

Unilateral Digital Services Tax in Africa; Legislative Challenges and Opportunities

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As the Base Erosion and Profit Shifting (BEPS) Project attains a significant milestone with 130 Members of the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework agreeing on international tax rules that address digitalization of the economy (Pillar 2), and the UN globally approving its tax treaty on Article 12(B) on automated digital services, a handful of African countries have joined their international counterparts in deviating from the global approach by developing and imposing unilateral digital services tax (DST) policy and legislation. This article examines the rationale of short-term measures of a unilateral DST, particularly in the African context post the COVID-19 pandemic and critically examines legislative measures imposed by a number of African countries. The article then contrasts general and specific challenges (applicable to African countries) in imposing a unilateral DST with opportunities that digital taxation presents for the continent, particularly in developing policy and legislation, and in implementation by tax administrations.

Keywords: DST, Africa, digital economy, tax, ATAF, OECD/G20 Inclusive Framework, BEPS, Pillar II, permanent establishment, allocation rules.

I INTRODUCTION

Technology multinational enterprises (MNEs) have expanded their physical and digital footprint and services to Africa. The companies have established regional hubs in strategic states within the continent, actively increasing their market-share and usage of services and products.¹ The MNEs undertake global digital sales and services online in business-to-business (B2B) and business-to-consumer (B2C) markets. These activities are developed from highly protected and patented algorithms that offer technically complex, novel, and dynamic global solutions and services. This has resulted in record-breaking valuations of companies and soaring profits with seven out of the top ten largest companies in the world when considering

market capitalization as companies being technology and data orientated MNEs.² The MNEs have access to vast financial and technical resources that include tax planning experts, resulting in complex business operations globally. African tax administrations have been reported to be the antithesis of the above; under-resourced³ and slow to adapt to the rapid changes to international tax landscape.⁴

The COVID-19 pandemic has accelerated the use of technology in Africa. African leaders and policymakers have taken cognisance of this, placing this as the main theme at the upcoming fifty-third session of the Conference of African Ministers of Finance, Planning and Economic Development, titled; 'Africa's sustainable industrialization and diversification in the digital era in

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¹ GSMA website, <https://www.gsma.com/mobilefordevelopment/blog/618-active-tech-hubs-the-backbone-of-africas-tech-ecosystem/> (accessed 3 Feb. 2021). There are 618 active technology hubs in Africa with Google, Facebook, IBM, Microsoft, and Airbus among companies establishing the hubs.

² Statista, *The 100 Largest Companies in the World by Market Capitalization in 2020* <https://www.statista.com/statistics/263264/top-companies-in-the-world-by-market-capitalization/> (accessed 20 Jan. 2021).

³ Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries, Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries, Jul. 2016 OECD Paper, at 27. Technical assistance in taxation is one of the core functions of the IMF. African tax administrations receive both funding and technical assistance from the IMF, World Bank, and ATAF to address international tax developments. Technical skills remain in many cases weak and shallow – even in many middle income countries. The ability to undertake even basic analysis of potential tax policy options is commonly poor, with similar weaknesses in administration and legal drafting.

⁴ ATAF (2017) African Tax Outlook, Pretoria: African Tax Administration Forum; 'It is the norm in sub-Saharan Africa that the great bulk of the revenues collected by the national tax administration come from a tiny proportion of its taxpayers'. African states have not been successful in adapting and expanding their tax base with taxing of the informal and digital sector remaining one of the biggest challenges. M. S. Tareq, M. A. Berg, V. D. Lledo, M. A. Spilimbergo, M. R. Ossowski, I. Yackovlev, M. N. Funke, A. Hajdenberg & M. M. Schindler, *Fiscal Policy in Sub-Saharan Africa in Response to the Impact of the Global Crisis (No. 2009–2010)* (2009). International Monetary Fund. The Authors opined that 'the scale of automatic stabilizer in Sub-Saharan Africa countries is weak due to their lower revenue to GDP ratios, poor structure of their tax systems'.

the context of Covid-19'.⁵ The emergence of technology and digital services, affords an even greater opportunity for the expansion and growth of market share of MNEs. This raises questions and issues of regulation, taxation, and technology spillovers in various African countries. Digital taxation has been one of the areas at the forefront of global tax policy discussions, particularly under the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) initiative.

