The Nexus between Tax Treaties, Transfer Pricing and BEPS. Lessons for African Tax Policy Makers and Administrators.

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Abstract

Tax is a sustainable tool for domestic revenue mobilisation for governments to fund public services. Revenue alternatives have been affected by the global financial liquidity challenges and have become unreliable. There are various tax loopholes threatening tax revenue mobilisation. This paper discusses tax loopholes around tax treaties and the threat they pose to domestic revenue mobilisation in Africa. The network of double taxation treaties is one of the mechanisms used by multinational companies to avoid paying taxes. Whilst tax treaties aim to stem double taxation and double non-taxation, some tax treaty provisions facilitate aggressive transfer pricing as well as base erosion and profit shifting. African Governments have a critical role to play to address tax loopholes inherent in tax treaties. This paper proffers recommendations such as reviewing the provisions of current tax treaties, developing new tax treaty frameworks and coordination of tax rules as important steps to address tax loopholes.

Key words: BEPS, tax treaties, transfer pricing, tax coordination, treaty shopping, domestic revenue mobilisation

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ACRONYMS

BEPS	Base Erosion and Profit Shifting
CIT	Corporate Income Tax
DRM	Domestic Revenue Mobilisation
DTA	Double Tax Agreement
DTT	Double Tax Treaty
EU	European Union
FDI	Foreign Direct Investment
FfD	Financing for Development
G20	Group of twenty countries
G8	Group of Eight Countries
GAARs	General Anti-Avoidance Rules
HLP	High Level Panel
IFFs	Illicit Financial Flows
IP	Intellectual Property
LOB	Limitation of Benefits
MDGs	Millennium Development Goals
MNCs	Multinational Companies
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
PE	Permanent Establishment
SAARs	Specific Anti-Avoidance rules
SDGs	Sustainable Development Goals
TJN-A	Tax Justice Network-Africa

1.0. Introduction

There is a hot global debate on the subject of base erosion and profit shifting (BEPS) and financing for development (FfD) and this is related to the challenges facing many African countries to meet the 2015 Millennium Development Goals (MDGs) as well as the new challenge faced by the developing countries to meet the financing needs of the post 2015 Development agenda (Sustainable Development Goals (SDGs)) among other domestic financing requirements. The historical thinking and tendency for most developing countries has been to rely on foreign direct investment (FDI) and official development assistance (ODA) as the main sources of finance. However, following the global financial crisis and liquidity crunch since 2007 and whose effects are still being felt, FDI and ODA have dwindled and hence are no longer a reliable source of finance. This has increased the importance of domestic revenue mobilisation (DRM) mainly in the form of taxation. Many researchers argue that taxation is a sustainable source of domestic revenue mobilisation. Therefore, there are increasing calls for developing countries to raise revenue through taxation.

Domestic tax revenue mobilisation is however not spared of its own critical challenges in the form of base erosion and profit shifting which has made tax collection a mammoth task in many African countries. There are several drivers of BEPS but this study focuses on BEPS linked to double tax treaties or agreements (DTTs or DTAs) and aggressive transfer pricing. The study uses some selected African countries case studies to demonstrate the challenges associated with tax treaties, aggressive transfer pricing and their links with base erosion and profit shifting. Interesting cases drawn from tax treaties for countries such as South Africa, Zambia and Uganda with Mauritius, India and the Netherlands are discussed to illustrate the links between tax treaties, transfer pricing and BEPS and the threat they pose to domestic tax revenue mobilisation. This has an ultimate bigger challenge on financing development in Africa. Based on these cases the study draws lessons for African policy makers and tax administrators and also proffers some recommendations aimed at addressing these challenges.

1.1. Problem Investigated

The paper investigates whether DTTs are a trick or treaty? There is a network of DTTs between African countries and developed countries as well as with some developing countries. The general view is that DTTs are signed to curb double taxation or double non- taxation as well as to promote foreign direct investment. However, despite this noble intention the DTT networks have become a major source of tax loopholes and tax leakages over the years because of various technicalities. The technicalities within the tax treaties have increasingly become drivers of abusive tax planning which is causing serious base erosion and profit shifting. This has negatively affected African countries' domestic revenue mobilisation capacity and hence negatively affected Africa's development as being reflected by the failure by most African countries to meet the MDGs. This situation also poses a negative threat to the key role that taxation is poised to play in the post 2015 financing for development process (post MDGs period).

1.2.Research Objectives

This paper outlines the link that exists between DTTs, transfer pricing and BEPS and exposes the related mechanisms and practices that lead to base erosion and profit shifting in Africa as well as the resultant threat these mechanisms pose to domestic revenue mobilisation. The paper then provides possible remedies in the form of recommendations which are expected to close the tax loopholes inherent with DTTs in order to strengthen the capacity of African countries to mobilise domestic revenue to support their development initiatives. This paper's objective is in line with the increasing worldwide view that tax is the most sustainable source of revenue which is expected to finance the development of Africa and other developing countries.

Overall this study aims to raise awareness and advocate for policy measures to combat consequences of tax loopholes within the context of the links between DTTs, transfer pricing and BEPS at the national, continental and international level. The ultimate goal is to safeguard the tax bases of developing and capital-importing countries by stopping the 'shifty business' and levelling the international tax playing field by allowing each country to be able to tax a fair share of the income earned by multinational companies (MNCs) operating in their territory.

