

Management of tax risk

Tax in Africa Survey 2007

Foreword

This is the first “Tax in Africa” survey of its kind and it originates from a growing need among foreign investors who are considering Africa as a viable investment destination. The survey focuses on key tax, business and regulatory challenges faced by companies operating in Africa. The main findings of the survey confirm the view that tax systems across the African continent are extremely divergent and most require modern tax reforms to make the region more attractive to doing business. Other trends emerging, which are consistent with global trends, are the focus on managing tax risk and compliance, the need for tax function effectiveness within companies and the growing demand for tax skills.

I want to thank all participants who took the time to contribute. The success of the survey is directly attributable to their enthusiastic participation.

We hope that you find the results of the survey interesting and useful and we welcome any feedback and comments.

A handwritten signature in black ink, appearing to read "Paul".

Paul de Chalain
Managing Partner, Tax Services, Southern Africa

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Tax in Africa Survey 2007

Executive Summary

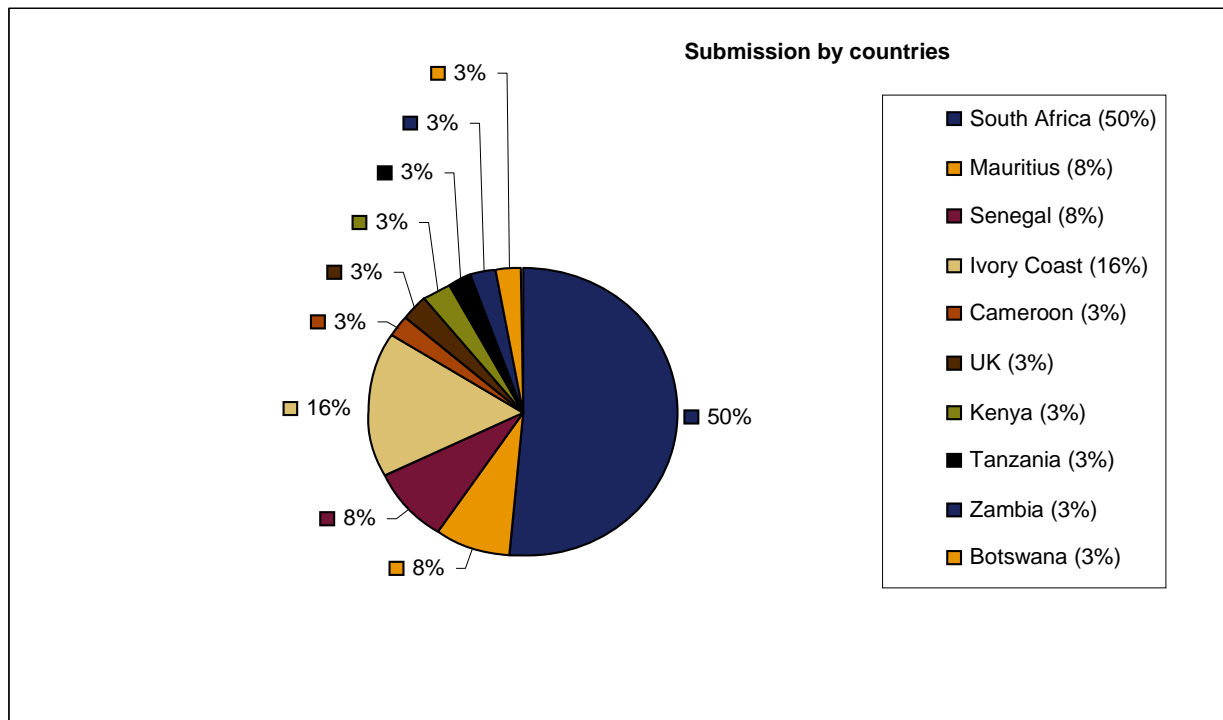
The main findings of the survey can be summarised as follows:

- South Africa is perceived to be the country that presents the greatest tax challenges on the African continent, followed by Nigeria and the Democratic Republic of Congo (“DRC”).
- Angola has the most difficult business and regulatory challenges on the African continent, followed by the DRC.
- Of all taxes, withholding and expatriate taxes are viewed as areas of particularly high tax risk.
- Political risk and exchange controls pose the greatest business and regulatory challenges.
- The greatest tax challenges facing a tax function in Africa relate to compliance with tax laws and practice and recruiting quality tax staff.
- Only 23% of participants surveyed felt that their companies were fully compliant in the area of share options’ taxation.
- Only 11% of participants surveyed felt that a tax strategy had been fully implemented in their respective companies.
- The management of compliance risk is the area of most concern to participants surveyed, followed by the management of operational risk.
- The greatest management challenges facing a tax function in Africa relate to managing relationships with fiscal authorities and finding tax staff with the required experience.
- 53% of those surveyed would like their tax advisers to understand their business and tax-risk appetite better, and to think more commercially.
- Those surveyed were most interested in finding out more on tax risk management, tax developments in Africa, GST/VAT, holding company structures and expatriate taxation issues.

Survey Participants and Methodology

Surveys were sent in electronic format to our base of tax clients (in different industries), and to our colleagues in PwC firms, operating in the African region.

