China’s One Belt One Road: Opportunities in Africa
The Kenyan tax landscape
Foreign Direct Investment In Nigeria
Investing in Africa: The Big Five of tax structuring
Transfer pricing in Zimbabwe: A review of the allegations against Econet Wireless

Investment protection legislation in South Africa
The emergence of a private equity market in Namibia
Private equity trends in Morocco
Private equity as a catalyst for growth in Africa
South African M&A: The impact of data protection laws
Contents

4  China’s One Belt One Road: Opportunities in Africa
   BY CAROLYN DONG, MATTHEW DAVIS AND SIMIN YU

7  The Kenyan tax landscape
   BY CALEB LANGAT

10 Foreign Direct Investment In Nigeria
    BY MOSADOLUWA PEACE ADELEKE

14 Investing in Africa: The Big Five of tax structuring
    BY TON VAN DOREMALEN AND WOUTER KOLKMAN

19 Transfer pricing in Zimbabwe: A review of the allegations against Econet Wireless
    BY ZINZILE ESTHER MLAMBO

23 Investment protection legislation in South Africa
    BY LUNGELO MAGUBANE

26 The emergence of a private equity market in Namibia
    BY PETER JOHNS AND RAUNA NDILULA

28 Private equity trends in Morocco
    BY CAMILIA BENANI

30 Private equity as a catalyst for growth in Africa
    BY OGECHI ONUOHA

35 South African M&A: The impact of data protection laws
    BY MONIQUE JEFFERSON, SAVANNA STEPHENS AND PASCAL DESPARD
Connecting you to Africa

Investment is the theme of this edition of Africa Connected, our regular collection of in-depth articles on doing business in Africa.

We have cross-border articles on China’s One Belt One Road initiative, the Big Five of tax restructuring, and private equity as a catalyst for growth in Africa; and jurisdiction specific pieces on Kenya, Morocco, Namibia, Nigeria, South Africa and Zimbabwe.

Please send us your feedback on Africa Connected, including topics you’d like to see covered in future editions.

DL-Africaconnected@dlapiper.com
China’s One Belt One Road: Opportunities in Africa

By Carolyn Dong, Foreign Legal Consultant (carolyn.dong@dlapiper.com) | Matthew Davis, Senior Associate (matthew.davis@dlapiper.com) | Simin YU, Senior Associate (simin.yu@dlapiper.com) – DLA Piper
Hong Kong, DLA Piper Shanghai

China’s One Belt One Road (OBOR) initiative, introduced by President Xi Jinping during his visits to Central and Southeast Asia in late 2013, has rapidly gained momentum, with its potential impact on trade and investment in Africa increasingly apparent.

Africa has long been an important market for China, with investment from Chinese companies (both private and state-owned), banks (both commercial and policy) and individuals spanning the entire continent. Moreover, the strength and depth of this broad economic and trading relationship continues to grow: the abundance of natural resources in Africa makes the continent both an excellent trading partner and an attractive investment destination for energy-hungry China with its population of 1.3 billion (and consequent need for raw materials) and excess of infrastructure development capabilities.

OBOR and Africa
The One Belt One Road initiative is a transformational development strategy and framework promoted by the highest levels of the Chinese Government. OBOR focuses on connectivity and cooperation among countries along two main routes: the land-based Silk Road Economic Belt and the ocean-going Maritime Silk Road, which run through the continents of Asia, Europe and Africa.

Importantly, OBOR, and particularly the Maritime Silk Road, touches on a number of African countries in East and Southeastern Africa (such as Ethiopia, Kenya, Tanzania, Mozambique, Madagascar, South Africa), North Africa (Egypt, Morocco and Algeria), and inland African countries such as the Democratic Republic of Congo, Zambia and Zimbabwe.
The broad strategy for the initiative is set out in its framework document, “Visions and Actions on Jointly Building Silk Road Economic Belt and 21st Century Maritime Silk Road.” Issued in March 2015 by China’s National Development and Reform Commission, Ministry of Foreign Affairs and Ministry of Commerce, it states that:

Key focuses for OBOR
OBOR underlines China's push to take a larger role in global affairs, and its need to export capacity in industries where there is overproduction, such as steel manufacturing and infrastructure construction. At its core, OBOR demonstrates a high-level political commitment in China to work with participating countries to facilitate an increase in interconnections and trade and investment flows.

Key sectors for OBOR include:
• Energy and power.
• Infrastructure projects.
• Public utilities.
• Construction, transport and logistics.
• Technology, media, telecoms and information technology.
• Financial markets.

OBOR is focused on reducing barriers to trade – both literal (such as inadequate port, rail and road infrastructure) and less tangible (such as enhancing trade liberalization and easing customs and quarantine processes). Accordingly, it calls for an improvement on infrastructure, with greater energy and power interconnections and a secure and efficient network of land, sea and air passages across key routes. Additionally, OBOR calls for greater policy coordination (such as establishing free-trade areas and improving cooperation in new technologies) and financial integration (such as carrying out multilateral financial cooperation in the form of syndicated loans and supporting foreign countries in issuing Renminbi-denominated bonds).

Today, OBOR’s key institutional framework and corresponding funding bodies have been established and are operating (e.g. Asian Investment and Infrastructure Bank (AIIB), Silk Road Fund, and BRICS New Development Bank - which also includes South Africa as a member), and Chinese corporate momentum is firmly in place behind the initiative. Additionally, relevant data supports the successful uptake of the initiative, including in a number of African jurisdictions.

OBOR projects in Africa
Examples of projects and investments undertaken in Africa under the auspices of OBOR include:
• A number of railway projects across Africa, including the completion of the first fully electrified cross-border railway line in Africa, linking Ethiopia’s capital, Addis Ababa, to the Red Sea port of Djibouti. This project was 70 percent financed by China’s Exim Bank, and built by China Railway Group and China Civil Engineering Construction. Similarly, Kenya’s 845km Mombasa to Nairobi railway line was formally completed in 2017, with a concessionary loan from China’s Exim Bank funding 80 percent of the costs (estimated at over US$3 billion). The project was constructed by China Rail...

“The Belt and Road Initiative aims to promote the connectivity of Asian, European and African continents and their adjacent seas, establish and strengthen partnerships among the countries along the Belt and Road, set up all-dimensional, multitiered and composite connectivity networks, and realize diversified, independent, balanced and sustainable development in these countries.”

OBOR thus provides a framework for, and guidance to, the significant and ever-growing Chinese investment in Africa. According to a 2017 McKinsey & Company report:

“In the past two decades, China has catapulted from being a relatively small investor in the continent to becoming Africa’s largest economic partner. And since the turn of the millennium, Africa–China trade has been growing at approximately 20 percent per year. Foreign direct investment has grown even faster over the past decade, with a breakneck annual growth rate of 40 percent.”

1 “Dance of the lions and dragons: How are Africa and China engaging, and how will the partnership evolve,” McKinsey & Company (June 2017).
and Bridge Corporation, with China's national news agency, Xinhua, declaring the project "an early result of the Belt and Road Initiative that will hasten regional growth through cross-border trade, skills transfer and industrialization."  

- Following the 2017 announcement of the proposed acquisition by Sinopec of Chevron's interests in the Cape Town refinery and South African and Botswana petrol retail businesses, industry media sources were quick to point out that "this increasing interest in Africa is likely to be part of China's One Belt One Road initiative."  

- A number of road-infrastructure projects, including Mozambique's Maputo bridge, built by China Road and Bridge Corporation, and the TIPAZA Cherchell Ring Expressway Project in Algeria, built by a consortium led by the China State Construction Engineering Corporation. Other projects announced in connection with OBOR include a number of private Chinese companies' foreign expansion and joint venture plans in Africa. In this vein, McKinsey & Company's report estimates that there are more than 10,000 Chinese-owned firms operating in Africa, around 90 percent of which are privately owned.  

Opportunities for international and African companies

China's One Belt One Road initiative is intended to be two-directional: to both promote Chinese outbound investments and encourage international investment into China and along the OBOR routes. OBOR - and the funding behind it - offers the opportunity for international and African companies and institutions to work with their Chinese counterparts in developing projects along the routes. International companies may joint-venture alongside, or subcontract to, Chinese corporations seeking to implement OBOR projects, or Chinese firms could seek out local partners to develop projects within host countries along the routes. Thus, when speaking with interested Chinese counterparties about OBOR projects - as compared to discussing general investment opportunities - foreign enterprises are likely to find a more receptive audience in China, due to the financing that has been specifically set up for them.  

Conclusion

Successfully implementing projects along the OBOR routes will not be without risks and challenges. Overcoming these will require thorough due diligence exercises and robust partnership and joint venture arrangements. More importantly, success will depend on companies finding the right partners and having support networks capable of providing a thorough understanding of local conditions, regulators, market players and ways of doing business in both China and the African host jurisdictions. In order to achieve this, on-the-ground-presence and knowledge of suitable partners and relevant contacts (both for African parties in China and for Chinese parties in Africa) is a prerequisite. Although China has allocated significant capital and resources towards implementing OBOR, it cannot implement the initiative alone. Success will depend on cooperation between Chinese companies and foreign (including African) counterparts in a raft of sectors and regions, covering everything from small-scale trade and investment to the delivery of large-scale multi-jurisdictional infrastructure.
The Kenyan tax landscape

By Caleb Langat, Director, Iseme, Kamau & Maema Advocates (IKM), DLA Piper Africa member firm in Kenya (clangat@ikm.co.ke)

When setting up an investment in a foreign country, an understanding of the tax landscape is often the difference between a profitable venture and one that is not. In Kenya, the tax regime is comprised of four main tax heads: income tax, value added tax (VAT), excise duty and customs duty.

Income tax

Income tax is charged on all income that accrues in or is derived from Kenya. The income tax regime is both source-based (meaning all income that was earned from Kenya will be subject to tax in Kenya) and residency-based (meaning income of a person who is considered to be tax-resident in Kenya will be taxed even though such income may not have been earned in Kenya).

The tax provisions are contained in the Income Tax Act (ITA). Types of tax under the ITA include corporation tax, which is charged at the rate of 30 percent of the tax adjusted profits of resident companies, and 37.5 percent of those of branches of foreign companies; employment income tax, which is computed on a graduated scale ranging from 10 to 30 percent; and capital gains tax, at the rate of 5 percent of the gain realized on disposal of certain assets.
Kenya operates a self-assessment tax regime that requires a person subject to tax to compute the tax payable and remit the same to the Kenya Revenue Authority (KRA) on or before the due date. There are, however, certain instances in which tax or a portion thereof must be withheld from payments made by a person:

- Tax on an employee's income is withheld and remitted by the employer under the pay as you earn (PAYE) system.
- Certain payments for which withholding tax (WHT) must be deducted at the prescribed rate and remitted to the KRA. The withholding tax rates range from 3 to 30 percent of the amount that is payable, depending on the nature of the payment and the residency status of the person being paid. Examples of payments that would be subject to withholding tax include management and professional fees, interest and dividends.

