

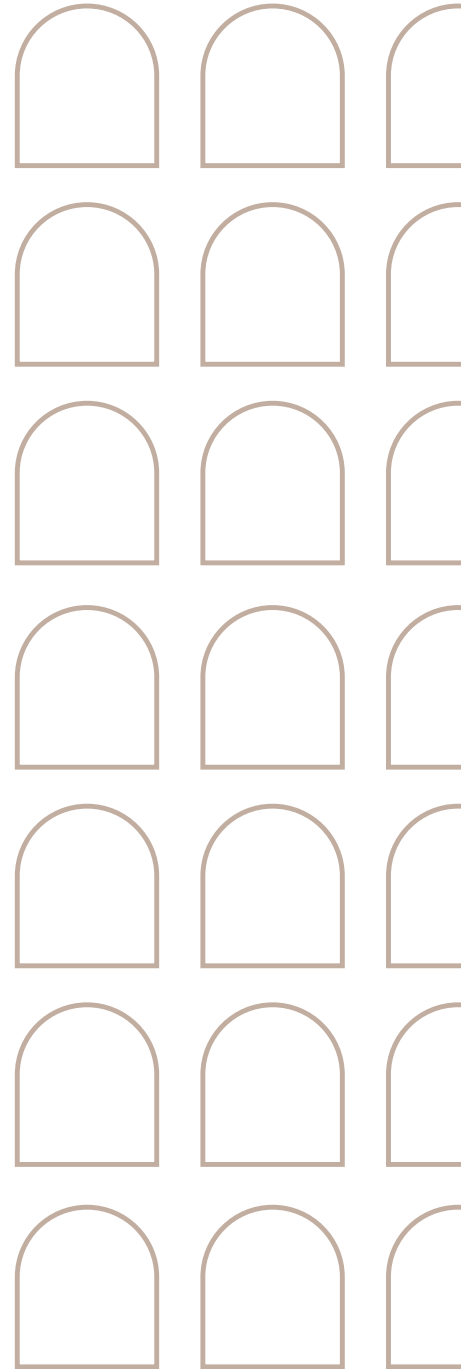
STG Policy Papers

POLICY BRIEF

COMBATING CROSS-BORDER TAX AVOIDANCE: THE CHALLENGES OF GLOBAL TAX COOPERATION IN SUB-SAHARAN AFRICA (SSA)

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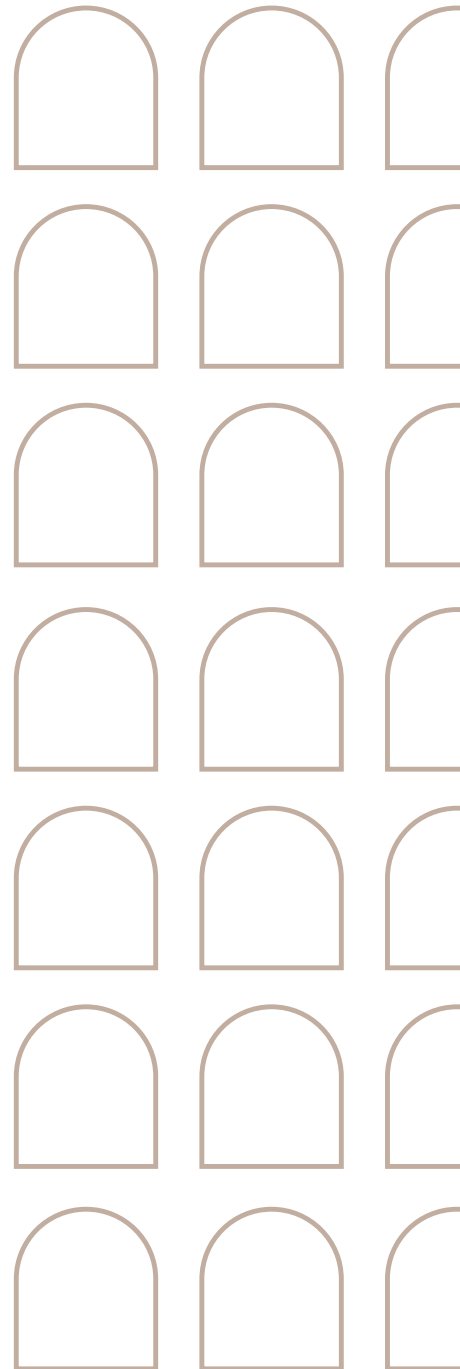


