

STATEMENT

of

Kevin Wayne Joselowitz
(Identity No. 661204 5091 085)

1. Introduction

- 1.1. I am an adult male non-practising attorney currently employed as an executive director of Java Capital (Pty) Limited.
- 1.2. At all material times and more particularly between 1 October 1999 to 31 March 2003 I was employed as an executive within the Corporate Finance Division of Corpcapital Investments (Pty) Limited ("Corpcapital Investments"). I joined the Corpcapital Limited group (the "Corpcapital group") on 1 October 1999 to establish (together with certain other colleagues) the Corporate Finance Division of Corpcapital Investments ("Corpcapital Corporate Finance"). Prior to joining the Corpcapital group I was a commercial partner of law firm Edward Nathan & Friedland Inc, a firm I had joined in 1990 as an articulated clerk.
- 1.3. In my capacity as an executive within the Corpcapital Corporate Finance division, I was, to the best of my knowledge, involved in all post October 1999 corporate restructuring processes pertaining to Corpcapital Investments' interest in Netainment N.V., registered in the Netherlands Antilles (Registration No. 2401/N.V.) ("Netainment").
- 1.4. Set out in the statement below is the background and detail pertaining to both the restructuring of:
 - 1.4.1. Corpcapital group's interest in Netainment;
 - 1.4.2. Netainment's interest in the online casino business which until 1 October 2001 had been owned by and operated by Netainment and thereafter, pursuant to a sale by Netainment of its online gaming business to Cytech Limited, incorporated in Belize (Registration No. 2200) ("Cytech"), by Cytech.

2. Restructure of Netainment

- 2.1. At the time that I commenced employment by the Corpcapital group, the Corpcapital group had already acquired and held a 47.5% interest in Netainment (being the vehicle which housed the online casino interests of the Netainment group). The 47,5% interest was owned by Mikado Group Holdings Inc ("Mikado") a British Virgin Islands company, a wholly owned subsidiary of Corpcapital Investments, which itself was a wholly owned subsidiary of Corpcapital.

- 2.2. In or about July 2000 I became involved (in my capacity as an adviser to Netainment) in a prospective transaction to merge Netainment's online casino interests with those of a Canadian controlled online casino group, English Harbour Entertainment Limited, incorporated in Antigua ("English Harbour").
- 2.3. The proposed merger methodology was that the businesses of Netainment and English Harbour would be merged in a new corporate entity to be incorporated in a jurisdiction to be mutually agreed to between Netainment and English Harbour. The proposed merger of Netainment and English Harbour is hereafter referred to as the "Amalco merger" and the proposed entity through which the merger was to be effected being referred to herein as "Amalco".
- 2.4. Intensive negotiations took place between July 2000 and December 2000. Netainment was represented by Corpcapital Corporate Finance. English Harbour was represented by the Canadian law firm Fasken Martineau Du Moulin LLP, Toronto. The negotiations culminated in the conclusion of a series of agreements pursuant to which Netainment and English Harbour would merge their businesses into a new company, 3AM Entertainment Limited ("Amalco") and the relationship between Netainment and English Harbour as shareholders in Amalco was to be regulated for in terms of a joint venture agreement. The series of formal agreements were (to the best of my knowledge) duly executed. Copies of the agreements are readily available if required.
- 2.5. The Amalco merger was ultimately not implemented by reason of the fact that one of the conditions precedent to the Amalco merger, namely, the securing of the approval of Microgaming Systems Limited ("Microgaming") to the Amalco merger was not secured. Microgaming was the owner of the software platform used in the operation of the online casinos operated at the time by both Netainment and English Harbour. For legal and commercial reasons, the merger could not be implemented without securing the requisite consent of Microgaming.
- 2.6. In anticipation of the Amalco merger and in parallel with the process to negotiate and document the Amalco merger agreements, for the reasons more fully dealt with in paragraph 2.8 below, the Corpcapital group's interest in Netainment was restructured by way of the interposition of an investment holding company, namely, Blue Eagle International Investments Limited ("Blue Eagle"), a British Virgin Islands company as between Mikado and Netainment. Blue Eagle was incorporated and constituted (and, to my knowledge, still constitutes) a wholly-owned subsidiary of Mikado.
- 2.7. The restructuring was effected in terms of a written sale agreement concluded between Mikado and Blue Eagle concluded on 15 December 2000, a copy of which is attached marked **Annexure KJ1** (the "Mikado/Blue Eagle agreement"). The salient terms of the Mikado/Blue Eagle agreement were as follows:
 - 2.7.1. Mikado (as seller) sold to Blue Eagle (as purchaser) with effect from 31 December 2000 ("the effective date"):

2.7.1.1. 2 850 bearer shares in the share capital of Netainment, constituting 47.5% of the entire issued share capital of Netainment;

2.7.1.2. all claims of whatsoever nature and from whatsoever cause arising which Mikado had against Netainment on the effective date;

the subject shares and claims of the sale being referred to herein as the “sold equity”);

2.7.2. the purchase price of the sold equity was stipulated as \$95,000,000.

The purchase price in the sum of \$95,000,000 was determined, not with reference to the application of any valuation methodology to the value of the Netainment business as such, but rather as a consequence of the fact that English Harbour required (for tax and fiscal reasons within the jurisdictions to which English Harbour was subject) to value its online casino interest in the sum of \$200,000,000. Given that the envisaged Amalco merger would have resulted in each of Netainment and English Harbour holding a 50% interest in Amalco and the need for consistency in the underlying transaction, it was appropriate that each of the Netainment business and the English Harbour business be transferred to Amalco at equal values. As English Harbour required the transfer of its business to be effected at a valuation of \$200,000,000 the Netainment business was to be transferred to Amalco at the same value. The \$200,000,000 valuation was used as the basis for allocating (solely for the purposes of the Mikado/Blue Eagle agreement) Mikado’s 47.5% shareholding in Netainment at \$95,000,000 (i.e. $\$200,000,000 \times 47.5\% = \$95,000,000$). Given that the Netainment/Mikado agreement constituted an internal restructuring arrangement in terms of which the entire issued share capital in and all claims on loan account against Blue Eagle (the acquiring entity) would be held by Mikado (the selling entity) and that the purchase price was not to be discharged or funded by any non-Corpcapital group entity, Corpcapital acceded to English Harbour’s request to accommodate English Harbour’s transaction pricing requirements.

2.8. The principal commercial reasons for the Mikado/Blue Eagle restructure were the following:

2.8.1. One of the principles required by the parties to the Amalco shareholders agreement (which agreement was to come into effect on implementation of the Amalco merger) was the “grand-fathering” up of rights of pre-emption such that each of the Netainment shareholders and the

English Harbour shareholders would enjoy pre-emptive rights not only over the other group's direct shareholding in Amalco but also in regard to the shareholding of the other's group companies where the sole asset of such group company was a direct or indirect interest in Amalco.

It would have been inappropriate for rights of pre-emption to have been granted by Corpcapital Investments over its shares in Mikado for, amongst others, the following reasons:

- 2.8.1.1. Mikado constituted the offshore holding company of the Corpcapital group of companies' offshore interest;
- 2.8.1.2. in addition to Mikado's 50% shareholding in Netainment, Mikado also held (and still, to my knowledge, holds):
 - a 50% investment in Cyber Finance Investments Limited, incorporated in the British Virgin Islands (Registration No. 293486) ("CFI");
 - 100% investment in Corpcapital Investments BVI (the offshore advisory subsidiary of the Corpcapital Group).

It was necessary to put Blue Eagle in place so as to allow for rights of pre-emption to extend above the level of Netainment but without rendering Corpcapital's other offshore commercial interests (held through Mikado) subject to rights of pre-emption. The most appropriate way of ensuring this was to interpose a company (Blue Eagle) between Mikado and Netainment and afford the English Harbour group rights of pre-emption over Blue Eagle without extending those rights of pre-emption to a more senior level. The restructure to interpose Blue Eagle as between Mikado and Netainment was effected with the knowledge of English Harbour that the restructure was necessary to accommodate the "grand-fathering" requirement.

- 2.8.2. The decision not to reverse out of Mikado its interest in CFI and its anticipated investment in Corpcapital Investments BVI (thus allowing for rights of pre-emption to be granted by Corpcapital Investments to the English Harbour Group over Corpcapital Investments' Mikado shares) was motivated by, mainly, the following reasons:

- 2.8.2.1. Mikado had historically been earmarked as the offshore holding company of Corpcapital's non-South African investments;
- 2.8.2.2. CFI was embroiled in litigation with Mini Vegas, a customer, relating to alleged unlawful gaming activities

undertaken by Mini Vegas, the proceeds of which were allegedly under the control of CFI and the subject of attachment and investigations by the Swiss and Luxembourg authorities. Mini Vegas' activities had cast suspicion on CFI's complicity and CFI had made representations to the authorities regarding its beneficial owners and their credibility, in response to enquiries. An immediately subsequent change of ownership would foreseeably have impaired CFI's credibility with the relevant authorities, for example, by implying that Mikado was seeking to distance itself and its principal assets (the interest in Netainment) from CFI's activities.

