The investment law of French Polynesia

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This paper gives a comprehensive overview of the investment regime of French Polynesia. It sets out the advantages and disadvantages of investment in French Polynesia, and specifically seeks to answer the questions "Why invest in French Polynesia?" and "How to invest in French Polynesia?"*

I INTRODUCTION

French Polynesia is best known for its scenery, its folklore and its culture and has a romantic and historical allure for people in other parts of the world and for those 12,000 miles away in Europe in particular. This paper deals not with these attractions but with another aspect of French Polynesia. It deals with the economic situation that exists alongside the image of a paradise and the beauty and special features of this French Overseas Territory.

The legislative and economic development of French Polynesia can, for the purposes of this paper, be said to have begun when Tahiti was given the status of a protectorate in 1842. That status was confirmed in 1847. Tahiti was annexed to France by statute of 30 December 1880, and the other islands (which with Tahiti now form French Polynesia) were annexed soon after and all the islands were organised as a colony, under the name of the French Oceanic Establishment, by decree of 28 December 1885.

The general institutional awakening in the French territories began only with the basic law of 23 June 1956. This was followed locally by the enactment of a statute of 1957 which allowed French Polynesia to move dramatically from a special legislative regime and to enjoy a degree of political decentralisation. The statute of 1957 was followed by those of 1977, 1984, and by the amendments of 1990, all of which dealt with the sharing of power between the Territory and the central government.

At the economic level the setting up of the Pacific Testing Centre (CEP-Centre d'essai du Pacifique) in 1963 was a major event which triggered great changes in French Polynesia. This happened notably because of the arrival of a large number of people from France who had income at their disposal, with the creation of a great number of

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employment positions for Polynesians, and with the setting in place of modern governmental infrastructures.

The CEP is therefore at the origin of an economic boom whose speed and extent is unprecedented. In 20 years French Polynesia moved from a traditional familial subsistence economy to a consumer led economy. But as will be seen the economy is artificial because its wealth comes essentially from the transfer of public money from France to the Territory. The effects of this have been the collapse of the primary sector, the stagnation of the secondary sector and the overstimulation of the tertiary sector.

In the 1970s the CEP, having reduced the volume of its activities, withdrew to Mururoa, the strategic site where the French nuclear testing takes place. However the economic imbalance created during this euphoric period is important: there was an artificial growth, and a geographic and economic change, as well as an increased dependence on the Metropol. Today the questions of a "life after CEP" and the reconstruction of a less dependent economy are being asked, and being asked with increasing urgency since France announced the 1992 suspension of nuclear testing.

It is now possible to observe a willingness on the part of the local public authorities and the metropolitan public authorities to create bases of development which are capable of giving the economy a second wind and to provide an answer to the withdrawal of CEP, in particular by reducing imports and encouraging a degree of self-sufficiency for the Territory.

The main elements of the policy that has been established concern arranging the greater development of local possibilities, modernising agriculture, the development of fishing and tourism from a home-grown level to an industrial level, the diversification of artisanal and industrial production, and the revitalisation of the island groups to reabsorb the rural exodus and to encourage in them the development of productive activities of a traditional and contemporary nature.

This new orientation demands large capital sums that at present can be achieved only by opening up French Polynesia to the outside world in order to attract investment and foreign capital. That money can then be directed to the sectors prioritised within the general development policy.

A series of measures have thus been taken by the public authorities in order to encourage potential investors, both local and foreign, to contribute to the development of those undertakings of an artisanal or semi-industrial kind which can play a role in import substitution.

The object of this paper is to provide a practical guide to the economic and legal aspects of investment in French Polynesia.

Attention will be focussed on those matters which are specially important for investment in French Polynesia. The paper is in two main parts. The first part seeks to answer the question "Why invest in French Polynesia?". It addresses the motivation and reasoning which might lead a person to invest in the Territory. For this purpose the specific characteristics of the Polynesian environment as seen from a geographic, economic, social, administrative, political, fiscal, legal and accounting point of view will be described. A brief analysis of the investment incentives is also given.

The second part seeks to answer the question "How does one invest in French Polynesia?". The emphasis in this part will be on the steps to take and the formalities that need to be completed to give a project the maximum chance of success. Finally, some recommendations are made in relation to difficulties that might arise in an investment project.

PART I INVESTING IN FRENCH POLYNESIA - WHY?

The answers to this question are provided by an analysis of the reasons and likely motives that draw investors to French Polynesia. These can relate to the environment on the one hand and investment incentives on the other.

I THE ENVIRONMENT

Every investor knows that the environment is an important factor in any investment decision. It is useful therefore to outline the positive and negative aspects of the Polynesian environment from the geographic, economic, social, administrative, political and fiscal points of view.

A The Geographical Setting

1 Negative factors

The particular geographical situation of French Polynesia in itself creates numerous structural difficulties. Situated in the centre east of the Polynesia triangle (Hawaii, New Zealand and Easter Island) French Polynesia is a Territory which covers a surface area of 4,000,000 square kilometres. In this immense ocean domain the total land area is a bare 4,000 square kilometres.

The Territory is made up of 108 main islands grouped into five archipelagos: the Australs, the Society Islands (of which Tahiti is one), the Tuamotu, the Gambier and the Marquesas. If the map of French Polynesia is superimposed on that of Europe it is easy to understand the extensive spread of the islands and to appreciate the extent of the practical problems that have to be resolved. If Tahiti is placed on Paris the Gambier are found in Rumania, the Marquesas in Sweden and the Australs in the Mediterranean. On a similar comparison with the United States, if Tahiti is placed on Denver the Gambier Islands would reach Florida, the Marquesas Texas and the Leeward Islands Utah. Besides this spread and the very great distances between the islands within the Territory, French Polynesia itself is isolated in the middle of the South Pacific at great distance from the main world markets. New Caledonia, New Zealand, Australia which are considered as neighbours are, even in the best of cases, 5 or 6 hours by air from Tahiti.

These geographical constraints are inevitable and must always be borne in mind in understanding the Polynesian realities.

2 *Positive aspects*

The geographical situation of French Polynesia also creates advantages. The main advantage is a privileged location at the centre of the Pacific Ocean which some people believe to be the economic zone of the future. Indeed the Pacific has become the privileged sector for production and exchange activities in the world. California and Japan are the two main bases of activity for the Pacific but the other developed countries such as Canada and Australia which are rich in natural resources play a role which is becoming more and more important. It is also important to note the emergence of the new industrialised countries such as Singapore, Hong Kong and Taiwan. The Pacific basin is blessed with a number of advantages: abundant population, mineral and other raw materials, and the absence of armed conflict.

French Polynesia can therefore be developed to play an increased role in the international exchanges which are evolving in this part of the world. Situated halfway between Los Angeles and Sydney, French Polynesia is an ideal stopping place on the routes which link the West coast of the United States to Australia and is therefore well positioned to derive a flow of transit traffic. It is also beginning to establish itself as a place for leisure activities and meetings.

B *The Economic Framework*

The Polynesian economy presents some important constraints but the advantages are not to be underestimated. The large investments already made and the projects in hand are both indicative of the present investment opportunities.

1 *Economic features which are unfavourable to investment*

(a) *Structural problems*

The Polynesian economy is essentially an economy of provision of services. Trade, fed by imports which seek to satisfy the public demand and stimulated by government spending, remains the central element of the Polynesian economy and is also the main obstacle to development of a viable production system which could increase the autonomy of the Polynesian economy.

The standard of living remains high although imports are covered by exports only to the level of 5%.

Those with money to invest are little attracted to the production possibilities and prefer those areas of commerce or land development which guarantee a better and earlier return.

Moreover the financial system which links the French Pacific franc to the French franc at a fixed rate is a disadvantage for the Polynesian economy. In fact French Polynesia has a strong currency which is dependent on an artificial economy.

