Examining the Implications of the Global Minimum Corporate Tax for Africa

Coalition for Dialogue on Africa (CoDA)
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Background and Context

African countries have long been faced with the challenge of striking the right balance between attracting multinational corporations (MNCs) and taxing their earnings. The prevailing thought has been that by reducing corporate income tax and lifting regulatory barriers, a country will be better positioned to attract foreign investment. However, when this behavior becomes widespread and turns into a competition among countries, MNCs can “shop around” for the lowest possible tax rates, leading to the “race to the bottom” phenomenon. The graph below, reproduced from the Tax Foundation, shows that every region has seen its corporate tax rates steadily decline over the last 40 years because of tax competition, to attract corporate investment.

Corporate Tax Rates Have Declined in Every Region over Time
Average Statutory Corporate Income Tax Rate by Region and Decade

Note: The number of countries included in calculated averages varies by decade due to missing corporate tax rates for years prior to 2020. That is the 1980 average includes statutory income tax rates of 74 jurisdictions compared to 177 jurisdictions in 2020.
Source: Statutory corporate income tax rates were compiled from various sources.

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However, for African countries, the challenge is more insidious. Many MNCs enjoy market valuation that often surpasses the GDP of their host countries. For example, each of these four companies: Amazon, Apple, Microsoft, and Google’s parent company Alphabet, has a market valuation of at least US$1 trillion, whereas the total nominal GDP for Africa in 2019 was estimated at US$2.6 trillion. With their size, power and influence, many countries find it difficult to monitor the activities of MNCs and lack the ability to bring them to justice when they commit infractions or violate their terms of contract.

Often, countries provide tax incentives to corporations believing that such policies would lead to increased foreign domestic investment (FDI), economic growth and jobs creation. However, a 2012 report issued by Tax Justice Network-Africa and ActionAid (TJN-A and AA) concluded that four members of the East African Community (EAC) – Kenya, Uganda, Tanzania, and Rwanda – were losing US$2.8 billion each year for providing tax incentives to corporations without the expected investment in return.

Tax concessions and incentives to attract foreign investors included 10-year corporate income tax holidays, generous capital investment deductions, and exemptions from VAT payments, import duties and withholding taxes. Yet, according to the TJN-A and AA report, many of the EAC countries suffered revenue losses even with the tax concessions and incentives, including in Tanzania, where revenue losses from all tax exemptions and incentives related with trade and foreign investment amounted to 6% of the GDP in 2008. In Kenya, the losses were estimated to be around 3.1% of GDP annually, in Uganda, the estimates were “at least 2%” in 2009/10; and in Rwanda, they were 4.7% of GDP in 2009.

In addition to revenue losses resulting from tax concessions and tax incentives, countries suffer losses due to corporations’ ingenuous ability to engage in a host of tax evasion and tax avoidance behaviors generally known as Base Erose and Profit Shifting (BEPS) (OECD). This is a practice where corporations use sophisticated tax planning strategies to shift profits from one country with higher tax legislations to another with lower tax laws, thereby eroding the tax base of the so-called higher tax jurisdiction. BEPS behaviors are made possible by a combination of several factors: increased globalization, mismatches in the tax laws of different countries, and ease of transfer of “intellectual property”. The rise of corporate tax havens has also been a major factor facilitating the ability of large corporations to transfer profit to avoid taxation from the host country.
Similarly, transfer pricing practices and methods (legal or illicit) have been used by corporations for profit shifting and tax avoidance. For Africa as a whole, during the 2000-2015 period, net illicit financial flow (IFF) between the continent and the rest of the world averaged US$73 billion per year from trade re-invoicing alone (ECA). Global Financial Integrity estimates that the illicit financial flows from Africa by way of other channels averaged US$26.7 billion per year over the period 2005-2014 (Spanjers and Salomon, 2017). Taken together, this amounts to US$100 billion annually, or 4% of the continent’s gross domestic product.

The International Center for Tax and Development (ICTD, 2016) further indicated that for Africa, the loss of tax revenue as a result of BEPS “leads to critical underfunding of public investments that could help promote economic growth, and it impacts negatively on badly needed finances to fund public infrastructure such as roads, hospitals and schools”. Furthermore, the ICTD suggests that BEPS “undermines the integrity of the tax system”, which in turn reduces voluntary compliance by all taxpayers. The paper further suggested that BEPS undermines competition, since MNEs have a competitive advantage over domestic companies, including SMEs.

All things considered, African countries have generally found themselves in a weak position compared to the large multinational corporations that they are trying to attract due their limited capacity to monitor tax avoidance and tax evasion behaviors of these corporations, and the global “race to the bottom”.

This is the context, from the African perspective, within which the proposal by the US Treasury Secretary, Janet Yellen, for a global minimum corporate tax needs to be examined to understand its impact on African economies.
How the Current International Tax System is Unfair for Africa

In its origin, the current international tax framework design was based on a “compromise” dating back to the 1920s, whereby active business income was to be taxed in the source country (where the production activity took place), whereas so-called passive income (including dividends, royalties and interest) was to be taxed in the residence country, where the ultimate profit owner (corporate or individual) resides (N. Nersesyan. IMF 2021). In addition to the source country and residence country, the current international tax system distinguishes the destination country, where the sales take place, and taxing right can be assigned to either the source, destination, or residence country. Currently, net profit arising from an “active” income is allocated based on the “arm’s length principle”, where individual transactions between related entities can be priced as if they were taking place among unrelated entities in a competitive market (this is the basis for transfer pricing).

