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Investing into Africa - tax considerations

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Agenda

Session 1 - Business structures and issues to consider

- Regulatory considerations
- Corporate structure
- Capital structure
- Exit strategies
- Holding Structures
- Conclusion

Session 2 – General tax considerations

- Source vs. residence tax systems
- Corporate tax considerations
- PE's
- Transaction taxes/ Indirect taxes
- Employee taxes
- Transfer Pricing
- Case Study

Introduction

Session 1
Business model optimisation

"Of the roughly US$15tn in world trade that takes place today, nearly a third of that is conducted between emerging and developing economies" – Afshin Molavi

Foreign investment considerations

Initial investment

- Foreign considerations
  - Exchange control
  - Residence or source basis of tax
  - Corporate forms
  - Local participation requirements
  - Transfer pricing & thin capitalisation
  - Stamp duty and other taxes
  - Special tax regimes
  - Exit requirements
  - Staff quotas

Local considerations

- ASX/ASIC requirements
- Australian residence basis of taxation
- Head office tax position, impact of transaction taxes
- CFC, foreign dividends,
- Transfer pricing and Thin capitalisation
- interest deductibility and incurral of expenditure when not deriving Australian income
- Forex
- Expats

Regulatory framework

1 Local participation

Many African countries will require some form of local participation. This could be either Government or private. Generally government participation is on a free carried basis which requires the investor to fund 100% of the project for 80% of equity. In other countries local participation is not on government level but by local private investors or staff. In addition local procurement or employment requirements also exist.

Need to consider how will this be funded as well as the potential Australian tax implications.

2 Incentives

Need to investigate carefully whether there is a Mining/oil and gas/other investment charter and whether this is this part of the legislation or not. Need to understand inter-action with income tax/VAT/Customs acts.

Special tax incentives-consider how they apply, to whom they apply and when they apply: If mining company do they apply to third party lenders, service providers, contractors.

3 Exchange Controls

Generally limit the free movement of capital. Special considerations for loan, interest rates, repatriation of profits and sale of assets.

4 Work permits

Many countries will impose quotas on number of expats.

Business model

Corporate structure

- Permanent establishment-when do you have a local business presence under domestic law
- Branch vs. Company-in some countries you cannot operate through a branch
- Private or public company-what is your future plans for a potential IPO or capital raising

Capital structure

- Need to understand the minimum capital required
- Are there Exchange Control rules that limit the flow of capital
- Do you need upfront approval e.g. South Africa/Mozambique
- What is the thin capitalisation requirements
- Stamp duty impact in the issuance of shares
- Flexibility of repatriating excess cash
- Debt vs. Equity

Business model

Consider how project is to be funded at which stage of life cycle

Exploration vs Construction vs Production

IPO

- Consider early in life of project if IPO is an option and if so on which stock exchange
- Consider tax implications of IPO jurisdiction
- How does IPO impact government participation if it has a free carried interest

Strategic investor with off-take

- How does investor enter the project: at local level or holding company
- Tax issues-sale could have CGT implications and share transfer taxes subscription would generally not attract CGT but need to consider stamp duty and dilution on current shareholders e.g.. government
- If strategic investor buys in needs to understand government free carried interest position and value proposition

Business model

Exit strategies

When considering the tax issues need to understand upfront what is the business strategy. Will the current shareholders take project to full production or do they wish to exit by selling to larger company.

Both options have vastly different tax implications.

Production

- return via dividends-income tax position; and
- capital growth-capital gains tax position in residence and source country.

Exploration and sale

- return on sale-CGT implications.

Business model

Expansion strategy

- Consider structure when multiple projects in-country and multiple projects in multiple countries
- Often limitations on number of permits in one company
- What happens if more than one proves viable-tax and other implications when transferring permits to SPV’s
- Consider central holding company for multiple projects
- Consider central treasury and procurement to obtain cost savings-profits from one project could be used to fund the next if done cost effectively i.e. no 30% withholding taxes

Business structures

Holding Structures

- The difference between a residence and source based tax system has potential for double taxation
- Need to consider if DA’s can assist in preventing potential double taxation
- Australia does not have extensive treaty network with Africa to prevent potential double taxation
- South Africa recently introduced a new holding company regime with exemption from Exchange Controls, CFC provisions and certain withholding taxes
- Mauritius traditionally used for holding company into Africa-good treaty network with beneficial tax system, fiscal stability and access to educated workforce

Beware – anti treaty shopping provisions

- Only entitled to benefits if a resident of one or both states and also the beneficial owner of the revenue stream.
- Flow through entities without substance problematic
- Consider level of substance
- Flow of transactions
- Source country may deny treaty benefits

Business structures

Conclusion

- Important to plan and consider structure up-front
- Understand business strategies for funding, future expansion and exit
- Understand impact on profit repatriation
- Beware of transaction taxes
- Comply with regulatory environment and consider in structure

Questions?