2.8.3. It was at the time contemplated that it may be appropriate for certain outside third parties (and, in particular, executives employed by the Corpcapital group and who were responsible for the Corpcapital group's investment in Netainment) to be incentivised by affording such persons an "interest" in the performance of the Netainment business (if the Amalco merger was not successfully implemented) or in Amalco (if the Amalco merger was implemented but for whatever reason it was not possible to incentivise or appropriately incentivise such persons through a direct "interest" in Amalco). Such incentivisation would not be capable of being achieved through Netainment as Netainment had outside minority shareholders (being The Big Blue Trust (23,5%), the Gandolf Trust (23,5%) and Dawson Inc (5%)) some or all of which would probably not have consented to such an incentivisation strategy through the vehicle of Netainment. It would also have been inappropriate for the incentivisation strategy to be implemented at Mikado level given Mikado's other existing and anticipated future commercial interests (which are not related to the casino business conducted by Netainment). The Blue Eagle vehicle (which had as its sole underlying commercial asset its attributable interest in the then existing Netainment business and, following the implementation of the Netainment/English Harbour merger, its attributable interest in Amalco) would have been the appropriate level to implement such incentivisation strategy. As it transpired, to my knowledge, no such incentivisation scheme has ever been implemented and no third party holds, whether directly or indirectly, any shares or has any rights or options to shares in Blue Eagle, which constitutes a wholly-owned subsidiary of Mikado.

2.9. Prior to the implementation of the Mikado/Blue Eagle agreement, advice was sought and secured from Eddie Broomberg S.C. and his South African associate E.J.P. Lai-King on the tax consequences of the proposed transaction and, in particular:

- 2.9.1. whether the disposal by Mikado of its 47.5% interest in Netainment would give rise to any South African tax consequences to the Corpcapital group;
- 2.9.2. whether the disposal by Netainment of its business to Amalco (pursuant to the envisaged Netainment/English Harbour merger) would give rise to any South African tax implications for the Corpcapital group;
- 2.9.3. whether the credit loan account created on the transfer by Mikado of its 47.5% interest in Netainment to Blue Eagle ought to have bear interest or whether such loan ought to have been capitalised;
- 2.9.4. various other tax consequences which could potentially arise in regard to any future restructuring by the Corpcapital group of its interest in Netainment, in particular, if Blue Eagle would thereafter unbundle its interest in Netainment to Mikado.

The tax advice received by Corpcapital was favourable and to the effect that should Netainment in pursuance of its objective to merge its business with English Harbour, dispose of its business to Amalco for a sum of US\$200,000,000, no adverse South African tax consequences should arise from the transaction.

- 2.10. Attached marked **Annexure KJ2** is a copy of written opinion furnished by E.B. Broomberg SC and E.P. Lai King dated 28 March 2001. Attached marked **Annexure KJ3** is a memorandum prepared by myself (in my capacity as an executive of Corpcapital Corporate Finance) setting out the commercial rationale for the restructure and an executive summary of tax consequences of the disposal by Mikado of its Netainment interest to Blue Eagle.
- 2.11. A combination of the commercial imperatives to restructure Mikado's shareholding in Netainment for the reasons set out in paragraph 2.8 and the favourable tax advise resulted in the consummation in December 2000 on the Mikado/Blue Eagle agreement and the consequential implementation of the restructure pursuant to which Mikado's 47.5% interest in Netainment was transferred to Blue Eagle.
- 2.12. Post the implementation of the Mikado/Blue Eagle agreement, the corporate structure of the Corpcapital group's interest in Netainment was (and to the best of my knowledge remains to date) as follows:
 - 2.12.1. Corpcapital Limited (Registration No. 1983/011384/06) constitutes the ultimate holding company of the group;
 - 2.12.2. Corpcapital Investments constitutes a wholly-owned subsidiary of Corpcapital Limited;
 - 2.12.3. Mikado constitutes a wholly-owned subsidiary of Corpcapital Investments;

- 2.12.4. Blue Eagle constitutes a wholly-owned subsidiary of Mikado;
- 2.12.5. Blue Eagle's sole asset constitutes its 47.5% interest in Netainment.

3. Disposal by Netainment of its business to Cytech

- 3.1. In terms of an agreement entered into on or about 8 May 2002 Netainment sold its business (for the reasons more fully dealt with below) to Cytech. The only contract, asset or liability excluded from this sale was the license agreement between Netainment and Microgaming Systems Anstalt (the licensor of the software platform previously utilised by Netainment) dated 10 December 1998 (the "MGS licence agreement"). A copy of the Netainment business disposal agreement is attached marked **Annexure KJ4** (the "Netainment business disposal agreement").
- 3.2. The salient terms of the Netainment business disposal agreement were as follows:
 - 3.2.1. with effect from 1 October 2001 Netainment sold as an indivisible whole and as a going concern its business comprising:
 - 3.2.1.1. all right, title and interest of Netainment in and to the full benefit of all contracts concluded with customers of the business in the ordinary course of business (excluding only the MGS licence agreement);
 - 3.2.1.2. all intellectual property rights owned by Netainment and used in the conduct of the business including its database of customers, trade marks, trade names, websites and (subject to restrictions contained in the MGS licence agreement), all domain names used in connection with the business;
 - 3.2.1.3. all systems, software and know-how used exclusively in connection with the business (other than the software licence to Netainment in terms of the MGS licence agreement);
 - 3.2.1.4. cash and credit balances at banks of the business as at the effective date;
 - 3.2.1.5. the goodwill attaching to the business,
 - including any liabilities (whether actual or contingent) to creditors of the business but excluding only rights or obligations arising out of or in connection with the MGS licence agreement;
 - 3.2.2. the consideration for the business was discharged by way of the allotment and issue of 100 shares in the issued share capital of Cytech to Netainment.

The effect of the Netainment business disposal agreement was that whereas prior to 1 October 2002, Netainment owned and operated the online gaming business, post this date Netainment maintained its 100% interest in the business (now owned by Cytech) through its holding of the entire issued share capital of Cytech.

- 3.3. The sale by Netainment of its business to Cytech was effected on advice of Corpcapital Corporate Finance (acting as corporate finance advisors to Netainment). The advice was that this was the optimal method for terminating the MGS licence agreement in a manner which would cause least prejudice to the continued operation of the business conducted by Netainment.
- 3.4. Netainment had taken a business decision to migrate off the Microgaming software platform onto a new software platform. The principal reasons for this decision were, to my knowledge, the fact that:
 - 3.4.1. the Microgaming software was extremely expensive and required the payment of a royalty fee equal to 25% to the gross win of the Netainment operated casinos (whereas a competitive product could be sourced at approximately 50% of the aforesaid royalty);
 - 3.4.2. over a sustained period of time there had been a breakdown in the business relationship between Microgaming and Netainment;
 - 3.4.3. Microgaming was a notoriously difficult business counter party. Other online casinos which operated off the Microgaming software platform (most notably English Harbour) had for substantially similar reasons to those of Netainment successfully migrated off the Microgaming software platform onto a competitive software platform.
- 3.5. The decision for Netainment to dispose of its business to Cytech was influenced by the terms of the MGS licence agreement. In terms of the MGS licence agreement (clause 29), Netainment was prohibited from operating a parallel software platform to that of Microgaming. Accordingly, it was not available to Netainment to migrate to a new software platform at the same time as Netainment operated off the Microgaming software platform. In terms of clause 22 of the MGS licence agreement, if Netainment terminated the MGS licence agreement, Microgaming would have been entitled to continued use of the client database belonging to Netainment.
- 3.6. Given that Microgaming had online remote access to the servers off which the Netainment business was conducted, the Netainment management were adamant given their knowledge of the manner in which Microgaming operated and having regard to a breakdown in the business relationship between Microgaming and Netainment, that the entire Netainment business would have been placed in jeopardy if Netainment were to have terminated the MGS licence agreement on notice to Microgaming.

- 3.7. The advise which was furnished to Netainment was that the client database of any business belongs, in the absence of any explicit provision to the contrary, to the owner of that business. As there was no provision, explicit or otherwise, in the MGS licence agreement which would indicate a departure from this principle, Corpcapital Corporate Finance concluded and advised Netainment that the client database was owned by Netainment and that Netainment was entitled to do whatever it wished with the database including, without limitation, the transfer of the database with or without value to any third party.
- 3.8. The aforesaid factors were the commercial and legal motivation for the restructuring of the Netainment business by way of the disposal by Netainment of its business to Cytech without Netainment terminating the MGS licence agreement. The MGS licence agreement has subsequently been cancelled.
- 3.9. To the best of my knowledge, the current position is that the online casino business is operated exclusively by Cytech. Cytech constitutes a wholly owned subsidiary of Netainment. The Corpcapital group's sole interest in the online gaming business (operated by Cytech) is held via the 47,5% shareholding interest registered in the name of Mikado (a wholly owned subsidiary of the Corpcapital group).

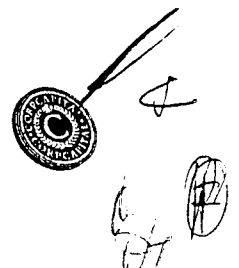
4. Conclusion

Whilst through both the restructure of Netainment (as described in paragraph 2 above) and the disposal by Netainment of its business to Cytech (as described in paragraph 3 above) certain technical internal restructurings took place for legal, commercial and strategic reasons, the restructurings did not change the Corpcapital group's real commercial ownership in the online casino (currently operated by Cytech).