2.0. The links between DTTs, Tax Planning and BEPS

This section begins by defining DTTs, BEPS as well as tax planning and then further gives an overview of international tax planning. To start with, DTTs are bilateral agreements between two countries that are supposed to help eliminate the potential for double taxation on cross-border investments. According to Hearson (2014), avoiding double taxation is a sensible aim, but DTTs can have outcomes that go beyond what was intended. Many investors seek to 'treaty shop' and channel funds through countries with especially favourable DTTs in order to avoid taxes (Hearson, 2014a). Developing countries have often agreed to DTAs that substantially reduce their scope to raise revenue.

DTTs in Africa are a major driver of base erosion and profit shifting. According to the OECD (2013), BEPS refers to "tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low resulting in little or no overall corporate tax being paid." The BEPS project coordinated by the Organisation for Economic Cooperation and Development (OECD) seeks to reform international tax standards that have become open to exploitation by multinational firms.

Furthermore, tax planning is generally referred to as tax strategies designed to prevent a tax liability from arising (Hearson, 2014a). Hearson (2014a) further argues that unlike tax evasion and tax avoidance, tax planning does not contravene either the letter or the spirit of the law. The paper has used the term tax planning to refer to a range of activities, from those explicitly intended or condoned by the government (for example, taking advantage of a tax incentive) to more "aggressive" activities that nonetheless do not meet the technical definition of tax avoidance (for example tailoring a business's presence in a country to push the limits of the definition of permanent establishment). As the definitions reflect, DTTs create opportunities for aggressive tax planning which eventually results in base erosion and profit shifting.

It is also worth noting that the world international tax landscape is changing as evidenced by the proliferation of tax planning schemes. The proliferation of tax planning schemes can be attributed to developments such as globalisation, the rise of the digital economy, "fluid movement of capital", growth in intellectual property (IP), growth in the financial services industry and the extension of tax treaty networks. Laws have generally not kept pace! On the international tax journey there are

some signposts along the way which depict the tax planning schemes. The sign posts include schemes such as:

- Treaty shopping. Treaty shopping has generally thrived because of inadequate safeguards, for example in the form of limitation of benefits (LOB) and anti-abuse clauses;
- Avoidance of permanent establishment (PE) mainly related to e-commerce and nexus;
- Intellectual property. The issue of tax incentives being given in return for IP, competition between nations for IP, and accelerated deductions allowed for the use of IP;
- The growth of the financial services sector has seen numerous hybrid instruments and other sophisticated financial instruments in a landscape with largely unsophisticated domestic laws to sufficiently regulate these instruments. The main tax losses to governments here have been as a result of deduction without taxable receipt;
- The existence of hybrid entities resulting in tax arbitrage based on differences in national rules and this has been widespread due to the rise in global trade. Hybrid entities are actively encouraged by legislation in some countries, for example US check-the-box, and the Netherlands CV-BV structures[1];
- Holding companies in particular jurisdictions. These are assisted by wide treaty networks and/or EU law, special holding company jurisdictions (e.g. ETVE in Spain). They usually follow low tax rates (e.g. income tax and capital gains tax) and are mostly set up in 'increasingly not tax havens' (e.g. the Netherlands, Ireland, and even the United Kingdom);
- Transfer pricing. This is related to the existence of numerous transactions between associated enterprises in global trade as well as business restructuring issues;
- Debt restructuring. This is often associated with thinly-capitalised entities, excessive interest deductions, transactions involving "disguised interest"; and

[1] The CV is a reverse hybrid entity (Dutch partnership/U.S. Corporation). For U.S. tax purposes, the foreign companies and the BV are tax transparent entities, so that dividends, interest and royalties received by the BV are considered active income of the CV. Accordingly, the earnings of this entity will not be subject to U.S. corporate income tax until such amounts are remitted to the U.S. Corporation. The BV is a hybrid entity (Dutch corporation/ U.S. branch (check-the-box election)). Dependent on the activities of the BV, its profits will be remote due to the pass-through of the royalties and/or interest income to the CV. Dividends are normally exempt from Dutch corporate income tax under the participation exemption. Interest and royalties paid from the BV to the CV are not subject to Dutch withholding tax, while in general dividends are taxed at a maximum of five percent Dutch dividend withholding tax (but possibly taxed at zero percent). The benefits of this structure include royalty and interest deduction at the source, and no pick-up of this income in the Netherlands or the U.S. In addition, dividends paid by the BV to the CV are not subject to U.S. taxation.

- Low-tax jurisdictions and harmful tax practices. This may involve entire jurisdictions, for example Isle of Man, Jersey, Guernsey, etc. and particular companies or sectors, for example IBC, IFSC and Luxembourg 1929 Company.

All the above mentioned schemes are associated with tax avoidance practices and thrive where opportunities or loopholes exist, for example in most developing countries' DTT provisions. These practices often result in base erosion and profit shifting. In response to this the keeper at the gate (policy makers and tax administrators) as well as the EU and the OECD have been working on targeting tax avoidance. This is evidenced by growth in volume of anti-avoidance legislation (e.g. general anti-avoidance rules (GAARs) and specific anti-avoidance rules (SAARs), agreements for exchange of information as well as rubik agreements and amnesties. GAARs are becoming more popular (for example in India and United Kingdom). GAARs have also become popular in tax treaties. Noteworthy SAARs include tax arbitrage (anti-hybrid) rules, rules limiting deduction of interest (e.g. UK, Germany), Controlled Foreign Company (CFC) legislation, rules to catch artificially diverted profits (e.g. UK "Diverted Profits Tax") and rules re residence (e.g. Ireland's rules re "stateless companies").