The OECD developed BEPS Action 1 to primarily identify appropriate tax rules to deal with digital businesses. The OECD released a program of work that intended to lead to a global consensus on revisions to the international tax system in order to prevent countries from imposing unilateral measures to tax the income of MNEs.⁶ The complexity and technical architecture of developing a 'consensus based solution'⁷ combined with the outbreak of COVID-19 that unsettled global momentum resulted in the OECD pushing back the anticipated deadline from the year 2020 to mid-2021 despite significant progress being made in 2020.⁸

The delay in a global approach combined with continued revenue loss from the digital economy spurred many states worldwide to develop unilateral digital services tax (DST) policies and enact legislation to address the hemorrhage and raise tax revenue. Paradoxically, EU Member States that are members of the OECD led the charge in imposing a DST and were some of the first countries to impose DST legislation in early 2020.⁹ African states have now similarly developed DST policies and agreements with two states, i.e., Kenya and Nigeria, having enacted DST (BEPS related) legislation to date.¹⁰ Africa, however, does have a history of digital related taxes and levies unrelated to BEPS structured proposals to address the digital economy. They directly burden consumers as well as counteract BEPS objectives and the

intended purpose of taxing digital MNEs. These will also be briefly examined further in this article.

A unilateral DST presents a unique challenge for Africa in the need to develop relevant robust, enforceable tax strategies and legislation to empower tax administrations to effectively tax the digital economy. Synthesizing simple solutions for complex digital transactions is difficult, however, this presents an opportunity for increased revenue for a continent that has the potential to significantly increase its tax base and add to Africa's development. Delays in reaching a solution has resulted in unilateral DST (DST) legislative measures being developed and enacted around the world.

This article shall examine African related challenges and general challenges in taxing the digital economy. These are primarily policy or legislative related issues that would have to be addressed by African countries in implementing a DST. The article then contrasts the challenges with opportunities that digital taxation presents for the continent.

2 BACKGROUND OF THE DIGITALIZED ECONOMY AND AFRICA

Taxation of the digital economy has emerged as one of the most salient and debated taxation issues of the previous and current decade worldwide following the advent of technological advancements, globalization, and the surge in profits of multi-national enterprises (MNEs). Tax planning by MNEs¹¹ has been a precursor to the DST issue particularly by taking advantage of gaps in the interaction of different tax systems to artificially reduce taxable income or shift profits to low-tax jurisdictions in which little or no economic activity is performed. Pressure from political, government, and civil-society spheres to address MNEs' tax planning¹² culminated in the OECD

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⁵ Economic Commission for Africa (2021), *53rd Session of the Economic Commission for Africa*, <https://www.uneca.org/cfm2021> (accessed 20 Jan. 2021), Africa's sustainable industrialization and diversification in the digital era in the context of Covid-19, 17 Mar. 2021 to 23 Mar. 2021.

⁶ OECD/G20 Inclusive Framework on BEPS, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy* (2019).

⁷ *Ibid.*, at 7. A multilateral taxation order regarding the digital economy is a tall feat requiring significant 'technical work that must be carried out ... political engagement and endorsement as the interests at stake for members go beyond technical issues and will have an impact on revenues and the overall balance of taxing rights'.

⁸ OECD, *OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors* (Feb. 2021), Italy on at 11. During the course of 2020, despite the COVID-19 pandemic, significant progress was made on the development of both Pillars. On 9 Oct. 2020, the G20/OECD Inclusive Framework approved a package comprising a Cover Statement, the Report on the Pillar One Blueprint and the Report on the Pillar Two Blueprint 'which reflect convergent views on a number of key policy features, principles and parameters of both Pillars, identifies remaining political and technical issues where differences of views remain to be bridged, and next steps'.

⁹ France was the first EU Member State to implement a DST, retrospectively entering into force on 1 Jan. 2019; Italy's DST legislation has been in force since 1 Jan. 2020, the United Kingdom enacted its finance bill in Mar. 2020, and Spain's DST law was enacted in Jan. 2021.

