



# Reform of the Global Tax Regime: An African Perspective

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# Introduction

- The UN Secretary General to prepare a report on international tax cooperation to be tabled at the UNGA 78th session this year
- Paper prepared by the Coalition for Dialogue on Africa is intended to serve as a background briefing note for African negotiators
  - It makes the case for reform
  - highlights what Africa should seek in a reform process
  - reviews on going discussions in major forums.

- Taxation is the time-honoured way for governments to raise revenue.
  - Source of government revenue
  - Used to influence behaviour through sin taxes like on smoking and alcoholism or environmental taxes.
  - Promotion of good governance by ensuring that taxpayers pay attention to the working of government.
- The United Nations is currently engaged in discussions on reforming the global taxation system.

- The role of the international tax regime is essentially to allocate taxing rights between countries.
- The current system is based on Separate entity, Permanent establishment (PE), and Double Taxation Agreements
- The separate entity idea treats subsidiary and associated companies in a multinational corporation (MNC) as legally separate entities that should be taxed separately.
- The system then uses the devices of Permanent Establishment (PE) and double taxation agreements to moderate the allocation of taxing rights.



# NEED FOR INTERNATIONAL TAX REFORM

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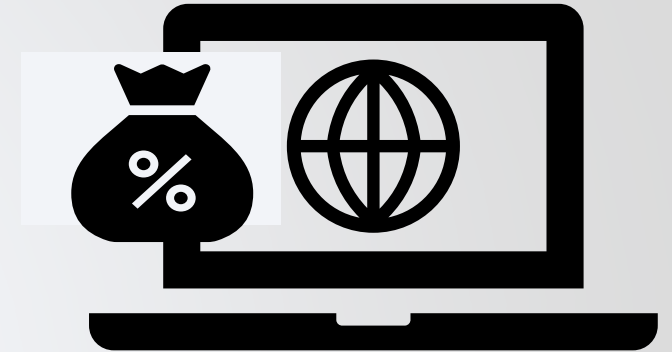


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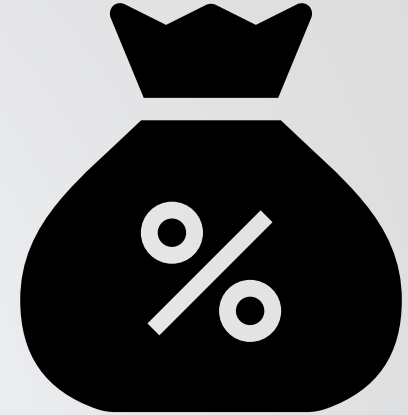
- Global Tax Reform is required to fix inadequacies and anomalies in current system
- The current system takes no account of changes in the world economy brought about by globalisation
  - There 60,000 multinationals in the world and half of global trade now takes place within related entities.
  - The concept of multinational companies consisting of separate entities is an unsustainable fiction.
  - Related companies can make loans to one another or charge for management and treasury services in a manner so as to reduce their tax obligation in a particular jurisdiction.

- The digital sector has also changed the dynamics of the global economy.
  - Two-thirds of world income comes from the service sector where the generation of an activity and its consumption (the digital economy) might not involve physical movement of goods.
  - Some of the biggest companies in the world like Facebook, Apple, Amazon, Netflix, and Google are in this sector.
- The provision of some services across borders without physical borders like digital content makes the notion of permanent establishment problematic





- Challenges for tax authorities
  - Relevant data and information is not readily available to tax authorities to assess claims made by MNCs or assessing activities undertaken by digital companies.
  - Comparisons are difficult because of differences in quality
  - Similarly, it is difficult to assign value to intangible assets such as services and intellectual property
  - Double taxation agreements can facilitate tax planning, including base erosion and profit shifting.
  - If not well negotiated, tax treaties can be used to give more advantage to residence countries as opposed to source countries.
  - Tax competition has become rife