Kevin Wayne Joselowitz

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C158/0001C/KJ/DSP/20001218/I

A G R E E M E N T

to be entered into between

Mikado Group Holdings Inc
(a company incorporated in the British Virgin Islands)

and

Blue Eagle International Investments Limited
(a company incorporated in the British Virgin Islands)



WHEREBY IT IS AGREED AS FOLLOWS :

1. Interpretation and preliminary

The headings of the clauses in this agreement are for the purpose of convenience and reference only and shall not be used in the interpretation of nor modify nor amplify the terms of this agreement nor any clause hereof. Unless a contrary intention clearly appears -

1.1. words importing -

1.1.1. any one gender include the other two genders;

1.1.2. the singular include the plural and *vice versa*; and

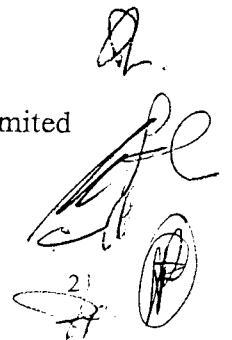
1.1.3. natural persons include created entities (corporate or unincorporate) and the state and *vice versa*;

1.2. the following terms shall have the meanings assigned to them hereunder and cognate expressions shall have corresponding meanings, namely :

1.2.1. “**company**” means Netainment NV, a company incorporated in the Netherlands Antilles;

1.2.2. “**effective date**” means 31 December 2000;

1.2.3. “**purchaser**” means Blue Eagle International Investments Limited

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- 1.2.4. "seller" means Mikado Group Holdings Inc;
- 1.2.5. "sold claims" means all claims of whatsoever nature and for whatsoever cause arising, if any, which the seller may have against the company on the effective date;
- 1.2.6. "sold equity" means collectively the sold shares and the sold claims.
- 1.2.7. "sold shares" means 2 850 bearer shares in the share capital of company, constituting 47.5% of the entire issued share capital of the company;
- 1.3. if any provision in a definition is a substantive provision conferring rights or imposing obligations on any party, notwithstanding that it is only in the definition clause, effect shall be given to it as if it were a substantive provision in the body of the agreement;
- 1.4. when any number of days is prescribed in this agreement, same shall be reckoned exclusively of the first and inclusively of the last day unless the last day falls on a Saturday, Sunday or public holiday, in which case the last day shall be the next succeeding day which is not a Saturday, Sunday or public holiday.
2. **Sale of the sold equity**

- 2.1. The seller sells to the purchaser, which purchases as one indivisible transaction the sold shares and the sold claims.
- 2.2. Notwithstanding the date upon which this agreement is signed and the date upon which the sold equity is delivered to the purchaser, the sold equity is sold with effect on and as from the effective date, from which date all risk in and



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benefits attaching to the sold equity shall be deemed to have passed to the purchaser.

3. Purchase price

3.1. The purchase price of the sold equity is \$95,000,000 (ninety five million US Dollars).

3.2. Of the purchase price, so much as does not exceed the face value of the sold claims shall be allocated in respect of the sold claims and the balance shall be allocated in respect of the sold shares.

4. Payment of the purchase price

4.1. The purchase price shall be discharged by way of the purchaser crediting the seller's loan account in the books of the purchaser in the sum of \$95,000,000 (ninety five million US Dollars).

4.2. The loan account referred to in clause 4.1 shall be payable by the purchaser to the seller on demand.

5. Closing

On the effective date (or such at such other date as agreed to by the parties), the seller shall deliver to the purchaser –

5.1. the share certificates or other documents of title reflecting that the sold shares will, with effect from the effective date, be held for the beneficial ownership of the purchaser;



R
RE
[Handwritten signature]
[Handwritten initials]

- 5.2. a written cession of the sold claims;
- 5.3. such other certificates or documents as may be required to effect a transfer of the sold equity into the name of the purchaser or (if required by the purchaser) to be held for the benefit of the purchaser.

6. Warranties and representations

The seller warrants in favour of the purchaser that:

- 6.1. it is the beneficial owner of the sold equity;
- 6.2. it is able to pass free and unencumbered title in and to the sold equity to the purchaser;
- 6.3. no third party has any claim in and to the sold equity.

Save as aforesaid, the sold equity is sold free of any warranties or representations of any nature whatsoever.

7. Further Assurances

The parties shall with reasonable diligence do all such things and provide all such reasonable assurances as may be required to consummate the transaction contemplated hereby, and each party hereto shall provide such further documents or instruments required by the other party as may be reasonably necessary or desirable to effect the purposes of this agreement and carry out its provisions whether before or after the effective date.



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A. (top)
RE (middle)
J (middle)
A (middle)
P (bottom)

8. **Governing law**

This agreement shall be interpreted in accordance with English law which shall be the governing law of this agreement.

9. **Notices**

9.1. All notices under this agreement, whether in respect of court process or other documents or communications of whatsoever nature, shall be given to the parties at the following addresses :

9.1.1. purchaser:

c/o Schindlers Corporate Management (UK) Limited
21 Cork Street
London, W1X 1HB

Attention: Alex Goodman/Mandy Feldman

Telefax: +44 20 7287 4243

9.1.2. seller:

c/o Schindlers Corporate Management (UK) Limited
21 Cork Street
London, W1X 1HB

Attention: Alex Goodman/Mandy Feldman

Telefax: +44 20 7287 4243

9.2. Any notice or communication required or permitted to be given in terms of this agreement shall be valid and effective only if in writing but it shall be competent to give notice by telefax.

9.3. Either party may by notice to any other party change the physical address to another physical address where postal delivery occurs or its postal address or its telefax number, provided that the change shall become effective *vis-à-vis* that addressee on the 3rd business day from the receipt of the notice by the addressee.



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9.4. Any notice to a party:

- 9.4.1. sent by prepaid registered post (by airmail if appropriate) in a correctly addressed envelope to it at its designated address to which post is delivered shall be deemed to have been received on the 5th business day after posting (unless the contrary is proved);
- 9.4.2. delivered by hand to a responsible person during ordinary business hours at the physical address designated herein shall be deemed to have been received on the day of delivery; or
- 9.4.3. sent by telefax to its chosen telefax number stipulated in clause 9.1, shall be deemed to have been received on the date of despatch (unless the contrary is proved).

9.5. Notwithstanding anything to the contrary herein contained a written notice or communication actually received by a party shall be an adequate written notice or communication to it notwithstanding that it was not sent to or delivered at its designated address.

10. **Breach**

If either party breaches any material provision or term of this agreement and fails to remedy such breach within 10 (ten) days of receipt of written notice requiring it to do so (or if it is not reasonably possible to remedy the breach within 10 (ten) days, within such further period of time as may be reasonable in the circumstances) then the aggrieved party shall be entitled without notice, in addition to any other remedy available to it at law or under this agreement, to terminate this agreement or to claim specific performance of any obligation whether or not the due date for performance has arrived, in either event without prejudice to the aggrieved party's right to claim damages.

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11. **Costs**

Each party shall be liable for all costs and expenses incurred by it, including but without any limitation, fees of agents, representatives, solicitors, counsel, accountants, investment and other banks, actuaries and other professional advisors employed by such party in connection with the negotiation, preparation, execution and implementation of this agreement.

12. **No Rights to Third Parties**

The parties agree that a person who is not a party to this agreement has no right under the *Contracts (Rights of Third Parties) Act 1999* to enforce any term of this agreement but this does not affect any right or remedy of a third party which exists or is available under that act.

13. **Counterparts**

13.1. This agreement may be executed in counterparts, but shall not be effective until each party has executed at least one counterpart.

13.2. Each counterpart, when executed, shall be an original, but all the counterparts together constitute the same document.

SIGNED by the parties and witnessed on the following dates and at the following places respectively:

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DATE

PLACE

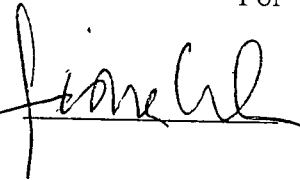
WITNESS

SIGNATURE

For **Mikado Group Holdings Inc**

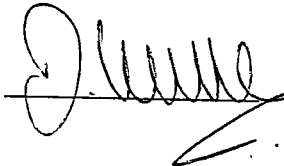
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LONDON

1. 




Schindlers reg. Treuunternehmen

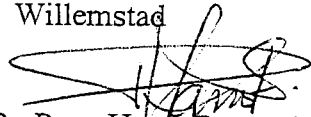
2. 

As Sole Director

For **Blue Eagle International Investments Limited**

1. 
1. Remir Sinlae

December 15, 2000 Willemstad

2. 
2. Rosa Hanst Fernandes-Correia


HBM B.V.I. Ltd.



ELK/DW/CORPCAPITAL
15.01.2001

Ex Parte: **CORPCAPITAL LIMITED**

Consultant

In re:

PROPOSED RESTRUCTURE OF THE NETAINMENT NV INTEREST

OPINION

Introduction

1. Consultant's 47,5% interest in Netainment N.V. (Netco) is held via Corpcapital Investments (Pty) Limited ("Corpinvest"), a company registered in South Africa. Corpinvest wholly owns a British Virgin Isles' company, Mikado Group Holdings Inc ("Mikado") which in turn holds two investments, a 47,5% interest in Netco, a Netherlands Antilles company, and a 50% interest in Cyber Finance Investments Limited (CFI), a company registered in the British Virgin Isles.

Non-residents hold the remaining 52,5% issued share capital of CFI and Netco.

The current corporate structure is set out under Annexure 1.

2. Netco and an independent third party, English Harbour Entertainment Limited ("English Harbour"), concluded negotiations in December 2000, to merge their businesses into a new company, Amalco Limited ("Amalco"), a company incorporated in the Isle of Man.