The survey comprised 15 questions on tax and business/regulatory challenges faced by companies operating in the African region. Not all questions were relevant to all participants of the survey – therefore not all questions had the same response rate. 50% of the responses were from businesses operating in South Africa. A split of the responses by country is shown below:

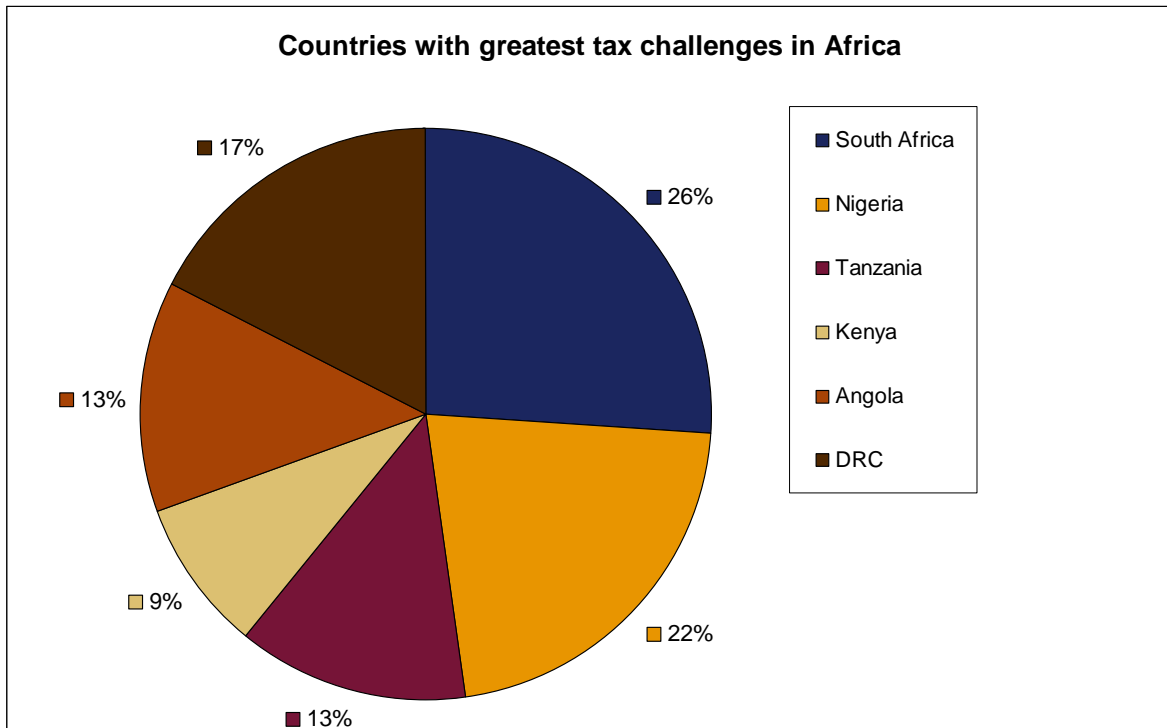


Survey Questions and Responses

The responses to the 15 questions on tax and business/regulatory challenges are summarised on the pages that follow.

1 Which African countries present the greatest tax challenges?

Please rank the three African countries that present the most difficult tax challenges for your company (1 being the most difficult, 2 the next most difficult, and 3 the third most difficult).



Comment

South Africa is perceived as the country that presents the greatest tax challenges for companies operating in Africa. South Africa came ahead of Nigeria, the DRC and Angola.

This result was somewhat unexpected with regard to South Africa. Most of the comments made by survey participants on South Africa refer to its increasingly complex tax and exchange control legislation (see below for some of the comments). It may be that the legislative complexity of South Africa and costs of compliance are outweighing the legislative/enforcement uncertainty of Nigeria, the DRC and Angola.

Below are some of the comments made by participants on reasons why they chose specific countries:

South Africa

- “South Africa’s tax rules are increasingly complex, especially regarding CFCs, transfer pricing, place of effective management etc” (South Africa based participant)
- “Complexities of tax combined with exchange control legislation in South Africa” (Kenya based participant)
- “Regarding South Africa, heavy administrative burden with respect to dealing with tax authorities” (Mauritius based participant).

Nigeria

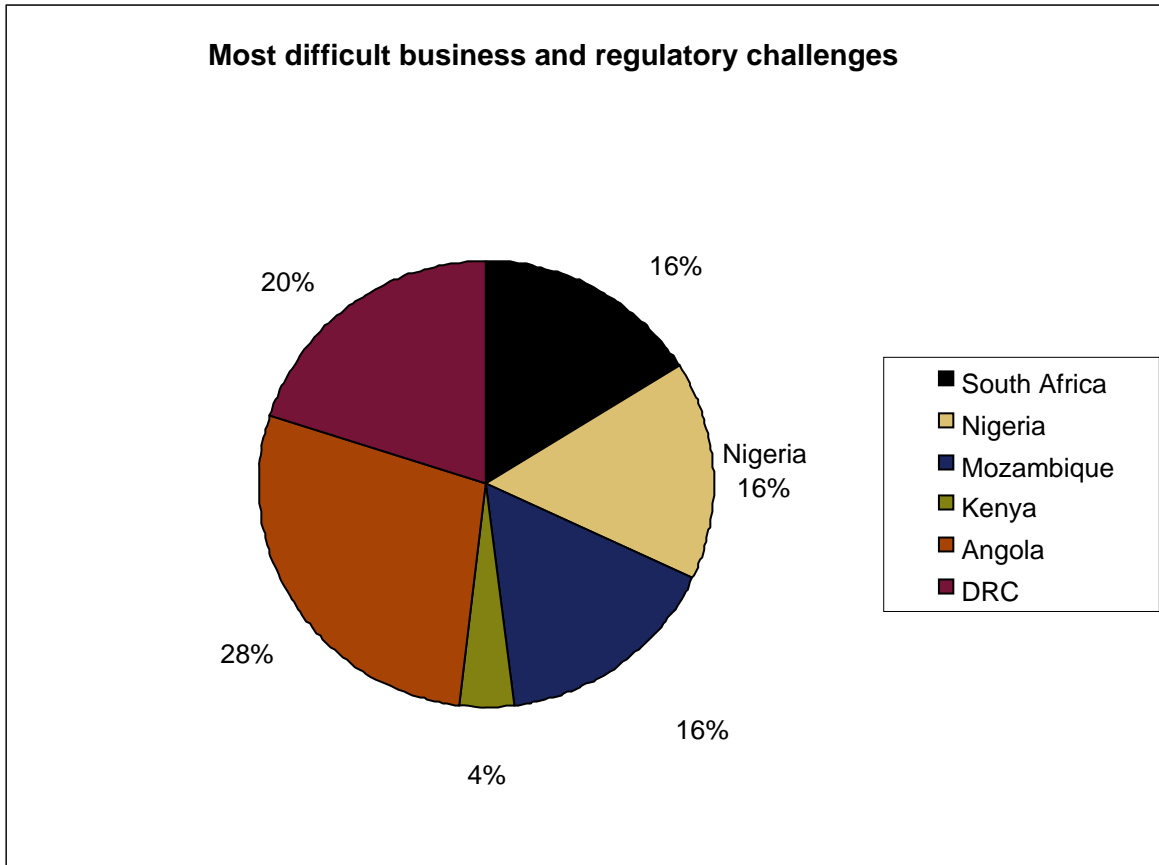
- “High levels of corruption and lack of training of tax inspectors in Nigeria” (UK based participant)
- “Lack of clarity on law, aggressive and unreasonable tax authorities in Nigeria” (South Africa based participant)
- “The multi-level tax regime in Nigeria” (Kenya based participant).

