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Politics of Economic Rents and Petroleum Resources Taxation in Oil and Gas Industry

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ABSTRACT

This paper argues the politics of economic rents and petroleum resources taxation in oil and gas industry. It does this through the understanding concept of economic rent, royalties, corporation tax, resource rent tax and brown tax. It surveys the comparative merits and demerits of royalties, corporation tax, resource rent tax and brown tax. The paper discusses the concept of tax structure and proposes that it should be progressive and fair to both government and investors. The principles of a good tax structure should include simplicity, convenience, ability to pay, economical, equity and certainty. While the characteristics of a good tax structure should include proportionality, it should ensure fairness and acceptability by both the government and the citizens together with foreign investors. This way, it enhances the longevity of that particular tax system and rewards will be very high. Although taxation is mandatory to all income earners and profits gainers, there are key economic considerations in designing a tax structure for new petroleum producing countries. The paper argues these economic considerations to include ownership of petroleum resources, good investments laws, strong, accountable and transparent economic institutions, good fiscal and monetary policies, land ownership, strong private banking industry, market driven insurance policies, market for consumption of petroleum products, dynamic and friendly technology, strong regulatory environment and affordable trained workforce.

As the taxation is implemented, the concept of source and residence taxation become very handy and the paper argues that source of the income and residence of the investor should be taken into the consideration from the onset of the designing of tax system and particularly in oil and gas industry. While the source of income may be in the country and residence outside the country, the tax system should carefully consider this so that the investor and the tax agency (the government) consent and each party plays it role conveniently. Although advantages and disadvantages of source tax and residence tax stand, the main rules in determining sources of investment income remains of source rules. The paper notes interest-based politics has let to unsuccessful implementation of tax system in oil and gas industry. While the paper reviews copies of empirical literature, it uses comparative method and process-tracing in understanding politics of economic rents and petroleum resources taxation in oil and gas industry. It concludes that incremental sliding scale taxation is appropriate in oil and gas industry and politics of greed affects the tax regime implementation in petroleum industry.

Keywords: politics, economic, rents, petroleum, resource, taxation, structure, oil, gas, industry.

1. INTRODUCTION

Economic rent has remained a very essential concept in the entire oil and gas industry and particularly, in the upstream sector. While it has appeared as a tall idea in the petroleum value chain, economic rent has surfaced as surplus profits the government obtained from its investments in petroleum resources. Although it is a very imperative tool for the government, economic rent is also very valuable for the International Oil Companies (IOCs) or the licensee given that the government would require the IOC to pay these economic rents so that it maintains or retain its license. Failure to pay the economic rents through royalties and other taxes would force the government to revoke the license of the IOC. While royalty is one of the devices for collecting economic rents from petroleum exploitation to the state, other devices such as corporation tax, resource rent tax and brown tax are also used for collecting the economic rents. While each device is an element of petroleum resources taxation, each of these devices has its own comparative merits which make it an effective tool for collecting economic rents. Thus, what is economic rent? What is the concept of royalties, corporation tax, resource rent tax and brown tax? what are the comparative merits and demerits of royalties, corporation tax, resource rent tax and brown tax? What is the concept of tax structure and principles of good tax structure? What are the characteristics of a good tax structure? What are the key economic considerations in designing a tax structure for a country that is soon embarking on petroleum exploitation? What is the concept of source and residence taxation? What are the advantages and disadvantages of source tax and residence taxation? And what are the two main rules in determining sources of investment income? The paper will answer the above questions. The paper is outlined as follows: section one introduced the paper. Section two discusses the concept of economic rent. Section three discusses the concept of royalties, corporation tax, resource tax and brown tax. Section four discusses the comparative merits of royalties, corporation tax, resource rent tax and brown tax. Section five discusses comparative demerits of royalties, corporation tax, resource rent tax and brown tax. Section six discuses the concept of tax structure. Section seven analyzes key economic considerations in designing a tax structure for a country that is soon embarking on petroleum exploitation. Section eight discusses the concept of source and residence taxation. Section nine appraises the interest-based and greed politics in petroleum resource taxation in oil and gas industry, section ten concludes while section eleven suggests direction for future research.

2. The concept of economic rent

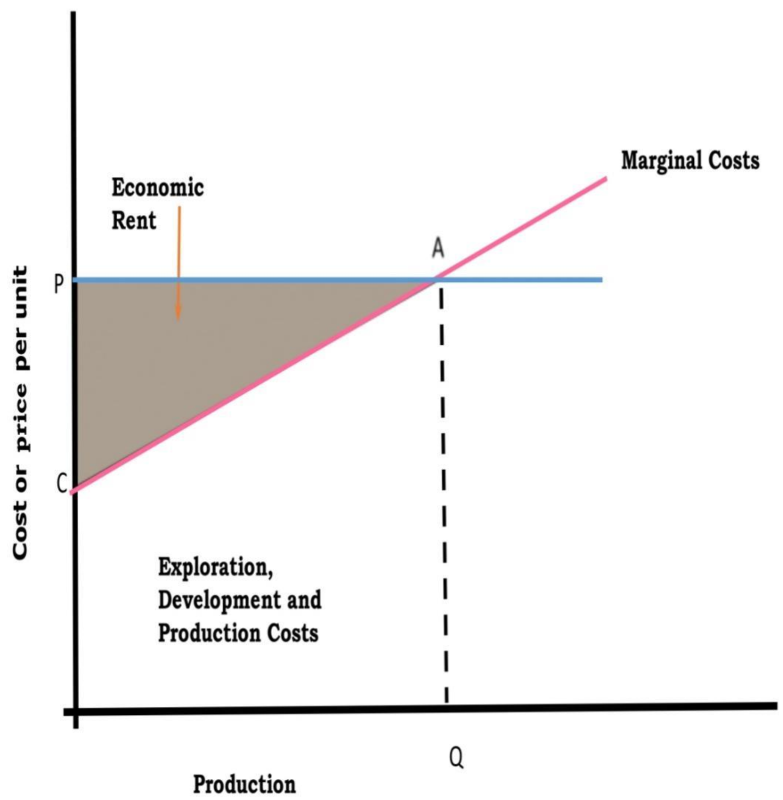
The concept of economic rent is as ancient as petroleum economic itself. Various reputable, contemporary, world class economists from John Maynard Keynes (1883–1946), Milton Friedman (1912–2006), Arthur Lewis (1915–1991), Warren Buffett (1930–2010) and Elinor Ostrom (1933–2012) to mention but a few have broadly discussed and applied the concept of economic rent in the contemporary world. Their arguments are succinctly captured and it is applied on markets failures, inefficiencies, distortions or information irregularities. They argued that economic rent originated to fill the market gaps created by market failures, inefficiencies and information distortions. This precarious market situation would require agents, particularly, economic agents to ensure that the market does its sure roles of freely allowing the forces of demand and supply to interact without any interference. When the market forces don't interact freely to cause the market perfection, the economic rents are normally considered undeserved in such imperfection market. Nonetheless, the economic rents are paid by the economic agents to the governments to aid in stabilization of the market and to safeguard that market inefficiencies and information distortions

