales: Experience, Challenges and Remedial Efforts in Tanzanian Perspective” (2014) 4.

[290] Bajungu “Capital Gains Taxation and Indirect Sales: Experience, Challenges and Remedial Efforts in Tanzanian Perspective” (2014) 6.

expenditures and timing for payment of capital gains tax.[291] This opens up windows for aggressive tax planning by the IOCs.

Similarly, there are several challenges in managing transfer pricing in Tanzania. For one, the Tanzania's anti-transfer pricing regime is still at its nascent stages.[292] There is a need for qualified and competent personnel to enforce the arm's length rule. In addition, since most of the transactions are cross-border, occurring in countries that do not have cooperation in exchange of tax information, determination of prices that is at arm's length is difficult.[293] Moreover, the choice of either OECD or UN Model in case of lacunae in the Transfer pricing Regulations creates a problem of inconsistency.[294] Thus, it may open loopholes for tax avoidance.

6.5 Parallel Fiscal Rules in the PSA and Tax Laws

The analysis of PSAs under Table 1.2 indicates that the PSAs have clauses that contain own fiscal rules, which are inconsistent with the tax laws. In practice, the cost oil or gas resembles the deductible costs under the Income Tax Act 2004 and run parallel to each other.[295] However, the concept of cost recovery, as provided for under the PSA, is not covered under either the Income Tax Act 2004 or Petroleum Act 2015.[296] For instance, the PSA sets a ceiling for cost recovery at 50 percent and 70 percent of the total production

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[291] This is one of the issues in the BG case discussed under Chapter 5 section 2.5.4.5 Bajungu "Capital Gains Taxation and Indirect Sales: Experience, Challenges and Remedial Efforts in Tanzanian Perspective" (2014) 6. In South Africa, for example, paragraph 26(1) of the 8th Schedule to the No. 58 of 1962 (as amended) requires the valuation to apply market value. Under paragraph 31(1)(g) of the 8th Schedule market value is defined as "the asset sale price that could have been obtained between a willing buyer and willing seller dealing at arm's length in an open market".

[292] The Transfer Pricing Regulations only passed in 2014. See Msike and Mabula "UN-ATAF Workshop on Transfer Pricing Madagascar Tanzania Case Study" (2016) 4.

[293] Bajungu, C "Fairness in Taxing Multinationals and Extractive Industries": Tanzanian Perspective" (2013) 16-17. A paper presented on a conference organized by tax justice network (3-4 October 2013) available at https://en.xing-events.com/eventResources/T/Z/NrPHZSvfGUAnRs/Charles_Bajungu.pdf (accessed 20 October 2016)

[294] Bajungu, C "Fairness in Taxing Multinationals and Extractive Industries": Tanzanian Perspective" (2013) 16-17.

[295] See Chapter 6 section 6.5

[296] Section 47 of Petroleum Act 2015 provides for the application of PSAs but does not provide for details on the terms of the contract. Similarly under section 11 of the Income Tax Act expenses are either deductible or depreciated.

net of royalty for onshore and offshore projects respectively.[297] This contravenes the rules of deductibility of expenditures under the Income Tax Act 2004, which do not set a ceiling for such deductions. Since the cost recovery ceiling is subject to negotiation, a conflict with the provision of Income Tax Act 2004 may ensue. However, the position of the law is very clear, as it was cemented in the case of *Geita Gold Mine v the Commissioner General*,[298] the provisions of the law prevails over any agreement.[299] Further to that, there is no charging provision for APT in both the Income Tax Act 2004 and Petroleum Act 2015. It means that APT is purely a contractual, thus subject to negotiations. This is not only contravenes the article 138(1) of the Constitution but also complicates tax administration. For example, the role of TRA is to interpret tax laws and not agreements.[300] Similarly, negotiability of APT may also create inconsistency and lack of uniformity in the imposition of taxes, contrary to the principle of equity in taxation.[301]

It is also notable that there are clauses in the PSAs that purport to grant exemptions on VAT, import duty and withholding tax on dividends.[302] This is contrary to the provisions of tax laws where only the Minister of Finance can grant tax exemptions.[303] Furthermore, purporting grant tax exemptions in the PSA is contrary to the procedures, which require such exemptions to be published in the Government gazette.[304] This inconsistency between the PSA and the tax laws creates a legal quagmire. For instance, in *Geita Gold Mining Limited v Commissioner General*,[305] it was held that although the Minister for Energy and Minerals had powers to enter into Mining Development Agreements (MDA) and to determine the terms thereof; such powers did not include granting fiscal reliefs to MDA holders.