Other measures being taken include termination (and possible renegotiation) of tax treaties (e.g. Mongolia), rules requiring provision of information (DOTAS and FATCA), rules targeting bank secrecy, intergovernmental cooperation (e.g. mutual assistance measures) and BEPS – No laws yet! Where next from here? Worth considering are measures not coordinated at international level, competitiveness versus increased tax revenue: the tension at the heart of policy making and the complexities of anti-avoidance rules. At the end of the day, there is no one-size-fits-all solution: differing considerations between developed and developing countries, and within each group have to be considered.

2.1. DTTs a trick or treaty?

As mentioned earlier, tax treaties are meant to combat double taxation and double non-taxation. They are in some instances also additionally used as a tool to attract FDI. However, there have been growing concerns in the context of tax treaties mainly related to their potential to aid base erosion and profit shifting. The main key concerns are around the challenges DTTs bring on withholding taxes, permanent establishments, capital gains tax, treaty shopping or anti-avoidance and administrative cooperation (Hearson, 2014b). This has resulted in recent DTT cancellations

and renegotiation initiatives. According to Hearson (2014b), there is a growing attention on the question of tax treaties signed by developing countries and the costs of tax treaties have been highlighted in recent years by NGOs such as Action Aid and SOMO[2]. During 2014, an influential IMF paper warned that developing countries "would be well-advised to sign treaties only with considerable caution,"[3] and the OECD, as part of its BEPS project, proposes to add text to the commentary of its model treaty to help countries decide "whether a treaty should be concluded with a State but also…whether a State should seek to modify or replace an existing treaty or even, as a last resort, terminate a treaty.[4]

2.1.1. Withholding Taxes

Over time, treaties signed by African countries have capped the rates of withholding taxes (WHTs) that they can apply at lower and lower rates. Although this partly reflects a fall in statutory WHT rates in some countries, Zambia is an example of a country where the revenue that can be raised from recent increases in statutory WHTs will be limited by the limits imposed in its treaties.

2.1.2. Permanent Establishment

Countries' domestic laws define the threshold at which a multinational business becomes liable to tax on the profits it makes there. Tax treaties usually restrict this definition more than domestic law, but in other cases the model treaties suggest areas in which domestic law could operate with a lower threshold. There are a lot of possible variations within the model treaties' PE definitions, this paper briefly reviews three important areas for developing countries at present. The first is the threshold for how many days a construction site must exist before it constitutes a PE. In all Uganda's treaties for example, the answer is six months (twice as much as domestic law, which says 90 days), while Zambia's vary between three and twelve months (domestic law says 183 days). Both countries may have given away too much in an environment where, as one government official remarked, "the Chinese can do things in three months."

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[2] Mike Lewis, Sweet Nothings: The Human Cost of a British Sugar Giant Avoiding Taxes in Southern Africa (London: Action Aid UK, 2013); Katrin McGauran, "Should the Netherlands Sign Tax Treaties with Developing Countries?," SOMO, 2013, http://somo.nl/publications-en/Publication_3958/at_download/fullfile.
[3] IMF, Spillovers on International Corporate Taxation (Washington, DC, 2014).
[4] OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, 2014), doi:10.1787/9789264219120-en.

The second issue concerns supervisory activities connected to a construction site. Here both countries have done well at maintaining the right to tax, with only a few exceptions, such as the Uganda-UK treaty. The third issue is the provision of services where there is a 'fixed base', i.e. a consistent physical presence. Zambia's domestic law definition explicitly permits it to tax these profits if the presence lasts six months, but Uganda's does not. The large number of Zambian treaties that don't include a service PE provision is therefore more concerning than those of Uganda, where the position is less clear.

In these and other areas of PE definition, Uganda has generally done better than Zambia at retaining its taxing rights, but these gains may be frustrated by its domestic law definition, which is strong in terms of the short number of days it applies, but narrow in the list of activities, especially the lack of an explicit mention of the 'service PE'. Conversely, Zambia has a strong domestic definition that mostly follows the UN model convention, but this is often restricted by concessions in its tax treaties.

2.1.3. Capital Gains Tax

Capital gains tax could be an important source of revenue for many developing countries. But tax treaties frequently create possibilities for avoidance by multinational investors. Countries that don't currently have capital gains tax should not ignore these provisions of tax treaties, in case they decide to introduce a capital gains tax at a future date.

