Bob Conrad

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Capital Gains: Regulation Outline

(For discussion purposes only)

The October mission recommended that a capital gains tax be imposed on transfers, either direct or indirect, of any mining title or license. Steps necessary to implement such a procedure are outlined here. Examples are supplied to illustrate particular situations.

I. Intent: To impose a tax on the capital gain (or loss) resulting from the transfer of exploration, development, mining and any other license related to minerals and mineral development sourced in Guinea. There are two types of transfers.

   a. The mining license itself can be transferred by the person or persons holding the license; this is called a "direct transfer."

   b. The owners, either resident or nonresident, of the entity (or entities) of the Guinean entity (or entities) holding the license can transfer ownership of the Guinean entity. This is an "indirect transfer". Indirect transfers can be of two types:

      i. Type 1: Indirect transfers made by Guinean persons. That is the person holding any ownership interest, either direct or indirect, of the Guinean person holding the license related to mineral interests in Guinea and who transfers all or part of that interest is also a Guinean person.

      ii. Type 2: Indirect transfers made by a person that is not organized under the laws of Guinea (a domestic person for present purposes), is not a physical person liable for income tax in Guinea or has a permanent establishment in Guinea. (I used treaty language is used for lack of a better term. Perhaps there is a better term.) That is the person holding any ownership interest, either direct or indirect, of the Guinean person holding the license related to mineral interests in Guinea and who transfers all or part of that interest is not an entity organized under the laws of Guinean, is not a physical person liable for income tax in Guinea or has a permanent establishment in Guinea.

A capital gains tax should be imposed on both the direct transfer of a mining license and on the transfer for any equity interest in the domestic entities holding a mining license (Type 1 indirect transfer).[1] A withholding tax should be imposed on Type 2 indirect transfers. Such distinctions are necessary because it is important to identify whether the transferor of any interest is subject to the Guinean income tax and, if not, to ensure that the proper person withholds tax on the gain from the transfer made by a nonresident person. Type 2 indirect transfers will be made by persons who are not Guinean taxpayers, so that a withholding tax, or a final tax, is employed in lieu of the generally applicable tax. In the case of Type 2 indirect transfers, the Guinean person whose equity is transferred (the last entity in any chain of domestic entities) will be the withholding agent for the tax and will be required to comply with all reporting requirements.

c. Examples

i. Entity G is an entity organized under the laws of Guinea and holds a mining license. Entity G transfers 30% of the mining license to Entity H, another entity organized under the laws of Guinea. Such a transfer is a direct transfer for the purposes of this tax and Entity G will be subject to capital gains tax.

ii. Entity G is an entity organized under the laws of Guinea and holds a mining license. Entity G is owned by Entity I, another entity organized under the laws of Guinea. Entity I transfers 51% of its interest in Entity G to another person. This is a Type 1 indirect transfer and Entity I will be subject to capital gains tax.

iii. Entity G is an entity organized under the laws of Guinea and holds a mining license. Entity G is owned by Entities L and M, both organized under the laws of Guinea. Entity L is owned by Entity N, which is organized under the laws of the United States. Entity N transfers 100% of its interest in Entity L to any other person. This is a Type 2 indirect transfer. A withholding tax will be imposed on the value of the transfer and Entity L is liable for withholding the tax.

II. Rules

a. Taxable Event:

[1] The transfer of equity interests in any domestic entity by a person liable for income tax in Guinea should be subject to a standard capital gains tax. The Type 1 indirect transfer where the seller is a Guinean person should naturally fall within the scope of the general capital gains provisions. It is important that a capital gains tax be imposed on indirect transfers made by domestic persons. Foreign companies may be able to escape the tax if they create Guinean companies for the purposes of title transfers absent a domestic capital gains tax. At the minimum more anti abuse rules would have to be developed.

i. Any direct transfer of a license related to minerals in Guinea, either in whole or in part;[2] and

ii. Any indirect transfer of a license related to minerals in Guinea, either in whole or in part.; except that the taxable event will be limited to two tiers of nonresident ownership structures. Two tiers means that the scope of the withholding tax will be limited to one non-resident entity or entities owning all or part of the Guinean entity holding the license.

iii. Exceptions:

1. The domestic capital gains tax on any indirect transfer will not apply if the shares of the domestic entity are traded on an internationally-recognized stock exchange. (The transferor should be subject to capital gains tax.)