DRC

- “Regarding the DRC, the legislation commonly differs from the prevailing practice in treatment of taxes” (South Africa based participant)
- “Not enough tax experience in the DRC” (Ivory Coast based participant)
- “The level of corruption in the DRC means that taxes are levied for little or no reason” (Zambia based participant)
- “Difficult to deal with tax authorities in the DRC as they do not speak English” (South Africa based participant).

2 Which African countries present the most difficult business and regulatory challenges?

Please rank the three African countries that present the most difficult business and regulatory challenges for your company (1 being the most difficult, 2 the next most difficult, and 3 the third most difficult).



Comment

Respondents felt that Angola was the most difficult and the DRC the second most difficult country to deal with in terms of business and regulatory challenges.

The comments made by participants on the reasons for their choice provide an insight into the particular problems faced in these countries.

Angola

- “Language barriers / Angola is very expensive and bureaucratic” (South Africa based participants)

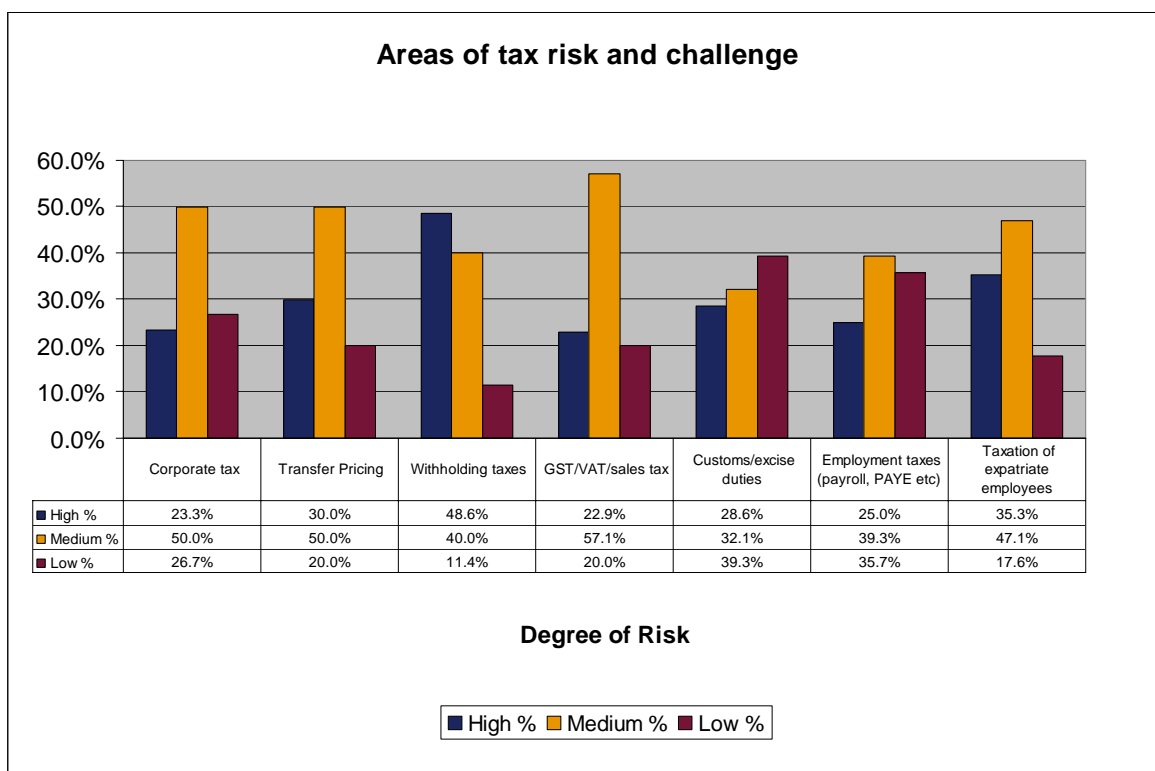
- “The complexity and cumbersome nature of processes involved” (Kenya based participants)
- “The legal environment is not clear” (Ivory Coast based participant)

DRC

- “Lots of unrest and political instability” (South Africa based participant)
- “Corruption and the ever changing laws” (Zambia based participant)
- “The complexity and cumbersome nature of processes involved” (Kenya based participant).

3 Areas of tax risk and challenge

(a) What degree of risk do you associate with each of the following areas of taxation?