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[297] Article 12 (a), Model PSA 2013 onshore areas include shelf up to water depths of 500 meters and offshore areas include water depths beyond 500 meters.

[298]Tanzanian Tax Revenue Appeals Tribunal at Mwanza, Appeal No. 4 of 2012 (unreported).

[299] See also *Tullow Uganda Ltd & Another v. Uganda Revenue Authority* TAT Application No. 4 of 2011, Uganda Tax Appeals Tribunal at 68 (Unreported), where it was held that "[a] contract cannot override a statute".

[300] Section 5(1)(a) and the First Schedule to the Tax Revenue Authority 1995.

[301] Cameron and Stanley Oil, Gas, and Mining: A Sourcebook for Understanding the Extractive Industries (2017) 69.

[302] See Table 1.2.

[303] See Chapter 5 section 3.2

[304] See Chapter 5 section 3.2.

[305] Tanzanian Tax Revenue Appeals Tribunal at Mwanza, Appeal No. 4 of 2012 (unreported).

7 Conclusion

The chapter examined the different measures adopted in Tanzania to counteract tax revenue leakage. These measures include the anti-corruption regime, anti-tax avoidance rules, criminalization of tax evasion and administrative measures. In essence, these measures aim to close the gaps and loopholes in the tax system, remove incentives for corruption, closing windows of opportunity for corruption as well as sanctioning tax evasion. The chapter has also highlighted, with examples, the challenges of administering the oil and gas tax regime. These challenges include the existence of gaps in the tax system, limited transparency, unregulated negotiations of fiscal terms, and negative delegation of tax law making powers parallel fiscal rules between the PSA and the tax laws. These challenges form the basis for recommendations in the next chapter.

PART III: CONCLUSION

This part provides a conclusion. The conclusion specifically provides a summary on how the Tanzanian oil and gas fiscal regime addresses tax revenue leakage. This part also provides recommendations.

CHAPTER SEVEN: SUMMATIVE CONCLUSION AND RECOMMENDATIONS

1 Introduction

The main aim of this study is to examine and analyze the legal framework for prevention of tax revenue leakage in the upstream oil and gas industry in Tanzania.[1] In doing so, it scrutinizes the different concepts, methods and options available in a public trusteeship model of natural resource holding. Specifically, the analyses in chapters two, three and four provide a theoretical framework in which to understand tax revenue leakage. Those chapters also identify the causative factors for tax revenue leakage and the corresponding remedial measures. Chapter five and chapter six adopt the analytical tools developed under chapter four to evaluate and analyze the measures addressing tax revenue leakage in Tanzania.

Generally, the findings of this study under chapter six indicate that Tanzania has adopted several measures to counteract tax revenue leakage. It implies that the level of Government's tax revenue depends on how these remedial measures are enforced. However, there are numerous constraints on the applicability of such remedial measures. These constraints include negative delegation of tax-law making powers, existence of gaps in tax laws, limited transparency, unguided negotiation of fiscal terms, and parallel fiscal rules between PSA and tax laws.[2] In view of these discussions, this chapter summarizes the main ideas, provides a conclusion of main arguments and recommendations for policy makers and legislators. The next section collates all the major issues raised in this study.

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[1] See Chapter 1 section 3.

[2] See Chapter 6 section 6.

2 Summary of Main Issues

This study uses the resource curse theory to analyze and evaluate tax-related challenges in the Tanzanian upstream oil and gas industry. The resource curse study unravels the paradox of oil and gas wealth in Africa.[3] It explains the reasons why most oil-rich countries in Africa experience slower economic growth, corruption, abject poverty, political instability, and autocracy.[4] Although there are many factors that contribute to the occurrence of the resource curse, this study argues that the "curse" is partly a result of systemic under-taxation.[5] The analysis demonstrate that Tanzania's fiscal regime has fiscal terms that match international best practices.[6] The major assumption underlying this study is that several factors impede the Government's ability to collect the potential taxes.[7] For this reason, this study posits that the problem of under-taxation is not the result of inadequacy of the law, but rather the environment within which such laws are implemented.[8]

This study identifies the factors that create loopholes for tax revenue leakage to include tax exemption, tax avoidance, tax evasion and fiscal corruption.[9] As it is argued throughout this study, in absence any counteractive measure, only a fraction of the potential taxes may be collected and remitted to the treasury.[10] The leakage of these tax revenues implies the loss of much needed revenue required to finance Governmental projects.[11] Thus, leakage impedes the Government's capacity to provide social services and other developmental projects.[12] To apply these findings to the context of Tanzania's taxation regime, this study highlights the following main issues.