The over-valuation of the French Pacific franc relative to other currencies means that imported products are more attractive than local products and this slows down the development of the production sector of the economy. It also exacerbates the difficulties of a tourist industry which has the reputation of being expensive and of average quality. At the present time the economy of Polynesia is therefore strongly dependent on the exterior and this increases its fragility.

(b) The limited nature of the internal market

At the last general census, which took place in September 1988, it was established that the total population of French Polynesia is 189,000 inhabitants, of whom 70% live in Tahiti.

This small internal market has an effect on the relative cost of investment both public or private.

For example the automatic telephone and satellite television systems now set up on a semi-automatic basis in the distant islands of the Tuamotu (12,000 inhabitants) and the Australs (6,500 inhabitants) probably represent the most expensive telephone and television systems per head of population in the world!

At the level of private investment, the possibilities of developing a production line industry which would be able to compete effectively with imported products in the many areas where economy of scale plays an important role are strictly limited. The only areas where it is possible to have these developments are those where mass production does not afford a decisive advantage (eg baking, printing, animal food, cosmetics).

Moreover the small size of the local market linked to exclusive rights of importation create non-competitive situations which in turn generate large profit margins.

(c) The high cost of production

Local enterprise is heavily dependent on the importation of raw materials and of the tools and machines needed for production. The distance from the sources of supply increases the cost of transport of imported products. The Polynesian tax system is based mainly on a heavy indirect taxation that further affects the final cost of raw materials and equipment and ultimately the cost of the manufactured products. Moreover local labour is relatively expensive compared with the labour costs in other countries of the South Pacific such as Fiji, Western Samoa and the Cook Islands.

Finally rural poverty which has resulted from the rapid urban concentration around Papeete, the narrowness of the habitable coastal strip, and in particular the rapid development of the rental market, has led to the price of land being prohibitive.

(d) *The lack of natural resources*

The Polynesian islands are small and of recent formation. Their natural economically exploitable resources are modest. Unlike New Caledonia, which has important deposits of nickel, the absence of natural mineral and energy sources has kept French Polynesia out of the major industrial revolutions.

The only mineral resource discovered so far is phosphate. The exploitation of a deposit at Mataiva in the northern Tuamotu is now possible. Extensive studies on the economic impact and consequential disturbance to the environment were undertaken. The decision of the territorial authorities to grant a mining permit to a syndicate (made up of partners from France, Australia and Canada) has been temporarily suspended following opposition from a part of the population of the atoll concerned.

In spite of the difficulties described above the Territory nevertheless provides an economic environment which is hospitable to investment.

2 *Investment opportunities*

(a) *Tourism*

Tourism has for several years been the principal industry of the Territory. Whole islands, such as Bora Bora, Moorea and Rangiroa, live by tourism. However in spite of all the advantages that nature has given the Territory, the development of tourism remains well below its potential. The territorial government aims to double hotel capacity by 1995 - that is to say a further 2,500 rooms. In qualitative terms, if priority till now has been given to an upper class clientele which alone made possible survival through the ups and downs of economic and social upheaval, today it seems necessary to open up to a less affluent and more populist tourism. Studies undertaken by the Polynesian Office of Tourism in the United States and in France have identified such a market.

(b) *Industry*

Following the efforts of recent years to develop production activities and to transform the economy in order to provide substitutes for imports, several dozen small and middle-sized industrial units have been established. They satisfy demand for small amounts in a great variety of areas. The existing industrial set-up is however far from having reached its potential and numerous opportunities still exist for investors. The Territory is not yet ready to provide for itself in terms of equipment and consumption goods.

A privileged relationship with the EEC, with states of the South Pacific, and with certain other countries (USA for example) makes it possible to envisage the establishment of industries which, beyond satisfying the local market, could have export possibilities.

(c) Agriculture

The Territory imports almost 80% of its food. This situation of extreme dependence on external sources is worrying but reveals the existence of a very significant local market which could justify the setting up of an agricultural undertaking. The enterprises that exist are for milk products, cooking oils, meat, small goods, animal foods, aerated beverages, fruit juices and brewing.

The potential for activities to establish or extend in the field of food processing (canning and bottling) and agricultural product processing is considerable. The preserving of fresh products (fruit and vegetables) and the processing of these same products are the two main areas for commercialisation of agricultural products. The enterprises likely to be developed in the coming years are the processing of fresh fruits, products derived from the coconut (milk and oil), the dehydration and drying of fruits, vanilla, and the recognition of the worth of certain aromatic plants for cosmetic and pharmaceutical use.

Moreover the current investigation of diverse export markets encourages early development in the field of tropical fruit products. There is also the same possibility for flower production which shows promise because of the increased number of direct air links with potential markets such as the United States, Europe and Japan.

(d) Handicraft and small businesses

The best areas at the moment are service (repairs and maintenance), small businesses in the food production area (bread making, pastry making and confectionery), and handicrafts (small workshops dealing in working and mounting plastics, wood and leather).

(e) Energy

The prospects for the future involve the development of renewable energy sources such as sea, sun, wind and water. The territorial and national governments consider that the energy sector is a privileged one for cooperation between France and French Polynesia with the states of the South Pacific, and so it is envisaged that there will be an exportation of hydro-electric and solar-electric systems to these other countries.

(f) Fishing, aqua-culture and pearl culture

The Polynesian ocean domain is an important natural resource but it is under-exploited through lack of appropriate means. The marine resources are still without any significant exploitation. The Territory decided to support the development of a true fishing industry by the establishment of fishing bases and the creation of a local fleet. At the moment fishing at an industrial level is the exclusive domain of the fleets from Asia (Japan and Korea) but locally based fishing is developing little by little.

The lagoons of Polynesia are the ideal place for aqua-cultural activities. Their use for raising crustaceans, fish and shellfish began several years ago but is still possible to foresee a great number of development prospects in this area even if only to satisfy a nascent local demand of which as yet only 20% is met by local production.

The culture of pearls is a more and more profitable and blossoming activity. The black pearl gave rise to an industry for the growth and commercialisation of pearls which places it among the first rank of exports of the Territory. Since 1983 there has been a veritable gold rush in the Tuamotu and Gambier archipelagoes. The governmental authorities of the Territory receive on average three requests for maritime permits per week. This activity is becoming more and more profitable as the techniques for grafting and the control of the mortality of oysters is better understood.

(g) Other areas of opportunity

(i) Research and technologically advanced activities

The state of technological advance of French Polynesia relative to its South Pacific neighbours is shown in a number of areas. Scientific and technical research of high quality gives Polynesia a special impact in the region. This advanced technology is the result of activities undertaken by government research centres of both France and the Territory. This research potential favours the establishment of private research centres which can contribute to the development of activities in the quaternary sector: renewable energy sources, computer technology.

(ii) Goods and services for persons in retirement

The fiscal paradise lifestyle and the pleasantness of the Polynesia climate are all advantages which are likely to attract wealthy superannuitants. There is a potential market for retirement homes and apartment complexes which include restaurant services, medical facilities and sporting activities for the elderly.

3 Relationships with foreign investors

Because of the historical links that Polynesia has with France, metropolitan French have naturally been the prime investors in the Territory, particularly until about 10 years ago.

After the political unrest in New Caledonia much New Caledonian capital moved to French Polynesia. This phenomenon was however short-lived because as soon as the new constitution was in place for New Caledonia the New Caledonian investors withdrew their capital from French Polynesia.

Since May 1989 the reopening of the air-link Papeete Tokyo by Air France presents new perspectives. Important Japanese investors have shown their interest in a number of projects in French Polynesia (particularly hotel projects). Thus in 1989/1990 one Japanese investment group bought the main hotels of Tahiti (the Beachcomber, the Park Royal, and the Hyatt Regency), in Moorea (the Sofitel Ia Ora), and at Bora Bora (the Moana Beach - a hotel complex of great luxury constructed entirely in the lagoon of one of the most beautiful Polynesian islands).

