Supporting Inclusive Resource Development (SIRD)
East Africa
TRAINING PROGRAM
2019

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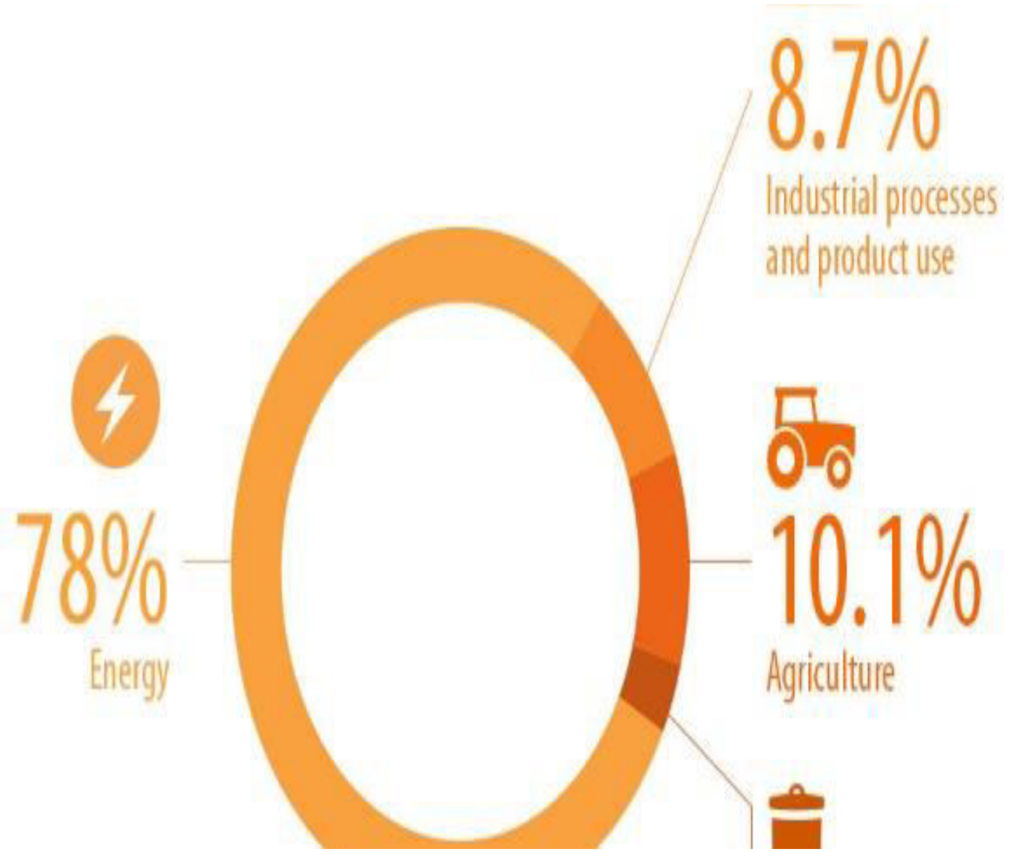
QUESTIONS ?

Name the various taxes affecting the extractive industries in Kenya?

How does the fiscal regime affect the decision of a prospective Investor in the extractive industry to invest in Kenya?



Revenue Management in the Extractives Industry

INTRODUCTION

- The Extractives Industry is a broad term representing;

a. Oil (Crude Oil, Petroleum and Petroleum products)
b. Gas (LPG)
c. Natural Minerals (Gold, diamonds, copper, rare stones)

- Land is defined under the Constitution of Kenya to include all minerals and mineral oils as defined by law.

INTRODUCTION

- **Extractives**: Refers to the extraction of raw materials from the earth such as metals, minerals and other aggregates.
- The extractives industry has the potential to generate revenue from the various commodities, which revenue;

i. Pays the investors and their lenders

ii. Protects the environment

iii. Caters for the community needs.

- Africa holds 30% of the worlds mineral reserves, 10% of the world oil and 18% of the worlds natural gas.

