TAX JUSTICE NETWORK AFRICA

GLOBAL TAX GOVERNANCE AND RULE MAKING

Summary

1. Global architecture
2. BEPS
3. African standards
4. Illicit Financial Flows
5. Group Exercise

TAX JUSTICE NETWORK AFRICA

PART 1 – THE GLOBAL ARCHITECTURE

WHO SETS THE RULES AND WHY?

01

GLOBAL ARCHITECTURE

1

OECD-DRIVEN

International tax standards are set and driven by **OECD and G20 countries**

2

LIMITED ROLE OF THE UN

The UN has limited resources and in taxation, **our governments are not supportive**

3

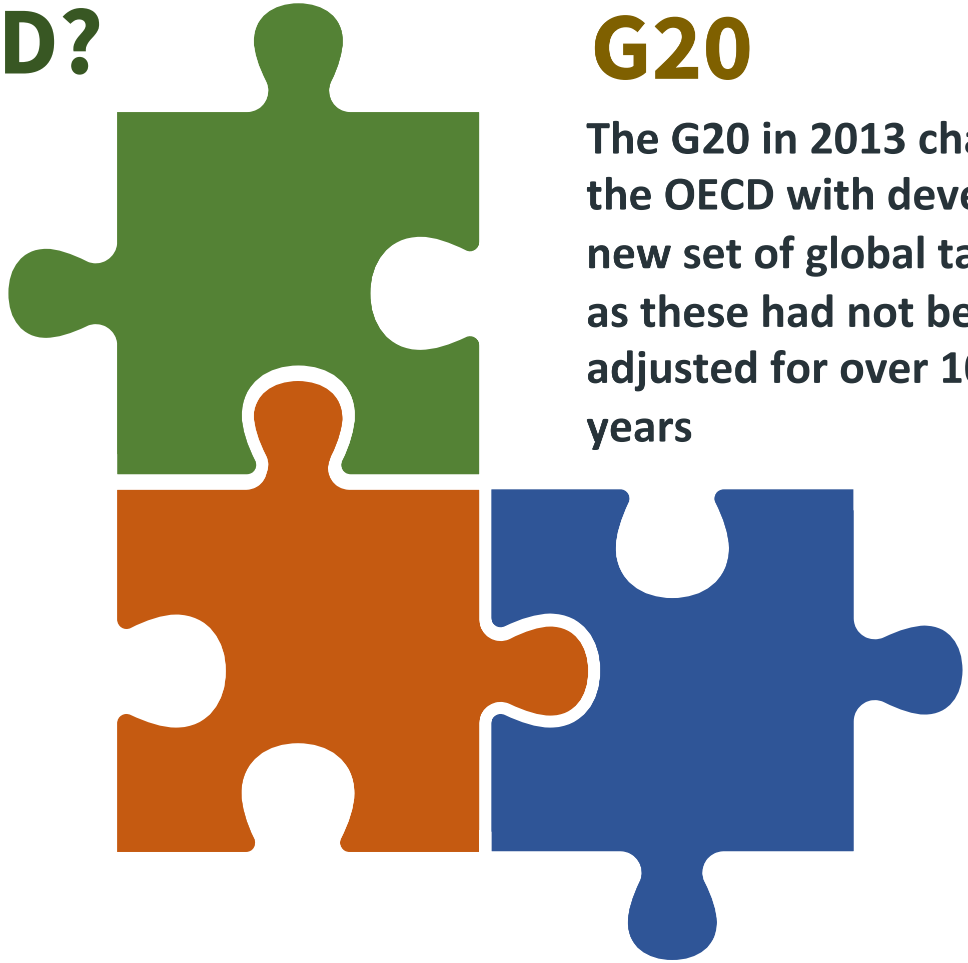
AFRICANS ARE REACTIONARY

African countries have not been **proactive in advancing African issues**

GLOBAL ARCHITECTURE – OECD

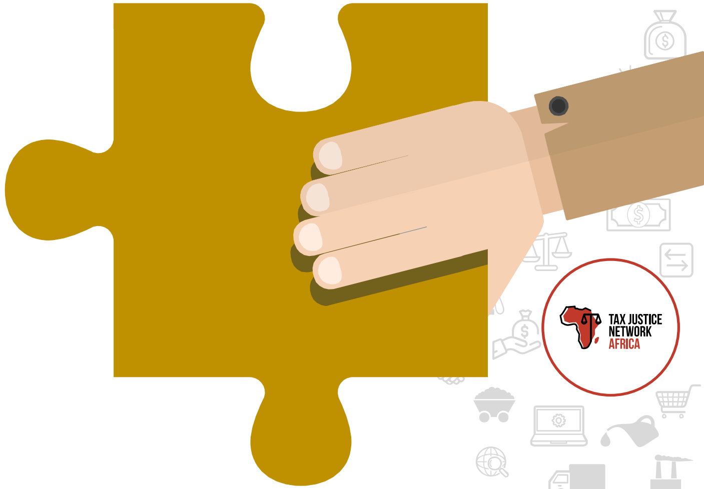
Who is the OECD?

The OECD is a multilateral organization made up of 34 members. HQ in Paris



G20

The G20 in 2013 charged the OECD with developing new set of global tax rules as these had not been adjusted for over 100 years



Why the OECD

The OECD traditionally made global tax rules for their members as they constitute the bulk of global trade

IMF/WB/UN

There are other global institutions that could have carried out the work – why not then?

WHY IS THERE NEED FOR CHANGE?

- Rise of **extremely powerful multinational corporations** with highly integrated global operations
  - (Top 200 companies manage bigger economy than 182 countries.)

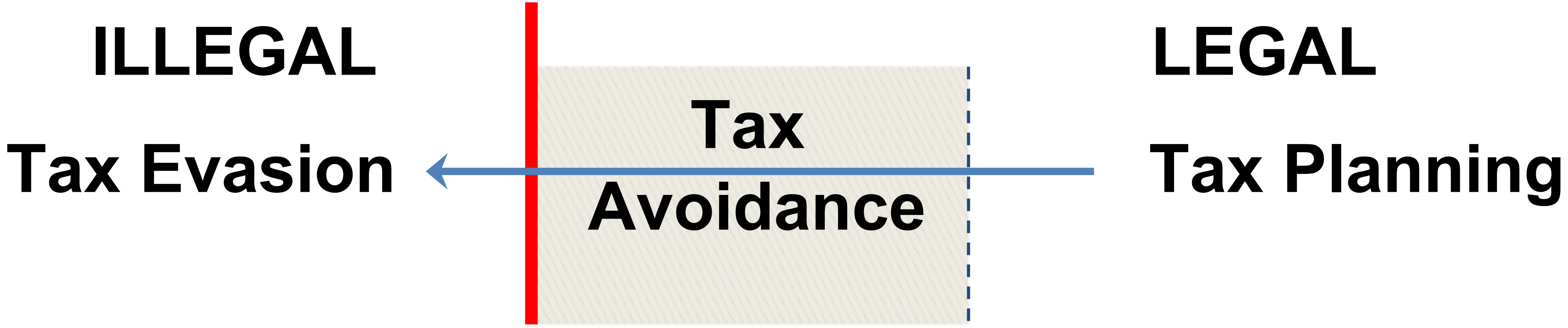
- **Free movement of capital**, labour and intellectual capital
- **Global Rules not kept at pace** with artificial shifting of profits
- **Governments competing for limited capital** employing aggressive tax incentives e,g private rulings, IBCs
- Internet and E-commerce