(Sobel et al, 2024). It is important to be remembered that market is like human being, it reacts to any information around it be it good or bad. Thus, any lie or deceit will always have negative consequences on the running of the markets and supposed to be avoided at all times. Thus, economic rents ensure that information clarify and efficiencies are reinstated to the market and consequently to the entire economy (Lado et al, 1997).

From the general market understanding of economic rent concept, the concept was taken and applied in the upstream segment of oil and gas industry. According to Daniel Johnston (2003) in his groundbreaking work "*International Exploration, Economics, Risks and Contract Analysis*", economic rent is defined as the difference between the value of the costs of extraction of the oil and the value of production of oil (Johnston, 2003). It is similar with additional profits (Hughes, 1975). To be sure, these extra profits can be taken as taxes paid by the investor. Thus, economic rent is supranormal profits (Boldrin and Levine, 2018).

On the other hand, Hoe Brown (2004) argues that economic rent is noticed when the earned income remained high after deduction of cost of production and this gives the profits (Brown, 2004). To be certain, when incomes are higher than the minimum required expenses, the investors would have no any investment option but to accept the investment and wait for 'next best opportunity' and that is when economic rents are appreciated in the economy (Lado et al, 1997). Although rent is defined as surplus, a financial reoccurrence that was not even required for the investment to go ahead, rent is also defined as the higher the market price for crude oil and gas, the higher the rents to both the IOC and the government (Swab and Werker, 2018). Thus, economic rent unquestionably defines the owners' benefits in the petroleum resources. The key owner of the hydrocarbon resources in most cases is the host government who controls these resources for the interests of its citizens (Stigler, 1971). In the upstream segment of oil and gas industry, economic rents are shared via a formula of 'host government's take verse 'IOC's take''. This is mostly done in Production Sharing Agreement/ Contract (PSA/PSC). These economic rents are accrued through taxes, royalties, bonuses and levies (Mintz and Chen, 2012).

Indeed, from the standpoint of government in the hydrocarbon resources producing countries, economic rent is what is annually collected from the petroleum industry for the use of the land or sea, or what is famously called 'government take' (Johnston, 2003). On the other hand, the IOCs defines economic rent as the profit that is above and over the total costs of production. This profit may be stated as the net difference between the cost of production and the market price of the crude oil. It can also be expressed as the proceeds in surplus of the supply price of an investment. More still, economic rent is the difference between the value of production of the crude oil and the costs associated with the production. These costs consist of exploration, drilling and production as well as costs of operations plus suitable share of profits for the petroleum industry (Wessel, 2007). As extensively argued earlier, economic rent is the excessive profits and it is identical with supranormal profits. Jack Mintz and Duanjie Chen (2012) in their seminar work "*Capturing Economic Rents from Resources through Royalties and Taxes"* articulated that economic rent is realized after the petroleum contractor had recovered its costs of production, drilling and operations. In other words, IOCs generally collect their economic rents after the realization of break-even point (Banafi and Filippini, 2010).



Source: Johnson, 2003

3. The concept of royalties, corporation tax, resource tax and brown tax

The above concepts as defined as follows

3.1. Royalties

It is defined as an amount of money that exploration and production contractors pay to the petroleum and mineral resource rights' owners of a producing oil or mineral fields (Danson, 2011). It is also defined as the share of revenues that goes to the licensor.

Royalties are categorized into three families:

- Ad valorem/ value-based royalty--value produced (% value)
- Specific/unit of production-based royalty- physical quantity produced ($ barrel)
- Profit-based royalty--Percentage of some measure of income

- Ad valorem valued-based royalty

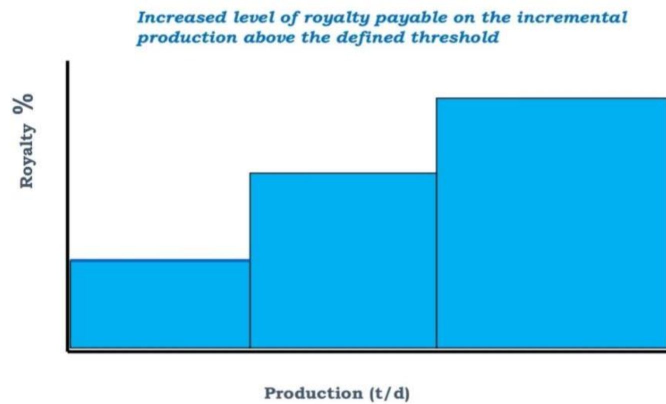
It is characterized as follows:

- It is based on value of petroleum or mineral production;
- The valuation required agreement either at gross or net levels and together with the date;
- Sales revenue are either expected or actual;
- Its valuation points of reference should be cleared. Either at the crude oil markets, London gold/metal or market exchange or other sources of international prices;
- Actual sales contract is either domestic contract price or free on-board export price;
- Point of valuation is either collection point, shore or export point well-head;
- It is not based on profits, so it is not neutral;
- It uses R-Factor for costs deduction using sliding scales;
- It provides some revenues streams stability to government;

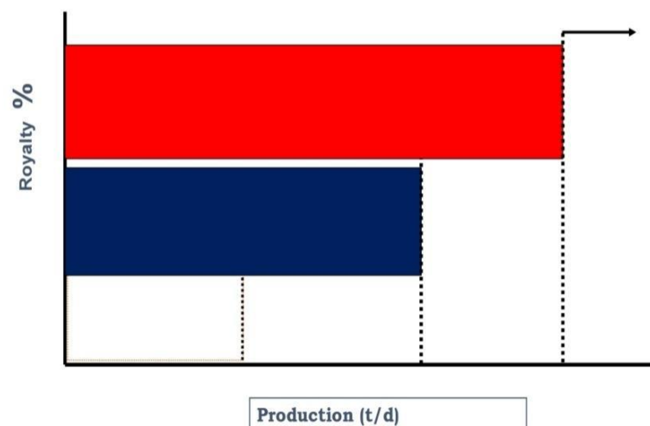
- It can lead to premature abandonment by the investor; and
- It is not flexible when prices and costs change (Chamley, 2006).