2. The withholding tax will not apply on any Type 2 indirect transfer if the shares (a majority?) of the entity or entities directly or indirectly owning the Guinean domestic are traded on an internationally-recognized stock exchange.

3. Type 2 indirect transfers will be limited to two tiers of the nonresident corporate structures. (Not being a lawyer I am not sure if the direct or indirect test is sufficient. It is possible that a chain of non-resident companies can exist and it might be good policy to try to stop tracing up the chain at some point subject to an anti-abuse rule (below)).

iv. Examples

1. Corporation G is a Guinean person holding a mining license in Guinea. Corporation G is a wholly-owned subsidiary of Corporation H, a corporation chartered in the Cayman Islands. Corporation H is a wholly-owned subsidiary of Corporation I, a corporation organized under the laws of the Netherlands. Corporation H is a first-tier corporation while Corporation I is a second-tier corporation. Furthermore, the gain from transfers of shares of Corporation H by Corporation I will be subject to withholding Corporation G as long as Corporation H's shares are not publicly traded.

[2] There may have to be special rules for cases of liquidations, bankruptcy, and corporate organizations.

2. Same facts as the last example, except that Corporation I is a wholly-owned subsidiary of Corporation L, a corporation organized under the laws of France. Corporation L is a corporation with a tier higher than two. With the exception of the anti-abuse rule (see below), any transfer of ownership from Corporation I to any other person will not come within the scope of this law. If Corporation I transfers all or part of Corporation H to any other person, then the provisions of this law will apply.

b. Anti-abuse Rule: The second-tier limitation will be suspended if it can be demonstrated that the higher-tier entities were organized for the purpose of avoiding the withholding tax. In this case, the transfers by higher-tier entities will be deemed to have been made by the second-tier entity.[3]

c. Source Rule: Any transfer, either direct or indirect, of a license related to minerals in Guinea is deemed Guinean source.

d. Taxpayer

   i. In the case of any direct transfer, the taxpayer is the Guinean person holding the license at the time of the transfer.

   ii. In the case of any indirect transfer, the taxpayer is the person transferring the shares or other ownership interest of the first-tier non-resident person or persons. When the person transferring the shares or other ownership interest is not a Guinean person, the Guinean person whose equity is held in all or in part by the person transferring the shares or other interests will withhold a tax on behalf of the nonresident. Such a charge will be treated as a final tax for Guinean purposes.

e. Only Guinean persons may hold any license related to minerals and mining within the territory of Guinea.

f. Accrual: The tax accrues at the time of ownership transfer (as that time is defined (someone needs to supply the definition)), regardless of whether cash or other compensation is made at the time of ownership transfer.

g. Base of Charge:

[3] As stated it might be sufficient to have no limitation on the number of tiers and simply have a direct or indirect ownership test.

i. In the case of a direct transfer: the difference between the value of the accrued transfer on the date of the transaction and the adjusted basis of the license on the audited books of account of the seller.

ii. In the case of an indirect transfer: the difference between the adjusted basis of the value of the Guinean person at the time of the transfer and the pro rata share of the adjusted basis of the seller's total assets based on the audited books of account of the tier-one entity at the time of the sale. "Pro rata share" for the purposes of this law means: the proportion of the adjusted basis of the license to the adjusted basis of total assets of the tier-one entity multiplied by the proportional net gain resulting from the share transfer.

   1. Example: Corporation M is a Guinean person holding an exploration license and is a wholly-owned subsidiary of Corporation N. Corporation N is a corporation chartered under the laws of the British Virgin Islands. Corporation N is a wholly-owned subsidiary of Corporation O, a corporation organized under the laws of Germany. The adjusted basis of Corporation N's interest in Corporation M at the time of the transaction is 100, while the total assets of Corporation M are valued at 500. Corporation O transfers full ownership of Corporation M to any other person for consideration of 1200. The basis for the withholding tax in Guinea will be 140 (or [1200 – 500]/ (100/500)).

iii. In the case of a direct or indirect transfer where the seller retains an economic interest in the property in exchange for an overriding royalty or other periodic compensation, the base of the charge is equal to the compensation for the transfer at the time of the transfer and any subsequent overriding royalty or other periodic compensation.

h. Rate: 30% (or the generally applicable corporate tax rate) on the value of the transfer at the time of the transfer and 30% on the gross value of any overriding royalty or other periodic compensation.