Tax rates that are set out in the ITA may be varied by a double tax agreement (DTA) that Kenya is party to and has been operationalized. One of the main aims of DTAs is to prevent the double taxation of the same income in more than one jurisdiction. Kenya has entered into DTAs with 14 countries, and is currently negotiating DTAs with a number of other countries.

VAT
VAT is charged on the supply of taxable goods or services made in Kenya by a registered person. A person who makes or anticipates making taxable supplies in excess of KES5 million annually (US$50,000) is required to register for VAT. The burden of the tax is borne by the final consumer of the goods or services. For VAT purposes, supplies are categorized into five categories:

- Standard-rated supplies, which are supplies made in Kenya that are subject to VAT at the standard rate of 16 percent.
- Select fuel products which are subject to VAT at 8 percent.
- Zero-rated supplies, which are taxable supplies subject to VAT at the rate of 0 percent.
- Exempt supplies, which are not subject to VAT at all.
- Supplies not made in Kenya, which are outside the scope of the VAT legislation.

The tax provisions regarding VAT are contained in the Value Added Tax Act 2013 and regulations issued thereunder. The Act lists all zero-rated and exempt supplies. All other supplies made in Kenya that are not specifically listed in the schedules of exempt or zero-rated supplies are considered standard rated, and are subject to VAT at 16 percent.

Excise duty
Excise duty is administered by the Excise Duty Act 2015. The duty is charged on the following categories of items:

- Excisable goods manufactured in Kenya by a licensed manufacturer.
- Excisable services supplied in Kenya by a licensed person.
- Excisable goods imported into Kenya.

It has often been referred to as a "sin" tax, because it has traditionally been imposed on goods the consumption of which the government seeks to discourage, such as alcohol and tobacco. However, this is no longer the case, as in recent times excise duty has also been introduced on goods and services that would not be considered taboo, but are taxed with the intention of generating revenue for the government. These include cosmetics and fees charged by banks and other financial service providers.

Excise duty is charged on a specific or ad valorem basis, depending on the particular goods or services that are subject to excise duty, as set out in the schedules to the Excise Duty Act 2015.

Customs duty
Customs duty is tax paid on importation of goods into the country. The East African Community (EAC) - which comprises Kenya, Rwanda, Uganda, Tanzania, South Sudan and Burundi - operates as a single customs union. The customs laws for the EAC Customs Union are administered under the EAC Customs Management Act 2004. The customs duty as determined under the Act ranges from 0 to 25 percent of the value of the imported goods as determined under the Act, and is payable on importation of goods by the importer.

Tax incentives
To encourage investment in certain sectors that are a key focus of the government, the tax laws contain a number of tax incentives. For instance, businesses engaged in manufacturing stand to benefit from an investment deduction allowance (IDA) on the construction of buildings and the purchase and installation therein of machinery used for manufacturing. The businesses can claim IDA as a tax-deductible expense at the rate of 100 percent of the capital expenditure incurred. Where a building is constructed or machinery is installed in a building situated outside the cities of Nairobi, Kisumu
and Mombasa and the investment is in excess of KES200 million (US$2 million) the IDA available would be at the rate of 150 percent of the capital expenditure incurred.

The government has also sought to promote investment in infrastructure and energy through tax incentives. The Cabinet Secretary for National Treasury and Planning has exempted, from income tax, payments made to non-residents for services rendered under a power purchase agreement, and interest payments on loans from foreign sources for investing in energy or water sectors, roads, ports, railways or aerodromes.

Export processing and special economic zones
There are also a number of tax benefits available to companies that are set up in designated export processing zones (EPZs) and special economic zones (SEZs). EPZs are designated areas for the manufacture of goods for export, whereas SEZs are designated areas where business-enabling policies, integrated land uses and sector-appropriate on-site and off-site infrastructure are provided to support businesses. Tax incentives that EPZs enjoy include exemption from payment of income tax for the first ten years of operation, and a reduced rate of 25 percent for the subsequent ten years, after which the standard 30 percent corporation tax rate will apply. SEZ businesses are exempt from payment of withholding tax on dividends. Management or professional fees or training fees, consultancy, agency or contractual fees, royalties, interest and technical service fees paid by SEZ businesses to non-residents are subject to WHT at a maximum rate of 5 percent. Any other payments made to non-residents that are subject to WHT are taxed at a maximum rate of 10 percent.

Goods and services that are purchased by enterprises operating in an SEZ are not subject to VAT and excise duty. The EAC is still formulating regulations with respect to the customs treatment, but it is understood that, in principle, goods entering SEZs will be exempt from customs duty and, unlike the case for EPZ businesses, SEZ companies will be at liberty to sell in the EAC. However, the concept of SEZs is in its nascent stages, and the customs treatment of goods leaving the SEZ to the EAC countries will be important in determining the success of the SEZ regime. The risk is that if goods sold within the EAC are subject to customs duties, they may end up being too expensive and therefore uncompetitive.

Challenges
Notwithstanding the array of attractive tax incentives, investors face a number of challenges when investing in Kenya. The relatively low number of DTAs that Kenya has operationalized is a particular challenge, as it exposes investors to higher tax rates and, potentially, to double taxation.

Kenya has recently been overhauling its tax regime, which undoubtedly creates a level of uncertainty for investors. Since 2013, Kenya has enacted new laws for VAT and excise duty and on tax procedures, and is currently overhauling the income tax laws. Not all of the changes in the new laws are desirable for investors. In fact, many investors have chosen a wait-and-see approach until the new Income Tax Act has been passed, to assess the impact it would have on their investment. Many tax challenges can be foreseen and effectively managed if an investor takes the initiative to understand the tax landscape when planning to invest in Kenya. The introduction of new tax laws is meant to modernize and promote investment, to ensure that Kenya remains one of the more attractive investment destinations in Africa today.

By Caleb Langat, Director, Iseme, Kamau & Maema Advocates (IKM), DLA Piper Africa member firm in Kenya
Foreign Direct Investment
in Nigeria

By Mosadoluwa Peace Adeleke, Associate, Olajide Oyewole LLP, DLA Piper Africa member firm in Nigeria (madeleke@olajideoyewole.com)

Introduction
Nigeria has enormous resources, most of which are yet to be fully exploited. It has been reported that apart from oil, Nigeria’s other natural resources include natural gas, tin, iron ore, coal, limestone, niobium, lead, zinc and arable land and are worth billions of dollars. There is no denying the fact that tremendous opportunities for foreign direct investment (FDI) exist in industries such as agriculture, natural resources, tourism, consumer goods, textiles and entertainment.

Foreign investment in Nigeria
There are two options for foreign investors looking to invest in Nigeria:

• Foreign portfolio investment, which involves investing in stocks and securities of an existing Nigerian company.
• Foreign direct investment, which involves establishing a business enterprise and acquisition of business assets in Nigeria.

Any foreign company intending to do business in Nigeria (except for companies exempted by the President) must be incorporated as a separate entity in Nigeria. Before incorporation, such foreign company cannot have a place of business in Nigeria, save for the receipt of notices and other documents as matters preliminary to incorporation.¹

Nigeria, having recently experienced a recession marked by lower oil revenues, has made policy decisions which have rekindled the country’s economic prospects. As reported by the Nigeria Bureau of Statistics, capital inflows (FDI, portfolio and other investment) reached US$12 billion in 2017 – mainly due to policy changes and the recovery in the oil sector.²

Reasons for foreign investment in Nigeria
There are many factors that influence the level of foreign direct investment in Nigeria, one of which is the large consumer market. The Nigerian government has also provided a number of incentives related to taxes, exports and other sectors to encourage more investment from within and outside the country.

An improvement in the ease of doing business offers further encouragement; the business registration process has been simplified, which has eased the constraints of registering a business. The free flow of investment capital and freedom from expropriation of investment (besides acquisition for public purposes) have also boosted the country’s draw as an investment destination.³

Investors are allowed to freely repatriate their capital and net profit after tax without any restrictions provided they have a certificate of capital importation (CCI), which is evidence that their investment was brought into Nigeria. CCIs are issued by Authorized Dealers (banks licensed by the Central Bank of Nigeria to deal in foreign exchange) within 24 to 48 hours after the investor has brought its foreign investment into Nigeria.⁴

The role and impact of foreign investment in Nigeria’s economic development
The increase in the influx of direct investment in Nigeria has been a crucial factor in the economic growth of the country. It has

¹ Section 54 - 56 of the Companies and Allied Matters Act (CAMA) Cap C20 Laws of the Federation of Nigeria (LFN) 2004
³ Section 25 of the Nigeria Investment Promotion Commission (NIPC) Act Laws of the federation of Nigeria Cap N117 LFN 2004 (NIPC Act)
⁴ https://www.cbn.gov.ng/OUT/2012/CIRCULARS/TED/TED.FEM.FPC.GEN.01.014.2012.PDF
facilitated the development of the working population through the transfer of knowledge and technical skills and also aided in the standardization of processes and products. Foreign investment has helped in infrastructure development and generated revenue for the country through taxation. More importantly, it has encouraged exports of local products, resulting in further investment in the country.

**FDI restrictions and constraints in Nigeria**

Generally, foreign investors are allowed under the law to wholly own businesses or in partnership with others in Nigeria, except for businesses operating in the areas of:

- Manufacturing of military/paramilitary wears and accoutrements.
- Production of arms and ammunitions.
- Production and dealing in narcotic drugs and psychotropic substances.
- Other items as the Federal Executive Council may from time to time determine.5

In addition, there are sector-specific restrictions that investors must be aware of:

- **Oil and Gas:** The Nigerian Oil and Gas Industry Content Development Act defines a Nigerian Company as a Company registered in Nigeria in accordance with the provisions of the Companies and Allied Matters Act with not less than 51 percent equity shares owned by Nigerians. It further provides that Nigerian operators and indigenous service companies shall be given first consideration in the award of oil blocks, licenses and works in the sector. Thus, to be competitive in the award of contracts, at least 51 percent equity should be owned by Nigerian investors.6

- **Private Security:** A foreign investor is prohibited from having an equity stake in a private security company in Nigeria.7

- **Engineering:** A company and its employees who are engineers engaged in engineering services

---

5 Section 17 and 18 of the NIPC Act
6 Section 106 of the Nigerian Oil And Gas Industry Content Development Act 2010 http://ncdmb.gov.ng/images/GUIDELINES/NCACT.pdf
7 Section 13(1)(e) of the Private Guards Companies Act Cap P30 LFN 2004
must be registered with the Council for the Regulation of Engineering in Nigeria (COREN). One requirement for registration is that the company must have Nigerian directors registered with the COREN holding at least 55 percent of the company's shares. Also, expatriate engineers who are granted provisional registration cannot register a 100 percent-owned engineering consulting firm in Nigeria.8

- **Broadcasting:** For a foreign investor to acquire a broadcasting license in Nigeria, the majority of its equity stake must be owned and operated by Nigerians and must not represent foreign interests.9

- **Management Restriction:** Private limited companies must have at least two shareholders, two directors and a company secretary.10 A public company is required by the SEC to have at least five directors (at least one of whom must be an independent director).11 Also, a Nigerian company looking to employ foreign nationals must obtain expatriate quota approvals before employing them, and are required to file monthly immigration returns stating the utilization of expatriate quotas.12

### Regulatory framework of foreign investment in Nigeria

There are myriad laws, rules and regulations a foreign investor must be aware of before deciding to invest in Nigeria. This is in addition to sector specific laws. The following are the primary legislations governing investment in Nigeria:

- **The Companies and Allied Matters Act**13 This regulates the establishment and operations of business entities in Nigeria. A foreign company cannot operate a business in Nigeria unless it is registered under this Law.14

- **Nigerian Investment Promotion Commission (NIPC) Act**15 The NIPC is the agency responsible for overseeing the participation of foreigners in business enterprises in Nigeria. Foreign investors are required to register with the NIPC immediately after incorporation.

