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A COMPARATIVE STUDY OF INCOME TAX LEGISLATION FOR FOREIGN OIL AND GAS COMPANIES INVESTING IN AFRICA

By
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Submitted in partial fulfilment of the requirements for the degree
MCom in Taxation

in the

FACULTY OF ECONOMIC AND MANAGEMENT SCIENCES

at the

UNIVERSITY OF PRETORIA

Supervisor: Mrs. H. du Preez

Date of submission:
AUGUST 2012

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ACKNOWLEDGEMENTS

Firstly I bring all the glory to my Lord and Saviour for giving me the power to be able to complete this mini dissertation.

I like to acknowledge the following people in helping me through this process:

- My loving wife, Nerina, for her support and encouragement.
- My bubbling daughter, Kara for understanding that dad had to spent time completing his studies.
- My parents and in laws for their prayers and support.
- For my colleagues at the Auditor-General of South Africa for supporting me in my choice to complete my Master's degree.
- Lastly but not least my supervisor, Hanneke, for her guidance and support in completing this mini dissertation.

I thank you all.

ABSTRACT

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by

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The oil and natural gas industry worldwide has become one of the most important commodities due to its value in use and dependency in our modern lifestyle. Countries with rich oil and natural gas reserves has shown to exploit these resources to the country's economic benefit. South Africa has in the past not been part of the big oil and natural gas producing countries of the world. But recent discoveries of possible shale gas reserves in the Karoo Basin attracted interest by foreign oil and gas companies with the potential that South Africa has as an oil and natural gas producing country.

The purpose of this study is to compare the South African income tax law and regulations with that of the Republic of Equatorial Guinea, which arguable can be seen as one of the world's big oil and natural gas producing countries. The study firstly develops an understanding of each of the two countries' oil and natural gas industries and thereafter compares the two countries income tax laws, the income tax system and collection method of the income tax revenues. The study then concludes on the status of the South African income tax regime in comparison to the Republic of Equatorial Guinea's income tax regime. The introduction of the Tenth Schedule to the South African Income Tax Act (58/1962) has brought the income tax laws in South Africa in line with international practice. Consideration should be given to broadening the income tax revenue collection methods in order to broaden the tax base for South Africa.

Key words: South Africa, Equatorial Guinea, Foreign oil and gas company, natural oil and gas, Income tax, shale gas reserves.

OPSOMMING

'N VERGELYKENDE STUDIE VAN DIE INKOMSTE BELASTING WET VIR BUITELANDSE OLIE EN GAS MAATSKAPPYE WAT INVESTEER IN AFRIKA

deur

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Die olie en natuurlike gas industrie wêreldwyd het een van die mees belangrike kommoditeite geword as gevolg van die waarde en afhanklikheid wat dit het vir ons moderne leefstyl. Lande met ryk olie en natuurlike gas reserwes het bewys dat die gebruik daarvan tot voordeel van 'n land se ekonomiese groei kan lei. Suid-Afrika het in die verlede nie as een van die wêreld se reuse in olie en natuurlike gas produksie getel nie. Maar met die onlangse ontdekking van moontlike skalie gas reserwes in die Karoo Kom het belangstelling van buitelandse olie en gas maatskappye gelok in die potensiaal wat Suid-Afrika het om 'n olie en natuurlike gas produserende land te wees.

Die doel van die studie is om 'n vergelyking te tref tussen Suid-Afrika se inkomste belasting wette en regulasies met die van die Republiek van Equatoriaal Guinea, wat gesien kan word as een van die reuse van die wêreld as dit kom by olie en natuurlike gas produserende lande. Die studie skets eerstens 'n agtergrond van die twee lande se olie en natuurlike gas industrieë en daarna vergelyk die studie die twee lande se inkomste belasting wette, die inkomste belasting stelsels en invorderings metodes van die inkomste belasting. Die studie kom dan tot 'n gevolgtrekking oor die status van die Suid-Afrikaanse inkomste belasting omgewing teenoor die Republiek van Equatoriaal Guinea se inkomste belasting omgewing. Die bekendstelling van die Tiende Skedule tot die Inkomste Belasting Wet (58/1962) het die Suid-Afrikaanse inkomste belasting wet in lyn gebring met internasionale inkomste belasting wette. Oorweging moet geskenk word aan die

invorderings metodes van die inkomste belasting te verbreed om sodoende die belastingbasis te vergroot.

Sleutelwoorde: Suid- Afrika, Equatoriaal Guinea, Olie en natuurlike gas industrieë, natuurlike olie en gas, Inkomstebelasting, skalie gas reserwes.

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CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

As resource owners, most African governments have valuable assets underground. According to Buhlungu, Daniel, Southall & Lutchman (2006:492), Africa is rich in natural resources, such as, oil and natural gas deposits. African governments need to utilise these assets, but due to a lack of infrastructure and skills in the field of engineering which is specifically concerned with the oil and natural gas industry in Africa, the exploration and eventual production of oil and natural gas deposits often ends up in foreign hands. The crude oil and natural gas deposits can only be exploited once. In order to transform these assets into financial gains, African governments must attract foreign capital on the basis of terms that ensure that they gain the greatest possible value for their natural resources. Furthermore, the uncertainty in respect of the value which the natural resources will accumulate in value is a risk which foreign investors have to consider when making the decision to invest in these African countries (Davies, Ossowski & Fedelino, 2003:153).

On the other hand, since the world needs the oil and natural gas resources which Africa possesses, the continent is an attractive foreign investment opportunity for European and American oil and gas companies (Buhlungu et al., 2006:492-494). This results in a perfect supply and demand equation which offers African governments the opportunity to generate additional taxation. Furthermore, a foreign oil and gas company can access a commodity which is in high demand worldwide (Maxwell, 2011:5).

A question for both African governments and foreign oil and gas companies is how to structure their agreements to ensure the best possible benefits on both sides. Any African government would want to ensure its attractiveness as an investment opportunity for such a company and at the same time secure the highest possible return on its natural resources. The company would want to successfully explore and produce oil and natural gas at the best possible rate of return for its investment in a particular African country.

The oil and natural gas industry affects the average citizen every day. People fill up their motor vehicles at local service stations, cook on gas stoves at home and enjoy the outdoors with their Cadexes. Natural resources, such as, oil and natural gas, have played a significant role in the development of Africa (Maxwell, 2011:2). Foreign investors are very optimistic about these opportunities in Africa and it is for this reason that the study attempts to provide further insights into the Republic of South Africa's (RSA) competitiveness when attempting to attract foreign oil and gas companies to become involved in the exploitation and production of petrochemicals locally. This is more advantageous than importing most of these resources from abroad which is currently the case (Buhlungu et al., 2006:492).

The study focuses on comparing the provisions applicable to oil and gas companies in the RSA Income Tax Act (58/1962) (Tax Act) to the fiscal regimes of other African countries, such as, the taxation laws and regulations of the Republic of Equatorial Guinea (REG). The reason for choosing to compare the REG with the RSA in respect of income taxes for foreign oil and gas companies is relevant due to the following:

- The RSA and REG are both rich in natural resources, such as, oil and natural gas.
- The REG has an income tax system which can be compared to that of the RSA.
- The REG is a developing state similar to that of the RSA and it is part of Africa.
- The REG like the RSA has had foreign oil and gas companies investing in the oil and natural gas industry.

The RSA is dependent for approximately 66% of its oil needs on imports and of this, 75% is imported from the Middle East and 23% from other African countries. The latter figure reflects a considerable increase in recent years (Petroleum Agency SA, 2010). Although RSA is not renowned for its oil deposits, it is, however, a developer of the natural gas to liquids technology (Buhlungu et al., 2006:500). In recent years it has provided some investment opportunities to foreign oil and gas companies exploring for possible natural gas deposits. For instance, the natural gas potential in the Karoo Basin has yet to be assessed (Shell, South Africa, 2011).

African oil and natural gas reserves were estimated at approximately 200 billion to 210 billion barrels of oil at the end of 2010 (Maxwell, 2011:3). The main contributors to oil and natural gas in Africa are listed in Table 1.

Table 1: African proven oil and gas reserves: 2010

Country	Oil (million bbls)	Gas (bcf)
Nigeria	37,200.0	186,880.0
Libya	46,420.0	54,680.0
Algeria	12,200.0	159,000.0
Egypt	4,400.0	77,200.0
Angola	9,500.0	10,940.0
Sudan	5,000.0	3,000.0
Cabon	2,000.0	1,000.0
Congo	1,600.0	3,200.0
Chad	1,500.0	-
Equatorial Guinea	1,100.0	1,300.0
Unganda	1,000.0	500.0
Cameroon	200.0	4,770.0
Tunisia	425.0	2,300.0
Ghana	660.0	800.0
Mozambique	-	4,500.0
Namibia	-	2,200.0
Rwanda	-	2,000.0
Cote d'Ivoire	100.0	1,000.0
Muaritania	100.0	1,000.0
Democratic Republic of Congo	180.0	35.0
Ethiopia	0.4	880.0
Tanzania	-	230.0
Somalia	-	200.0
South Africa	15.0	-
Benin	8.0	40.0
Morocco	0.7	51.0
Total	**123,609.1**	**517,706.0**

Source: Ernst & Young, 2011

According to Table 1 the largest oil and natural gas producing countries in Africa are Nigeria, Libya, Algeria, Egypt and Angola. These countries represent 80% of the oil and 90% of the natural gas production respectively (Maxwell, 2011:4). In recent years, the REG, which ranks in 10th place (Table 1), became one of the more established oil and natural gas rich African countries. Discoveries of oil and natural gas were made in the REG in the 1960's but production only started in the 1990's. RSA, on the other hand, possesses minimal proven oil and natural gas reserves in comparison to its African

counterparts. This places RSA in 24th place (Table 1). This is further illustrated in Table 2 which shows that the REG has larger proven oil and natural gas reserves than the RSA.

Table 2: Ten largest African producers of oil and gas

Oil: 2010	Thousand barrels per day		Gas: 2009	bcf per day
Nigeria	2,065		Algeria	7.88
Angola	1,790		Egypt	6.07
Libya	1,550		Nigeria	2.25
Algeria	1,250		Libya	1.54
Egypt	740		Equatorial Guinea	0.61
Sudan	480		Mozambique	0.35
Congo	270		Tunisia	0.35
Equatorial Guinea	255		South Africa	0.18
Gabon	245		Cote d'Ivoire	0.15
Chad	100		Angola	0.07
others	237		Others	0.13
Total	**8,982**		**Total**	**19.58**

Source: Ernst & Young, 2011

From a theoretical perspective, the study will make three valuable contributions to the RSA income tax regime with regard to the oil and natural gas investment decisions of foreign oil and gas companies. Firstly, it attempts to determine how the tax laws of the RSA compare with that of the REG and to focus on the oil and natural gas industry. Therefore, it adds to previous research conducted in respect of mining industry and mining operations (Cloete, 2010). Secondly, it attempts to analyse the particular revenue generation methods which are being used by the RSA government to collect its share of the profits from oil and natural gas resource exploitation as compared to the REG. Thirdly, it weighs up the overall perspective on the RSA income tax regime against that of the REG income tax regime.