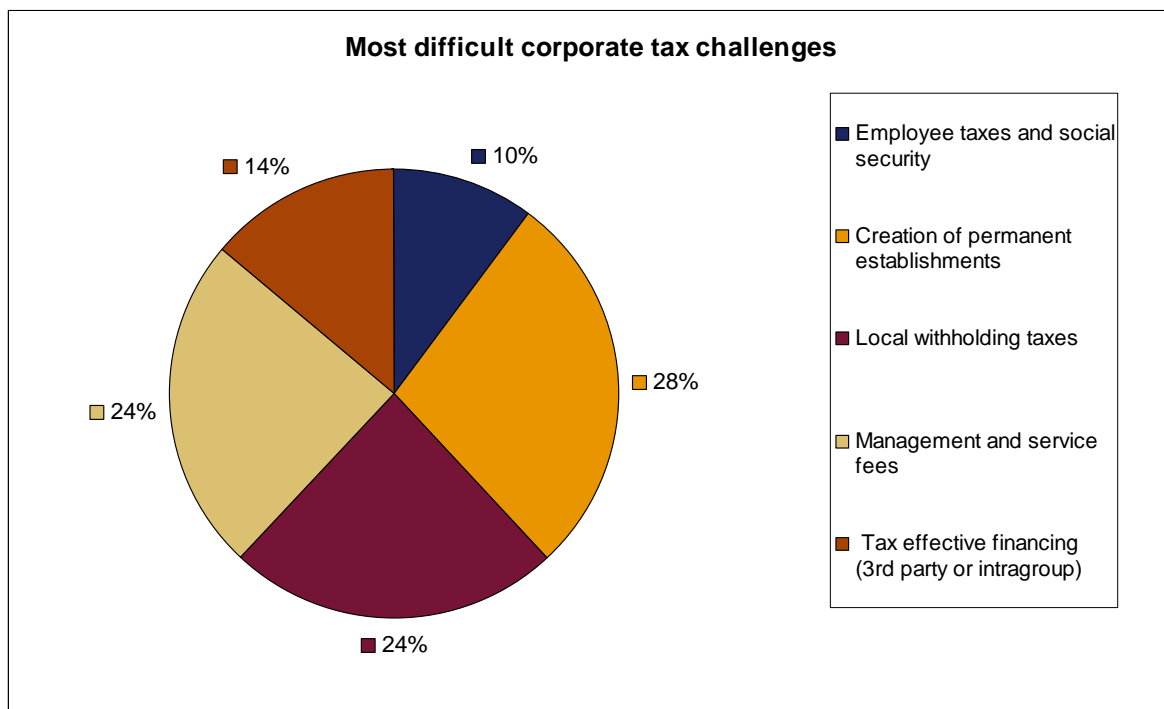
Comment

The area of withholding tax poses the highest risk for respondents. Nearly 90% of respondents considered the area of withholding tax as either a high or medium risk area. This is not surprising, given the number of countries in Africa which have withholding tax regimes with respect to, *inter alia*, dividends, interest and royalties, and given that few African countries have extensive networks of double taxation agreements to reduce or eliminate such withholding taxes.

The taxation of expatriate employees and transfer pricing were also considered to be high risk areas for respondents. As companies grow and extend their operations into other countries in the African continent, this inevitably leads to more intra-group transactions such as the purchase and sale of goods and provision of services (potentially subject to withholding taxes and transfer pricing legislation), and the increase in the movement of human capital cross borders.

Interestingly, the area of customs and excise duties was regarded by nearly 40% of respondents as low risk, which was not expected.

- (b) Please rank the three areas of company taxes that present the most difficult challenges for your company with respect to your operations in Africa (1 being the most difficult, 2 being the next most difficult and 3 being the third most difficult).



Comment

The three corporate tax aspects that respondents believe are a significant challenge on the African continent are:

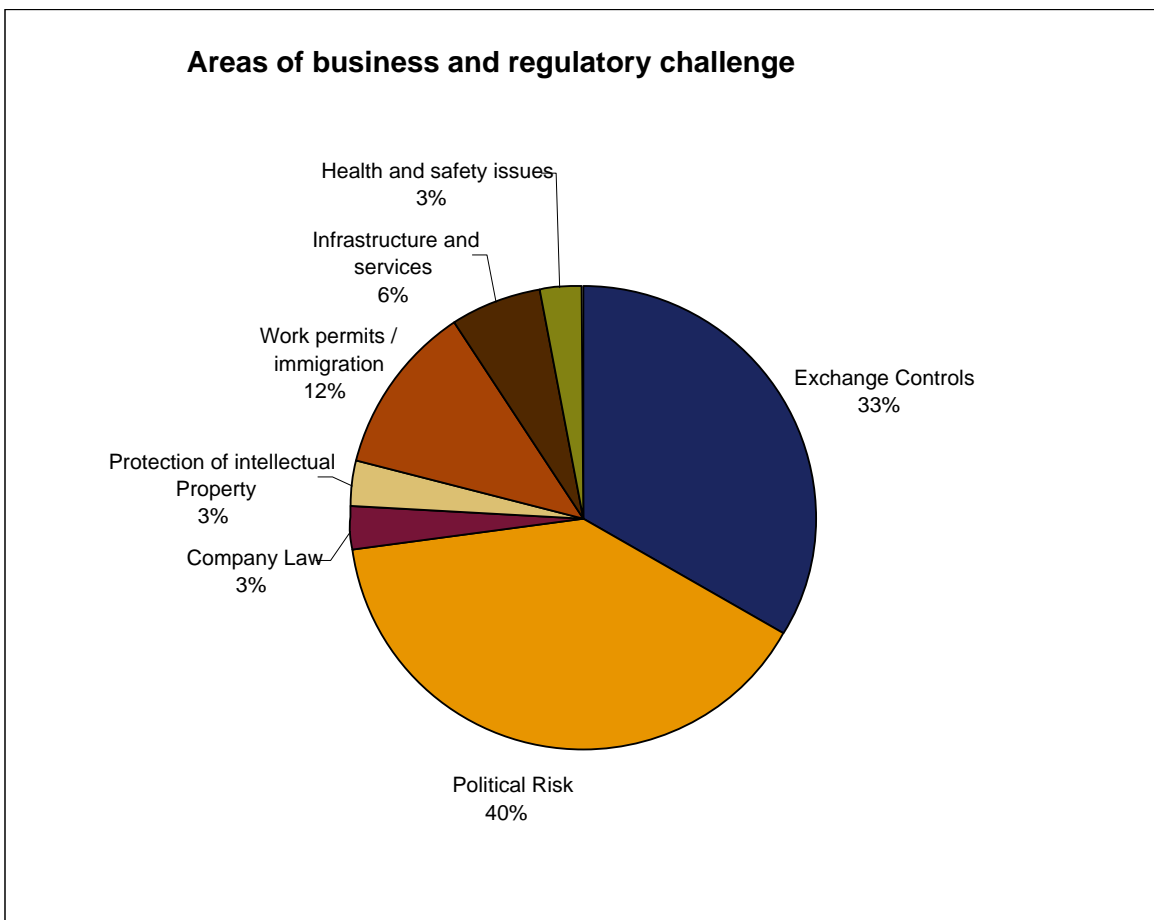
- (1) The creation of permanent establishments;
- (2) Local withholding taxes; and
- (3) Management and service fees.