3. Preceding the aforementioned merger into Amalco, Mikado disposed of its 47,5% shareholding in Netco to Blue Eagle International Investments Limited ("Blue Eagle"), a British Virgin Isles company and a wholly owned subsidiary of Mikado, for a sum of US\$ 95 million. Mikado financed the sale on a non-interest bearing inter-company loan account. Thereafter and prior to 31 December 2000, Netco sold its business to Amalco, for US\$ 200 million, returning a distributable profit of approximately the same amount.

In consideration for the acquisition of the aforementioned businesses, Amalco issued ordinary shares in equal proportions to Netco and English Harbour with the balance of the purchase consideration credited to loan accounts in favour of the latter companies.

A diagram of the re-structured group is set out under Annexure 2.

4. Netco as a consequence of the disposal is now a dormant investment holding company, rich with approximately US\$ 200 million in distributable reserves and should Netco, on or after 1 January 2001, distribute these reserves, as a dividend to its shareholders, the following South African income tax consequences would arise:

4.1 Section 9E of the South African Income Tax Act, No. 58 of 1962 (the Act), as amended by the Revenue Laws Amendment Act (Act 59-2000) defines a "foreign dividend" as "*any dividend received by or which accrued to any person from any company which is a foreign entity as defined in section 9D*" (underlining added)

- 4.2 A "foreign entity" is defined as: *"....any person(other than a natural person or a trust) which is not a resident"*
- 4.3 A "resident" is defined in section 1 of the Act as;
"...any-
 (a) *natural person who is -.....*
 (b) *person (other than a natural person) which is incorporated, established or formed in the Republic or which has its place of effective management in the Republic"*
- 4.4 It is obvious that Netco is a "foreign entity" and Blue Eagle would receive a "foreign dividend", from Netco of approximately US\$ 95 million i.e. its 47,5% aliquot share of the reserves.
- 4.5 Blue Eagle in turn, also a "foreign entity" is furthermore a "controlled foreign entity" of Corpinvest, as defined in section 9D, namely *"... any foreign entity in which any resident or residents of the Republic, whether individually or jointly, and whether directly or indirectly, hold more than 50 per cent of the participation rights, or are entitled to exercise more than 50 per cent of the votes or control of such entity";*
- 4.6 Section 9D deems certain income of a "controlled foreign entity" to accrue to South African residents and subsection 9D(2) provides as follows: *"There shall be included in the income for the year of assessment of any resident contemplated in the definition of "controlled foreign entity" ..., an amount equal to the proportional amount of the net income of such entity which bears to the total net income of such entity the same ratio as the percentage of the participation rights of such resident in relation to such entity bears to the total participation rights in relation to such entity:....."*
 (underlining added).
- 4.7 Subsection 9D(2A) defines "net income" for the purposes of 9D(2) as *"...an amount equal to the taxable income of such entity determined in accordance with this Act as if such controlled foreign*

entity had been a resident... (underlining added).

It is clear that any income received by Blue Eagle is to be examined in terms of the provisions of the South African Income Tax Act, as if the company was a resident of South Africa, and any taxable income included in its "net income".

Corpinvest, a "resident" as defined would then be taxed on this "net income" in proportion to the "participation rights" it holds in Blue Eagle.

4.8 Subsection 9E(3) of the Act provides: *".....where during any year of assessment any foreign dividend is received by or accrues to any resident, the amount to be included in the gross income of such resident.....shall-*

(a) if such resident-

i).....

ii) in the case of a company, together with any other company in a group of companies of which such company forms part, hold for their own benefit,

at least 10 per cent of the equity share capital in the company declaring the dividend, be the proportionate amount of the profit from which the dividend is distributed....." (underlining added).

4.9 A summary at this point is appropriate. Subsection 9D(2A) requires Blue Eagle's taxable income to be quantified as if the company was a "resident" of South Africa and that taxable income is to be included in its "net income"

Subsection 9E(3) provides that any "foreign dividend" received by a "resident" is to be included in that "resident's" gross income.

Accordingly the dividend received by Blue Eagle from Netco will be included in Blue Eagle's "net income" and as Blue Eagle does not qualify for any concessions provided by subsection 9D(9), subsection 9D(2) will cause Corpinvest to be taxed on that "foreign dividend" included in the "net income" of Blue Eagle.

- 4.10 The conclusion arrived at after a rather tortuous tour of sections 1, 9D and 9E, is that the "foreign dividend" received by Blue Eagle from Netco would fall for inclusion in Corpinvest's taxable income, under subsection 9D(2) of the Act.
5. Two proposals are under consideration as an alternative to a future dividend declaration by Netco and the accompanying "foreign dividend" complications of section 9E.

Proposal 1 – Preference share issue.

6. In place of a dividend declaration by Netco, a return of capital to the shareholders, for the same amount, could be structured on the following basis: -
- 6.1 An independent offshore financial institution subscribes in cash for preference shares in Netco, with a par value of say US\$ 1000, for US\$ 198 million (US\$ 200 million less a discount of say 1%), resulting in the company raising preference share capital of US\$ 1000 and a share premium of US\$197,99 million. The holder of the preference shares will be entitled to preference dividends and a repayment of the nominal value of the preference shares on redemption.
- 6.2 The entire distributable reserves of Netco, approximately US\$ 200 million, would be distributed to Divco, as a preference dividend leaving the capital structure of Netco comprising of nominal ordinary share capital, nominal preference share capital and a large share premium. The corresponding asset on the balance sheet would be the Amalco investment.
- 6.3 After a period of 18-24 months Netco would be unbundled and the effective 23,75% holding in Amalco distributed to Blue Eagle as a repayment of share premium, sans any adverse tax consequences

under sections 9D or 9E to the Group.

A repayment of share premium is excluded from the definition of a "dividend"; refer exclusion (f) to the definition, in section 1 of the Act and therefore outside of the "foreign dividend" provisions in section 9E.

No income is received by Blue Eagle, on the repayment of share premium, and no amount falls for inclusion into "net income".

Accordingly Corpinvest is unaffected by the provisions of section 9D.

Proposal 2 – Netco "A" and "B" share issue.

7. Netco's share capital is divided into "A" shares, issued to Blue Eagle, and "B" shares, issued to the non-resident shareholders, on a 47.5% : 52.5% ratio. The rights attached to the "A" and "B" shares rank pari passu in all respects.
8. A dividend is declared to the "B" shareholders and settled by the distribution of a dividend in specie of the "B" shareholders' aliquot portion of the Amalco shares. The end result is that Netco's distributable reserves and its investment in Amalco reduces by 52.5% and the "B" shareholders acquire their 52.5% stake in Amalco as a direct holding.
9. The "B" shareholders will forfeit, in favour of the "A" shareholders, any future participation in profits arising from the remaining 47,5% Amalco investment held by Netco.
The "B" shareholders retain their voting rights but the "A" shareholders are conferred a call option on the "B" shares.

Advice Required

10. An opinion is required on the following issues:

- 10.1 Will the disposal of the Netco interest by Mikado to Blue Eagle give rise to any South African tax consequences for the Group?
- 10.2 Will the disposal of the Netainment business from Netco to Amalco give rise to any South African tax implications for the Group?
- 10.3 Will the unbundling alternatives of the Amalco interest from Netco, refer proposal 1 and proposal 2, give rise to any South African tax implications for the Group?
- 10.4 Should the loan from Mikado to Blue Eagle, arising from the disposal of the Netainment interest, bear interest or could the loan be capitalised?
- 10.5 What are the South African tax implications should Blue Eagle, after an unbundling of Netco in line with proposal 1, refer point 6 supra, dispose of its interest in Amalco?
- 10.6 Could Section 103 of the Act be successfully applied to the proposed restructure?
- 10.7 What are the South African tax implications for the Group if Netco does not unbundle its investment in Amalco, but disposes of the investment at a price in excess of the carrying amount of US\$ 95 million?

Disposal of the Netco interest by Mikado to Blue Eagle.

11. Mikado, prior to 31 December 2000, is not a South African "resident" as defined in section 1 of the Act, refer point 4.3 supra, being a company incorporated in the British Virgin Isles with its place of effective management outside of the Republic.
The amended subsection 9D(2), refer point 4.6 supra, which seeks to determine the "net income" of Mikado as if it were a "resident" is only operative from 1 January 2001, and only applies in respect of years of assessment commencing on or after that date. The relevance of this lies in Mikado's financial year ending on 31 August, which results in the new

subsection 9D(2) only applying to Mikado from 1 September 2001 onwards.

12. Subsection 9D (2) of the Act, prior to the amendments enacted by the Revenue Laws Amendment Act (Act 59-2000) provided as follows:

" There shall be included in the income of any resident contemplated in the definition of "controlled foreign entity" in subsection (1), a proportional amount of any investment income received by or accrued to such entity, which bears to the total investment income received by or accrued to such entity, the same ratio as the percentage of the participation rights of such resident in relation to such entity bears to the total participation rights in relation to such entity:...."

13. Investment income is defined as *"investment income as defined in section 9C (1) and includes any foreign dividend as defined in section 9E;"* (underlining added).

Section 9C(1) defined "investment income" as:

" any income in the form of any annuity, interest, rental income or royalty or any income of a similar nature."

