Public Private Partnership - Taxation

Public Sector Tax Seminar

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General Overview

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Introduction

Introduction

- Public Private Partnerships (also known as P3s or PPPs) - contractual arrangements between public and private sector entities where private sector participates in multiple elements of public infrastructure projects

- PPP - single private entity responsible and financially liable for performing all or a significant functions in a project

- PPPs combine private sector capital with public sector commitments (and sometimes, capital) to procure facilities, improve public services and/or improve the management of public sector assets

Introduction…cont'd

- PPPs focus on public service results and offer a more cost-effective approach to public sector risk mgt infrastructure

- Projects undertaken as PPP are often used in whole or in part by the general public or a public agency

- Public Participant - State or state agency/County government

- Private Participant - joint venture/domestic/foreign

Is it a partnership?

- Not in the traditional legal sense, more likely a joint venture or a "lease" or "franchise" arrangement

Introduction…cont'd

- PPPs can be either concessions or greenfield projects

- Concessions occurs when a private entity takes over the management of a state-owned asset for a given period during which it also assumes significant investment risk

- Concessions include:

a) Rehabilitate-Operate Transfer (ROT)

b) Rehabilitate-Lease-Transfer (RLT) or Rehabilitate-Rent-Transfer (RRT)

c) Build-Rehabilitate-Operate-Transfer (BROT).

Introduction…cont'd

❖ Greenfield projects require a private entity or a public-private joint venture to build and operate a new project for the period specified in the contract

❖ The project usually returns to the public sector at the end of the concession period

❖ Greenfield projects may include but not limited to:

a) Build-Lease-Own (BLO)

b) Build-Operate-Transfer (BOT) or Build-Own-Operate-Transfer (BOOT)

c) c) Build-Own-Operate (BOO)

Objectives of PPPs

- Enhance capital sources for creating new and improving existing infrastructure
- Promote efficiency in infrastructure development and execution
- Leverage existing assets and future cash flows to facilitate capital formation and respond to pressing infrastructure needs
- Private sector knowledge and skills transfer
- Economic growth drivers

PPP's Risks

- Political, regulatory and change of law risk
- Additional costs of project oversight, documentation and execution may exceed savings from efficiencies
- Market projections fail to pan out

Advantages of PPP'S

- Tapping new money for infrastructure
- Cost savings
- **Ease of public debt**
- PPPs can spur innovation
- PPPs shorten project delivery by several years
- Transfer of supply and demand risk to the private sector

PPP's in Kenya

Some of the opportunities for PPPs are:

- Standard Gauge Railways
- Lapsset project
- Dongo Kundu Special Economic Zone
- Increase of power generation to 5300 MW
- 10,000 KM road plan