Certainty as to when a company's activities in a country will give rise to tax is a vital part of an expansion plan and therefore whether the company's activities will create a permanent establishment will be a major issue for them.

Locally applied withholding taxes can lead to double taxation, and management and service fees have been used to reduce the profits of a foreign entity and extract funds. It is not surprising, given the increased expansion into Africa, that tax issues related to expansion are rated as presenting the most difficult challenges.

4 Areas of business and regulatory challenge

Please rank the three areas of business and regulatory challenges that present the most difficult challenges for your company with respect to your operations in Africa (1 being the most difficult, 2 being the next most difficult and 3 being the third most difficult).



Comment

Political risk and exchange controls pose by far the greatest business and regulatory challenges for companies doing business in Africa.

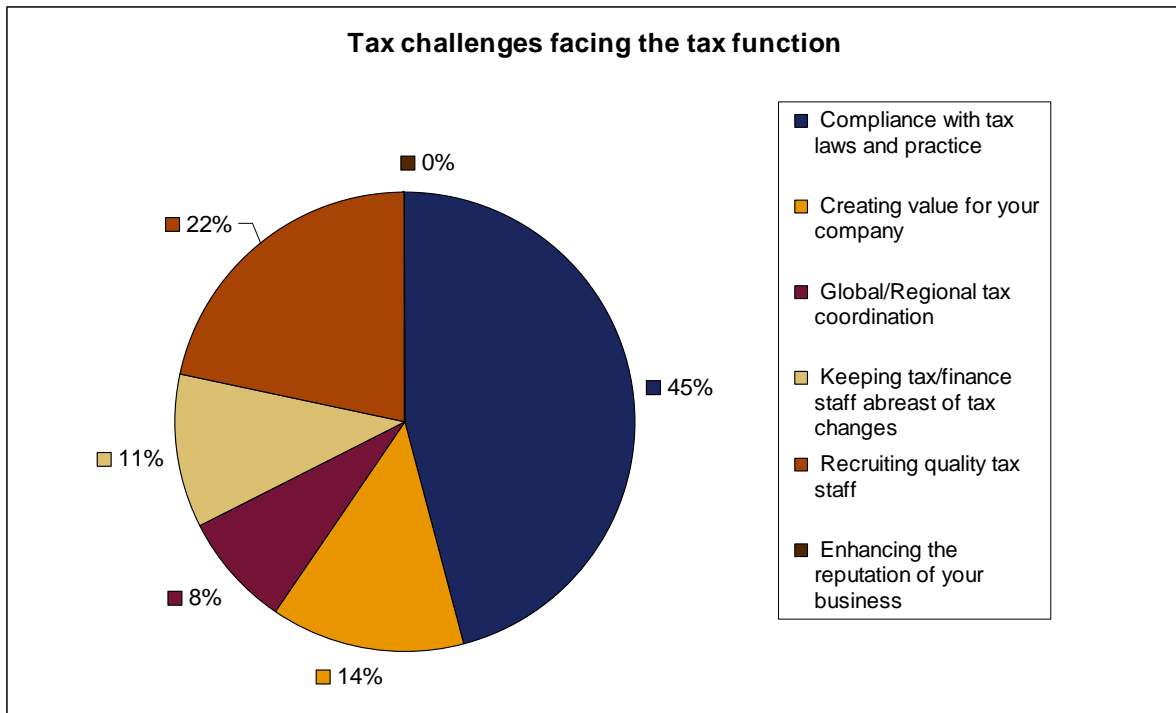
Obtaining work permits and dealing with other immigration issues also pose a significant challenge.

Company law, protection of intellectual property and health and safety issues are regarded as the least challenging areas for companies.

Protecting your investment and work force, being able to extract profits and freely move the work force are often taken for granted when investing in first world countries. Not so in Africa, where the possibility of forfeiture of the business, or ability to remit profits could change over night as political regimes come and go, or exchange controls are imposed.

5 Tax challenges facing the tax function

Please rank the three most important challenges facing your tax function with regard to your African operations (1 being the most important, 2 being the next most important and 3 being the third most important).