1.2 PROBLEM STATEMENT

Although some studies have weighed up the similarities and the differences in the mining industry and mining operations in the RSA compared to some other African countries, very little is known about the competitiveness of the RSA's income tax regime with regard to the oil and natural gas industry when compared to other African countries, such as, the REG (Davies et al., 2003; Buhlungu et al., 2006; Cloete, 2010; Maxwell, 2011). The RSA introduced a number of new policies, such as, the Tenth Schedule to the Tax Act and

other legislation, such as, the Minerals and Petroleum Resources Development Act of South Africa (28/2002) (MPRDA) in order to close the gap between the RSA and its African counterparts. It was, therefore, the ideal opportunity to conduct this study after the implementation of the abovementioned legislation.

1.3 PURPOSE STATEMENT

The purpose of this study is to compare the income tax and other specific duties charged in particular countries which a foreign oil and gas company would need to consider when investing in the oil and natural gas industries of those countries. Available research has not focused on the oil and natural gas industry as forming part of the broad taxation categorisation of mining industry and mining operations in Africa, and how it compares with the way in which fiscal policy is applied in the RSA (Cloete, 2010). Furthermore, a literature study on the chosen topic has not found any discussions directly related to the oil and natural gas industry in the RSA in relation to the rest of Africa from a taxation perspective (Ernst & Young, 2011; Maxwell, 2011). However, these sources do provide valuable information with regard to the oil and natural gas industry, on the one hand and relevant tax regimes, on the other from an African perspective. Therefore, the study should prove of value to prospective foreign oil and gas companies who could add the findings to the foreign oil and gas companies' existing findings of earlier studies and draw a comparison between the RSA and the REG income tax regimes with regard to the oil and natural gas industry. This is important because of the recent discovery of natural gas reserves in the Karoo Basin of the RSA.

1.4 RESEARCH OBJECTIVES

The following research objectives are put forward:

- To compare the oil and gas industries in the RSA and the REG by evaluating the income tax laws, collection methods and overall tax regimes.
- To identify the similarities and differences in the income tax regimes imposed on the oil and natural gas industries in the RSA and the REG.

1.5 DELIMITATIONS

This study has certain delimitations. Firstly, the context of the study is limited to only those issues which the foreign oil and gas companies need to consider which arise from the income tax laws and regulations of the RSA and the REG respectively. The study does not consider other investment decisions which such a company would need to evaluate based on geographical, political and, or the surveyed information on exploration and exploitation which is available for each of these two African countries. It was not the purpose of the study to compare the total duties, such as, indirect taxes which each country will collect during the life-time of a foreign oil and gas company in the two countries.

Secondly, the study is limited to a review of the literature on tax payments only from the point of view of each of the African countries and does not consider aspects in respect of import and export duties in respect of the two countries. The study does not include consideration of special agreements or double tax agreements negotiable between the country of origin of the particular foreign oil and gas company and the government of each of the two African countries which are compared in this study. It is not the aim of this study to conduct an in-depth examination of the production sharing contract requirements. In the REG these requirements are usually determined on the basis of specific agreements between the foreign oil and gas company and the REG government unless an industry norm exists which needs to be considered by a particular foreign company for its decision-making purposes.

1.6 ASSUMPTIONS

The following assumptions were made:

- Formal legislative processes are the only methods applied by the RSA and the REG governments for collecting their share of foreign oil and gas company's revenue.
- The term 'foreign oil and gas company' implies that the company is only operational in the exploration and production activities of oil and natural gas in the respective country.

- The study assumes that international taxation treaties do not provide foreign oil and gas companies with additional or amended revenue collection requirements or benefits.
- The study considers only profits which are paid to the RSA and the REG governments in the form of a tax, royalty or levy as relevant for comparison.
- The effects of inflation or the state of RSA and REG economic environments are assumed to be comparable.

1.7 DEFINITION OF KEY TERMS

In this study a number of key terms are used and are defined below.

Bonus: A 'bonus' refers to a payment in terms of a signed Production Sharing Contract (PSC) with the REG government as interpreted by Ernst and Young (2011:126).

Currency translation method: In terms of this study the 'currency translation method' refers to the method prescribed by the relevant financial reporting framework applicable to a foreign oil and gas company (PetroSA, 2011:80).

Exploitation: For the purposes of this study 'exploitation' refers to the extraction of the oil and natural gas reserves in terms of a right granted to a foreign oil and gas company by the government of the specific country (PetroSA, 2011:7).

Exploration: As defined in section 1 of the Minerals and Petroleum Resources Development Act of South Africa (28/2002) (MPRDA) 'exploration' means the re-processing of existing seismic data, the acquisition and processing of new seismic data, or any other related activity to define a trap to be tested by drilling, logging and testing, including the extended testing of a well with the intention of locating a discovery.

Ministry: The use of Ministry in this study refers to the governmental department that is, or may be responsible for Petroleum Operations in the REG as defined in article 8 of the Hydrocarbons law of the REG No. 8 of 2006 (Equatorial Guinea Hydrocarbons Law, 2006).

New order right: A new order right means a right granted to an applicant in terms of section 1 of the Minerals and Petroleum Resources Development Act of South Africa (28/2002) (MPRDA) and includes oil and natural gas rights.

OP26 lease agreement: An OP26 lease in the context of this study is a lease agreement granted in terms of the repealed Mining Rights Act of South Africa (20/1967). The Act was repealed by the Minerals and Petroleum Resources Development Act of South Africa (28/2002) (MPRDA) on 1 May 2004).

Ownership control: In terms of the Public Financial Management Act of South Africa (1/1999) (PFMA) (South Africa. National Treasury, 1999), ownership control means the ability to exercise any of the following powers to govern the financial and operating policies of the entity in order to obtain benefits from its activities:

- To appoint or remove all, or the majority of the members of that entity's board of directors or equivalent governing body.
- To appoint or remove that entity's chief executive officer.
- To cast all, or the majority of the votes at meetings of that board of directors or equivalent governing body.
- To control all, or the majority of the voting rights at a general meeting of that entity.

Production: As defined in section 1 of the MPRDA 'production' means any operation, activity or matter that relates to the exploration, appraisal, development and production of petroleum.

Surface rental: The 'surface rental' refers to the amount payable to the Ministry by a foreign oil and gas company for a period determined by the production sharing contract based on the area size stipulated in the PSC as defined in article 57b of the Hydrocarbon Law No 8 of 2006 (Equatorial Guinea Hydrocarbons Law, 2006).

The following abbreviations set out in Table 3 are referred to in this study. Most of these abbreviations are commonly used in the oil and natural gas industry.

Table 3: Abbreviations used in this document

Abbreviation	Meaning
Bbls	Barrels
Bcf	Billion cubic feet
CEF	Central Energy Fund
CGT	Capital Gains Tax
FOGC	Foreign oil and gas company
GDP	Gross domestic product
GTL	Gas-to-Liquids
MPRDA	Minerals and Petroleum Resources Development Act of South Africa (28/2002)
PFMA	Public Financial Management Act
PSC	Production Sharing Contract
REG	Republic of Equatorial Guinea
RSA	Republic of South Africa
SARS	South African Revenue Service
STC	Secondary tax on companies
Tax Act	Income Tax Act (58/1962)
TCF	Trillion cubic feet
USA	United States of America
VAT	Value Added Tax

1.8 AN OVERVIEW OF THE CHAPTERS

This study deals with energy sources which are scarce and costly to produce. This is a topical challenge in the world today (Maxwell, 2011:2). The objective of chapter 2 is to provide some background on the oil and natural gas industry in the RSA and the REG in order to understand how these countries deal with investments made in their oil and natural gas industries. The objective of chapter 3 is to provide a comparison of the income tax legislation and other duties pertaining to foreign oil and gas companies in the RSA and the REG by identifying the similarities and differences between the two countries.

In Chapter 4 a rating study conducted by the World Bank is firstly used to compare the income tax regime and systems of the RSA and the REG which have been implemented in order to provide a holistic view of what a foreign oil and gas company can expect to find in each of the two countries. Secondly, it would also be important to compare the methods that the RSA and the REG governments have put in place to collect their share of the oil

and natural gas profits from such companies. This is described in the second part of chapter 4.

In conclusion, chapter 5 focuses on the policies which the REG has implemented to collect their share of the oil and natural gas profits of a foreign oil and gas company. Chapter 5 also provide recommendations to the RSA government could apply with a view to future policy developments with regards to the taxation of foreign oil and gas companies investing in the RSA. Furthermore chapter 5 also provides a conclusion in respect of each of the research objectives and provides possible topics for further study in this area.

CHAPTER 2

OIL AND NATURAL GAS INDUSTRIES IN THE REPUBLIC OF SOUTH AFRICA AND THE REPUBLIC OF EQUATORIAL GUINEA

This chapter discusses the context of the oil and natural gas industries in the RSA and the REG. A good understanding of the oil and natural gas industry in each country will provide the reader with valuable background information to subsequent chapters.

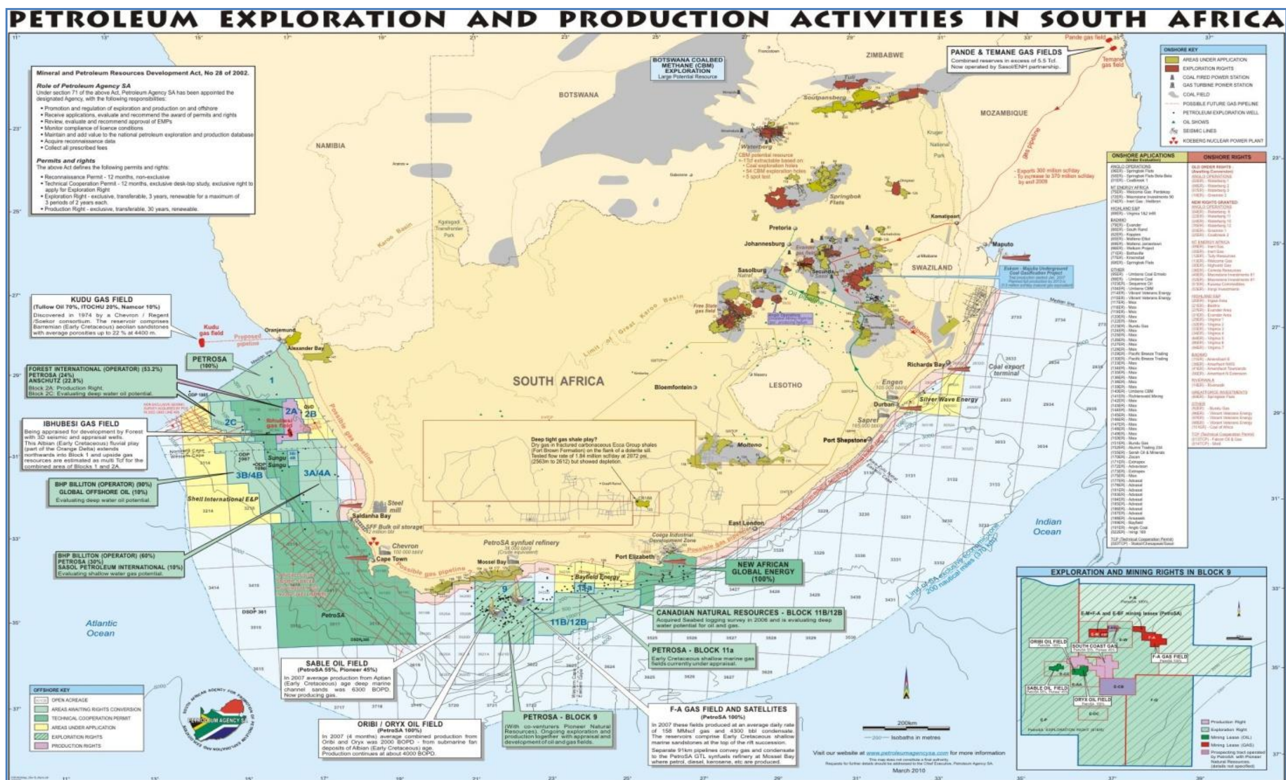
The oil and natural gas industry can be categorised into three main groups of activities, namely, the upstream activities which consist of the exploration and production activities, the midstream activities which are the pipeline facilities and the storage facilities (or tanker farms) and, lastly, the downstream activities which consist of the refining and retailing activities (Buhlungu et al., 2006:492).

