



TANZANIA REVENUE AUTHORITY

ISO 9001: 2008 CERTIFIED

UN ANNUAL TAX MEETING 10TH SESSIONS IN GENEVA

**“CAPITAL GAINS TAXATION AND INDIRECT SALES:
EXPERIENCE, CHALLENGES AND REMEDIAL EFFORTS
IN TANZANIAN PERSPECTIVE”**

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27/10/2014 - 31/10/2014



United Nations

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Coverage

- ❑ Introduction
- ❑ Practical Administrative and Policy issues in CGT on Indirect Sales
- ❑ Important Concepts and Provisions of the law
- ❑ Indirect Sales: Experience and Challenges
- ❑ Practical Law Implementation: Challenges and Success
- ❑ Farm-in , Farm-out Taxation Experience
- ❑ Remedial Efforts to the Challenges
- ❑ Conclusions



1.0 Introduction

- ❑ Disposal of shares under Tanzania Income Tax Law, whether direct or indirect is a capital transaction giving rise to a Capital Gain Tax (CGT).
- ❑ One major condition is that the transaction should involve a “domestic asset” as defined under the Act.
- ❑ The indirect sale of the shares is captured into tax net under the concept of change of underlying ownership of an entity.
- ❑ The Capital Gain would therefore extend to capture overseas disposals associated with resident entities.
- ❑ This would take place either direct or through interposed entities structure.
- ❑ A number of sections of the Income Tax Act, 2004 addresses various issues relating to CGT from defining terms like domestic assets and underlying ownership sect 3, to calculation of gain sect 36, cost deduction sect 37, Realization sect 39, change of control sect. 56 etc. You may visit TRA website for the Act.

2.0 Practical Administrative and Policy issues in CGT on Indirect Sales



- ❑ Though the indirect sales are taxable under Tanzanian law, it has not been an easy task owing to the practical problems
- ❑ Who becomes the taxpayer in case of overseas transaction is one of the practical challenge
- ❑ The section 56 of the Act found the answer by deeming a resident entity to have realized the assets immediately before change of control in it.
- ❑ Then difficulties in enforcement and collection of the tax arises after the above challenge
- ❑ Again the same resident entity becomes the recipient of the assessment for that purpose.
- ❑ Recovery measures available under domestic law follows

3.0 Important concepts and provisions of the law

- ❑ Domestic asset: An asset owned by a resident person including shares in a resident corporation; securities; loan stock; goodwill; intellectual property; interest in land and building situated in Tanzania.
- ❑ Direct or indirect control: By the owner of the shares, whether direct or indirect together with associates, controlled 25% or more of the voting power in the corporation.
- ❑ Underlying ownership concept in an entity: Membership interest owned in an entity, directly or indirectly, through one or interposed entities, by individual or by an entity whether resident or non-resident (owners).

4.0 Indirect Sales: Experience and Challenges



- ❑ In the recent years, direct and indirect transfer of shares have been increasingly noticed, both in the extractive and non-extractive sectors, posing challenges to Tax Administration in Tanzania.
- ❑ Section 56 of ITA 2004 captures the indirect sale of shares where the underlying ownership of an entity changes by more than 50% as compared with that ownership during the previous three years.
- ❑ Some practical challenges that are faced under Section 56 are:
 - Disposal of shares may have occurred in the country where there is no tax treaty between Tanzania and that country.
 - Change of more than 50% in reality is difficult to find in most cases, leaving the other underlying ownership which changed by less than 50% untaxed!
 - No formula put in place to apportion the number of shares changed in the group to be allocated in relation to the capital gains in the respective country.
- ❑ Section 56 was amended in 2012 to include shares as assets. Spirit of the amendment was to capture the foreign indirect sales.

4.0 Indirect Sales: Experience and challenges (Cont'd)



- ❑ Transfer of such assets is in most cases considered as a taxable transaction in Tanzania.
- ❑ As it is the case in other tax jurisdictions, one most prevalent form of direct and indirect transfer of assets has been the transfer of shares resulting from the reorganizations/restructurings of certain group of companies.
- ❑ Although such type of transactions are in other tax jurisdictions treated as exempt from CGT due to the absence of any consideration, they are not treated as such in Tanzania.
- ❑ One of the rationale for imposing CGT on such transactions has been the fact that there could be significant post –restructuring tax risks posed as the new set-ups might be prompted mainly by tax avoidance motives.
- ❑ Section 56 of the Income Tax Act , 2004, therefore serves as an anti-avoidance provisions for that purpose.