- **The Companies Income Tax Act, Personal Income Tax Act, Value Added Tax Act, Stamp duties Act, Capital Gains Tax Act, Petroleum Profit Tax Act and other rules, regulations notices issued by the relevant tax authority.** These laws provide for the tax obligations of companies and individuals operating in Nigeria.

- **Investment and Securities Act (ISA)**16 The ISA empowers the Securities and Exchange Commission with the responsibility of regulating the investment and securities business in Nigeria.

- **Immigration Act:** The Immigration Act regulates and controls the entry, exit and employment of foreigners in Nigeria.17

- **National Office for Technology Acquisition and Promotion (NOTAP) Act:** The Act established the NOTAP, which is responsible for registering contracts/agreements that relate to the transfer and acquisition of foreign technology.18

- **Foreign Exchange (Monitoring and Miscellaneous Provisions) (FEMMA) Act:** This is the primary legislation for foreign exchange transactions in Nigeria. The Act establishes an Autonomous Foreign Exchange Market where transactions in foreign exchange are conducted, monitored and supervised.19

Some sector - specific laws include the Nigerian Communications Commission Act and regulations, Nigerian Broadcasting Commission Act, the Pensions Reform Act and regulations and guidelines issued by the relevant regulator.
Government policies on ease of doing business in Nigeria

In early 2017, the Government launched the Economic Recovery and Growth Plan (ERGP), which led the drive to review previous policy decisions. New policies included an investor and exporter foreign exchange window (IEFX) and a tightening of monetary policy. The priorities of the ERGP include stabilizing the macroeconomic environment, achieving agriculture and food security, improving transportation infrastructure and driving industrialization focusing on SMEs. One of the achievements of the ERGP is the introduction of the Voluntary Asset and Income Declaration Scheme (VAIDS), which is gradually restoring the efficiency of the country’s tax system. It was reported that a total of NGN20 billion (of a target of NGN305 billion) has so far been collected from the 262 corporate taxpayers who have declared their assets under the scheme.21

Also, the government’s efforts to promote transparency and efficiency have led to its policy to digitize CCIs hence the transition to e-CCIs.22

The bill to repeal the Companies and Allied Matters Act (CAMA) – which is awaiting the assent of the President of Nigeria – when enacted will ease the rigors of doing business in Nigeria, thereby making investment in the country more attractive. The bill, amongst other things, provides for sole directorship and sole shareholding for small companies. This provision is consistent with several other progressive economies such as the UK and Hungary. Private companies will now also be permitted to provide financial assistance to their shareholders, increasing the chances of attracting much needed investment, as shareholders or potential shareholders have access to funds, security, and so on, which in turn enables them invest in such companies. This will also encourage viable acquisitions, further promoting economic growth.

Conclusion

There should be cohesion between the government and private organizations, the objective being to implement world-class corporate guidelines and standards into the nation’s governance. FDI would best benefit Africa when accompanied with a transfer of skills, investment in innovative research and development, and increased local manufacturing of pharmaceuticals and other intermediary products. This, reinforced with the implementation of trade agreements, will drive greater trade exports from Africa.

By Mosadoluwa Peace Adeleke, Associate, Olajide Oyewole LLP, DLA Piper Africa member firm in Nigeria

Investing in Africa: The Big Five of tax structuring

By Ton van Doremalen, Partner (ton.vandoremalen@dlapiper.com) | Wouter Kolkman, Associate (wouter.kolkman@dlapiper.com) - DLA Piper Dubai, DLA Piper Amsterdam

In Africa, the Big Five are the lion, leopard, rhinoceros, elephant and Cape buffalo. For investors in Africa, fast-paced and fundamental international tax changes, both in African countries and at the Organisation for Economic Co-operation and Development (OECD) and UN level, require careful assessment of the Big Five of tax structuring: capital gains tax, withholding tax, permanent establishment, corporate income tax, and investment protection planning through the use of bilateral investment treaties.

In practice, foreign investors will want to explore legal structures and set-ups that provide them with a favorable post-tax return on investment. Therefore, in addition to a favorable bilateral investment treaty network, potential holding jurisdictions should have an extensive double tax treaty network that could aid in the prevention of any unnecessary tax leakage. For investing into Africa, certain holding jurisdictions including Mauritius, Netherlands, the UAE and the UK will continue to be favored by those foreign investors.

For such holding jurisdictions to be effective, in light of the OECD’s new principal purpose test (PPT) rule and in order to successfully claim tax treaty benefits (if any), companies should avail themselves of adequate local substance (e.g. office space, qualified personnel, and key decision-making). In our view, this development is likely to encourage centralization of activities, people and functions in one place or a few places globally.
by international businesses, resulting in the formation of global or regional investment platforms. From an Africa inbound investment perspective, the four holding jurisdictions mentioned above are well equipped to do just that, even though the tax structuring of each individual investment should be carefully analyzed.

Characteristics of the Big Five
Compared to other regions, African countries generally have relatively high levels of domestic taxation, which can erode profitability.

Capital gains tax (CGT)
In most countries, CGT is levied on the capital gains (profits) realized on the sale of an asset that increased in value under certain circumstances, such as the shareholding in a local subsidiary. Tax treaties can allocate taxing rights to the investor country, as opposed to the source country. Several African countries have issued legislation that allows for CGT in case of an indirect transfer of assets (such as indirect share transfers). These include Cameroon, Kenya, Mozambique, Tanzania and Uganda.

Withholding tax (WHT)
WHT can be levied on a wide array of payments, including dividends, interest and royalties. Some African countries also levy WHT on payments for services, such as management services. In Liberia, WHT is imposed on proceeds (as opposed to capital gains arising). In certain situations, tax treaties can reduce such WHT (e.g. to 0 or 5 percent), or eliminate it altogether.

Permanent establishment (PE)
Activities carried out by a business in another country resulting in revenue being generated or value created can be deemed taxable by local tax authorities. This concept, generally referred to as a PE (or a fixed establishment), may require the revenue-generating foreign company to formally register under some corporate identity, such as a branch, representative office or subsidiary.

In addition to tax treaties, some African countries may have local guidance on what does and does not constitute a PE. For example, South Africa released a binding private ruling in May 2010, stating that the presence of a database replica and a web server will constitute a PE of a foreign company (which in some other countries has been subject to debates for years).

Corporate income tax (CIT)
Each African country will have its own CIT regime, the details of which require careful consideration prior to making an investment. Investors should pay attention among others to transfer pricing (TP) requirements and interest deductibility restrictions, such as thin capitalization rules. For example, Nigeria has very recently revised and strengthened its TP regulations.

Bilateral investment treaties (BITs)
Although the fifth category of the Big Five of tax structuring - BITs - is not a tax matter, it is nevertheless an extremely important consideration for international investors, as it can significantly reduce local country risk exposure. Historically, BITs are developed by capital-exporting countries to promote investment and protect their nationals' interests in capital-importing countries.

Broadly speaking, BITs impose obligations for the host country to be fair and equitable in how they treat foreign investments, meaning that these investments must be treated at least as favorably as national investments. As such, nationalizing or expropriating investments from foreign investors is not allowed under the BITs, unless the measures
are non-discriminatory, taken in the public interest and are against prompt, adequate and fair compensation to the investor.

BITs generally contain investor-state dispute resolution or international arbitration provisions. This element is a clear distinction from other types of treaties in that it may allow a foreign investor to sue a host country, without exhaustion of local remedies, before an international tribunal if such investor believes that the BIT governing his investment has been violated. Examples of international tribunals are the International Centre for Settlement of Investment Disputes (ICSID), the United Nations Commission on International Trade Law and the International Chamber of Commerce (ICC).

The right base camp

There are several factors to consider when setting up a base camp for (intermediate) holding and finance companies. The primary function is to position investors optimally regarding the Big Five of tax structuring, while securing legal rights with respect to the investments. We will focus on four jurisdictions currently popular among Africa-focused investors: Mauritius, the Netherlands, the UK and the UAE.

First of all, the right country provides tax benefits to foreign investors at the following levels:

- Reduced WHT and CGT protection at source country level (with the use of tax treaties).
- Efficient tax treatment at intermediate level (such as participation exemption for dividends and capital gains).
- Reduced or no WHT on repatriation of income by the intermediate holding to investors.
- A BIT network for protection against nationalization/expatriation.

Mauritius

Over the last years, this island in the Indian Ocean has become a gateway for the African mainland. This success is in large part due to a relatively large double tax treaty network, and 0 percent WHT on dividends, interest and royalties. The standard corporate income tax regime is also competitive.

In addition, Mauritius has many non-tax advantages, including its position as one of Africa’s most interconnected countries and over 25 BITs with African countries that mitigate the risk of nationalization.

In late 2016, Mauritius joined the OECD Inclusive Framework on Base Erosion and Profit Shifting (BEPS) by adding a rider stipulating that it would review all its tax treaties to bring them up to G20 minimum standards by the end of 2018. Regardless, assuming investors can demonstrate adequate substance at the intermediate holding level, Mauritius is still a viable option in light of its extensive double tax treaty network.

Netherlands

The Dutch have always been known for their affection with international commerce and trade. At present, the Netherlands has one of the largest double tax treaty and BIT networks worldwide. Further, pursuant to the so-called participation exemptions, benefits derived from foreign participations (e.g. dividends and capital gains) are generally exempt from Dutch CIT.