EXECUTIVE SUMMARY

Africa is dealing with the challenge of achieving the United Nations Sustainable Development Goals. Yet, the need for substantial public revenues, particularly in Sub-Saharan Africa (SSA) to finance the development is coupled with the important tax losses due to Multinational Enterprises' aggressive tax planning. The OECD's rich reform proposals in the recent decade were intended to curb cross-border tax avoidance and enhance domestic resource mobilisation capacities in the developing countries. Yet on the ground, the scale of tax-motivated Illicit Financial Flows (IFFs) in SSA is dramatic especially in the extractive sector. In this regard, this paper investigates the reasons why these reforms have not achieved satisfactory results so far. The findings illustrate a certain degree of complexity on three levels: the fundamental principles of tax base division in the current international tax system, the characteristics of the global tax reforms and the implementing capacities in SSA.

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1. INTRODUCTION

Facing the challenge of reaching the [UN Sustainable Development Goals](#), Sub-Saharan Africa (SSA) is experiencing limited public revenues despite their mineral resources potential.¹ In addition, the tax havens² and financial scandals worldwide coincide with the substantial Illicit Financial Flows (IFFs) out of the African continent.³ Both [Addis Ababa Action Agenda](#) and [Mbeki Report](#) were important occasions in which IFFs out of Africa were officially publicised. The latter reported the important role of global corporations' tax abuse in the tax losses within the continent. In SSA's mining sector which attracts many Multinational Enterprises (MNE), the scale of tax avoidance is very high.⁴ Meanwhile, the international community's response to the MNEs' aggressive tax planning resulted in important tax reforms issued by the Organisation for Economic Cooperation and Development (OECD).⁵ The goal was to put an end to cross-border tax abuse and strengthen domestic revenue mobilisation capacities in the developing countries.⁶ However, despite their importance in content and in size on one hand, and the domestic reforms undertaken in a number of SSA countries on the other hand, the results on the ground are far from satisfactory.⁷

To explain this situation, this paper identifies a certain degree of complexity on three levels: the allocation of taxing rights mechanism, the characteristics of the global tax reforms and the countries' implementing capacities in SSA. They are labeled respectively **concept**, **content** and **context**.

2. CONCEPT: TAXING RIGHTS ALLOCATION PROBLEMATIC

Taxing (MNEs) is an important source of public revenue for developing countries.⁸ However, the taxation of cross-border income in the current international tax system is surrounded by complex factors:

2.1. Source-based taxation vs. residence-based taxation

In order to understand the conflict between residence-based taxation and source-based taxation, we need to imagine a world with an exclusive mode of taxation. The residence principle allows a better tax collection and redistribution⁹ and best fits the "ability-to-pay theory".¹⁰ Likewise, source-based taxation best fits the "benefit theory"¹¹ and the hosting country being aware of the taxpayer's circumstance can tax the income.¹²

Therefore, the adoption of pure residence taxation is more likely to deprive developing countries from important tax revenues, but also countries cannot neglect taxing businesses making profit in their territories only because they are not residents.¹³ A pure source taxation, in contrast, may favour a "race to the bottom" and harmful tax competition.¹⁴

2.2. Complex Intra-group transactions (transfer pricing strategy)

Nowadays, a considerable part of international trade takes place between related entities.¹⁵ Yet, abusive transfer pricing strategies may facilitate tax base shifting, thus reducing MNEs' tax liability. Consequently, fighting corporate tax avoidance by overseeing these transactions may be relevant, but challenges may arise. In

1 International Monetary Fund, "Tax Avoidance in Sub-Saharan Africa's Mining Sector", African and Fiscal Affairs Departments, (2021), p.04.

2 Tax Justice Network, "The State of Tax Justice 2021", (2021), p.14.

3 United Nations Economic Commission for Africa: [Institutional Architecture to Address Illicit Financial Flows](#), (Economic Governance Report I), 2021.

4 International Monetary Fund, *supra*, p.05.

5 The United Nations Tax Committee is also issuing tax rules and currently leading initiatives to fight against IFFs in Africa.

6 See OECD's official website <https://www.oecd.org/ctp/tax-and-developing-countries.htm>.

7 "Mbeki Report", *supra*, stated that the African continent is annually losing 50 billion dollar due to the illicit financial flows. Tax Justice Network's recent estimate, "State of Tax Justice 2021", *supra*, has given the number of 1.7 billion dollar as annual tax loss due to cross-border corporate tax abuse.