Moreover at the beginning of 1990 Westpac took control of one of the main banking networks in French Polynesia. These examples confirm the importance that overseas partners can have for the Territory's economy.

In the present situation investors are indispensable for economic and social development in French Polynesia and serve to ease the difficulties presented by the progressive withdrawal of the CEP.

4 Modern and sufficient infrastructures

The existence of modern infrastructures in French Polynesia is often not well known. Yet the level of development of the infrastructures in the fields of communications, health and education compare well with those of the most advanced industrial countries. For example, the level of distribution of computing equipment, solar energy equipment and video equipment is one of the highest in the world.

The territorial government maintains an interest in the development of port and airport infrastructures and of air and maritime services for the island groups.

Finally in order to facilitate the setting up of different types of industry new industrial zones are in the process of being developed on the islands of Tahiti and Moorea.

C The Human and Social Setting

1 The difficulties in the Human and Social area

In French Polynesia investors experience a number of difficulties of a social nature.

(a) The over-development of the government and administrative sector

A large portion of the economic agencies do not participate directly in production. Some figures show this clearly. Compared to France there are approximately twice as many public servants (48%, as against 22%, of the total number of persons in salaried employment) and the salary distributed by the public sector in Polynesia is two-thirds of the national total whereas in France it is 22%.

(b) The shortage of and the high cost of qualified workers

Technicians, entrepreneurs and senior and middle level managers are attracted to the public sector which, because its salaries are clearly higher, draws these skills away from the private sector.

The level of salaries for qualified workers therefore has a tendency to align itself with the public service and this results in high salary cost, and a salary cost which is much higher than in other economies in the region. For example, the public service award provides for a salary of 300,000 French Pacific francs (that is to say 16,500 French francs ($US3,000 or $NZ6,000)) per month for an employee at level CC1 which is secondary school certificate plus 3 years tertiary education - ie a person without experience.

(c) The lack of qualification of labourers

This has the consequence of slowing the introduction of new and better skills and preventing the best use of existing equipment.

2 The advantages of the human and social environment

Certain factors work in favour of the investor: the population is young (40% are under 20 years of age), the population has significant purchasing power, and there are very low social costs. The taxes for social welfare are very low because there is no unemployment benefit and low expense involved in pension payments (the retirement regime was only put in place in 1968, the numbers in the population affected is very small, and the pensions provided are modest). The average contribution by an employer to social services is 25%.

D The Administrative and Political Framework

1 Unfavourable factors

The over-development of the administrative sector is an obstacle to economic development in French Polynesia because the budget of the Territory is dedicated to an important extent to paying for the public service. The amount of money available for the investment which must in principle serve the policy of economic growth is inadequate. Thus, for example, out of an annual budget of about 70,000,000 French Pacific Francs investment monies are only 15,000,000 French Pacific Francs - 20% of the total territorial budget.

The size of these obligatory charges leaves little room for manoeuvre or for an effective policy of economic revival and necessitates recourse to indebtedness in order to finance investment expenses.

At the political level the institutions of the Territory are characterised by a degree of governmental instability which can be explained in particular by a lack of political maturity on the main part of the local elected representatives who have held power for only the last 10 or so years. This political instability often makes investors hesitant.

2 Favourable factors

The particular political status of French Polynesia can nevertheless be seen to have elements which are positive for an investor. In fact the statute for internal autonomy granted to the Territory confers very extensive powers on the local leaders; their freedom of action in respect of relationships with external partners is important. Notably they have the responsibility for choosing partners in economic matters. One of the greatest concerns is to reduce the economic dependence of the Territory by attracting to Polynesia types of investment which are suitable to this strategy.

At the institutional level the division of power between the Territory and the State can be stated briefly as follows. Those matters which are within the State power are listed in a limitative way. Essentially they are foreign affairs, the issue of money, defence, justice, communications, and higher education. The Territory has authority for all the matters which are not directly attributed to the State.

In this sense, and unlike local authorities within the French Republic, French Polynesia is not only self-administering but it also governs itself. For that there are two types of local power:

- The Territory Assembly, which consists of 41 elected counsellors, appoints the President of the Government and takes decisions in the fields for which the Territory has plenary power.
- The Government, which consists of 6 to 12 Ministers appointed by the President, administers the Territory. The Council of Ministers establishes the agenda for the Territorial Assembly as well as the processes for the implementation of the Territorial Assembly's decisions.

In order to help local authorities in the economic, social, and cultural development, France has placed an important range of logistic, technical and financial advice at the disposition of the Territory.

Financial assistance from the State comes principally through the intermediary of FIDES (the Investment Fund for the Economic and Social Development of the Overseas Territories) which encourages investment in programmes which fall within the framework of the contract between the central Government and the Territory. Monetary stability and the free circulation of money between French Polynesia and France creates an environment which is supportive of investment development.

E The Tax System

The taxes, duties and levies are determined by the Territory. The result is a fiscal system which is unique and independent of France. This can be a handicap to investors on certain counts but advantageous on others.

1 Unfavourable aspects for investment

These are of two kinds: a heavy indirect tax system and an almost total absence of international agreements for the avoidance of double taxation.

(a) The heavy indirect tax

The fiscal system of French Polynesia is an unbalanced one. Indirect taxation accounts for about 80% of the revenue of the Territory. There is no VAT.

Within the indirect tax system customs duties and import tax account for 76% of all the revenue receipts. The import tax system has three categories of duty -

(1) An entry tax which affects all imported products whatever their origin. It represents roughly 30% of all the territorial revenue and 46% of the indirect tax take. The level of duty is 9% (reduced), 22% (ordinary), 31% (intermediate), 43% (higher).

(2) Customs duties which are applicable to products imported from countries other than the EEC or French Overseas Territories. These duties represent roughly 7% of the indirect tax take. The level of the tax varies between 0% and 30% according to the tariff classification of the product. The average tax level is 10%.

(3) Parafiscal taxes are applied to all products. The most important is the new social welfare tax. It is set at 10% and represents 20% of the indirect tax take. This indirect taxation has serious consequences for local enterprises: supplies are expensive, there is little competition, export is difficult and the costs have to be borne by the enterprise until the sale of the products.

(b) The lack of international agreements relating to double taxation

There is only one double taxation agreement. It was signed in 1957 and avoids double taxation between French Polynesia and France. It relates only to income from corporate cash investments.

Because of its separate financial system French Polynesia is fiscally a foreign country vis-à-vis France and other countries.

Double taxation creates a substantial obstacle to development of international exchanges but the system of direct taxing is particularly advantageous in Polynesia.

The rules of territoriality state that all companies whose head office is outside the Territory but which conduct business within the Territory must pay the companies' tax, or stamp duty and the tax on capital investments.

2 Factors favourable to investment

The indirect tax system as it exists in French Polynesia is a substantial advantage for investors. The direct taxation system is characterised by the absence of a general tax on revenue of individuals. For enterprises the system of the taxing of social benefits is less burdensome and the tax on income from cash investments is advantageous. The cost of registration for companies is relatively low.

(a) Tax paradise for individuals

There is no general tax on income applicable to individuals. Wages and salaries are non-taxable and the social charges are minimal (6.3% of salary). Death duties do not exist. Because of the high cost of living, an individual loses an important part of their income through the tax on consumption items. Individuals not involved in commercial, industrial, small business or professional activities are liable to pay the following taxes: a capital gains tax established by a decision of the Territorial Assembly of 23 December 1989; a land tax on improvements (about 15% of the rental value); a tax on transactions involving rented property (maximum 6%); a house tax; and a tax on private net banking income.

