TRANSFERS OF MINERAL RIGHTS - CAN COUNTRIES CAPTURE THE BENEFITS?

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Overview

- The headlines
- Indirect transfers – the issue
- Responses to date
- Enforcement issues
- Effect of international treaties
Heritage Oil, Tullow and Uganda

- Heritage Oil Incorporated in Mauritius
  Ultimately owned in the United Kingdom

- Tullow Incorporated in the Isle of Man

- Sold shares in Ugandan oil project $1.45b

- Sale agreement is signed offshore – in the Channel Islands
- Government of Uganda imposes capital gains tax - $434m
Heritage Oil, Tullow and Uganda

- Heritage challenges in the Uganda Tax Tribunal
  - Unsuccessful

- Heritage commences international arbitration in London
  - Unsuccessful

- Heritage sued by Tullow – indemnity
  - Unsuccessful
Riversdale, Rio Tinto and Mozambique

Riversdale Mining Limited
Re-named Rio Tinto Coal Mozambique (Australia)

Riversdale Energy (Mauritius) Limited

Riversdale Mozambique Limitada

Rio Tinto

International Coal Ventures Limited (India)

Purchased on the ASX ($4 billion) 2011

$50m
Cairn Energy and India

- Cairn India incorporated in 2006
- Cairn UK transferred its entire shareholding in CIHL to Cairn India
  - In return for shares
  - For about $4.23 billion
- Cairn India subsequently underwent an IPO
The issue – indirect transfers

Residence Country

Source Country

Contractor

Project
The issue – indirect transfers

Contractor

Residence Country

Source Country

Sub.

Project
Should such transfers be taxed?

- Why do it?
  - Protect country’s tax base from erosion
  - In resource-rich developing countries this can be the country’s most important asset

- Barriers
  - Lack of international norms
  - Difficult to enforce
  - Tax avoidance – treaty shopping
  - Stabilisation clauses
How has it been done?

- India
- Law amended in 2012 with retrospective effect from 1961

- Section 9(1)(i) “all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India or through the transfer of a capital asset situated in India”.

- Explanation 5 to Section 9(1)(i) of the Act – “For the removal of doubts, it is hereby clarified that an asset or a capital asset being any share or interest in a company or entity registered or incorporated outside India shall be deemed to be and shall always be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India.”
How has it been done?

• Identifying offshore transfers that should be taxed
  - When foreign shares derive value *substantially* from assets located in India
  - Defining ‘*substantially*’- greater than 50% of total value
  - Evolving guidelines for valuing India assets and foreign shares

• How much of the gains should be taxable?
  - Pre-2015: Entire gains taxable if substantiality threshold breached?
  - Post-2015: Pro-rata taxation

• What transfers should be exempt?
  - Pre-2015: No exemptions
  - Post-2015: Exemption for Small shareholding (less than 5%) and select group restructuring
  - No exemption for transactions in listed securities
How has it been done?

- China
- State Administration of Taxation, Announcement number 7, 2015 (replaces Circular 698) – ex post determination

  “When a non-resident enterprise (NRE) engages in an indirect transfer of assets, including shares of Chinese resident enterprises, through an arrangement that **does not have a bona fide commercial purpose** in order to avoid paying enterprise income tax (EIT), the transaction should be re-characterised as a direct transfer of the Chinese assets in accordance with article 47 of the EIT law”

  “Assets” are assets attributed to an establishment in China, immovable property in China and shares in Chinese resident enterprises.

  Two exceptions:
  - Normal trading of listed shares
  - Tax treaty exemption exception
Issues around implementation

- Tax policy and tax administration
- Minimum percentage or value of source country assets
- Proportion to tax
- Exemptions
  - Publicly traded shares
- Internal reorganisation
  - Cairn India
  - Is it a disguised transfer to avoid tax?
Enforcement

- Detection
  - Reporting

- How to collect the tax from a non-resident
  - Withholding

- Consequences
  - If not reported, concession is lost
  - Change in tax basis
  - Treat resident company as agent of non-resident
Tax treaties


Tax treaties

- Developing countries
  - Exercise caution when entering into BTTs
  - Can be helpful but can also limit taxing ability

- Investment treaties can also be an issue
  - Heritage Oil
  - Cairn Energy
Conclusion

- Taxation of indirect transfers is of key importance to many resource-rich developing countries.
- Designing laws need to take into account issues of detection and enforcement.
- Beware of tax treaties.

Thank you.