¹⁰ Kenya introduced a digital services tax through its Finance Act 2020 amending Income Tax Act and Income Tax (Digital Services Tax) Regulations, and Nigeria through the Finance Act 2020 amending the Companies Income Tax Act.

¹¹ OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2014 Deliverable 11*.

¹² BBC website, *Corporation Tax: Easy for Multinationals to Avoid?* (5 Apr. 2012), <https://www.bbc.com/news/business-17625874> (accessed 20 Jan. 2021).

In the United Kingdom, the Public Accounts Committee at the House of Commons took evidence in 2012 from Starbucks, Google, and Amazon. The evidence indicated that Starbucks had captured a 31% market share but had reported losses in fourteen out of fifteen years (and shown a modest profit in the other year) and that, in 2011, Google had paid only GBP 6 million tax on nearly GBP 400 million revenue. Public Accounts Committee, Monday 12 Nov. 2012, HC 716. The United States Senate Permanent Subcommittee on Investigations held an important hearing in 2013 that highlighted Apple's tax planning strategies. Offshore Profit Shifting and the United States Tax Code-Part 2 (Apple Inc.): Hearing before Permanent Subcommittee on Investigations of S. Comm. Homeland Sec. & Governmental Affairs, 113th Cong. (2013).

developing an Action Plan on BEPS in 2013 that identified fifteen actions to address BEPS.¹³

Global expansion of MNEs to every continent has resulted in increased value and profits, however, this has not translated to an 'equitable' payment of taxes. MNEs have been criticized for not paying their 'fair share' of rents to the foreign jurisdictions in which they operate.¹⁴ This has further come to public attention following the European Commission's 2016 tax ruling over transfer pricing arrangements on the corporate taxation of Apple (Ireland). It was found that Apple only paid an effective corporate tax rate that declined from 1% in 2003 to 0.005% in 2014 on the profits of Apple Sales International.¹⁵ The ruling was recently overturned, however, on the grounds that there is a requisite legal standard of demonstrating that there was a selective advantage for the purposes of Article 107(1) TFEU.¹⁶ Ultimately, this does not detract from the findings that a disproportionately low amount of tax was paid by Apple. The same practice occurs globally with MNEs' presence increasing with the growth and inclusion of developing countries into the technological revolution.

Africa has joined the digital economy that is led by growth in internet uses particularly on mobile devices. In 2018, Sub-Saharan Africa was the fastest growing region of unique mobile subscribers, and it was projected that the trend would continue until 2025.¹⁷ Nigeria and Ethiopia are projected to have the fastest growth rates between now and 2025 at 19% and 11%, respectively.¹⁸ Digital economies are emerging in Africa with increased B2B and B2C online retail purchases across the continent for which consumers purchase from both domestic online stores and global MNEs such as Amazon and Alibaba. With the rise in mobile subscribers and smartphone use comes the increase in mobile applications, social-media, online platforms, and online transactions in both retail and services.

Africa also has a rising population. United Nations Children's Funds (UNICEF) Generation 2030/Africa Report predicts that one of every four people will be African by 2050 and that four in ten of the world's people

will be African by the end of this century.¹⁹ Africa also has the largest concentration of young people in the world²⁰ who are potential users and drivers of digital technology. The increased presence and use of online and digital transactions and use of services coupled with the growing (and youthful) population together with the disruption of traditional physical trade and transactions in the advent of the COVID-19 pandemic will result in increased digital transactions. As online purchases, digital advertising through the internet, and social media worldwide services expand globally, such digital markets have found exponential growth in Africa. African tax laws, like most countries around the world, may not be equipped to adequately address digital services as will be examined in this article. This may directly result in untaxed revenue generated by MNEs which African economies currently critically require.