- Massive industry supporting tax avoidance

WHY IS THERE NEED FOR CHANGE?

- **Enhance institutional capacity** to tax income earned by MNEs operating in your territory.
- **Global acknowledgement** that tax bases of developing and capital-importing countries need to be safeguarded for sustainable development. (Less reliance on aid, stop the exploitation)
- **Need to restore public confidence** and credibility of governments while enhancing competition on even footing for all players in your economy.
- **Deepen involvement of developing countries** in the global norm setting bodies in taxation.

WHAT IS BEPS?

- BEPS arises because under the existing rules MNEs are often able to **artificially** separate the allocation of their taxable profits from the jurisdictions in which these profits arise
- This can result in income going untaxed anywhere, and significantly reduces the corporate income tax paid by MNEs in the jurisdictions where they operate (thus affecting competition, distorting investment decisions and reducing overall trust in the tax system)



OBJECTIVES OF BEPS

- **Changes to international tax rules** to address the gaps between different countries' tax systems, while still respecting the sovereignty of each country to design its own rules.
- The existing international tax rules on **tax treaties, permanent establishment, and transfer pricing** reviewed to ensure that profits are taxed where economic activities occur and value is created.
- Establish **enhanced transparency,** including through a common template for companies to report to tax administrations on their worldwide **allocation of profits and tax**.