2.1 OIL AND NATURAL GAS INDUSTRY IN THE RSA

Although one could say that the RSA cannot be counted among the African giants as far as oil and natural gas reserves are concerned, it can, however, be rightly regarded as Africa's gateway to foreign investors (United States of America. Department of State, 2011). This is evident in the fact that RSA has accounted for nearly one third of Africa's gross domestic product (GDP) in recent years (Buhlungu et al., 2006:484). The economy of the RSA is viewed as that of a developing state with a GDP of around $357.3 billion (United States of America. Department of State, 2011). The RSA is not rich in proven natural resources, such as, oil and natural gas but has a large number of coal deposits. The RSA is the only country in the world that manufactures fuel products from coal (United States of America. Department of State, 2011).

The Petroleum Oil and Gas Corporation of South Africa (SOC) Limited (PetroSA), a public entity under the ownership control of the Central Energy Fund (SOC) Limited (CEF) which is in turn fully owned by the RSA government, was the first to produce synthetic fuels from natural gas at the Gas-to-Liquids (GTL) refinery of PetroSA in Mossel Bay (PetroSA, 2011).

Figure 1: RSA oil and natural gas resources map.



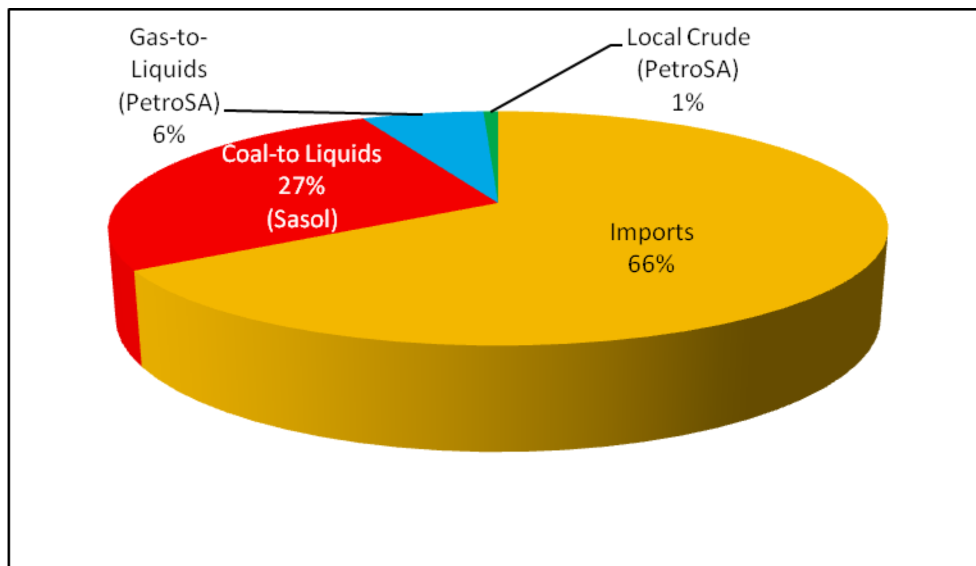
Source: Petroleum Agency SA (2010)

Figure 1 shows a map of the exploration blocks currently under development in the RSA. The RSA upstream oil and natural gas industry began in the 1940's after a geological survey was conducted by the RSA government. During 1967 the RSA government passed the Mining Rights Act which allowed foreign oil and gas companies to explore for oil and natural gas off-shore of the RSA coastline. (Petroleum Agency SA, 2011). These companies mainly discovered natural gas off the south east and west coast areas as indicated on Figure 1 (PetroSA, 2011).

Since the 1970's foreign oil and gas companies lost interest mainly due to the political sanctions against the RSA in force at the time. The former Soekor (Pty) Ltd, was the first RSA government-owned exploration company, and was the only oil and gas company to still undertake off-shore exploration on the RSA coast from mid-1970 until 1994. In 2001 PetroSA was formed by merging Soekor (Pty) Ltd and Mossgas, which was the RSA state-owned company which operated the GTL refinery in Mossel Bay. (Petroleum Agency SA, 2010).

Today, the South African Agency for Petroleum Exploration and Exploitation (SOC) Limited (Petroleum Agency SA) acts as the RSA agent for awarding exploration rights to various oil and gas companies. Thus, a foreign oil and gas company has to apply to the Petroleum Agency SA for a new order right for a specific oil and natural gas field as shown in Figure 1. If the company is granted the new order right this will allow it to explore and exploit any oil and/ or natural gas from that well (MPRDA, 2002). Currently, PetroSA has the largest interest in the upstream activities around the RSA coast together with other partners, such as, Canadian Natural Resources, SASOL Petroleum International and the American-based foreign oil and gas company, Pioneer (Petroleum Agency SA, 2010).

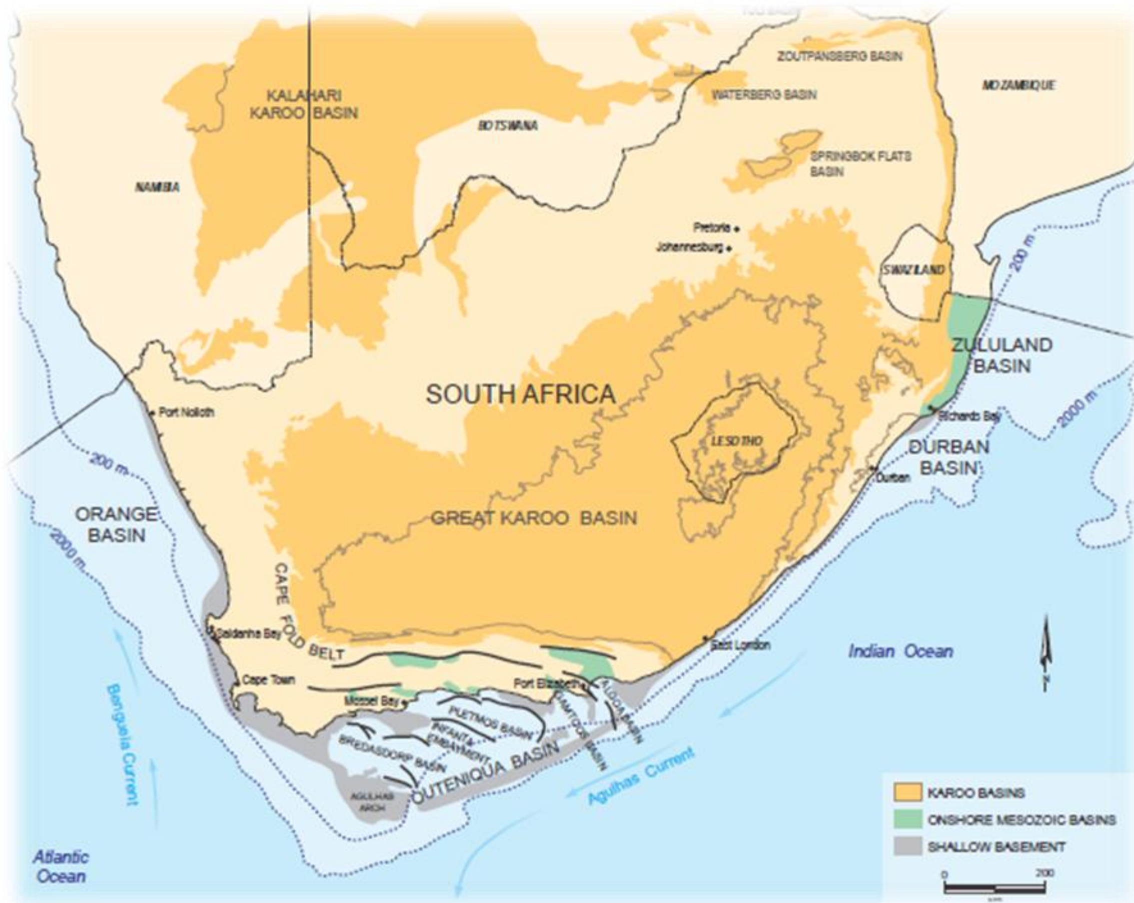
Figure 2: RSA oil supply in 2007.



Source: Petroleum Agency SA (2010)

It is evident from Figure 2 that the RSA fuel supply mainly consists of imports from foreign countries. PetroSA is currently the only oil and gas company in the RSA which is active in the upstream activities. As indicated in Figure 1, these activities are in the FA natural gas fields and the Oribi/ Oryx and Sable oil fields, all of which are mainly off-shore of Mossel Bay (PetroSA, 2011).

Figure 3: Structural elements and sedimentary basins of the RSA



Source: Petroleum Agency SA (2011)

As demonstrated in Figure 3, the RSA oil and natural gas areas consist of three basins, namely, the shallow basement, the on-shore Mesozoic Basin and the Karoo Basin. When combined, these areas stretch around 1.1 million square metres and the coastline has a total length of around 3000 km. The available surveyed seismic data of the three basins covers approximately 233 000 km of two-dimensional information and 10 200 square kilometres (km^2) of an off-shore and limited on-shore area.

The RSA has been in the news because of its yet-to-be-confirmed shale gas deposits in the Karoo Basin (Petroleum Agency SA, 2010). The confirmation of the shale gas deposits, which still needs to occur, is done by pumping water under high pressure down the drill holes to cause hydraulic fracturing – commonly known as 'fracking'. Environmental activists and inhabitants of the Karoo have come out strongly against the use of fracking in this area with its scarce water supply and delicate ecosystem. The debate has to date not been resolved and the foreign oil and gas companies were sent back to the drawing

boards to specifically consider the impact that their exploration activities will have on the Karoo environment.

Surely, this will not be the end of attempts by oil and gas companies to be the first to discover shale gas in the Karoo Basin. The benefits of using natural gas have been shown in the United States of America (USA). Natural gas is a 50% cleaner source of energy than coal and is a 30% cleaner energy source than oil. In the USA shale gas output in 2010 was nearly 5 trillion cubic feet (TCF) and the estimated deposits of shale gas in the USA currently will be enough to heat homes in the USA and to power electric plants for the next two decades. This is especially significant for the RSA in view of the fact that the Marcellus Shale area in the USA, which stretches from Tennessee to New York, is approximately one-third of that of the possible shale gas area in the Karoo Basin (De Wit, 2011).

