



Investments into Africa

Tackling tax and regulatory challenges

Africa offers unique opportunities to multi-national enterprises (MNE's) as part of their strategies for growth. It is commonly recognised that Africa holds significant reserves of the world's metals and minerals and is therefore of key importance for mining groups. Yet a surprising fact is that natural resources generate only a third of Africa's GDP growth. The remainder comes from other sectors such as wholesale and retail, transportation, telecommunications and manufacturing.

Several African countries compare very well to the famed BRIC economies on ease of doing business and political risk. According to an UNCTAD report, the profitability of foreign companies in Africa has been consistently higher than in most other regions in the world. Since 2004, Africa has had the highest growth rate of private foreign direct investment (FDI) into emerging markets, which in 2010 increased by more than 20%. The rate of return on FDI in Africa has averaged 29% since 1990, and since 1991 it has been higher than in all other regions – by a high margin in a number of years.

In addition, Africa's population is vast and, when compared to the developed world, is relatively underserved. Africa's steadily growing per capita income drives the emergence of aspiring African consumer markets with a surprising level of sophistication and growing spending power. Yet these consumers are rarely offered products or services commensurate with their lifestyle and aspirations. Therefore, there are significant opportunities in such areas as telecommunications, banking and financial services, freight and logistics, retail and many more.

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However, just as Africa offers potential for great rewards, there are also significant risks associated with an expansion strategy in Africa. The degree and nature of these risks vary significantly from one African country to another. However, as regards tax and regulatory issues, there are certain common themes which emerge. It can therefore be helpful for MNE's with an African expansion strategy to bear these in mind. As the second most dynamic region after Asia, Africa's stocks are systematically undervalued and offer serious growth prospects for investors who are prepared to learn and take informed risks expanding into the continent.

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Double Tax Agreements (DTA's)

From a tax planning point of view, it is certainly easier for an MNE to expand into a country with which group companies (and particularly the holding company) have DTA's. These treaties assist in avoiding double taxation and also provide certainty in many cases. Where disputes arise, it is also possible to enlist the assistance of the tax authorities in the respective countries (for example, by means of competent authority proceedings).

Unfortunately many African countries have limited DTA's. In practice this problem is sometimes dealt with by investing into Africa via a location which has a relatively good treaty network into Africa (for example, South Africa or Mauritius). However, the fact remains that treaty relief is, in many cases, simply unavailable.

As discussed more fully below, the absence of an extensive treaty network makes it possible for African countries to impose unusual withholding taxes on foreigners. For this reason it is necessary for investors to do a higher degree of tax planning when investing into Africa than might be necessary compared to investments into other regions.

Withholding Taxes

As previously mentioned, African countries often impose withholding taxes on a wide range of outbound payments. These include those types of payment which are often subject to withholding taxes (interest, royalties and dividends) as well as other payments which are usually not subject to tax in this way – for example, management fees and technical fees.

The consequences can be painful. For example, Nigeria imposes a withholding tax of 10% on various types of outbound payment, including management fees and technical fees. This may mean that the tax due is more than the arm's length profit made by the company rendering the service. This is demonstrated by the fact that, in terms of standard transfer pricing practice, intra-group management fees are usually calculated on a cost plus basis, and the mark-up typically applied is around 5%.

Tax relief in the local jurisdiction of the service provider may also not be available, or may be limited. For example, in South Africa a full credit is only available for foreign taxes paid in respect of foreign sourced income. Therefore a full credit is not available for foreign tax on income from a South African source (such as management services rendered from South Africa).

There are various strategies which may be employed to try to avoid, or mitigate, these difficulties. For example, by using a limited risk model it may be possible, to avoid the need for management fees by effectively building the value of the relevant activities into the price charged for goods or services. However, the full implications of such a strategy need to be carefully considered. For example, this option may well increase the dutiable value of goods for customs duty purposes.

Another option might be to route the flow of transactions via a country with a favourable DTA network into Africa. However, this option is only feasible in respect of those African countries which have DTA's (and there are many that resist signing DTA's because of the resultant loss of withholding tax revenue).