2.1.4. Treaty Shopping or Anti-Avoidance

Tax treaties, especially those with low-tax jurisdictions such as the Netherlands and Mauritius, create significant risks for tax avoidance. Domestic rules may not be enough to prevent this, but developing countries' tax treaties rarely contain specific or general anti-abuse rules. The use of tax treaties for BEPS has a growing profile, not least in Zambia following a report by Action Aid that highlighted the use of the country's treaties with Ireland and the Netherlands.[5] The concern here is companies' exploitation of tax rules (for example on PE) to prevent profits made in a developing country from being taxable there, or to shift those profits from the developing country to an offshore location. A full armoury of defences against these practices requires both specific rules

[5] Lewis, Sweet Nothings: The Human Cost of a British Sugar Giant Avoiding Taxes in Southern Africa.

to target particular known practices and general rules that widen the net. To be most effective, rules in domestic law and in tax treaties need to be designed to work together. Uganda, for example, has a general 'limitation of benefits' rule in its income tax law, which specifically denies tax treaty benefits to companies whose underlying owners are not mostly residents of the treaty partner. In any event, both countries' treaties overwhelmingly lack anti-abuse provisions. General anti-abuse provisions in tax treaties are not currently common, although it is likely that they will become more so thanks to current work ongoing at the OECD. However, successive updates to the model tax conventions have already introduced specific provisions that prevent the abuse of certain aspects of the treaties. These provisions appear in hardly any of the treaties signed by Uganda and Zambia and most other African countries.

2.1.5. Administrative cooperation

Officials in Zambia and Uganda indicate that one reason for negotiating new tax treaties and renegotiating old ones is to obtain administrative cooperation between tax authorities. This is undoubtedly important for tackling offshore tax evasion and for auditing multinational companies. But comprehensive tax treaties may not be the best way to achieve it. Signing up to the Africa Tax Administration Forum (ATAF) Agreement on Mutual Assistance in Tax Matters (AMATM) and the ATAF Practical Guide on Exchange of Information for Developing countries could be more beneficial to African countries to combat illicit financial flows and improve the mobilisation of domestic resources on the content (Africa Tax Administration Forum, 2015).

2.2. DTTs' experiences in Africa

Africa has a growing tax treaty network and this patchwork is the product of 50 years of changing power relations, policy fashions and tax measures. Analysing the processes that led to the treaties in force today reveals that in many cases they do not fulfil the original role that may have been envisioned by developing countries who signed them (Hearson, 2014b). Hearson (2014b) estimates that there are almost 300 tax treaties in force in sub- Saharan Africa countries. About half of them are with Western European countries, chiefly with former colonial powers and Nordic countries. The number of treaties with Western Europe has been growing steadily, and continues to grow at the same pace. Based on the International Bureau for Fiscal Documentation (IBFD) tax treaties database, the 1990s showed a sharp increase in the rate at which sub-Saharan countries

continue to sign treaties with traditional investor countries at a steady rate. Sub-Saharan African countries have more recently begun to conclude treaties with emerging economies and other developing countries. This includes a growing number with low-tax countries that are risks for treaty shopping. African countries signed treaties, as they began to sign with countries in other parts of the world, not least other African countries: South Africa, Mauritius and Tunisia all emerged as significant treaty partners for sub-Saharan countries during the last two decades.

This historical pattern needs to be taken into account when comparing treaties. The IBFD tax treaties database shows that about 100 treaties, most of them with countries of Western Europe that are sources of foreign direct investment and aid, are more than 20 years old. Half of these were signed before the United Nations model tax treaty was first published in 1981. Ideas about the content of tax treaties, patterns of investment, tax rates and systems, forms of tax planning, and political priorities on the continent have all changed considerably since these treaties were concluded (Hearson, 2014b). These older treaties may present very different challenges when compared with those – around 100 – signed since 2000. This latter group includes a large number with South Africa and Mauritius, the main hubs through which investment enters the region. It also includes treaties with newer sources of investment that are not OECD members, such as India and China. These treaties may be more up-to date in areas such as provisions for administrative cooperation between tax authorities, and can be regarded as treaties between developing countries.

Some developing countries seem recently to have become concerned by the negative impacts of some of their treaties (Hearson, 2014b). Rwanda and South Africa have successfully renegotiated their agreements with Mauritius. Argentina and Mongolia have cancelled or renegotiated several agreements. Responding to this pressure, two of the developed countries whose treaty networks have raised concerns, the Netherlands and Ireland, have begun a process of review.[6] In 2014 Tax Justice Network-Africa (TJN-A) carried out country case studies for Kenya, Uganda and Zambia in order to investigate this apparent shift in opinion among policy makers, and to see what lessons can be drawn by other developing countries. Uganda and Zambia appear to be questioning past

[6] Netherlands Ministry of Finance, Government's Response to the Report from SEO Economics Amsterdam on Other Financial Institutions and the IBFD Report on Developing Countries, vol. 2012, 2013; Irish Ministry of Finance, Public Consultation: Spillover Analysis – Possible Effects of the Irish Tax System on Developing Economies (Dublin, 2014).

DTT decisions. As part of the country studies, TJN-A carried out fieldwork in the form of interviews with government officials and private sector tax advisers in Kampala and Lusaka in September 2014.[7] Uganda has announced a review of its policy towards tax treaties[8], while Zambia is renegotiating several of its treaties. The Ugandan review has several motivations, according to finance ministry officials. The lack of a politically enforced policy to underpin negotiations is one concern. "When I go to negotiate, all I have is my own judgement," according to a negotiator. "We thought that cabinet should express itself" (Hearson, 2014b). Policy makers are also concerned about the taxation of technical services provided by professionals in the oil industry, and are asking questions about the relatively poor deal Uganda got in its as yet unratified agreement with China.