Modifying royalties
Ad-valorem base royalties are regressive tax which means their take decreases as their tax base increases (Wright, 2017). Royalties can be made to be more progressive through generation of more revenues when the level of production increases (Wessel, 2007).

Sliding scales
Royalties are divided into incremental and slabs sliding scales:
i. Incremental sliding scales
ii. Slab sliding scales



Source: Danson, 2011



Source: Danson, 2011

3.2. Corporation Tax
This is a tax that is paid by the corporation or company. It is the main tax that a limited company must pay to the government (Chamley, 2006). This tax must be paid on the company's profits as well as on any

gains from selling assets such as property, land or shares that have increased in value (Danson, 2011). While it is directed on profits, it is a main form of tax governments use to tax individuals and commercial enterprises.

3.3. Resource Rent Tax

It is calculated as a cash flow tax. It means that investments and revenues are taxed on an ongoing basis in a year in which they are earned or incurred (Atkinson and Stiglitz, 2006). It is also called additional profit tax or rate return profit sharing. It differs in detail and application from country to country. The main aim of resource rent tax is tax positive Net profit Value (NPV) when it is realized (Chamley, 2006). After income tax and other taxes have been applied, others are then treated as costs. Revenues from oil and gas production regularly are determined on the basis of spot market.

3.4. Brown Tax

This is a type of a tax named after Carey Brown. It is realized when a tax resource extraction is balanced by a tax deduction for exploration and production. Cash flows of the corporations, companies and other entities are taxed using a flat rate tax with companies projecting a negative cash flow while receiving government subsidy. While the tax deduction for exploration and production reduces the cost of exploration and production, its makes resources more abundant (Danson, 2011). This therefore means that the economic cost of harnessing these resources is lower. Brown tax applies at flat rate since the government doesn't set a specific tax rate given that companies cash flows are hard to predict. Hence, brown tax objective is to be completely neutral. Indeed, brown tax is fixed on annual net cash flow. Taxes are collected in the years where there is positive cash flows and subsidies are paid in years when cash flow is negative

4. Comparative merits of royalties, corporation tax, resource rent tax and brown tax

Royalties

- **Appropriate device for the collection of economic rents.** Royalties are highly suited and can be differentiated between different scales of operations. For instance, sliding scales which is divided between incremental sliding scales and slab sliding scales (Danson, 2011).
- **Relatively easy to administer.** Royalties are very easy to administer by any agent that collect economic rents. It is not complicated and it is simply to manage the administration of royalties not only in the entire tax administration but also in the oil and gas operations (Lado, et al, 1997).
- **Not sensitive to fall in prices.** Royalties are not sensitive to fall in the prices. Given that they are calculated in sliding scales, they cannot be easily affected by the price's instability. This is the greatest merit of royalties in oil and gas industry given that the industry is volatile due to the volatility of the prices (Bell, et al, 2024).
- **Benefits from Inflations.** As the country goes through inflation or hyperinflation, royalties stay focused and revenues increase during the time of inflation. Thus, they provide some revenue stability to the government.
- **Safe to borrow.** Royalties are less volatile than the stocks and they are safe to borrow by any borrower. This is because the economic changes through price volatility are considered in design of royalties. Hence, they are not all the times based on profits thus so neutral.

Corporation tax

- **Directed at the profits.** Corporation tax or companies' tax are generally designed and directed at the profits the corporation or company has made. Thus, it is applied when a profit has been realized in the corporation (Atkinson

and Stiglitz, 2006). It typically ranges from 20% to 50% base on each country.

- **Neutral.** It is generally considered as a neutral tax instrument. This is because the companies or corporation generally find it useful because it is based on the ability to pay. While it is considered neutral, caveat has it that it should not be considered neutral in all the circumstances (Hebous and Mengistu, 2024).
- **Less risky.** Corporation tax is less risky to the companies or individuals but more to the governments. This is because it is taxed on profits companies have made. When companies make losses that it is difficult to tax it.
- **Great source of revenue for government.** Corporation tax is a great source of revenue for the government as companies or corporation goals is profit-making. Hence, the government has continued to received enormous revenues through corporation tax.
- **Distribution of services.** Once the government receive the corporation or company tax, it distributes the revenues for the public services such provision of security, building of roads, hospitals or schools. This way, corporation tax is quite beneficial to the society not directly but through the government (Schwerhoff, 2009).

Resource rent tax

- **Neutral.** It is taxed on the rent of the property or investment. Although it doesn't require whether the business is making profit or not, it is called additional profits tax.
- **Designed on positive cash flows.** This is because the revenues or investments are taxed on the year they are incurred or earned and the corporation tax should be administered on a positive NPV.
- **Losses can be carried forward.** Given that corporation tax is administered on the positive cash flow with positive NPV, it allows the losses to be carried forward (Chamley, 2006).
- **Ownership.** Resource rent tax demonstrates the ownership of the land by the government. Given that sense of ownership, the government can then tax the property or investments to acquire revenues.

Brown tax

- **Easier to administer.** Brown tax is earlier to administer than the resource rent tax because it is applied on flat rate.
- **Fix on annual net cash flows.** The percentage of tax is fixed on annual net cash flow not only daily or monthly cash flow.
- **Designed to be completely neutral.** Given that it is taxed on flat rate, the government doesn't set a specific tax rate given that corporate cash flows are hard to predict (Danson, 2011).
- **Enormous revenues to the government.** Given that it is a flat and neutral tax, it raises a substantial amount of revenues for the government that can be used and applied to reduce other taxes (Atkinson and Stiglitz, 2006).

