Multifaceted challenges of digital taxation in Africa

- Digitalisation has prompted the evolution of innovative business models and created new forms of value creation. In the mobile telecommunications industry, this has resulted in the ubiquity of over-the-top (OTT) and other digital apps and services such as social networking platforms and fintech services. To supplement meagre tax bases, several African governments have imposed regressive excise taxes on these services, which impact end-users. With the poor most negatively affected, this undermines developing countries’ universal access strategies and impacts a wide range of social and economic development efforts.

- On the global stage, tax avoidance by dominant international firms have prompted ongoing negotiations for a reset of the international tax system, including digital taxes. As part of the reset, the Organisation for Economic Co-operation and Development (OECD) has proposed new global tax rules that would enable taxation of firms (including technology platforms) in jurisdictions where they generate revenues, regardless of whether they have a physical presence in the country.

- Despite the shortcomings of the OECD’s proposed tax system, for those African countries that are participating in the BEPS inclusive framework (IF), the reform efforts may provide the necessary platform to elevate the discourse on the disproportional impacts of corporate tax avoidance in Africa and provide a more sustainable tax base for capital investments in critical infrastructure and social investment and protection, particularly in the context of COVID-19.

Introduction

In the midst of the COVID-19 pandemic, dominant multi-national technology corporations such as Facebook, Amazon, Apple, Netflix and Alphabet⁴ (FAANG) have experienced massive revenue increases due to social distancing measures, new work-from-home realities and demand for home entertainment (Murphy et al, 2020). Due to tax system mismatches between countries—FAANG, whose value is concentrated in services trade and intangibles, are amongst other multi-national enterprises (MNEs) exploiting Base Erosion and Profit Shifting (BEPS) gaps to avoid paying corporate income tax (CIT) revenue in all the jurisdictions in which they operate (OECD, 2019).

Some countries have taken steps ahead of the finalisation of the BEPS proposed measures in taxing their elusive digital economy firms over and above value added taxes (VAT) to

---

⁴ Formerly known as Google
mobilise state revenues. In Africa, countries such as Nigeria, Kenya, Zimbabwe and Tunisia have implemented or are in the process of implementing digital service taxes (DST). DSTs are aimed at collecting revenue from commercial activity and are distinct from the excise or ‘sin’ taxes on social media and mobile money users that have been counterproductive both in raising revenues, as they inhibit use, which further undermines universal access objectives and violates associated human rights.

The problem with regressive mobile taxes

One of the barriers that inhibit Internet connectivity and limit use is the high cost of Internet enabled mobile devices and data (Gillwald & Mothobi, 2019). These high costs are exacerbated in a number of African countries such as Uganda, Tanzania, Lesotho, Zambia, and Cameroon, to name a few—where governments have laws that result in high custom duties on mobile devices and impose excise taxes on over the top (OTT) services and/or other digital mediums such as mobile money (GSMA, 2017; GSMA, 2020).

Excise taxes and custom duties are usually confined to goods and services that are price-inelastic and are considered ‘luxury goods’ and/or have negative externalities, such as alcohol and tobacco products. They are therefore often referred to as ‘sin taxes’. Given the influence of mobile devices and social media on Internet connectivity, as well as how some mobile services have spurred financial inclusion, OTT services, mobile devices and mobile money, clearly are ill-suited for excise and custom duties (Rukundo, 2020; McKinsey, 2013; IMF, 2015). The proliferation of excise taxes in the form of social media and mobile app end-user taxes on the continent, highlights poor tax administrative capability (Matheson & Petit, 2017).

In many African countries, political motives and limited capacity undermine the development of legislation and policies designed under sound tax principles (Gupta et al., 2020). For example, there is evidence that these taxes actually lowered domestic tax revenue and reduced Internet connectivity (Stork et al., 2020). Camouflaged by “economic arguments” of increasing government revenue, sin taxes also have implications on the right to freedom of expression and access to information, which are increasingly best exercised online. In addition, since mobile money is disproportionately used by marginalised groups (informal sector, women, youth, etc), mobile money taxes also have implications for the attainment of financial inclusion and wider socio-economic development goals (GSMA, 2020).

Lastly, often these taxes are justified by a misguided understanding of the role of OTTs in the Internet value chain. This not only impacts connectivity and affordability of mobile services, especially for those who already face connectivity barriers, but it also has negative impacts on all segments of the Internet value chain, such as information and communications technology (ICT) infrastructure investment decisions, (GSMA, 2017; Stork et al., 2020).
The global (digital) tax system reset—is it really inclusive?

The Organisation for Economic Co-operation and Development (OECD) and the Group of Twenty (G20) have co-ordinated an ambitious plan to overhaul the international tax system, now referred to as “BEPS 2.0”. The plan consists of two pillars, which are aimed at: (i) Establishing new profit allocation and nexus rules, and (ii) Ensuring that all multinational enterprises pay a global minimum tax (Global anti-Base Erosion) (OECD, 2019). Through the BEPS Inclusive Framework (IF), the process allows non-OECD members to participate and commit to completing 15 Action plans to achieve the objectives of both pillars.

There are growing concerns that despite the rhetoric of inclusivity and support for developing countries, BEPS 2.0 does not allow all countries to participate on equal footing, since the transfer pricing rules and some of the action plans do not reflect the multiple tax policy and administration deficiencies in developing countries, and the proposals do not adequately address underlying global issues surrounding MNE corporate tax evasion (Stiglitz, 2019; Brugger & Engebretsen, 2020; Hearson, 2020). In addition, there are allegations that some of the 22 African countries that are BEPS IF Members, were coerced into membership from fear of blacklisting and trade retaliation threats on unilateral digital taxes (Colin, 2020; Ernst & Young, 2020).