According to Hearson (2014b), Zambia, it seems, is keen to update very old treaties that were negotiated on poor terms by government officials in the 1970s. But a recent treaty signed with China on poor terms has created a difficult precedent, dragging down the terms of its recent negotiation with the UK.[9] Zambia is also encumbered with several colonial-era treaties that need urgent attention. The IBFD tax treaties database shows that, overall, Zambia is an example of a country with a lot of treaties dating from the 1970s, while Uganda's treaties are more recent, mostly concluded in the late 1990s and 2000s. Zambia has decided to renegotiate some of the treaties that are most at risk of abuse, while Uganda has announced a freeze in new treaties while it formulates a clear policy.

Zambia has begun to renegotiate some of its older treaties, including with the UK, Netherlands, India and Ireland (the latter a particularly bad deal for Zambia). Even if these renegotiations produce good outcomes, some problematic treaties will remain. Its agreements with Switzerland and France are extensions of treaties signed by the UK in the 1950s, during the colonial era. The Swiss treaty prevents Zambia from imposing any tax on interest, royalty and management fee payments to Swiss residents.

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[7] Interviews for this project were conducted in Kampala and Lusaka in September 2014. Across the two countries, Hearson (2014b) spoke with ten current and former government officials, eight private sector tax advisers, and a number of other stakeholders. Comments are attributed in such a way as to avoid identifying interviewees who requested anonymity.

[8] Ismail Musa Ladu, "Govt Suspends Double Taxation Pacts," Daily Monitor, June 06, 2014.

[9] The newly renegotiated treaty with the UK is discussed in Martin Hearson, "Time We Scrutinised China's Tax Treaty Practice, Too," Tax, Development and International Relations, 2014, http://martinhearson.wordpress.com/2014/07/02/time-we-scrutinised-chinas-taxtreaty- practice-too/.

More recent Zambian treaties with Mauritius and the Seychelles – countries commonly used for treaty shopping – do not contain anti-abuse provisions, and the treaty with China sets low withholding taxes that are likely to drag down Zambia's taxing rights in any (re)negotiations, as they have already done with the UK. According to Hearson (2014b) the Mauritius and Seychelles treaties were negotiated many years before they were signed and the process of approval took too long such that by the time the agreements were signed, the agreements were 'out of tune' and therefore lacked the standards policy makers now insist upon.

The IBFD tax treaties database further shows that Uganda, in contrast, did not sign any tax treaties (apart from with Zambia) until 1992. From 1997 until 2007 it signed a handful, mostly with European countries, and a treaty with China (on terms similar to Zambia's) is agreed but not yet ratified. While Uganda's treaties retain greater rights for it to tax foreign investors than Zambia's do, there are still weak spots, in particular the treaties with the Netherlands and Mauritius. The former has much lower source taxing rights than Uganda's other treaties, and neither contains an anti-treaty shopping provision. Uganda's treaties tend to have more provisions that protect its taxing rights than do those of Zambia, although the latter's more recent treaties are an improvement. This may be because many of Zambia's earlier treaties were negotiated before the UN model tax treaty was published. The UN model sets out wording that is more suited to developing countries than the other major model, that of the OECD.

Important differences between the UN and OECD models include the definition of PE, which defines when a company's activity in (say) Uganda becomes significant enough to incur tax on its profits. In addition, Uganda seems to have been keen from the start to retain the right to levy a withholding tax on technical service fees, something that neither the UN nor OECD model currently provides for. In both countries, there has been a trend towards lower withholding tax rates in the most recent treaties.

2.2.1. Some past explanation for tax treaty renegotiation

Tax treaties reflect the political, legal and economic environments of the time at which they were

concluded. This includes colonial relations, the fashion for 'tax sparing credits', and the era before recent developments in tax information exchange. All countries now need to re-examine their treaties in the light of current political, economic and legal realities.

2.2.2. Colonial legacy

When African countries became independent, they could choose whether or not to inherit the agreements put in place by their colonial parents. Some, such as Uganda and Tanzania, preferred to let the colonial legacy lapse without replacing it, apparently prioritising tax revenue over investor friendliness. Others, such as Kenya and Nigeria, kept their old agreements in place until they were ready to renegotiate in the 1970s, perhaps fearing a negative effect on investment if they cancelled. In some others, such as Zambia and (until very recently) Malawi, a few colonial-era agreements stayed in force where renegotiations were not completed. In Zambia's case, its agreements with France and Switzerland are actually ancient United Kingdom treaties, based on negotiations by the UK in 1950 and 1954, and extended to its colonies. These treaties have long been superseded in the UK by new treaties, but as the updates were signed after Zambia's independence, the old agreements remain in force as far as Zambia is concerned.

Hearson (2014b) argues that the Zambia-Switzerland treaty is perhaps of more concern, given the considerable volume of trade between the countries, the use of Switzerland in tax avoidance and evasion schemes, and the presence of Swiss investors, especially Glencore. The treaty prevents Zambia from levying any withholding tax on interest, royalty and management fee payments to Switzerland, and it has an out-of-date exchange of information provision that is likely to be ineffective. Zambia has tried to renegotiate it in the past, officials said, but requests have been rebuffed and the treaty is now slated for termination (Hearson, 2014b).

2.2.3. Cancellations and renegotiations: what was achieved and why?

There are a number of examples of developing countries that have cancelled or sought to renegotiate particular tax treaties. Cancellations may improve the prospects for renegotiation, or they may follow from a failure to renegotiate. In any event, the results of renegotiations have been mixed for developing countries. Cancellations in recent years have tended to relate to concerns

about treaty shopping. But in the 1970s, Kenya and Nigeria – for example – terminated the tax treaties they had inherited from colonial times, as part of a strategy to negotiate better terms.