Comment

Tax functions within many companies are focusing heavily on compliance with tax laws and practice. Around 45% of respondents ranked tax compliance with laws and practice as the most important challenge facing their tax function, followed by recruiting quality tax staff. Respondents felt that creating value for the company was the third most important tax challenge. These results were not unexpected.

The ranking of tax challenges may be strongly influenced by the need to comply with the Sarbanes-Oxley Act and other similar legislation. In the current environment of new tax laws and regulations, tougher reporting requirements, expanding business operations and ever expanding tax function responsibilities, a key requirement placed on companies is compliance with increasingly onerous tax laws and practice. In order to meet this requirement, it is necessary for companies to have quality tax staff with adequate skills and knowledge.

6 Compliance in the African countries in which you operate

Indicate the extent to which you and your employees are compliant in the African countries in which you operate with respect to the following areas:

Extent to which you are compliant	Full %	Partial %	None %
Corporate tax registration	74	10	16
Corporate tax filings	72	13	15
Withholding taxes	57	27	16
Payroll taxes - local employees	69	17	14
Payroll taxes - expatriate employees	54	25	21
Consumption taxes (VAT / GST)	67	16	17
Directors' tax filings	61	13	26
Payroll taxes - expatriate employee tax filings	50	29	21
Immigration regulations	67	11	22
Exercise of share options	23	23	54

Comment

Most (at least 7 out of 10) respondents regarded themselves as fully compliant with corporate tax registrations and corporate tax filings on the African continent.

At least 6 out of 10 respondents felt that they were fully compliant with payroll taxes (local employees), consumption taxes (VAT and GST), immigration regulations and directors' tax filings.

Only half of the respondents were fully compliant with payroll taxes and filings in respect of their expatriate employees. This is not surprising. Many expatriates receive a significant portion of their salaries paid in their home country and the local entity may not be aware of the full salary packages of the expatriates, and therefore neither the local entity nor the expatriates are compliant, either in terms of payroll withholding or individual tax filings.

Similarly, only half of the respondents regarded themselves as fully compliant with respect to withholding taxes. The area of withholding tax has featured as an area of concern by a number of

respondents in response to survey questions and is therefore clearly an area where businesses need to focus to ensure full compliance.

Less than a quarter of the respondents felt that they were fully compliant in the area of exercise of share options. Generally speaking, not many African countries have introduced specific legislation with regard to the taxation of share options. As with split remuneration, the local entity may not know when an employee exercises a share option issued by a foreign parent company, and therefore may be unaware of any reporting/withholding requirement by the company or the employee.

7 Indicators that a tax strategy is in place

Please indicate the extent to which the following have been implemented in your company:

Participant response	Fully Implemented %	Partially Implemented %	Not Implemented %
A documented tax strategy agreed with senior management	11	41	48
Your total tax bill is communicated to and understood by senior management	30	58	12
Regular communication with senior management on tax matters	41	52	7
Clear roles and responsibilities defined for all areas of tax	60	32	8
Value creation is measured as a key performance indicator for the tax function	32	40	28
Risks managed by the tax function are identified and reported	70	23	7

Comments

It is encouraging that risks managed by the tax function are fully identified and reported by 70% of respondents. 60% of respondents fully implement clear roles and responsibilities for all areas of tax and 41% of respondents have fully implemented a policy of regular communication with senior managers on tax matters in their companies.

Over 90% of respondents had the following strategies fully or partially in place:

- Regular communication with senior management on tax matters;
- Clear roles and responsibilities defined for all areas of tax; and
- Risks managed by the tax function are identified and reported.

The implementation of communication with senior management on tax matters may have been brought about by the requirements of Sarbanes-Oxley and other similar regulations.

However, nearly half of the respondents did not have a documented tax strategy agreed with senior management. This is a global trend, and PwC has developed a service offering “Tax Function Effectiveness”, which aims to assist companies with devising and implementing a tax strategy within their organisation.

8 Indicators that the tax function is operating effectively

Tax Compliance and Advisory - please indicate the extent to which the following have been implemented in your company:

Degree of implementation	Full %	Partial %	None %
A process for indicating the impact of tax changes	14	86	0
Tax function sign off for acquisitions and divestments	43	43	14
Tax function sign off for changes to corporate structure	41	52	7
Tax function sign off for changes to systems/business processes	15	70	15
Early involvement of Tax in tax sensitive transactions	45	55	0
Effectively controlled tax compliance, accounting and payment functions	52	45	3
Highly automated tax compliance, accounting and payment functions	24	52	24

Comment

The majority of respondents (at least 85%) currently have fully or partially implemented processes to control the tax compliance, accounting and payment function effectively; and to ensure tax function signoff for acquisitions / divestments and changes to the corporate structure.

All respondents have a fully or partially implemented process in place for indicating the impact of tax changes and for the early involvement of Tax in tax sensitive transactions.

However, 24% of respondents do not currently have a highly automated tax compliance, accounting and payment function. It is surprising that we are not seeing more companies implementing more highly automated systems, especially given the increasing focus on tax compliance. With enhancements in technology and internet capabilities on the African continent, one might have expected companies to seek greater efficiency in this area than has so far materialised.

There may be a number of reasons for this (namely):

- tax is a complicated area; and
- there is a need for people to input into the process; and
- the barriers of language and different time zones may make this function difficult to implement practically, especially within a multinational group.

Only 15% of respondents have not implemented procedures for tax sign off for changes to business systems and processes. Tax returns are generally based on the underlying accounting records. Changes to business systems and processes can result in changes to the data that is recorded in particular accounts or in the way that the information is made available for inclusion in a tax return. Therefore it is important that the tax department is included in any discussions / policy decisions regarding changes to business systems and processes.