5. Comparative demerits of royalties, corporation tax, resource rent tax and brown tax

Royalties

- **Unplanned changes.** Measures can change in the industry and in the market and these changes can affect royalties' administration negative. For instance, changes in the socio-economic and political conditions.
- **No consideration on price increase.** When designing the royalties no one knows whether prices will increase or decrease and this continues to make royalties problematic

Corporation Tax

- **Double taxation.** The corporation can pay tax for the income and it can be asked again by the shareholders to pay taxes again on the dividends. This is double taxation on income.

- **Excessive tax fillings.** Numerous payments made either on the incomes or the tax on the income requires paperwork and this can be too much fillings.

Resource Rent Tax

- **Determination of rates.** It requires definition of discounting rates, tax rates, total tax regime, tax base (for income tax), area (ring fence) and gold plating. This determination is a lot of work and it is problematic (Mazzucato, etal, 2023).
- **Risks loaded.** It apportions high risks on the government.
- **Difficulty administration.** It is difficult to be administered.

Brown Tax

- **High risks.** It is both risky to the government and the company. The government can lose revenues easily due to changes in prices. The company can lose if the government doesn't pay the subsidy.
- **Difficulty in predicting cash flows.** Due to the flat rate of the taxes as determined by the government, it is extremely difficult to predict annual cash flows.

6. The concept of tax structure

Many great economists and tax scholars have defined tax structure. Scholars such as Daniel Johnston, Silvano Tordo, Abe Atkinson & Joseph Stiglitz and Adam Smith have defined tax structure extensively. While many of these scholars are contemporary scholars and did not bring out a concise concept of tax structure. Adam Smith has brought out a concise and coveted conceptualization and definition of tax structure. According to Adam Smith in his seminal work, *the Wealth of Nations, 1776*, Adam smith defines tax structure as any tax rate or ratio which is imposed or levy on a business person or a company (Smith, 1776). Taxes can be presented using several methods such as marginal, average, effective and statutory.

Besides, Tax structure is defined as a monetary value or charge imposed by the government on entities, persons, transactions or on property to yield revenues for public purpose (Tordo, 2007). In other words, it refers to the enforced proportional contributions from ordinary persons, businessmen and women and from property levied by the state for purpose of its sovereignty in the support of government with public interests and needs (Atkinson and Stiglitz, 2006).

6.1. Principles of good tax structure

These are guidelines or concepts that distinguishes a good tax structure. Given that a lot of people see taxation as a good evil, it should be managed in such a way as to create less pain to the payer, just like the honey bee which gathers nectar from the flower without aching the flower. Many Economists, particularly, Adam Smiths (1776) for a long time have laid down the principles or guidelines which policy makers should take into account in making tax systems and these principles are referred to as canons of taxation system. They are argued as follows:

Convenience

Under at circumstance, the taxpayer should not undergo difficult situation to pay. The medium, mode, time and manner of payment should not give extra burden to the taxpayer.

Equity/Fairness

The same amount of tax should be paid by the persons or corporate companies' earnings the same wealth. This is called horizontal equity taxation. The tax payments should increase the taxable incomes increase and this is called vertical equity taxation (Hebous and Mengistu, 2024).

Economical

The cost of colleting tax should be kept as low as possible to both the tax payer and collecting agent. The general rule of thumb is that the cost of administration and

collecting agent should not exceed 5% of the tax revenue (Banafil and Filippini, 2010). The cost of compliance should be kept as low as possible to the taxpayer.

Certainty

A good tax structure is where the taxes are well comprehended by the collectors and payers. The reason and time of payment together with the amount to be paid by an individual should be clearly documented and certain. The tax structure should be based on laws and regulations enacted by legislature of a particular country.

Ability to pay

The tax structure should not take away a lot of incomes being taxed so as to dishearten the participation or performance in the tax base.

Simplicity

The type of tax structure and the way of assessment and collection must be simple enough to be comprehended by both the tax collectors and taxpayers. Complex tax design leads to delays, corruption, disputes, high costs and avoidance of collection in terms of resources and time.

6.2. Characteristics of a good tax structure

In complying with the principles of taxation, tax structure should be characterized as progressive, regressive or proportional.

Progressive tax

This is where the tax structure is designed in a way that the tax rate increases as the incomes increases. Most income taxes are progressive such that the tax rate increases with the increase in income. A progressive tax is based on the rule of vertical equity.

Regressive tax

This is a tax structure which is not based on the ability to pay. It is designed in a way that effective tax decreases as income increases.

Proportional tax

This is a tax system where the rate has been fixed in disregard to the amount at the tax base. A proportional tax may be viewed to be regressive despite its continuous rate which is more burdensome for low-income payers than to high income payers.

7. Key economic considerations in designing a tax structure for a country that is soon embarking on petroleum exploitation

Petroleum resources exploitation requires a tax structure that is progressive and which is fair, convenience, economical, simply, certain and ability to pay. In achieving this, key economic considerations are essential and they are discussed as follows:

7.1. Ownership of petroleum resources

Petroleum resources are very important extractive resources in any country and thus they are harnessed for the benefits of the citizens. One of the key economic considerations in designing tax structure for the infant petroleum resource country is the ownership of the petroleum resources. Most of the constitutions or statutes all over the world define the ownership of the petroleum resources as vested in the government on behalf of their people (Blake and Roberts, 2006). This is very essential because the government can freely decide to exploit these resources with no ownership disputes. This is what section 244 of the Uganda constitution, 1995 says about the petroleum and minerals ownership in Uganda. Hence, the government of Uganda adopted a progressive Petroleum Sharing Contract (PSC) where the government take is detailed and enormous. For instance, the government of Uganda is entitled to the signature bonuses, discovery bonuses, surface rentals, royalty, training levy, profit oil, income taxes (from the revenues of the IOC cost oil plus profit) as well as windfall taxes per acreage.