14. Mikado remains a "controlled foreign entity" as defined in section 9D but the, pre 1 January 2001, profit on disposal of its Netco shares to Blue Eagle should be immune from the provisions of the Act, provided that it does not fall within the deeming provisions of sections 9D or 9E and in particular the definitions of "investment income" and "foreign dividend". The profit returned on the sale of the Netco shares obviously do not fall under the description of an annuity, interest, rental income or royalty income but the proceeds from the sale of the Netco shares do fall within paragraph (b) of the definition of a "foreign dividend" in section 9E which reads:

" any amount derived by any person from the disposal by such person of

any share or interest ina company, to the extent that such company or any subsidiary of such company has any undistributed profits which were derived from a source outside the Republic which are not deemed to be from a source within the Republic, or from profits deemed to be from a source within the Republic which have not been subject to tax in the Republic, which were directly or indirectly available for distribution to such person:....." (underlining added).

15. Proviso (iii) to the above definition however excludes any disposal of any share or other interest in the fixed capital in a company where:
"... such person retains the same effective interest in the equity share capitalof the company as prior to disposal: Provided that the provisions of this subparagraph shall not apply if one of the main purposes of such disposal is the avoidance, postponement or reduction of liability .for any tax....." (underlining added).
16. It is manifest that Mikado retained the same effective interest in the equity of Netco after the disposal to Blue Eagle, as prior to the disposal, thereby allowing Mikado to rely on the aforementioned exemption, provided of course that the disposal was motivated by sound commercial reasons rather than a tax avoidance purpose.
17. The merger of the Netco and English Harbour businesses into Amalco, required that the shareholders of Netco and English Harbour enjoyed pre-emptive rights over their direct and indirect interests in Amalco.
 Due to Mikado housing other interests besides the Netco investment, viz. a 47,5% interest in CFI, it was inappropriate for pre-emptive rights to have been granted by Corpinvest at the Mikado level.
18. It was necessary to incorporate Blue Eagle and transfer the Netco interest therein, as the sole asset of Blue Eagle, to facilitate the granting of a pre-

emptive right at the Blue Eagle level, such that Corpinvest's other commercial interests were not prejudiced, while satisfying the pre-emptive requirements of English Harbour.

19. A further reason for relocating Netco into Blue Eagle was to allow the possibility that Consultant's executives, as an incentive, could participate in the rewards of the Amalco operation by taking up share options in Blue Eagle.
20. Notwithstanding the fact that Netco may have reserves available for distribution, the disposal by Mikado to Blue Eagle should not constitute a deemed 9E foreign dividend and accordingly will not constitute "investment income".
Corpinvest should therefore be immune from the deeming provisions of section 9D, provided that the profit on disposal accrues to Mikado on or before the last day of its financial year i.e. 31 August 2001.
21. Should the profit accrue to Mikado after 31 August 2001, the position would be quite different. The amendment to section 9D, which replaced the definition of "investment income" with net income would be effective. It is manifest that should the profit on disposal accrue to Mikado after 31 August 2001, and should that profit be on revenue account, that profit would fall to be included in the definition of "net income", and Corpinvest would be subject to South African tax on that profit in terms of the amended section 9D.
22. I am advised that Mikado's trading history would inhibit a convincing argument that the proceeds could be on capital account. In any event should the proceeds be on capital account, the amended subsection 9D(2A) provides that Mikado's "net income" shall be an amount equal to its taxable income, determined in accordance with our Act, as if Mikado

was a resident.

The recently released drafts of the Eighth Schedule, dealing with our new Capital Gains Tax (CGT), to be introduced with effect from 1 October 2001, applies to the worldwide assets of residents. Prima facie, a capital profit on disposal of Netco, after 1 October 2001, by Mikado, a deemed resident for the purposes of subsection 9D(2A), could be drawn into Mikado's "net income", resulting in a section 9D(2) tax liability for Corpinvest.

Of course the CGT legislation is still in draft form and the position may change as the legislation develops to finality.

23. Section 9E(7)(e) exempts from tax -

"... any foreign dividend declared or deemed to have been declared by any company to the extent that the profits from which the dividend is distributed -

- i) relate to any amount of income which has or will be included in the income of the shareholder of such company in terms of section 9D; or
 - ii) have or will be included in the taxable income of such company in terms of this Act; or
 - iii) have otherwise been included in the taxable income of the shareholder in terms of paragraph (a) of the definition of "foreign dividend".
- (underlining added)

In the event that the profit on disposal is on capital account and taxed as a capital gain under 9D(2A), read with the Eighth Schedule, any dividend distribution out of that capital profit will fall for exemption under section 9E(7)(e).

Considering that only 50% of a company's taxable capital gains are included in its taxable income it appears, prima facie, that an overall economic advantage would be gained, vis-a-vis the position should the

profit have been on revenue account and fully included in taxable income.

Disposal of the Netainment business from Netco to Amalco.

24. Should Netco in pursuance of its objective to merge its business with that of English Harbour, dispose of its business to Amalco for a sum of US\$200 million, no adverse South African tax consequences should arise from that transaction. Netco is not a "controlled foreign entity", for the purposes of Section 9D, provided that the remaining 52,5% shareholding is not held by "residents" as defined in the Act. A Netherlands Antilles tax liability may arise from the transaction but I do not comment thereon. There is a potential South African tax implication for the Group should Blue Eagle dispose of Netco or should Netco distribute dividends to Blue Eagle but the disposal of the Netco business to Amalco, should not in itself, cause any adverse South African tax implications for the Group, whether the disposal is concluded before or after 31 December 2000.

Unbundling of the Amalco interest from Netco – South African tax implications.

Proposal 1 – issue of preference shares

25. If Netco is unbundled per point 6 supra, an ordinary dividend would never be declared and a potential South African tax liability for the Group will be indefinitely avoided.

The unbundling may be summarised as follows:

- 25.1 An independent offshore financial institution, Divco subscribes for preference shares in Netco at a premium;
- 25.2 The issue price would approximate the profit of US\$200 million after tax, less an appropriate discount to Divco.

- 25.3 The rights attaching to the preference shares would be limited to preference dividends and a repayment of the nominal value of the preference shares, on redemption.
 - 25.4 A preference dividend is declared to Divco reducing all distributable reserves of Netco to nil, leaving the company with ordinary share capital, preference share capital and share premium.
The preference shares are redeemed at par and Netco after 18-24 months is wound up, allowing it to transfer its investment in Amalco to Blue Eagle as a repayment of share premium.
 - 25.5 Netco is in turn, wound up after a suitable time interval of say 2-3 years.
26. The accounting and tax result would be:
- 26.1 Blue Eagle obtains the Amalco investment for US\$ 95 million;
 - 26.2 The Amalco investment is distributed by Netco to Blue Eagle as a repayment of share premium which will not fall for inclusion into the latter company's "net income" as defined in section 9D, nor will such repayment fall into the definition of a "dividend" in section 1 of the Act obviating the receipt of a "foreign dividend" by Blue Eagle;
 - 26.3 Netco is disposed of without a Section 9E deemed dividend implication as the company has no undistributed profits available for distribution, at the time of its disposal.
27. The tax and accounting result appears optimal but an obvious concern is whether section 103 could be successfully applied to the proposed restructuring. Consideration must firstly be given as to which of the following aspects of the restructure could be exposed to a section 103 enquiry:
- 27.1 The transfer of Netco shares from Mikado to Blue Eagle?
 - 27.2 The disposal of the Netco business into Amalco?

- 27.3 The unbundling transactions at the Netco level, resulting in the transfer of the Amalco shares to Blue Eagle?
- 27.4 All of the above transactions as they should be viewed as components of one integrated scheme.
28. In the case of *Hicklin v Secretary for Inland Revenue, 41 SATC 179*, the Secretary for Inland Revenue unsuccessfully attempted to apply section 103 to what it regarded as a “dividend strip” scheme. The facts of the case were as follows:
- 28.1 The taxpayer and two others were the sole shareholders and directors of a private company R, whose main activity was the management of another private company A. From its incorporation R’s profits were always retained, no dividends were declared or paid out. In 1971 the businesses of R and A were sold to a new company NA and R derived a capital accrual of R150 000 from the sale that it allocated to a non-distributable reserve.
- 28.2 Companies R and A, now dormant, continued in existence and R from time to time, borrowed money from A and advanced interest-free unsecured loans to its shareholders.
29. A resolution at R’s annual general meeting on 30 July 1973, resolved to pay a dividend of R30 000 out of distributable profits which was subsequently not implemented as the shareholders abandoned the idea due to the resultant tax liability.
30. In 1975 the Appellant fortuitously met a manager of RN Corporation Limited, a company interested in the acquisition of dormant companies having distributable profits. RN made a written, non-negotiable offer to purchase the shares in R from the shareholders.

- 36.4 Before Section 103(1), as it then was, can find successful application, the following four requirements all had to be present:
- 36.4.2 A transaction, operation or scheme;
 - 36.4.3 The transaction must have the effect of avoiding or postponing liability for tax on income or reducing the amount of the tax;
 - 36.4.4 The transaction must be entered into or carried out by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, of the nature of the transaction in question or must have created rights or obligations which would not normally be created between persons dealing at arm's-length under such a transaction; and
 - 36.4.5 The avoidance, postponement or reduction must be the sole or main purpose of the transaction.
- 36.5 Revenue counsel had erred in submitting that the conduct of the shareholders, including their continual borrowing from R, the retention of R, although dormant, the abandoning of the intention of declaring dividends and the ultimate transaction with RN, constituted a wider "scheme" envisaged under section 103(1). The only transaction, operation or scheme in issue was the agreement with RN.
- 36.6 The RN agreement did have the effect of avoiding liability for income tax and there was little doubt that while the avoidance was not their sole purpose, it was one of the main purposes.
- 36.7 In relation to the normality requirement it was important to determine whether the transaction was concluded "at arm's-length". When considering the normality of the rights or obligations so created or of the means or manner so employed, due regard has to be paid to the surrounding circumstances. The problem of normality or abnormality is mainly a factual one. In entering into the RN

agreement both sides manifestly dealt with each other at arm's-length. Neither R nor its shareholders, as directors or otherwise, were associated with or interested in RN. It was part of RN's business to purchase the shares of companies with capital and distributable reserves and this offer was made in the ordinary course of that business. There was thus nothing abnormal about that undertaking.

