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International Tax

Do tax havens still have a role in structuring inbound investment?

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Introduction

When I started my tax career in the UK back in the 1980s, the media paid very little attention to tax issues except at the time of the budget, when, much like Uganda, newspapers would report how much more personal income tax readers should expect to pay in the coming year and, most importantly, how much duty was going to be charged on fuel, cigarettes and alcoholic beverages. The complex tax planning of multinationals and high net worth individuals ('HNWIs') attracted very little attention and my occupation was considered by most people to be nerdish and dull.

This has changed dramatically, particularly in the last decade, though sadly, tax advisers are still not considered as exciting as, say as a Formula One drivers, or Hollywood actors. As a result of the 2008 financial crisis and some very well-publicised leaks of confidential information regarding tax structures used by multinationals and HNWIs (such as LuxLeaks and the Paradise Papers), tax is now a topic for headlines around the world all year round. In Uganda, a great deal of attention has focused on the issue since Heritage Oil's decision to sell its interests in 2009 and its argument that this would not give rise to tax in Uganda. Usually at the heart of these stories is the use of tax havens to minimise taxes.

Tax havens

So, what is a tax haven? There is no generally accepted definition, but a consensus has developed that the key features of a traditional tax haven include low or zero direct taxation of income and gains and secrecy laws enabling the beneficial owners of assets held in or via the jurisdiction to avoid the need to disclose details of their interests.

Some commentators have broadened the definition to include jurisdictions with higher headline tax rates and less stringent secrecy requirements, but which have beneficial tax regimes, e.g. for intellectual property, financing or trading activities. Countries like Ireland, Luxembourg, and in some opinions even the UK would be regarded as tax havens under such wider definitions. This is controversial, and for the purposes of this article, I shall concentrate on traditional tax havens: places such as the Cayman Islands, Jersey or the British Virgin Islands.

Motivation for tax havens

Historically, there have certainly been tax advantages for multinationals and HNWIs in using traditional tax havens as part of investment structuring. For the unscrupulous, secrecy provided a shelter for wealth derived from tax evasion, corruption and other criminal activities. The association of tax havens with these kinds of activities has certainly given them a bad name. But tax havens have been used by the law-abiding too, as part of legitimate business planning exercises. Secrecy is helpful in preserving commercial secrets, not just the fruits of illegal activities, and the low or zero tax rate could provide a mechanism to defer tax until ultimate repatriation to (taxable) shareholders and for lowly taxed profits to be reinvested in new projects.

Tax haven entities might be used as intermediate holding companies in group structures (which could enable sales of subsidiaries without attracting taxation in the countries of operation), as finance companies to lend funds to companies carrying out new projects, to hold a group's intellectual property and to provide management and other services. It was always important to ensure that such arrangements had commercial substance to ensure their effectiveness, but in practice the level of substance required to establish the effectiveness might not be very onerous and some carelessness in implementation was also common.

Suspicion against tax havens

The governments of emerging economies have generally been very aware of the danger that tax havens pose to their domestic tax base. Payments which reduce the domestic tax base such as interest, royalties and management fees are usually subject to withholding when paid to non-resident entities (applicable at 15% in the case of Uganda) significantly reducing the benefits and in the past few years many countries, including Uganda, have extended the application of taxation to capital gains realised on indirect disposals of domestic assets (such as the sale of an intermediate holding company in a tax haven, holding an indirect interest in a mine or telecoms licence).

Stringent transfer pricing rules have also been implemented to ensure that payments don't exceed arm's length amounts. There has been a great deal of concern that double tax treaties which restrict taxing rights in respect of capital gains, or reduce the rate of withholding taxes on payments, have been abused to avoid tax. Traditional tax havens generally do not have extensive treaty networks (most in fact have none), so this has not been an issue in relation to their use in group structures.

Base Erosion and Profit Shifting Action Points

Another recent development has further restricted the potential benefits to multinationals from investing via traditional tax havens. In 2012, the G20 requested the OECD to develop an action plan for tackling the problem of aggressive tax planning which was eroding tax revenues across the globe at a time when government revenues were already under huge pressure in the aftermath of the financial crisis of 2008. The problem was christened BEPS (base erosion and profit shifting) and the OECD working with many non-member states, has produced a programme of 15 actions to help states to coordinate their approach to aggressive tax planning.

These are summarised in the table below.