The RSA government will need to prepare itself to optimise their share of the potential profits from the activities of foreign oil and gas companies in the RSA (Petroleum Agency SA, 2010).

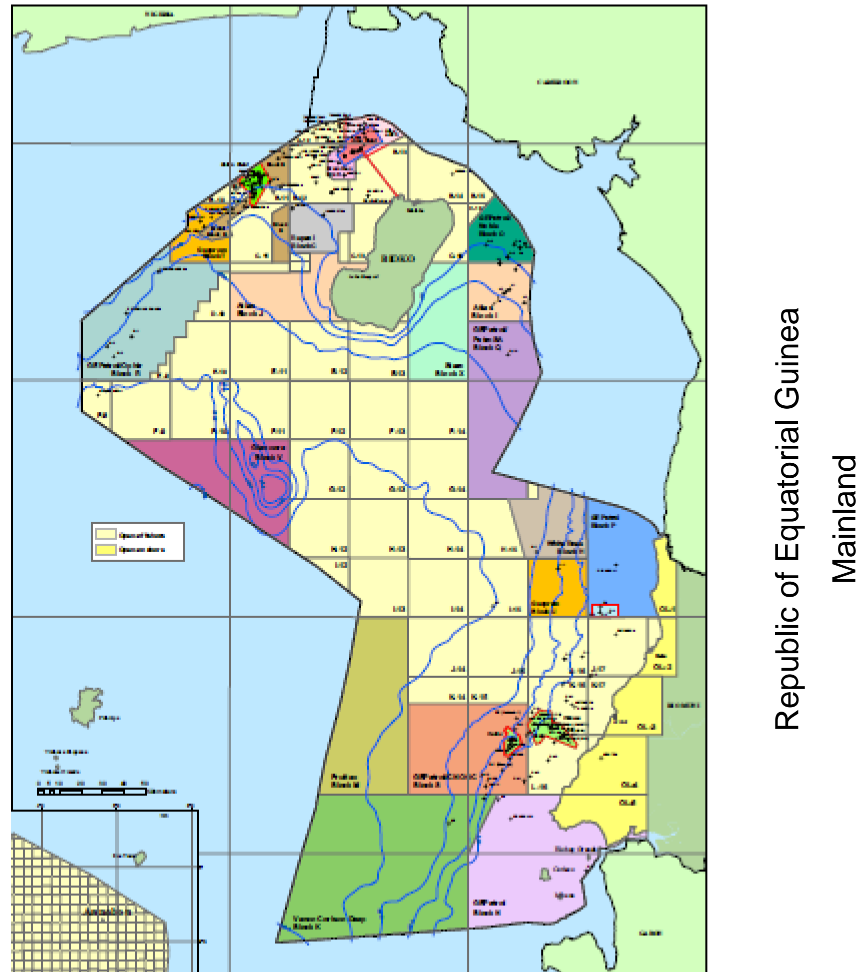
2.2 OIL AND NATURAL GAS INDUSTRY IN THE REG

The REG is situated in western Africa and shares borders with Cameroon and Gabon. The western side of the REG borders the Atlantic Ocean. With a GDP of $24.66 million this once poor nation had a huge influx of revenue from its rich oil and natural gas reserves which were discovered in 2000. More than 81% of the revenue accumulated by the REG government consists of receipts from the oil and natural gas industry (United States of America. Department of State, 2011).

Like the RSA, the REG has established a national oil and gas company, namely, GEPetrol which was registered in 2001. It was originally intended to be the primary state-owned institution responsible for the REG downstream oil sector but due to the large interest shown in the REG oil and natural gas reserves by foreign oil and gas companies its primary focus has shifted to managing the production sharing contract with foreign oil and gas companies. GEPetrol, as in the case of PetroSA, partners with these foreign

companies to undertake exploration operations (United States of America. Department of State, 2011).

Figure 4: REG Licence map showing exploration wells in November 2011.



Source: Equatorial Guinea. Ministry of Mines, Industry and Energy (2011)

Like the RSA, the REG oil and natural gas fields are mainly located offshore. This area is divided into two separate sections, namely, the shelf around the Bioko Island and the shelf off Rio Muni which is enclosed between Cameroon and Gabon. The Zafiro field is the major oil producing field in the REG and is situated in the top-left corner of Figure 4. It produces approximately 100 000 barrels of oil per day. As one can see in Figure 4 the oil fields are numbered as “Blocks” in alphabetical order with approximately 20 blocks currently in either the production or the exploration phases. The REG produces roughly 274 000 barrels of crude oil per day which represents 0.34% of the world production and it is estimated that the REG oil reserves will last approximately 17 years at the current production rate (MBendi Information Services, 2011).

The REG natural gas reserves mainly consist of gas condensate and dry gas which was discovered in blocks O and I. These fields are situated in the Alba, Alen and Aseng fields which are indicated in the top right-hand corner of Figure 4 (MBendi Information Services, 2011).

A foreign oil and gas company will apply for a production sharing contract with the aim of exploring and, or engaging in production activities in a specific oil and natural gas field with the Ministry. If the company is granted the right to a specific oil and, or natural gas field by means of a signed contract, this will allow it to explore and exploit any oil and, or natural gas from that well (MBendi Information Services, 2011).

Like the RSA the REG imports the largest part of its downstream products, and the only local downstream company is Getotal which is owned in equal portions by the REG and Total (MBendi Information Services, 2011).

As can be seen in the maps in figures 3 and 4, the oil and natural gas production in the REG is mainly derived from off-shore exploration and production. This is emphasised because off-shore exploration and production activities are highly specialised and accordingly also require costly capital infrastructure. It is for this reason that both the RSA and the REG need to attract foreign oil and gas companies which have the know-how and resources to exploit and produce the oil and natural gas that both these countries need in order to sustain their economic growth (Buhlungu et al., 2006:492; United States of America. Department of State, 2011).

The RSA government, through PetroSA, has invested in the REG in the form of a signed production sharing contract with the Ministry for exploration rights in the REG, Block Q. PetroSA began its exploration in the REG during 2007 but has not yet discovered feasible oil or natural gas deposits. PetroSA's exploration activities are still continuing in the REG (PetroSA, 2011).

2.3 CONCLUSION

Based on the background information of the RSA and the REG oil and natural gas industries one can see that the environments of these two countries in respect of oil and natural gas exploration and production have some similarities and differences.

The most common similarity is the fact that both countries possess surveyed data of their off-shore basins which are divided into exploration blocks. In both the RSA and the REG there are still un-surveyed oil and natural gas exploration blocks. Furthermore, both countries have a process which a foreign oil and gas company will have to follow to apply for the right to explore and, or produce oil and/ or natural gas in either country. The RSA and the REG also have state-owned entities which act as agencies on behalf of the governments of country. These agencies are involved in the application and processing of licences for exploration and, or production rights. A further similarity between the RSA and the REG is linked to the development of Africa in the last two decades. In both the RSA and the REG the oil and natural gas industries only became active in the late 1990's and early 2000. However, both countries still rely heavily on foreign investment in the oil and natural gas industry due to the specialist nature and cost implications of the exploration and production processes. Lastly, both countries are still heavily dependent on imports of refined oil and natural gas to meet their requirements.

The main difference between the oil and gas industries in the RSA and the REG is the fact that the REG is a larger oil and natural gas producer than the RSA. In addition, the REG has already attracted foreign oil and gas companies to invest in its oil and natural gas industry. Furthermore, the REG has far more proven oil and natural gas reserves than the RSA. Consequently, the oil and natural gas industry contributes to the largest part of the REG's GDP. The situation in the RSA is different because the oil and natural gas industry is only a small contributor to the RSA's GDP (U.S. Department of State, 2011). Another difference between the two countries in this respect is the fact that the REG has more success with its oil reserves than with its natural gas reserves which mainly consist of gas condensate and dry gas. This is in contrast to the situation in the RSA which has developed the Gas-to-Liquids (GTL) refinery where natural gas is used and transformed into liquid petrochemical products. In addition, the RSA is the only country in the world

where liquid petrochemical products are produced from coal because there are large coal reserves. On the other hand, the discovery of oil reserves in the RSA is limited to the Oribi/ Oryx and Sable oil fields. Nevertheless, there is a possibility that shale gas reserves may exist in the Karoo Basin in the RSA whereas no shale gas has yet been discovered in the REG oil and natural gas exploration blocks.

In view of the similarities and differences in the oil and natural gas industries in the RSA and the REG, the next chapter compares the tax legislation of the two countries, and the cost of doing business in this industry in the RSA and the REG.

CHAPTER 3

OVERVIEW OF THE INCOME TAX LEGISLATION APPLICABLE TO THE REPUBLIC OF SOUTH AFRICA AND THE REPUBLIC OF GUINEA

This chapter firstly provides an analysis of the income tax legislation of the RSA and the REG with regard to the income earned by foreign oil and gas companies. The taxation laws and regulations of each country pertaining to the income from operational and capital cash flows of a foreign oil and gas company are investigated. Secondly, the different types of deductions allowed in each of the country's tax systems are explained together with other special considerations which a foreign oil and gas company would have to take into consideration when it decides to invest in either the RSA or the REG. The chapter concludes by comparing the RSA and REG tax systems and identifying any similarities and differences between the income tax legislation and other applicable duties of the two countries.

3.1 RSA INCOME TAX LEGISLATION AS IT PERTAINS TO FOREIGN OIL AND GAS COMPANIES

In Table 4 the RSA Tax Act pertaining to foreign oil and gas companies (referred to as FOGCs) is explained.

Table 4: Summary of RSA income tax systems

Applicable Tax	Applied to FOGCs
Corporate income tax.	The income tax obligation pertaining to FOGCs is largely determined by the general taxation provisions, namely, sections 1 to 112 of the Tax Act and in particular section 26B of the Tax Act. A FOGC will typically need to be familiar with the normal income tax relating to corporations, special provisions as determined by the Tenth Schedule to the Tax Act plus royalties and withholding tax obligations (Ernst & Young, 2011:346).
	Until recently, the tax regime applicable to FOGCs in the RSA was largely determined by the OP26 lease agreement signed between a FOGC and the RSA government from 1965. This lease agreement effectively froze the Income Tax Act of RSA of 1977 for the benefit of FOGCs subject to a few variations to the standard OP26 agreement on individual accounts (South Africa. National Treasury, 2006:15). The OP26 lease agreements brought some stability in a very high risk industry so that the RSA government could attract foreign investment. These OP26 lease agreements were enforced until the introduction of the MPRDA in 2002 which requires that a FOGC has to apply for new order rights in terms of the MPRDA effectively replacing the OP26 lease agreements (MPRDA, 2002). To enable the RSA government to standardise the legislative requirements which were contained in several OP26 lease agreements a decision was made to formalise the key aspects of the OP26 lease agreements into law (South Africa. National Treasury, 2006:16) and introduce the Tenth Schedule to the Tax Act.
The enactment date of the	FOGCs had to apply the Tenth Schedule to the Tax Act from 2 November 2006 (South Africa. National Treasury, 2006:15).