In South Sudan, the ownership of petroleum resources is governed by the Transitional Constitution of the Republic of South Sudan

(TCRSS), 2011, as amended. Article 173 (1) clearly stipulates that the ownership of petroleum resources shall be vested in the people of South Sudan and shall be developed and managed by the national government on behalf of and for the benefit of the people. Hitherto, petroleum is a national resource regardless of its location and its exploitation and management is bestowed on the national level of governance and peculiarly, to the Ministry of Petroleum as a regulator of the petroleum industry but under the supervision of the National Petroleum Commission as the policy maker. The Petroleum Act, 2012 as amended section 12 (1) bestowed the responsibility for the management of petroleum industry to the Ministry of Petroleum. Indeed, the negotiation of petroleum agreements, the signing, management and even termination of the agreements is the responsibility of the Ministry of Petroleum as provided for in section 12 (3) (b) and (c) of the Act.
Nonetheless, upon the negotiation and signing, the National Petroleum and Gas Commission grants its approval on behalf of the government and ensure that the agreements are consistent with Petroleum Act, 2012, as stipulated in section 11 (3) of the Act. Hence, the Minister of Petroleum is the only signatory of petroleum agreements entered into between the consortia of international and national oil companies. Moreover, the development and management of petroleum industry is guided by certain principles as stipulated in Article 173 (2) of the Transitional Constitution, 2011 as amended. These principles include creating lasting benefits for society, promoting efficient and sustainable resource management; usage of petroleum revenues to develop other sectors of the economy, particularly, agriculture; restoration of land and resources affected by development and management shall be ensured; promoting balanced and equitable development; protection of the environment and biodiversity and safeguarding interests of future generation, amongst other principles stipulated in the Transitional Constitution.
For the consistency with the above principles, Article 175 (2) (a) of the Transitional Constitution stipulates that the Ministry of Petroleum (MOP) shall negotiate all petroleum contracts for the exploration and development of petroleum industry and ensure that they are consistent with principles, policies and guidelines. So, during any negotiation of petroleum contracts, the Ministry of Petroleum negotiating team is dutybound and is always expected to visualize the above principles and ensure that they are incorporate in production sharing agreement.

7.2. Good investments laws

Good investments laws attract Foreign Direct Investments (FDI) and it is a key economic consideration. Petroleum industry is an international industry where international players are the key investors. In a designing a tax structure for infant petroleum exploitation, conductive investments policies and laws are very essential so that the investors can bring more revenues to the country through taxation (Bower, 2009). This also means that taxes should not be very high. This is in tandem to economical tax principle which stipulates that the taxpayer and collecting agent should collect as low tax as possible. Good investments laws include established rule of law institutions, tax holidays for companies that have substantively invested in the country and they have comprehensively obliged to the government laws, regulations and policies. Without good investments laws, the IOCs may not venture in that country to exploit the hydrocarbon resources and thus national governments will keep struggling to harness these petroleum resources (Markus, 2006).

7.3. Strong, accountable and transparent economic institutions

According to John R. Common (2008), institutions refer to the rules, procedures, policies, laws, regulations and systems that

work in constraint (Common, 2008). Strong institutions are systems that check themselves and resilient in their endeavors. Accountable institutions are those rules, procedures, laws, regulations and systems that are able to explain themselves. Besides, transparent institutions are those systems that provide information to the public about what they are doing. Thus, in designing a tax structure in emerging petroleum resource country, an economic consideration of these economic institutions is very imperative as it shall assist in delivering services that are required by investors, business men and women as well as the general citizenry. A great tax structure is that which flourishes in strong, accountable and transparent economic institutions.

7.4. Good fiscal and monetary policies

Fiscal policies deal with fiscal discipline in the implementation of the government budgets, programmes and projects while monetary policies deal with inflation, exchange rates and management of reserves. A design of an excellent tax structure requires an economic consideration of good fiscal policies whereby the government departments respect and work within the budgets, plans, programmes and projects (Sobel etal, 2024). Where the government executives are successful curtailed by the fiscal policies then then government can ripe great outcomes from the plans. So fiscal discipline is very key in designing of tax structure. Monetary policies on the hand are critical for stability of tax structure. Issues of inflation, exchange rates and reserves must be managed and balanced in the country to enhance strong economy and successful tax structure (Hughes, 2016). Indeed, an economic consideration of good fiscal and monetary policies is very essential for great tax structure in a country that is soon embarking on petroleum exploitation.

7.5. Land ownership

Land is a very important factor of production and development. To ensure that there is proper design for excellent tax structure for a country embarking on petroleum exploitation, there must be an economic consideration of land. This is because without persuasive policies of land ownership in the country, the IOC investors may find it difficult to invest in the new petroleum frontier (Ayuk, 2020). In most of the Sub-Saharan Africa countries' constitutions, land is divided into three ownerships: the government, the private citizens and the community. In the context of South Sudan, the government owns 30% of the lands within the cities and more interestingly, the government is technically the owner of other lands given that the land titles are given as leasing up to 999 years Thus, an economic consideration of land policies that systematized land ownership in the country for proper tax design structure is key for a country that is soon embarking on petroleum exploitation.

7.6. Strong private banking industry

Private banking sector or industry is very essential for a rewarding tax structure design. While it is critical that an oil and gas industry cannot prosper without private banking, taxation cannot be efficient without private banking as well given that the banks will provide opportunities for cash deposits, loans, business advisory services as well as compliance benchmarks (Diming, 2020). A country where private banking is still at the embryonic state, the tax structure or system doesn't produce great results. This is because tax revenues can be swindled and stashed into personal pockets. Hence, strong private banking industry is a key economic consideration for a country that is soon commencing on the hydrocarbon extractions.

7.7. Market driven insurance policies

Insurance industry is very important for business in the country. Businesses and their property need to be protected from accidents and natural disasters. Hence, insurance industry needs policies that are market driven in a way that the policies protect both

international and local investors in the country. Advantages of having market driven insurance policies is that these policies will encourage investments in which the investors will in turn provide revenues through corporate taxes (Danson, 2011). These revenues can be used in developing further the petroleum industry in the newly petroleum producing country.

7.8. Market for consumption of petroleum products

Producing petroleum resources without internal market is very risky. It is important consumption of petroleum products is promoted internally first before going externally. The purpose of having petroleum resources is first to promote the socio-economic development of a country by ensuring that what is produced is first consumed in the country (IMF Report, 1994). Thus, consumers policies need to be strengthened to ensure that local population buy the products from the petroleum companies at affordable prices. By promoting internal market, then tax structure is strengthened and this very useful for country that is soon embarking on petroleum exploitation.