	Action	Description
1	Tax challenges of the digital economy	Addresses the tax challenges of the digital economy and identifies the main difficulties that the digital economy poses for the application of existing international tax rules.
2	Neutralising the effects of hybrid mismatch arrangements	Develops model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effects of hybrid instruments and entities (e.g. double non-taxation, double deduction, long-term deferral).
3	Designing effective controlled foreign company (CFC) rules	Sets out recommendations to strengthen the rules for the taxation of CFCs.
4	Limiting base erosion involving interest deductions and other financial payments	Outlines a common approach based on best practices for preventing base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income.
5	Countering harmful tax practices more effectively, taking into account transparency and substance	Revamps the work on harmful tax practices with a focus on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for preferential regimes, such as IP regimes.
6	Preventing the granting of treaty benefits in inappropriate circumstances	Develops model treaty provisions and recommendations regarding the design of domestic rules to prevent treaty abuse.
7	Preventing the artificial avoidance of permanent establishment status	Contains changes to the definition of permanent establishment to prevent its artificial circonvention, e.g. via the use of commissionaire structures and the likes.
8 - 10	Aligning transfer pricing outcomes with value creation	Contain transfer pricing guidance to assure that transfer pricing outcomes are in line with value creation in relation to intangibles, including hard-to-value ones, to risks and capital, and to other high-risk transactions.
11	Measuring and monitoring BEPS	Establishes methodologies to collect and analyse data on BEPS and the actions to address it, develops recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluates the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis.

	Action	Description
12	Mandatory disclosure rules	Contains recommendations regarding the design of mandatory disclosure rules for aggressive tax planning schemes, taking into consideration the administrative costs for tax administrations and business and drawing on experiences of the increasing number of countries that have such rules.
13	Transfer pricing documentation and country-by-country reporting	Contains revised guidance on transfer pricing documentation, including the template for country-by-country reporting, to enhance transparency while taking into consideration compliance costs.
14	Making dispute resolution mechanisms more effective	Develops solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, via a minimum standard in this area as well as a number of best practices. It also includes arbitration as an option for willing countries.
15	Multilateral convention to implement tax treaty related measures to prevent BEPS	Provides an analysis of the legal issues related to the development of a multilateral instrument to enable countries to streamline the implementation of the BEPS treaty measures. On 7 June 2017, over 70 Ministers and other high-level representatives participated in the signing ceremony of the Multilateral Instrument.

Source: https://www.oecd.org/ctp/beps-actions.htm

It isn't the purpose of this article to provide readers with a comprehensive overview of the BEPS actions and the status of their implementation, so interested readers are encouraged to visit the OECD website for more information. Whilst BEPS was initiated by the governments of developed economies, developing countries have been encouraged to participate and significant effort has been devoted to preparation of toolkits to assist them with implementation.

Not all of the BEPS actions listed are directly relevant to the use of tax havens, but the overall direction of travel clearly is: to ensure that tax planning is ineffective if it is relies on concealment, arbitrage between different national systems and the form rather than the true substance of arrangements within multinational groups. In that context the question arises whether tax havens still have a role in legitimate tax planning for inbound investment? Many multinationals have responded to BEPS and the attendant public scrutiny by unwinding their more aggressive structures. This may involve simply making their tax haven entities resident in another more 'respectable' jurisdiction and I have seen a number of companies in the extractive industries moving the management and control (and hence tax residence) of tax haven subsidiaries to the parent company's home jurisdiction in recent years. It must be remembered therefore that simply because a company is incorporated in a tax haven, it may not necessarily be tax resident in that location.

Do tax havens still have a role?

There is at least one situation where tax havens still seem to have a role, however. Private equity investors and development finance institutions, still make use of tax haven companies in structuring their investments. There seem to be two major reasons for this. The first is that investors may prefer to rely on the legal frameworks and court systems available in offshore locations to manage political risks in the countries where they are investing. As time goes by one hopes that this is becoming less of concern to investors.

The other is a tax reason: unlike multinational companies, private equity investors normally pool capital from a number of sources in different jurisdictions for individual projects, or groups of projects. Each individual investor will have its own tax profile: tax residence, tax rates for income and gains, treaty network etc. Private equity firms wish to pool investments without adding to the tax burden on hoped for profit flows and the easiest way to do that is to invest via a tax haven entity which won't impose any taxes on profits and gains repatriated through it. Investments therefore tend to be made via tax haven holding entities, which may be structured as partnerships, with a suitable intermediate holding company in a jurisdiction which has a favourable treaty with the investment destination jurisdiction to mitigate tax on repatriated profits and any gains.

The substance of the intermediate holding company will usually be subject to close scrutiny by tax authorities, and careful consideration by advisers and. Most tax treaties require adequate substance in the jurisdiction where residence is claimed in order for treaty relief to be available and some countries, including Uganda, also have domestic legislation specifically designed to restrict access to treaty relief in cases where the taxpayer claiming it lacks economic substance.

Conclusion

In conclusion, I think that two points are worth repeating. The first is that for multinationals in general, traditional tax havens now have a limited role in planning investments because they generally don't contribute to tax saving due to the existence of withholding taxes, capital gains taxation which embraces indirect disposals, substance requirements and transfer pricing rules. Such opportunities are there are have been restricted yet further by the implementation of the BEPS actions. The second is to draw attention to the key role that they may still play for other types of investors, particularly private equity, in enabling the pooling of investments in a tax efficient manner. Whilst outsiders tend to assume that any use of tax haven companies is suspect, it is still important to understand specifically why they are used in any specific situation before leaping to the conclusion that the motive is tax avoidance.

