Tax Planning in Africa and reactions from tax authorities

Ridha Hamzaoui
18 June 2015
AGENDA

Tax planning strategies for Africa
- Major holding jurisdictions in Africa
- Tax and business features

Tax planning techniques for African countries
- The indirect transfer of assets
- Treaty shopping and back to back structures
- Landmark recent Supreme court decision from the Netherlands (Structure involving South Africa and Mauritius companies)
- Reactions from the tax authorities and legislators: recent developments on anti-avoidance rules under domestic tax law and tax treaties

Conclusion
Tax planning strategies for Africa
Tax planning strategies for Africa

**Foundational Structure I**
Holding and Finance Company

- Parent
- Tax Favored HoldCo
- African Affiliates
- Loans/Licenses

**Foundational Structure II**
Holding / Financing Branch

- Parent
- Tax Favored HoldCo
- African Affiliates
- Financing & IP Company/Branch
- Loans/Licenses

**Foundational Structure III**
Holding and Finance Hybrid Structure

- Parent
- Tax Favored HoldCo
- Tax Favored Sub-HoldCo
- Affiliates
- Loans/Licenses
- Loans/Licenses
Major holding jurisdictions for African countries

- Mauritius
- The UAE
- The Netherlands
- South Africa
- Morocco
- Tunisia
<table>
<thead>
<tr>
<th>Jurisdictions</th>
<th>Treaties in force with African countries (as of 1 January 2015)</th>
<th>Total number of treaties signed with African countries</th>
<th>Corporate tax rate</th>
<th>WHT rates on Dividends Interests Royalties</th>
<th>Ease of Doing Business Ranking 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mauritius (GBC 1 regime)</td>
<td>16</td>
<td>19</td>
<td>Effective 3% for GBC 1</td>
<td>0% 0% 0%</td>
<td>28 in the world - 1st in Africa</td>
</tr>
<tr>
<td>UAE</td>
<td>8</td>
<td>12</td>
<td>0%</td>
<td>0% 0% 0%</td>
<td>22 in the world</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>9</td>
<td>11</td>
<td>Effective 2.5% to 5% based on a cost plus ruling</td>
<td>15% 0% 0%</td>
<td>27 in the world</td>
</tr>
<tr>
<td>South Africa (headquarter company regime)</td>
<td>21</td>
<td>24</td>
<td>28% Nominal rate and much lower effective rate based on transfer pricing rulings</td>
<td>0% 0% 0%</td>
<td>43 in the world – 2nd in Africa</td>
</tr>
<tr>
<td>Morocco - Coordination centres - Regional or international headquarters (Casablanca Finance City)</td>
<td>7</td>
<td>13</td>
<td>Tax base: 10% of the operating costs + income from non-operating activities -the higher of (i) their taxable income or (ii) 5% of the amount of their operating expenses in case of a profit-making year. -Nominal tax rates: 30% and 8.75% for export free zones companies</td>
<td>15% 10% 10%</td>
<td>71 in the world</td>
</tr>
<tr>
<td>Tunisia (Export companies)</td>
<td>12</td>
<td>17</td>
<td>10% (standard rate of 25%)</td>
<td>5% (25%) 20% (25%) 15% (25)</td>
<td>60 in the world</td>
</tr>
</tbody>
</table>
Tax planning techniques for African countries
The indirect transfer of assets

- Tax Planning Technique used to avoid the jurisdiction tax of source countries mainly regarding substantial capital gains on real estate and shares
- Businesses involved: Telecommunications, Extractive industries and financial businesses
- Sensitive issue!
- Reactions from tax authorities and legislator
- Not addressed by the OECD BEPS Action Plan.
- Addressed by the UN Tax Committee
Capital Gains: Indirect transfer of real estate properties

Country X

| X | X | X |

Country B

| real estate | Co. | real estate | Co. | real estate | Co. |

Country Y
Country A

X

Country B

B co

Intermediate Co.

Intermediate Co.

B co.