At present, the Netherlands does not impose WHT on interest and royalties. On September 18, 2018, 2018, the Dutch government published tax proposals outlining the government’s intention to further enhance the investment climate for groups with operations in the Netherlands, by lowering the corporate tax rate to 22.25 percent in 2021 and abolishing the current dividend withholding tax (of 15 percent) by 2020. The government also seeks to introduce new measures, including a conditional WHT on royalties, interest, and dividends, and an increase in the substance requirements for Dutch holding/license/financing companies to stay aligned with the latest international (OECD/EU) tax developments.

UK

Similar to the Netherlands, the UK has an extensive double tax treaty and BIT network, and levies no CGT on the sale by an investor of its interest in a UK company. It also provides a tax exemption on the sale by a UK holding company of its interest in (trading) subsidiaries. Further, no UK WHT is levied on outbound dividends. Apart from tax advantages, the UK historically has close ties with many countries on the African continent.

In light of the impending withdrawal of the UK from the EU, the UK may lower its CIT rate and provide additional incentives to keep and attract businesses. At the time of writing, the precise impact of Brexit is not yet clear.
United Arab Emirates
Strategically situated between Europe, Asia and Africa, the UAE is actively promoting its African trade and investment links, and has been very successful in doing so. Further, the UAE does not levy CIT, CGT or WHT. Over the last decade, the UAE has been massively expanding its double tax treaty and BIT network, including with many African countries. In order to promote foreign investments, the UAE has set up numerous free-trade zones that are governed pursuant to a special framework of rules and regulations and generally provide additional tax concessions and customs duty benefits. These zones are extensively used by foreign investors and multinationals as regional hubs for their investments and operations in the Middle East, North Africa and Sub-Saharan Africa.

The UAE is favored among international companies and expats alike for its ease of doing business, well developed infrastructure and interconnectivity. In addition to its large harbors, the UAE provides one of the best “air lifts” in the world, where the local airlines (Emirates and Etihad) service almost every top destination on the African continent.

The below matrix provides a quick overview of the number of tax treaties and BITs concluded between the aforementioned countries and African countries.

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>TAX TREATIES*</th>
<th>BITS*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mauritius</td>
<td>15+</td>
<td>25+</td>
</tr>
<tr>
<td>Netherlands</td>
<td>10+</td>
<td>25+</td>
</tr>
<tr>
<td>UAE</td>
<td>10+</td>
<td>15+</td>
</tr>
<tr>
<td>UK</td>
<td>20+</td>
<td>20+</td>
</tr>
</tbody>
</table>

* Entered into with African countries.

Anti “poaching” initiatives
There has been growing concern in various African countries that multinationals have not been paying their fair share of source tax on the continent. As a result, many countries have been trying to strengthen their tax regimes, as well as enhance their domestic tax authorities.

In June 2018, the OECD and the African Tax Administration Forum (ATAF) signed a renewal of their Memorandum of Understanding (MoU) until June 2023, agreeing to continue to work together to further improve tax systems in Africa. The MoU sets their cooperation towards the achievement of the common objective of promoting fair and efficient tax systems and administrations in Africa. Simultaneously, the UN Committee of Experts on International Cooperation in Tax Matters is reviewing and updating the UN Model Tax Convention.

OECD BEPS
Effectively starting with the development by the OECD of its BEPS project in 2012, the international tax landscape has changed drastically in recent years. With its BEPS Action Plan published in 2015, the OECD aims to provide governments with clear international solutions for fighting corporate tax planning strategies that exploit gaps and loopholes of the current system to artificially shift profits to locations where they are subject to more favorable tax treatment.

The most recent instrument devised by the OECD to counter tax avoidance, including treaty shopping, is its Multilateral Instrument (MLI). The MLI came into force in July 2018, and provides unilaterally alters existing tax treaties by including, among others, the PPT test and a mutual agreement procedure (MAP) for countries that choose to apply the MLI for specific bilateral tax treaties concluded by them.

The PPT rule denies double tax treaty benefits to a taxpayer where one of the principal purposes for entering into a transaction or arrangement was to obtain that benefit. For the rule to apply, the obtaining of a tax benefit need not be the sole or main or dominant purpose of the arrangement or transaction in question. As a result, centralization and the related concentration of actual substance, for example at the holding company level, will be instrumental for demonstrating commercial reasons and economic substance to counter another country’s tax authorities’ challenge under the PPT rule. Some examples of substance include having: a physical office, qualified personnel on the payroll (and on the board) for proper decision making, execution and registration of the transactions entered into by the company/group, and locally kept primary bank accounts and administration (bookkeeping).

The MAP provision will facilitate resolution of cases of double taxation as well as a proper and correct interpretation and application of the provisions of a bilateral double tax treaty by...
allowing taxpayers to approach the competent authorities of both states for that purpose.

Currently, the MLI has been signed by over 83 countries, covering more than 1,400 bilateral tax treaties.

**UN Model Tax Convention**

Tax treaties provide a balance of source country (i.e. host country) and residence country (i.e. investor country) taxation and are originally aimed to avoid double taxation. More recently, a secondary objective has been introduced: the avoidance of double non-taxation.

As mentioned above, tax treaties are either based on the OECD Model Tax Convention or the UN Model Tax Convention. Both conventions come with their own set of rules and commentary and assistance to countries in negotiation processes.

There are numerous differences between the OECD Model Tax Convention and the UN Model Tax Convention. As the full name implies, the UN Model Tax Convention aims to promote greater inflows of foreign investment to developing countries. Generally speaking, the UN Model Tax Convention favors retention of greater so-called source country taxing rights. One of the significant features of the UN Model Tax Convention is a limited "force of attraction" rule, allowing the source country to tax certain profits not actually attributable under normal rules to the PE, but which relate to sales of similar goods or merchandise in the source country, as well as other business activities of the same or similar kind carried on by the enterprise in the source country.

Another significant difference between the OECD Model Tax Convention and the UN Model Tax Convention is that the latter does not contain maximum WHT rates whereas the former does (from 5 to 15 percent, depending on several conditions such as a specific minimum ownership in the paying company). As a result, tax treaties based on the UN Model Tax Convention generally have higher maximum rates than those based on the OECD Model Tax Convention.

Taking notice of the OECD's BEPS Action Plan, the United Nations Conference on Trade and Development (UNCTD) released an updated UN Model Tax Convention in May 2017 (the previous UN Model Tax Convention originated from 2011). The new UN Model Tax Convention adds a PPT as well as a limitation on benefits test (LOB) to counter double tax treaty shopping (both the PPT and LOB are also included in the OECD Model Tax Convention).

Through LOB rules, the UN Model Tax Convention seeks to target structures that are seen as typically resulting in the indirect granting of treaty benefits to persons that are not directly entitled to them. In other words, the LOB is a mechanism that addresses particular conduit arrangements.

In order to protect their tax base as efficiently as possible, it seems logical that most African countries prefer the UN Model Tax Convention over the OECD Model Tax Convention, although many of the treaties concluded with Mauritius, the UK, the Netherlands and the UAE still follow the OECD approach.

**BIT renegotiations on the horizon**

As is currently happening with tax treaties, there are talks in the international community about renegotiation of BITs in order to create more balance between the rights and duties of the host countries and the investors. For example, in May 2018, the Dutch Ministry of Foreign Affairs launched an internet consultation in relation to a new draft model BIT that may be the basis for the renegotiation of Dutch BITs. One of the most notable implications of this model is the introduction of substance requirements in order to benefit from BIT benefits (i.e. excluding "mailbox companies"). It can be expected that other EU Member States may follow and introduce similar criteria/restrictions. Where substance has become an increasingly important topic for tax over recent years, the same might be happening for BITs in the near future.
Transfer pricing in Zimbabwe: A review of the allegations against Econet Wireless

By Zinzile Esther Mlambo, Associate, Manokore Attorneys, DLA Piper Africa member firm in Zimbabwe (zmlambo@manokore.com)

Understanding Zimbabwe’s relatively new transfer pricing laws is crucial to foreign investors in Zimbabwe, foreign businesses in the country, and Zimbabwean organizations doing business with offshore entities. The crux of the laws, like all transfer pricing legislation, is that they allow the Zimbabwe tax authorities to adjust a taxpayer’s taxable income to include income that, if the arm’s length principle had been applied, would have accrued to either of the parties.

Legislation
The Zimbabwe Finance (No.2) Act 9 of 2015 introduced new transfer pricing regulation with effect from the year of assessment beginning January 1, 2016. The regulation was introduced by the inclusion of section 98B and the Thirty-Fifth Schedule to the Income Tax Act [Chapter 23:06]. Section 98B introduced the concept of a controlled transaction, which is a transaction, operation or scheme with an associated person. The section reinforces the application of the arm’s length principle, being that the taxable income derived in a transaction between associated persons must be equal to that which would have been derived in a transaction “between independent persons, in comparable transactions carried out under comparable circumstances.”
Associates are defined as follows:

1. Any person, other than an employee, who acts in accordance with the directions, requests, suggestions or wishes of another person.
2. A near relative.
3. A partner of the person.
4. A partnership in which the person is a partner, if the person, either alone or together with one or more associates, controls 50 percent or more of the rights to the partnership’s income or capital.
5. The trustee of a trust under which the person, or an associate of the person, benefits or may benefit.
6. A company which is controlled by the person.
7. Where the person is a partnership, a partner in the partnership who, either alone or together with one or more associates, controls 50 percent or more of the rights to the partnership’s income or capital.
8. Where the person is the trustee of a trust, any other person who benefits or may benefit under the trust.

Notwithstanding the wide definition of associate, section 98B is not limited in application to associated persons, but also to any person who is resident in Zimbabwe and engages in any transaction with a person resident outside Zimbabwe in a jurisdiction considered by the Commissioner-General of the Zimbabwe Revenue Authority (ZIMRA) to provide a taxable benefit in relation to that transaction.

The Commissioner is, therefore, given wide powers in determining the jurisdictions that are considered to provide taxable benefit, and may do this on a case-by-case basis.

The section is in addition to section 98 of the Income Tax Act, which is generally referred to as the “tax avoidance section,” and which already codified the arm’s length principle – although with much less certainty than the position under section 98B.

Econet Wireless

In 2017, allegations of transfer pricing violations and externalization of funds were made against Econet Wireless, in terms of which it was alleged to have deprived the tax authorities of US$300 million. It was alleged that Econet was involved in ‘a transfer pricing scheme that involved the overstatement of prices on equipment bought from Econet Capital – its sister company based in Mauritius.’