Most renegotiations do not begin or end with a unilateral treaty cancellation; instead a new treaty supersedes the old one, or a protocol amending the previous treaty is agreed (Hearson, 2014b). A number of recent renegotiations provide better and worse examples from which developing countries can draw lessons. The Rwanda-Mauritius (2013) renegotiation produced a significant improvement in terms for Rwanda. With withholding taxes set at zero, it was perhaps the case that "the only way was up"! But Rwanda's new terms were among the best that any sub-Saharan country had obtained in a treaty with Mauritius, with higher withholding taxes and low permanent establishment thresholds. The South Africa-Mauritius (2013) is perhaps the best example of a renegotiation that took place without a prior cancellation. South Africa achieved major gains from its recent renegotiation with Mauritius. This included the right to tax capital gains from the sale of South African assets by Mauritian-owned 'property rich' companies, and to impose withholding taxes on royalties and interest, as well as a higher tax on dividends. The treaty also makes it harder for South African-managed companies to qualify as tax resident in Mauritius.

2.2.4. Developments in African organisations

The EAC, COMESA and SADC have all formulated model treaties for negotiations with each other or with third countries. Although each model has one or two more ambitious provisions than the UN model, they are all on average less source-based than the UN model. An ambitious opening position for an African country should therefore pick the best available provisions from existing treaties, African models and the UN model (Hearson, 2014b).

2.3. DTTs and transfer pricing

Transfer pricing refers to the price of transactions occurring between related companies, in particular companies within the same multinational group (Hearson, 2014a). Governments set rules to determine how transfer pricing should be undertaken for tax purposes, predominantly based on the arm's length principle. Much of the debate on tax-motivated IFFs revolves around the formulation and enforcement of transfer pricing regulations, their shortcomings, and the way in which they are abused for tax evasion and avoidance purposes (Hearson, 2014a).

Transfer pricing in an economy is very important to corporate policy makers, economic policy makers, tax authorities, and regulatory authorities. Transfer pricing manipulation reduces the total quantum of an organization's tax liability by shifting accounting profits from high tax to low tax jurisdictions. It changes the relative tax burden of MNCs in different countries of their operations and reduces worldwide tax payments of the firm (Gupta, 2012). Some tax treaty networks have the effect of creating a web of low and high tax jurisdictions which increases the appetite of multinational companies to want to manipulate transfer prices so that a huge quantum of their profits are shifted to low tax jurisdictions through the abuse of tax treaty provisions (SEATINI-Uganda; ActionAid International Uganda, 2014).

In addition, most tax administrations in Africa do not have coordinated tax rules such as customs valuation rules, value added tax rules and transfer pricing rules. This often results in different transactions values being used for customs duty, value added tax and income tax purposes and hence encouraging transfer pricing manipulation by MNCs. Transfer pricing manipulation in the form of trade mispricing ultimately lead to tax base erosion and tax revenue losses in many developing countries. Transfer pricing manipulation and DTTs loopholes are detrimental to domestic revenue mobilisation. The international commercial transactions component of IFFs in Africa which includes tax evasion, trade misinvoicing, abusive transfer pricing involving mostly MNCs accounts for 65% of IFFs (Africa Union (AU) / Economic Commission for Africa (ECA), 2015).

2.4. DTTs, DRM and BEPS

Tax is the source of the much needed revenue for financing public expenditure but tax revenue mobilisation faces challenges posed by MNCs through tax dodging (SEATINI-Uganda; ActionAid International Uganda, 2014). Tax losses are also being attributed to the network of double taxation treaties which are being used as a mechanism by companies to avoid paying taxes and also as a channel for illicit financial flows (IFFs) from Africa (SEATINI-Uganda; ActionAid International Uganda, 2014). The High Level Panel (HLP) Report on illicit financial flows from Africa (2015) reports that over $50 billion is lost annually in Africa through illicit financial flows. (Africa Union (AU) / Economic Commission for Africa (ECA), 2015).

The OECD – and also the G20 and the G8 – have acknowledged that base erosion is a serious problem that threatens the integrity of the corporate income tax (CIT), undermines the capacity of governments, negatively impacts on individual taxpayers and some businesses (OECD, 2013). The OECD BEPS Action Plan was instituted to bring about fundamental changes in international taxation, in line with effectively preventing double non-taxation of income, as well as minimising the role of no or low taxation jurisdictions which facilitate MNCs' practices to artificially segregate taxable income from the activities that generate it (Mosioma, et al., 2014). In line with this, there is also an increasing call for the international tax system to accord a fair share of the tax base to the territory where income was earned. Double taxation treaties (DTTs)[10], in actual fact have been working as a mechanism that enables base erosion and profit shifting in Africa.

2.5. DTTs, Low tax jurisdictions, transfer pricing and BEPS

Tax researchers often use the terms low tax jurisdictions, tax havens, offshore jurisdictions and secrecy jurisdictions interchangeably. The commonality in these terms is the issue of the provision of low or zero taxes to income invested in these jurisdictions as well as the offering of high level of secrecy. Secrecy jurisdictions are those that intentionally or unintentionally enable individuals or corporations to escape regulation elsewhere, by concealing either fully or partially, relevant information (Hearson, 2014a). The secrecy provisions offered by some jurisdictions can help individuals or corporations evade or avoid taxes. It can also help criminals and corrupt officials to hide their ill-gotten money from authorities elsewhere.