Country C

Treaty between A and C similar to the OECD MC

- Transfer of C co. shares instead of Bco.
- Exclusive residence taxation

No treaty between A and B

Capital gains tax
Zain Appeal Court Decision issued on 10 September 2014

Indirect transfer of assets

Telecommunications company in Uganda 100% held via a Dutch company Zain Africa BV, Zain Africa BV is held by another Dutch company Zain BV

Zain BV transferred its share in Zain Africa BV to another Dutch company (Bharti A BV).

Uganda Revenue Authority: No treaty benefits under Article 13.4 of the Netherlands Uganda treaty based on section 88(5) of Income Tax Act

USD 85 million tax dispute
Anti-treaty shopping - domestic tax law – African perspectives

Section 88(5) of Uganda’s Income Tax Act. This is an anti-treaty shopping provision, which denies the benefits of the treaty to a company whose ‘underlying ownership’ is mostly in a third country:

Where an international agreement provides that income derived from sources in Uganda is exempt from Ugandan tax or is subject to a reduction in the rate of Ugandan tax, the benefit of that exemption or reduction is not available to any person who, for the purposes of the agreement, is a resident of the other contracting state where 50 percent or more of the underlying ownership of that person is held by an individual or individuals who are not residents of that other Contracting State for the purposes of the agreement.

The question is whether Uganda’s domestic tax law can override its treaty obligations?
Appeal Court ruled in favour of tax authority

Court accepted applying this provision in treaty context which is consistent with the OECD position

MAP...

Article 13.4 Mauritius Uganda tax treaty
Issue: GAAR’s compatibility with tax treaties

- Treaty interpretations
  - Literal v. intentional
- Guidance in the OECD Commentary
  - Pre-2003: States may wish to preserve the application of domestic GAAR in tax treaty context
  - Post-2003: Prevention of tax avoidance is the purpose of tax treaties
- Relevance of the OECD Commentary (static/dynamic)
- Will judiciary follow such interpretations?

P.s. BEPS action 2 and 6; preamble, insertion anti-abuse / anti-mismatch provisions in the Model/ tax treaties
Tanzania Income Tax Act

- Tanzania Legislation
- Section 56 of the Income Tax Act
- counteract the current tax avoidance practice of selling local companies through overseas holding companies
- where the underlying ownership of a Tanzanian entity changes by more than 50 percent within a period of three years, the local entity will be deemed to have realized its assets and liabilities and thus be required to pay capital gains tax
An anti-treaty shopping provision was introduced under amended Finance Act for 2014.

The provision states that in tax treaties, residents of the other contracting state may only enjoy the benefits of the treaty if at least 50% of the underlying ownership of the resident person is held by individuals who are residents of that contracting state. The provision does not, however, apply where the resident is listed on the stock exchange in the other contracting state.
Extra-territorial approach for capital gains scope

Cameroon – Finance Law 2014

Article 42 of the General Tax Code: “Are taxable capital gains realized in Cameroon or abroad, on the transfer of shares, bonds and other types of interests in Cameroon-based companies including rights on mineral resources, made by natural or legal persons.”
Cameroon – Finance Law 2015

Add expressly that the transfer may be indirect, and the meaning of the term “indirect transfer”

Article 42 of the General Tax Code: “Are taxable capital gains realized in Cameroon or abroad, on transfer, including indirect transfer, of shares, bonds and other types of interests in companies incorporated in Cameroon including rights on mineral resources, made by natural or legal persons.

The indirect transfer of shares, interests, bonds of companies incorporated in Cameroon includes any transfer made in Cameroon or abroad between two non-resident companies belonging to the same scope of consolidation when one of the entities owns fully or partly, the share capital of a company incorporated in Company.”
Other African countries

- French speaking African countries
- GAAR based on the abuse of law theory
- Algeria introduced by Finance Law 2014
- Gabon introduced by Finance Law 2015

- .....  