When a business in Zimbabwe does business with a company outside of the country, whether it is a sister company or not, ZIMRA may scrutinize the transaction for possible transfer pricing schemes. How, then, does ZIMRA determine the correct value of the transaction at arm’s length? The answer is in the Thirty-Fifth Schedule to the Income Tax Act. The different methods are, briefly, as follows:

1. The **Comparable Uncontrolled Price Method**, which requires comparing the price charged in that transaction to the price charged in a comparable uncontrolled transaction.
2. The **Resale Price Method**, which requires comparing the resale margin that a purchaser of property in a controlled transaction earns from reselling that property in that transaction with the resale margin that is earned in comparable uncontrolled purchase and resale transactions.
3. The **Cost Plus Method**, which requires comparing the mark up on those costs directly and indirectly incurred in the supply of property or services in a controlled transaction with the mark-up on those costs directly and indirectly incurred in the supply of property or services in a comparable uncontrolled transaction.
4. The **Transactional Net Margin Method**, which requires comparing the net profit margin relative to an appropriate base, such as costs, sales or assets, that a person achieves in that transaction with the net profit margin relative to the same base achieved in comparable uncontrolled transactions.
5. The **Transactional Profit Split Method**, which consists of allocating to each associated person participating in a controlled transaction the portion of common profit (or loss) derived from such transaction that an independent person would expect to earn from engaging in a comparable uncontrolled transaction.

---

2 Ibid
In its response to the transfer pricing scheme allegations, Econet stated that: “The Mauritius procurement arm of the group extended three years’ credit to the Zimbabwe Company. It accepted payment partly in shares and partly cash. The price to the Zimbabwe Company included finance charges covering the three-year period which were equivalent to 18% per annum of the cost of the equipment. The finance charges were quite low compared to the rate of between 24.7% to 44.7% per annum (as per the Monetary Policy Statement issued on 28 July 2010) at which the company would have borrowed locally at the time.”

Accordingly, Econet used the Comparable Uncontrolled Price Method to justify the amounts charged and paid to its sister company. It is important, therefore, for businesses to be aware of the different methods and how they may be applied in the event that they are in a position where the tax authorities require a justification of a transaction value. A business cannot, however, simply pick the method that allows them the most benefit, but must select the most appropriate method for the transaction.

It must be borne in mind that, in all likelihood, the method that will be deemed to be most appropriate is the one that will result in more tax being paid over to the tax authorities, so a transaction may need to be tested against all the methods.

The result
In Zimbabwe, as in other jurisdictions, the law says that, when it comes to tax issues, you pay now, argue later. The tax authorities are also given the authority to appoint a bank as their agent and instruct it to pay over funds held in a taxpayer's account by means of a garnishee order. Accordingly, if an adjustment is made to the amount of tax due by the taxpayer as a result of transfer pricing, ZIMRA may lawfully take the tax, penalty and interest from the taxpayer’s bank account.

This is what initially happened in the Econet matter. ZIMRA issued a garnishee order over Econet’s accounts for US$67 million. Though the garnishee order was subsequently set aside by an order of the High Court, with the consent of ZIMRA, setting aside such orders is no easy feat. The court has been known to sympathize with taxpayers who have been bankrupted by garnishee orders while still upholding them as lawful.

The newly elected president of Zimbabwe has adopted the mantra that the country is open for business. Accordingly, though transfer pricing issues have not been vigorously pursued by the tax authorities in Zimbabwe in the past, it is advised that, to avoid a potential financial setback, any offshore entity or individual doing business in the country should take transfer pricing considerations into account in every transaction.

By Zinziile Esther Mlambo, Associate, Manokore Attorneys, DLA Piper Africa member firm in Zimbabwe

---

3 Ibid
4 Section 69(1) of the Income Tax Act
Investment protection legislation in South Africa

By Lungelo Magubane, Associate (lungelo.magubane@dlapiper.com) - DLA Piper Johannesburg

On 13 July 2018 the Protection of Investment Act 22 of 2015 came into operation, providing a degree of protection to investors in relation to their investments and aiming to achieve a balance of rights and obligations that apply to all investors. The Act attempts, among other things, to codify standard bilateral investment treaty (BIT) provisions and provide domestic legislation which deals with investor-state relations.

As one of the leading countries in terms of foreign direct investment (FDI) influx on the African continent, South Africa is clearly an attractive destination for investment, but as in any country it is not without a certain level of risk. The enforcement of the Act may go some way to mitigating some of those potential dangers by offering protection to investors against state action which can affect their investments in South Africa.

Foreign investment in South Africa

In Piero Foresti, Laura de Carli & Others v The Republic of South Africa1 a group of European mining investors submitted a request to the International Centre for Settlement of Investment Disputes (ICSID) for international arbitration against the South African government in relation to the Italy-South Africa BIT and the Belgium and Luxembourg-South Africa BIT. The claimants’ submissions in Piero Foresti included an allegation that they had been denied fair and equitable treatment when required to divest 26 percent of their investments to historically disadvantaged South Africans following the enactment of the Mineral and Petroleum Resources Development Act, as part of South Africa’s Black Economic Empowerment requirements pertaining to the issuing of mining rights. The claimants asserted that this threatened their economic interests in South Africa and breached each of the BITs’ prohibitions on expropriation. The ICSID issued an arbitral award dismissing the claims against the South African government on a “with prejudice” basis and ordered the claimants to pay part of the South African government’s legal fees and costs.

Following the decision in Piero Foresti, the Department of Trade and Industry undertook a review of all BITs to which South Africa was a signatory and the main findings of the review were that:

- The terms of the BITs varied widely.
- Most had been entered into with European countries in 1994 and 1995, when South Africa had emerged from international isolation and there was widespread investor uncertainty about the policy direction of the country, therefore BITs were used to strengthen relations with strategic countries and as a tool to promote investment.
- Efforts to attract investment had resulted in South Africa agreeing to unequal and unsustainable terms as a result of separate negotiations with each country.

The recommendations from that review process were endorsed by Cabinet in April 2010 and South Africa subsequently gave notice of its intention to terminate several BITs, including those entered into with Denmark, Spain, Germany, Belgium, Luxembourg, Switzerland and the Netherlands. The government also stated its intention not to renegotiate or renew BITs once they expired. This notice was given to each country’s diplomatic representative in South Africa by way of a diplomatic
note issued by the Minister of International Relations, noting that, as South Africa was exercising its right to unilaterally terminate each BIT, investments made prior to the date of termination of the BITs would continue to be protected by the BIT for ten years from the date of termination.

Investments covered by the Act

Investment is defined broadly in the Act, and so foreign investors may find it relatively easily to fall within its scope and to enjoy the protection it offers. An investment is defined as:

- any lawful enterprise established, acquired or expanded by an investor in accordance with the laws of South Africa, committing resources of economic value over a reasonable period of time, in anticipation of profit;
- the holding or acquisition of shares, debentures or other ownership instruments of such enterprise; or
- the holding, acquisition or merger by such an enterprise with another enterprise outside South Africa to the extent that such holding, acquisition or merger with another enterprise outside South Africa has an effect on an investment in South Africa.

The Act refers to investors and foreign investors interchangeably, without defining either term appropriately, but there are several notable sections where the legislature saw it fit to refer specifically to foreign investors:

- Physical security of property

South Africa must accord foreign investors and their investments a level of physical security as may be generally provided to domestic investors in accordance with minimum standards of customary international law and subject to available resources and capacity.

- National treatment

Foreign investors and their investments must not be treated less favorably than South African investors in similar circumstances.

- Transfer of funds

A foreign investor may, in respect of an investment, repatriate funds subject to taxation and other applicable legislation.

The direct protection against expropriation or unfair and inequitable treatment of a foreign investor which can be found in most BITs, and which the claimants in Piero Foresti relied on, has not been replicated in the Act. In fact, section 12 of the Act empowers the government or any state entity to take measures which may include:

- Redressing historical, social, economic inequalities and injustices.
- Upholding the rights guaranteed in the Constitution.
- Promoting and preserving cultural heritage and practices, indigenous knowledge and biological resources or national heritage.
- Fostering economic development, industrialization and beneficiation.
- Achieving the progressive realization of socio-economic rights.
- Protecting the environment.

These regulatory measures are couched in broad terms and could be used to justify almost any constitutional state action taken by the government. Plausibly, a constitutional amendment could make it permissible for the government to implement a policy that might otherwise have fallen foul of standard protections provided for in BITs. Applying constitutionality as a yardstick introduces an element of uncertainty which BITs avoided, because a constitutional amendment can be implemented with relative ease if the governing party gathers the required number of votes in the legislature.

Dispute resolution

Section 13 of the Act sets out the dispute resolution process to be followed by an aggrieved investor and emphasizes the need to exhaust domestic remedies. Its main features are:

- Within six months of becoming aware of a dispute in respect of an action taken by the South African government which has affected that investor’s investment, an affected investor may approach the Department to appoint a mediator to resolve the dispute.
- The Department of Trade and Industry must maintain a list of qualified mediators of high moral character and recognized competence in the fields of law, commerce, industry or finance, who may be relied upon to exercise independent judgment and who are willing and able to serve as mediators.
- The mediator must be appointed by agreement between the government and the foreign investor from the list maintained by the Department of Trade and Industry; failing which, by agreement between the Department of Trade and Industry and the foreign investor. In the event of the Department being a party to the dispute, a joint request by the parties must be made to the Judge President of one of the divisions of the High Court to appoint a mediator.
Importantly, and subject to applicable legislation, an investor, upon becoming aware of a dispute, is not precluded from approaching any competent court, independent tribunal or statutory body in South Africa for the resolution of a dispute relating to an investment.

Provided domestic remedies have been exhausted, the South African government may consent to international arbitration between South Africa and the home state of the affected investor.

Speaking in July 2012, the Minister of Trade and Industry highlighted South Africa’s concerns about investor-state arbitration, which underpins the remedies available to an investor in terms of BITs, saying: In spite of the Minister’s remarks against “unpredictable” international arbitration, section 13(5) of the Act allows the South African government to consent to international arbitration. This is an important departure from the investor-state arbitration position contained in BITs, and leaves foreign investors exposed to the risk of political considerations that might render their home state reluctant to pursue state-state international arbitration on their behalf. More importantly, the Minister’s remarks are skeptical regarding innovations in investor-state dispute settlement procedures and the surrounding body of international investment law, which has brought predictability and control over the execution of arbitration procedures.

In terms of the transitional arrangements provided for in the Act, existing investments that were made under previously applicable BITs will continue to be protected in accordance with the terms and periods stipulated by those BITs, and any investments made after the termination of a BIT, but before the enforcement of the Act, will be governed by general South African law. It is likely that the Act will be the subject of much litigation as the South African government positions itself to implement changes to its land reform policies.

In conclusion
In a somewhat ironic twist, South Africa has almost travelled full circle; its response to foreign investor uncertainty and the urge to attract foreign direct investment following its first democratic elections in 1994 drove it to sign up to a raft of BITs on terms that it might otherwise not have done so. Almost 25 years later, it has jettisoned most of those BITs and finds itself anxious to court foreign investors who bemoan the current political uncertainty and populist rhetoric that prevails in relation to matters of nationalization and expropriation.