African DTTs often offer opportunities for investors to opt for round tripping of their investments via low tax jurisdictions. Domestic investors in some African countries sometimes obtain benefits

[10] DTAs can also enable IFFs. DTAs have a positive role in a number of respects. Since double taxation can stifle economic activity and deter investment, and agreements between countries to avoid such consequences are important and necessary policy interventions. However, the benefits of DTAs depend on their provisions. A well negotiated and balanced DTA will not deter FDI, and it should not contain provisions that encourage IFFs. Troublesome examples of such provisions include those that seek to remove or lower withholding taxes on management fees and remove limitations on intracompany loans. The content of DTAs reflect the relative bargaining strength of the partners, and given their weak capacities African countries start out at a disadvantage in negotiating such agreements. The OECD model treaty does not allow for withholding taxes on royalties and management fees, while the version produced by the United Nations Tax Committee gives stronger rights to taxation at source. The case of DTAs underlines the need for Africa to build capacity to negotiate economic contracts effectively (Africa Union (AU) / Economic Commission for Africa (ECA), 2015, pp. 41,42). This study lends support to the model treaty proposed by ATAF.

intended for overseas investors by channeling their investment through an offshore or low tax jurisdiction (round tripping). A widely cited example is Indian investors' use of Mauritius to avoid capital gains tax: the terms of the India-Mauritius treaty prevent India from taxing capital gains by a resident of Mauritius, even if this is a shell company set up by an Indian national. In addition to this some DTTs open up gaps for transfer pricing abuse which results in allocation of greater chunks of profits to low tax jurisdictions to avoid paying high taxes in high tax jurisdictions. The end result of all these practices is the erosion of the tax base caused by profit shifting.

2.6. Possible ways of tackling BEPS

The OECD BEPS action plan provides various measures aimed at combating base erosion and profit shifting. In addition, the Tax Justice Network-Africa (TJN-A) and its partners (CSOs) across Africa have been working to expose mechanisms and practices that lead to base erosion and profit shifting. The HLP report on illicit financial flows from Africa also provides recommendations in the form of policy measures aimed at combating the consequences of BEPS at national, regional, continental and international level. All the measures are meant to stop the MNCs 'shifty business' as well as creating a level playing field in sharing the international tax cake. Based on the measures suggested by the OECD BEPS action plan, Civil Society Organisations (CSOs) and the HLP Report recommendations and other researches, this paper suggests the following measures of closing tax loopholes which lead to base erosion and profit shifting:

- Coordination of tax rules. This entails synchronising customs valuation, transfer pricing and value added tax (VAT) rules in order to use similar values on trade transactions for customs duty, income tax and value added tax purposes.;
- Each country should be able to tax a fair share of the income earned by MNCs operating in their territory with special regard accorded to safeguarding the tax bases of developing and capital importing countries. This requires the setting of new tax rules to make MNCs pay their taxes where their economic activities are actually located, rather than in jurisdictions where MNCs' presence is explained for mere tax-avoidance purposes.;
- There is need to explore the merits, risks and alternatives of the current international tax system in line with MNCs transactions including the possibility of using the unitary approach of taxing MNCs. This is viewed as one of the strong alternatives to the arm's length principle;

- Making it a statutory requirement for MNCs to submit a worldwide combined report to the tax authorities of each country in which they operate, including consolidated accounts for the firm as a whole, as well as a public country-by-country breakdown of their employees, physical assets, sales, profits and taxes due and paid. This is a way of enforcing multilateral adoption and implementation of measures to end financial and corporate secrecy;
- The need for a United Nations (UN) intergovernmental tax body to lead the process to discuss the reform of the international tax system to ensure that developing countries can participate on an equal footing with their developed countries counterparts. In the current BEPS action plan arrangement only OECD members and the non OECD G20 countries (Argentina, Brazil, China, India, Indonesia, Russia, Saudi Arabia and South Africa) participate on an equal footing as full members of the OECD working parties on BEPS. However, it cannot be assumed that the interests of countries such as Brazil, India, South Africa or Indonesia, are synonymous with those of smaller non-G20 countries;
- There is need for African countries to move away from damaging tax competition among themselves and foster regional cooperation in tax matters. Tax competition usually evident in DTTs is a common practice across Africa. Tax competition however usually result in countries offering numerous unnecessary tax incentives which erode tax bases and often lead to the race to the bottom;
- African countries need to fully participate in the new global standard of multilateral and automatic exchange of tax information, as well as transparency of beneficial ownership;
- Creating or adopting more effective anti-avoidance measures or provisions, for example by modifying tax rules to more closely align the allocation of income with the economic activity that generates that income, and the incisive defining of and attribution of profits to a Permanent Establishment (PE), attribution of income to intangibles, CFC rules, minimum tax rules, and limitations on deductions[11] for payments made to low- and zero-tax jurisdictions;

[11] No role for Switzerland: The Swiss role refers to the practice of paying management fees to subsidiaries located in Switzerland, thus shifting profits out of the country and reducing taxes liability,. In this case, the suggested statute would counter base erosion by disallowing the deduction of fees paid to the Swiss registered company. The proposed deduction limitation would be triggered by the lower tax rate enjoyed by the subsidiary company, thus stopping profits from being moved (Mosioma, et al., 2014). .