TIMELINE OF THE BEPS PROJECT

2013

OECD and G20 governments, working together on an equal footing, adopt a 15-point Action Plan to address BEPS

2014

Engagement of developing countries through regional and international meetings

2014

Structured engagement of developing countries into CFA and Working Parties beginning Jan 2015

2015

Project finalisation and commencing the work on establishing the Inclusive Framework

THE STATE OF GLOBAL PROCESSES IN 2015

3rd Financing for Development Conference. This was the first time a full text on DRM has been captured as a proposed resolution.

AGENDA 2063 is the African Union's development vision for Africa in 50 years' time. Tax is a crucial element for DRM to achieve poverty reduction and less reliance on aid.

OECD

BEPS means changes in the international tax rules which affect African countries. It is important that African countries make their voices heard through this process.

PART 2 – WHAT IS THE ROLE OF AFRICA?

WHO SETS THE RULES ON OUR CONTINENT?

02

AFRICAN ARCHITECTURE

- There is no single authority of the African tax governance architecture

- Most countries derive their standards from OECD or the United Nations

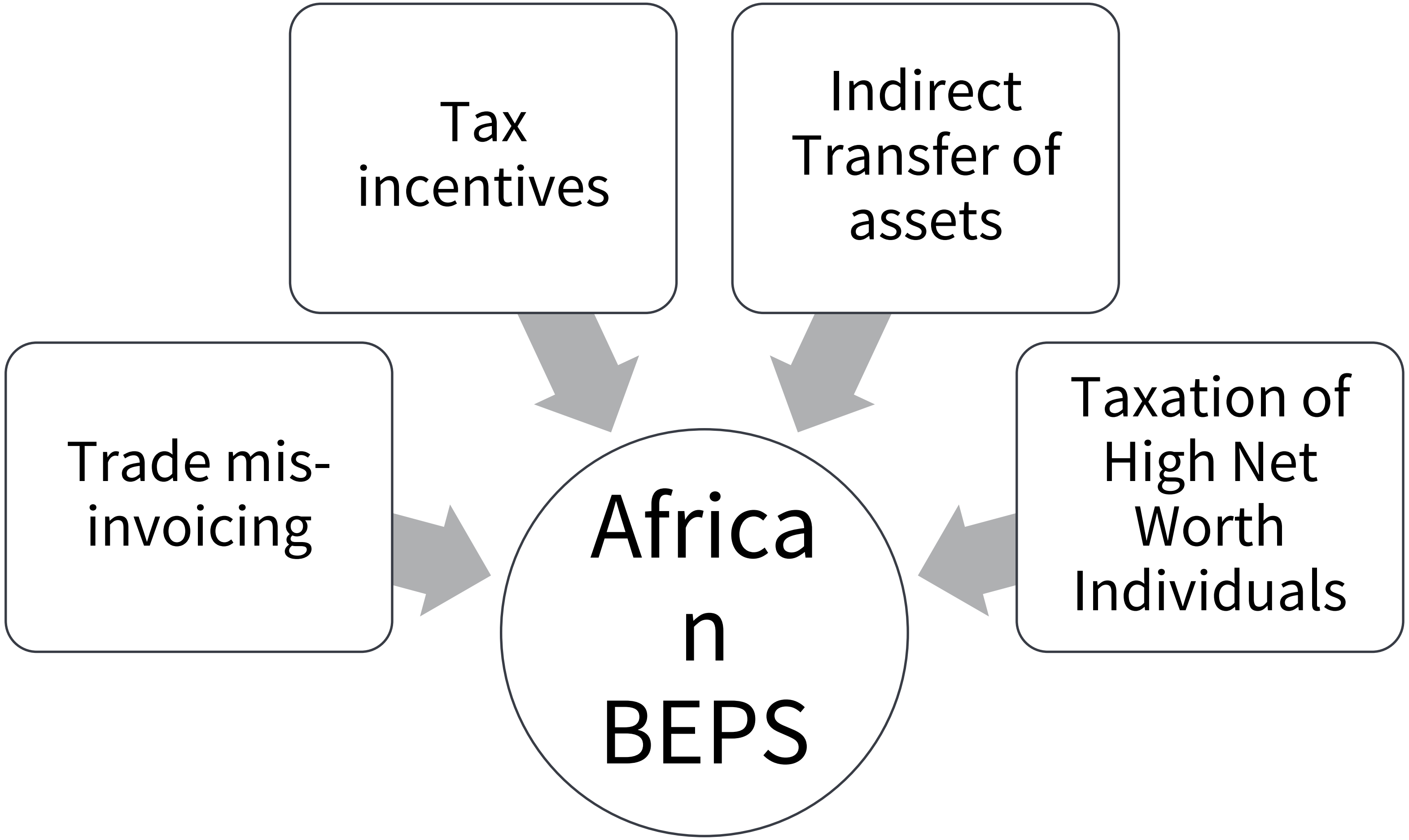
- The debate in Africa is whether the global rules are fit for purpose for African countries