Whether this Act satisfies its stated objective of providing protection to investors will largely depend on how it is implemented; however, a single piece of legislation aimed at all investors offers a more transparent and equitable approach when compared to the conditions under various disparate BITs.

“Investor-state dispute resolution that opens the door for narrow commercial interests to subject matters of vital national interest to unpredictable international arbitration is of growing concern to constitutional and democratic policy-making. In short, international jurisprudence is no substitute for multilateral cooperation to strengthen global governance in the area of investment policy.”
**The emergence of a private equity market in Namibia**

By Peter Johns, Director (peter@esinamibia.com) | Rauna Ndilula, Associate (rauna@esinamibia.com)
Ellis Shilengudwa Inc (ESI), DLA Piper Africa member firm in Namibia

Since obtaining independence in 1990, Namibia has experienced extensive capital outflows to more traditional and sophisticated markets, in particular South Africa. Such outflows can be attributed to the strong economic ties between Namibia and South Africa through, among other things, joint participation in the Southern African Customs Union, currency linkages through the Common Monetary Area, historical connections, inactivity of the Namibian Stock Exchange (NSX), and the proximity of large and more developed financial markets in South Africa. In order to attempt to reduce the capital outflows and to stimulate economic growth in Namibia, its government introduced legislation to impose measures promoting investment and growth in local markets and industries.

In 2013, the minister of finance issued regulations under the Pension Fund Act 24 of 1956, increasing the minimum domestic asset requirements for pension funds and insurance companies in Namibia. The regulations prescribe that pension funds and insurance companies must invest between 1.7 and 3.5 percent of the market value of their respective investments in unlisted investments in Namibia.

The regulations further set out the manner in which pension funds can invest in the unlisted sector, and specifically provide that all unlisted investments must be made through separate special purpose vehicles (SPVs), for which extensive criteria are provided, and which may be managed only by duly registered fund managers. The Namibia Financial Institutions Regulatory Authority regulates the registration and conduct of both SPVs (being the funds) and fund managers.

Through the implementation of the regulations, the Namibian government adopted a broad-based approach to developing the private equity market in Namibia, by way of providing development capital to unlisted entities, in particular small and medium enterprises. The importance of the private equity industry to finance companies with growth potential has become more evident. Private equity entails both risk and reward, by allowing investors to invest capital in projects with an expectation of significant returns for the investment risk involved. For this reason – the illiquidity of investments and the high minimum investment commitment – private equity investments are generally out of reach of average individual investors, especially in a developing country such as Namibia.

The regulations further attempt to decrease the financial gap faced by small- and medium-scale enterprises and individual investors.

In this regard, the Namibian Government is motivated to ensure and see the emergence of a full-blown private equity market in Namibia, to achieve sustainable economic growth, long-term economic development, and domestic resource mobilization in Namibia.

In its role as the largest pension fund in Namibia, the Government Institutions Pension Fund (GIPF) has become a pioneer of the private equity market in Namibia. Through its unlisted investment policy, the GIPF has been fundamental in providing development capital to unlisted entities, in particular small and medium enterprises. The importance of the private equity industry to finance companies with growth potential has become more evident. Private equity entails both risk and reward, by allowing investors to invest capital in projects with an expectation of significant returns for the investment risk involved. For this reason – the illiquidity of investments and the high minimum investment commitment – private equity investments are generally out of reach of average individual investors, especially in a developing country such as Namibia.

The regulations further attempt to decrease the financial gap faced by small- and medium-scale enterprises and individual investors.

In this regard, the Namibian Government is motivated to ensure and see the emergence of a full-blown private equity market in Namibia, to achieve sustainable economic growth, long-term economic development, and domestic resource mobilization in Namibia.

In its role as the largest pension fund in Namibia, the Government Institutions Pension Fund (GIPF) has become a pioneer of the private equity market in Namibia. Through its unlisted investment policy, the GIPF has been fundamental in providing development capital to unlisted entities, in particular small and medium enterprises. The importance of the private equity industry to finance companies with growth potential has become more evident. Private equity entails both risk and reward, by allowing investors to invest capital in projects with an expectation of significant returns for the investment risk involved. For this reason – the illiquidity of investments and the high minimum investment commitment – private equity investments are generally out of reach of average individual investors, especially in a developing country such as Namibia.

The regulations further attempt to decrease the financial gap faced by small- and medium-scale enterprises and individual investors.

In this regard, the Namibian Government is motivated to ensure and see the emergence of a full-blown private equity market in Namibia, to achieve sustainable economic growth, long-term economic development, and domestic resource mobilization in Namibia.

In its role as the largest pension fund in Namibia, the Government Institutions Pension Fund (GIPF) has become a pioneer of the private equity market in Namibia. Through its unlisted investment policy, the GIPF has been fundamental in
the establishment of at least 20 private equity funds managed by various fund managers, and has committed more than NAD5 billion (US$340 million) to these funds since 2010, in order to fulfill its required minimum domestic asset investment requirements. The mandates of the various funds include procurement debt, property financing, small and medium enterprises development, property development, infrastructure development, bulk municipality services, transport and logistics, information and communications technology, health, renewable energy, education, private equity and venture capital.

During July 2018, the GIPF further announced its intention to introduce economic infrastructure financing, and that it has identified six fund managers to manage a NAD3 billion (US$200 million) capital commitment.

Some of the benefits allied with the processes followed by the GIPF through the establishment of the various funds are the introduction of alternative financing capital to various sectors of the local economy, employment creation, skills improvement in the financial management sector (i.e. fund managers), creation of public-private partnership opportunities, and the possibility of financing various national projects.

The funds further create co-investment opportunities for foreign financial institutions, and other potential investors, to invest in Namibia. In this regard, comfort can be provided to foreign investors to invest with the GIPF, through established structures, in projects in various sectors throughout Namibia.

A possible long-term benefit of the private equity market would be an increase in activity of the NSX. As fund managers look to exit various investments, a possible exit strategy would be to list such investments on the NSX, which could encourage further investments on the NSX, creating confidence and, ultimately, curbing further capital outflows from Namibia.

The emergence of the private equity market in Namibia has played a vital role in the Namibian government’s efforts to curb the outflow of capital, provide alternative financing options to entities forming part of the small and medium enterprises sector (which would not have qualified for traditional financial assistance), and providing access to capital for domestic investment opportunities. In turn, these factors should, in the long term, stimulate economic growth and provide a platform for the influx of foreign capital.

By Peter Johns, Director, and Rauna Ndlulua, Associate, Ellis Shilengudwa Inc (ESI), DLA Piper Africa member firm in Namibia.
Private equity trends in Morocco

By Camilia Benani, Senior Associate (camilia.benani@dlapiper.com) – DLA Piper Casablanca

In the last 15 years, private equity in Morocco has experienced significant change. In 2016, according to a survey of the Moroccan Association of Capital Investment, MAD305 million was raised and MAD786 million invested in Morocco by private equity. The 2018 annual AVCA\(^1\) conference was held in Marrakech, with national and international players representing sectors including agribusiness, education, life sciences and healthcare, industry, energy and mining.

Inspired by the European market, the legislator has, for example, recently recognized regulated collective investment trusts and real estate investment trusts (REITs, or OPCI in French). Today, investment funds are a significant source of financing in Morocco for small and medium-sized companies (SMEs).

A key reason for this rapid growth of private equity is Morocco’s standing as a financial hub and entry platform for doing business in Sub-Saharan Africa.

Private equity as an alternative to bank financing

The number of investment transactions has drastically increased. The establishment of Moroccan and foreign funds (including Chinese funds in anticipation of direct investments in Morocco as a part of China’s One Belt One Road initiative) has multiplied, and the amounts invested in those funds have also increased.

This evolution is also the result of banks no longer granting easy financing, which encourages companies to use private equity as an alternative. The growth is also attributable to the creation of free-trade zones in Morocco (for example in Tangiers and Kenitra) that attract increasing levels of specialized funds, and the implementation of Casablanca Finance City, a financial ecosystem offering a range of legal and tax incentives encouraging private equity funds to locate the headquarters of their pan-African investments in Morocco (such as Wendel Africa, Brookstone Partners and Africa50).

This coincides with a shift of mentality by entrepreneurs and Moroccan family businesses that are increasing attracted to training programs (particularly through the Elite program of the Casablanca Stock Exchange), which cover the benefits of private equity and prepare them for the opening-up of their capital to private equity funds.

Some obstacles to effective growth

This growth, however, can occasionally be hindered by cultural issues, and there is still a long way to go in terms of Moroccan SMEs and family businesses opening up...

---

\(^1\) African Private Equity and Venture Capital Association
to private equity funding. Fears of loss of independence, a heavy financial formalism and interference into family affairs remain prevalent.

Further issues are that the legal and tax arsenal is arguably not yet attractive enough for some private equity funds in the Moroccan market, and is not flexible enough to create incentive management packages. The tax framework must also be clarified, for example by increasing the number of state double tax treaties, or by adopting the parent-subsidiary tax consolidation arrangement to avoid negative tax impacts.

Management packages
In order to incentivize a company's managers, private equity funds regularly offer management packages, which enable managers to make significant profits when the financial objectives set out by the fund are achieved.

Such packages can take several forms, including a free-share allotment for managers, or preferred shares through which managers receive substantial pay raises when the company has reported a strong performance. Indexing managers' remuneration to the company's performance helps create a motivating dynamic that aligns the investment fund and managers' interests.

Other mechanisms include the signing of "put and call options" (good and bad leaver) by which the funds undertake to acquire the managers' shares when they leave the company, indexing the redemption price with criteria such as the company's performance, or the departure of the manager (e.g. resignation or dismissal).

A rigid legal arsenal
Morocco's legal arsenal is strict, imposing numerous conditions and restrictions on the creation of preferred shares (whether shares with double-voting rights or priority dividend shares). The implementation of these had two significant limits. The first is the legal requirement of fully paid-up shares, and the second is the requirement of share ownership for at least two years by the same shareholder. Further limitations, with regard to the creation of priority dividend shares, are that the company must have made distributable profits in the last two financial years, and that they may not exceed a quarter of the share capital.

Also, apart from a few limited cases, removal of shareholders voting rights is not allowed, nor the issuance of multiple voting rights - save for the exception noted above.

These restrictions make it difficult for investors to implement sufficiently flexible management packages. As such, lawyers must find creative contractual arrangements to fill the gap.

The new investment fund trend
Investment funds in Morocco increasingly behave more and more as corporate actors, becoming long-term investors by diversifying the type of business sectors they operate and invest in, and taking more and more space in the management of the businesses.

With diversification of the product range, private equity actors are no longer confined to their investment policy of minority or majority shareholders, and we see more funds investing both as a minority and majority shareholders and on long-term basis (e.g. seven years, instead of three to five years).