(b) *Tax regime for enterprises*

For enterprises, the tax on income from industrial, commercial or professional activities is relatively low. Two tax systems co-exist - a tax on income and a tax on services.

(i) *Tax on income*

This applies - (1) to companies whatever their object, (2) to civil partnerships involved in a commercial, industrial or small business activity, property development for sale and purchase, and resale activities concerned with real property, and (3) to one person limited liability companies (EURL-entreprise unipersonnelle à reponsabilité limité); unless they opt to pay the business tax.

The level of tax varies between 25% and 45% and is proportional to the fixed assets and employment costs in relation to the net taxable income.

Assessment of tax is based on the net gain as determined by the gross income of the company.

(ii) *Business tax*

Unlike the companies tax this tax on transactions does not relate to the net revenue of the tax payer but is a charge on receipts. Those who must pay the business tax are broadly speaking all who receive income other than by way of salary, or agricultural endeavour, and natural and legal persons who are not liable to company tax: commercial income, the income from liberal professions, artisanal income, and income from real property.

The total annual sum of receipts is taxed according to the following rates: 1-5% for those who provide services and those in the liberal professions, and 2-10% for traders.

The tax is however lessened by:

a favourable threshold system for natural persons;
a system of moderating coefficients applicable to the tax base for enterprises whose profit margins are limited (bakeries, wholesalers, fuel suppliers, ship chandlers, providers of public works and civil engineering);
a system of moderating coefficients which is applicable to the total tax for certain providers of services.

(iii) *Tax on income from corporate cash holdings*

This tax applies to all benefits distributed which are not placed in reserve or credited to capital, and all sums put at the disposal of shareholders from capital.

The tax is borne by the beneficiaries and collected by the company as a withholding tax. The tax is set at 10%, except for bearer shareholders for whom the tax is set at 12%. Relative to the similar provisions which apply in France, this tax is low.

(iv) Registration duty (stamp duty)

Some examples are:

sales of immovable property are subject to registration duty of 7% when the price or value of the property is lower than or equal to 15,000,000 French Pacific francs, above that value the tax is 9%;

sales of going concerns taxed at 5%, new goods at 1.25%;

registration duty on company documents and those of other corporate bodies.

F The Legal and Accounting Framework

What follows is a brief overview of the legal and economic systems of Polynesia so that the information on the Polynesian investment environment is as complete as possible. The sources of law in French Polynesia are the following:

Provisions of the central government: in order to apply in French Polynesia the provision must be promulgated and published in the *Official Gazette* of France. Very often the final article of a statute states "this Act, with the exception of articles ..., is applicable in the Overseas Territories and Mayotte". Following this indication the statute is then promulgated and published in French Polynesia by way of order of the High Commissioner published in the *Official Gazette* of French Polynesia - generally after consultation with the Territorial Assembly.

Provisions made by the territorial authorities: these are established by decisions of the Territorial Assembly and by the Council Ministers in all the areas where power has been devolved by the Statute of the Territory.

The main provisions in force in the Territory are:

part of the French Code of Commerce;

as far as company law is concerned, the laws of France. These apply equally in French Polynesia - in particular the law of 24 July 1966 and the decree of 23 March 1967 relating to commercial companies;

the law of 25 January 1985 on the management and judicial winding-up of enterprises;

The labour law of France does not apply. The labour law of Polynesia which dated from 1952 was repealed and replaced by the new basic law which was voted in on 17

July 1986. The provisions of that law were adopted by the Territorial Assembly in January 1991.

The provisions of the general plan of 1982 are applicable to accounting matters since the promulgation in the *Official Gazette* of French Polynesia of law number 83-353 and of decree number 83-1020 by order number 64NS/MRCL of 14 January 1985.

II INVESTMENT INCENTIVES

The policy for redirecting the Polynesian economy undertaken by the Territory and France aims at reducing the economic dependence of the country vis-à-vis the outside world and to promote development more directed to local possibilities. In order to attain this goal while mitigating the difficulties produced by the environmental factors mentioned in Part I it is necessary to attract investors whatever the cost.

It is in this context that steps have been taken to favour the development of activities in the production sector which are capable of assisting in import substitution.

The code of investment, the Pons law, special development funds, soft loans, and regimes allowing the delayed payment of customs duty, constitute the range of incentives provided for investors by the territorial and French authorities.

A The Investment Code

The investment code is the primary instrument of territorial policy for favouring production investment.

It brings together all the financial and tax advantages granted by the Territory for investment programmes which "tend to promote, in the framework of the plans and programmes for economic development of the Territory, social progress, the creation of new jobs, and the reduction of economic dependence of the Territory on external markets".

The code is a group of provisions which set up a regime which derogates from the general regime and is at present governed by two decisions of 2 June 1983 which have defined the third investment code. The text in force was preceded by earlier versions in 1971 and 1976.

The first decision sets a permanent framework of general provisions used by the Territory in relation to the encouragement of productive investment. The second decision specifies each year the ways in which the code will be applied progressively to direct activity in the territory.

1 *The legal framework of the code*

(a) *Its field of application*

(i) *The economic sectors involved*

The investment code applies to the tourist industry, to animal breeding and agriculture, to food production, maritime activities (aqua-culture, pearl culture and fishing), renewable sources of energy, inter-island communication, production and transformation activities, and export enterprises.

(ii) *The conditions for operation of the code*

Investment projects must comply with minimum thresholds which vary between 15,000,000 South Pacific francs and 30,000,000 South Pacific francs - thresholds which relate to the economic interest in the activities envisaged.

The code deals in the same way with new undertakings and with those already in existence.

In the case of an extension the projects are eligible when the amount of the new investment reaches either the relevant threshold or at least 30% of the total of the gross capital investment of the undertaking (other than land and intangible assets).

(b) *The definition of investment*

Investments include real property expenditure (other than the purchase or renting of land or buildings), infrastructure expenses and environmental upgrading, equipment cost (furniture, tools, equipment, breeding stock) and the various fees involved (architects' costs, lawyers' fees and notarial charges). Account is taken of the profits expected over a maximum of 3 years.

2 *The privileges granted*

The advantages of the code are given to assist the approved undertaking, at the moment of investment, and in its first years of operation.

The code lists the advantages: tax holidays, financial assistance, guarantees as to the stability of the tax regime, and temporary protection measures in the internal market.

The code also sets out limits: the cumulative total of the privileges has a ceiling of 30% of the approved investment.

(a) *Fiscal privileges*

These relate to registration duties and direct taxes and the entry tax.

(i) Registration duty

No duty is payable on the constitutive document or capital accretions of approved companies.

(ii) Direct taxes

The exemptions here relate to 5 taxes: licences, land tax on buildings (only for hotels), tax on the income from corporate cash holdings, and depending on the legal nature of the undertaking, company tax or the tax on professional services.

These tax exemptions are subject to a double limitation: as to the amount (the global ceiling of the advantages) and as to the period for which they exist (in general 8 years in the hotel industry and 5 years in other sectors).

(iii) Entry duty

All goods coming into the Territory are subject to duties and import tax. The code permits exemptions from these entry duties on equipment. The term entry duty has here a restrictive sense because customs duty and the parafiscal taxes are not exempted. This distinction often causes confusion in the minds of investors for whom the entry taxes group together all the duties payable at the time of importation.

It should also be noted that alongside the code, a decision of the Territorial Assembly of September 1988 allows exemption from entry duties for primary products imported by local enterprises for production and transformation.

Since this decision was taken almost all enterprises in this domain of activity have benefited from the tax exemption thus allowing them to lower their prices and to compete more effectively with imported products.

Although this decision has not been expressly included in the code it has become an almost automatic complement to the code.

(b) Financial aid

The systems here include partial reimbursement of the social levies and the surcharge on investment aid.