Applicable Tax	Applied to FOGCs
Tenth Schedule.	
Corporate tax rate.	The corporate income tax rate applicable in the RSA on the income derived by FOGCs from oil and natural gas production is a maximum of 28% provided that the income is due by virtue of the OP26 lease agreement. The corporate income tax rate was changed to 31% for FOGCs in instances where the new order right was not derived from an OP26 lease agreement read from paragraph 2 of the Tenth Schedule to the Tax Act. FOGCs which derive income from other activities than that of exploration and production of oil and natural gas, such as, oil and gas refining, will be subject to the normal income tax provisions of the Tax Act.
Withholding tax levied on payments.	The Tax Act does not levy any form of withholding tax (other than value added tax) on payments made by companies or FOGCs specifically.
Royalties' payable on minerals and petroleum production.	As from 1 March 2010 a mineral and petroleum resources royalty became payable to the RSA government in terms of the Mineral and Petroleum Resources Royalty Act, 2008 (Act. 28 of 2008) (Royalty Act) and the Mineral and Petroleum Resources Royalty (Administration) Act, 2008 (Act. 29 of 2008) (Royalty Administration Act). The royalty payment is determined as a percentage of gross sales of mineral resources as determined by section 3 of the Royalty Act.
Secondary tax on companies or dividend	Secondary tax on companies (STC) (which was replaced by the withholding tax on dividends with effect on 1 April 2012) will apply to profits declared to shareholders from a foreign company's oil and natural

Applicable Tax	Applied to FOGCs
tax.	gas income but to a maximum of 5% as per paragraph 3 of the Tenth Schedule to the Tax Act. Again this is subject to prior beneficial determination by the OP26 lease agreement, and, if applicable, it will limit the STC to 0%. The withholding of tax on dividends declared to shareholders, known as dividend tax in the RSA, will be levied as of 1 April 2012 at a rate of 15% of the distribution. This replaces STC which will be phased out over a period of one year (South Africa. National Treasury, 2012:14).
Expenditure or losses incurred which is allowed as deductions for income tax purposes.	The deductions allowed for FOGCs in the RSA follows the same route as for normal companies. It is determined that all actual expenditure and losses incurred in a year of assessment will be allowed (paragraph 5 of the Tenth Schedule to the Tax Act) provided a FOGC is allowed to take into consideration certain limitations and preferential deductions when determining its taxable income. The limitations deal with the acquisition of the oil and gas right whereas in the case of a normal acquisition a FOGC is not allowed to deduct the cost of the oil and gas rights as expenditure to determine its taxable income.
Deductions allowed on capital items incurred.	A FOGC will be allowed to deduct all expenditure and losses actually incurred for purposes of the exploration and production of oil and natural gas whether it is of a revenue or capital nature. Generally all expenditure or losses incurred for purposes of the exploration activities will be regarded as capital in nature because of the capital potential it provides to a FOGC (Ernst & Young, 2011:349). Capital deductions are allowed in terms of the Tax Act in the form of depreciation on assets placed into service by a FOGC. The depreciation rates are standard and must be determined using the straight-line method

Applicable Tax	Applied to FOGCs
	as determined by the Tax Act (South Africa. Department of Finance. Inland Revenue, 1995:1).
Accelerated capital allowances on fixed assets acquired.	The preferential deductions referred to in the previous paragraph are the capital allowances provided by paragraph 5 to the Tenth Schedule to the Tax Act. These can be summarised as follows. • 100% deductable allowance on expenditure of a capital nature actually incurred in the year of assessment in respect of exploration based on the oil and gas rights. • 50% deductable allowance on expenditure of a capital nature actually incurred in the year of assessment in respect of production based on the oil and gas rights.
Offsetting of losses made in the prior year against current year taxable income.	Losses incurred in one year of assessment can be set off in a succeeding year of assessment.
Limitations on the period within which offsetting of losses must be used in years.	A FOGC is allowed to off-set prior year losses as long as it still has an accumulated taxable loss which it can bring over from the previous tax year. Therefore, no limitation exists.
Off-setting of losses against	The Tenth Schedule to the Tax Act even allows the off-setting of losses incurred between exploration and production activities of a FOGC

Applicable Tax	Applied to FOGCs
profits between different projects of the FOGC.	(paragraph 5 to the Tenth Schedule to the Tax Act). A limitation of 10% is set on off-setting losses incurred in oil and natural gas exploration or production against other taxable income derived by a FOGC (paragraph 5 to the Tenth Schedule to the Tax Act).
Effective CGT rate inclusion in determining the corporate income tax payable.	A disposal of an oil and gas right is subject to the general Capital Gains Tax (CGT) as determined by the Eighth Schedule to the Tax Act at an effective rate of 14% (Ernst & Young, 2011:346). In the recent budget announcement for the 2012/2013 budget year the inclusion rate for companies' capital gains was increased from 14% to 18.6% (South Africa. National Treasury, 2012:16).
CGT reliefs available in order to determine its corporate income tax payable.	The disposal and obligation to account for CGT is subject to certain roll-over reliefs available to the seller of the oil and gas right. In this study the effect of disposals is only described where the oil and gas right is held as a capital asset (Ernst & Young, 2011:349). • The first of these reliefs provides the selling FOGC with the roll-over treatment where the seller is deemed to sell the oil and gas right for an amount equal to its base amount (the amount for which the FOGC acquired the oil and gas right) and the purchaser acquires it for the base cost amount of the seller (paragraph 7 to the Tenth Schedule to the Tax Act). • The second relief option to the seller and purchaser of the oil and gas right is called the 'participation treatment'. The difference between the market value of the oil and gas right and the base cost of the oil and gas right constitutes gross income for the seller and allowed expenditure for the purchaser to deduct from their other oil and gas-

Applicable Tax	Applied to FOGCs
	related income (paragraph 7 of the Tenth Schedule to the Tax Act).
Relief on foreign currency gains or losses to determine the taxable income.	To enhance the stability of investment by FOGCs in the RSA, the Tenth Schedule to the Tax Act provides FOGCs with the benefit of determining their currency gains and losses with reference to the currency translation method used by the company for financial reporting purposes (paragraph 4 of the Tenth Schedule to the Tax Act). This effectively means that such companies do not have to account for foreign currency gains or losses on transactions concluded in foreign currency in relation to their RSA oil and natural gas operations.

In order to draw an effective comparison between the RSA and the REG income tax legislation as it pertains to foreign oil and gas companies, sub-chapter 3.2 presents the income tax legislation of the REG in the same format in which the description of the RSA in table 4 above is presented.

3.2 REG INCOME TAX LEGISLATION AS IT PERTAINS TO FOREIGN OIL AND GAS COMPANIES

In Table 5 the REG Tax Law pertaining to foreign oil and gas companies (FOGCs) is explained.

Table 5: Summary of REG income tax systems

Applicable Tax	Applied to FOGCs
Corporate income tax.	The REG income tax regime is determined by the REG Tax Code (law 4/2004, Regulating the Taxation System in the REG (dated 28 October 2004)) and directed for FOGCs through the REG Hydrocarbon Law No. 8

	of 2006. In addition, the REG government signs the PSC with the FOGC. This study does not aim to conduct an in-depth study of the PSC requirements as these are usually determined in specific agreements between a FOGC and the REG government unless an industry norm exists which needs to be considered by a foreign company for its decision-making purposes. The REG government initiated a framework within which oil and natural gas activities must be conducted in the REG in line with the REG Hydrocarbon Law (8/2006). This legislation introduced a framework in which oil and natural gas activities had to be conducted in the REG from the date of the legislation. The Hydrocarbon Law recognises the REG's dependency on FOGCs for its developing needs in the country from the oil and natural gas industry which, according to the United States of America Department of State (2011), is the largest economic industry of the REG.
The enactment date of the Hydrocarbon Law.	The Hydrocarbon Law was enacted on 3 November 2006 with the REG Tax Code dated 28 October 2004 (Ernst & Young, 2011: 126).
Corporate tax rate.	The REG Tax Code read with The Hydrocarbon Law determines that FOGCs will be subject to a corporate income tax rate of 35%. The corporate income tax rate applicable to FOGCs is similar to that of any other company registered in the REG (Ernst & Young, 2011: 126-127).
Withholding tax levied on payments made.	In addition, all payments made by FOGCs are subject to withholding tax of 10% on payments to non-residents and 6.25% to the residents of the REG. This is a tax levied specifically on companies in the oil and natural gas industry in the REG (Ernst & Young, 2011: 129).
Royalties'	Royalties on oil and natural gas production is charged at a minimum rate

payable on minerals and petroleum production.	of 13% or as determined by the PSC signed between the REG government and a FOGC (Ernst & Young, 2011: 126).
Secondary tax on companies or withholding tax on dividends.	The REG Tax Code does not prescribe any STC other than the withholding tax on dividends. Withholding tax rate on dividends received by foreign shareholders is 25%. Withholding tax rate on interest paid to non-resident entities is subject to 10% on the gross amount paid (Ernst & Young, 2011: 129).
Expenditure or losses incurred allowed as deductions for income tax purposes.	In order to determine the taxable income of a FOGC, the allowable deductions are restricted to a large extent to those budgeted for as usually required by the PSC. These are exploration and production costs incurred by an oil and gas company. There are restrictions placed on the following types of expenditure which is not deductable for tax purposes in the REG as directed by the Hydrocarbon Law (Ernst & Young, 2011:127): • Interest on loans obtained by a FOGC from any affiliated company or the parent company or non-affiliated third parties which exceed the commercial rate charged by official REG banks. • Expenditure incurred prior to the conclusion of the effective date of the PSC. • Any bonus or discovery bonus paid by a FOGC. • The annual surface rental rate paid to the REG government. • Amounts paid in excess of 7.5% of the annual budget approved by the Ministry during the initial exploration period and expenditure in excess of 5% of the said annual budget during the development and exploitation phase. • Any expenditure defined as fines for either the non-performance of set minimal exploration work or violations of the laws or regulations imposed by the REG government.

	• Audit and inspection expenses incurred by the REG government at the head office of a FOGC in cases where original documentation is not available at the particular foreign company's office in the REG. • Specialised services acquired by a FOGC as specified in the PSC. A FOGC is allowed to deduct the general and administration expenditure which it has incurred outside of the REG national territory as determined by the PSC.
Deductions allowed on capital items incurred.	The REG does allow certain capital allowances in the form of depreciation on assets placed into service by a FOGC. The depreciation rates are standard and must be determined using the straight-line method (Ernst & Young, 2011:127).
Accelerated capital allowances on fixed assets acquired.	The REG Tax Code does not provide for any accelerated depreciation on the assets of a FOGC (Ernst & Young, 2011:127).
Off-setting of losses made in the prior year against current year taxable income.	Losses incurred in one year of assessment can be set-off in a succeeding year of assessment (Ernst & Young, 2011:127).
Limitations on the period within which off-setting of losses must	Losses incurred in one year of assessment are deductible up to a maximum of five years (three years for companies other than oil and gas companies) (Ernst & Young, 2011:127).

be used in years.	
Off-setting of losses against profits between different projects of a FOGC.	The REG does not allow losses that are incurred on one project of a FOGC to be offset against the profit of another project (Ernst & Young, 2011:127). It is advisable to account for the oil and natural gas operations separately.
Effective CGT rate inclusion in determining the corporate income tax payable.	The REG treats capital gains as ordinary business income and it is taxed at the standard corporate rate of 35% (Ernst & Young, 2011:129).
CGT reliefs available in order to determine its corporate income tax payable.	The REG tax law does, however, provide a relief in respect of capital gains realised on the disposal of fixed assets which was used in the course of FOGC's activities for a 3-year period provided that the company reinvests the capital gain in new fixed assets for its activities. (Ernst & Young, 2011:128).
Relief on foreign currency gains and losses to determine the taxable income.	There is no specific relief for gains and losses made due to fluctuations in the exchange rate. The PSC will determine the financial method which in most cases will follow the annual work programme and annual budget approved by the Ministry.