As the market grows increasingly competitive, with a shortage of potential targets, the difference between corporate and private equity funds is becoming less clear. The interests of both private equity funds and corporates are becoming more aligned with regard to a company's valuation and investment policies.
Private equity as a catalyst for growth in Africa

By Ogechi Onuoha, Associate, Olajide Oyewole LLP, DLA Piper Africa member firm in Nigeria (oonuoha@olajideoyewole.com)

In Africa, between 2012 and 2017, 953 private equity (PE) deals - worth US$24.4 billion - were reported.¹ The main sector focuses for PE investments in 2017 were consumer discretionary and IT; others included financial services, education, healthcare and agribusiness.² Although the total value of African PE fundraising decreased from US$3.4 billion in 2016 to US$2.3 billion in 2017, this was largely due to the fact that a number of big funds had achieved final closes in prior years.³

Nigeria accounts for 73 percent of the US$10.7 billion value of private equity funding in the West-African region.⁴ This is not surprising, considering a number of PE deals concluded in the country between 2012 and 2017 - such as the US$350 million private equity investment in Japaul Oil, the flurry of PE firms that participated in the bid for 9mobile, and the proposed US$100 million investment into Nigerian mid-cap companies by Arkana Partners.

The Nigerian government has made concerted efforts to ease doing business in the country and increase foreign direct investments into the economy. These include the introduction of e-registration of companies, business names and incorporated trustees by the Corporate Affairs Commission; the establishment, by the Central Bank of Nigeria, of the investors’ and exporters’ foreign exchange (FX)
window to improve liquidation in the FX market and facilitate timely execution and settlement for eligible transactions; and the reform of the Nigerian Pension Commission Regulation on Investment of Pension Fund Assets to allow for greater flexibility in the investment of PE funds. All of these led to an influx of foreign investment into the economy, estimated at a value of over US$4 billion at the end of Q3 2017.\(^6\) In addition, the proposed Companies and Allied Matters Act Bill is expected to further reduce the complexities of doing business in Nigeria.

According to the Southern African Venture Capital and Private Equity Association (SAVCA), the total size of PE investments in Southern Africa more than doubled in 2017, from ZAR15.5 billion to ZAR31.3 billion,\(^6\) and well above the annual average of ZAR14.7 billion over the preceding ten years. SAVCA further reported that, in 2017, South Africa’s private equity capital penetration rose to 0.7 percent of GDP.\(^7\) Notably, the Financial Sector Regulation Act,\(^8\) which took effect on April 1, 2018, is a new piece of legislation expected to bring about a major transformation of South Africa’s financial services regulatory and risk management framework. However, it is yet to be determined what actual impact the Act will have on PE activities in South Africa.

AVCA ranks Kenya as the second most attractive country for PE investments in Africa over the next three years, after Nigeria.\(^9\) This is apt, considering that Kenya already accounts for KES70 billion of the KES100 billion PE fund inflows into East Africa in the first seven months of 2018.\(^10\) Investor confidence and interest in Kenya is heightened following the outcome of the past presidential election and the PE market is on standby to witness bigger deals and attract more funds into the economy.

**Value created by the private equity industry**

By providing funding for African companies, PE investments generate a multiplier effect. Not only does the industry yield profits for its investors (including general partners, limited partners and portfolio companies), it also creates socio-economic benefits for consumers. Businesses backed by PE investments have been shown to grow faster than other types of companies.\(^11\) This is largely due to the hands-on style of ownership played by PE partners and investors in these businesses. Moreover, PE injects international capital into Africa and strengthens economies. In this way, there is an indirect effect on the stability, strength and vibrancy of both local and regional economies.

An improved investment climate is essential for attracting investments and fostering economic growth. One effective way of improving the investment climate of an economy is by strengthening corporate governance principles in both the private and public sectors. Private equity funds, as providers of capital to businesses in emerging markets, work towards improving governance standards to optimize the management of and return on investments made, which, in turn, fosters greater investment flows to the economies concerned. Therefore, with an increasing acceptance of PE capital, the likelihood of adoption of best practices in the management of private companies greatly increases.

**FAFIN: A PE success Story**

The Nigerian government's initiative of creating vibrant private-sector-led agricultural financing has received a boost with the successful US$65.9 million final close of the Fund for Agricultural Finance in Nigeria (FAFIN), which was managed by Sahel Capital and co-sponsored by the Federal Government of Nigeria (through the Federal Ministry of Agriculture and Rural Development, and the Federal Ministry of Finance), the German development bank KfW, and the Nigeria Sovereign Investment Authority (NSIA).

In 2014, FAFIN was launched, with US$32.8 million, as a private equity fund for investing in small and medium-sized enterprises (SMEs) in Nigeria’s agribusiness sector. It has been reported\(^12\) that between the period of FAFIN's launch and its final close in 2017, Sahel Capital assessed over 100 companies and invested in the diary, edible oils, poultry

---

5. Ibid
6. SAVCA 2018 Private Equity Industry Survey
7. Ibid, page 9
8. Act No 9. of 2017
and cassava value chains of four indigenous high-growth companies in Nigeria. FAFIN is also reported to have created over 500 new jobs (50 percent of which are occupied by women and youths) and improved the lives of over 1,000 smallholder farmers by supporting innovative business schemes.13 As part of this close, the African Development Bank, CDC Group and the Dutch Good Growth Fund have jointly committed US$31 million to FAFIN to further drive agricultural growth and development in Nigeria.14 Sahel Capital intends to invest in more companies with the additional capital raised and, consequently, create more jobs and improve the livelihoods of more farmers in Nigeria.

Risks and challenges for private equity firms and investors

Currency risks, and more specifically, foreign currency shortages and exchange rate fluctuations, have been identified as a major challenge facing private equity investors in Africa. For instance, in response to the fall in oil price, the Central Bank of Nigeria ended the naira's peg to the US dollar in June 2016, prompting the Nigerian currency to lose a third of its value in a short time. This situation resulted in a shortage of dollars in the country, making it difficult for many companies to convert their naira earnings into dollars.

Based on research studies carried out in Kenya,15 another identifiable challenge for PE investors in Africa is the difficulty faced by fund managers in finding businesses with proper operational and management structures in which to invest. Thus, though there may be available capital for deals, there is a lack of quality deals available. This may be as a result of the attitude of African companies towards ownership stakes in their businesses. African companies are more prone to borrowing than giving up majority equity stakes in their companies. In addition, PE investors in Africa are usually faced with the same kind of deals, because most intermediaries are able to source deals only from their confined geographic and professional networks.16

Political risks and macroeconomic instabilities have also been cited as major factors deterring PE investments in African markets. The termination of the PE-backed Rift Valley Railways' concession in 2017 by the Kenya and Uganda governments, due to the company's alleged failure to meet the conditions under the concession agreement, is an example of a failed deal as a result of political risk pertaining to a project of national importance.

One pertinent challenge faced by African dealmakers is the long period of time spent in concluding PE deals. This could be attributed to a number of reasons, including insufficient due diligence, the involvement of too many middlemen, and wrong deal connections.

Mitigating the risks

According to AVCA research,17 the most important strategy for managing currency risks in Africa is investing in resilient businesses, including those concerned with consumer staples, healthcare and energy. Another option open to PE investors seeking to hedge FX risks is portfolio diversification across sectors and geographies. Although reported to be the least important strategy, currency risk hedging is an additional option for managing currency risks. For instance, in order to protect investors against losses arising from currency risks, the Overseas Private Investment Corporation (OPIC) - a US government development finance institution - has been providing insurance for its investors since 2011.

With respect to managing political risks, one major approach is to diversify across regions and countries. Investors may also build important and strategic relationships with policymakers.

13 Ibid
14 Ibid
in order to monitor political developments. Although not considered a popular strategy in Africa, political risk insurance presents a viable option for protecting investments from political risks. Again, OPIC offers political risk insurance to US businesses taking advantage of commercially attractive opportunities in emerging markets. By providing protection against risks such as political violence and civil disturbance, OPIC has helped to stimulate the growth of FDI across emerging markets, including Africa.

**Promises and opportunities**

In spite of the risks and challenges for investing in Africa, the continent’s growing population and landscape continues to provide both attractive and viable investment opportunities for PE firms. These opportunities can be seen in the sectors of agriculture, energy, financial services, consumer goods and real estate; these sectors are relatively protected from the economic risks arising from a fall in commodity prices and local currencies. PE firms with a deep understanding of the African market and dense networks are in a better position to benefit from the opportunities presented by the economy.

More specifically, agriculture is Africa’s largest economic sector, representing 15 percent of the continent’s total GDP, or more than US$100 billion annually. The World Bank reports¹⁸ that agribusiness is projected to be a US$1 trillion industry in Sub-Saharan Africa by 2030. This is apt, considering that the continent has a huge domestic market, owns 60 percent of the world’s unused arable land, and has abundant labor resources and, in most parts, a favorable climate.

PE firms can key into agribusiness as a viable source of Africa’s growth, support SMEs involved in agriculture, and aid in the development of local value chains.

The financial services sector also plays a fundamental role in expanding economic growth in Africa. Banking, investment insurance and debt and equity financing help to build credit and enable businesses start up, grow, expand, increase efficiency and compete fairly in both local and international markets. As such, a vibrant financial services sector is essential for Africa’s growth and economic development. PE firms may invest in Africa’s financial sector to bring about financial innovation, efficient payment and clearing systems and a healthier credit financing system.

However, to keep PE investors interested in the African market and enable the continent to actualize its full potential, African governments need to be in close partnership with PE stakeholders, adopting policies and strategies that are both investor- and business-friendly. For African private equity to be effective in the long run, both the public and private sectors must be in constant dialogue to grow capital markets and stock exchanges, thereby providing greater liquidity, security and access for investors and increasing their networks and market connections. Policies should also be geared towards changing Africa’s perceived weak exit environment. Private equity fund managers must actively engage the existing local captains of the industries in which they choose to invest. Fund managers who are likely to succeed in the long run are those who have successfully adapted to the particular needs of the evolving African market.

By Ogechi Onuoha, Associate, Olajide Oyewole LLP, DLA Piper Africa member firm in Nigeria

---

¹⁸ The World Bank, Growing Africa: Unlocking the Potential of Agribusiness
South African M&A: The impact of data protection laws

By Monique Jefferson, Director (monique.jefferson@dlapiper.com) | Savanna Stephens, Associate (savanna.stephens@dlapiper.com) | Pascal Despard, Associate (pascal.despard@dlapiper.com) – DLA Piper Johannesburg

Key data-protection takeaways for due diligence:

- Only upload personal data in the virtual data room that is necessary for the purpose of the transaction.
- Where possible, anonymize personal data in a manner that it cannot be re-identified.
- Avoid uploading special personal data unless consent of the data subject is obtained.
- Implement appropriate security safeguards.
- Ensure that individuals who have access to personal data are bound by appropriate confidentiality undertakings.
- Conclude a data transfer agreement to regulate the trans-border flow of personal data to recipients in foreign countries that do not have adequate data protection laws.
- Consider whether regulatory approval is required before processing personal data.