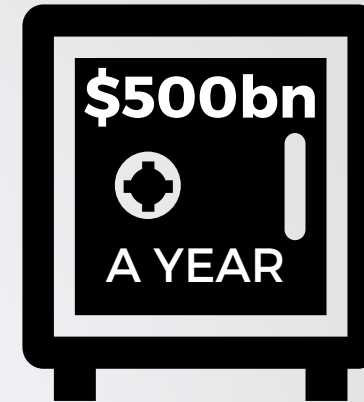


**Over 3000  
DTAs in existence.**

## Consequences of an Inadequate Global Tax System

- There is wide-spread evidence that taxes are not paid where value is created or where economic activities take place. This tax abuse.
- While fear double taxation is genuine, any solution must enable countries to get their fair share of taxes.
- The current tax system causes loss of revenue for countries especially African economies which are very dependent on corporate tax revenues.
- Provisions of tax treaties are sometimes used to extract terms that aid tax evasion or aggressive tax avoidance.
- Tax havens and financial secrecy jurisdictions facilitate tax competition and the hiding of wealth.
  - Lack of coherence in dealing with tax at the international level as compared for instance to corruption and money laundering where there are global arrangements such as the UN Convention Against Corruption and the Recommendations of the Financial Action Task Force.

Tax planning in multinational corporations up to



Tax havens cost governments between:

**\$500bn - \$600bn**

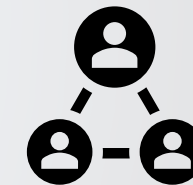


**Countries lost up to \$50 billion annually from illicit financial flows**



**AFRICA'S  
INTERESTS IN  
GLOBAL TAX  
REFORM**

- A primary concern for Africa about the global tax system is about increasing revenues available for government expenditure and investment in domestic economies.
- Similarly, Africa must continue to insist that taxation should be enabled where economic activity takes place.
- Africa must also be concerned about protection of sovereign taxing rights as Taxation is ultimately a domestic matter.
- while not encouraging tax competition any tax system that evolves should enable African countries to use incentives to attract investments.
- Tax transparency is also very important for African countries. While acknowledging the various arrangements made for the exchange of tax information the candid truth is that their provisions are beyond the capacities of African countries
- A global tax regime must allow for different levels of capacity including to negotiate or implement complex tax agreements.
- A new global tax regime should be inclusive and legitimate.
- Negotiations on the new global tax system should proceed steadily rather than trying to achieve everything at once.





# ONGOING ATTEMPTS AT TAX REFORM

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Help!



- Report of the High-Level Panel on Illicit Financial Flows from Africa
- Addis Ababa Action Agenda on Financing for Development
- General Assembly Resolution 77/244 on the Promotion of inclusive and effective international tax cooperation
- G20/OECD BEPS Processes

## The OECD 2-Pillar Solution and its Projected Impact on African Economies

1. The OECD 2-pillar solution emanating from the Inclusive Framework (IF) process is a solutions to some of the critical issues plaguing the current international taxation framework.
2. OECD's "Inclusive Framework" is built on two key pillars.

**Pillar 1** is aimed at realigning the reporting of MNC profits with value creation. It has three core elements.

**Firstly:** partly reallocates taxing rights i.e., the right to tax the largest and most profitable MNCs numbering about 100 towards "market" or "destination" countries where they sell goods and services.

**Secondly:** simplifies the transfer pricing of distribution activities.

**Lastly:** element introduces mechanisms to tackle tax disputes. As is clear, the first pillar addresses the broader challenge of the digitalised economy and thus introduces new taxing rights over foreign-based corporations.

**Pillar 2** establishes a global minimum effective tax rate of 15% on the profits of MNCs. It applies to multinational groups with revenues of €750m or more. Pillar 2 rules follow a "common approach", which means that the Inclusive Framework members adopt the rules on a voluntary basis. As with Pillar 1, Pillar 2 has three elements, including an Income Inclusion Rule (IRR), which imposes a minimum tax rate on MNC's overseas activities. The OECD published model rules for Pillar 2 in March 2022, along with technical commentary and concrete examples of how to apply the Global Anti-Base Erosion (GloBE) model rules.

## Specific challenges of the Two-Pillar Solution :

**Lack of Inclusivity:** Only 23 African countries were part of the IF at the time the two-pillar solution was arrived at. By contrast because of the set-up of the United Nations, countries with less technical capacities can overcome their inadequacies by working within the African Group or the Group of 77.