- Do African countries have sufficient capacity to implement global rules → essentially made by developed countries for developed country problems, e.g. lack of data in Africa for TP comparability

AFRICAN ARCHITECTURE

- African countries **have no coordination when granting an incentive** → Tax administration not involved. Some countries this is left to Ministry of Trade or Investments
- There is limited role of African multilateral organisations
- Poor support for African CSOs and technical bodies
- Poor coordination of policy objectives as a region and subregionally
- Tax incentives **can create an opportunity to profit shift** → ATAF has noted an increase in related party transaction from ma West African State to a Southern African State → The Southern African State as many incentives….it's not Mauritius by the way!

AFRICAN BEPS



AFRICA'S INVOLVEMENT IN BEPS

Action 4 - (Interest deductibility)

Action 7 - (Artificial Avoidance of Permanent Establishment status)

Actions 8 to 10 - (Aligning Transfer Pricing Outcomes with Value Creation)

Action 6 - (Preventing Treaty abuse)

Action 13 – (Transfer Pricing Documentation)

DELIVERED BY OECD IN 2014

CONSORTIUM ON IFFS

United Nations
Economic Commission for Africa

THE AFRICAN CAPACITY BUILDING FOUNDATION

AFRICAN TAX ADMINISTRATION FORUM
FORUM SUR L'ADMINISTRATION FISCALE AFRICAINE

Thabo Mbeki FOUNDATION
"Dedicated to Africa's Renaissance"

BANQUE AFRICAINE DE DEVELOPPEMENT
AFRICAN DEVELOPMENT BANK
AFRICAN DEVELOPMENT FUND
FONDS AFRICAIN DE DEVELOPPEMENT

ALSF
African Legal Support Facility • Facilité africaine de soutien juridique

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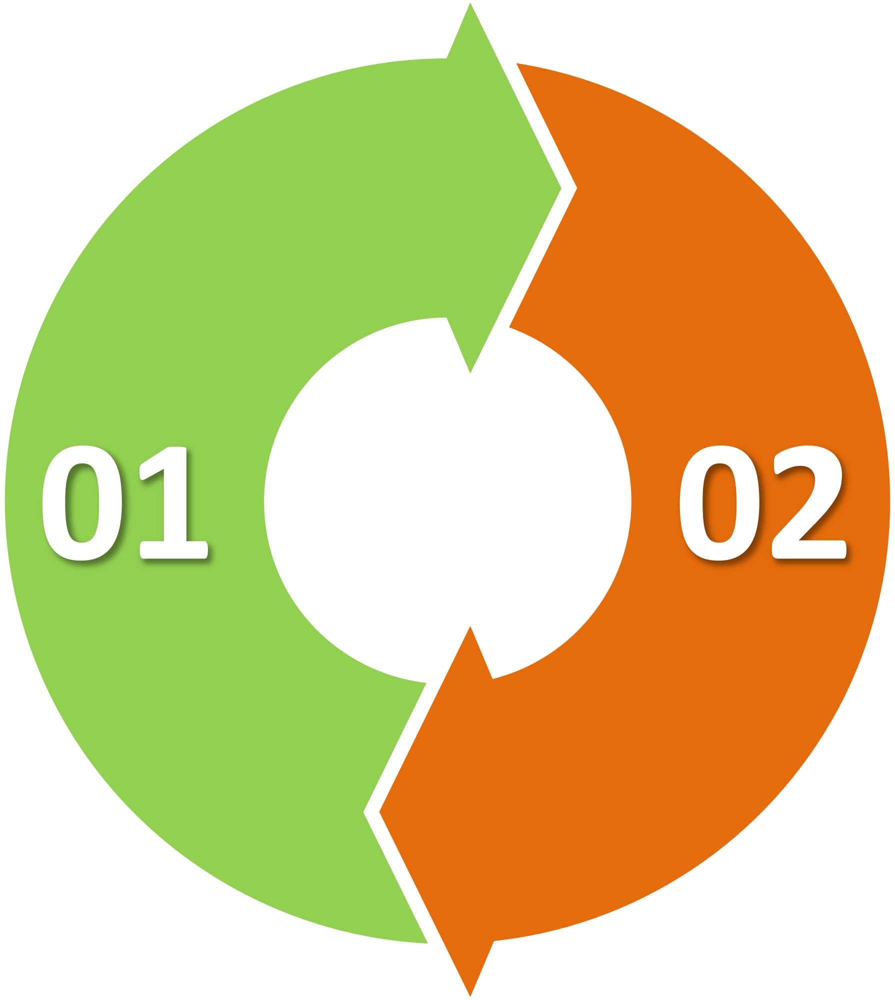
PALU
Pan African Lawyers Union