- Egypt GAAR introduced by a special package Decree-Law No. 53 for 2014
The indirect transfer of assets – Lessons from the BRICS

- India and China
- GAAR
- India: Vodafone case
- China: Chongqing case
  - Circular 698 of 10 December 2009
  - SAT new announcement on the indirect transfer of shares by non-resident enterprises on 3 February 2015
  - Reasonable commercial purpose
  - Indirect transfer without reasonable commercial purposes
Dutch Supreme court decision on base erosion rules

- Decision issued on 5 June 2015
- Interest deduction on tainted related party debt
- In 2007 a listed parent company of a South African media group issued shares. Approximately 60% of the proceeds were directly wired to its Dutch third-tier subsidiary (“Dutch Holding Company”)
- The proceeds were contributed as capital to a second-tier Mauritian company, which in turn granted an interest free loan to its 100% Mauritian subsidiary which is the group’s internal financing company (“Mauritian Financing Company”)
- Mauritian Financing Company lent the proceeds to the Dutch Holding Company through an interest bearing loan
- The Dutch tax authority denied the interest deduction at the level of Dutch Holding Company
- Article 10a Dutch corporate income tax Act (CITA) provides that interest on related party debt are not tax deductible in instances where the debt is connected with certain acquisitions, capital contributions or dividend distributions. An exception applies if the taxpayer can demonstrate that business reasons predominantly underlie the transaction and the debt obligation connected therewith.

Based on a summary provided by Loyens & Loeff on 5 June 2015
Dutch Supreme court decision on base erosion rules

South Africa

SA Media Group

Mauritius

Shares issues
60% of proceeds transferred to Dutch Holding Co

Mauritius Co

Contribution in capital to Mauritius Co

100%

Mauritius Financing Co

Netherlands

Dutch Holding Co

100%

Interest free loan

Interest bearing loan

© 2015 IBFD
First of all the Supreme Court ruled that the burden of proof to demonstrate that business reasons predominantly underlie an acquisition and the related party debt lies with the taxpayer.

The character and substance of the legal transactions involved in our case are insufficient to meet this burden of proof.

The Supreme Court also ruled that the business reasons exception must take into consideration all parties that are involved in the transactions i.e. the Dutch Holding Company cannot claim that it had no alternative but to accept the loan offer from the Mauritian Financing Company.

Furthermore the Supreme Court ruled that a parent company is free to fund its subsidiaries with either debt or equity. The Supreme Court clarified that this would trigger a limited scope for the Dutch base erosion rules: If (equity) funds are not diverted through low-taxed group companies, but directly lent to a Dutch taxpayer, the legislator has in principle accepted the tax consequences (interest deduction in this case).
 Defence of the taxpayer.....

The Dutch Holding Company claimed that the business reasons exception by definition applied to the Mauritian Debt, because it acquired participations from third parties. This reasoning is in line with older case law (BNB 2005/169), which the Supreme Court ruled under its abuse of law doctrine (fraus legis) prior to the codification of the base erosion rules in article 10a CITA. The Supreme Court has now decided that his former decision is not relevant for the interpretation of Article 10a CITA.

The parliamentary background upon amendment of article 10a CITA
The Supreme Court confirmed that the Dutch Holding Company has not demonstrated sufficient business reasons for the Mauritian Debt and denied the interest deduction in the Netherlands.
Spillover analysis for the Netherlands tax treaty network launched in 2013

The Netherlands will approach 22 other low-income and low/middle-income countries to add anti-abuse provisions to the existing tax treaties to the extent desired.

Treaties re-negotiations are going on with Ghana, Tanzania, Uganda and Zambia.
On 5 June 2013, Malawi terminated the 1969 treaty with the Netherlands

New treaty signed on 19 April 2015

The Treaty contains an anti-abuse provision, which provides that the treaty benefits for dividends, interest and royalties will not apply if a transaction was only entered into to obtain treaty benefits.
Netherlands tax treaties with African countries

- Netherland Ethiopia tax treaty
- Protocol to the treaty signed on 18 August 2014
- *The protocol provides for the inclusion of a limitation on benefits (LOB) clause in article 21A of the treaty under which "qualified persons" are entitled to treaty benefits.*
- However, the treaty benefits may also be granted to non-qualified persons if the competent authorities of both contracting states determine that the establishment, acquisition or maintenance of a company or the conduct of operations does not have as the main or one of its main purposes to obtain treaty benefits.

