Tax for financing development

As developing economies grow, tax receipts should become the primary source of development finance. Why do tax receipts in Africa remain so low in relation to GDP?

By **Logan Wort**, Executive Secretary, African Tax Administration Forum

Improved domestic resource mobilisation (DRM) – investing income from domestic resources to benefit the country's society and economy – is key to achieving the Sustainable Development Goals in Africa. Although most African countries have improved their tax revenue to GDP ratios from 2000 to 2016, these are still much lower than in most other parts of the world. Indeed, much work needs to be done to improve DRM in Africa.

African countries face three major challenges in their bid to build more efficient tax regimes and improve DRM:

- weak and deficient legislation and tax treaties;
- difficulties tax administrations face in accessing information;
- tax administrations' limited technical and audit capacity.

The pace of change in the global tax agenda is exacerbating these challenges, while at the same time offering opportunities to bring in new rules to help DRM. One of the main international collaborative efforts to rewrite the rules on taxation regimes is the Organisation for Economic Co-operation and Development (OECD) and G20's base erosion and profit shifting (BEPS) project.

The project is now in its implementation phase: the OECD has launched an 'inclusive framework' to bring together over 100 countries and jurisdictions to collaborate on implementing the BEPS package. And, last November, various jurisdictions concluded negotiations on a multilateral instrument for enforcing taxation. This will allow them to transpose results from the BEPS project into more than 2,000 tax treaties worldwide.

However, the African Tax Administration Forum (ATAF) and many of its members are concerned that the gap is widening between the pace of change in global standard setting and the capacity of many African countries to address the implementation challenges.

Successful implementation of new tax standards will require political support to bring about changes to domestic legislation, revise tax treaties and improve exchange-of-information networks, both between government agencies within each country and with other tax jurisdictions.

Governments will also need to commit the necessary resources to increase the capacity of their tax administrations to address illicit financial flows through tax evasion and tax avoidance.

Addressing the challenges

ATAF is providing a wide range of technical assistance to our members that aims to address both the policy and operational challenges. We have been providing on-the-ground technical assistance to a number of our members to help them with transfer pricing and other cross-border taxation risks. This help includes:

- reviewing their domestic legislation and rules and helping them draft revised legislation aligned to international standards, but adapted to meet the specific challenges faced in Africa – such as undervalued exported commodities;
- reviewing the tax administration's risk assessment processes to ensure that resources focus on the highest risks to the tax base;
- building skills for auditing, and providing advice on audits (on an anonymised basis to protect taxpayer confidentiality);
- advising countries on the BEPS project tools: the inclusive framework and the multilateral instrument.

There is considerable global focus at the present time on international tax issues. However, ATAF is mindful that for some African countries, these may not be the most significant risk to the tax base. Instead, these countries would benefit from technical assistance on domestic tax issues.

ATAF is now embarking on a two to three-year project in Africa to reduce the fiscal losses to African governments caused by mispricing of traded items. This project will identify the key issues relating to trade mispricing in Africa, to help countries address these issues in a targeted and focused manner. The project will enable ATAF to assist its member countries technically to identify, analyse and better understand their country-specific challenges and to address them sustainably.

We are also starting a pilot programme in one of our member countries to develop a more effective fiscal regime for the extractive industries. We will then look to roll this technical assistance out to other member countries, using learning from the pilot.

We use the experience we gain from these programmes to develop products for our members. These products are underpinned by a global standard but adapted to meet the specific challenges faced by our members. Products include:

- a suggested approach to drafting transfer pricing legislation – this is based on the 'arm's length principle' but includes a number of legislative options to address specific African challenges;
- an ATAF model agreement on the avoidance of double taxation – this aligns the OECD and UN model agreements to suit the specific needs of African countries and provides new commentary for provisions not dealt with by the OECD/UN.

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▲ Women near Kolwezi, DRC, wait to receive mine waste from which they make a meagre living by separating out the cobalt. On five mining deals between 2010 and 2012, the DRC government lost out on tax receipts of $1.3 billion through mispriced assets being sold via offshore-registered companies

We have also developed other products to help member tax administrations address certain operational challenges. These include:

- a transfer pricing risk assessment tool to help members identify high-risk transfer pricing transactions – this has been piloted by the Federal Inland Revenue Service in Nigeria and is now being rolled out to other member countries;
- an ATAF agreement on mutual assistance in tax matters – this is a powerful multilateral instrument that allows for the exchange of information, joint audits and investigations, and mutual administrative assistance among African countries.

We also take learnings from these country programmes to feed back and influence the global standard-setting process in Paris, where ATAF has a seat at the OECD Committee on Fiscal Affairs (the tax decision-making body) and the OECD working parties (the technical drafting bodies).

We do this work through our cross-border taxation technical committee. This has already had a significant impact on the outcomes of the OECD/G20 project in 2015, including:

- the recommended approach to interest deductibility rules;
- revised transfer pricing guidelines relating to pricing cross-border commodity transactions;
- revised transfer pricing guidelines relating to intra-group services;
- revision to Article 5 of the OECD Model Tax Convention (this relates to the issue of 'permanent establishments' in tax jurisdictions).

A significant impact

The technical assistance programmes we are delivering on transfer pricing and other international tax issues are already achieving significant results:

- some countries have enacted new legislation that is aligned to international best practice but with additional provisions to meet the specific challenges faced by African countries – for example, simplified provisions to cap excessive royalty payments to related parties;
- improved risk assessment processes are ensuring that limited specialised audit resources in African tax administrations are only used on the highest-risk issues;
- increased revenue collection from transfer pricing audits – in the past 18 months this has risen by well over $100 million across the countries in which we work.

The successes described above have not been achieved in all the countries receiving such technical assistance, however.

Often progress is limited, due to a lack of political support. For example, in one country, the tax administration drafted new transfer pricing rules in 2013, but these have still not been enacted.

There is also a need for closer working between the different government departments responsible for tax policy. With the increased pace of the global tax agenda, this need for closer working will only become greater.

We need greater advocacy work in Africa to ensure that ministers and parliaments are fully aware of the need to create more effective international taxation regimes. ATAF has built strong relationships with its member tax administrations and with some ministries of finance, but more needs to be done. We are therefore working closely with a number of partners on advocacy work. This includes the High-Level Panel on Illicit Financial Flows, where ATAF will take the lead role with regard to tax. ●