MNE's may also include the tax costs in the charge to the local entity.

Therefore, unfortunately there is no single strategy that works in all cases.

Transfer Pricing Rules

One of the key tools for managing transactions within MNE's is a global transfer pricing policy. Such a policy should govern the pricing of intra-group transactions and should ideally demonstrate to tax authorities in all relevant countries that such transactions have been concluded at arm's length prices. Examples of common intra-group transactions are sales of goods, supplies of services (including head office services), making available intellectual property in return for royalties and financial assistance.

Some African countries have transfer pricing rules. These include South Africa, Namibia, Rwanda and Zambia. However, there are many African countries which either do not have formal transfer pricing rules or have little experience when it comes to the implementation and enforcement of such rules. An example of a country without transfer pricing rules is Nigeria – the economic powerhouse of West Africa.

For this reason it is important for MNE's with African operations to establish the status of transfer pricing rules in each country. The extent, and nature, of disclosure to the authorities should be carefully considered. Where appropriate, it may be advisable to engage proactively with tax authorities in a country in order to demonstrate the arm's length nature of the pricing of transactions. Evidence of acceptance of pricing methodologies in countries which have a similar business model may be helpful.

Regulatory Restrictions

Apart from tax, inbound investors into Africa also need carefully to consider the impact of local regulatory restrictions. For example, it may be necessary to obtain the participation of local shareholders before being able to form a corporate entity or access licenses to trade in the country concerned. Outbound intra-group payments may require prior central bank approval. Access to foreign currency may be restricted or denied.

The nature, and extent, of the restrictions which apply vary significantly from country to country.

Expatriates

Skilled expatriates are essential to an MNE's strategy to expand into Africa. Expats can become de-motivated by difficulties associated with obtaining visas, remaining tax compliant in multiple jurisdictions and the logistics of travel through parts of Africa. Expat packages are often extremely expensive, since they include – over and above the normal package of the individual concerned – the cost of additional elements such as relocation, tax equalisation and accommodation. Therefore the failure of an expat assignment can be costly and can significantly set back the newly established operations of the MNE. One of the biggest factors contributing to the failure of such assignments is unhappiness of the spouse or family of the expat employee. Careful planning, and managing of expectations, is therefore essential to ensure the greatest possible chance of a successful secondment. This process needs to embrace not only the employee but also their immediate family.

The South African Value Proposition

It is sometimes said that Africa's not for sissies. However, for MNE's with global expansion strategies, Africa offers unique opportunities. South African based multi-nationals have expanded into Africa with great success. Therefore South African advisors are uniquely qualified to assist with formulating an integrated strategy for MNE's with global ambitions that include the African continent.

The recently enacted Headquarter Company rules will also enable South Africans to promote their country as an ideal intermediate holding company destination for expansion into Africa. These rules effectively circumvent the difficulties previously posed by certain tax rules as well as the exchange control system.

Global groups expanding into Africa should therefore consider South Africa as a destination for an African headquarters.

Such an African headquarters can serve as a central repository for gathering experience of the challenges and opportunities that Africa offers. Such institutional knowledge can reside both in staff with relevant experience and in sources of information such as databases. It is sometimes considered necessary to position such a Head Quarters close to the markets that it serves (for example East Africa, West Africa, or Southern Africa). However, possibly other factors are more important than physical proximity. These include ease of travel and the quality of the communications infrastructure in the location of the headquarters.

South Africa has an excellent infrastructure, ease of communication and of travel. South Africa has direct flights to and from many African capitals and the rest of the world. Advisors are readily accessible, either for meetings or via virtual forms of communication such as teleconferences. The Deloitte experience shows that clients take advantage of its services in co-ordinating pan-African projects via Johannesburg because of this ease of communication and access.

It is therefore quite conceivable that South Africa will, at last, succeed in its long-held ambition of providing the rest of the world with a reliable launch pad into Africa.

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Designed and produced by Creative Solutions at Deloitte, Johannesburg. (0000/lie)

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