8 C. Fuest, S. Hebous and N. Riedel, "Critical Issues in Taxation and Development", chapter on "International Profit Shifting and Multinational Firms in Developing Countries", Massachusetts Institute of Technology, 145-166, (2013).

9 R. J. Vann, "Problems in International Division of the Business Income Tax Base", (2007), p.7.

10 D. M. Ring, « International Tax Relations: Theory and Implications », Boston College Law School Faculty papers, (2007), p88.

11 W. Schön "One Answer to Why and How to Tax the Digitalized Economy", Max Planck Institute for Tax Law and Public Finance, Working Paper 2019-10, (2019), p 04.

12 D. M. Ring, *supra*, p.117.

13 D. M. Ring, *Ibid*.

14 Tax Justice Network, "Source and Residence Taxation", (2005).

15 J. Cooper, R. Fox, J. Loeprick, and K. Mohindra, "Transfer Pricing and Developing Economies": A Handbook for Policy Makers and Practitioners. Directions in Development, Public Sector Governance. Washington DC, World Bank, (2016). <http://hdl.handle.net/10986/25095>.

fact, MNEs have highly discretionary power over the price of intra-group transactions.¹⁶ In addition, thanks to innovation and technological integration, products tend to be unique¹⁷ whereas intangible assets are difficult to value. Consequently, taxable income can be easily shifted from high-tax countries to low or zero-tax countries.

2.3. International tax system

What makes the international tax system particular and complicated at the same time is that it is composed of domestic laws and international conventions. In addition, the absence of clear provisions in international law on how to allocate taxing rights¹⁸ results in a competition between different countries over the shared tax base. Furthermore, the fact that each country is sovereign with regard to the design of the tax policy within its territory results in differential tax rates between countries and created another sort of tax competition in favour of profit shifting.

3. CONTENT: COMPLEXITY OF THE REFORMS

The OECD's recent reforms are highly technical, multilateral and issued in a relatively short period of time. These factors are essential with regard to the scale of the international tax avoidance and evasion but they may also be the origin of some implementing issues particularly in low-income economies.

3.1. The "one size fits all" approach

OECD's reforms include standards with multilateral dimension and full reciprocity.¹⁹ Thus, their efficiency requires a certain degree of responsiveness for an effective transposition within different jurisdictions. Yet, given the gap in institutional and human resources capacities between the developed and developing

countries, one may expect compliance gaps. This is implicitly recognised when the OECD decided to defer the implementation deadline of the Exchange Of Information (EOI) tools for the least developed countries.²⁰ The technical assistance provided however, is limited in time and addressed to the exclusive implementation of the new proposed rules.

3.2. Highly technical rules

The exchange of information ([AEOI](#) and [EOIR](#))²¹ entails the transmission of highly sensitive financial information that needs a basic infrastructure, well-resourced units, trained and skilled personnel with offices that guarantee a minimum of information security.²² The project is also costly in the sense that considerable efforts need to be put on improving the IT infrastructure and data safeguard framework.²³

Likewise, the OECD's Base Erosion and Profit Shifting ([BEPS](#)) project introduced the Transfer Pricing Guidelines which is based on the "Arm's length" rule to ensure an allocation of taxing rights on the basis of the value creation principle. It entails the search for comparable transactions for the purpose of assessing the price of intra-group transactions.²⁴ Setting specific units with skilled auditors is therefore a must. In addition, finding similar transactions for price assessment implies huge compliance costs for tax administrations and in most cases impossible to achieve.²⁵

3.3. Reforms issuing time

In the aftermath of the global economic crisis, many new international tax rules have been issued. This is obviously to reduce the scale of tax avoidance and the disastrous effect of the crisis but they also require capacity mobilisation and adequate legal frameworks at national level. While dealing with the implementation

16 United Nations Economic Commission for Africa, *supra*, p. 25.

17 A. Ezenagu, "Safe Harbour Regimes in Transfer Pricing: an African Perspective", ICDT working Paper, Institute of Development Studies, (2019), p.8.

18 W. Schön, *supra*, footnote 18, p 3.

19 S. Beer, M. Coelho and S. Leduc, "Hidden Treasures: the Impact of Automatic Exchange of Information on Cross-Border Tax Evasion", IMF Working Paper, (2019), p.10.

20 The OECD, Global Forum on Transparency and Exchange of Information for Tax Purposes "The Global Forum's Plan of Action for Developing Countries Participation in AEOI" (2017), p. 7.