(i) Partial reimbursement of social welfare costs

The code provides for the reimbursement during the three years following the entry into operation of the approved installations, up to one-third of the social welfare charges for enterprises set up in Tahiti and 50% for enterprises set up in any island other than Tahiti. For enterprises already in operation this aid is granted only for jobs which have effectively been created by the approved programme.

(ii) Investment bonus

This is assessed on the investment expenses which have received the benefit of provisions in the code. In theory the maximum level of this bonus is 15%, with the exception of hotel projects for which the maximum benefit varies between 5% and 16% depending on the place where the projects are operating and the investment sums.

In practice the benefits are rarely allowed at this level. When the bonus is granted, and that is not always done, the level varies most often between 5% and 10%.

It should be stated that this bonus is a subsidy absolutely acquired by the enterprise on the condition that the enterprise fulfils its undertakings.

The bonus is granted in 4 amounts subject to two constraints: the third amount can only be made after the completion of at least 90% of the project, and the balance will only be credited six weeks after the coming into operation of the installations and subject to the condition of their being in conformity with the agreed programme.

The importance of these investment aid benefits relative to the other advantages is reduced with the putting in place of the procedure for exemption from entry duties which did not exist in the earlier codes. The Territory, which finds it easier not to receive than to give, is inclined to be generous in the granting of aid by way of bonuses rather than by use of positive incentives.

(c) The regime for re-invested benefits

This provision allows certain benefits to be exempted from tax, the benefits participating in the financing of a programme approved by the code. It in fact concerns two types of investors:

companies which invest on their own account in an extension programme;
companies which invest in the approved programmes of other companies.

It must be mentioned that this system does not yet allow the creation or the increasing of a fiscal deficit.

(d) Temporary measures for the protection of the internal market

In general products which are the object of local manufacture have by virtue of decisions of the territorial government, some custom protections. This protection can take the form of the establishment of entry taxes of a higher level on imports of the competing products or even of the partial or complete limiting of the importation of these products.

It must be noted however that these measures are temporary. They can exist for a maximum period of 3 years which is renewable only once.

In 1991 the list of prohibited imports included about 20 products: basically food products which were likely to compete directly with local production (pasta, tropical fruits and juice, fish, pork small goods, potatoes, coffee, and certain other products such as pearls and cement).

Among the products whose importation is limited are: aerated beverages, animal food, bakery items, pastry, biscuits, certain maintenance products, foam and PVC furniture, and solar water heaters.

B The Pons Law: Tax Measures in Favour of the French Investor

Article 22 of the finance law for 1986, law 86-824 of 11 July 1986, considerably increased the fiscal incentive provision for investment in the Departments, the Territories and the overseas possessions. Article 22 was adopted on the motion of Mr Bernard Pons, then Minister of the DOM-TOM, and is therefore known by the generic name of the Pons Law. The Pons law applies to two types of investment: investments made by enterprises and certain investments made by individuals. Details are given here about the effect of this law in French Polynesia.

1 Investments made by enterprises

Firstly an important point must be emphasised: for metropolitan enterprises which invest in French Polynesia, the advantages that flow from the provisions of the Pons law are in addition to those in the investment code.

The provisions of the Pons law which apply to investments by enterprises are presented here by way of comparison with the Investment Code. The Pons law authorises deductions for two possible types of investment: direct investment, and indirect investment by way of subscription to the capital of companies.

(a) Direct investment

Here direct investment means the acquisition of real property assets by the investor. The notion of investment in the Pons law is not defined as in the Investment Code, but with few exceptions covers the same property.

The investments must have a professional aspect and be made in undertakings situated overseas which concern certain areas of economic activity.

(i) Professional aspect

The Pons law specifically excludes property for personal use (for example car or house of the investor). This provision which is not in the code makes it possible to avoid approving goods which did not need approval.

(ii) Overseas establishment

The field of application of the Pons law is more extensive than that of the code because it is not concerned only with investments made in French Polynesia but also with investments made in departments, Territories and Overseas possessions. Any French or overseas Department enterprise which makes an investment in Polynesia can benefit from the provisions of the Pons law. On the other hand a Polynesian enterprise which invests locally cannot obtain the benefit of the Pons law because of the fiscal autonomy of the Territory.

(iii) Areas of economic activity

They are largely identical in the two laws. There are however two differences worth mentioning:

The construction and public works area provided in the Pons law is not in the code, on the other hand parallel industrial activities (for example cement works and steel fabrication) can be approved under the code.

The small business sector which is provided for in the Pons law is not provided for in the code because it usually involves investments which are of too small a nature to be relevant. To assist in this matter the Territory has created a special assistance fund for small businesses.

(iv) The date of making of the investment

Unlike the code whose application can be easily delayed to each calendar year, the Pons law requires that investments be made between 15 September 1986 and 31 December 1996.

(v) The right to deduction

The deduction benefits the owner of immovable property. The enterprise can deduct from its taxable income of the year the totality of productive investment.

(b) Indirect investment

Indirect investment concerns subscribing to the capital of eligible companies.

(i) Subscriptions which give a right to deduction

The provision of capital that gives a right to the deduction is that made when the company is being set up or when an increase in the capital of a regional development company in the DOM-TOM is being made. The deduction is also available to other companies:

which are subject to the companies tax;
which operate overseas;

which are involved in economic activity which relates to those sectors which have been approved for direct investment;
of which the gross value of the assets which are necessary to the economic activity does not exceed 10% of the total assets.

In French Polynesia the only development company is the Society for the Development and Expansion in the Pacific (SODEP). This company has not, so far, opened itself to public investment in France. French enterprises therefore cannot take the benefit in French Polynesia of the present provisions which relate to regional development companies.

(ii) The exercise of the right to deduct

An additional constraint exists in relation to direct investment. The deduction cannot be had except by an undertaking which is subject to companies tax or to the real income tax regime of the Metropol.

The amount of the deduction is equal to the amounts subscribed eventually including the charge on issue but excluding subscription rights.

(c) The methods of deduction of the tax

The deduction methods are the same for direct and indirect investments.

(i) Formalities

There is a major difference between the Pons law system and that of the investment code. The code system is burdensome and the advantages allowed speculative. Under the Pons law the assistance is automatic and no particular steps need be taken by the enterprise. The deduction is made by way of audit documents having been presented on the declaration of the result of the activities in the course of which the investment is being made. Unlike the code, the deduction can reduce or cancel out the tax benefit or create a deficit which can be carried forward.

(ii) Investments exceeding 30,000,000 French francs

These investments must be brought, before their making, to the attention of the Minister in charge of the budget. Approval is assumed in the absence of a reasoned objection within three months.

2 Investments made by individuals

The provisions of the Pons law relating to individuals can be dealt with briefly. Private individuals, who have their tax domicile in France or in one of the DOM, who invest in the DOM-TOM within the period between 1 January 1986 and 31 December 1996 either directly in immovable property or indirectly through a company which is active in the eligible sectors can benefit from tax reductions for the five years which follow the making of the investment.

(a) Investments in immovable property

The following are the investments in immovable property which can give rise to the tax benefit:

the construction of a principal dwelling;
the construction of a dwelling which will be let to a person who will use it as a principal dwelling;
the taking of shares in a company whose purpose is to build new dwellings in the DOM-TOM let unfurnished to persons who will make them their main dwelling.

(b) Purchase of shares

This right to a tax deduction is available for shares in companies:

which are subject to the companies tax and which make productive investments in the DOM-TOM and whose area of economic activity is in one of the sectors specified by the Pons law.
regional development companies in the DOM-TOM. This possibility does not exist in French Polynesia.