INTRODUCTION

- Extractives in Kenya contribute approximately 5% to gross domestic product (GDP).
- Kenya’s extractives sector is characterized by a wide range of minerals including soda ash, limestone, barite, fluorspar, gypsum, carbon dioxide, salt, manganese, soapstone, graphite, copper, gold, chromite, and nickel, among others.
- The Country has also recently discovered a range of extractive resources, including niobium and rare earths, mineral sand deposits (including titanium ores such as retile, clementine and zircon), coal, as well as oil and gas deposits.

INTRODUCTION

- Land is defined to include all minerals and mineral oils as defined by law.
- **Article 60 of the Constitution-** sustainable and productive management of land resources including protection of ecologically sensitive areas and sound conservation
- **Article 69 (1) (a) of the Constitution-** bestows on the State the responsibility to ensure sustainable utilization, management and conservation of the environment and natural resources, and ensure the equitable sharing of the accruing benefits between present and future generations.
- **Article 42 of the Constitution-** all people have the right to benefit equally from the use of natural resources. Entitlement to a clean and healthy environment.

The Constitution of Kenya,2010

- The following criteria shall be taken into account in determining the equitable shares provided for under Article 202 and in all National legislation concerning County Government enacted in terms of this Chapter-

(a) the national interest;

(b) any provision that must be made in respect of the public debt and other national obligations;

(c) the needs of the National Government, determined by objective criteria;

(d) the need to ensure that County Governments are able to perform the functions allocated to them;

(e) the fiscal capacity and efficiency of County Governments;

(f) developmental and other needs of counties;

(g) economic disparities within and among counties and the need to remedy them;

The Constitution of Kenya,2010

(h) the need for affirmative action in respect of disadvantaged areas and groups;

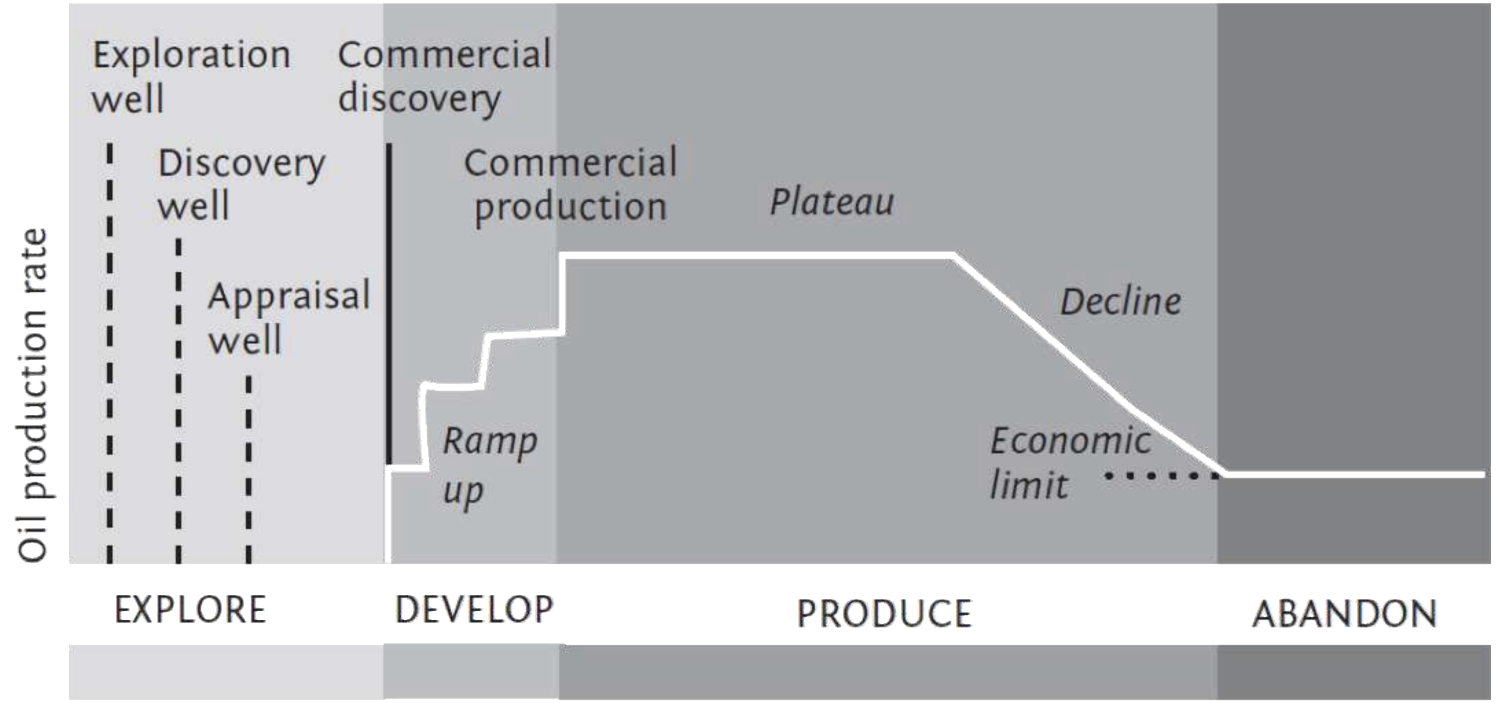
(i) the need for economic optimisation of each county and to provide incentives for each County to optimise its capacity to raise revenue;

