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Africa mining finance know-how

Ethiopia

Overview of legal system

The legal system in Ethiopia is largely based on civil law with elements of international, customary and Islamic law also applicable. The key piece of legislation is The Constitution of the Federal Republic of Ethiopia which was adopted on the 8th December 2014.

The legal system in Ethiopia is predominantly parliamentarian. The highest executive powers are vested in the Prime Minster but all powers exercised by the executive branch must be exercised in line with the Constitution.

Overview of laws applicable to mining activity

As regulated by the Ministry of Mines and Energy the principal laws that govern the mining industry are as follows: the Constitution of the Federal Republic of Ethiopia, the Mining Income Tax Proclamation (as amended), the Mining Operation Proclamation (as amended) and the Council of Ministers' Regulations on Mining Operations (as amended). Other environmental, labour, and health and safety laws are also relevant to the mining industry.

The Mining Act regulates and stipulates the appropriate processes for obtaining one of the various licences available and sets forth the rights and obligations of holders of one of these licences. All applications must be made to the Licensing Authority.

Reconnaissance Licence

The holder of a Reconnaissance Licence is allowed to carry out non-exclusive reconnaissance operations over the specified area of land subject to various environmental safeguards. The licence can be granted for a period of up to 18 months but this period is non-renewable.

Exploration Licence

Provided that the applicant has the necessary financial and technical capabilities an Exploration Licence will be originally issued for a period not exceeding three years. This can subsequently be renewed twice, for one year periods. This maximum total can however be extended provided that the applicant can prove advanced additional exploration activity is a necessity.

An Exploration Licence confers upon the holder the right to conduct testing and analysis on all of the minerals found but does not allow for the sale of any of the discovered minerals. The holder has an obligation to begin exploration operations within 60 days of the issuance of the licence.

Retention Licence

The holder of a Retention Licence is granted the opportunity to maintain control over an area of land he has been prospecting in which mineral deposits of potentially significant value have been found but mining operations cannot begin immediately as a result of adverse market or economic conditions. The holder is obliged to produce progress reports highlighting the economic conditions prohibiting the operations and those efforts being made to ensure mining will eventually begin.

The licence is originally granted for a period of up to three years and can be renewed once for a further period not exceeding three years. However a licence will not be granted if the licensing authority believe the applicant can indeed start operations or else the granting of the licence may encourage anti-competitive behaviour within the Ethiopian mining industry.

Small Scale Mining Licence

Assuming the necessary financial and technical capabilities are in place a Small Scale Mining Licence can be granted for a period of up to ten years, renewable for further periods of five years. The licence confers upon the holder the right to market and sell all minerals produced. The holder must however begin mining operations within one year of the issuance of the licence.

As according to the Mining Act ‘Small Scale’ is defined as anything not exceeding 100,000 cubic metres for the operation and 75,000 tons of minerals to mine for precious and semiprecious minerals, and 150,000 tons for open pit mining and 75,000 tons for underground mining for metallic minerals. For industrial minerals the limit is 120,000 tons.

Large Scale Mining Licence

Provided that a work programme is in place, that the necessary environmental review has been accepted and that the appropriate technical and financial capabilities have been exhibited, a licence can be granted for a period of up to 20 years. This is renewable for periods not exceeding ten years each. The licence gives title of the minerals to the holder. ‘Large Scale’ mining is defined as anything above the limits for Small Scale mining.

Restrictions on foreign ownership

In the mining industry there are no restrictions on foreign ownership of project companies wishing to establish a mining operations in Ethiopia. However, reconnaissance operations may only be conducted by Ethiopians who have a licence, whereas foreigners are not permitted to conduct reconnaissance operations at all. Only Ethiopians nationals can apply for, and obtain, artisanal mining licences.

There are no provisions in place to prohibit foreign nationals from owning private land. However, pursuant to the Constitution the Ethiopian government does have the right to expropriate any immoveable property on the land with the holder entitled to compensation.

Local content

All holders of a Mining Licence have an obligation to give preference to Ethiopian goods and services so long as they are available at the needed time and of equal quality. Furthermore the government will incentivise mining operations which are deemed to promote domestic resources.

Available structures for borrowing vehicles

Limited Liability Company (LLC)

In order to incorporate a limited liability company in Ethiopia it is necessary to have at least one director and two shareholders. The minimum paid up capital required at incorporation is approximately 520 US dollars. There are also several other nominal fees required to complete incorporation.