There are also arguments that negotiations regarding equitable global tax rules should be made by the United Nations (UN) rather than OECD, where all countries are members and can participate on a truly equal footing—a UN convention on tax can hold countries to legally binding, equitable standards on corporate taxation, financial transparency and tax justice (Ryding, 2020; Cobham et al., 2020).

What’s at stake for African countries?

The African Development Bank’s (AfDB) projections, reveal that the continent will need infrastructure investments of up to USD 130-170 billion per year until 2025 to close Africa’s infrastructure gap (2019). Taxes and other fiscal determinants are key investment factors that influence the attractiveness of a location for international investors (UNCTAD, 2015).

For African IF members, subscribing to the OECD BEPS IF system may provide assurance for investors, which could potentially encourage domestic and foreign infrastructure investments and alleviate supply-side Internet connectivity constraints such as infrastructure—including electricity, physical communication and foundational digital systems, such as identification and payment systems, which also affect availability, accessibility and affordability of the Internet. However, as currently proposed, the OECD

---

2 Ongoing negotiations currently has 137 countries agreeing to implement 15 Actions.

3 Under target 17.1 the UN has emphasised a renewed initiative to enhance domestic resource mobilisation (DRM), through international support to developing countries to improve, in particular, domestic tax collection.
BEPS IF creates a new set of complex rules, which are incompatible with tax challenges in many African countries (ATAF, 2020a).

In the current economic landscape, domestic resource mobilisation (DRM)\(^4\) has become the best finance strategy to counter the direct public health, social and economic impacts of the coronavirus pandemic over the long term (ATAF, 2020b). However, governance challenges in Africa, such as political interventions, pervasive corruption, weaknesses in tax policy regimes, inadequate legal systems, underdeveloped financial systems and institutional weaknesses in National Revenue Authorities (NRAs) undermine social and economic potential, as they create challenges for effectively mobilizing domestic and international resources (Gupta et al, 2020).

The stakes are high for African governments—How do they attract foreign direct investment (FDI) whilst countering corporate tax avoidance? How can they ensure the necessary capacity to implement tax systems efficiently and ethically without negative externalities? Will the OECD BEPS package really expand tax bases and prevent corporate tax revenue erosion? Will the complex package worsen uneven international tax system dynamics or will it be a true equalizer?

**Recommendations**

The COVID-19 pandemic has revealed a pressing need to address fair and effective taxation that can finance the fulfilment of economic and social rights of citizens. To address tax challenges that arise from digitalisation, African governments should:

**Ensure digital taxes do not impede digital economy growth.** Digital platforms have lowered costs and allowed greater access to ICT services for lower income users. As policymakers continue to evaluate options to tax digital businesses it will be necessary to avoid creating distortive tax policies that lack economic rationale and create negative externalities at different parts of the Internet value chain; ultimately counteracting fiscal or public policy objectives of meaningful, affordable access and human rights obligations to citizens and limit innovation and productivity efforts.

**Understand how evolving technologies have created new business models and value creation.** Policymakers should have a fundamental understanding of how evolving technologies have created new business models and transformed value creation. The digital economy cannot be easily separated from the rest of the economy, thus tax policies designed to target a single sector or activity are likely to be unfair and have complex negative consequences and fail to leverage the role of the ICT sector as an economic multiplier for the entire economy. Excise taxes on OTT services and mobile money should be phased out as they lack merit and constitute a form of double taxation since VAT already applies to telecommunications data services.

\(^4\) DRM is the process through which low-income and lower middle-income countries raise and spend their own funds to provide for their people. It is an important way to increase the level of predictable financial resources that can be directed to the financing of national development policies and projects.
Conduct economic tax impact assessments prior to tax implementation. Understanding the potential impacts and unintended consequences that an intervention may have through detailed assessment of implications and creating rigorous economic rationale for digital taxes can facilitate better tax policy design, prevent adverse effects on revenue generation and mitigate the digital divide, especially for marginalised groups (women, youth, the informal sector, etc.) who already face higher barriers to Internet access. Also, including public consultation can prevent the implementation of poorly structured taxes that penalise the poor, lower connectivity and have a negative impact on economic growth.

Elevate current international considerations. Participating in multilateral discussions on international tax and trade reform, such as the OECD BEPS IF and the World Trade Organisation’s E-Moratorium is crucial for African countries to ensure their challenges are addressed in the global tax reset and new rules on cross-border digital flows. While participation is important, African states must bear in mind that their challenges are different from those of developed countries and therefore their final solutions will have to be fit for purpose and unique to the realities of their local economies.

Update NRAs and other relevant government agencies to operate in a digital economy. The resource constraints of many of Africa’s revenue administration bodies should be considered in the development of tax reform proposals. Significant funds should be allocated to digital administrative systems and training of staff. In addition, data confidentiality and protection will need to be in place for well-established financial reporting systems compiled from private databases.

Strengthen regional collaboration. For African states, collective action through a unified digital tax regime will more likely provide better compliance since individual African countries are relatively insignificant markets for digital MNEs and African states that are members of the OECD BEPS IF package are basically rule-takers in the current global tax landscape. In addition, a coordinated tax regime will ensure better alignment with regional coordination efforts under the African Continental Free Trade Agreement (AfCFTA).

References


---

Read more RIA policy briefs here.

Authors
Shamira Ahmed: sahmed@researchictafrica.net
Alison Gillwald: agilwald@researchictafrica.net

Enquiries
Email: info@researchictafrica.net
Phone: +27 214476332
Website: www.researchictafrica.net
409 The Studios, Old Castle Brewery, Beach Road, Woodstock, Cape Town