(j) the desirability of stable and predictable allocations of revenue; and

(k) the need for flexibility in responding to emergencies and other temporary needs, based on similar objective criteria.

(2) For every financial year, the equitable share of the revenue raised nationally that is allocated to county governments shall be not less than fifteen per cent of all revenue collected by the National Government.

COMPONENTS OF PETROLEUM PRODUCTION



Example of an oil project timeline

Petroleum Act,2019

- Part VII, Section 57 provides for Petroleum Revenue Share Mechanisms
- The Profit from upstream petroleum operations shared by contractor and National government in accordance with Petroleum Agreement (PSC)
- The National government's share of petroleum revenues before the imposition of taxes shall be deposited into petroleum fund, and managed in accordance with Public Finance Management Act, 2012.

Petroleum Act, 2019

- Part VII, Section 58 expressly provides for sharing of National Government's share of profits
- All upstream petroleum operations that generate revenue shall be shared between the 3 entities; National government, County government and the Local community.
  a) The County government 20%
  b) National government 75%
  c) Local Community 5% payable to a trust fund, board of trustees, established by County Government in consultation with the Local Community.
- Reviewed after ten (10) years.

Existing Production Sharing Contract (PSC) under the Petroleum (Exploration and Production) Act of 2012.

- In the extractives Industry PSCs refer to a contract executed between a Government and a resource extraction company (or various companies/organisations)
- The company agrees to meet all costs of production, exploration and risks "**Costs Oil**"
- In this kind of agreement, the government owns a share of the product "**Profit Oil**".

COMPONENTS OF PRODUCTION SHARING CONTRACT

- All contracts are based on a Model Production Sharing Contract (PSC) issued as a schedule to the Regulations. The signed Production Sharing Contracts have the following key component:

a) Signature Bonus: This is a one-off fee payable to the Government by the Company upon signing of an oil exploration contract. It depends on the area of the Block and previous data acquired on the Block.

b) A **surface fee** is also payable and is calculated on the basis of the surface area of the Contract Area on the date those payments are due .

c) Work programme and expenditure: The contractor guarantees the agreed work programme and minimum expenditure. Initially pegged at 15% bank guarantee and 85% parent company guarantee. The Ministry has improved this to a 50% bank guarantee and 50% parent company guarantee.

d) Cost oil: This is the percentage of crude produced allowed for recouping investment costs incurred during exploration and production of oil. It is normally 60% of all the oil produced for about five years.