For the determination of the purpose test, the following facts and circumstances are decisive:
- the nature and volume of the activities of the company in its country of residence in relation to the nature and volume of the income to which the benefits to be granted relate;
- both the historical and the current ownership of the company; and
- the business reasons for the company residing in its country of residence.
Mauritius tax treaty network

- **Tie-breaker rules under Article 4.3 revised**
  - Mauritius Rwanda tax treaty
  - Mauritius South Africa tax treaty
  - MAP is the way forward...
  - In line with OECD
  - New MoU signed on 22 May 2015

- **Exclusion approach for persons registered under the Financial Services Act**
  - Mauritius Egypt tax treaty
  - Articles 10, 11 and 12 of the Agreement shall not apply to persons registered under the Financial Services Act 2007 (formerly incorporated under the International Companies Act)
Mauritius tax treaty network

- Several countries are waiting for the outcome of the re-negotiation of the treaty between Mauritius and India
- Introduce an LOB to the treaty specifically dealing with article 13 on capital gains or possibly applicable to the whole treaty
- On the condition of keeping article 13 of the treaty unchanged ...No source taxation on capital gains
- Ensure stability and certainty for foreign investors

- According to the Mauritius side, This would achieve both targets which are:
  - (1) addressing concerns of the Indian with regard to treaty shopping and misuse of the treaty India – Mauritius; and
  - (2) conserve the attractiveness of Mauritius as a holding company jurisdiction
Under the LOB provision India-Singapore

- A minimum level of annual expenditures of SGD 200,000

- The period of 24 months is computed by referring to two blocks of 12 months immediately preceding the date when the gains arise.

- A company listed on a recognized stock exchange in Singapore will not be subject to the LOB clause.

Also a request with respect to certificates of residence
Besides entitlement for resident individuals, states and related entities and certain charitables /pension funds/ investment funds, other resident non-individuals only receive benefits if they meet one of the following tests:

- Publicly traded corporations
- Ownership and base erosion test
- “Active trade or business” test
BEPS action 6: Art. X, par. 7: “Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting the benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention”.

© 2015 IBFD
Reasoning of THE OECD

- BEPS action 6: Art. X, par. 7
- Principal purpose test in the form of a GAAR included in the treaty
- How to prove an intention?
- Tax benefit from which perspective?
- If you succeed the LOB test you still need to go through par. 7 and the principal purpose test
- Increased uncertainty… and exposure to double taxation
Ghana - Netherlands

Memorandum of understanding on automatic exchange of information (MoU) signed by Ghana on 24 March 2015 in Accra, and by the Netherlands on 3 April 2015 in the Hague. The MoU entered into force on 3 April 2015 and will apply for the first time to information concerning the 2014 calendar year.

The goal of the MoU is to effectuate the Council of Europe - OECD Mutual Assistance Treaty (1988) (as amended through 2010) and the exchange of information between the two countries as agreed upon in article 27 of the Ghana-Netherlands Income Tax Treaty (2008).
Conclusion

- Domestic Anti-Avoidance rules seems to be the way forward to counter the indirect transfer of assets in African countries.
- Reaction from court: Positive but still to be confirmed!
- Treaty shopping and back to back structures: the trend is the introduction of various LOB/anti-avoidance provisions in most of treaties signed by African countries with financial centres and other treaty partners.
- Countries are not waiting for BEPS final deliverables!
- Is a US LOB provision suitable for developing countries?
- Does tax authorities have the capacity to implement it in practice?
- Is the principal purpose test proposed by the OECD needed?
Thank you
R.Hamzaoui@ibfd.org