Based on the detailed descriptions of both the RSA and the REG income tax systems in sub-chapters 3.1 and 3.2 above, Table 6 summarises the similarities and differences between the income tax legislation in the RSA and the REG in order to draw a comparison between income tax legislation in the RSA and the REG as it pertains to foreign oil and gas companies.

3.3 CONCLUDING REMARKS ON THE COMPARISON BETWEEN THE INCOME TAX LEGISLATIONS OF THE RSA AND THE REG

Based on the review of the two tax systems above, Table 6 provides a list of the similarities and differences between the RSA and the REG income taxes legislation relating to foreign oil and gas companies (FOGC).

Table 6: Income tax similarities and differences between the RSA and REG

Income tax provision relating to FOGCs	RSA	REG
Corporate income tax applicable on taxable income of a FOGC.	√	√
Oil and natural gas industry: specific legislation dealing with taxation of FOGCs.	√	√
The effective date on which the specific legislation dealing with oil and gas tax provisions was enacted.	Nov. 2006	Nov. 2006
Corporate tax rate applicable to FOGCs.	28% / 31%	35%
Withholding tax levied on payments made by FOGCs.	×	√
Royalties payable by FOGCs on minerals and petroleum production.	√	√
Secondary tax on companies applicable to FOGCs. (Until 30 March 2012)	√	×
Withholding tax on dividends applicable to FOGCs. (RSA effective from 1 April 2012)	√	√
Expenditure or losses incurred by FOGCs allowed as deductions for income tax purposes.	√	√
Deductions allowed on capital items incurred by FOGCs.	√	√
Accelerated capital allowances on fixed assets acquired by FOGCs.	√	×

Income tax provision relating to FOGCs	RSA	REG
Off-setting of losses made in the previous year by FOGCs against the current year's taxable income.	√	√
Limitations on the period within which off-setting of losses must be used in years.	No limit	5 years
Off-setting of losses against profits between different projects of a FOGC.	√ (10% limited)	✕
Effective CGT rate inclusion in determining the corporate income tax payable by a FOGC. (*REG considers proceeds of a capital nature part of normal profits)	14% (18.6% from 1 March 2012)	35%*
CGT reliefs available to FOGCs in order to determine the corporate income tax payable.	√	√
Relief on foreign currency gains and losses to determine a FOGC's taxable income.	√	✕

From Table 6 it is clear that tax legislation in the RSA specifically in respect of foreign oil and gas companies is slightly more similar than different to tax legislation in this regard in the REG. But the main difference between the income tax systems in the RSA and the REG is the extent to which a foreign oil and gas company will be required to pay income tax in relation to its profits in the REG. Therefore, based on this overview the conclusion can be drawn that, although there are some similarities in what a foreign oil and gas company can expect when investing in either the RSA or the REG, the outcome as far as profits are concerned will be different at the end of the day because the tax systems within each of the two countries are different.

In the next chapter, a further comparison is made between the income tax systems of the RSA and the REG in terms of their complexity and collection methods.

CHAPTER 4

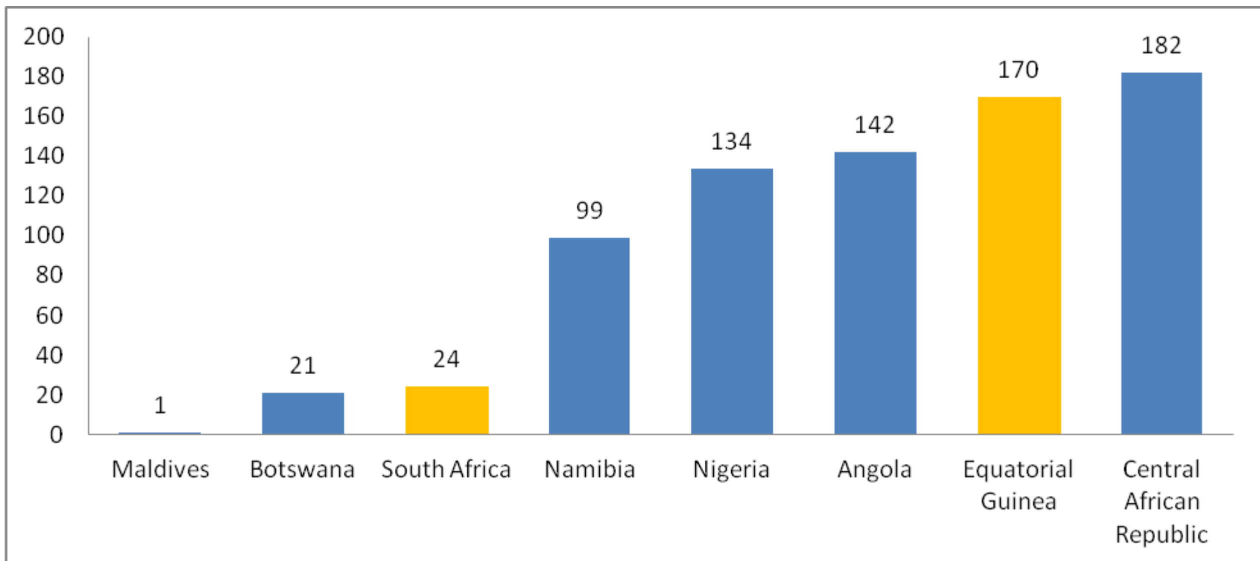
COMPARISON OF THE INCOME TAX SYSTEM COMPLEXITY AND COLLECTION METHODS IN THE REPUBLIC OF SOUTH AFRICA AND THE REPUBLIC OF EQUATORIAL GUINEA

In a comparative study of income tax legislation in respect of foreign oil and gas companies investing in the RSA and the REG it would be important to evaluate what level of effort such a company would need to comply with the specific country's taxation system. In this chapter, a publication issued by the World Bank (2011) which rates countries according to the relevant laws and regulations which enhance business activity or constrain it is used to evaluate the income tax regimes of the RSA and the REG. Furthermore, the chapter also investigates the differences in the collection methods applied by the RSA and the REG for collecting their revenue based on the income tax legislation and other duties payable by foreign oil and gas companies.

4.1 CONSIDERATIONS AND RESULTS ASSESSED IN THE WORLD BANK'S RATING STUDY

The rating study focuses specifically on tax matters. The study rates 183 countries worldwide and Figure 5 indicates how the RSA and the REG measured up to the rest of the countries in Africa.

Figure 5: Rating of tax regimes in Africa



Source: World Bank, 2011

In Figure 5, the outcome of the rating study shows the level of effort required in terms of the number of hours per year spent to prepare and file a return, in paying taxes, the total tax rate (tax liability as a percentage of profits before all taxes are considered) and the number of tax payments per year. It shows that the RSA achieved a rating of 24th among the 183 countries considered with the REG rated further back in the 170th position. The RSA's rating has come down by one position from 2010 as against the REG's rating which improved by two places for the same period. The reason that the RSA fell one place was due to the marginal increase in its total tax rate as a percentage of profit. On the other hand, the REG's improved rating was not due to any change in the applicable criteria but due to regressions in the rating of some of the other countries considered in this rating study.

Furthermore, Table 7 below indicates how the RSA and the REG measured up to other countries in the region based on the number of hours per year spent in preparing and filing a tax return, paying taxes, the total tax rate and the number of tax payments per year. This is a further indication that the RSA tax regime provides a better balanced tax system than that of the REG.

Table 7: Economic ranking criteria for rating countries on paying taxes

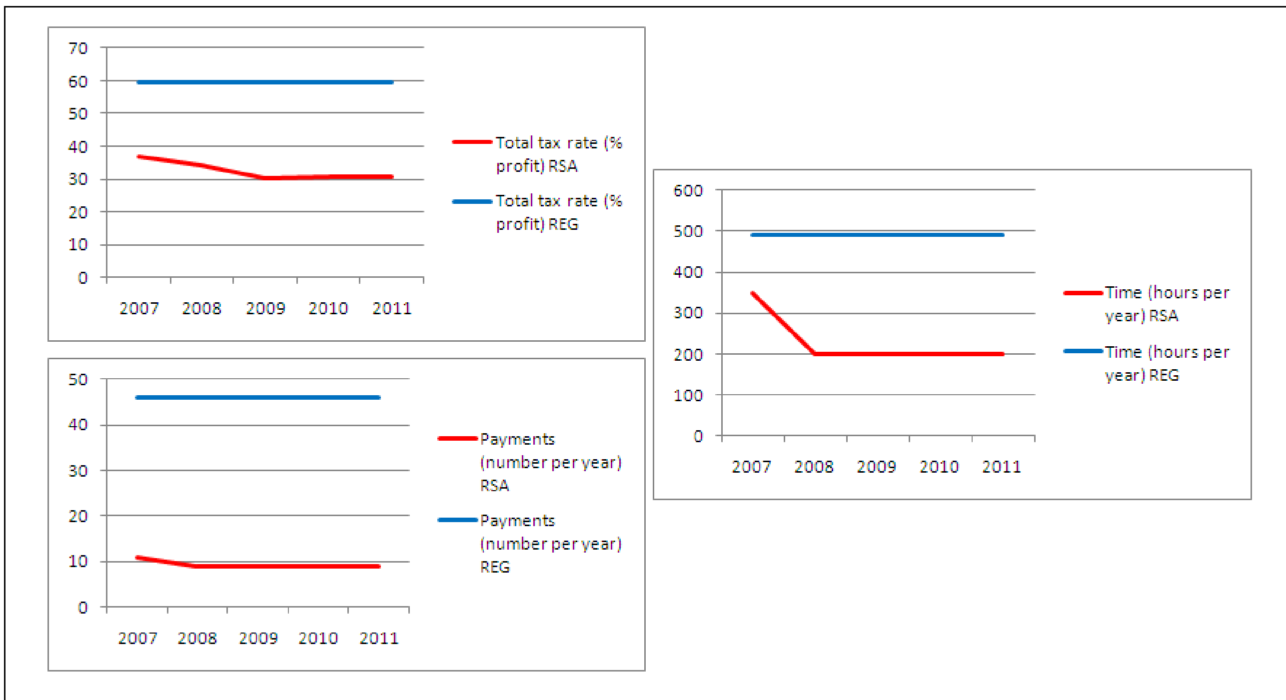
Country	Rating	Payments (number per year)	Time (hours per year)	Profit tax (%)	Labor tax and contributions (%)	Other taxes (%)	Total tax rate (% profit)
Maldives	1	3	0	0	0	9.3	9.3
Botswana	21	19	152	15.9	0	3.6	19.5
South Africa	24	9	200	24.3	2.5	3.7	30.5
Namibia	99	37	375	4	1	4.6	9.6
Nigeria	134	35	938	21.8	9.7	0.7	32.2
Angola	142	31	282	24.6	9	19.5	53.2
Equatorial Guinea	170	46	492	13.5	25.4	20.6	59.5
Central African Republic	182	54	504	176.8	8.1	18.9	203.8

Source: World Bank, 2011

As indicated in Table 7, the total tax rate as a percentage of profit in REG is 59.5% as opposed to 30.5% in RSA which is a difference of 29%. Furthermore, a foreign oil and gas company will make approximately 46 tax payments per annum on average in REG compared to the average expected 9 payments which a foreign oil and gas company will make in RSA based on the rating study. Also of importance to a foreign oil and gas company is that it will have to take into account the fact that it will be spending more resources in order to comply with the tax legislation in REG than it would in RSA. This is borne out by the fact that the rating study shows that a tax payer will spend approximately 200 hours on tax-related matters in RSA as opposed to 492 hours in REG.

