

What You Should Know When Purchasing an Oil&Gas or Mining Company

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The sale and purchase of oil and gas or mining companies are one of the most complex transactions. There are many nuances in checking the acquired asset, obtaining transaction permits from state authorities, and taxation aspects. The article outlines the main practical tips for committing such transactions in Kazakhstan.

Legal Due Diligence

No matter whether it is purchase of subsoils use right (asset deal) or company that owns subsoil use right (share deal), or holding company, in all these cases the legal due diligence of the target asset is recommendable.

The subsoil use industry is associated with high risks:

- risks of no commercial discovery after exploration;
- failure of actual confirmation of reserves previously approved (including the geological misrepresentation);
- risks of termination of the subsoil use contract due to violation of the license and contract terms, etc.

In addition to operating activities, the company's 'corporate history' is also subject to the check. For instance, when transactions for the change of control over a subsoil user committed without the permit of the competent authority are detected, there are high risks of terminating the subsoil use contract even with the new owner of the subsoil use project. As another precedent there is the case when a transaction for sale-and-purchase of a subsoil user was cancelled under the claim of spouses. Individuals-shareholders of LLP sold their shares and in a few years their spouses have filed claims to invalidate the transactions due to the absence of notarised consents of the spouses to the disposal of joint property. Any such violations affect the 'quality' of the acquired asset and can help to reduce the price or receive seller's guarantees to compensate the buyer for damage, if the identified risks are occurred after the transaction closing.

Taxes

Tax issues are subject to special analysis when structuring a transaction. As a rule, VAT and income tax are relevant for such transactions.

VAT arises, where the subsoil use right and related assets (e.g., a shift camp, gold recovery plant, or field construction facilities) are sold (a subsoil use contract is assigned). At the same time, VAT can be avoided by structuring the transaction through the sale of shares in a company that owns such assets.

Income tax and mitigation thereof are more complicated issues. A seller tries to structure the transaction with minimal own taxation. In this case, the transaction parties should always remember the following three things.

First, any 'artificial' reduction of the purchase price also reduces the 'acquisition cost' for the buyer. When such a buyer resells the asset in the next few years to another, his tax will be calculated on the basis of the acquisition cost. Therefore, the higher the acquisition cost for the buyer now, the lower his taxable income from capital gain in future.

Second, tax legislation stipulates extraterritorial taxation of income from the sale of oil&gas or mining companies. In other words, even if it is not a Kazakh legal entity that is being sold, but its foreign parent company, and even if the buyer and seller are also foreign entities, the seller's income (capital gain) from the sale will be taxed in Kazakhstan in any case.

Third, if the parties structure the transaction incorrectly and consider that they have optimised taxation, or simply do not pay income tax in Kazakhstan, then the obligation to pay capital gain tax will be imposed on the subsoil user. Thus, the buyer should pay maximum attention to the issues of income tax optimisation, since subsequently the obligation to pay this tax may be imposed on the acquired subsoil user. For instance, you can provide for the seller's obligation to indemnify the buyer for any such future tax claims.

Sale-and-Purchase Agreement (SPA)

An agreement can be really simple, when an asset is sold 'as is'. These are cases when the seller is selling and the buyer is acquiring an item in whatever condition it presently exists, and the buyer is accepting it with all faults, whether or not immediately apparent.

The agreement may also be more balanced towards the buyer, when the seller provides for warranties and representations. For instance, it can be warranty of the subsoil use right validity under a subsurface use contract, warranty of no significant and hidden risks, etc. A comprehensive due diligence allows identifying more specific risks and requesting the seller to provide indemnification for such risks.

Transaction Approvals (Permits) by State Authorities

Any transaction is usually checked for the need to obtain two types of permits:

- 1) Approval of a competent authority to the transaction;
- 2) Consent to economic concentration.

Both permits are obtained by the buyer, however it requires assistance (provision of documents and necessary information) from the seller.

A transaction permit, with rare exceptions, is required in all cases of changing control (direct or indirect) over a subsoil user. When the subsoil use right is sold, then in addition to obtaining a permit, it is also required to sign a supplement to the subsoil use contract. All these issues are within the competence of the Ministry of Industry and Infrastructure Development of the Republic of Kazakhstan (on solid minerals) and the Ministry of Energy of the Republic of Kazakhstan (on hydrocarbons and uranium).

If the subject of a transaction is a subsoil plot or a deposit being recognised as strategic under Article 43 of the Code of the Republic of Kazakhstan On Subsoil and Subsoil Use, then in considering the issue of a permit, the competent authority will also consider the exercise by the state of its priority right to purchase control over such a deposit. To this day, 137 subsoil plots are recognised by the state as strategic, where 56 are uranium and 81 are oil and gas fields. Besides, the seller may be required to obtain permit from the Government of the Republic of Kazakhstan to alienate an asset that is recognised as strategic under Article 193-1 of the Civil Code of the Republic of Kazakhstan (for instance, interest (stock) in uranium companies).

The need of obtaining the consent for economic concentration (*issued by the Committee for the Protection and Development of Competition of the Ministry of National Economy of the Republic of Kazakhstan*) requires a number of 'tests' of the proposed transaction.

For instance, if a 100% interest in LLP that is a subsoil user is sold, then the buyer must obtain consent for economic concentration, if:

- ✓ the total book value of the assets of the LLP and buyer's group of persons exceeds 10,000,000 MCI (i.e., 25,250,000,000 tenge for 2019 or about 65 mln US dollars at a rate of 390 tenge per 1 US dollar);

or

- ✓ the total sales volume of the LLP and the buyer's group of persons for the latest financial year exceeds 10,000,000 MCI.

If the subsoil use right is sold, then the buyer must obtain consent for economic concentration, if:

- ✓ the book value of the subsoil use right exceeds 10% of the book value of fixed assets and intangible assets of the seller;

and

- ✓ the book value of assets or sales volume of the buyer's group of persons for the latest financial year exceeds 10,000,000 MCI.

In practice, obtaining the above permits from state authorities is complicated by the fact that both processes are not running in parallel. The Committee for the Protection and Development of Competition suspends considering the application for consent to economic concentration until the applicant obtains a transaction permit from the competent authority. Although there are no legal or other explanations for this order. The competent authority is actually considering a new investor for the availability of managerial, financial, technical and other project management capabilities. The Committee for the Protection and Development of Competition is considering a transaction for the possible restriction of competition as a result of its commitment.

Special attention shall be also given to the obligations of the parties after the transaction closing. For instance, the Code On Subsoil and Subsoil Use requires submission to the competent authority of the so-called notice on change in control over the subsoil user. The subsoil user is required to submit such a notice within 30 calendar days after the change in control.

All the above is only a part of what could and would be reviewed in terms of transactions on purchase-and-sale of oil&gas or mining companies. The right approach to the transaction arrangement will allow the parties reducing time and financial costs as well as the likelihood of disputes among them in the future.