COOPERATION WITH AFRICA

Tax Challenges of Digitalization in Africa

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Abstract

The G20/OECD project on tackling base erosion and profit shifting provided broad recommendations but did not address in detail the tax challenges of the digitalized economy, deciding to return to the issue at a later date (Action 11) (OECD, 2017). Discussions are currently ongoing as to what form international co-operation on the tax challenges of the digitalized economy should take. However, currently, Africa faces challenges in effectively participating in international discussions in this area. As such, this policy brief discusses the role of African countries and the G20 in ensuring that international approaches to taxing the digitalized economy are undertaken in consultation with Africa and reflect Africa's interests. In addressing the tax challenges of digitalization in Africa two important principles of international tax cooperation emphasized by the Addis Ababa Action Agenda (AAAA, arts. 28, 29) must be respected: to be universal by fully taking "into account the different needs and capacities of all countries" and be inclusive (UN FfD, 2015).

Challenge

In the context of the G20/OECD BEPS project, the Inclusive Framework for BEPS Implementation (IF) was created with the objectives to level the playing field for all committed (interested) and relevant jurisdictions and ensure that they are involved on an equal footing in the setting of the future standards relating to BEPS issues, the implementation and monitoring of the BEPS outcomes, including tailoring implementation solutions for BEPS outcomes that are appropriate for all capacity levels. Currently, as of February 2019, 128 jurisdictions (including 22 African countries) have joined the IF (OECD, 2019).

There are a few African representatives in OECD Working Parties on international tax matters, who may not represent the full diversity of African countries and views. Moreover, even for those African countries that can participate, the participation at the OECD's Committee on Fiscal Affairs (CFA) and working parties has challenges and will continue to challenge African countries' resources and capacities to the limit. The current level of participation is not sustainable over the longer term. In addition, the fact that African countries that are members of the IF need to implement the BEPS Minimum Standards (which is a challenge for many of them) is a further obstacle to their participation, as observed in international tax discussions (Salm and Ibrahim, 2018). This is especially the case since the peer review process that is part of IF membership contains a large number of technical elements, which will put further capacity constraints on African tax administrations. Meeting the minimum standards will also require changes to domestic legislation and to tax treaties. Considerable advocacy work will be needed to obtain political support for these changes.

The above is compounded by the fact that G20 members have taken or are threatening to take punitive measures against African countries that fail to implement international tax standards such as the BEPS Minimum Standards and standards of the Global Forum (OECD, 2018). This could amount to penalizing countries for processes that are meant to be voluntary in the quest for tax transparency. Aside from the direct negative effects of such punitive measures, they would also undercut African countries' ability to influence global discussions on tax issues, as the threat of sanctions may force them to

implement standards in which they have no say.

In addition, as African economies become more digitalized, countries are increasingly concerned about the ensuing tax challenges. Digitalization enables multinational enterprises (MNEs) to carry out business in African countries with no or very limited physical presence in those countries. This impedes the establishment of taxing rights over the profits made by an MNE from the business activities it carried out in a specific African country; thus, rendering the *nexus rule* inefficient in protecting Africa' s tax bases.[1] It is important here to note that these business models go beyond social media platforms, search engines and online market places. In fact, digitalization affects the economy, especially the value chains of a wide range of businesses.

These new business models stemming from the digitalization of the economy raise questions as to whether fundamental changes are needed to the two key underlying principles of the international tax rules: the *nexus rules* mentioned above and the *profit allocation rules.*[2] In particular, digitalization raises the question of how taxing rights on income generated from cross border transactions should be allocated between jurisdictions. The allocation of taxing rights between residence and source jurisdictions has been an issue of considerable concern for African countries for many years. African countries are generally source countries and tax on a source basis.[3] African countries often report that they consider the current nexus and profits allocation rules are weighted too heavily in favor of the residence jurisdiction to the detriment of the source (African) jurisdiction.

Such business models with these associated challenges are becoming more and more prevalent in Africa and this is largely explained, among others, by the following factors:

- The continent is a huge consumer of e-commerce and global telephony.

[1] The nexus rule allocates taxing rights to a country where a non-resident enterprise creates sufficient physical presence.
[2] The profit allocation rule determines how the MNE's global profits are allocated between jurisdictions, primarily using transfer pricing rules.
[3] Source taxation means that the income is taxed in the country in which it arises no matter where the recipient is tax resident.

- There is a substantial development in ICT infrastructure and increase in internet penetration in Africa. According to the ITU statistical dataset (2017), internet penetration reached 21.8% by end of 2017 from just 6.7% in 2010 mainly due to rapidly increasingly mobile penetration. According to the ITU 2018 global and regional ICT estimates, of all regions, Africa experienced the strongest growth in the number of people using the internet, with the percentage increasing from 2.1% in 2005 to 24.4% in 2018 (ITU, 2018).

Youthful demographic profile also leads to the growing use of the internet, social media platforms, cloud computing and other technological advances.

Proposal

We ask G20 and African leaders to take urgent and decisive action to ensure that taxation of the digitalized economy works for Africa, through actions at the national, sub-regional, pan-African and global levels.