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[3] See Chapter 1 section 1.1

[4] See Chapter 1 section 1.1

[5] See Chapter 3 section 3.

[6] See Chapter 2 section 4 and Chapter 5 section 2.5

[7] See Chapter 3 section 3.

[8] See Chapter 4 section 2.

[9] See Chapter 3 section 3.

[10] See Chapter 3 section 3.

[11] Taxation is the major source of Government revenue

[12] Article 9(c) and (i) of the Constitution of the United Republic of Tanzania 1977 and section 6 of the Natural Wealth and Resources (Permanent Sovereignty) Act 2017 oblige the Government to utilize national resources for eradication of poverty, illiteracy and diseases.

First, in Tanzania, the ownership oil and gas *in situ* vests in the State, regardless of whether these resources are situated in land, inland waters or the sea.[13] However, this is not "ownership" in strict sense as understood in property law.[14] Instead, the Government holds the resources in trust, to be managed on behalf of, and for the benefit of both current and future generations.[15] Therefore, it is the Government's duty to ensure not only optimal exploitation of the resources, but also to ensure that it receives adequate economic benefits (through royalties, taxation and Government participation) from their exploitation.[16]

While State ownership entitles the Government to undertake the exploration and extraction by itself, the Tanzanian state typically undertake extraction through a partnership between International Oil Companies (IOCs) and Tanzania Petroleum Development Corporation (TPDC). As owner of oil and gas *in situ,* the Government stands in the same position as a landlord to receive rent in form of fees, royalties and bonuses as compensation for allowing extraction of oil and gas.[17] These special levies and charges apply alongside the generally applicable taxes, such as corporate income tax, value added tax (VAT), stamp duties, import duties, local Government taxes, withholding tax and capital gains tax.[18] In addition, the law requires TPDC to acquire at least 25 percent of equity interests in every oil and gas project.[19]

Second, the Tanzanian oil and gas industry is in its early stages. Although the exploration for oil and gas in Tanzania commenced in 1952, and discoveries of natural gas were made

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[13] Section 4 of the Petroleum Act 2015; vest in the United Republic of Tanzania and the President is the trustee.

[14] Chapter 5 section 2.1

[15] The Government is expected to use the oil and gas revenues to fund social services and ensure economic growth Section 251 of the Petroleum Act, Article 9(c) and (i) of the Constitution of the United Republic of Tanzania 1977 and section 6 of the Natural Wealth and Resources (Permanent Sovereignty) Act 2017. See also. Daniel, P *Petroleum Revenue Management An Overview* (Washington DC, World Bank, (2002) 5. Sachs, JD. & Warner, AM "The Big Push, Natural Resource Booms and Growth" 59 *Journal of Development Economics* (1999) 43-76, 43-47. Under PTD the state is required to act in the best interests of the nations see Sax, JL "Public Trust Doctrine in Natural Resource Law: Effective Judicial Intervention" 68 *Michigan L. Rev.* (1970) at 474-785. See also the Natural Gas Policy 2013.

[16] See sections 113, 116 & 218 of the Petroleum Act 2015. See also Inkpen, A and Moffett, MH *The Global Oil and Gas Industry: Management, Strategy and Finance* (Tulsa, PennWell Corporation, 2011) 41.

[17] See Chapter 5.

[18] See Chapter 5. Section 3.2

[19] However, TPDC has the discretion to decide for a lesser or higher percentage. See section 44(5) Petroleum Act 2015.

in 1974 and 1982, production commenced only in 2004 at Songo Songo and in 2006 at Mnazi Bay.[20] Similarly, there are two PSAs at production stage namely Msimbati (Mnazi Bay with 5 tcf) and Songo Songo (with 2.7 tcf) and Kiliwani North-1 (with 13.1 tfc) at the development stage and expected to start production in 2020.[21] Thus, the contribution of natural gas production to the GDP is still very low.[22] However, with the completion of the 530-kilometre natural gas pipeline, the plans for construction of an LNG plant as well as the 1140 km Uganda-Tanzania oil pipeline, there are prospects that Tanzania is an emerging oil and gas economy in the near future.[23]

Third, Tanzania uses the Production Sharing Agreement (PSA) system as the mechanism for grant of exploration or extraction rights to IOCs.[24] There are two ways of granting exploration or extraction rights to prospective IOCs, namely direct negotiations and competitive tendering.[25] In the same vein, the PSA is used as a mechanism for creating Government tax revenues through imposition of taxes and charging royalties, bonuses, production sharing, state equity participation and rental fees.[26] Some of these fiscal terms, such as royalties and taxes are fixed in the law while others, such as production sharing and bonuses are subject to negotiations.