36.8 The Court found in favour of the taxpayer, concluding that although the other requirements of section 103(1) were present, crucially, requirement (c) in Section 103(1)(i) and (ii), viz. an absence of normality, was not fulfilled.

37 Applying the principles enunciated in the Hicklin case to the instant proposal, earlier discussions with Consultant indicate that sound commercial reasons exist, other than the obtaining of a tax benefit, for transactions 28.1 and 28.2. The presence of cogent commercial reasons as the main purpose for the transactions, irrespective of the fact that tax avoidance has resulted or was one of the considerations in carrying out the transaction, should be sufficient to successfully resist the application of section 103(1) refer **CIR vs Conhage, 61 SATC 391 (SCA)**.

In brief the court, in the Conhage case, held that where a taxpayer entered into a transaction, operation or scheme in order to achieve a commercial objective, in that case to raise finance, and did so in a manner that avoided tax, it was not even relevant to examine whether the rights and obligations created were abnormal. Since the main purpose of the transaction was to raise finance and not to avoid tax, irrespective of the fact that tax was a consideration, section 103(1) could not be successfully applied.

38 Returning to the question raised in point 27, it is transaction 27.3, the Netco unbundling that would bear the brunt of a section 103(1) enquiry

39 Section 103(1) as it is currently worded, provides:

"Whenever the Commissioner is satisfied that any transaction, operation or scheme (whether entered into or carried out before or after the commencement of this Act, and including a transaction, operation or scheme involving the alienation of property)—

- (a) has been entered into or carried out which has the effect of avoiding or postponing liability for the payment of any tax, duty or levy imposed by this Act or any previous Income Tax Act, or of reducing the amount thereof; and*
- (b) having regard to the circumstances under which the transaction, operation or scheme was entered into or carried out—*
 - (i) was entered into or carried out—*
 - (aa) in the case of a transaction, operation or scheme in the context of business, in a manner which would not normally be employed for bona fide business purposes, other than the obtaining of a tax benefit; and*
 - (bb) in the case of any other transaction, operation or scheme, being a transaction, operation or scheme not falling within the provisions of item (aa), by means or in a manner which would not normally be employed in the entering into or carrying out of a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; or*
 - (ii) has created rights or obligations which would not normally be created between persons dealing at arm's length under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question; and*
- (c) was entered into or carried out solely or mainly for the purposes of obtaining a tax benefit, "*

offshore dividend strip. However should the dividend strip be integrated into a transaction motivated by genuine cogent commercial objectives, the possibility of a successful outcome would be enhanced.

- 44 A possible scenario could be the approach by an independent party to purchase Amalco from the Group, in which case the disposal may be transacted on the basis of the instant proposal except that the Amalco shareholding could be distributed to the purchaser as a dividend in specie, and the significant share premium raised would be available to immunise any distributions to shareholders against sections 9D and 9E, to the extent that distributions are made out share premium.

Under such a scenario the main purpose of the transaction would not be tax related but motivated by a commercial purpose to sell the Amalco investment to a willing buyer and a defence against section 103 would be based along the principles enunciated in CIR vs Conhage.

Proposal 2 – Netco “A” and “B” share issue

- 45 The issue of “B” shares to the 52.5% outside shareholders and a distribution of their aliquot share of the Amalco investment, as a dividend in specie, effects an unbundling of 52,5% of the Amalco investment to the “B” shareholders.

The South African income tax implications require careful examination, assuming that after the unbundling,

- 46.1 Netco’s remaining reserves, available for distribution, total US\$ 1 million,
- 46.2 The “B” shareholders forfeit any future rights to any income earned by Netco from the residual 47,5% Amalco investment
- 46.3 The “A” shareholders are awarded a call option on the “B” shares.

- 46 The "B" shareholders are non South African residents and the issue of "B" shares and dividend distribution to them will not cause any South African tax consequences in their hands.
- 47 What requires examination is whether Netco continues to remain outside the provisions of section 9D. Netco will be a CFE if any resident or residents of South Africa, individually or jointly, directly or indirectly, hold more than 50 per cent of the participation rights or votes of the company.
- 48 Corpinvest via the "A" shareholder, Blue Eagle, holds 47.5% of Netco. Blue Eagle may, at its discretion, call for the "B" shares, at which time it will become the sole shareholder of Netco. Until that time the "B" shareholders retain their full voting rights and the "A" and "B" shares continue to rank pari passu in all respects.
- 49 The "B" shareholders forfeit their rights to any future income earned by Netco from its Amalco investment and in effect to any further participation in the capital and profits of Netco apart from their 52.5% share in the issued share capital and the "pre-unbundling" US\$ 1million reserves. As both class of shares rank pari passu, until such time as the reserves in Netco are sufficient to allow the "A" shareholders to receive an equalising dividend, proportionate to the amount already distributed to the "B" shareholders, in practice the "B" shareholders would have no claim on the "pre-unbundling" reserves. To illustrate, should Netco be wound up immediately after the "unbundling" the remaining US \$ 1million would be distributed to "A"
- On that basis, immediately after the "unbundling", the "A" shareholder, Blue Eagle, would enjoy 100% participation rights in Netco, rendering it a CFE.

- 50 Moving forward on that basis, after the unbundling of the pro-rata interest in Amalco to the "B" shareholders, the future "net income" of Netco, including section 9E dividends from Amalco will fall to be taxed in Corpinvest's hands under section 9D.
- 51 The advantage of the share split appears to lie in the flexibility afforded to the "B" shareholders should they wish to paddle their own canoe in respect of their portion of the Amalco investment. The subsequent classification of Netco as a CFE would only affect "net income" earned after the 52,5% Amalco unbundling and should the Netco reserves, available for distribution, accumulated up to that date, never be distributed, there would be no adverse tax consequences for Corpinvest.

Loan from Mikado to Blue Eagle.

- 52 It is advisable that every aspect of the proposed restructuring, refer points 5.1 to 5.3, comply with the requirements of commercial "normality", in the event that the separate parts of the restructuring are viewed by SARS as an entire integrated scheme falling within the ambit of section 103. The loan from Mikado to Blue Eagle, to finance the purchase of the Netco shares, should therefore bear interest at a market-related rate and every aspect of the loan should bear the hallmarks of an arm's-length transaction.
- 53 Furthermore In the event that a market related interest rate is not charged, the provisions of section 31 could impute interest income into the hands of Mikado which in turn would lead to a section 9D tax liability for Corpinvest.
- 54 In conclusion, to obviate an exposure to section 103 and section 9D read with section 31 it is recommended that the loan is capitalised to share capital.

After unbundling Netco, and the acquisition of Amalco, Blue Eagle disposes of Amalco.

- 55 The disposal by Blue Eagle would trigger the receipt of a deemed section 9E dividend in the hands of Blue Eagle, to the extent that Amalco had undistributed profits directly or indirectly available for distribution, at the time of disposal. The deemed dividend would be included in Blue Eagle's "net income" for the purposes of section 9D and Corpinvest would be taxed under the provisions of that section.
- 56 The capital gains tax provisions would not be applicable to the above disposal due to paragraph 25(2) of the Eighth Schedule (first draft), which provides that the proceeds identified in quantifying a capital gain, may not include any amount taken into account when determining the taxable income of the taxpayer, before the inclusion of any capital gain.
- 57 Of course should a dividend be declared by Blue Eagle, from profits previously subjected to tax as set out above, the provisions of section 9E would not apply i.e. if Blue Eagle is deemed to have received a section 9E dividend totalling US\$ 100 million, on which Corpinvest in turn was taxed under section 9D the subsequent receipt of that US\$ 100 million as an actual dividend from Blue Eagle, would not be taxed again as a foreign dividend receipt in the hands of Corpinvest.

Netco does not unbundle its Amalco investment but disposes of Amalco for a profit.

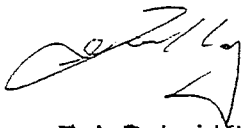
- 58 Netco is not a "controlled foreign entity" as defined in Section 9D. and a profit arising from the disposal of its Amalco investment would not in itself trigger a South African tax liability for the Group. The disposal would theoretically fall into the definition of a "foreign dividend" but as Netco is

not a "controlled foreign entity", the charging provisions of section 9D(2) would be inoperative.


59 A South African tax event would only arise on:

43.1 The sale of Netco by Blue Eagle, in the form of a deemed section 9E dividend receipt by Blue Eagle, to the extent that Netco had undistributed profits available for distribution, with section 9D consequences for Corpinvest or

43.2 A declaration of the profit derived by Netco to Blue Eagle, which would be a section 9E "foreign dividend" receipt in Blue Eagle's hands, again giving rise to a South African section 9D tax liability for Corpinvest.



E.J. P. Lai King.



I agree

E.B. Broomberg S.C.

LONDON, 28/3/01.