The current international tax system is a complex network of more than 3000 bilateral “double-taxation treaties”, which define the rules of how and where taxation on active or passive income can take place (IMF, 2021). One of the key principles of the international tax system is avoidance of double taxation, i.e. more than one claim by different jurisdictions on the profit earned by a multinational company. Double taxation treaties, therefore, serve to allocate taxing rights between source and residence countries. Such treaties often assign more taxing rights over passive income to residence countries, for example, by setting maximum withholding tax rates on cross-border bilateral payments of interest, dividends and royalties from income earned in source countries.

Permanent establishment and double taxation agreements are instruments to moderate the allocation of taxing rights. Permanent establishment arises when a business that is not legally resident has a fixed place of business in the source country, which can give rise to tax liabilities, and as discussed before, double taxation treaties are used to prevent business income from being taxed twice for the same activity. The determination of whether the business income should be taxed in the source or home country and the method of taxation is then made within the treaties, based on the principle of permanent establishment.
These building blocks of the current international tax system put Africa in a fundamentally unfair position for the following reasons:

a. Given the current international tax rules, the primary taxing rights are allocated to the source country. This allows MNCs to “shop around” for the lowest tax jurisdictions, laying the groundwork for the “race to the bottom” behavior of countries, the effect of which is the transfer of taxable profits from one country to another based on a lower tax regime.

b. Many African countries have limited tax administration capacity. They have to spend a lot of money to enforce the current international tax system at home, especially given its complexities which require a lot of information and technical skills. A further burden comes from the fact that tax authorities find it difficult to establish the capacities required to manage international tax related processes including audit and interpretation of tax laws and the establishment transfer pricing units and large tax offices. Very often, therefore, they are not able to challenge tax practices in MNCs, as already explained above.

c. Due to limited technical tax treaty negotiation capacity in many African countries, the tax treaty negotiation dynamics themselves can contribute to exacerbating BEPS. For instance, some clauses in double taxation agreements restrict withholding taxes or allow large intra-company loans, which facilitate loss of revenues to African countries. Indeed, tax treaties, if not properly negotiated, could enable double non-taxation because of differences in the treatment of financial items in different jurisdictions.

d. The current international tax architecture lacks adequate remedy for countries that have been negatively impacted by adverse tax behaviors by large corporations. There is a lack of coherence in dealing with tax misbehavior at the international level 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.

e. Currently, with the ubiquitous nature of digital technology, establishing a large physical presence is no longer a requirement for production activity to take place. Indeed, digital companies may carry out significant economic activities in a country with little physical presence (scale without mass). At the same time, many digital companies can generate value from selling data derived originally from users of their services in a country where they are not required to pay tax. For example, providers of search engines do not pay tax on the data gathered from users although they generate value by selling such information to advertisers. For these reasons, continuing to allocate taxing rights based on the principle of “permanent establishment” has become anachronistic, resulting in substantial loss of revenue for Africa.

1 IMF 2019, Corporate Taxation in the Global Economy
There is broad consensus that the current international tax system needs to be reformed. To prevent and reduce corporate tax avoidance and tax evasion practices, OECD and the G20 have launched a BEPS initiative that led to the development of a BEPS package consisting of 15 actions intended to equip governments with the domestic and international instruments needed to tackle tax avoidance. Over 135 countries and jurisdictions have agreed to collaborate on the implementation of the BEPS package. The OECD/G20 15 BEPS actions include the following:

### Components of the OECD BEPS Package

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With this package, it is expected that countries now have the tools to ensure that profits are taxed where economic activities generating the profits are performed and where value is created. These tools are also meant to give businesses greater certainty by reducing disputes over the application of international tax rules and standardizing compliance requirements.

The Janet Yellen proposal was made in reference to the OECD-G20 BEPS initiative and the new US domestic priorities of the Biden administration. Indeed, although not yet agreed to, a global minimum corporate tax has become one of the pillars of the proposed BEPS reforms.

The second idea being proposed is to tax digital MNCs based on where their users are located. The OECD has released revenue impact estimates, which assume a 12.5 percent global minimum tax rate, and found significant revenue gains for countries at all income levels (www.atlanticcouncil.org).
There are many unanswered questions surrounding the practical application of the global minimum corporation tax reform. For instance, given the current widespread abuse and sophisticated profit shifting techniques, there is a question of whether a global minimum corporate tax will on its own deter all corporate tax avoidance and evasion.

Many tax experts have questioned the efficacy and effectiveness of such a global minimum tax, as many businesses are concerned about the impacts on their competitiveness, possible double taxation, and increased compliance costs (www.atlanticcouncil.org). Moreover, with respect to African countries, there are questions about the capacity to enforce such a rule in this new global reform.

How well African countries fare, in this new global reform will depend on the following factors:

a. The level of political involvement of African countries in discussions around the international tax regime reforms.

b. The ability of African countries to set their priorities even as they continue to work in global tax forums, most notably the BEPS Inclusive Framework. A global compact on reform of international tax system, like what exists at the international level on corruption and money laundering, would, for instance, better advance Africa’s position in these international tax reform processes.

c. The willingness of African countries to establish a regional tax policy forum at which tax policymakers can consult and learn from one another about international tax issues. Such forums would help African countries build consensus prior to participating in international tax negotiations.

d. The ability of African countries to substantially raise their negotiation capacity and domestic capacities for tax policy and tax administration.

e. Further commitment of African countries to pursue ongoing national and regional fiscal and budget reforms to strengthen their domestic tax systems, including substantially raising their levels of tax negotiation, tax administration and domestic resource mobilization capacities.