Contacts for this Publication

Bill Page
(Author)
bpage@cristaladvocates.com

Bill is a Senior Advisor with Cristal Advocates. He has concentrated on working with energy companies with a particular focus on cross border transactions and M&A since 1989 and is a leading global energy and tax practitioner with wide international experience. Between 1986 and 1998, he worked in London with the UK tax authorities and Big Four accounting firms. From 1998 to 2004, he was based in Kazakhstan working across the Caspian region with Deloitte. He was in the region at the time it was developing its infrastructure for crude oil production with international investment following the collapse of the Soviet Union.

From 2004 to 2008, he worked in Russia where he led Deloitte's oil and gas industry group and established Deloitte's office in Sakhalin. He moved to East Africa in 2009 leading Deloitte's energy and resources industry group in Uganda, Kenya, Tanzania, Rwanda, Ethiopia and Mozambique. He was initially based in Kampala, Uganda later relocating to Dar es Salaam, Tanzania. Bill returned to the UK in 2014 supporting Deloitte UK teams working on outbound projects investing in Africa and was a key member of Deloitte UK's energy and resource practice until his retirement from the firm in September, 2018.

Bill is a graduate of Oxford University and completed his inspectors' training with the UK Inland Revenue in 1989. ■

Denis Yekoyasi Kakembo
dkakembo@cristaladvocates.com
+256 751 834 168

Denis is the Managing Partner at Cristal Advocates where he also leads the energy and tax practice. He is qualified both as a Lawyer and Chartered Accountant with vast experience serving various industries in Sub Saharan Africa. Before joining Cristal Advocates. He had worked for close to 10 years with Deloitte and Touche where he started his career and rose to senior managerial positions.

At Deloitte, he lived and worked in Uganda, Kenya, Tanzania and the United Kingdom for over 6 years and subsequently became the firm's chief of staff for the Energy and Resources Industry Group seeing him play a lead advisory role in Uganda, Kenya, Tanzania, Mozambique, South Sudan, Somalia and Ethiopia.

Denis is widely published and a regular commentator in the local, regional and international media and speaker at various forums regarding the taxation and financing of energy projects as well as the protection of large capital projects within the framework of international investment law.

He holds a Master of Laws degree in Petroleum Taxation and Finance from the University of Dundee in the United Kingdom and various other qualifications. ■

John Teira
jteira@cristaladvocates.com
+256 704 493 997

John leads the public policy and advocacy practice at the firm and combines unique public and private sector experience.

Prior to joining Cristal Advocates, he had worked as a Private Secretary to the President of the Republic of Uganda. During this time, he participated in several public and private sector engagements that included advising and coordinating activities relating to oil and gas as well as infrastructural projects of national significance. John had earlier worked with the Post Bank Uganda Limited and Shonubi Musoke and Co. Advocates.

He holds a Bachelor of Laws degree from Makerere University and a Post Graduate Diploma in Legal Practice from the Law Development Centre and various other qualifications. ■

Dickens Asiimwe Katta
dasiimwe@cristaladvocates.com
+256 772 370 021

Dickens leads the oil and gas practice at Cristal Advocates. He has an in depth appreciation of Uganda's oil and gas sector having served as the maiden Company Secretary of the Uganda National Oil Company (UNOC) and the Uganda Refinery Holding Company Limited (URHC). UNOC represents the Government of Uganda commercial interests in the oil and gas sector while URHC represents government interests in the refinery project as well as managing the petrol based industrial park.

Dickens was instrumental in UNOC's formation and initial period of operation and also served as its head of Contracts, Negotiations and Advisory until May 2018. Prior to joining UNOC, Dickens was Legal Counsel at the Petroleum Directorate of the Ministry of Energy playing key legal advisory roles on the negotiation and implementation of PSAs, Joint venture and other oil and gas agreements. He was also part of the team that shepherded the process of enacting the current Ugandan oil and gas Legislations and Regulations including the local content requirements.

He is a certified project control specialist (IFP) and holds a Master of Laws Degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom, a Post Graduate Diploma in Legal Practice and a Bachelor of Laws degree from Makerere University. ■

Francis Tumwesige Ateenyi
ftumwesige@cristaladvocates.com
+256 702 540 936

Francis leads the litigation and dispute resolution practice at the firm. He is an Advocate of the High Court of Uganda with expertise in oil and gas, infrastructure and dispute resolution. He has been part of teams advising on projects in Uganda, Tanzania, Mozambique and South Africa. He specializes in regulatory compliance, national content, health and safety and dispute resolution.

He joined Cristal Advocates from Kizza, Tumwesige, and Ssemambo Advocates. He previously worked with the Advocates Coalition for Development and Environment (ACODE). He also undertook a traineeship with the oil and gas division of Webber Wetzel in Johannesburg, South Africa.

He holds a Master of Laws degree in Petroleum Law and Policy from the University of Dundee in the United Kingdom and various other qualifications. ■

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Contact us

Cristal Advocates
32 Lumumba Avenue
4th Floor, Padre Pio House
Lumumba Avenue

P.O. Box 1769 Kampala, Uganda
Tel: +256 (414) 671 274
Email; admin@cristaladvocates.com
www.cristaladvocates.com