After incorporation provided the company has more than 20 shareholders it is necessary to appoint three auditors. There are no obligations for the directors and shareholders to be Ethiopian residents.

Public Limited Company (PLC)

Commonly used by investors who would like to trade shares on regulated commercial markets, the Commercial Code provides that the minimum paid-up capital of a PLC is approximately 1,800 US dollars. However, for any foreign investment, there is a minimum capital requirement of USD200,000 for an investment project by a foreign investor and USD150,000 where the foreign investor is investing jointly with a domestic investor. It is obligatory upon incorporation to appoint a minimum of three directors, five shareholders and one auditor.

Branch Office

Foreign entities are allowed to establish and operate branch offices in Ethiopia subject to approval from the Ethiopian Investment Commission. Its scope of operations is defined by the parent company. With a branch office however the liability will be unlimited. There are nominal fees associated with the establishment of a branch office.

Government free/earned carried interest in projects

The Government of Ethiopia has the right to a free carried interest of 5% in any mining project. The Ethiopian government may seek to further increase their equity participation in a project through negotiation with the project company.

Taxation of mining projects (including royalties)

The Mining Act sets forth all of the relevant taxation payable by a company engaging in a mining project. Income tax is payable at a rate of 25% (5% lower than normal corporations pay). Tax is also payable on 10% of dividends and on 5% of local interest deposits. All imported equipment and goods that are needed for the mining operation will be exempt from the associated custom duties and taxes.

Ethiopia does have double tax treaty rates in place with many countries including China, France, India, Russia, and the United Kingdom. The tax treaty with the United Kingdom stipulates that tax is payable at a rate of 10% on dividends, 5% on interest and 7.5% on royalties.

The fee levied for royalties is contingent upon the type of mineral being mined and the nature of the licence. The relevant fee for large scale mining operations will be between 2% up to the maximum of 8% which is levied on precious minerals.

Withholding tax on interest and dividends. Possible structures to mitigate withholding on interest

In Ethiopia withholding tax is payable at a rate of 10% on dividends, 5% on interest and 5% on royalties pursuant to the Income Tax Proclamation.

Further, a licensee effecting payment to a non-resident subcontractor shall withhold and transfer to the tax authority 10% of the payment.

F/X issues

The NBE does not authorise the repatriation of interest and principal payments on loan or credit facilities that have not been approved by it. Therefore all capital brought in and invested in Ethiopia must be registered by the Ethiopian Investment Commission and the NBE. Technology transfer agreements must be also be registered with the Ethiopian Investment Commission to avoid difficulties during repatriation of profits and dividends and other payments.

All payments out of Ethiopia will require a permit and all transactions in foreign exchange must be carried out through authorized dealers as supervised by the National Bank of Ethiopia. The national bank has delegated most of the foreign exchange transaction functions to the commercial banks but it still strictly dictates margins. Importers and exporters can obtain import/export permits through the relevant commercial banks. In addition exporters can indefinitely retain 30% of their foreign exchange proceeds but must sell the remaining 70% to commercial banks within four weeks. Foreign investors are allowed to repatriate all of their profits abroad.

The Transparency in Foreign Currency Allocation and Foreign Exchange Management Directive No.FXD/46/2017 that was issued in 2017 provide an expanded and detailed list of import items and payments for which priority is given in the allocation of foreign currency. The External Loan and Supplier's Credit Directive No. 47/2017 allows foreign investors whose debt to equity ratio doesn't exceed 60:40 of the foreign capital to access an external loan.

Hedging

There is no ISDA opinion available which would address the enforceability of the termination, bilateral close-out netting and multibranch netting provisions of the 1992 and 2002 ISDA Master Agreements. This does not mean that such provisions would not be enforceable and if necessary a legal opinion from a local counsel in Ethiopia can be sought to confirm this. Alternatively (or if such enforceability cannot be confirmed) a back-to-back hedging structure can be put in place with a shareholder of a Ethiopian company or another group company located in a jurisdiction where the enforceability of such provisions has been confirmed in an ISDA opinion.

Nature of available security

Security is available over both movable and immovable assets. A pledge over moveable assets requires taking possession of the pledged asset. Local private banks often require a large percentage of loans as collateral, which must usually consist of cash or durable capital physically located in Ethiopia. The national bank must approve loans from overseas institutions that require hard currency debt repayments.

Cost of granting security

In Ethiopia stamp duty is payable on a wide range of legal documents. For example it is payable with respect to security deeds at a rate of 1% of the value of the deed. Additional nominal fees are payable with respect to executions and all other contracts or assignments.

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