i. If the capital gain is zero or below, then no tax is charged. The loss may be used to offset capital gains to the extent that the gain is Guinean source in the year the capital loss accrues or in any subsequent tax year. In the case of an overriding royalty, any capital loss carry forward may be used as a deduction from overriding royalty payments until the carry forward is exhausted.

j. Adjusted Basis: Adjusted basis is defined as the value of transferred assets measured on the transferor's audited books of account on the date of the transfer. The adjusted basis will include the initial value of the license in question plus any additions (including capitalized expenses related to the license) less any accumulated amortization, depreciation, or depletion allowed for tax purposes. In the case of a direct transfer, the adjusted basis is the basis of the license itself. In the case of an indirect transfer, the adjusted basis is the value of total assets on the transferor's books of account at the time of the transfer multiplied by the proportion of the ownership interest transferred.

i. If the books of account used to measure the adjusted basis are not unaudited, are not maintained according to international accounting standards, or are otherwise unavailable to the Guinean authorities, then the adjusted basis for computing the net gain will be deemed to be zero.

ii. If the transfer is between related parties (however defined), then the Minister of Finance has the power to adjust the value of the transfer to reasonably approximate an arm's-length value.

k. Currency: The value of the transfer will first be measured in the currency used to measure the adjusted basis of assets where the exchange rate used for the compensation is measured at the time of the transfer. The tax will then be computed in the currency used to measure the adjusted basis and the tax will be payable in Guinean Francs, or US Dollars converted using the exchange rate at the time of the transfer.

l. Notification: Any person holding a license related to minerals or mining in Guinea is required to notify the Ministry of Finance of any change in the ownership of either the Guinean entity, or of any entity holding an equity position in the first-tier non-resident company, either before or at the time of the change in ownership structure. Failure to notify will result in the immediate revocation of the license by the State of Guinea without compensation. The relevant person will be exempted from this rule to the extent that the shares of the equity of the transferor are publicly traded on an internationally-recognized stock exchange. (This is a harsh rule and may create incentives for bribery and avoidance. The tradeoff is lack of compliance given the probability of getting caught. I don't know the answer and a discussion of the alternatives would be helpful.)

m. Only a Guinean person may hold any mining or exploration license. Any attempt to transfer a license to a non-Guinean person will result in the immediate revocation of the license without compensation.

III. Examples

a. Corporation A is organized under the laws of Guinea and is a Guinean person. Therefore, Corporation A may apply for any license related to mining in Guinea.

b. Corporation B is organized under the laws of Guinea and is a wholly-owned subsidiary of Corporation C, a company incorporated under the laws of the United States. Corporation B may apply for and hold any license related to mining in Guinea. Corporation C may not own any license related to mining in Guinea.

c. Corporation D is organized under the laws of Guinea and forms a joint venture with Corporation E, organized under the laws of France. Corporation D currently holds a mining license related to mining in Guinea. Corporation D would like to contribute 30% of the mining license to the joint venture and in effect make Corporation E a partial owner of the 30% license. Such a proposal is a prohibited transaction.

d. Corporation H is organized under the laws of Guinea and currently holds an exploration license. Corporation H would like to transfer the exploration license to Person M, a resident of the United Kingdom. Such a proposal is a prohibited transaction.

e. Corporation X currently holds a mining license with an adjusted basis equal to 10. Corporation X transfers the license to Corporation Z, a Guinean entity. Such a transfer is a direct transfer.

f. Corporation X currently holds a mining license with an adjusted basis equal to 10. Corporation X transfers 25% of the value of the license to Corporation Y, a Guinean entity, as Corporation X's contribution to a joint venture between Corporation Y and Corporation X. Such a transfer is a direct transfer.

g. Corporation R is a Guinean entity holding a mining license in Guinea. Corporation R is a wholly-owned subsidiary of Corporation S, a corporation organized under the laws of China. Corporation S's only asset is the equity shares of Corporation R. Corporation S is a subsidiary of both Corporations Z and A. Corporation Z is organized under the laws of the United States while Corporation A is organized under the laws of Spain. Both Corporations Z and A own 50% of the equity in Corporation S. On March 1, Corporation Z transfers 30% of its ownership (15% of total shares) of Corporation S to any other person. Corporation Z's adjusted basis in Corporation S is 100. The share transfer made by Corporation Z is an indirect transfer. Corporation R is required to notify the Government of Guinea and to withhold tax on the net gain.