PROBLEMATIC TAX AREAS IN AFRICA

TAX INCENTIVES

Ask the question: Are we getting revenue out of this or are we giving away money?



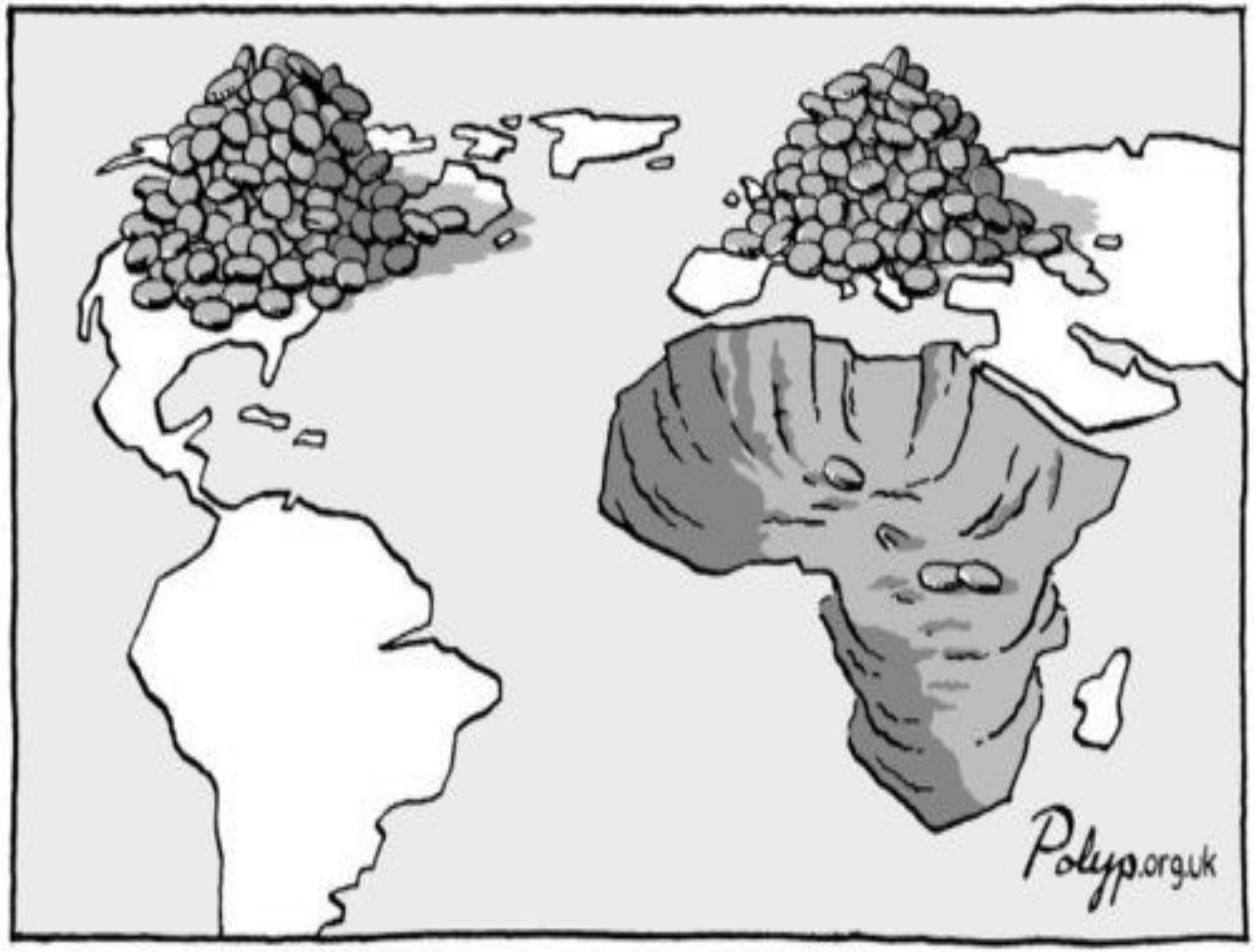
OUTDATED LAWS

Its 2018 and not 1970: The world has changed since then and so too should our laws

TAX INCENTIVES – EXPECTATIONS

- Attract investments;
- Transfers of know-how and technology
- Increased employment and improved workforce;
- Assistance in improving conditions in less-developed areas';
- Increased economic activity from related suppliers and consumers;
- Increased tax revenue from investor (after incentive expired)

TAX INCENTIVES – REALITY



'GOLD DIGGERS'

- Overgenerous or poorly designed;
- Give away tax revenues
- incentives are captured by politically connected firms and used as a merry-go-round for diverting public funds into political finance.
- Incentivize perverse results (such as stretching out investment over time to extend the tax holiday)

PART 3 – LOOPHOLES

AREAS OPEN TO EXPOITATION

03

LOOPHOLES

- Complexity → Creates greater space for different interpretation OECD Guidelines have expanded
- Pushback from business especially in developing countries → Action 4 Report on interest deductibility
- tax arbitrage → the common practice of analysing tax rules that differ from country to country, to strategically exploit the differences in order to keep the amount of taxes paid to any government, anywhere, as low as possible.