Balancing Act in PPPs

Private participants financing goal

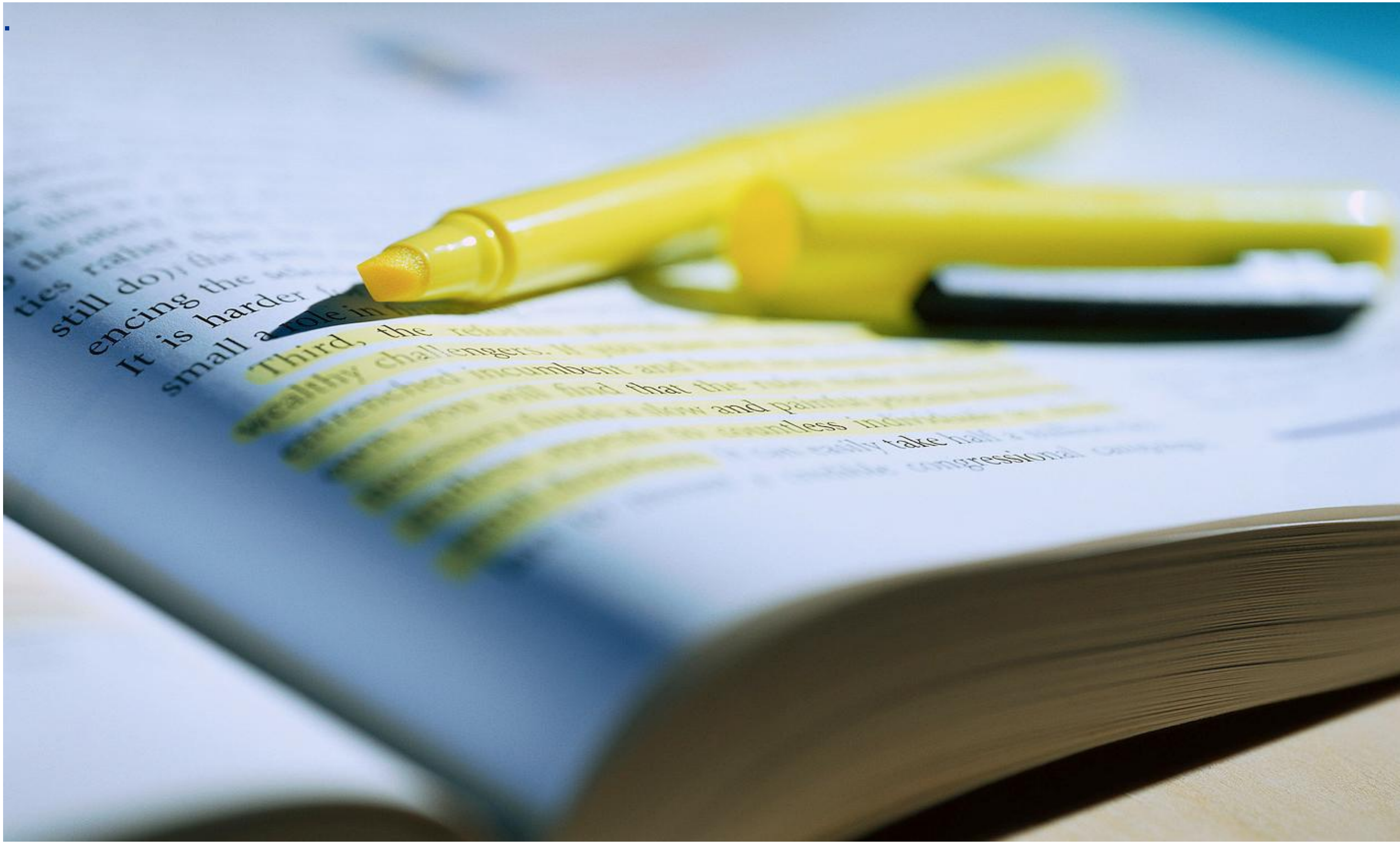
- Return on investment

Public participants financing goal

- Obtain asset at lowest cost
- Avoidance of excessive debt limits
- Avoidance of public procurement requirements

Reality is that the cost or the risks involved have the potential to reduce or eliminate the perceived benefits to each side

Highlights of The Public Private Partnership Act (PPP Act)



Highlights of PPP Act in Kenya

- The Public Private Partnership Act No 15 of 2013

- Came into force on 8th February 2013

- Defines a PPP as an arrangement between a contracting authority and a private party in which a private party:

- Undertakes to perform a public function or provide a service on behalf of the contracting authority

- Receives a benefit for performing a public function either in compensation from a public fund or charges/fees to consumers/users or both; or

- is liable for risks arising from the performance of the function in the agreement.

Highlights of PPP Act …cont'd

Formation of a PPP under the PPP Act

Schedule 2 of the PPPA defines the type of arrangements a contracting authority can enter into with a private party:

- a management contract limited to a period up to 10 years;
- output performance based contact limited to a period up to 10 years;
- a lease not exceeding 30 years;
- a concession not exceeding 30 years;
- Build own operate transfer scheme not exceeding 30 years;
- Build operate and transfer scheme not exceeding 30 years;

Highlights of PPP Act ...cont'd

- Build, lease and transfer for a specific period;
- Build, transfer and operate;
- Develop, operate and transfer with the infrastructure facility being transferred within a period not exceeding thirty (30) years;
- Rehabilitate, operate and transfer within a specified period;
- Rehabilitate, own and operate; and
- Land swap

Highlights of PPP Act …cont’d

Concession for Natural Resources

Where a concession has been granted for the exploitation of natural resources under Article 71 of the Constitution, the project agreement should be ratified by Parliament.

“Natural resources” is defined in the Constitution to mean:
“*…the physical non-human factors and components, whether renewable or non-renewable, including—*
(a) sunlight;
(b) surface and groundwater;
(c) forests, biodiversity and genetic resources; and
(d) rocks, minerals, fossil fuels and other sources of energy”

Incorporation of a PPP in Kenya

- ❖ All project companies must be incorporated in Kenya

Sec 59…a "successful bidder shall establish a project company in accordance with the Companies Act (Cap. 486) for the purpose of undertaking a project in accordance with a project agreement…"

- ❖ The PPPA defines a project company as a "special purpose vehicle company ***incorporated*** by a successful bidder under for the purpose of undertaking a project