(c) The methods of tax deduction

During the five years after the real property investment or the purchase of shares individuals benefit each year from a tax reduction on revenue equal to:

10% of the investment each year for five years until 1989
5% of the investment each year from 1990 to 1996

So an individual domiciled in France who invested in 1991 within the framework of the Pons law could obtain a reduction in tax only to a maximum of 25% of the investment while an investment made in 1986 would benefit from a tax reduction equal to 40% of the investment made. The interest of these provisions therefore is decreasing as 1996 comes closer. If the reduction is greater than the tax due the excess cannot be reimbursed or imputed.

3 The effects of the Pons law in French Polynesia

The effects of the law on tax benefits has been slow to show any effect in French Polynesia mainly because of the marked lack of information about investment possibilities in French Polynesia. On the other hand French citizens seem to have kept an exotic image of Polynesia which is incompatible, in their eyes, with any industrial project.

On the other hand the taxation benefits seem to have been very successful in the DOM particularly in the Antilles and Reunion because perhaps of proximity and the nature of the commodities, but also because an investor who comes from these

Departments can take advantage of the tax measures, which is not the case for a Polynesian investor.

In the real property sector in Polynesia several projects have certainly benefited from the tax system. Notably apartments which have been part of a programme for sale in France. It seems however that investors have somewhat overestimated the market for deluxe apartments since many tenants prefer separate houses given the privileged nature of the Territory.

Certain investors have been able to take advantage of the Pons law when new hotel complexes have been established and equally through the inter-island airline, Air Tahiti, when it increased its capital for the purposes of renewing its fleet.

C Special Financial Assistance From the Territory

Apart from the advantages presented by the Investment Code for specific investments exceeding a prescribed limit, the Territory's financial assistance comes from aid granted through special funds to modest projects.

Special financial assistance concerns, in particular the agricultural, social, industrial, arts and crafts and tourist sectors.

D Special Rates Financings

Credit policy is an important means for the Territory to direct investors' choices toward the desired development objectives.

This specific policy is communicated though the financial institutions which play a key role in French Polynesia:

L'institut d'emission d'outre-mer (IEOM)
La caisse française de developpement (CFD)
La societe de credit et de developpement de l'Oceanie (Socredo).

1 Credit policy of the IEOM (Overseas Central Bank)

Apart from the issuing of bank notes and coins, setting bank rates, studying the economy of the Territory, and clearing between banks, one of the main concerns of the IEOM is to offer banks help to refinance loans. Its credit policy is essentially selective, and tends to favour development of economic sectors considered as having priority.

Unlike France, French Polynesia does not know credit regulation, other than consumer credit granted to private individuals.

In practice, the IEOM's intervention is to confer discounts on business in priority sections (eg Tourism).

2 Credit policy of the CFD (French Development Agency)

A public financial institution, the CFD provides help either directly by financing public collectives or indirectly through the Socredo Bank.

Its resources come from loans raised on the national or international market.

Thanks to special interest rates granted by the French Finance Administration, the CFD is able to offer long term credits at low interest rates.

3 Credit policy of the Socredo Bank

This financial institution has a special status: its capital is equally held by the CFD and by the Territory.

Apart from financing public collectivities and private individuals, Socredo lends funds to companies doing business in French Polynesia.

The main part of its activity (68%) is done with business in the productive sector, and this perfectly illustrates its features.

E Suspending of Customs Duties

On fulfilment of specific conditions (eg distinct warehouse, specific accounts), the suspending of customs duties leads to a system similar to a free zone.

In order to favour the development of industry and commercial activity local customs laws offer a range of duty regimes.

1 Temporary admission

This authorises importation, without paying taxes, for goods which are to undergo a transformation process and be exported later.

Usually such benefit is limited to a six month period.

2 Warehouses

Warehouses are used to store, under specific conditions, foreign goods benefiting from a suspension of import duties and charges and then to clear them through customs as per requirements, for any destination, including re-export.

The duties and charges are collected on release of the goods to the market. A wide range of warehouses is thus made available to traders and industrialists:

(a) The ordinary private warehouse which, in Papeete, takes the form of a public bonded warehouse, is open automatically to any products which are not generally excluded from the warehouse, and to all importers. The issuing of a warehouse warrant is possible with such type of establishment. The maximum period of time allowed for the storage of goods is two years.

(b) A special private warehouse may be authorised in any part of the Territory where the requirements of trade or industry make it necessary. It is reserved exclusively for the beneficiary in order to meet the requirements of industrial or commercial operations, in premises of which he has sole enjoyment, whether he owns or rents them. The maximum period of time allowed for the storage of goods in a special private warehouse is one year. This is a special form of private warehouse for tourist product export which allows duty-free sales to be made to visitors to the Territory.

(c) The special warehouse is open to certain products, the storage of which requires adequate technical facilities (eg oil products). This is reserved for exclusive use by the beneficiary. The maximum period of time allowed for storage of goods in a special warehouse is three years.

(d) The industrial warehouse enables firms specialising in export activities or operating in both the export and the domestic market, to deal with goods and to benefit from a suspension of the duties and charges to which they are normally liable. Duties and charges are collected at the time of introducing manufactured products to the domestic market.

3 General system of preference (GSP)

French Polynesia is one of three Territories entitled to benefit from the GSP provisions. This system provides customs duties exemption for 3000 types of products imported into the United States. So far, due to the reduced possibilities for French Polynesia to export manufactured products toward the United States, this advantage is rarely used. However, it could be worthwhile for some French companies already exporting in the United States, to consider a partial relocation of their production in French Polynesia. Needless to say, such a system could be considered only for activities with low freight costs.

PART II HOW TO INVEST IN FRENCH POLYNESIA

This part provides a guide for potential investors in French Polynesia. It specifies what type of actions should be taken and provides advice for each step of the investment.

I ACTIONS TO BE TAKEN

Usually investors face difficulties relating to the knowledge of local legal regulations and the formalities required.

Some important investment phases must be carefully considered. The investor has first to identify the investment projects to comply with the legal provision governing foreign investments, fill the application required by the investment code, and then find the appropriate financing.

A *Identification of Projects*

Various administrative bodies are able to help potential investors willing to invest in French Polynesia, by providing statistics, and information which could be of assistance to the project.

1 *Local administrative bodies*

Due to the willingness of the local government to attract investment, the local administration, provides some valuable sets of information though local agencies:

La mission permanente des investissements (Commission for Investments)
L'institut territorial de la statistique (Territorial institute in statistics)
L' evaam (office for development of aqua-culture and maritime activities)
Le service des investissements (investment board)

2 *Other sources of investment assistance*

Some local banks (Socredo in particular) are collecting (through loans already granted), information statistics which are available for their clients. The Chamber of Commerce is at the disposal of the investor to provide administrative assistance. Local lawyers, who specialise in commercial matters, are also a reliable source of advice.

B *Applications and approval of foreign investments in French Polynesia*

1 *Legal framework*

Insofar as foreign investments are concerned, these are subject to the same regulations as applicable in France.

The main texts to be referred to are:

67-78 of January 27, 1967, modified by decrees No 69.294 of March 21 1968, No 71-143 of February 22 1972 and No 80-617 of August 17;

Decree No 68-1021 of November 24 1968, governing the financial relations with overseas countries;

Ministerial memorandum of May 21 1987 relating to direct investments in France, which specifies the procedures for implementing the above-mentioned decrees.

Order of June 1 1988 defining certain procedures for implementing decree No 68-820 of November 24 1968.
Law No. 84-820 of September 6, 1984, establishing the statute of the Territory of French Polynesia, modified by law No. 90-612 of July 12, 1990.

Generally, any direct foreign investment in France is subject to a declaration or prior authorisation from the Minister of Economy and Finance through the CFD bureau.

Any company of which over 20% of the capital is held by non-residents or by French firms, being themselves under the control of non-residents, is deemed to be under foreign control.

A report relating to the direct investment operation should be sent to the administration within 20 days after its execution.