Figure 6 indicates how the RSA and the REG measured up over the previous 5 years against the same rating study criteria.

Figure 6: A 5-year analyses of the tax rating study.



Source: World Bank, 2011

Figure 6 shows a gradual improvement in the RSA tax system compared to that of the REG tax system which did not have any regressions or improvements in respect of the criteria considered.

4.2 COLLECTION METHOD COMPARISON

The methods used by the RSA and the REG in collecting their share of the value created by a foreign oil and gas company through the investment it has made in the respective countries and the company's profits from sales of oil and, or natural gas to the market are discussed below. As will be seen the collection methods are focused on two aspects. These aspects are, firstly, taxing the particular foreign oil and gas company for allowing it to explore and operate within the borders of the respective countries and, secondly, taxing the profits obtained from sales of the oil and, or natural gas products to the market. These methods are mainly incorporated in legislation. The consequences of non-adherence to particular sections of the relevant legislative requirements are also discussed below.

4.2.1 Method of collecting a share in the oil and natural gas profits made by foreign oil and gas companies in the RSA

The RSA oil and natural gas industry is mainly regulated from a duty collection point of view by the MPRDA, the Mineral and Petroleum Resources Royalty Act, 2008 (Act. 28 of 2008) (Royalty Act), Mineral and Petroleum Resources Royalty (Administration) Act, 2008 (Act. 29 of 2008) (Royalty Administration Act) and the Tax Act. The duty consists of royalties payable to the RSA government determined as a percentage of gross sales of mineral resources.

The RSA government's share in the profits and capital gains of a foreign oil and gas company is mainly collected from income taxes and royalty payments.

The royalty payment is determined by using the gross sales of a particular company and multiplying it with percentages set out in section 3 of the Royalty Act. The South African Revenue Service (SARS), the tax collection authority in RSA, is responsible for collecting the income taxes and royalties in terms of the Tax Act and Royalty Act respectively. The foreign oil and gas company is responsible for calculating the income tax and royalties due to SARS on a bi-annual basis as determined by section 5 of the Tax Act and section 5 of the Royalty Administration Act. Penalties and interests are charged in cases where foreign oil and gas companies do not calculate the amounts due accurately, or do not pay the amounts due on time (section 80 of the Tax Act and section 14 and 16 of the Royalty Administration Act).

The RSA government has implemented a system of self-declaration of taxes and duties due to the RSA government which is collected and administrated by SARS. This consists of an electronic system where provisional and annual tax returns are submitted to SARS. Provisional tax returns are required to be filed with SARS at least twice per financial or tax year. The first provisional return and payment is due after the first six months of the particular foreign oil and gas company's financial year. The second provisional return and payment is due on, or before its financial year end and if required a final payment before the end of the following six months after its financial year-end (Fourth Schedule to the Tax Act). SARS will on its own discretion periodically perform a tax audit on the tax returns

submitted. Furthermore, the RSA government relies on a structured corporate governance system which requires foreign oil and gas companies, for instance, to recognise and pay the legislative taxes and duties owing to the RSA government (Ernst & Young, 2011:346).

The success of the implementation of this system has improved the RSA tax burden on the taxpaying entity (World Bank, 2011). However, there is no provision made for the payment of bonuses or surface rentals (Ernst & Young, 2011:346).

4.2.2 Method of collecting a share in the oil and natural gas profits made by foreign oil and gas companies in the REG

The REG government has multiple methods of collecting its share in the oil and natural gas activities of foreign companies. This is done through the REG Tax code, the Hydrocarbon Law and the various PSC's signed with these companies.

The REG government collects its share of the oil and natural gas operation profits through income tax, royalties, bonus payments, surface rental payments and withholding taxes. The income tax, royalties, bonus payments, surface rental and withholding taxes are usually paid in accordance with the PSC but usually to the Ministry. The REG method of collection is determined by the PSC (Ernst & Young, 2011:126).

The REG tax year is the calendar year ending 31 December and the financial year of each foreign oil and gas company must correspond to the tax year. The REG tax code determines that a tax return must be filed by the 30th of April in the following calendar year. Furthermore, a minimum company tax equal to 1% of the turnover in the previous year must be paid over to the Ministry by 31 March. The final payment for income tax due to the REG must be paid by 30 April.

The duties, such as, the surface rentals, bonus payments and royalties are determined by the production sharing contract and are administered in accordance with the production sharing contract. Penalties are also charged for late or understated income tax returns and amounts due to the Ministry (Ernst & Young, 2011:126). The PSC determines penalties for foreign oil and gas companies which do not conform to the work programme as approved

by the Ministry which in turn will impact on the royalties, bonuses, surface rentals and withholding taxes charged.

4.2.3 Process followed by the RSA and the REG to collect tax and duties

Table 8 consolidates the information from the previous sections into a practical example of what steps a foreign oil and gas company will have to take in order to comply with income tax legislation and contract agreements in each of the countries.

Table 8: Process followed by each country to collect its tax and duties

<table>
<tr><th>Tax or Duty</th><th>RSA</th><th>REG</th></tr>
<tr><td colspan="3">A FOGC will have to bear the following in mind:</td></tr>
<tr><td rowspan="5">Income Tax</td><td colspan="2">Register as a taxpaying company.</td></tr>
<tr><td>The company can determine its own financial and corresponding tax year-end.</td><td>The company will have a financial year-end of 31 December with its corresponding tax year-end also falling on 31 December.</td></tr>
<tr><td>Make at least two provisional tax payments during the financial year.</td><td>The company will pay a minimum income tax equal to 1% of its turnover in the previous year which is payable by 31 March. The final instalment of its corporate income tax is due by 30 April following the 31 December tax year-end.</td></tr>
<tr><td colspan="2">Maintain records of all its income and expenses during the financial year in order to complete its annual tax return of taxable income and allowable deductions. Submit annually a tax return to the tax collection authority.</td></tr>
<tr><td>After SARS has evaluated the tax return it will either opt to perform a tax audit or accept the tax return and issue the FOGC with a tax assessment which summarises the</td><td>The REG tax collection authority will evaluate the tax payable based on the financial information submitted and issue the FOGC with a tax receipt confirming the income tax</td></tr>
</table>

Tax or Duty	RSA	REG
	tax due to, or by the company.	payment.
Payment of royalties, surface rentals and bonuses	The FOGC will apply through the Petroleum Agency SA for an exploration and/or production permit in terms of the MPRDA.	The FOGC will apply for a PSC for purposes of exploring and/or production in a specific oil and natural gas field with the Ministry.
	Upon the commencement of the oil and/or natural gas production the FOGC will have to determine the royalty levy payable to SARS on a bi-annual basis.	The FOGC will in terms of a PSC be responsible for making the following minimal payments to the Ministry: • A signature bonus payment for awarding the PSC to the company. • Annual surface rental determined by the size of the field granted to the company for exploration and/or production activities based on a levy per hectare. • Additional bonus payments at the commencement of further exploration and/or production stages. • Royalty payable based on the daily disposable production calculated on a percentage sliding scale depending on the barrels or cubic feet per day of oil and natural gas production respectively.

After considering the summary of the collection methods applied by the RSA and the REG to collect their share of the profits of a foreign oil and gas company the last part of this

chapter consolidates the elements evaluated in sub-chapters 4.1 to 4.2 in order to arrive at a conclusion on the similarities and differences in the income tax regimes and systems of the RSA and the REG.

4.2.4 Summary of the methods of collection

Certain similarities exist in the collection methods of the RSA and the REG in respect of income taxes and duties from foreign oil and gas companies. The collection of income taxes due on profits from the foreign oil and gas companies sales of oil and natural gas products are taxed in a similar manner and collected by a central revenue authority of the state in each country. In both countries penalties and interests are charged on the under-payment or late payment of taxes and duties due to the state.

In both the RSA and the REG a royalty levy is charged on the sales of the oil and natural gas products. This effectively represents the benefits which the state gains from its oil and natural gas resources. In both countries the obligation to pay a royalty is legislated. The RSA has recently issued two sets of legislation to govern the payment of royalties on any natural resource within the set boundaries of the RSA. The Mineral and Petroleum Resources Royalty Act No 28 (2008) which enforces the payment of a royalty and the Mineral and Petroleum Resources Royalty Administration Act No 29 (2008) which sets the formula for determining the amount of royalty payable and the timelines for purposes of administering the royalty obligation. In contrast, the REG determines the need for a foreign oil and gas company to pay a royalty in terms of the Hydrocarbon Law No 8 (2006). The administration and amount of royalty payment is determined by the production sharing contract.

The collection methods in the RSA and the REG differ in that additional duties are charged by the REG in terms of the PSC. These are the bonus payments, surface rental and withholding taxes.

In conclusion, the RSA, therefore, has the opportunity to gain more value in the form of taxes and duties from foreign oil and gas companies as opposed to the REG due to the additional duties charged. As can be seen in Table 1 and Table 2, the possible reason for

this could be the fact that the REG can enforce a less accommodating tax regime compared to the RSA because of its proven success rate in oil and natural gas reserves (Maxwell, 2011:2).

In contrast, the rating study's results provide valuable information which a foreign oil and gas company can take into account when comparing the tax regulations in the RSA and the REG. It is evident from the elements considered in the rating study that the RSA's tax legislation and system is assessed as a better developed system that could be more beneficial to economic development than the tax system of the REG.

The summarised similarities and differences set out in Table 6 together with the criteria used for the rating study as the basis for considering a country's ability to attract or discourage a foreign oil and gas company and, lastly, the collection methods described, make it clear that the RSA and the REG tax regimes are more different than similar. A foreign oil and gas company may decide that from an income tax point of view it would be beneficial for the company to invest in the RSA rather than in the REG. One aspect that this study did not consider in its comparison of the RSA and the REG is the availability of oil and natural gas reserves in each of the countries. According to Maxwell (2011:2) it is clear that the REG has a much greater success rate as far as proven oil and natural gas reserves is concerned. A foreign oil and gas company will, therefore, has to weigh up the benefits of achieving success in its exploration and exploitation efforts in the REG compared to the better established tax regime of the RSA.