21 Only five countries (Seychelles, South Africa, Mauritius, Ghana and Nigeria) are implementing AEOI. The number of requests sent is also low. See Global Forum on Transparency and Exchange of Information for Tax Purposes "Tax Transparency in Africa 2020" (Africa Initiative Progress Report: 2019), (2020), p.39.

22 Global Forum on Transparency and Exchange of Information for Tax Purposes, *supra*, p. 30.

23 *Id.*, p. 40

24 A. Ezenagu, *supra*, p.7.

25 *Id.*, footnote 12.

of EOI tools, the OECD came up with the BEPS project with its 15 actions, [Common Reporting Standards](#) and recently the [Two-Pillar reform](#). For example, one of the issues reported in the exchange of information process in Africa was the time taken to answer requests due to the reallocation of EOI staff to other units and the scarcity of resources initially devoted to the implementation of BEPS and transfer pricing.²⁶

4. CONTEXT: THE AFRICAN CONTINENT'S IMPLEMENTING CAPACITIES

The field of analysis is large and diverse so this section is limited to three important issues: tax administration capacities, financial sector development and political will.

4.1. Tax administrations

Despite a range of reforms undertaken in African countries to improve tax administrations' quality and performance, the existing weaknesses are not to be neglected.²⁷ In fact, the centralised character of collecting taxes combined with the limited role of Revenue Authorities in some countries²⁸ have made tax compliance time the second longest one.²⁹ Furthermore, while improvements have been made in electronic filing and payment, the use of digital information to increase performance is rather slow³⁰ and the physical interactions in the form of physical inspections and visits are still present.³¹ In addition, transfer pricing units in many SSA countries lack human resources. In 2018, transfer pricing units in Nigeria included only 32 officers for about 3000 companies, 20 in Tanzania and nine in Uganda.³²

4.2. Financial sector

An efficient and globally integrated financial system is crucial in the context of a highly globalised world. In addition an adequate financial regulatory environment is also vital to curb IFFs.³³ It is therefore necessary to work towards a well-structured and globally integrated financial system. Evidence shows however, that African financial institutions remain under-developed compared with those in other regions of the world, and that they are not fully integrated into global financial markets despite the use of new technologies.³⁴ In terms of Gross Domestic Saving, SSA registered the least rate compared to other regions in the world.³⁵ In the other side, Kenya is leading the SSA countries using electronic payments but at the same time its financial sector remains highly secretive followed by Nigeria and Angola.³⁶

4.3. Political will

The number of African countries joining the Global Forum and Inclusive Framework is clearly growing in number.³⁷ Yet, this commitment should also be translated on the ground. Evidence shows in fact, that taxation is still not balanced due to the fact that most important taxpayers are more organised and politically influential.³⁸ Corruption is still a problematic issue³⁹ and the relation between taxpayers and tax authorities lacks trust. In addition, the general conditions of tax administrations and financial sectors discussed above show that there are a lot of efforts to be made in the fields of legislation, accountability and transparency.

26 N. Monkam, G. Ibrahim, W. Davis and C. V. Haldenwang "Tax Transparency and Exchange of Information (EOI): Priorities for Africa", CARI/CIPPEC(2018), p. 7.

27 M.Moore "What is Wrong with African Tax Administration?", ICDT Working Paper 111, (2020), p.8.

28 Id, p. 13.

29 It is calculated 285 hours compared to the global average of 240 hours. Chad 766 hours followed by Ethiopia with 306 hours and Angola with 287 hours. United Nations Economic Commission for Africa, "Fiscal Policy for Financing Sustainable Development in Africa" (Economic Report on Africa), chapter 5 on "Tax Administration in Africa", 95-116, (2019) p.96.

30 Id, Supra, p.113.

31 M.Moor, supra, p. 8.

32 A. Ezenagu, supra, p.9.

33 United Nations Economic Commission for Africa, supra, note 3.

34 The financial development index in Africa averages 0.14 compared to 0.25 in the Middle East and 0.33 for Asia and Pacific. Id, Chapter 4, "National Financial System Architecture to Address Illicit Financial Flows", p. 86.

35 S. M. Kapaya, "Financial System and Economic Development in Africa: A Review and Policy Recommendations", International Journal of Academic Research in Accounting, Finance and Management Sciences, Vol. 9, No.4, (2019), pp. 98-117.

36 Tax Justice Network, "Financial Secrecy Index", (2021).

37 Currently 33 African countries have joined the Global Forum and 25 have joined the Inclusive Framework (with the exception of Nigeria and Kenya not signing the Two-Pillar agreement in October 2021).