Introduction

Prudent South African businesses are, where applicable, ensuring compliance with GDPR – preparation that will ensure a smooth transition to their future obligations under POPIA.

For corporate lawyers, data protection laws are important in M&A, as there are significant risks of data and privacy breaches during due diligence. In this phase of the transaction, the seller will upload documents to the virtual data room relating to the target to be acquired.

These documents usually contain personal data of the natural persons who are shareholders, directors, employees or contractors with whom the target has contact. When due diligences are conducted on an urgent basis, mistakes often occur.

Data processing under GDPR

Under GDPR, “personal data” covers any information relating to an identified or identifiable natural person, who is defined as the data subject. This includes the person's name, identification number, location, or any factor relating to their physical, physiological, genetic, mental, economic or cultural identity.

Sensitive data is any data that reveals racial or ethnic origin, political opinions, religious or philosophical beliefs, or trade union membership; genetic data; biometric data; and data concerning health or a natural person's sex life or sexual orientation. The process of sensitive data is generally prohibited.

GDPR applies not only to EU entities that process personal data within the region, but also to:

- Entities established in the EU that process personal data outside of the region.
- Entities established outside of the EU whose processing activities relate to the offering of goods or services to persons within the EU, irrespective of whether a payment to or by those persons is required.
- The monitoring of the behavior of persons, insofar as their behavior takes place within the EU.

Application of GDPR

The protection of personal data is seen by the EU as a fundamental right and, under GDPR, data subjects have been granted more autonomy over their personal information. GDPR has a wide reach, and non-compliance can result in severe consequences.

Multinational companies established in the EEA, or with dealings or monitoring of the behavior of data subjects located in the EEA, are advised to comply with GDPR to protect against any risks.

1 2016/679
in the absence of the explicit consent of the data subject. “Processing” means any operations that are performed on the personal data, such as collection, recording, organizing, structuring, consultation, use, disclosure, dissemination or any form of making available, aligning or destroying the data.

Before disclosure of personal data within a virtual data room takes place, one of the grounds of justification must be met. The first ground is the consent of the data subject, which will permit the disclosure without redaction. The consent may be granted by employees to employers in terms of their contracts of employment, but may be withdrawn at any time at the sole discretion of the data subject.

The second ground is the legitimate interest test, which requires three elements to be satisfied: (1) there needs to be a legitimate interest, (2) it must be necessary to process the personal data in order to achieve the interest, and (3) a balancing exercise must be done, comparing the individual’s interests, rights and freedoms and the legitimate interest being sought. The legitimate interests can be interests of the purchaser, third parties, commercial interests, or broader benefits to society.

Regardless of whether consent is obtained, the data subject must be informed in advance of the processing of their data, and the purpose for which it is being processed.

The other grounds of justification are where the disclosure forms part of a legal obligation, either in law or in the performance of a contract; where the disclosure would be in furtherance of a public service mission; or where the disclosure is necessary to protect the vital interests of the data subject or another natural person.

**Data processing under South African legislation**

South Africa has attempted to bring its data protection law in line with European legislation through POPIA, which seeks to give effect to the right to privacy contained in the country’s Bill of Rights, and is widely regarded as being a codification of the common-law position regarding the processing of personal data. Only some provisions of POPIA are in force, but the remainder are expected to come into effect in the near future. Most South African businesses are taking measures now to ensure that they comply with POPIA.

POPIA uses the term “personal information” to refer to the information relating to an identifiable natural person and existing juristic persons. For purposes of this article, the term “personal data” will be used for both POPIA and GDPR.

Currently, the sections of POPIA in force are those relating to establishing the office of the Information Regulator (the regulatory authority), the powers to make regulations to give effect to POPIA, and the definitions sections. The Information Regulator has also published draft regulations to POPIA.

Under POPIA, the processing of personal information is permissible only in circumstances where there is a recognized justification. One of the justifications is the voluntary, informed consent of the data subject. Other justifications are where the processing is necessary for the conclusion or performance of a contract to which the data subject is a party; where the processing complies with an obligation imposed by law; or where it is necessary for the proper performance of a public law duty by a public body.

Personal information may also be processed where it is necessary to protect the legitimate interests of the data subject, or where it is necessary for pursuing the legitimate interests of the responsible party or a third party to whom it is disclosed.

Importantly, data subjects may object on reasonable grounds to the processing of their personal information on the basis that it is necessary for protecting or pursuing legitimate interests.

As regards special personal information (religious or philosophical beliefs, race or ethnic origin, trade union membership, political persuasion, health or sex life, criminal behavior, or biometric information), the consent of the data subject to the processing of such information is generally required, save for certain limited exceptions.

**Compliance during due diligence**

When undertaking a due diligence process, compliance is crucial at two stages. First, the upload of the documents to the virtual data room may fall within the ambit of processing under POPIA or GDPR. Second, when evaluating the target asset’s compliance with POPIA and GDPR in respect of the personal data it holds. When processing personal data, the entity must be seen to have received consent.
or be relying on another lawful justification.

In the context of due diligence, the seller could probably rely on the justification that the processing of the personal information of its employees, directors or shareholders is necessary for pursuing its legitimate interests or those of the potential purchaser. The data subjects should, however, be informed of this. The consent of the employees, directors or shareholders would generally be required when uploading special personal information under POPIA. Another option would be to de-identify the information in such a manner that it cannot be re-identified.

For the seller to ensure compliance with GDPR, it should enter a data-processing agreement with the operator of the virtual data room, and all persons with access to the virtual data room should be bound by a confidentiality agreement that includes standard data protection obligations and provisions, including the obligation to implement and maintain appropriate security safeguards and notify the seller of any data breaches.

When the seller is uploading documents, it should evaluate the document with reference to:

- Whether the personal data is necessary to achieve the purpose of the due diligence.
- Whether the personal data can be redacted from the document before uploading it.
- Whether a model template can be used in the circumstances.
- Whether consent for the disclosure of personal information has been obtained by the data subject and, if not, whether there will be justification for disclosure without consent.
- To whom the personal data relates, and whether they have been informed of the disclosure in the due diligence.

In the spirit of data minimization, the seller should assess all documents containing personal data and ensure that any document being uploaded is absolutely required by the purchaser to evaluate the target assets and operations. It is paramount that no sensitive/special personal data that reveals a person’s racial or ethnic origin, political opinions, religious or philosophical beliefs, health or sex life, trade union membership, biometric information or criminal behavior is included in the virtual data room unless consent of the data subject is obtained, and unless such information is necessary for carrying out the due diligence.

In an employment due diligence, it may sometimes be necessary to consider health information in relation to occupational injuries or to consider the number of employees who are members of a trade union. Where possible, the names of the individuals should be redacted, failing which the individuals’ consent would be required.

Under GDPR, where the seller establishes appropriate technical and organizational measures (TOMS), the scope for disclosure of personal data increases, as the seller’s legitimate interest test is reinforced and simultaneously data subjects’ interests in secrecy are safeguarded. One way of achieving this is through setting up specific teams of people to deal with the personal data, so that if there is a breach, it can be rectified immediately; these are known as “clean teams.”

When a purchaser is assessing, in due diligence, the assets and regulatory compliance of the seller, it must include the purchaser’s data protection compliance status. Any potential compliance liabilities can be identified, and the purchaser can be advised on how best to amend the seller’s practices and operations to comply, post-completion, with data protection laws.

If an entity is GDPR-compliant, it will generally also be compliant with POPIA, which is less rigorous. There are, however, certain distinctions between them. For example, POPIA applies to juristic persons as well as natural persons, and there are certain instances in which prior authorization from the Information Regulator is required before processing personal information.

Transfer of personal data

GDPR restricts the transfer of personal data outside of the EU and EEA, but the data subject may consent to the transfer of their data to a specific country. Further, a transfer outside of the EU/EEA is permitted to certain countries that enjoy the benefit of an “adequacy decision” made by the European Commission, whereby a country’s data protections laws are considered to be sufficiently in line with the purpose of GDPR.

The US does not offer similar data protection rights, and so US entities must have assented to the EU-US Privacy Shield regime in order to receive and transfer personal data. Some virtual data rooms are hosted in the US, and so it is important to
confirm that such operators have assented to the regime before transferring any personal data.

On July 5, 2018, the European Parliament adopted a resolution on the adequacy of the protection afforded by the EU-US Privacy Shield and decided that, unless the US is fully compliant with GDPR by September 1, 2018, the European Commission must suspend the Privacy Shield until the US authorities comply with its terms.

GDPR states that, in the absence of a determination by the European Commission that a country provides adequate data protection, personal data may be transferred to a third country or an international organization if measures are taken to ensure appropriate safeguards are implemented, and that there are effective legal remedies for data subjects.

South Africa has not been subject to an adequacy decision. Where there is a transfer of personal data to a country that does not have adequate data protection laws, both GDPR and POPIA require one of the following:

- An agreement in place with the group entity that includes standard contract clauses to provide adequate protection.
- The entities to subscribe to binding corporate rules that are established to ensure that any transfer of personal data and subsequent processing of the data in that country is carried out with a satisfactory level of protection.

The personal data may also be transferred with the consent of the data subject. Under POPIA, special personal information may not be transferred to locations that do not have adequate data protection laws without the prior authorization of the Information Regulator.

Consequences of non-compliance

Non-compliance during a due diligence will occur if personal data is uploaded to the virtual data room without there being a justification for the processing – for example, in the absence of the necessary consents or legitimate interests. Non-compliance may also arise where mass personal data is uploaded without using the principle of minimization. As such, personal data should be uploaded only where it is necessary and relevant.

It is imperative to evaluate a target’s data protection status, as there are major risks for the purchaser if the target is found to be in breach of GDPR. Violations of data protection laws within the EU and EEA are subject to fines of up to €20 million or up to 4 percent of total annual worldwide turnover. Under POPIA, non-compliance penalties include administrative fines of up to ZAR10 million and up to ten years in jail.

To the extent that it is not possible to eliminate all data protection risks in the due diligence process, there should be adequate data protection warranties in place in the transaction agreements between the seller and purchaser. Such warranties should be accepted only if a sufficient level of data protection compliance measures are in place within the target, at a level that may be verified in the due diligence process. These measures include the use of appropriate TOMS and confidentiality undertakings, which would reduce the risk of a data protection breach.
Our Presence in Africa

DLA Piper has established market knowledge and deal experience working across the continent

- DLA Piper Africa
- DLA Piper has experience of working in these jurisdictions

To find out how we can help you do business in Africa, please get in touch: africaenquiries@dlapiper.com