March 2001

Memorandum

in re: **Structure of the Netainment N.V. interest**

Introduction

1. Prior to the restructure contemplated in paragraph 3 below ("the restructure"), Corpcapital Limited's ("Corpcapital") interest in Netainment N.V. ("Netainment") was held through a wholly owned subsidiary of Corpcapital Investments (Pty) Limited ("CorpInvest"), namely Mikado Group Holdings Inc ("Mikado") a British Virgin Isles company.

The pre-restructuring corporate structure is set out in Part I of **Annexure A**.

2. During 2000, Netainment and an independent third party, English Harbour Entertainment Limited ("English Harbour") concluded an agreement (the implementation of which was subject to the fulfilment of certain outstanding conditions precedent) to merge their businesses into a new company, 3AM Entertainment Limited ("Amalco").
3. During December 2000 (in anticipation of but preceding the implementation of the aforementioned merger into Amalco), Mikado disposed of its 47,5% shareholding in Netainment to Blue Eagle International Investments Limited ("Blue Eagle"), a British Virgin Islands ("BVI") company and a wholly owned subsidiary of Mikado. The consideration paid by Blue Eagle to Mikado for Mikado's 47,5% shareholding in Netainment was US\$95m (equating to 47,5% of the US\$200m consideration payable by Amalco to Netainment for the Netainment business). Whilst, for the purpose of facilitating the transaction, Mikado financed the sale on inter-company interest free loan account, Mikado's loan account into Blue Eagle is to be capitalised.
4. If the English Harbour/Netainment merger (the "Amalco merger") becomes unconditional and is implemented then, as a consequence of the disposal of its business to Amalco, Netainment will be constituted as a dormant investment company which will have US\$200m in distributable reserves.

On the assumption that the Amalco merger is implemented then the post-restructuring corporate structure is set out in Part II of **Annexure A**.



5. **Executive Summary of tax consequences of the disposal by Mikado of its Netainment interest to Blue Eagle**

In summary, the US\$95m consideration paid by Blue Eagle to Mikado will not be taxable in either Mikado's hands or in CorpInvest's hands for the following reasons:

- 5.1. Mikado (which is a BVI company) is not subject to either income tax or capital gains tax;
- 5.2. as the income earned by Mikado was earned in respect of years of assessment commencing before 1 January 2001 and the nature of the income did not constitute investment income (as then defined in the South African Income Tax Act), the gain made by Mikado on the disposal of its interest in ~~Blue Eagle~~ *Netainment* is not be subject to South African income tax.

A description of the commercial motivation for the restructure and a more detailed analysis of the South African tax consequences is set out below.

6. **Commercial rationale for restructure**

6.1. The principal commercial reasons for the restructure were the following:

- 6.1.1. One of the principles required by the parties to the Amalco shareholders agreement (consequent upon the merger of the Netainment business and the English Harbour business through the vehicle of Amalco) was the "grand-fathering" up of rights of pre-emption such that each of the Netainment shareholders and the English Harbour shareholders would enjoy pre-emptive rights not only over the other group's direct shareholding in Amalco but also in regard to the shareholding of the other's group companies where the sole asset of such group company was a direct or indirect interest in Amalco.

It would have been inappropriate for rights of pre-emption to have been granted by CorpInvest over its shares in Mikado for, amongst others, the following reasons:

- Mikado constitutes (and is intended to constitute) the offshore holding company of the Corpcapital group of companies' offshore interest;



- in addition to Mikado's 50% shareholding in Netainment, Mikado also holds:
 - a 50% investment in Cyber Finance Investments Inc ("CFI");
 - 100% investment in Corpcapital Investments BVI (the offshore advisory subsidiary of the Corpcapital Group).

It was necessary to put Blue Eagle in place so as to allow for rights of pre-emption to extend above the level of Netainment but without rendering Corpcapital's other offshore commercial interests (held through Mikado) subject to rights of pre-emption. The most appropriate way of ensuring this was to interpose Blue Eagle between Mikado and Netainment and afford the English Harbour group rights of pre-emption over Blue Eagle without extending those rights of pre-emption to a more senior level).

6.1.2. The decision not to reverse out of Mikado its interest in CFI and its anticipated investment in Corpcapital Investments BVI (thus allowing for rights of pre-emption to be granted by CorpInvest to the English Harbour Group over CorpInvest's Mikado shares) was motivated by, amongst others, the following reasons:

- Mikado had historically been earmarked as the offshore holding company of Corpcapital's non-South African investments;
- CFI was embroiled in litigation with Mini Vegas, a customer, relating to alleged unlawful gaming activities undertaken by Mini Vegas, the proceeds of which were allegedly under the control of CFI and the subject of attachment and investigations by the Swiss and Luxembourg authorities.

Mini Vegas' activities had cast suspicion on CFI's complicity and CFI had made representations to the authorities regarding its beneficial owners and their credibility, in response to enquiries. An immediately subsequent change of ownership would foreseeably have impaired CFI's credibility with the relevant authorities, for example, by implying that Mikado was seeking to distance itself



and its principal assets (the interest in Netainment) from CFI's activities.

- 6.1.3. It was and is contemplated that certain outside third parties (and, in particular, current and future executives employed by the Corpcapital group) may be incentivised by affording such persons an "interest" in the Netainment business (if the Netainment/English Harbour merger was not successfully implemented) or in Amalco (if the Netainment/English Harbour merger was implemented but for whatever reason it was not possible to incentivise or appropriate to incentivise such persons through a direct "interest" in Amalco). Such incentivisation would not be capable of being achieved through Netainment as Netainment has an outside minority shareholders (being The Big Blue Trust (23,5%), the Gandolf Trust (23,5%) and Dawson Inc (5%)) some or all of which would probably not consent to such an incentivisation strategy through the vehicle of Netainment. It would also be inappropriate for the incentivisation strategy to be implemented at Mikado level given Mikado's other existing and anticipated future commercial interests (which are not related to the casino business conducted by Netainment). The Blue Eagle vehicle (which has as its sole underlying commercial asset its attributable interest in the existing Netainment business and, following the implementation of the Netainment/English Harbour merger, its attributable interest in Amalco) would be the appropriate level at which such incentivisation strategy would be implemented.

7. Tax Analysis

- 7.1. Mikado is not a South African "resident" as defined in s1 of the Income Tax Act No 58 of 1962 ("the Act"), being a company incorporated in the BVI with its place of effective management outside of the Republic.
- 7.2. Mikado however constitutes a "controlled foreign entity" as defined in s9D of the Act (i.e. being a foreign entity in which any resident or residents of the Republic directly or indirectly hold more than 50% of the participation rights or are entitled to exercise more than 50% of the votes or control of such entity).
- 7.3. Section 9D of the Act deems certain income of a "controlled foreign entity" to accrue to the South African resident which controls the entity. Accordingly, certain income received by a controlled foreign entity is to be examined in



relevant class of shares. Dividends will only be payable from the relevant class of reserves attributable to the various classes of share capital;

- 7.13.7. simultaneously with the creation of the new classes of shares, Blue Eagle, being the holder of the "A" shares, will concluded a call option with the holders of the "B" and "C" shares. Blue Eagle will only be entitled to exercise this call option in the event that the entire distributable and non-distributable reserves relating to the "B" and "C" shares have been distributed to the "B" and "C" class shareholders in the form of a dividend. The call option strike price will be the par value of the underlying "B" and "C" class shares. The call option would also cater for a partial acquisition of the "B" and "C" class shares to the extent that there is only a partial distribution of dividends to those classes of shares (i.e. the call option would be capable of being exercised *pro rata* to the extent to which distributable or non-distributable reserves were distributed to the "B" and "C" shares).

The above structure will allow for an "unbundling" of Netainment's shareholding in Amalco to the "B" and "C" shareholders without requiring the unbundling of Blue Eagle's attributable interest in the Amalco shares to Blue Eagle (which would result in such dividend being taxable at a CorpInvest level).

- 7.14. Even assuming that after effecting the relevant distributions to the "B" shareholders and the "C" shareholders Blue Eagle exercises its call option (thus constituting Netainment, a controlled foreign entity), provided that the reserves, available for distribution, accumulated up to that date are never in fact distributed to Blue Eagle, in our view the realisation proceeds (up to the \$95 million valuation) will not give rise to any adverse South African tax consequences to CorpInvest.

8. Summary

- 8.1. Mikado (which is a BVI company) is not subject to either income tax or capital gains tax on the US\$95m consideration paid to by Blue Eagle for the 47,5% Netainment interest.
- 8.2. As:



- 8.2.1. the nature of the income received by Mikado for the disposal of its Netainment shares did not fall within the definition of "investment income";
- 8.2.2. the disposal took place prior to years of assessment commencing before 1 January 2001.

CorpInvest will not be subject to South African income tax arising from the realisation by its controlled foreign entity (i.e. Mikado) of its interest in Netainment;

- 8.2.3. as the transaction would have taken place pre-1 October 2001, one does not need to concern oneself about any South African capital gains implications;
- 8.2.4. there was a commercial rationale to the transaction, any undistributed profits within Mikado at the disposal date will not be subject to South African income tax.

8.3. The structure contemplated in paragraph 7.13.5 above, will enable the Corpcapital Group to utilise any gains made on the realisation of the Netainment business or the realisation of shares in Amalco, as the case may be, without requiring such funds to be declared up to a wholly owned group company in the form of a dividend, which would have resulted in such "foreign dividend" being taxable in the hands of CorpInvest.

8.4. As the reserves in Netainment (as constituted on or about 28 December 2001) were utilised by Netainment to discharge certain fee obligations of Netainment, such reserves will not fall to be taxed in South Africa either in relation to Netainment (which is not a controlled foreign entity) or in relation to any Corpcapital group company by virtue of its interest in Netainment.