- Outdated legislation → Old laws for new terms of business makes it easy to find loopholes.

LOOPHOLES

01

AGGRESSIVE TAX PLANNING

- The lack of strong interest deductibility legislation allows taxpayers to strip out profits through related party transactions (excessive loans & excessive interest – tax deductible)
- Due to poor legislation on documentation, taxpayers may to take their chances

02

TREATIES

- Lack of treaties among African countries → This may be exploited by taxpayers.
- It makes it difficult to go into mutual assistance procedures (MAP) as arbitration may prove difficult for low capacity administrations.

03

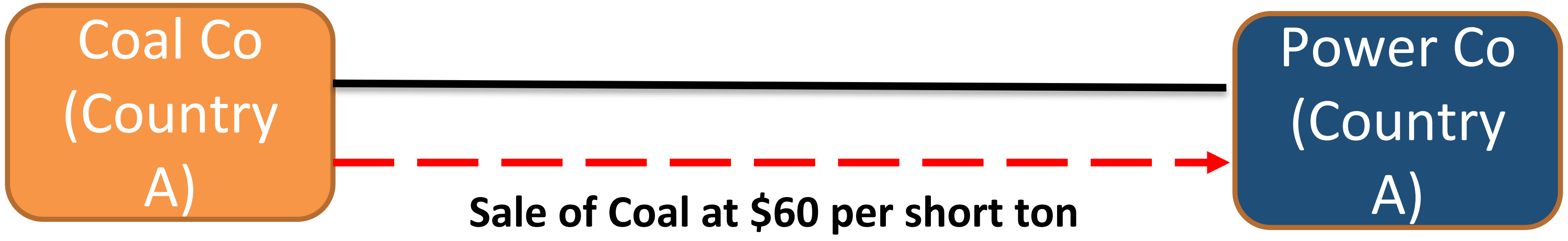
POOR PENALITIES

- The bulk of legislation on the continent is outdated and has low penalty regimes.
- The penalties do not scare off taxpayers and therefore there is a risk of increased non-compliance culture, e.g. $1000 fine viz Multiple $$$ profits

LOOPHOLES → QUICK QUIZ – WHERE IS LOOPHOLE?

“Any person who wilfully fails or neglects to furnish, file or submit any return or document required by the Commissioner under the power conferred by this Act ……shall be guilty of an offence and liable to a fine not exceeding level seven ($1000) or to imprisonment for a period not exceeding one year or to both such fine or imprisonment.”