The disruptive nature of digitalization has reached Africa. Mobile operators report shrinking use of traditional voice and Short Message Service (SMS) revenue and strong growth in data revenue across the continent²¹ with mobile applications and internet services such as Whatsapp replacing them. Mobile phones and the internet are used to purchase goods that were traditionally subject to customs duties, such as films, music, software, video games, and books. The World Trade Organisation (WTO) two year moratorium on imposing customs duties on electronic transmissions that has renewed every subsequent two years prevents members [African countries] from a vital source of revenue.²² In a communication from India and South Africa to the WTO in 2020, the countries highlighted that the potential tariff revenue loss to developing countries is estimated at USD 10 billion per annum (using average bound tariffs), with Sub-Saharan African countries losing approximately USD 2.6 billion.²³ Further, three countries account for 80% of the cross-border e-commerce in the world: the United States, China, and the EU.²⁴ This emphasizes that the benefits of digital economy are immensely disproportioned, and they do not serve all people equally. More important to this article is that the west and China are the biggest revenue benefiting

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¹³ OECD, *Action Plan on Base Erosion and Profit Shifting* (2013). These actions address priority areas which inter-alia include the digital services tax (Action 1), PE status avoidance rules (Action 7), and the development of a multilateral instrument to address BEPS issues (Action 15).

¹⁴ J. Bankman, M. A. Kane & A. O. Sykes, *Collecting the Rent: The Global Battle to Capture MNE Profits*, 72(2) Tax L. Rev. 197–234 (2019).

¹⁵ European Commission Website, https://ec.europa.eu/commission/presscorner/detail/en/IP_16_2923.

¹⁶ the Treaty on the Functioning of the European Union – part three: union policies and internal actions – title vii: common rules on competition, taxation and approximation of laws – Ch. 1: Rules on competition – s. 2: Aids granted by States – Art. 107.

¹⁷ GSMA report, *The Mobile Economy Sub-Saharan Africa 2* (2019).

¹⁸ *Ibid.*

¹⁹ UNICEF Generation 2030 Report, at 10.

²⁰ UN website, <https://www.un.org/en/africa/osaa/peace/youth.shtml#:~:text=According%20to%20the%20United%20Nations%2C%20226%20million%20youth%20aged%2015,three%20quarters%20of%20Africa's%20population> (accessed 1 Feb. 2020).

²¹ C Stork, S. Esselaar & C. Chair, *OTT – Threat or Opportunity for African Telcos?* 3 (Mar. 2016), Conference Paper.

²² WTO, *The 1998 Declaration on Global Electronic Commerce*, WT/MIN(98)/DEC/2 (25 May).

²³ WTO, *Working Programme on Electronic Commerce, the E-Commerce Moratorium: Scope and Impact, Communication from India and South Africa* (10 Mar. 2020).

²⁴ UNCTAD, *Rising Product Digitisation and Losing Trade Competitiveness* (2017).

countries with Africa having significant revenue losses from the failure to tax the digital economy in Africa. A DST on digital sales and services therefore presents an opportunity for African countries to expand their tax base that has eroded significantly over the years.

The African Tax Administration Forum (ATAF) has led the charge in Africa in the efforts to address taxation of the digitalized economy. It has issued technical notes on key issues regarding digitalization and taxation,²⁵ particularly on establishing a consensus-based proposal that meets the needs of African countries.²⁶ The discussion dealt with three issues: (1) new nexus rules, (2) new profit allocation rules, and (3) a new global anti-base erosion rule. The ATAF further published a suggested approach to drafting legislation on taxing digital services that was prepared by the secretariat and ATAF's Cross-border Taxation Technical Committee. It would assist African countries in implementing a digital service tax for transactions of highly digitalized businesses. As of April 2021, only two African countries enacted DST specific legislation, specifically, Kenya through its Finance Act 2020 amending the Income Tax Act and Nigeria with the Finance Act 2020 amending the Companies Income Tax Act. Kenya's legislative approach shares many structural and substantive similarities with the ATAF approach and levies a 1.5% tax on a 'digital service' (within the ATAF's recommended 1.5%–3% range). It has also enacted income tax (digital service tax) regulations that define a 'digital service' in Regulation 3(1), similar to section 3(1) of ATAF's model legislation. However, there are diverging differences in other rules such as user-location rules which is a stand-alone regulation applicable to both residents and non-residents. Ultimately, the ATAF's model legislation provides a strong legislative base for African states to craft DST legislation that addresses the critical issues and challenges posed by the digital economy.