5.0 Practical Law Implementation: Challenges and Success



- ❑ In practice, we have had some cases, involving direct transfer of shares, (though without monetary consideration) where tax had been imposed and paid by treating the transactions as if there is corresponding considerations.
- ❑ This treatment extends to indirect transfer of shares as long as there is change in the control of the domestic entity and underlying ownership concept comes in.
- ❑ Unlike the taxation of normal direct sale, indirect sale taxation particularly in the mining sector has not been as successfully as expected.
- ❑ **CGT case of indirect sale in the Tanzania's extractive sector is yet to be decided by the highest Court of Appeal. The decisions of the lower level appellant mechanisms were unfavorable to the Tax Administration hence an appeal has been recently lodged to the Supreme Court.**

5.0 Practical Law Implementation: Challenges and Success (Cont'd..)



Perhaps some facts of the above case would reflect the challenges and tax planning confronted:

- ❑ The case involves the exploration of sensitive and precious mineral: Company A (a non-resident entity) established a subsidiary B (with 100% ownership) in Tanzania which had the rights to explore and extract the mineral in Tanzania.
- ❑ Huge quantities of the Mineral Resources were later discovered by the Tanzanian Subsidiary following the exploration. This discovery significantly increased the economic viability of the mining project in Tanzania. That situation significantly enhanced the value of the shares of Company A .
- ❑ Company C (also a non resident) which is mining company immediately concluded a deal to buy Company A, also a non-resident and acquired all its shares for a consideration worth approximately **1bn USD**.
- ❑ This transaction caused change of underlying ownership in a resident company A by more than 50% hence TRA assessed CGT.

5.0 Practical Law Implementation: Challenges and Success (Cont'd..)



- ❑ The decision of the lower Courts on this case was that, though there was indeed a change in underlying ownership of a subsidiary entity in Tanzania hence realization of the shares, yet the shares were not taxable because the Tanzanian Income Tax Act, did not include shares as taxable under CGT.
- ❑ Following this decision of the Courts, the Income Tax Act, 2004 was amended and now contains provisions which impose capital gain tax on such transactions.
- ❑ Besides the restructuring or re-organization in the foreign group of entities that cause change of underlying ownership in Tanzania which has recently been taxed as stated before, no any indirect sales that have fallen within the requirement of the law to be taxed, signifying tax planning in the transactions.

6.0 Farm-in , Farm-out Taxation Experience



- ❑ Different from other tax jurisdictions, farm-in farm-out transactions are not taxed under CGT but as business income
- ❑ This is attributable to the lack of specific tax regime to capture such transactions under the current Income Tax Act.
- ❑ Gain from realization or transfer of rights attributable to extractives, or land involved in mineral prospecting or development does not fall under CGT assets hence opted to be taxed as normal business income.
- ❑ Challenges are confronted in deductibility of expenses, timing of assessment and rationale of this treatment, though the investors in this sector seems to prefer it over CGT.
- ❑ New Extractives tax regime is expected to address these challenges.

7.0 Remedial Efforts to the Challenges



- ❑ Despite the 2012 amendments made under section 56, further changes have been proposed in the new extractives tax regime, under IMF consultancy. The proposal further include more rules on how to calculate gains during realization (including farm-out/in arrangement).
- ❑ Introduction of Practice Note on CGT for Foreign Indirect Sales to provide mechanisms addressing challenges in taxing CGT with focus to extractive sector.
- ❑ Collaborative work between TRA, international community including eg. UN, NTA (Norway), US Treasury and taxpayers through their Tax Consultants (just to mention a few).
- ❑ Learning the practice of other tax jurisdictions has been one of the initiative, and some areas have been borrowed for inclusion in the proposed new extractives tax regime.
- ❑ New requirements in the law relating information exchange with a taxpayer, return filing, deductions etc.



Conclusions

- ❑ The international cooperation efforts should ensure that tax revenue benefits optimally the source countries which own extractive resources.
- ❑ Mere business structures and planning should not deny these countries to tax the gains that accrue from their natural resources
- ❑ Given the nature of the extractive sector and activities involved from exploration to development stages, different rules governing taxation of indirect sales are advisable.
- ❑ Though revenue for developing countries is the main motive for advisable rules, the investment in the sector is capital and risk intensive and hence should be fairly compensated.
- ❑ Administrative and Policy guidance work by UN should therefore be focused on transparency, good-faith in dealings, practicability and investment –revenue balanced rules to achieve intended goals.



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