**Inadequate Revenue:** The two-pillar solution certainly shows the potential for increased tax revenues globally. Pillar 1 envisages a re-allocation of \$125bn annually while \$150bn in annual revenues is expected from Pillar 2 for all participants. It is not at all evident that African countries will benefit substantially from such revenues due to unduly high thresholds. On Pillar 2 work undertaken by Tax Justice Network has estimated that only 3% of the gains from this pillar will go to low-income countries whilst 60% of the new revenues will go to developed economies.

**Abolition of Digital Service Taxes:** If as various studies have shown, the amount expected under Amount A is not significantly larger than what is already obtained under digital service taxes or significant economic presence laws, then it is not clear if African countries should sign up to these provisions.

**Tax Competition:** One of the most touted aspects of the IF deal is that it will help to prevent a race to the bottom especially with regard to Pillar 2 which in effect sets a floor for tax competition. There are two problems with this perspective. The first is that the level of 15% may have been set too low in comparison to existing levels of taxation around the world.

**Mandatory and Binding Arbitration:** The concerns of those that did not sign up to the deal regarding mandatory and binding arbitration can be viewed from two perspectives. One is that it may put sovereign tax matters in under the control of international arbitrators which may be unconstitutional in their countries and also in the control of arbiters who cannot be trusted to be impartial. There is also the issue of costs. Arbitration is not only costly and lengthy but will also stretch the legal and tax administration capacities of African countries.

**Administrative Capacities:** Due to limited capacity, African tax administrators may not know if the effective tax declared by an MNC is less than the 15% required under GloBE.



- Global Forum for Transparency and Exchange of Information for Tax Purposes. The Global Forum was established by the OECD to promote global standards on transparency and exchange of information for tax purposes.
- Its two main standards are the
  - Tax-related Exchange of Information on Request
  - Automatic Exchange of Information.
- Cooperation between Global Forum members takes place through:
  - Monitoring and peer review activities and is facilitated by a Multilateral Convention on Mutual Administrative Assistance in Tax Matters

## United Nations Processes

- Through its Committee of Experts on International Cooperation in Tax Matters.
- It has helped to shape international tax norms while providing an alternative to the OECD model tax treaty
- The UN Tax Experts Committee takes into account capacity differences and also helps ensure balance between taxing rights and investment objectives.
- Its inclusive and effective work is increasingly being used as compared to OECD Model.
- The UN Tax Committee is however limited by the fact that it is a committee of experts serving in their personal capacities
- Although it works transparently, its membership is not universal even if elected to ensure geographical equity





# UN ASSEMBLY RESOLUTION & SG REPORT

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- UNSG Report "Promotion of inclusive and effective tax cooperation at the United Nations"
- OECD outcomes do not address their needs and priorities and its processes are not universal and inclusive.
- push-back from the OECD but Africa and the global South must work together to achieve an outcome that meets their needs and priorities.
- SG's Report made three proposals for the process going forward:
  - A UN Multilateral Convention on Tax
  - A UN Framework Convention on International Tax Cooperation
  - A UN Framework for International Tax Cooperation



**SUGGESTED  
ACTIONS GOING  
FORWARD**

The background features a network diagram with nodes and connecting lines. A large, semi-transparent orange arrow points from the top right towards the bottom left, overlaid on the network. The nodes are rendered in a 3D style with shading, and the lines are thin and grey.

- African countries should strengthen their knowledge of global tax issues by improving collaboration between their Permanent Missions as well as Foreign and Finance Ministries.
- The Africa Group in New York must work on building a broad-based coalition of African countries and other countries in the Global South (G77) and key civil society actors
- The UN Model Tax Treaty has had more uptake by developing countries than the OECD Model Tax Treaty.
- Negotiators must bear Africa's interests in mind at all times. care must be taken to ensure that the choices made ab initio reflect Africa's interests including revenues, sovereignty, taxing rights, transparency, legitimacy, inclusiveness, capacities, etc.

- It is important during preliminary negotiations not to concede best practice type provisions like peer reviews in any outcome as these are backdoor ways of introducing conditionalities
- Adequate consultations should be undertaken to determine the choice of which of the instruments proposed in the UNSG's paper should be used.
- A UN Framework Convention on International Tax Cooperation would seem most suitable as negotiations on the new global tax system should bring incremental changes
- Taxation is ultimately about revenues; we cannot separate global tax reform from on-going efforts to reform the global financial system. It is perhaps now time to consider an annual issuance of Special Drawing Rights.