- ❖ A special purpose vehicle is defined as ***"a company incorporated in Kenya*** by the successful bidder, the sole purpose of which shall be to execute the PPP contract awarded"

Taxation of PPP’s

Taxation of PPP in Kenya

Corporation Tax

- PPP are incorporated as companies in Kenya and as such are taxed as a subsidiary
- PPP's are subject to corporation tax at 30%
- Losses of PPPs can be carried forward for a maximum of 4 years
- PPPs can claim investment deduction of 150% if the project is outside NRB, MSA & KSM while 100% if in the 3 cities

Taxation of PPP in Kenya

Withholding Tax

PPPs should account for WHT upon making payment on services residents or non-residents for services that attract WHT

Services	Residents	Non-residents**
Management/professional fees/training fees	5%	20%
Technical	5%	20%
Royalty	5%	20%
Dividends	5%	10%
Interest	15%	15%

**DTA rates applicable to non-resident rates

Taxation of PPP in Kenya

Value Added Tax

Purchases and sale by PPPs are subject to VAT

However, Paragraph 29 of First Schedule to the VAT Act provides that, *"Taxable supplies, excluding motor vehicles, imported or purchased for direct and exclusive use in the construction of a power generating plant, by a company, to supply electricity to the national grid approved by Cabinet Secretary for National Treasury upon recommendation by the Cabinet Secretary responsible for energy"*

Therefore, PPPs involved in construction of power generating plant may be exempt from VAT

International Best Practice

Malaysia

- Malaysia has established the PPP unit within the Prime Minister's Department responsible for coordinating and executing PPP projects

- Malaysia has a wide range of investment incentives contained in the *Promotion of Investment Act 1986*

- The main incentives applicable to PPPs include:

- **Pioneer Status** - the most important advantage of acquiring pioneer status is the partial exemption from income tax for a period of five years

Malaysia…cont'd

- **Pioneer Status** - Granted to companies participating in promoted activities producing promoted products

- Companies are granted a tax exemption on 70% of statutory income. However, tax rebate extends to 85% of statutory income for five years in designated locations

- **Investment Tax Allowance** - Companies are granted an allowance of 60% in respect of qualifying capital expenditure

- Allowance in respect of qualifying expenditure extends up to 80% for companies located in designated areas

Malaysia…cont’d

- **Infrastructure Allowance** - available for any company resident in Malaysia engaged in manufacturing, agriculture, hotel, tourist and other industrial and commercial activity in Sabah, Sarawak, and the Designated Eastern Corridor of Peninsular Malaysia.

- The allowance is offset against up to 85% of statutory income in the year of assessment. Any unutilized allowances can be carried forward to the subsequent years until they are fully utilized

- **Stamp Duties Remission** –on service agreements signed between companies and the government - reduces transaction cost

Singapore

- Singapore does not have specific legislation designed to provide tax incentives to encourage PPPs

- However, Singapore has traditionally offered a wide range of tax incentives for many years such as:

- Pioneer incentives
- Investment allowances
- Development and expansion incentives

These incentives are similar to those outlined above in the Malaysia legislation and can be utilized by companies involved in infrastructure development

Indonesia

- The Indonesian government has a policy on PPP as part of its five-year national development plan intended to streamline the PPP process

- The Ministry of Economic Affairs has published a PPP investor's guide, which states that the government will assist with land acquisition and tariff reduction in certain circumstances

- The Minister for Economic Affairs announced that tax incentives for infrastructure projects will be similar to those in manufacturing in the form of tax holidays and tax allowances

Indonesia…cont'd

The Indonesian Income Tax Law provides various incentives to encourage companies to invest in certain qualifying business sectors and or regions such as:

- A 30% investment allowance;
- Accelerated depreciation of fixed assets (twice as fast as the normal rate);
- Longer tax loss carry forward period (extended from five years to ten years);
- A reduction of withholding tax on dividends paid to foreign shareholders from 20% to 10%; and
- Tax Holiday (5 to 10 yrs) and a 50% tax reduction for 2 yrs after end of the tax holiday

Proposed Tax Incentives for PPPs in Kenya

Proposals for tax incentives?

- Tax holidays for PPS
- Tax stabilization for PPPs
- Reduced corporation tax and WHT rates
- Location based incentives
- Extended loss carry forward provisions
- Accelerated capital and investment allowances
- Import duty exemptions

Conclusion

Conclusion

There exists no special tax incentives for PPPs

However, in order to achieve vision 2030, the government will need to involve PPPs

One of the sure way of attracting PPPs is coming up with tax incentives for PPPs

Caveat

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

Q & A

Session