Session 2
General tax considerations

General tax considerations

- Residence vs. Source basis of taxation
- Controlled foreign company legislation
- Debt vs. Equity
- Transaction taxes
  - withholding taxes
  - VAT
  - Customs
- Profit repatriation-foreign dividends
- Capital gains tax
- Individual tax considerations
- Transfer pricing
- Foreign exchange
- R&D

General tax considerations

Residence vs. Source basis of taxation

- Australia taxes residents on worldwide income
- Many African countries protect their tax base through taxing non-residents at source or deemed source
- Potential for double taxation if residence country does not provide credit
- Cannot consider in-country tax issues without considering residence country taxing rights e.g. CFCs and CGT

Controlled foreign company provisions

- Residence country has taxing right over foreign subsidiaries-not double taxation because the tax not imposed on subsidiary but on resident holding company
- Exemptions apply
- Tainted transactions between a resident and a CFC
- Proposed amendments to Australia's CFC provisions
- Consider potential double whammy if use an intermediary location with additional CFC rules

General tax considerations

Funding

- Need to consider what is the local definition of debt vs. equity
- What are the minimum capital requirements- thin cap rules
- Often Exchange Controls apply an additional level of compliance
- Consider Arm's length debt test as well as interest rate
- Most African countries have high withholding taxes on interest

Questions

1. When funding is provided from offshore, who bears the withholding tax costs?
2. If transaction is grossed up is the transaction still arm's length?
3. What is quasi-equity?
4. How can you use this effectively to ensure flexible funding arrangements?

General tax considerations

Transaction taxes

- These are taxes generally levied on the gross value of the transaction irrespective of the profit made on the transaction. Potentially leads to double tax especially where no treaty exists.

- Problematic for Australian holding companies in losses or non-tax paying as use of foreign tax credits limited and becomes a permanent cost.

Examples

- Withholding taxes on royalties, interest, dividends, technical fees and management fees
- VAT on local and inbound transactions
- Customs duties

General tax considerations

(Transaction taxes-continued)

Withholding taxes

- Tax levied at source on the recipient
- Generally a final tax
- Levied on the gross value of transaction irrespective of profits
- Irrespective of source African countries levy WH Tax on any inbound charge including cost recharges

Challenge

Many Perth companies incur and record expenses in Holding Company. However under exploration permit need to prove minimum spend in country. As soon as charge recorded in source country WH tax becomes due and payable. Creates big cash flow issues and increases costs of project.

VAT/GST

- Inbound charges often attract VAT/GST on imported services

Customs

- Consider whether exemptions available during exploration and construction phases.
- Ensure can extend to third party contractors and suppliers-ensure terms and conditions

General tax considerations

Profit Repatriation

- What is short and long term strategy
- What is the strategy around profit repatriation: dividends vs. capital gains

Dividends

- Local country withholding taxes
- Foreign treatment of dividends: non-assessable non-exempt
- Consider franking credits when declaring dividends to local shareholders.
- Generally no franking thus effective tax rate can be as high as 66%!!

Capital Gains

- Generally levied on disposal of assets or value shifting arrangement
- Need to consider carefully when complying with local ownership/government participation and how interest is transferred.
- Potential double taxation: Source country will tax if land rich and residence country taxes on worldwide basis
- Potential to mitigate through local participation exemption or roll over relief
- Effective structuring critical

General tax considerations

Individual Tax issues

- Foreign expats - Residence vs. Source taxation
- Split contracts
- Secondments - cost recharges
- Beware of tax rate differentiation because of currency differences
- Fringe Benefit taxes

General tax considerations

Transfer Pricing

- Div. 13 requires multinational companies to ensure intra-group transactions are conducted at arm's' length

4 key areas

- Goods, services, IP, financial assistance

- Most African countries do not have specific TP legislation-generally have an arm's length statement
- Mostly apply OECD Guidelines in practice

Controversial matters

- Management fees
- Interest charges
- Commodity off-take arrangements
- R&D work done in Australia
- Secondments
- Contractor recharges

General tax considerations

Conclusion

- Need to consider various tax issues carefully
- Upfront planning can prevent costly tax mistakes
- Increased focus by tax authorities on cross-border tax issues
- Getting your tax wrong can dramatically impact the rate of return on your investment
- Always consider both the residence and source country tax issues

Questions?

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