Fourth, in view of attracting new investments and maintaining the existing ones, the Government of Tanzania offers several tax incentives.[27] These tax incentives include accelerated cost recovery, capital goods exempted from import duty and VAT, stabilization of fiscal terms, relief from double taxation.[28] Another notable incentive is that certain fiscal elements, such as bonuses, production sharing, and Government equity

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[20] Tanzania Natural Gas Policy (2013) 1; Pedersen, RH and Bofin, P *The politics of gas contract negotiations in Tanzania: a review* (2015) 8-9;

[21] See Table 1.1.

[22] According to TEITI in 2014 gas used for production of electricity only contributed 1.4 percent of the GDP TEITI "Scoping Report on the Preparation of EITI Reconciliation Reports for the years of 2012/2013 and 2013/2014 for Tanzania Extractive Industries Transparency Initiative (2015) 32 available at http://www.teiti.or.tz/wp-content/uploads/2017/01/2012-2013-2013-2014_Final-TEITI-Scoping-Report.pdf (accessed on 25 August 2016)

[23] See Chapter 1 section 3.

[24] Chapter 5, section 2.3

[25] See Chapter 5. Section 3.1. See also section 48 Petroleum Act 2015.

[26] See Chapter 5.

[27] Chapter 5, section 3.1

[28] Chapter 5, section 3.1

participation, are subject to negotiation.[29] There are also other general incentives, such as the guarantee against expropriation of property and the use of neutral mechanisms for dispute settlement.[30] There are three methods of granting tax incentives, namely incentives fixed in the law, discretionary incentives through Government notices, and incentives granted at the time of signing the PSAs.[31] In addition, Tanzania provides for fiscal stabilization, thus giving guarantees to the IOCs that the fiscal terms will not change within a specified period.[32]

Fifth, while the extraction of natural gas has the potential to create massive tax revenues, several factors may undermine the Government's ability to collect taxes. In that regard, this study has identified several factors that are likely to cause tax revenue leakage.[33] These factors include tax incentives, such as tax exemptions, lowering tax rates and special tax treatment, which result into non-payment of taxes that would have otherwise been payable. In addition, the IOCs adopt a variety of techniques, such as transfer pricing, thin capitalization, corporate re-organization and treaty shopping to minimize, reduce or eliminate their tax obligations. Similarly, the IOCs may engage in outright criminal conducts, such as non-declaration of income, forgery, under-invoicing and double accounting. Likewise, some Government officials - motivated by their own interests - engage in corrupt transactions to defraud the Government tax revenues. For instance, corrupt Government officials may willfully fail to collect taxes due, short levy taxes, grant undeserving tax incentives to the IOCs or divert revenues collected for their own account. All these factors demonstrate the close connection between under-taxation, corruption, tax avoidance and tax evasion.

Sixth, several factors make it possible for the IOCs to avoid or evade taxes without being detected or punished.[34] These factors include the existence of gaps and loopholes in the tax system, information asymmetry between the tax administrators and the IOCs as well as the weak mechanisms of detecting, preventing and punishing tax avoidance and tax

[29] Chapter 5, section 3.1
[30] See Chapter 5, Section 4.1
[31] Chapter 5, section 3.2
[32] Chapter 5, section 3.1
[33] See Chapter 3, Section 3.
[34] Chapter 4. Section 2.

evasion.[35] For example, there are weak anti-avoidance measures, such as the lack of an effective GAAR, thin capitalization rules, anti-treaty shopping and existence of tax havens.[36] In the same connection, fiscal corruption thrives, because as long as there are factors that motivate Government officials to engage in corrupt practices, the window of opportunity for corrupt practices remains widely open.[37] The lapses in the legal system that create a window of opportunity for corrupt practices include lack of oversight mechanisms on the exercise of power and uncontrolled discretion vested on Government officials.[38]

Seventh, in response to the problem of tax revenue leakage, the Government adopts several counteractive measures.[39] One of these measures is anti-tax avoidance legislation, which aims at closing the gaps and loopholes in the tax system.[40] It includes the general anti-tax abuse rules (GAAR) deals with unforeseen tax avoidance schemes, the specific anti-tax abuse rules (SAAR) addresses specific tax avoidance techniques. The specific anti-tax abuse rules (SAAR) include the arm's length principle, ring fencing of costs and revenues, rules on realization of petroleum rights, anti-tax treaty shopping rules and restrictions on debt financing.