COMPONENTS OF PRODUCTION SHARING CONTRACT

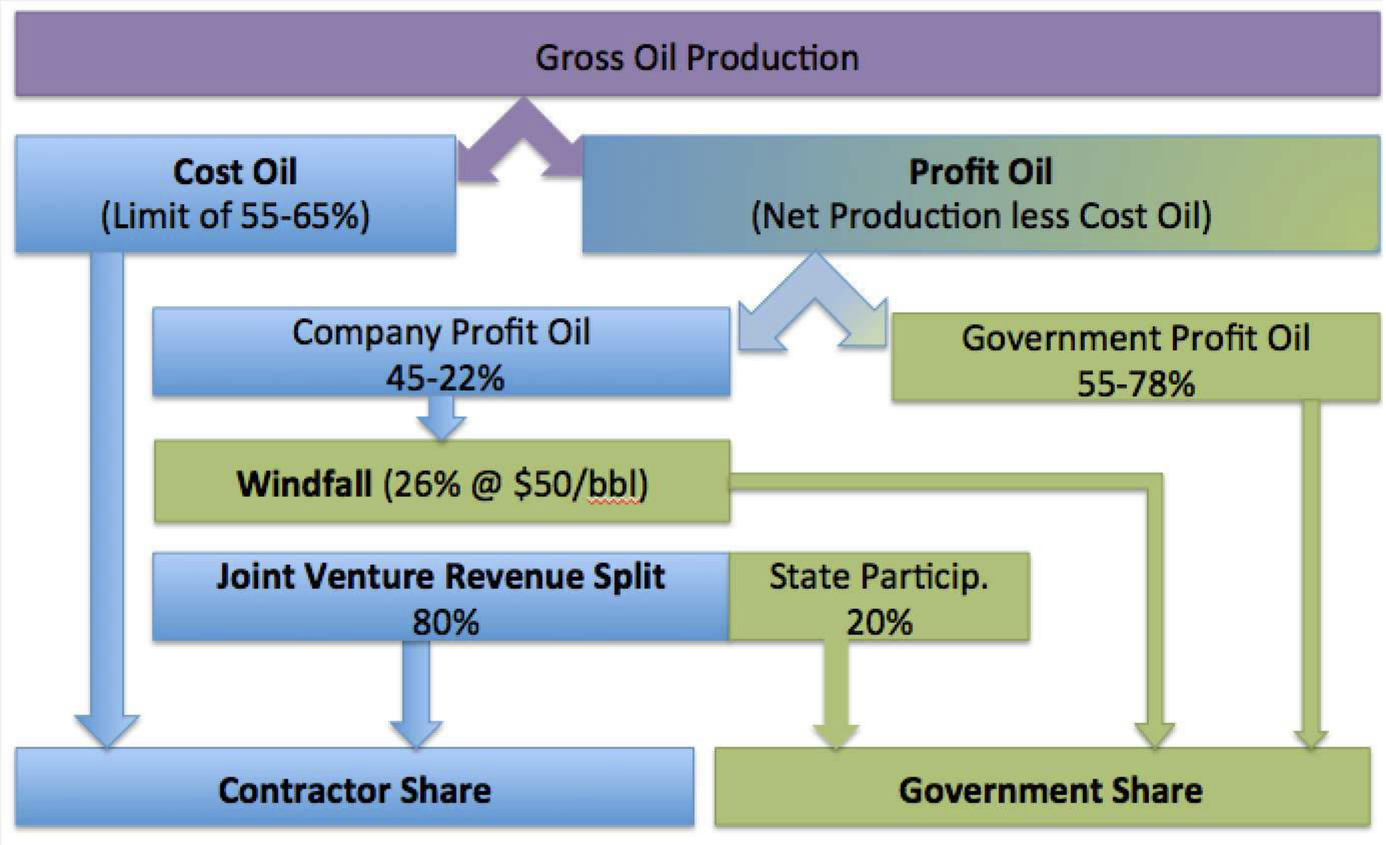
e) Profit oil: This is the remaining oil after deducting cost oil and is shared between the Government and the contractor.