INCENTIVISING PROFIT SHIFTING



- Prior to 2018 **Power Co purchased coal from foreign unrelated supplier**
- Coal Co set up end 2017 to mine coal to supply related party Power Co for its power plant
- Coal Co given a tax holiday of 10 years (CIT rate 0%) to encourage coal mining to be done in country
- Coal Co sells to Power co at an inflated price → This reduces the profits of Power Co (they now pay less tax).
- **Coal Co is now not paying tax** (tax holiday) **and Power Co is now "making losses"** caused by an internal relationship.
- **Therefore 2 companies, owned by 1 Group in 1 country not paying any tax**

Power Co Financials

	2017	2018
Sales	500m	550m
COGs	(200 m)	(400m)
Gross Profit	300m	150m
Op Exps	(200 m)	(200m)
Op. Profit	100m	(50m)
Tax (30%)	(30m)	Nil

LOOPHOLES → TRANSFER PRICING RULES

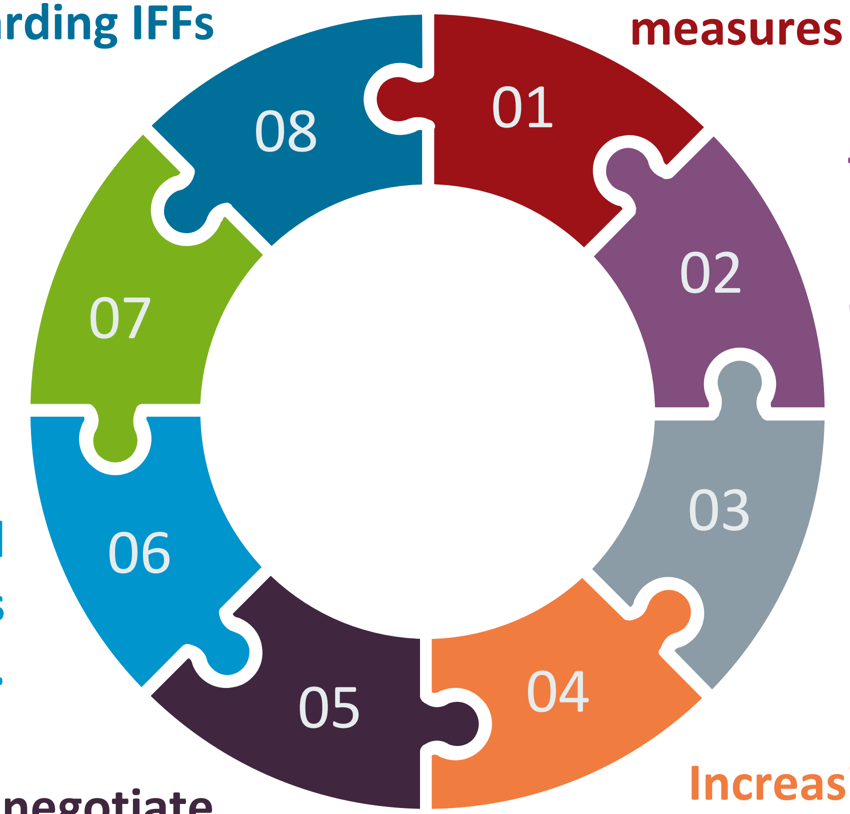
OLD RULES	NEW RULES	RATIONALE FOR THE CHANGE
Emphasis on the price of the transaction	Emphasis on all the terms and conditions of the transaction	Focusing only on the price of a transaction creates opportunities for abusive transfer pricing by taxpayers adding terms and conditions to the transaction that would not occur at arm's length resulting in profit shifting through inappropriate pricing

PART 4 – GROUP EXCERCISE

LET’S HAVE SOME FUN!!!

04

GROUP EXERCISE



Implementing corporate transparency measures

Taxing Africa's vast income and assets held offshore

Changing the international tax consensus that has influenced Africa's tax systems

Increasing capacity building, training, and resources for institutions and regulatory agencies for work on IFFs.

Building capacity to negotiate economic contracts effectively

Building efficient and effective tax administrations and Customs.

Increase collaboration between Tax Policy and Administrators in fighting IFFs

Advocacy and Joint efforts by Governments, CSOs, Media, Public and Private sectors regarding IFFs

THANKS FOR YOUR ATTENTION !!!