In addition, there are several administrative measures for the prevention, detection and punishment of tax avoidance and tax evasion.[41] These measures include an obligation on the IOCs to keep and maintain records as well as Tanzania Revenue Authority (TRA) and Petroleum Upstream Regulatory Authority (PURA) powers to audit the IOC's books of account and transactions. Moreover, the Energy and Water Utilities Regulatory Authority (EWURA) prescribes oil and gas prices. In the same vein, transfer of petroleum rights must be endorsed by the Commissioner General for TRA and approved by the Minister of Energy and Minerals. As regards administrative capacity the TRA has established a

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[35] Chapter 5 section 2.5
[36] See Chapter 6 section 6.
[37] See Chapter 6 section 6.2 and 6.3.
[38] See Chapter 6 section 6.2 and 6.3.
[39] See Chapter 4 section 3 and Chapter 6. Sections 2,3,4 and 5.
[40] See Chapter 6 section 3.
[41] See Chapter 6 section 5.

special unit, namely International Tax Unit (ITU), that deals with transfer pricing and double taxation agreements.

The other counteractive measures relate to criminalization of tax evasion.[42] Criminalized conducts include using or making false and misleading statements, aiding or abetting tax evasion, forgery, conspiracy to commit an offence and cheating, failure to pay taxes and impeding tax administration.

As regards fiscal corruption, the anti-corruption regime targets closing the windows of opportunity for corrupt practices as well as removing the incentives for Government officials to engage in corrupt transactions.[43] In doing so, it aims to eradicate certain types of conduct, such as giving or receiving bribes, facilitating tax evasion, public officials living above their lawful income, misuse of public power for personal gains, misappropriation of public funds and negligence in the discharge of public duties. The punishment meted out for these offences include imprisonment, fines as well as forfeiture of proceeds of crime. The law also establishes the Prevention and Combating of Corruption Bureau (PCCB) as the central anti-corruption agency in the country. There are also measures to enhance transparency in the country, such as an obligation on the Government to keep, maintain and disseminate information relating to the granting of rights, contracts, revenue collection and management. It also includes the establishment of EITI Committee, which reconciles the payments made by the IOCs and those received by the Government. There are several limits on the Ministerial discretionary powers to sign PSAs. There are, moreover, restrictions on Ministerial powers to grant exemption, remit any interests or penalty imposed by any tax law. These limits aim to control the procedures for decision-making and the substantive decision itself.

Although these remedial measures do not guarantee complete closing of loopholes in the tax system, their deployment has the potential to mitigate the impact of tax revenue leakage.[44] Furthermore, these remedial measures form the basis for further research in the oil and gas industry.

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[42] See Chapter 6 section 4.

[43] See Chapter 6 section 2.

[44] See general discussion of the concept of tax revenue leakage under Chapter 3.

3 Concluding Recommendations

This study has established that Tanzania, like many other African countries, experiences several tax-related challenges in the upstream oil and gas sector.[45] In response to these challenges, Tanzania has adopted several measures to counteract tax revenue leakage. However, as discussions in Chapter 6 have demonstrated, there are numerous shortcomings in the measure counteracting tax revenue leakage. These shortcomings include negative delegation of tax-law making powers, existence of gaps in tax laws, limited transparency, unguided negotiation of fiscal terms, and parallel fiscal rules between PSA and tax laws.[46] In the light of these shortcomings, this study concludes that although Tanzania has several measures to counteract tax revenue leakage, the level of Government's tax revenue nevertheless depends on the manner in which these counteractive measures are enforced. The next section provides recommendations on how to improve the measures counteracting tax revenue leakage.

Despite the remedial measures Tanzania has adopted to prevent tax revenue leakage, several shortcomings need reform. These shortcomings include discretionary tax and royalties exemptions, open-ended fiscal incentives, low penalties for tax evasion and insufficient anti-avoidance rules. Consistent with the analytical framework developed under chapter 4, this section provides recommendations on how to address the identified shortcomings.

First, instead of relying on tax incentives as a method of attracting investments in the oil and gas industry, the Government should strive to improve the environment for doing business in the country. Where it is necessary to grant tax exemptions, the law should provide the mechanisms to analyze and evaluate the costs and benefits of granting such tax incentives.[47] Moreover, to tighten the loopholes in the tax incentives regime, all tax laws should have a "sunset" provision, which limits the applicability of incentives within a specified period or externalities.[48] Once such period expires or externalities are addressed, such incentives cease to apply. In the same vein, law should prescribe the

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[45] See Chapter 6 section 6.