f) Windfall profit: Where oil prices are higher than the negotiated threshold, the Government creams off contractors take above the threshold crude oil prices by 26%.

g) Exploration phases – there are three exploration phases of two years each, the initial period, first additional period and second additional period. For ultra deep offshore blocks, the initial period is extended to three years due to extra logistical challenges in the deep water acreage.

h) Relinquishment – is 25% of the area of the block for each period. The PS has the license rental fee and training fee included. In Block 12B for examp license rental fee is set at $40,000 during the first year (2012-2013) and $8 during the second year, training fee is $100,000 per annum. During the production phase the training fee is set at a minimum of $200,000 in Block with Lion Petroleum.

COMPONENTS OF PRODUCTION SHARING CONTRACT



Mining Act,2016

- The Mining Act regulates the Mining Sector.
- The Act states that all minerals are vested in the National government and may only be issued to any other person subject to processes established under the Act.
- Any authorization for the exploitation of minerals is granted through the Commissioner of Mines and Geology or an officer duly authorized by him.
- The Commissioner has powers to grant, refuse, suspend, cancel or extend prospecting and mining rights. The Act confers a wide discretion upon the Commissioner in making such decisions.

Mining Act,2016

- Any holder of a mineral right shall pay Royalties to the state under section 183. The amount/rates payable are prescribed by the Cabinet Secretary and also depends on the various mineral classes.
- Royalties payable are to be distributed in the following percentages;