- African countries have to move to reforming rules on the treatment of intra-group financial transactions, such as those related to the deductibility of payments (for example, limiting deductibility of interest and other payments to related entities) and the application of withholding taxes (for example withholding taxes on payments of royalties, interest, and service fees). Most African DTT provisions provide for a generous deductibility of payments and payment of zero or low withholding taxes which results in tax base erosion;
- Improving transfer pricing documentation requirements and formulation of transfer pricing guidance at national, regional and continental levels;
- Most African countries' DTTs need to be renegotiated in a way meant to balance the allocation of taxing rights between residence and source countries;
- Some issues may be better tackled by joint approaches from African countries and other developing countries, for example to persuade the Netherlands to revise its tax treaties and internal law to end its use as a conduit for untaxed profits. Hence, it is important for African countries, along with other developing countries also to make their own evaluations of measures that would be suitable for them to adopt, either alone or preferably jointly without waiting for international solutions.

3.0. **Research design and methodology**

The paper uses some selected country DTA case studies for Uganda, Zambia and Kenya with countries such as Mauritius India, Netherlands and the United Kingdom and brings out an understanding of the nature of the treaty partners and highlights the general risks and shortcomings. Reference is also made to the case of South Africa. An overall reference to African countries' network of DTAs is also done. The study also carries out a comparative analysis of DTA provisions in the OECD and UN tax models and also made reference to developments in African regional economic blocs. Out of the analysis of the tax models the issue of the allocation of taxing rights between the source and residence country and the impact it has on developing countries is critically discussed as well as three key elements that are likely to broaden or restrict African countries' ability to raise tax revenue. These elements are the definition of permanent establishment (PE), withholding tax rates and the taxation of capital gains.

4.0. Findings

The study found out that African countries are experiencing significant tax losses from tax treaty abuse, transfer pricing manipulation and profit shifting leading to tax base erosion. The study also found out that the UN tax model is more progressive than the OECD model in tax treaty issues.

The paper further establishes that policymakers in African countries in 2014 inherited tax treaty networks that are based on past priorities stretching back several decades. These treaties are not based on their present day needs or informed by current economic priorities or circumstances. This leaves African countries vulnerable to unnecessary revenue loss, not only through tax treaty shopping, but also because past governments negotiated away taxing rights for which they no longer get good returns. A wave of African countries' deciding to renegotiate tax treaties was also observed.

5.0. Conclusions

There is an interconnect between tax treaties, transfer pricing manipulation and BEPS. Most tax treaties signed by African countries drive base erosion and profit shifting and do not allow the fair sharing of the international tax base. African countries face a challenge in ensuring that the different economic measures chosen to support economic development through mobilisation of revenue, promotion of trade and investment are efficient in promoting investment whilst also preventing both tax avoidance and double non-taxation among other issues.

There is no one-size-fits-all approach to fixing these problems. Some treaties may resolve real double taxation problems, or have clinched borderline investments. But we can be sure that all treaties in force in African countries, whether they are five or fifty years old, need an evidence-based review. A clear policy framework needs to guide renegotiations, cancellations and any new future treaties. It should take into account:

- Whether there is a real need, based on the two countries' tax systems, to protect investors from double taxation;
- The actual or expected effect of a treaty on investment flows;
- The revenue costs from the treaty, including from tax treaty shopping; and
- Any precedent set for future negotiations.

6.0. Policy Recommendations

The paper proposes the following recommendations to African governments:

- Increasing participation in the OECD BEPs process in order to make an influence in the process of the reforms being made on the international tax platform which will be beneficial to developing countries;
- Strengthening and coordinating transfer pricing rules, customs valuation rules and value added tax rules in order to curb transfer pricing manipulation and associated tax loopholes;
- Making improvements or clarifications to transfer pricing rules to address specific areas where the current rules produce undesirable results from a policy perspective;
- On transparency: the development of model provisions for disclosure of `aggressive tax planning' strategies and improving transfer pricing documentation requirements and strengthening the 'mutual agreement procedure' to help deal with conflicts between states;
- Reviewing all existing tax treaties and domestic legislation, to identify areas where they are most vulnerable to revenue loss. This should include permanent establishment definitions, protection from treaty shopping, and withholding and capital gains taxes;
- Formulating ambitious national models by applying a "best available" approach to existing models (EAC, COMESA, and UN), current treaties, and domestic legislation, none of which are currently adequate and identify red lines for negotiations from within these models and cancel these high-impact treaties if the red lines cannot be obtained;
- Based on investment and remittance data, request renegotiations of treaties that have the greatest actual (or potential in terms of capital gains) cost. These renegotiations should be conducted on the basis of an improved distribution of taxing rights, not a "balanced "negotiation;
- Incorporate an assessment of tax foregone due to tax treaties into an annual breakdown of tax expenditures;
- Ensuring that all tax treaties are subject to parliamentary approval as part of the ratification process;
- Ensuring that future updates to provisions of the UN and OECD model treaties, or to their commentaries and reservations or observations, reflect the positions set out in their national models; and
- Strengthening the African model treaties (EAC, COMESA, SADC) so that they act as opposite poles to the OECD model, rather that compromises between the UN and OECD models.

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