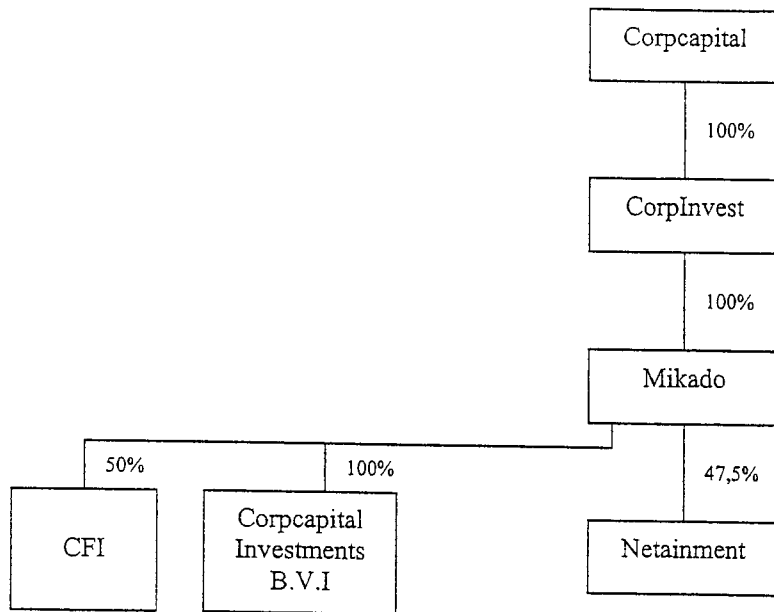
9. Supporting opinion

An opinion furnished by E B Broomberg SC and E P Lai King dated March 2001 in support of the above tax analysis is attached marked **Annexure B**.

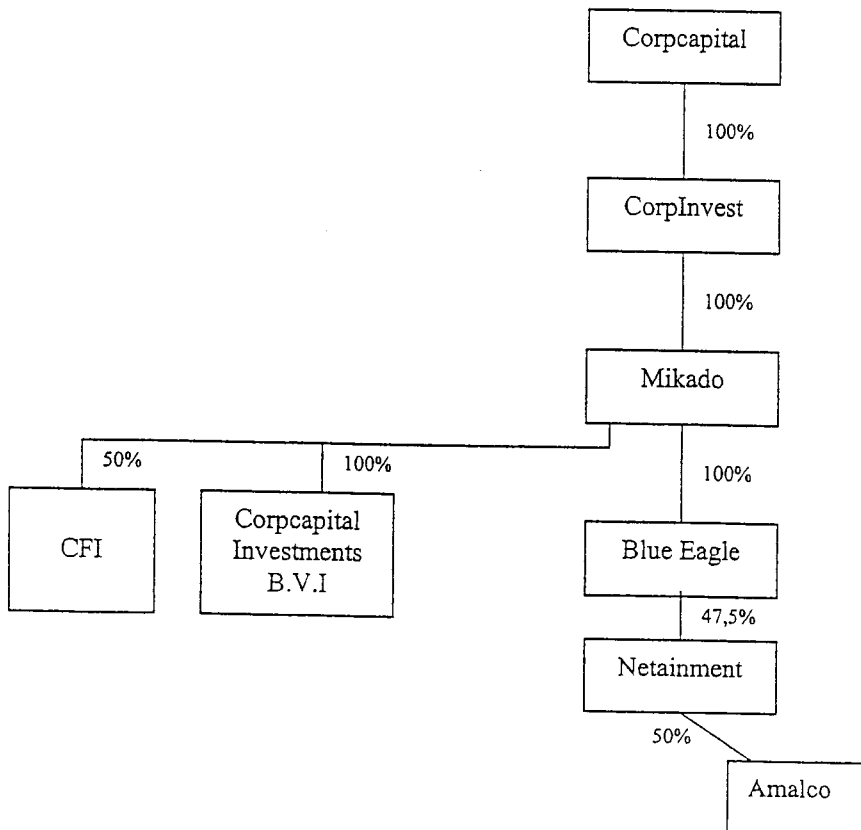


Pre-restructure corporate structure

Part I



Part II



Supporting opinion by E B Broomberg and E P Lai King dated March 2001



Agreement

entered into between

Netainment N.V.

(a corporation incorporated under the laws of the Netherlands Antilles)

(“the seller”)

and

Cytech Limited

(a corporation incorporated in Belize)

(“the purchaser”)

1. Sale of the Netainment business

The seller sells, transfers and cedes to the purchaser as an indivisible whole and as a going concern with effect from 1 October 2001 (the “**effective date**”) from which date the risk in and benefit of the business shall vest in the purchaser, the business comprising:

- 1.1. all right, title and interest of the seller in, to and under, and the full benefit of, all contracts concluded with customers of the business in the ordinary course of business (excluding the licence agreement between the seller and Microgaming Systems Anstalt entered into on or about 2 December 1998 (the “**Microgaming agreement**”));
- 1.2. all intellectual property rights owned by the seller and used in the conduct of the business including:
 - 1.2.1. all trade names and trade marks;
 - 1.2.2. the database of customer details (including, without limitation, names, e-mail address, physical address, telephone numbers and other contact and/or marketing information) whether in writing or in electronic form, and whether current and/or historic in the conduct of the business;
 - 1.2.3. subject to the restrictions contained in the Microgaming agreement, all domain names used in connection with the business;
 - 1.2.4. the websites to which any of the Netainment domain names pertain including any “jump site” or “promotional site” through which a Netainment website is accessed and any proprietary software owned by Netainment relating to such websites;
- 1.3. all systems, software and know-how used exclusively in connection with the business (other than the software licensed to the seller in terms of the Microgaming agreement);



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- 1.4. cash and credit balances at banks of the business on hand as at the effective date;
- 1.5. the goodwill of the business, including the exclusive right of the purchaser to represent itself as carrying on the business and all right, title and interest of the seller in, to and in respect of the names "Netainment", "King Solomons" and "Lucky Liner" and variations thereof and all records and information relating to customers of the business and all pertinent files, catalogues and any promotional materials exclusively relating to the business;

including any liabilities (whether actual or contingent) to creditors of the business but excluding any rights or obligations arising out of, pursuant to or in connection with the Microgaming agreement.

2. Consideration

- 2.1. The consideration of the business shall be US\$200 000 000 to be discharged by way of the allotment and issue of 100 (one hundred) shares (issued as fully paid up) in the issued share capital of the purchaser (constituting the entire issued share capital of the purchaser) (the "consideration shares")
- 2.2. The consideration shares shall be allotted and delivered by the purchaser to the seller (in negotiable form) on the effective date (against delivery of the business to the to the purchaser).

3. Delivery

All assets comprising the business shall be delivered by the seller to the purchaser on the effective date.

4. Employees

There is no obligation on the purchaser to offer employment to any employees of the business.

5. Warranties and representations

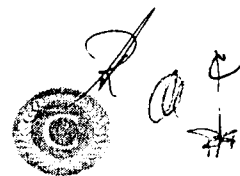
Save that the seller warrants that it is the owner of all the assets or rights comprising the business which are being disposed of by the seller to the purchaser in terms of clause 1, the business is sold on a "as is" basis free of any other warranties or representations of whatsoever nature.

6. Licence

The purchaser, with effect from the effective date, affords the seller a royalty-free licence to continue utilising the intellectual property rights, database, domain names, websites and other systems, software and know-how of the business. The purchaser shall be entitled (in its sole and absolute discretion) to terminate the aforesaid licence (in whole or in part) at any time by furnishing notice to the seller to such effect.

7. Breach


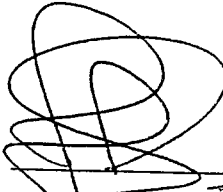
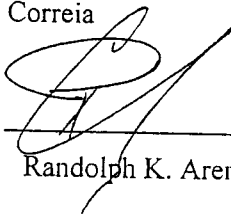

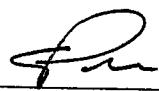
If any party breaches any material provision or term of this agreement and fails to remedy such breach within 7 (seven) days of receipt of written notice requiring it to do so (or if it is not reasonably possible to remedy the breach within 7 (seven) days, within such further period of time as may be reasonable in the circumstances) then the aggrieved party shall be entitled without notice, in addition to any other remedy available to it at law or under this agreement, including obtaining an interdict, to cancel this agreement or to claim specific performance of any obligation whether or not the due date for performance has arrived, in either event without prejudice to the aggrieved party's right to claim damages.



8. Whole agreement, no amendment

This agreement constitutes the whole agreement between the parties. No amendment or consensual cancellation of this agreement or any provision or term thereof and no extension of time, waiver or relaxation or suspension of any of the provisions or terms of this agreement shall be binding unless recorded in a written document signed by the parties. Any such extension, waiver or relaxation or suspension which is so given or made shall be strictly construed as relating strictly to the matter in respect whereof it was made or given.

SIGNED by the parties and witnessed on the following dates and at the following places respectively:

DATE	PLACE	WITNESS	SIGNATURE
May 8, 2002	Curaçao	1.  Rosa Hanst Fernandes-Correia	For: Netainment N.V. 
		2.  Randolph K. Arends	 Freddy Konings/ Alma M. Heide
MAY 15, 2002	BARBADOS	1.  STEVEN F. PARKER DIRECTOR	For: Cytech Limited
		2. _____	_____