    I. National government to get 70%

    II. County government to get 20%

    III. The Local community to get 10%

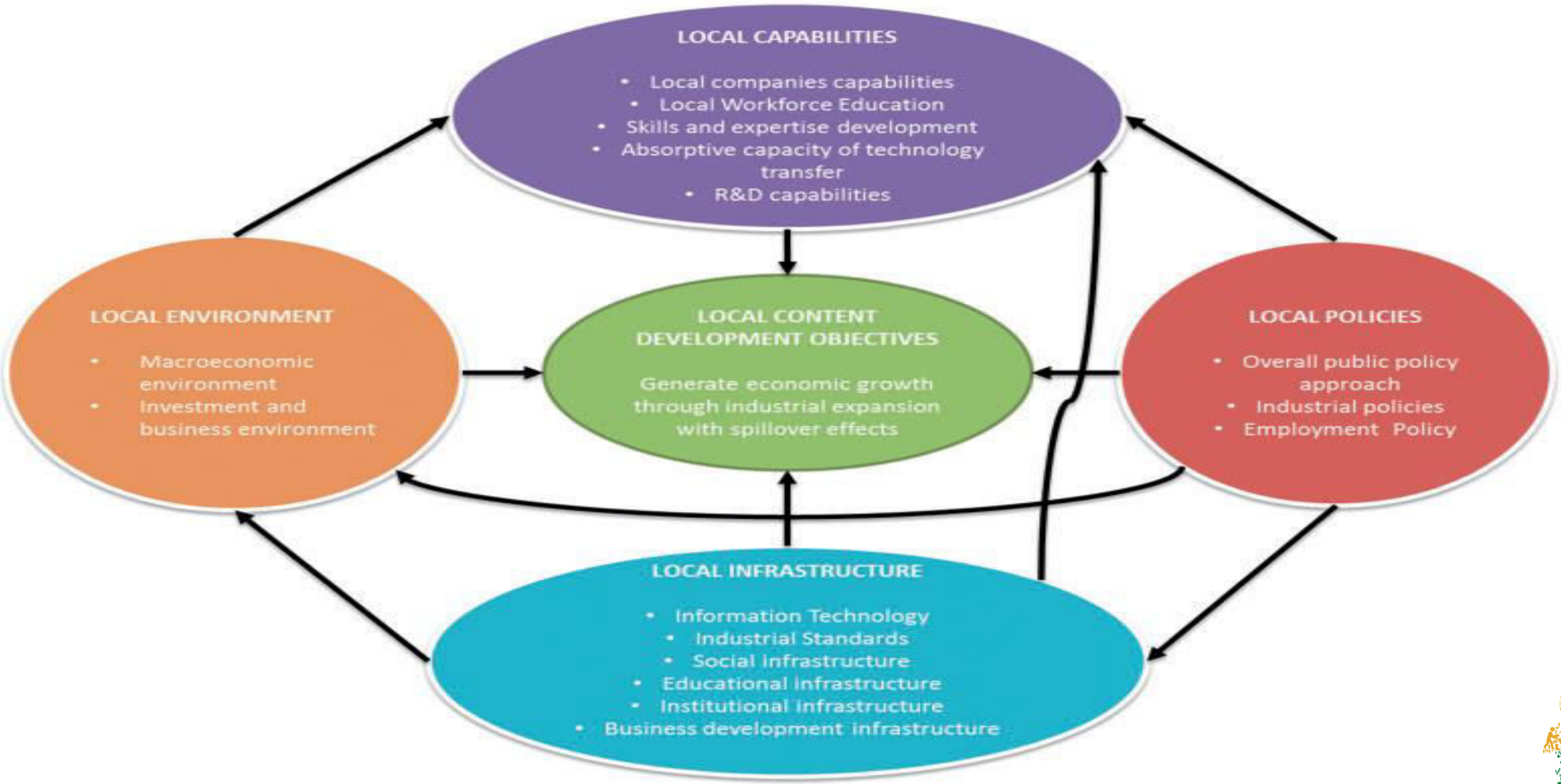
5. Local Content Policies

Local content policies provide that a percentage of domestic value added or domestic components be included in any specified product/commodity.

These include all government interventions aimed at increasing employment, services, manufacturing provisions and overall financial value to the local industry value chain.

Local content policies provide for the following;

- Public participation and involvement at all stages
- Local industry involvement
- Cost awareness


LOCAL CAPABILITIES
• Local companies capabilities
• Local Workforce Education
• Skills and expertise development
• Absorptive capacity of technology transfer
• R&D capabilities
LOCAL ENVIRONMENT
• Macroeconomic environment
• Investment and business environment
LOCAL CONTENT DEVELOPMENT OBJECTIVES
Generate economic growth through industrial expansion with spillover effects
LOCAL POLICIES
• Overall public policy approach
• Industrial policies
• Employment Policy
LOCAL INFRASTRUCTURE
• Information Technology
• Industrial Standards
• Social infrastructure
• Educational infrastructure
• Institutional infrastructure
• Business development infrastructure

Taxes Affecting the Extractive Industry

The Finance Act, 2014.

Income Tax Act Cap 470 Ninth Schedule.

The various taxes include the following;

- Income Tax
- Withholding tax
- Capital Gains tax
- Corporate Tax

Onshore and Offshore Taxes

Taxes Affecting the Extractive Industry

Corporation Tax

- Residents pay 30% income tax
- Non-residents pay 37.5%

Withholding tax

Capital Gains Tax

Limitations on Deductions

- There are various instances whereby there are exemptions on when tax may be imposed. This includes during exploration, development of the site and during decommissioning.
- Government Incentives
- Special Operating Frameworks
- Double Taxation Treaties

Revenue Collection in Counties

- Land rates
- Cess payment Points
- Business Permits
- Physical Planning Permits

Natural Resources (Benefit sharing) Bill 2018

Local Community Benefit Sharing Forum under Section 13 (1).

Royalties Fund which invest in the Commission on Revenue Allocation

Establishment of the Benefit Sharing Authority, whose functions are

- coordinate the preparation of benefit sharing agreements between local communities and affected organizations;
- determine the royalties payable by an affected organization engaged in natural resource exploitation;
- identify counties that require to enter into a benefit sharing agreement for
- oversee the administration of funds set aside for community projects.

Q & A Sessions