A. G20 countries should support a global and inclusive discussion of a new approach to taxation of the digitalized economy that considers Africa's perspectives and priorities, alongside those of other developing countries

1. Though African countries can participate in discussions on tax issues as part of the IF, there are significant challenges for African countries to implement the requirements of the IF membership as noted earlier in the present policy brief. Therefore, G20 countries need to change their approach to who can participate in global tax discussions and on what terms to fully include African countries. This should mean either supporting a greater role for the United Nations in global tax discussions or relaxing the requirements for IF membership so that it is easier for African countries to be members and fully participate.

2. In addition, the following guiding principles reflecting the concerns of African countries must underpin any amendments to the international

tax rules currently being debated:

- The current nexus and profit allocation rules are not ensuring appropriate taxing rights for source countries, particularly African countries. They are inappropriately skewed in favor of residence jurisdictions. This is encouraging illicit financial flows (IFFs) out of Africa through artificial profit shifting to low tax jurisdictions and the loss of taxes African countries need for development.

- The current profit allocation rules do not properly reflect the value created for the MNE by the brand perception in the minds of the customers in the market jurisdiction. In addition, other unique and valuable contributions to the profits of the MNE are not reflected in the profits allocated to the market jurisdiction, resulting often in a significant under-allocation of profits for tax purposes to the market jurisdiction.

- The drive for more effective administration would require, on the one hand, the significant reduction of the complexity of the current nexus and profit allocation rules which hinder their effective implementation by tax administrations and impairs tax certainty for African governments and businesses. On the other hand, it would need to consider simpler collection mechanisms including the use of withholding taxes which ATAF members report is a very effective taxation mechanism in Africa.

- Further work should be undertaken to address artificial profit shifting. That work should focus primarily on addressing base eroding payments that reduce the taxing rights of the source country. Such rules again need to be simpler to ensure effective implementation is possible by all tax administrations.

B. G20 countries should seek not to penalize African countries for failing to implement international tax standards that they do not have the capacity to implement

African countries should not be punished for failing to implement tax standards that the continent mostly does not have the capacity to implement and had no

say in developing (except for South Africa). In particular, the G20's intention to take defensive measures against jurisdictions failing to implement tax transparency measures should exempt African countries. Instead of penalizing African countries, the G20, as outlined in proposal A above, should focus on supporting them to implement such standards and give all African countries an opportunity to debate international approaches to tax policy on an equal footing, without the strings that are currently attached to membership of the Inclusive Framework.

C. African leaders should support the development of a common African position on the tax challenges of digitalization

Africa is in a unique position to seize the opportunities presented by the tax challenges of digitalization to take a proactive role in the international tax cooperation where it would contribute to steering the direction of the global standard agenda rather than providing inputs in a pre-determined agenda; thereby seizing the opportunity for more inclusiveness in international tax governance.

To that end, a multipronged strategy can be explored.

1. Extensive regional consultations in Africa would have to take place, where digitalization, its extent, challenges (including tax) and impacts are discussed in relation to countries' specificities and level of economic development and where solutions are designed and publicized that are suitable to the African context.

2. The outcomes of these regional consultations could then be debated at the level of the Network of Tax Organizations (NTO)[4] where the various

[4] The Network of Tax Organizations (NTO) came into effect at the CIAT General Assembly, 15-17 May 2018, in Ottawa, Canada, with the signing of a Memorandum of Understanding (MoU) by the eight tax organizations Secretariats for enhanced cooperation and coordination: 1) the African Tax Administration Forum (ATAF), 2) the Association of Tax Authorities of Islamic Countries (ATAIC), 3) the Commonwealth Association of Tax Administrators (CATA), 4) the Inter-American Centre of Tax Administrations (CIAT), 5) the Caribbean Organization of Tax Administrators (COTA), 6) the Centre for Exchange and

proposed solutions can be unpacked and refined. In this instance, the NTO would represent a key link between national interests and international considerations. This can be done in parallel with bringing together technical committees, task forces and working groups at ATAF, NTO, UN Committee of Experts on International Cooperation in Tax Matters, and OECD levels to shape together the global standards agenda.

3. Taking this work forward will require strong political support in Africa and for countries to work in a collaborative manner, sharing experiences, challenges and best practice. Such political support should be garnered at the level of the African Union through the *establishment of a political institution or platform where tax policy and tax administration issues will be discussed, standards set, and recommendations made at the highest level for implementation by governments*. Other African bodies such as the Regional Economic Communities, the United Nations Economic Commission for Africa (UNECA), the African Development Bank and regional tax organizations, such as ATAF and CREDAF, could contribute to this process by coordinating a common African position.

4. African countries should adopt measures as a priority to address the avoidance of permanent establishment by cross-border e-commerce companies, by adopting the ATAF's African Model Double Taxation Agreement (DTA). [5] It is a combination of the most appropriate provisions from both the UN and OECD Models with some variations which are not in either of these Models. The provisions included are all those which are more in favour of developing countries.

Studies of Tax Administration Leaders (CREDAF), 7) the Intra-European Organization of Tax Administrations (IOTA) and 8) the West African Tax Administration Forum (WATAF).

[5] The ATAF Model DTA is the ATAF model agreement for the elimination of double taxation with respect to taxes on income and the prevention of tax avoidance and evasion.

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