7.9. Dynamic and friendly technology

Technology is very critical and it is an enabler for any production or service. While designing a tax structure, an economic consideration for dynamic and friendly technology is very necessary. Technology helps in making things happen. It is an effective tool for administration of taxation and more important for effective management of accountable petroleum industry. In tax administration, digital transformation and automation are essential for the attractive tax systems. The adoption of new, dynamic and friendly technology can enable sustainable and successful tax reforms. Ensuring that the suitable taxation of the digitalized economy is ushered in and this is necessary in reducing the obstacles to compliance. Once, the technology supports the successful tax structure, it indirectly supports any petroleum exploitation activity. As it is widely state many times, petroleum industry is both capital and technology intensive. Hence, you need world class trained staff in both technical and managerial levels. At the petroleum industry, technology is the first and it is an economic tool. As the adage goes 'no technology no petroleum industry'. The discovery of technologies for cleaning, transportation, inspection and drilling has made the extraction and conversion of oil and gas molecules and their supply to the various parts of a country and across the world very easy (Chamley, 2006).

7.10. Strong regulated environment

Environment whether physical or emotional is an economic activity. In order to design a proper tax structure, one needs physical environment which is safe and clean. Once the environment is poorly regulated or the regulations are non-existent, the design of tax structure can be negatively affected. A tax regime that doesn't respect environment is doomed to fail. This is because no any investor can do business in a polluted environment. Once a genuine investor finds poorly regulated environment, this investor can immediately quit. And once that happens, then that the tax revenues are reduced. This also applies in the oil and gas industry where health, safety and environment (HSE), is very crucial for any petroleum industry goer (Markus, 2016). Any investor will wish to see the HSE policy for the country before doing the final investment decision (FID). And more importantly, the laws and regulations that govern the environment. So, for a country that want to embark soon on petroleum exploitation, it must ensure that environment is highly regulated with laws and regulations and above all these laws and regulations must be implemented to see great tax structure and great petroleum extraction.

7.11. Affordable trained labour force

Labour is a factor of production in economic and very relevant economic consideration in designing a tax structure for a country that is embarking in petroleum exploitation. A well trained and affordable workforce is able to produce goods and services and can be taxed to pay the relevant tax schemes to the government. For instance, employees are required to pay personal income tax (PIT) and companies they work with are taxed to pay sale tax, profit tax as well as social insurance to the government. The employees and companies share social insurance funds via company contribution of 17% on one hand and employee contribution of 8% on the other hand (Richardo, 1991). Whenever, the employees adhere to the tax laws and regulations, then they continued to strengthen the tax system. Moreover, a tax system that is designed and implemented amongst well-trained workforce is always successful than a tax system designed amongst uneducated workforce. Educated workforce would understand the important of taxation, unlike uneducated folks that will continue to languish in perpetual ignorance.

8. The concept of source and residence taxation

8.1. The concept of source

Income or profits which result from international activities such as cross border trade and investment may be taxed where income is earned thus the source principle. Hence, source refers to where income or profits is earned after an imposed tax outside the country's borders using the domestic income tax law (Tojo, 2016). Equally, capital taxes are characteristically levied with respect to property located in a country irrespective of the residence of the owner of the property. Rules for defining the source of income may vary. However, source taxation is usually applied where the income has a pertinent connection with that country. For example, income that accrued from the extraction of natural resources situated in a country would clearly have a strong nexus with that country and would generally be regarded as having its source in that country (Kobetsky, 2011).

Income will classically be taxed in accordance with the source principle where the activities or assets that produce the income are situated within a country. For instance, income from capital invested in an authority (interest and dividend) from personal activities executed in a country such as salaries will typically be observed as having its source in that country for determinations of income taxation (Rixen, 2011).

Some countries have statutory rules for ascertaining the source of income for tax reasons. These rules or guidelines may seek to provide thorough list of all types of income that will be considered as sourced in that country or may be just indicative of common circumstances where the income will be regarded as having its source there (Skaar, 1991). Other countries do not have statutory source guidelines or rules and depend exclusively on general source principles.

As an outcome of alterations in domestic source guidelines or rules and how they apply an item of income can be treated to have its source in more than one country. For instance, royalties can be paid by a resident of one country so as to be sourced in that country under that country's source guidelines or rules but can be paid in reverence of intellectual property used in another country so as to also be sourced in that other country under that country's own source guidelines (Irish, 1974). Besides, a company can derive profits from the sale in one country of goods produced by that company in another country so that these profits can be regarded by each country as at least partly sourced in that country. In these conditions, both countries can pursue to tax the income on the basis of the source principle. Tax treaties will help in eradicating the potential double taxation by assigning taxing rights between the signatory countries on the basis of

commonly agreed source guidelines or rules (Stratford, 2023). In summary, the concept of source-based taxation is argued on the principle that the country that offers the chance to generate income or profits should have the right to tax it.

8.2. The concept of residence

Income or profits which result from international activities such as cross border trade and investment may be taxed where tax payer resides thus the residence principle. On the residence principle, a country's claim to tax is grounded on the residential status of the taxpayer. In the case of income taxation, where the person is viewed as a resident for tax reasons, the country may tax the income of that person irrespective of where the income has its source (Pinto, 2007). Most countries tax their residents on their worldwide income. However, a few countries only tax income resulting from their residents from sources in those countries which is known as territorial taxation.

Domestic law guidelines of rules for ascertaining residence for tax determinations varies from country to country. With respect to individuals, residence is typically based on factors such as the family and economic ties that an individual has with that particular country, the presence of a place of dwelling in that country and the period of physical presence in that country. Citizenship varies from residence but it is imperative to remember that the United States needs its citizens to pay tax on their worldwide income even if they do not reside in that country (Becker and Fuest, 2011). This advances a number of issues when discussing and applying tax treaties with the United States but a detailed deliberation of these issues would go beyond the scope of this report.