[46] See Chapter 6 section 6.

[47] Zolt "Tax incentives: protecting the tax base" (2015) 480.

[48] Zolt "Tax incentives: protecting the tax base" (2015) 480.

criteria to be considered when granting such tax exemption. These criteria could determine who qualifies, why, how much and for how long. The procedure for grant of tax incentives should be publicized in the newspapers of wide circulation, and once granted, the names of such beneficiaries must also be published.[49] Similarly, all the recipients of tax incentives must be required to report annually on how much they have received and how they utilized such exemptions. Finally, all the discretionary powers to grant tax exemptions under the Income Tax Act 2004, Stamp Duty Act, and Excise Tariff Act should be abolished. Instead, like in the Value Added Tax Act 2014, all exemptions must be provided for in the law itself.

Second, as regards gaps in the tax system, it is recommended that the Model PSA should be part of the Regulations to ensure that the fiscal terms contained therein match those provided for in the legislation. Moreover, the Income Tax Act 2004 should be amended to include a provision for charging Additional Profit Tax (APT). In addition, the Income Tax Act 2004 should be amended to improve the imposition of capital gains tax for indirect transfers of petroleum rights. The amendment should entail the procedure for assessing realized assets, calculating gain at the time of realization and apportioning shares involved in the transfer. Furthermore, to enhance transparency in the collection of tax revenues, the tax administration should be streamlined (form a single agency for assessment and collection of taxes). In addition, to discourage thin capitalization, the Income Tax Act 2004 should be amended to incorporate an earning stripping rule whereby the deduction of interest should be limited to 30 percent of gross revenues before any deductions.[50]

Third, section 31 of the Prevention and Combating of Corruption Act and section 96 the Penal Code should be amended to include, as part of the penalties, an obligation to indemnify the Government for loss caused as a result of corruption. Similarly, the Tax Administration Act should be amended to ensure that all professionals who aid or abet tax evasion are expelled from professional bodies as well as cancellation of all fiscal incentives for the IOCs evading taxes. In addition, to ensure deterrence the penalties for

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[49] Zolt "Tax incentives: protecting the tax base" (2015) 481.

[50] Readhead *Preventing Tax Base Erosion in Africa: a Regional Study of Transfer Pricing Challenges in the Mining Sector* (2016) 40. OECD *Limiting Base Erosion Involving Interests Deductions and Other Financial Payments, Action 4 Final Report* (OECD Publications 2015) 38, 47

abuse of power should be increased from the current one (three years imprisonment) and lift the fine from the five million shillings, which is too lenient.

Fourth, the Tanzania Extractive Industries (Transparency and Accountability) Act, 2015 should lay down the criteria to be used to classify certain information as confidential. In absence of these criteria, a confidentiality clause may defeat the core purpose of transparency. Similarly, the Act should be amended to provide for a remedy where the disclosure of information is denied by the Government.

Fifth, the Tax Administration Act 2015 should be amended and impose an obligation on the Minister of Finance to table a report before the National Assembly, indicating the tax exemptions granted, the beneficiaries and the justification for such exemptions. To ensure vigilance in the grant of tax exemptions, the Tax Administration Act 2015 should spell out the policy objectives for granting tax exemptions, such as attraction of new investments or addressing certain identifiable bottlenecks in the investment regime.[51]

Sixth, the Petroleum Act 2015 or regulations should provide procedures for appointing negotiators as well as qualification criteria. In addition, the Act should prescribe guidance or procedure on how to conduct negotiations. For instance, the law should stipulate the mandate of negotiators in terms what they can and what they cannot do. The Act should also provide for a code of conduct for such negotiators.

From the above discussions, it is clear that the discovery of oil and gas resources in developing countries is neither an automatic blessing nor an immutable curse. Instead, whatever the impact of the presence of oil and gas resources in a particular country is, depends on the legal framework and the competency of its Governmental institutions. As this study demonstrates, some of the worst ills brought upon a country for having oil and gas resources – underdevelopment, corruption, poverty, and inequality – can be addressed by tweaking the oil and gas taxation regime. To some extent, the cure for the resource curse hence lies outside the sphere of mere regulation of the extractive process – it lies in the mechanisms supporting the state to monitor and deploy the proceeds of that process.

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[51] Zolt "Tax incentives: protecting the tax base" (2015) 468.

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