ILLICIT FINANCIAL FLOWS RISK FACTORS IN UGANDA'S OIL AND GAS SECTOR: A CALL FOR ACTION

Introduction

Illicit Financial Flows (IFFs) are becoming a real challenge to resource mobilisation for financing development in Uganda and Africa at large. IFFs refers to movement of money and value from one country to another that is illegitimately earned, transferred, and/or utilised. Africa is estimated to be losing USD 50bn in illicit financial flows every year. Uganda alone is estimated to be losing UGX2trillion per year and it is feared that the situation could get worse with the commencement of commercial oil production.

Uganda has, since the confirmation of the existence of commercial oil in 2006, taken steps to ensure that; the resource is well governed, the right revenues are generated from it and spent in a transparent and accountable manner. In this regard, the country has put in place a relatively comprehensive legal and policy regime for the regulation of the upstream and midstream petroleum operations as well as, the management of oil revenues. An elaborate institutional framework has also been put in place to facilitate the collection, administration and management of oil revenues for the benefit of all citizens.

However, the challenge that the country has to manage is how to guard against and/ or minimise external petroleum revenue leakages, and in particular to ensure that oil companies pay their fair share of revenues as provided for under the law. Failure to manage illicit financial flows will undermine the country's ability to generate the required revenue from its petroleum wealth which will perpetuate underdevelopment and poverty. This press statement therefore highlights the challenge of illicit financial flows, proposes mechanisms that can minimise the vice and makes a call for action to address the challenge.

IFFs in Africa

There is growing anecdotal evidence to show that, increasingly, Africa loses a significant portion of its domestic revenues. This has been documented by a High Level Panel on Illicit Financial Flows from Africa. A recent report by the Panel put the incidence of losses arising from IFFs from Africa at USD 1.3trillion in respect to the period between 1980 to 2018. In the case of Uganda, it has been indicated that for a period spanning from 2006 to 2015, the country lost in excess of USD 7billion in IFFs.

This loss was reported to be from trade mis-invoicing alone, which is just but one form of IFFs. According to the report, the development of the petroleum industry is likely to increase opportunities for trade mis-invoicing and several other different forms of IFFs.

Impact of IFFs

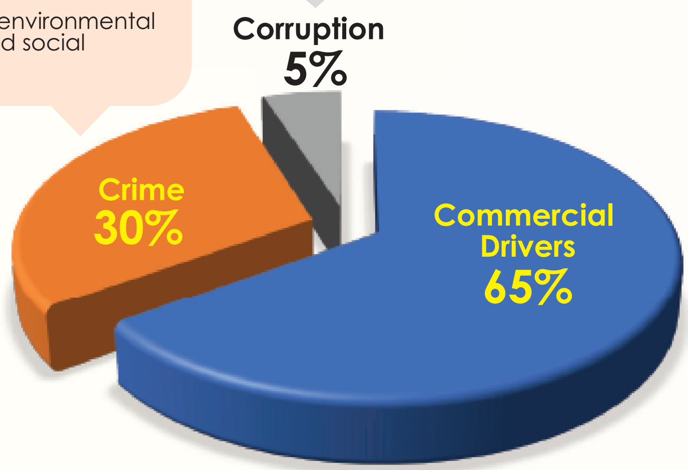
IFFs undermine the efforts of countries to boost their domestic revenues and, consequently, their ability to provide basic public goods and services.

Related to this, IFFs undermine the enjoyment of fundamental rights and freedoms and most especially, the progressive realisation of economic, social and cultural rights. IFFs also greatly restrict the ability of countries to achieve Sustainable Development Goals (SDGs). Moreover, by perpetrating illicit financial flows, multinational corporations enjoy a free ride while Small and Medium Enterprises (SMEs) bear the greatest brunt of the tax burden. In this way, IFFs promote and encourage regressive forms of taxation. This ultimately undermines the legitimacy of the tax system and in some cases that of the ruling regimes especially where there is State capture. As has been seen in several other countries, such a situation is a huge precursor for violence and unrest.