Residence can be based on the place of incorporation or constitution of the company. For example, the location of the entity, the place where it is controlled and managed and the place of its real management or other alike criteria that indicate a strong nexus with a country (Mazzucato etal, 2023). Variances in the domestic tax law criteria used to ascertain residence for tax purposes mean that individuals and companies that have links to more than one country may be regarded as tax residents of more than one country, and hence liable to tax on their worldwide income or capital in more than one country (Lejour and Verbon, 1998). Tax treaties characteristically address the probable double taxation that would result from such situations by providing guidelines or rules often referred to as 'tie-breaker guidelines' that situate tax residence to only one country for the reasons of the application of the provisions of a tax treaty (Harris, 2020). In sum, residence taxation of income is strictly based on principle of what the individuals and companies should pay towards the public services providing for them by the country where they live and based on all their incomes wherever the income comes from.

8.3. A country that has prior taxing rights and the remedy to double taxation

As discussed above, source and residence taxation are instruments of international taxation. A country that has prior taxing rights is a country where business activity is taking place, which is referred to as source rules or guidelines. Income will classically be taxed in accordance with the source principle where the activities or assets that produce the income are situated within a country. Besides, most countries tax their residents on their worldwide income. However, a few countries only tax income resulting from their residents from sources in those countries which is known as source taxation or territorial taxation. These countries believe that this is the right thing to do so that they acquire substantive revenues for capital, technology and services (Werra, 2016). Citizenship differs from residence but it is importance to recall that the United States requires its citizens to pay tax on their worldwide income even if they do not reside in that country (Becker

and Fuest, 2011). This advances a number of issues when discussing and applying tax treaties with the United States.
The remedy to double taxation includes having double taxation treaties in place and acceding to these treaties. For example, we have OECD Model Tax Treaty which was first published and rectified by first member states in 1963. It was later rectified again by other member states in 2008 and 2017. This treaty has methods for elimination of double taxation which are stimulated in article 23A on exemption methods and article 23B on the credit methods (OECD Tax Treaty, 2017). Moreover, another treaty is the UN Manual for Negotiation of Bilateral Tax Treaties between Developed and Developing Countries which was first rectified by member states in 1978 and revised in 2019, It provides clear provision in articles 40, 41 and 42 on elimination of double taxation. It reiterates on the methods for elimination of double taxation which include exemption methods and credit methods and most importantly, juridical relief (UN Manual Treaty, 2019). Finally, countries can also negotiate foreign tax credits either through unilateral or bilateral measures as a way of remedy to double taxation.

8.4. Advantages and disadvantages of source taxation

8.4.1. Advantages of source taxation

Neutrality

Source based taxation has source principle, which behaves best with the neutrality principle, both in terms of the symmetry between capital-import neutrality and capital-export neutrality and in terms of business transaction costs

Certainty and simplicity

Source based taxation is certain, clear and simple to understand because it argues taxing of the income or profits from the source. When mix with residence tax, it is simple to understand how income is taxed from the source of business.

Economic allegiance

A country that has given an opportunity for generation of income or profits has an economic right to tax it. In determining economic allegiance, the location of an individual's true economic interests had to be known and this is well-defined as "the place where wealth is generated, that is, the community of economic life that makes possible the harvest of the gaining of the wealth" (Kobetsky, 2011),

Equity considerations

Businessmen and women who sell their goods and services in other countries often fee more equitable to be taxed in the source country at the same level as their contestants in that country, peculiarly, if the level of taxation in the source country is lower than in the residence country (Masina, 2012). A foreign investor who uses another country's facilities should arguably not be taxed more than anyone else who under the same situations uses the facilities to the same extent. Taxation in source countries is justifiable given that traditionally, it is the source country that has provided most or all of the benefits related to production. At the same time, an integration of the seller's activities into the source country's economy has been essential before the source country could tax the income from such activities (Kobetsky, 2013). This has usually been fulfilled by the existence of a permanent establishment.

Benefits Claim

It can be deeply argued that taxes are the price paid by taxpayers for the use of state services collectively and therefore countries can therefore assert their right to tax based on the services or benefits provided. Thomas Rixen (2011) demonstrates that both the residence and source countries could assert a benefit claim to tax on services, however, the source country's claim is greater than that of the residence country (Rixen, 2011). It can therefore be crystal clearly argued that it is regularly the source country that has offered most or all

of the benefits relevant for the production of income can claim these benefits. This is because this country has incurred the costs of providing these benefits. Hence, source-based taxation claims these benefits.

Desire of source countries to tax foreigners

In his reviewing of the League of Nations resolutions on taxation, Mitchell Carroll acknowledged that taxation based on the source principle is widely applied, reflecting the desire of governments to tax foreigners, particularly, in the developing world (Carroll, 1939). It is similarly important to observe that that no country which charges an income tax waives taxing domestic source income, regardless of who has derived it (Pinto, 2007). As source countries characteristically have the first chance to collect tax on payments derived from within their borders, it is, as applied matter, hard to prevent them from taxing the payments (Irish, 1974).

8.4.2. Disadvantages of source taxation

Low generation of revenues streams

Source based taxation given its source countries taxation model always becomes unfair to share the revenues with residence countries because of the thin line between source and residence revenues. In his remarks concerning the League of Nations, Mitchell Carroll (1939) argued that, as least developing countries became more industrialized, they will transit from source-based tax principles towards residence-based tax approaches that will generate more revenues (Carroll, 1939). It is important to note that source-based tax principles could not be applied where countries are not economically balanced between it will generate low revenues.

Difficult in determining appropriate threshold

A key difficulty in adopting a source-based tax system is that source countries are unable to tax foreign businesses under the currently accepted international tax principles, including the permanent establishment standard given that the physical presence requirements integral in this standard are not fulfilled by foreign businesses that sell goods and services to persons in source countries (Becker and Fuest, 2011). Hence, if source-based taxation is to remain relevant, it will be necessary to find a new and appropriate threshold that does not depend on an economic allegiance based on physical presence (Pinto, 2007). Arvid Skaar (1991) argues that the permanent establishment threshold has lost its strength for new businesses and he further noted that a business's connection to the market is no longer reliable evidence of economic allegiance (Skaar, 1991). Therefore, if source-based taxation is to be adopted to accommodate transactions of goods and services for both functional and substantive reasons, a new threshold, not related to physical presence shall be required to base the taxing rights of source countries.