9 Tax planning – attitudes to risk

Please choose the most appropriate answer with regard to the following questions regarding tax planning in your company:

Participant response	Strongly Agree %	Agree %	Disagree %	Strongly Disagree %
We will undertake any tax planning opportunities provided they are supported by a credible basis in tax law	40	57	3	0
We will undertake tax planning only if it is part of a wider commercial transaction	22	45	33	0
We will change a commercial transaction to take advantage of tax planning opportunities	20	50	23	7

Comments

Nearly all respondents agreed or strongly agreed that they would undertake any tax planning opportunities provided that they are supported by a credible basis in tax law. 70% of respondents reported that they would change a commercial transaction to take advantage of tax planning opportunities; however, 67% of respondents will undertake tax planning only if it is part of a wider commercial transaction.

The above indicates that there is an awareness by respondents to undertake tax planning only as long as it is supported in law and if it is part of a wider commercial transaction, as opposed to the tax avoidance “schemes” which prevailed in years gone by.

10 Management of tax risk

- (a) Please rank the following in order of concern and indicate your degree of comfort that controls are in place in your company to address each category of risk with regard to your operations in Africa (1 being the area of most concern and 4 being the area of least concern).

Participant response	Degree of comfort that controls are in place		
	High %	Medium %	Low %
Risks ranked in order of concern:			
Compliance Risk	31	41	28
Operational Risk	16	32	52
Financial Risk	23	48	29
Transactional Risk	28	31	41

Definitions:

- Compliance risk – risk of failing to meet tax compliance obligations.
- Operational risk – risk of not applying tax laws to routine operations.
- Financial risk – risks associated with inappropriate disclosure in financial statements.
- Transactional risk – tax risk arising on transactions (e.g. acquisitions and disposals).

Comment

Nearly 70% of respondents indicated that they have a medium or low level of comfort that controls are in place to meet all tax compliance obligations. In respect of operational risk, there is generally a low degree of comfort that controls are in place to apply tax laws to routine operations. Given the routine nature of most business transactions, a higher level of comfort would be expected.

41% of respondents were not confident that there are sufficient controls in their organisations to address transactional risks. This may be expected as transactions are not routine and thus there are fewer effective controls that can be put in place to address risk with respect to such transactions.

In terms of ranking the concerns, respondents felt that compliance risk was the most important risk from a business perspective, followed by operational risk. Financial risk was ranked third and transactional risk fourth.

(b) Please indicate the level of knowledge within your company of the requirements of Sarbanes-Oxley - section 404 ("SOX 404") and the progress that your company has made towards meeting these requirements:

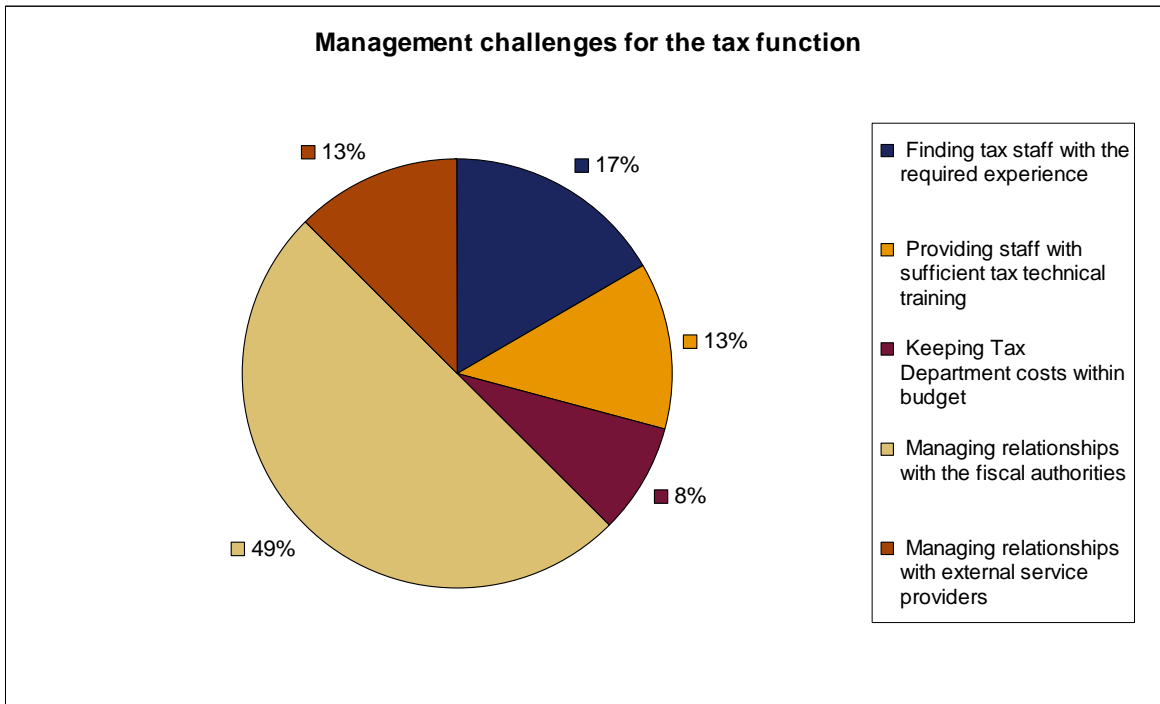
Participant response	High %	Moderate %	Low %	N/A %
Level of understanding of SOX 404	25	19	8	48
Progress made towards meeting SOX 404 requirements	27	13	3	57

Comment

48% of respondents regarded the question on their level of understanding of SOX404 as not applicable, while 57% of respondents regarded the question on progress made towards meeting SOX404 requirements as not applicable. This is not surprising given that the SOX404 requirements are only required to be met by SEC registered groups, although it is generally good practice for any listed company worldwide to implement an internal controls policy along the lines stipulated in section 404 of the Sarbanes Oxley Act of 2002.