3 DST: CHALLENGES AND OPPORTUNITIES

3.1 The Challenges of Digital Taxation

There are two overarching sets of challenges that African countries face with regards to digital taxation. The first are those that are unique or prevailing in African

jurisdictions and tax administrations which will be briefly examined below. The second are general global taxation challenges that emerged from the OECD's BEPS efforts at developing a unified digital services approach.

3.1[a] Digital Taxation and Challenges in Africa

While there are common challenges that African tax administrations experience primarily due to factors that developing countries encounter, there are also common or prevalent challenges faced by African countries and their tax regimes and customs administrations. Not all African states, however, share the same challenges. Most of them under this section are common pre-existing concerns that apply to developing countries and their respective customs administrations and should be taken into consideration when imposing a unilateral DST.

3.1[b] Illicit Financial Flows (IFF)

IFF have been a topic of issue and a challenge that African countries have struggled with for decades following the advent of decolonialization and the formation of African states from the 1960s to the present. There are varying definitions of IFF, however, it can ultimately be defined as 'all cross-border financial transfers which contravene national or international laws'.²⁷ Incidents of IFF continue to prevail in many countries around the world, however 'the social and economic impact on developing countries is more severe given their smaller resource base and markets'.²⁸ The primary reason that this remains a particular concern and challenge in Africa is that they deprive developing countries of resources that could be used to finance much-needed public services such as education, healthcare, and the infrastructure.

African countries are also concerned that their tax bases are being eroded by IFF due to MNEs artificially shifting profits to jurisdictions where the profits are subject to minimal or no tax.²⁹ The primary reasons for continuing capital flight are illegal motives such as tax evasion and the concealment of corruption.³⁰ The ATAF recognized the intertwined nature of digital taxation and IFF in Africa. In its technical note on the Inclusive Framework

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- ²⁵ ATAF, *The Tax Challenges Arising in Africa from the Digitalisation of the Economy*, ATAF 1st Technical Note, CBT/TN/01/19 (2019a).
ATAF, *Inclusive Framework Proposals to Address the Tax Challenges Arising in Africa from the Digitalisation of the Economy*, ATAF 2nd Technical Note, CBT/TN/02/19 (2019b).
ATAF, *Inclusive Framework Proposals to Address the Tax Challenges from the Digitalisation of the Economy*, ATAF 3rd Technical Note CBT/TN/03/2019 (2019c).
ATAF, *The Changes Needed to the Global Tax Rules If Africa Is to Address the Tax Challenges Arising from the Digitalisation of the Economy*, ATAF 4th Technical Note, CBT/TN/04/19 (2019d).
- ²⁶ ATAF, 2019c, *supra* n. 25.
- ²⁷ United Nations, *Coherent Policies for Combatting Illicit Financial Flows* 3 (2016).
- ²⁸ OECD, *Illicit Financial Flows from Developing Countries: Measuring OECD Responses* 15 (2014).
- ²⁹ ATAF, 2019a, *supra* n. 25, at 2.
- ³⁰ L. Ndikumana, Capital Flight and Tax Havens: Impact on Investment and Growth in Africa, *Contribution to the European Development Network (EUDN)*, Conference on 'Finance and Development', Berlin (11–13 Dec. 2013).

proposals to address the tax challenges from the digitalization of the economy, it was stated that 'we will work to ensure that the new rules meet the needs of African countries and address all of the issues facing African countries, including ... tackling artificial profit shifting to help stem illicit financial flows in Africa'.³¹

IFF are a considerable concern in the context of a DST due to the related industries that propagate these flows, specifically the telecommunications industry. In Kenya, it has been a driver for these activities due to its very dynamic and complex nature that makes it the perfect vehicle for IFF, specifically from commercial activities in the underground economy.³² This is also exacerbated by audit and capacity related challenges that African tax administrations face in the inability to not easily verify financial reporting by industry players.³³ South Africa experiences substantial challenges with regards to IFFs that account for nearly 7.6% of the Gross Domestic Product (GDP), representing nearly twice the average for developing countries.³⁴

Tax transparency and exchange of information have a crucial role to play in helping African Governments stem IFF and increase domestic revenue mobilization. These interventions, however, are predominantly addressed through bilateral and multilateral agreements which are also part of the BEPS agenda.³⁵ The challenge with regards to developing domestic policy and unilateral legislative instruments in relation to this is that most African countries that are party to BEPS are in the early stages of implementing country-by-country reporting (CbCr) legislation and, further, are not actively transmitting and receiving information on MNEs. This therefore means that policy and unilateral digital services legislation in Africa would be developed in the absence of information on MNEs' digital transactions in countries where their principal headquarters or businesses are based. These countries have no CbCr laws that would provide insight on taxes and transactions in various countries.