Collection and enforcement of problems

Even though a source-based tax system is implemented for transactions of goods and services, it will always be problematic to collect and enforce source taxes because businesses operate without assets or physical presence in the source country (Rixen, 2011). Hence, the lack of physical presence has affected the success of the source-based tax because the collections and compliance from the taxpayer is not well monitored and in most cases many taxpayers will abscond in paying taxes.

Characterization of income

In addition to the problems of implementing a source-based tax for the transactions of goods and services, business transactions have become problematic in the characterization of income as either royalties or business profits. Under the OECD Tax Model, the cataloguing of income as either business profits or royalties is not particularly essentially because the outcome has been that the payment is

taxable in the source country only if the income is akin to a permanent establishment there. Otherwise, the income is taxable only in the residence country. However, many OECD countries assert source country (withholding) taxing rights under Article 12 of the OECD Tax Model. Thus, for these countries, the difference between business profits and royalties is noteworthy. For example, income from most ICT and electronic transactions such as software and other digital tech products is often classified as business profits instead of royalties, referring, that the source country may not levy a withholding tax on such income. This outcome further reduces the implementation of a source-based tax system for all the transactions for goods and services, particularly the ICT and electronics transactions in the country (Bell et al, 2024).

Disagreements regarding source

To successfully implement a source-based tax system, there is need for an international consensus concerning the ascertained source of income for goods and services. If a consensus cannot be achieved, the prospect of double taxation increases (Diming, 2020). Besides, to effectively implement a source-based tax system for all the transactions, particularly, ICT and electronic goods and services transactions, it will be important to reach an international agreement on how to allocate income among jurisdictions that legitimately claim that the income is sourced from their jurisdiction. Double taxation can happen if two countries see themselves as the source country with respect to the same income, and a real mechanism to allocate taxing rights between competing claims will need to be put in place to ensure that income is subject to tax in only one jurisdiction (Hebous and Mengistu, 2024). Arriving at a consensus on the proper source of all the income will, however, not be an easy legal matter and the ability to reach a consensus is further extricated by various political contemplation's and competitions amongst countries for taxing rights with respect to the income generated by goods and services.

8.5. Two main rules determining sources of investment income

Sources of investment income is very important for successful taxation whether international or domestic taxation. Sources of investment income are discussed through the two main rules.

8.5.1. Where the investment is going take place (source rules).

This is determined under domestic law of the South Sudan. The Taxation Act, 2009 as amended, section 64 stipulates that income is derived from sources in South Sudan to the extent to which it is: a (i) "a resident person in carrying on a business except to the extent that it is attributable to a business carried on by the person through a branch outside South Sudan". This therefore means that the main rule to determine source of investment income is the residence source rules where the investment is taking place and the investor should be a resident in South Sudan in accordance to this law.

In Uganda, it determined under domestic law of the Republic of Uganda. The Income Tax Act, Cap 340, section 79 stipulates that income is derived from sources in Uganda to the extent to which it is: a (i) *"a resident person in carrying on a business except to the extent that it is attributable to a business carried on by the person through a branch outside Uganda*". This therefore means that the main rule to determine source of investment income is the residence source rules where the investment is taking place and the investor should be a resident in Uganda in accordance to this law.

8.5.2. Where the investor is coming from (source rules).

This is also specified in the South Sudan Taxation Act; 2009 as amended section 53 stipulates that income is derived from sources in South Sudan to the extent to which it is: a (ii) "a non-resident person in carrying on a business through a branch in

South Sudan". This therefore means that another main rule to determine source of investment income is the non-residence source rule where the investor is coming from and the investor should not be a resident in South Sudan in accordance to the Taxation Act, 2009 as amended.

This is also specified in the Income Tax Act, Cap 340, section 79 stipulates that income is derived from sources in Uganda to the extent to which it is: a (ii) *"a non-resident person in carrying on a business through a branch in Uganda".* This therefore means that another main rule to determine source of investment income is the non-residence source rule where the investor is coming from and the investor should not be a resident in Uganda in accordance to the Income tax act, Cap 340.

9. Interest-based and greed politics in petroleum resource taxation in oil and gas industry

The challenges of successful implementation of any taxation system is due to interest-based politics and greed that has made elites to design poor taxation structures. While this politics is universal in destroying taxation system, it is very common in sub-Saharan African states. For instance, majority of African states legislate good taxation laws that spell out good regulations, policies and systems but the implementation of these systems become a debacle. That is why taxation has become an indirect affair to most of African governments and it is no longer a serious economic rent leaving the governments to keenly focus on revenues from petroleum exploitations (Atkinson and Stiglitz, 2006),

10. CONCLUSIONS

The paper has comprehensively addressed politics of economic rents and petroleum resource taxation in oil and gas industry. It discussed economic rents as a profit, a surplus or amount that should be paid by the licensee (IOC) to the licensor (government). It then analyzed the economic rents instruments such as royalties, corporation tax, resource rent tax and brown tax. The paper discussed the economic considerations in designing a tax structure for a country that is soon embarking on petroleum exploitation. It argued the key economic considerations in designing a tax structure for a country that is embarking on petroleum exploitation to include ownership of petroleum resources, good investments laws, strong, accountable & transparency economic institutions, good fiscal and monetary policies, land ownership, strong private banking industry, market driven insurance policies, market for consumption of petroleum products, dynamic & friendly technology, strong regulated environment and well trained workforce. While the paper discussed the concept of source and residence taxation, its dived into advantages & disadvantages of source taxation and rules to determine source of investment income. The paper concludes that incremental sliding scale taxation is appropriate taxation model in oil and gas industry of today. It is worth to note that politics of greed continued to affect the tax regime implementation in oil and gas industry.

11. Recommendation for future research

While the paper has extensively covered the economic rents and petroleum resources taxation in oil and gas industry with deepest knowledge and enthusiasm, more discussions, debates and researches need to be commissioned in petroleum resource taxation. Future research is hereby recommended to other scholars in petroleum resources taxation in oil and gas industry to profoundly research on the demerits of incremental sliding scale taxation as the appropriate instrument for taxation in the volatile petroleum industry.

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