IFFs in the context of Uganda's Oil and Gas Sector

- Payment of bribes on offshore accounts of officials
- Transfer of corruption proceeds to secrecy jurisdictions by officials
- Underpayments/savings by companies as a result of compromise by officials

- Misreporting of petroleum volumes and quality
- Tax evasion
- Oil theft and bunkering
- Violations of environmental standards and social



- DTA abuse/Treaty shopping
- Unequal PSAs
  - Results into savings (IFFs from non payment of critical revenue by oil companies)
  - Stabilization clauses in these PSAs restrict government from generating additional oil revenues
- Base Erosion and Profit shifting (BEPs)
  - Abusive transfer pricing and profit shifting through price manipulation
  - Possible manipulation of recoverable costs or claim of ineligible costs
  - Inflated headquarter costs and interest rates

As a result of the potential threat of IFFs to revenue mobilisation and the negative effects they have had on oil rich countries in Africa such as Nigeria, Angola, Sudan, Cameroon and Mozambique, the Civil Society Coalition on Oil and Gas (CSCO) commissioned a study for the purposes of ascertaining the looming IFF risk factors in Uganda's petroleum sector. The study assessed the potential IFFs risk factors in the legal framework governing Uganda's upstream and midstream petroleum value chain and inquired into the beneficial ownership structures of selected multinational companies currently licenced to operate in Uganda's oil and gas sector among other issues.

Potential IFFs Risk Factors in Uganda's Oil and Gas Sector

The study findings show that while Uganda has taken several critical steps to safeguard its oil revenues, and ensure that the oil sector is properly governed, illicit financial flows risk factors still exist. First, the study shows that the major international oil companies currently involved in Uganda's oil sector are registered in tax havens, and some have concealed ownership structures which pose a high illicit financial flows risk. Second, existing Production Sharing Agreements (PSAs) give international oil companies undue advantage over the State to the extent that they contain stabilisation clauses aimed at restricting the State's capacity to tax the companies. Third, although Uganda currently has rather comprehensive transfer pricing rules aimed at reducing incidences of tax avoidance as a result of price manipulation in transactions between related companies, these are difficult to enforce due to secrecy, information unavailability, and limited institutional capacity. Fourth, the other illicit financial flows risk factor in the country's oil and gas sector is grand corruption which has been observed to be both systemic and systematic. Most recently, the Southern District Court of New York implicated a Ugandan Minister for receiving a bribe of USD 500,000 from a Chinese company for purposes of promoting its interests in the country's oil sector. Fifth, there is still limited capacity to prevent crimes arising from misreporting and other related issues.

Call for Action

In light of these risks and the potential impact of illicit financial flows on Uganda, the relevant actors and agencies are called upon to undertake the following actions:

Government of Uganda

- Expedite the ongoing renegotiation of existing Double Taxation Agreements especially those with the Netherlands ahead of the much-anticipated oil production. For each of these treaties, the government of Uganda should insist on inclusion of anti-treaty abuse provisions to the effect that multinational companies including those engaged in petroleum activities in Uganda cannot benefit from the agreement where the principle purpose of the transaction is to avoid payment of taxes.

- Specific to the Netherlands - Uganda Double Taxation Agreement, it is proposed for the government of Uganda to insist on revision of the current withholding tax rates on payment of dividends to at least 10%. The rate should apply uniformly irrespective of the level of ownership in the Ugandan paying entity.

- Consider ratification of the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS). BEPS refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no tax locations where there is little or no economic activity. This undermines the fairness and integrity of the tax system because businesses that operate across borders use BEPS to gain competitive advantage over enterprises that operate at domestic level.

- Boost the capacity and ability of government agencies such as the URA, IG, BoU, OAG and FIA, to detect and limit the extent of Illicit Financial Flows. This can be achieved through skilling of existing staff and hiring of specialised staff in the early detection of the different forms of IFFs especially those that occur in the context of oil and gas operations.

- Support the work of anti-corruption agencies such as the Inspectorate of Government, Directorate of Public Prosecutions (DPP), the Police and Office of the Auditor General (OAG) in the investigation and prosecution of high-level corruption that is often perpetrated by highly placed and well-connected individuals. This form of support involves ensuring less political interference in the work of anti-corruption agencies, appointment of members of the Inspectorate of Government (IG) in time, and the allocation of sufficient resources for the effective functioning of these agencies.