4.3 CONCLUDING REMARKS ON THE COMPLEXITY AND COLLECTION METHODS

In summary, a foreign oil and gas company should compare the complexity of the REG income tax regime with the more advanced income tax regime of the RSA when deciding to either invest in the RSA or the REG. Furthermore, the company will be liable to pay more income tax and other duties as a result of the extended collection methods which the REG has put in place as opposed to the collection methods adopted in the RSA.

Therefore, it has become evident that a foreign oil and gas company investing in the REG will be faced with the burden of spending more resources and time in trying to comply with

income tax legislation than it would in complying with the income tax regime in the RSA. However, if one takes into consideration the potential of success in exploiting possible oil and natural gas resources in the REG compared to finding oil and natural gas resources in the RSA, one would expect that the REG will be in a position to offer a better rate of return on its oil and natural gas resources than the RSA.

The next chapter presents an overall conclusion of the comparative study of the income tax legislation in respect of foreign oil and gas companies investing in Africa after a discussion of the findings on the oil and natural gas industries, income tax legislation, income tax regime complexities and collection methods applied in the RSA and the REG.

CHAPTER 5

FINDINGS, CONCLUSION AND RECOMMENDATIONS

A core challenge for the RSA and the REG is that the optimal balance between a tax regime that is business and investment friendly and one which can leverage enough revenue for public service delivery should be found. This would enhance the attractiveness of the regulatory environment of both countries, particularly, with regard to the collection of income taxes and other duties.

5.1 INTRODUCTION

The findings of the study could prove to be of value due to the relevance of its topic in the current world economy where natural resources are the subject of most bilateral discussions between countries across the world (Maxwell, 2011:5). Although the RSA cannot be regarded as a large oil and natural gas producing country when compared to the REG, recent explorations in the Karoo Basin have suggested that shale gas reserves might be discovered there. This development has made a comparative study of the RSA tax regime with that of other established oil and gas producing countries on the African continent necessary.

Previous studies have been conducted on the RSA tax regime applicable to mining companies in general (Cloete, 2010).These studies recommended that a further study into the income tax regime applicable to oil and gas companies should be conducted, particularly as a test of the recent introduction of the Tenth Schedule to the Tax Act when compared to the tax regime applicable to oil and gas companies in another country, such as, the REG.

Firstly, the study compared the oil and natural gas industries of the RSA and the REG in order to understand the environment which a foreign oil and gas company will find when choosing to invest in either of the two countries. Secondly, the study compared the income tax systems applicable to foreign companies mainly from a legislative perspective with some additional considerations with regard to contractual agreements that these

companies would be obliged to undertake, particularly in the REG. Thirdly, the complexities and methods of collection of income taxes and duties in the RSA and the REG were compared.

5.2 RESEARCH OBJECTIVES ANSWERED

The comparative study of the income tax legislation in respect of foreign oil and gas companies investing in Africa and, more specifically, the RSA and the REG set out to address the below mentioned research objectives.

5.2.1 Comparison of the oil and gas industries in the RSA and the REG

The first research objective was to compare the RSA and the REG oil and gas industries by evaluating the relevant income tax laws, collection methods and overall tax regime.

In the world today the oil and gas industry affects the economies and the citizens of each country. The comparison between the RSA and the REG oil and natural gas industries provided firstly a good understanding of the respective industries and identified the similarities and differences between the oil and natural gas industries of the two countries. The methods of identifying oil and natural gas fields and the process of allocating it to a foreign oil and gas company which has tendered for the right to explore or produce oil and natural gas products in the RSA and the REG are similar. In both countries the role of a state-owned entity plays a big part in the application and processing of licences to prospective companies. Furthermore, both the RSA and the REG are largely dependent on foreign investment in each country's oil and natural gas industry due to its specialised nature and the funding required exploring and extracting oil and natural gas.

It was evident that the oil and natural gas industry in the REG makes a much larger contribution to its GDP when compared to the oil and natural gas industry's contribution to the GDP of the RSA. The main reason for this is that the REG has an

established oil and natural gas industry with foreign oil and gas companies producing petrochemical products from its oil and natural gas reserves. Furthermore, it was found that the REG has had more success with its oil reserves in contrast to the RSA which has been more successful in the use of its natural gas reserves. This resulted in the successful implementation of the GTL technology in the state-owned refinery at Mossel Bay. In addition, the potential of the recent discovery of shale gas reserves in the Karoo Basin may have a big impact on the energy sector in the RSA.

The comparison between the tax legislation applicable to foreign oil and gas company operations in the RSA and the REG focused on identifying the similarities and differences between the tax regimes and to what extent the RSA may learn from the REG. Evidence presented itself that there are more differences than similarities in income tax legislation in the RSA and the REG, particularly as it pertains to foreign oil and gas companies. The major difference is that a foreign oil and gas company will be liable to pay a higher tax to the REG tax authority than would be the case in the RSA. This is due to (i) a higher corporate income tax rate applicable to the taxable incomes of foreign oil and gas companies in the REG as compared to the RSA, (ii) increased withholding tax liability on payments made by these companies in the REG, (iii) no accelerated capital allowances provided in the REG as opposed to the allowances provided in the RSA, (iv) restrictions on the allowance of deducting prior year assessed losses, and (v) a higher CGT rate in the REG compared to the effective CGT rate in the RSA.

The comparison of the methods of collecting the income tax and other duties payable by a foreign oil and gas company based on the income tax legislation and other agreements in the RSA and the REG also revealed certain similarities and differences between the two countries. In both the RSA and the REG the income tax liability is legislated through the tax legislation of the relevant country supported by specific legislation dealing with the taxation of oil and natural gas operations. Furthermore, in both countries it is a requirement that royalties should be paid to the governments.

Two major differences between the two countries were identified. The first major difference concerns the collection methods used by both countries. A foreign oil and gas company has to conform to the set timelines of the REG tax year which is a different approach to the collection methods applied by the RSA. The RSA tax legislation allows a foreign oil and gas company to determine its own timelines with some limits within which such a company would have to submit its tax returns. The second major difference is that the REG has a few additional methods of collecting revenue from foreign oil and gas companies as opposed to the RSA. This is usually as a result of a PSC signed between the REG and the company which lists additional payments which such a company would have to make to the REG on the awarding of the oil and natural gas rights.

Lastly, a rating study conducted on the income tax regimes of the RSA and the REG was used to compare the overall tax regime of the two countries against each other and against other African countries. The rating study considered factors, such as, the number of tax payments a company will make in a tax year, the total number of hours a company will spend on its income tax affairs and also the total percentage of tax payable to the RSA and the REG governments compared to their profits. Interestingly, the RSA tax regime was rated more advanced than that of the REG. The rating study also provides a five-year comparison of the RSA and the REG tax regimes in order to assess each element as to its improvement. Even in this comparison the RSA tax regime indicated an improvement over the five-year term, whereas REG did not show any improvement or regression over the same period.

5.2.2 Similarities and differences in the income tax regimes

The second research objective was to identify the similarities and differences in the income tax regimes together with the oil and natural gas industries in the RSA and the REG.

A foreign oil and gas company would have to consider three aspects as part of its decision-making process in respect of investing in the oil and natural gas industry in either the RSA or the REG. The first aspect it would have to consider is to what extent it will be successful in discovering oil and natural gas reserves in either the RSA or the REG. Secondly, the company would have to consider what the cost of operating in either the RSA and the REG would be based on the income tax and other duties payable. Lastly, the company would have to consider to what extent it will spend and allocate resources to comply with the RSA and the REG income tax legislations.

In the first instance, the success rate which the REG has achieved in discoveries of oil and natural gas reserves compared to discoveries in the RSA will favour a decision to invest in the REG. This is based on the fact that the REG is already an established oil and natural gas producer with a number of foreign oil and gas companies operating in the country. However, this situation may be influenced by a number of factors, such as, updated surveyed data on the oil and natural gas reserves and possible new discoveries in each country. This is especially important in view of the recent reports that there is a possibility that shale gas reserves might be found in the Karoo Basin.

Secondly, based on the similarities and differences identified in the RSA and the REG income tax legislation a foreign oil and gas company will have to be prepared to accept a higher cost of operating in the REG as opposed to the RSA. This is due to the fact that such a company will be taxed at a higher rate in the REG compared to the RSA with less beneficial deductions being allowed by the REG against its taxable income as opposed to the RSA. Lastly, the comparison of the RSA and the REG income tax regimes and the increased cost of complying with income tax legislation in the REG compared to income tax legislation in the RSA will also influence the company’s investment decision.

Thus, a foreign oil and gas company will have to weigh up the strengths, weaknesses, opportunities and threats in each country before it can make a

decision to invest in the oil and natural gas industry in either the RSA or the REG. The identification of the similarities and differences between the income tax legislation of the RSA and the REG as it pertains to the oil and natural gas industry will assist such a company in identifying these strengths, weaknesses, opportunities and threats so that it's can make an investment decision.

5.3 OVERALL CONCLUSION

Overall the study has indicated that there is specific income tax legislation that deals with the operations of foreign oil and gas companies investing in the oil and natural gas industry in each country.

In both countries there are also specific revenue collection methods in respect of the income tax and other duties due from foreign oil and gas companies. The REG has more methods of collecting revenue than the RSA.

The revenue generation from the oil and natural gas industry makes up a larger part of the REG economy compared to that of the revenue generation from the oil and natural gas industry in RSA. The reason for this is the extent of the proven and possible oil and natural gas reserves owned by the REG as compared to the proven and possible oil and natural gas reserves owned by the RSA. An important fact that should be kept in mind for future purposes is the recent discovery of possible shale gas reserves in the Karoo Basin which might change the comparison drawn in this study between the proven and possible natural gas reserves in the REG and the RSA.

Lastly, as evident from the World Bank's (2011) rating study which compared the tax regimes and tax systems of countries in the world, the tax regime and system of RSA rated better than the tax regime and system of REG. The study also indicated that the RSA tax regime and system has shown an improvement over a five-year period compared to the REG tax regime and system which remained largely constant during the same five-year period.

5.4 RECOMMENDATIONS FOR THE RSA'S TAX REGIME

The income tax legislation of the RSA compared well with that of the REG. According to the rating study results, the tax regime and system of the RSA was rated far more positively than the tax regime and system of the REG.

In view of the fact that the REG currently has far more proven oil and natural gas reserves compared to that of the RSA, the REG is placed in a better position to collect more revenue from the activities of foreign oil and gas companies. This also allows the REG to negotiate for more methods to collect revenue from these companies, such as, signature bonuses, surface rentals and other bonus payments. In view of the possible effect that the discovery of shale gas might have on the extent of the RSA's natural gas reserves, the only recommendation would be that the RSA government should consider broadening its revenue collection methods in the same way as the REG.

5.5 POSSIBLE FUTURE RESEARCH

One aspect which was not considered in this study is the effect of indirect taxes on the investment decisions and operations of foreign oil and gas companies in the RSA and the REG. This includes the impact of Value Added Tax (VAT), employee taxes, and customs and excise duties.

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