Effects of Double Taxation Agreements on Revenue Generation

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Double Tax Agreements

- What are they?
- Why are they important?
- How do they come about?
- What is the current situation?
- What are the challenges of entering into tax treaties?
- What is the way forward?

RELEVANCE OF THIS DISCUSSION

- From 2009 to 2012, Apple got away with sending $74bn in profits to its Irish subsidiaries, even though Apple products were designed in the United States, assembled mostly in China, and sold in Europe, Africa, Asia, and the Middle East, with relatively few sales in Ireland.
- According to Oxfam (2014), the United states alone lost an estimated $90 billion in 2008
- Developing countries lose $100 billion per year due to tax avoidance by MNEs (UNCTAD)
- The Mbeki Report revealed that African countries lose over $50 billion annually in illicit financial flows (IFFs), transfer mispricing being a significant cause of this revenue loss.
- In Kenya, the cases of Unilever v The Commissioner General, KRA and Karuturi Limited v Commissioner of Domestic Taxes are instructive of the transfer mispricing going on. See: Attiya Waris, "The Challenges Facing the Implementation of Transfer Pricing Rules and the Proposed BEPS Action 13 Recommendations in Kenya"

RELEVANCE OF THIS DISCUSSION (CONTD.)

- In Nigeria, the Publish What You Pay Norway (PWYP Norway) reported that between 2000-2010, Nigeria's crude oil export to the EU was overvalued to the tune of $1.6 billion, ranking 5th among 30 countries of overvalued crude oil commodity sale
- Canadian Barrick God Corp. (through its subsidiary, Acacia Mining) accused of dodging more than $40 million in corporate taxes, through "sophisticated scheme of tax evasion". Company failed to pay any corporate taxes in Tanzania between 2010 to 2013, while it paid more than $400 million in dividends to its shareholders from its gold-mining activities in Tanzania- The Globe and Mail
- Recently, the Tanzania government has hit a $190 billion tax bill on Acacia Mining, subsidiary of the Canadian company, Barrick Gold.
- Canadian companies- First Quantum and African Barrick Gold- contribute to the loss of $3 billion a year from corporate tax dodging in Zambia

Paradise Papers

- Paradise Papers: the hidden costs of tax dodging (https://www.oxfam.org/en/even-it/paradise-papers-hidden-costs-tax-dodging).
- OXFAM: Tax havens fuel inequality and hold back the fight against poverty. This simply has to stop.
- Africa's Satellite' Avoided Millions Using A Very African Tax Scheme (https://www.icij.org/investigations/paradise-papers/africas-satellite-avoided-millions-using-african-tax-scheme/).
- Tax Haven Mauritius' Rise Comes At The Rest of Africa's Expense (https://www.icij.org/investigations/paradise-papers/tax-haven-mauritius-africa/).

Paradise Papers (contd.)

- Paradise Papers reveal how tax havens damage Africa (https://www.dw.com/en/paradise-papers-reveal-how-tax-havens-damage-africa/a-41321485).
- The Paradise Papers show how Africa’s elite avoid taxes abroad as they do at home (https://qz.com/africa/1122267/paradise-papers-bukola-saraki-sam-kutesa-ibrahim-mahama-ellen-johnson-sirleaf-and-sally-kosgei-named-in-leaked-documents/).
- Paradise Papers: Everything you need to know about the leak (https://www.bbc.com/news/world-41880153).

Findings

- Tax treaties have gone beyond their initial purpose of avoiding double taxation.
- They contribute to the erosion of tax bases, shift of taxable profits from jurisdictions where they are due to low or no tax jurisdictions and double non-taxation.
- Articles 7 and 9 of the Model Tax Treaties contribute to the above, through enabling multinational enterprises to understate or overstate the taxable profits returned in tax jurisdictions for tax gains.
- This is as a result of two principles enshrined in their provisions: the separate entity principle and the arm's length principle.
- A fundamental shift is required to stem the erosion of tax bases, shift of profits and double non-taxation. Unitary Taxation offers a viable alternative.

Double Tax Agreement

- What are DTAs?
  - Agreements to eliminate double taxation, to foster cross-border trade and investment.
  - Agreements that seek to address the clash of different countries' income tax systems that arises from international commercial transactions
- Roles of DTAs:
  - To reduce double taxation by allocating taxing rights
  - To reduce tax evasion
  - How do DTAs prevent double taxation
    - Reducing tax rate earned at source, e.g. dividends, interest, royalties
    - Deciding what is subject to tax, e.g. management fees
    - Exempting income from taxation, e.g. capital gains tax.

Current split of taxing rights

- Source country is granted taxing rights for active income
- Resident country is granted taxing rights for passive income, such as dividends, royalties, interest…

SEPARATE ENTITY PRINCIPLE

- Derives from the legal personality theory- Salomon v Salomon
- See: Janet McLean, "The Transnational Corporation in History: Lessons for Today?"…- argues that the legal concept of the corporation was first applied to the King himself.
- **Are corporations concession of the state or are they economic contracts between parties, independent of the state? If economic contracts, why are subsidiaries treated as separate legal entities when one would consider them part of a single economic entity if viewed as a purely economic phenomenon?**
- Conflict between positive law and natural law?
- Extended by the League of Nations to related entities of MNEs
- Attributable to the nature of international trade during the negotiations- basically portfolio investment and exports

Tax Competition

- What is tax competition?
  - Tax setting by independent governments in a non-cooperative, strategic way; game with unfair and unbalanced rules
- Problem with tax competition:
  - Undermine fiscal prerogatives of the state- size of the state and level of distribution
- Forms of tax competition:
  - Lower tax rates; preferential rates for inward investment; tax loopholes; hybrid arrangements; regulation such as bank secrecy;
- Forms of capital targeted by tax competition?
  - Portfolio capital; foreign direct investment; paper profits

Consequences of tax competition

- Race to the Bottom: underbidding of tax rates by jurisdictions, leading to inability to meet infrastructure needs and budgetary expectations.
- Shift of tax burden from MNEs to SMES; capital to labour; direct taxes to indirect taxes;

Perpetrators of tax evasion and avoidance

- The ‘Big Four’ accountancy firms; law firms; banks; governments; supranational bodies
- How do they perpetrate this:
  - Sale of tax avoidance schemes; promotion of bank secrecy; enacting laws, policies and guidelines that make tax avoidance possible.

Efforts at improving DTAs

- The BEPS Process
- Reducing loopholes within the domestic law
- Review of existing treaties- Uganda, Zambia, India, Rwanda