All the formalities laid down in the regulations which fall within the scope of this investment must be carried out by an approved intermediary who is alone authorised to lodge files with the CFD.

Within the 2 months after the declarations are received, the Minister may request that the operations contemplated be postponed. However, he may waive the right of postponement before the time-limit has expired. In some instances, the time-limit may be reduced to one month. Provided the participation from non-resident shareholders or partners or residents under foreign control in the French companies concerned is in order, the following operations are exempted from declaration or prior authorisation:

Creation or extension of new branches or firms.

Subscription to an increase in capital of a French company operating under foreign control.

An investment by a real or corporate person already holding shares or a position as a partner, provided it does not increase its shareholding or that it already holds 75% of the company's capital.

An investment by a company owned by a group, provided that the percentage of shareholding for all the companies of the group as a whole does not increase or already exceeds 75%.

The acquisition in a French company under foreign control, of shares or holdings held by residents not being under foreign control, when the buyer or the group of companies as a whole to which its belongs, already holds at least 75% of the capital of the French company.

The acquisition, by a French company under foreign control of shares in a French company under foreign control held by other French companies owned by the same group as the buyer.

Operations of merger assets partially brought in, transfer or taking on lease of the management of a business, carried out between French companies under foreign control, all of them being owned by the same group.

Operations relating to loans, advances, guarantees, consolidations or waivers of debts, subsidies or appropriations for branches, granted to a French firm under foreign control by the non-residents having control over it, or by non-resident firms of the same group.

Subscriptions to the initial capital and acquisition of holdings in the capital of French firms, the sole activity of which is the construction of buildings intended to be used solely by the investor (or a firm controlled by the investor), the holding or management of real property, or the purchase of buildings in view of their sale.

Operations of direct investment carried out within the limits of an amount of FF 10 million (180 million French Pacific francs) by persons in non-industrial, hotel firms or retail trades which they have to operate on a personal basis without any company having to be set up.

Direct investments carried out by residents of the European Economic Community.

In accordance with European law, direct investments are not subject to the right of postponement and are exempted from prior authorisation.

However, operations taking part in the exercise of public authority or calling public authority or calling public order into question, such as those, the effect of which would be to thwart the enforcement of French laws and regulations, are not susceptible of benefiting from such exemptions of authorisation. However, prior declaration to the EEC remains and the Minister of Economy has 2 months within which to notify investors that they do not fall within an exemption.

(a) Liquidation of direct investments

Partial or total liquidation of a direct foreign investment can be carried out freely. Nevertheless, it must be the object of an a posteriori declaration within 20 days after the operation is executed. Transfers to a foreign country are executed upon presentation of relevant supporting documents.

(b) Transfer of operating profits

Transfers of operating profits are authorised, without any limitation as to amounts, on presentation of balance sheets, extracts of proceedings from the general shareholders meeting approving net dividends to be distributed, or any appropriate accounting documents.

The procedure of foreign investment in France is relatively straightforward and the time-limits are those usually applied in French Polynesia.

In French Polynesia the approved intermediaries are the financial and banking institutions.

In practice, the above regulations concern mainly Japanese, Australian and US investments.

C How to Present the Investment File in order to Benefit under the Investment Code

1 Request for agreement

(a) Form

Any requests for agreement under the investment code must be presented in 3 copies on special forms provided by the Secretary of the Commission for Investments.

This stage of the procedure is very important.

The agreement itself and the level of advantages granted is primarily based on the quality of the request.

The agreement request is made of two parts: definition of the investment and budget.

(b) Time limit

All agreement requests must be lodged prior to the constitution of a new legal entity. It is however possible to obtain, though a special procedure, a preliminary agreement which could authorise the investment project to be practically limited.

2 The agreement procedure

It takes usually 3 months to obtain the agreement decision. This commission is the first stage of the admission process. It is composed of 18 members and provides after a study of the project grounds, proposals for the final decision by the Council of Ministers.

3 The Council of Ministers

Final decision is given by the Council of Ministers.

In practice, opinions proposed by the investment commission are nearly always accepted by the Council of Ministers.

D Financing the Investments

Finding appropriate financing at the best rate is the first condition for the validity of the project. Short and medium term credit is provided by all banks in French Polynesia. Long term credits are only provided by the CFD, Socredo, and the Overseas Central Bank.

II RECOMMENDATIONS

There is not space here to discuss the solutions to all the possible difficulties that an investor could encounter in French Polynesia. Suffice it here to give general advice that could be useful at each step in an investment project - from the moment of deciding to make an investment through the launching of the project and on into the selection of the appropriate legal structure and of the appropriate fiscal regime for the undertaking.

A The Decision to Invest

The decision to invest is the most serious of all that a business person can take for it is irreversible and involves a long-term commitment.

Beyond the usual recommendations that apply to every investment project wherever the investment is to be made, it is appropriate here to set out some recommendations which are particularly linked to the Polynesian environment.

Indeed if the advantages which can be granted under the Investment Code amount to a degree of encouragement to invest in Polynesia, the investor must nevertheless be aware of the limits of these provisions which at first glance are very attractive.

Moreover at the moment of deciding to invest the investor must be able to estimate the particular impact of the advantages given by the territorial and state authorities. These advantages certainly have a beneficial effect relative to the profitability and costs, but they equally have adverse effects that the investor must be able to control.

1 The limits of advantages granted by the Investment Code

The non-automatic nature of the approval, the level of aid (which is often illusory), and the rigidity of the advantages are the major criticisms that could be made of the Investment Code applicable in French Polynesia.

(a) The non-automatic nature of approval

The notion of *possibility* is dominant in the provisions of the Investment Code: "an enterprise may receive the following advantages", "the enterprise may be exempted", "it may be granted a credit" etc. Consequently even if the enterprise fulfils all the necessary conditions for the grant of these advantages the approval is not automatic. Therefore there is a resultant lack of certainty for the investor. Indeed in a territory as limited as Polynesia it is clear that beyond the economic and financial motives, political and even human factors can influence the decision of the approving board.

(b) An illusory level of assistance

The second limit of the advantages granted by the code relate to the fact that the maximum level of aid which is 30% of the amount of the investment is often illusory. The Territory has never granted an investor more than the investor has sought, and therefore the approval request must always be built on the basis of a maximum amount equal to 30% of the intended investment.

The statistics provided by the territorial office responsible for investments shows that the 30% level is rarely attained. The level of assistance fluctuates in fact between 5% and 30% without it being possible to determine a clear line of principle in the decisions made by the approving board.

It is enough simply to note that at present the hotel industry appears to be the most favoured sector and that hotel projects which have received approval under the code are in the leading group of enterprises which have benefited from the highest rate of assistance.

Certain types of assistance are conditional, thus extenuating the illusory character of the global assistance level. Indeed if certain types of assistance when they are granted are certain (exemption from entry duty, the investment discount, the reimbursement of social costs), others depend on the fulfilment of certain conditions (the tax on benefits).

Also it is not unusual to see an enterprise, which has been approved, complete the period of exemption without having used all of the exemptions granted for the company tax - the first years of development in fact being paid for by deficits.

Even when a profit has been entered from the third year, the fiscal report of the deficit over the first two often results in it being impossible for the approved company to utilise all the advantages offered.

It is therefore necessary to establish projections which are as limited and realistic as possible in order to make maximum use of the fiscal exemptions.

In any case it is useful to impute, at the maximum, the assistance requested against the taxes which flow from a certain exemption (eg entry duty).

(c) *The rigidity of the advantages granted*

The various types of assistance are calculated and fixed once and for all on the basis of the dossier presented with the request for approval. Consequently if the real cost of the investment turns out to be higher than the pro forma invoices contained in the file, the duty exemptions cannot be corrected upwards, and the investor must pay the additional duty.