11 Management challenges facing the tax function

Please rank by level of importance each of the following challenges in your company and indicate the extent to which they are effectively managed (1 being the most important).



Comment

The above question addresses the management of the internal tax function (i.e. the management of relationships, people and costs).

In terms of level of importance, respondents thought that managing relationships with the fiscal authorities was the most important challenge to address. Finding staff with adequate tax experience was also a significant challenge.

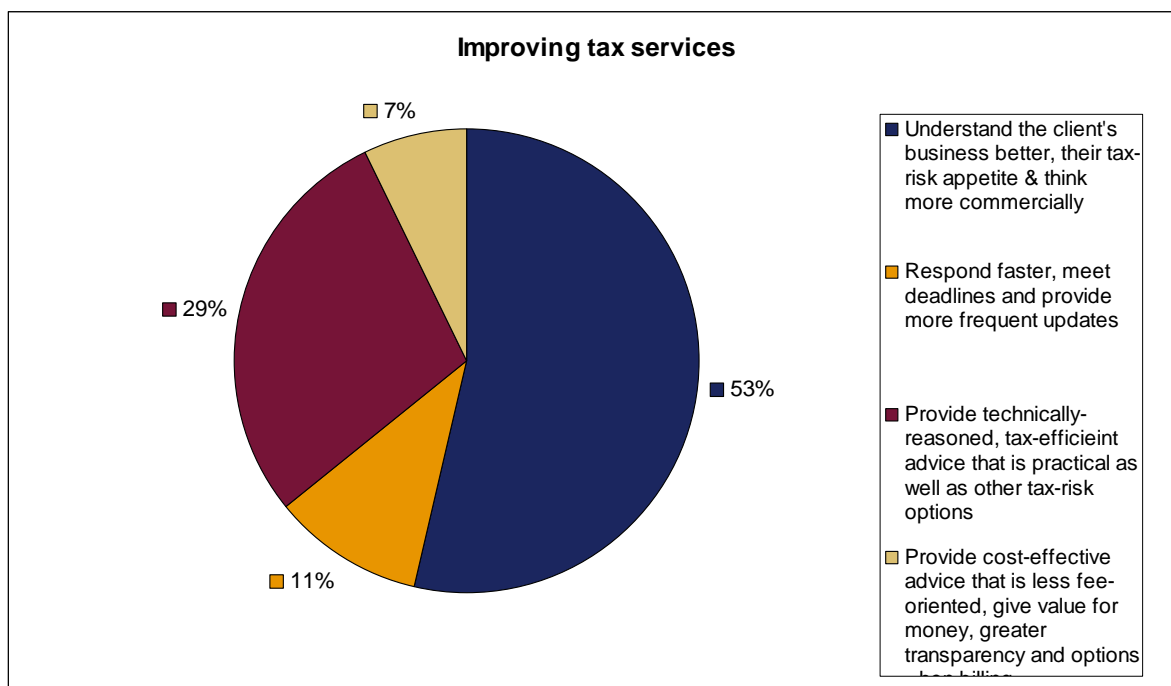
The risk associated with 'getting the tax wrong' is fuelling an increasing need by tax functions to maintain relationships with the fiscal authorities and find tax staff with the required experience. Furthermore, as tax laws and regimes across the African continent continue to increase in complexity, the need to draw on the depth and experience of external service providers' increases and thus managing and preserving relationships is increasingly important to those with an in-house tax responsibility.

Some comments from participants include:

- From the UK: *“Lack of external training courses for African taxes”*.
- From South Africa: *“I would like to get some routine training and would like to hear more about this”*.

12 Improving tax services

Please rank the three ways in which advisers could improve the tax services they provide to you (1 being the most important, 2 being the next most important and 3 being the third most important).



Comments

Respondents felt that understanding the clients business, their appetite for tax risk and thinking more commercially was a key area that tax advisors should address. Respondents also felt it important that tax advisors should provide technically reasoned and efficient advice that is practical as well providing other tax-risk options. Responding faster to client's needs and meeting deadlines was also regarded as an area where tax advisors can improve.

Some comments from participants included:

- From South Africa: “[It] would be good if [there was] more focus on pro-active tax planning advice”.
- From Kenya: “Advisors have to understand clients’ business if advice given, is to be relevant”.

13 Key topics of interest indicated by survey participants

To help us to ensure that the content of our Business Partners in Africa Conference is as relevant as possible for you, we should be grateful if you would select the topics that you would be particularly interested in.

Response

The topics in which respondents expressed the most interest were as follows:

1. Tax risk management
2. Update on tax developments in Africa
3. GST/VAT
4. Holding company structures
5. Expatriate taxation issues

The 2007 Business Partners in Africa Conference held in Mauritius in September 2007 catered for the above by hosting the presentations below:

Tax risk management

- Tax risk management in sub-Saharan Africa (David Tarimo and William Eastwood)
- Tax function effectiveness – improving your tax function's performance (Ine-lize Terblanche)

Update on tax developments in Africa

- The race for Nigeria (Ken Aitken)
- Democratic Republic of Congo: opportunities abound (David Guarneri)

GST / VAT

- VAT registration requirements and compliance in Africa (Charles de Wet and Russell Eastaugh)

Holding company structures

- Holding companies and regional headquarters – can Africa attract and retain? (Serge de Reus)

Expatriate taxation issues

- Expensive exposures – are you tracking your share option tax liabilities? (Claire Bladen)

We hope to run this (or a similar) survey every couple of years with a view to identifying changes in trends. If you have any questions with regard to the survey, or would like us to include further questions, please contact:

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