- Introduce a non-conviction-based asset recovery legal regime under the Anti-Corruption Act, 2009. Unlike the current conviction-based regime, this makes it easier for the IG and DPP to recover assets purchased using proceeds of corruption in a timely manner. More importantly, a non-conviction-based approach should be complimented by an equally comprehensive mutual legal assistance framework to facilitate the cross border and offshore recovery of proceeds of corruption.

- Enact a dedicated Extractive Industries Transparency Initiative (EITI) law to support the operationalisation of EITI standard following Uganda's recent admission as a member country. The EITI law, among other things, should put in place a framework for transparency and accountability in the disclosure of extractives revenues including those from the petroleum sector.

- Publish past, present, and future Production Sharing Agreements (PSAs) that the government of Uganda has entered into with various oil companies.

Call for Action *continued*

Petroleum Authority of Uganda

- Put in place, early enough, the appropriate metering and signature certification mechanisms to guard against oil bunkering, theft and misreporting of oil production quantities. All these practices pose very strong IFFs risks if not firmly and effectively dealt with.

- Join emerging tax information exchange initiatives under the African Tax Administration Forum (ATAF) and the Organisation for Economic Cooperation and Development (OECD) in order to ameliorate IFFs risks posed by information asymmetries.

- Set norm prices for oil being produced in the Albertine region as well as other future productive regions. Norm prices should correspond to the price that the petroleum could have been traded for between independent parties in a free market. This way they present an important reference for taxation purposes.

- Advise line Minister on the need to review the Petroleum (Exploration, Development and Production) (Metering) Regulations 2016, to, among others, enhance the level of current sanctions, and to expand on the scope of petroleum offences to include offences such as oil theft and bunkering in addition to false metering and misreporting.

Uganda Revenue Authority

- As the country enters the production phase, the capacity of the International Tax Unit should be boosted by, among others, increase the number of staff beyond the current eleven. This is because from the onset, commercial oil production is expected to create more demands and to build pressure on the unit since its work is not restricted to the petroleum sector alone.

- Establish a specialised Transfer Pricing Unit dedicated to the oil and gas sector. This may be independently set up or can exist within the current international tax unit. Whichever way it is set up, the unit would be responsible for ensuring that multinational oil companies comply with transfer pricing rules and regulations at all stages of the petroleum value chain.

Offi ce of the Auditor General

- Boost internal capacity to provide oversight by way of review, approval, and audit of workplans and budgets submitted by the oil companies. This can be achieved by increasing the number of staff with specialised training in oil and gas audits which will in turn improve the efficiency with which the OAG conducts audits in the sector.

- Strengthen the audit, and cost recovery verification function of the Office through regular training and hiring of specialised staff.

Uganda Registration Services Bureau

- Develop comprehensive beneficial ownership rules that, among others, require companies engaged in oil and gas exploration, development, and production to provide details and identities of natural persons who directly or indirectly exercise ultimate control over them (beneficial owners) as part of their annual filings.

- Maintain a publicly accessible centralised register of beneficial owners of companies engaged in the exploration, development, and production of oil and gas in Uganda. Above all, this list should be regularly updated.

International Oil Companies

- Comply with, and embrace principles relating to responsible tax and business practices such as those developed by the UN and OECD. As part of this initiative, oil and gas companies must provide public information about their tax strategies and business practices.

- Embrace existing global reporting standards for businesses, provide regular updates and publicise all oil and gas and other related tax and revenue payments made to the government of Uganda in respect to their operations.

- Respect environmental and social standards and regulations in the course of oil exploration, development and production activities. Companies should invest in more environmentally and socially sustainable initiatives instead of seeking to make savings out of non-compliance. Failure to do this will expose the State to costs of rectifying environmental and social damage caused by the companies. Given the amount of costs involved, this will greatly impact the realised revenues.

CSCO
CIVIL SOCIETY COALITION ON OIL AND GAS
UGANDA

The Civil Society Coalition on Oil and Gas in Uganda **(CSCO)** is hosted by the Advocates Coalition for Development and Environment **(ACODE)**

Contact:
Tel: +256 312 812 150
Email: info@csco.ug
Website: www.csco.ug

Supported by: DGF Democratic Governance Facility, Norad, WWF, voice include.innovate.influence., OXFAM