Conversely if goods actually imported have a real cost which is lower than the budgeted amount, the exemption from entry duty not used will be lost for the investor and there is no possibility of transferring the unused exemption to another category of assistance. Particular attention must therefore be paid in the fixing of the amount of the investment in order to detail as closely as possible its real and final cost. In order to avoid future price fluctuations, it is therefore necessary to be able to obtain a very quick decision between the date of the deposit of the application and the result. Therefore the document presented for approval should be as complete as possible and even contain explanations which have not been required in order to avoid additional documents being requested from the officers who consider the file. Any such request for supplementary information causes delays in the handling of the file by the approval commission.

The above criticisms show the limits of the investment code and that they are caused essentially by the restrictiveness of the administrative structure and the rigidity of the various processes. These criticisms must not however be seen out of context and must be placed side by side with the important advantages offered by the code.

2 *The impact of the advantages granted*

The advantages that the Investment Code can have are:

> The hope for profitability: the code by bringing about a reduction in charges (debt charges, social welfare charges, taxes) can be a factor which improves profitability. It definitely does allow the investor to compete with importers.
>
> The appreciation of the risk: by influencing the final cost of the investment through entry duty exemptions, the code permits the limiting of the amount of capital investment invested and a limiting of recourse to external financing.
>
> Liquidity: the advantages of the code are that by reducing the capital invested and increasing profitability it accelerates the rate of return from the invested sums.

The Investment Code therefore necessarily has a leverage effect since it improves the financial profitability of a project. However an investor must always bear in mind that the advantages offered can equally have detrimental effects. Indeed, the greatest problem of the assistance systems relates to the fact that they make an activity appear profitable when it may not structurally be so. They make it difficult to understand the real profitability of approved enterprises and give a false appreciation to an observer or even to the investor himself of the financial health of the approved company.

Moreover the protection that local products benefit from vis-à-vis imported products and the absence of effective competition in many sectors is no incentive to producers to improve their productivity or the quality of their products.

Finally the direct or indirect assistance given by the code in itself generates an important part of the distributable profit of approved undertakings. The false image that the accounts legally presented can give has the risk of encouraging a dividend distribution policy which is overly generous with regard to the financial equilibrium of the company. This problem is all the more serious in the case of a French investor whose main motivation is the profitability of his investment.

The application for approval is relatively complex for the uninitiated. Consequently it is advisable to make use of the services of a professional who has a good knowledge in the preparation of applications relating to the investment code and who can be the advocate and personal adviser of the investor.

B Choice of the Legal and Fiscal Regimes for the Enterprise

The focus here is on the parameters within which a decision about the appropriate fiscal system is taken.

1 Choice between the companies tax and the professional services tax

The general system of taxing for companies in French Polynesia is similar to that of France in that there are two main types of taxation on the income of enterprises (a companies tax and a professional services tax in Polynesia - and a companies and a revenue tax in France) but the comparison ends there.

Indeed if the companies tax of French Polynesia does have its origin in the main principles which regulate the tax in France, the professional services tax has no relationship with the French revenue tax. Consequently the analysis of the system is different. The advice of a local accounting expert is desirable in order to make the best use of the limits of the taxation system in order to have minimal incidence of the tax.

2 The combining of a taxation on the professional services tax and a taxation on the companies tax

The advantage of this combination is that it may be possible to achieve a gross taxation level which is lower than a tax which would result from either single method of taxation.

In order to succeed the operation over all must be able to be separated into several cycles of distinct and complementary phases. Each cycle of the operation then forms a distinct legal entity because it will carry its own taxation, be it the professional services tax or the companies tax. For example if the operation consists in the production of sardines in tins and the distribution of these products, the production cycle will give rise to legal entity A and the distribution cycle to a different legal entity B. Entity A will produce the tins of sardines and entity B will provide services by distributing the products for entity A. The principle is therefore to create around a central activity satellite activities which provide services in general and which give rise to fewer charges. It is therefore necessary to enquire which of the entities will be subject to the companies tax and which to the services tax.

The most advantageous tax solution is to submit those entities which support the most taxes to the companies tax and by doing so reduce to the minimum the tax leviable to rates between 25% and 45%, the surplus of the profit being then transferred to another entity to be taxed at 6% as a maximum instead of 25% to 45%. In the above example the entity responsible for production must be subject to the companies tax because of the significance of its costs (purchase of primary materials, labour costs, writing-off of equipment etc). Entity B responsible for distribution will be subject to the professional services tax. In order to avoid any tax risk, it is advisable that the invoice price given by entity B is as close as possible to the normal price or the market price depending on the circumstances.

PART III CONCLUSION

The question of what happens after CEP and the construction of an economy less dependent on state control remains today to the extent that all the efforts made by local and central agencies have up till now achieved only partial results. The sectors of the "natural economy" have not achieved independence. They are maintained thanks only to state intervention. Contradictions between the words and the reality increase. The primary sector and tourism contribute only 15% to the gross local product. Local production only meets 20% of the need. By comparison with Overseas French Departments French Polynesia has certainly the advantage of increasing the attractions of the Investment Code and the Pons law. However the Overseas Departments (Guyane, Martinique, Guadeloupe and Reunion) have the advantage of being much closer to France which reduces costs and makes it easier for a potential French investor to think of taking a voyage of enquiry. The status of Department gives them a "political visibility" which is reassuring in the long-term. These departments moreover have structures for the promotion of investments which are, in significant ways, lacking in French Polynesia. New Caledonia, another French Territory of the Pacific, has attractions which should not be overlooked. It has a more industrialised image than French Polynesia because of the mining activities and a more favourable investment environment since the putting in place, on a largely consensus basis, of new institutions as a result of a referendum. It also benefits from a priority given by the central government to its economic development. Moreover, unlike French Polynesia the fiscal measures in the Pons law apply not only to French residents but also to residents of New Caledonia because the latter live under a direct tax regime almost identical to that of France (revenue tax and companies tax).

The Investment Code which for 5 years has shown all its qualities but also all its limits and the Pons law which till now has not had all the intended effects in French Polynesia no longer suffice to maintain an adequate investment rhythm. Savings in Polynesia are insensitive to the attractions of investment in local production and remain with a reduced but less risky income. Consequently the local authorities are considering putting in place a more attractive system which would complement the existing text and permit the use of the under used local savings. This is the objective of the investment certificates and the territorial investment society. According to Bernard Poirine in his many articles published in reviews by the Territorial Institute of Statistics the path of economic autonomy in French Polynesia doubtless relies on respecting certain conditions:

salary controls, notably in the public sector;
budgetary control in order to reduce the burden of the public sector on the economy;
tax reform.

Indeed the present unbalanced tax regime of French Polynesia causes high prices, does not sufficiently encourage local production, and makes the development of tourism and exporting difficult.

Poirine says: "It is quite clear that it is not possible at the same time to promote import substitution and maintain the financing of the territorial budget at 75% through customs receipts. It is necessary to choose between these two mutually exclusive economic and tax strategies".

The alternative solutions which he proposes are the exemption of customs duty for intermediate products and the means of production, the reduction of indirect taxation and the increase in direct taxation (revenue tax, succession tax) and the introduction of VAT.

Is it wise to invest in French Polynesia? Despite the obstacles described in this paper the investment possibilities can be attractive.

For small and medium investments risks can be significantly limited if the foreign investor takes a share in a local company which has proved itself in the market or in a project in association with local partners.

The main projects involving foreign investment are, notwithstanding local policies, accepted with a certain circumspection and reserve because of the fear of seeing whole sections of the local economy pass into foreign control, and have given rise to certain protectionist reflexes. The fact remains that an investment partnership with corporate investors from France (who can be interested in investing in order to benefit from the Pons law) could lead to participating in the most important commercial companies in the Territory and in the creation of new industries.