38 M.Moor, O. Fjeldstad and W. Prichard "Taxing Africa, Power, Politics and Public Participation" International Center for Tax and Development (2018).

39 M.Moor, supra, p. 11. Tanzania

5. CONCLUSION

For an efficient fight against cross-border tax avoidance in Sub Saharan Africa, actions must be undertaken both at international and national levels with an effective cooperation and coordination:

- The OECD must consider the domestic circumstances and capacities in low-income countries in Africa and with the support of the United Nations development programmes, already in place, accompany their reforms with the priority to be given to the generalisation of digital technologies within tax administrations and the modernisation of the financial sector. This will not only improve African countries' tax performances domestically but also help them to efficiently engage in the global and multilateral instruments against international tax evasion.
- Tax authorities within SSA must define rigorous anti-avoidance rules on MNEs' cross-border commercial transactions and financial transfers, and equip tax administrations with sufficient resources and well trained auditors in a way they will be able to oversee the complex intra-group transactions in accordance with the transfer pricing guidelines.
- Furthermore, the use of tax incentives as a strategy to attract foreign investments must be monitored. Tanzania which introduced the obligation of cost-benefit analysis and parliamentary scrutiny before granting tax incentives is a good example to follow.⁴⁰
- Lastly, international tax governance could be more efficient if the global tax initiatives are coordinated. Because the current "fragmentation" which resulted in proposals⁴¹ issued by different institutions — in reference to the OECD and the United Nations — to tackle the same issue could bring more uncertainty than efficiency in a context characterised with growing global tax challenges.

40 United Nations Economic Commission for Africa, "Study on the Global Governance Architecture for Combating Illicit financial Flows", 2018, p.36.

41 The OECD's rich proposals are meant to combat tax avoidance and tax evasion. In the other side, The United Nations' policies to curb tax-motivated Illicit Financial Flows- in reference to tax avoidance and tax evasion—also seek to enhance public revenues in the developing countries in the framework of the Sustainable Development Goals. In addition, both two institutions issued bilateral conventions on double taxation and transfer pricing rules.

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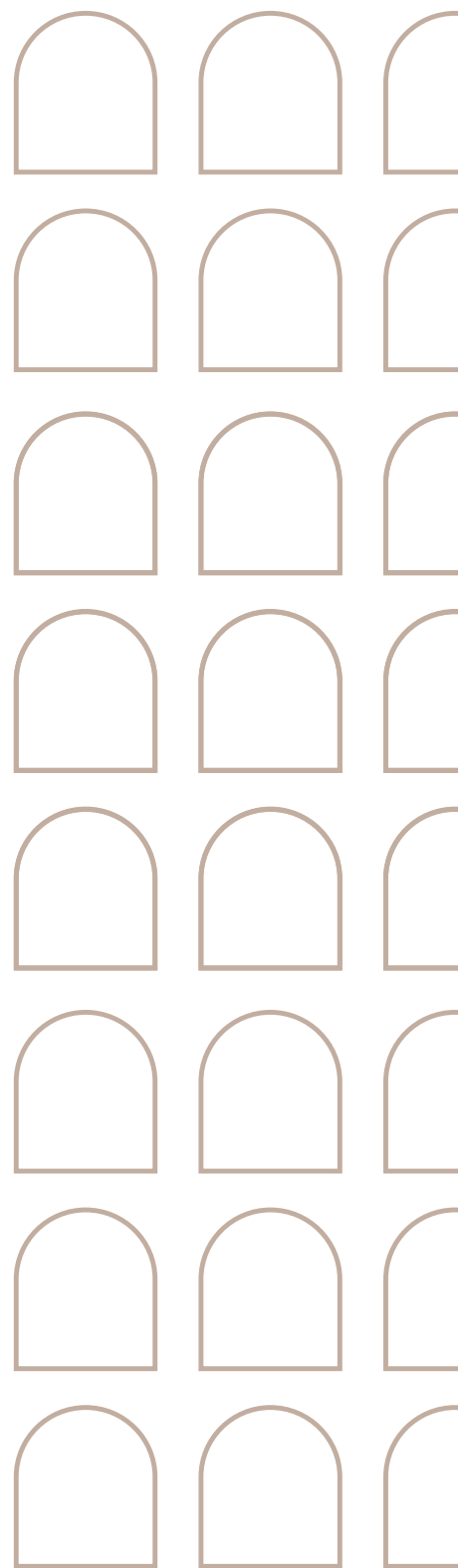
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