DST policy and legislation will have to simultaneously address IFF as the two are intertwined. The objective is to redress the evasion of undeclared profits. Despite the high levels of capital flight and tax avoidance and a relatively elevated level of dependence on corporate income tax,

African countries will have to establish simple and effective methods of increasing their tax base through a form of a DST.

3.1[c] Information Deficiencies

The expanding digital economy poses a greater risk for the tax base of developing countries than for that of developed countries. The CIT and the Value Added Tax (VAT), which are the taxing mechanisms most threatened by the digital economy, form a much larger portion of the total tax revenues in developing countries than in developed countries.³⁶ Creating relevant and effective unilateral policies requires considerable information on the existing digital environment, services, and transactions in order to adopt appropriate policies, legislation, and administrative strategies. The first challenge, therefore, is that many African countries experience information and data collections related challenges. Information needed to ascertain the existing and potential tax base includes a number of subsystems to cover specific areas.³⁷

Good tax administration focuses on the collection of information.³⁸ This is required in order to determine the existing and potential tax base of a DST. Information is critical for tax administrations to:

- (1) assessing the potential tax base for the aggregate economy;
- (2) identifying potential taxable entities and – at least, in principle – being able to estimate the amount of the tax base for each if it proves necessary to do so;
- (3) establishing a 'risk management' function to classify potential taxpayers into relatively homogenous groups from the point of view of differences in the resources needed and the strategy that the administration must employ to collect taxes from them; and
- (4) monitoring and providing feedback on the effectiveness of strategies employed by the administration in collecting taxes from different groups of potential taxpayers.³⁹

Under BEPS and when developing unilateral DST laws, its will be critical for African states to collect and interpret domestic data to both effectively aggregate the

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³¹ ATAF, 2019c, *supra* n. 25.

³² ATAF, *Compilation on Abstracts on Tax Systems in Africa* (2019).

³³ M. Mbithi, *Effective Taxation of the Telecommunications Industry in Kenya: A Mitigating Tool Against Illicit Financial Flows*, Kenya Revenue Authority, 39.

³⁴ *Ibid.*

³⁵ Illicit Transfers and Tax Reforms in South Africa: Mapping of the Literature and Synthesis of the Evidence at 10, May 2018, Partnership for African Social and Governance Research.

³⁶ OECD BEPS Action 13 provides for country-by-country reporting which requires all large MNEs to prepare CbC reports with data on global allocation of income, profits, and taxes paid in jurisdictions in which they operate.

³⁷ S. Rukondo, *Addressing the Challenges of Taxation of the Digital Economy: Lessons for African Countries*, ICTD Working Paper 105 (Jan. 2020).

³⁸ R. M. Bird, *Improving Tax Administration in Developing Countries*, 1(1) J. Tax Administration 27.

³⁹ *Ibid.*, at 23.

Ibid., at 27.

digital base and apply appropriate risks. The collection of information on revenue generated from the local jurisdiction would also be critical in designing the DST and establishing thresholds and eligibility for taxation. It is also imperative that African countries are able to access and receive data from other tax administrations on MNE activity and revenue. This is because proposals for new nexus and profit allocation rules as well as for the new Global Anti-Base Erosion (GloBE) rule⁴⁰ would require tax administrations to have access to a range of data from other countries.

The collection of data within African countries continues to be a challenge as this requires deliberate changes in technological and strategic policies to information based administration, and considerable investments in technological recordkeeping and systems. This has been a priority for the ATAF which entered into an Memorandum Of Understanding (MOU) with the OECD in October 2012 agreeing to work together to improve tax systems in Africa. Information, empirical data, and economic analyses of the digital environment and revenue relating to it will be vital in developing relevant taxation legislation of the digital economy.

3.1[d] Technical and Financial Resources

Bird and Wilke highlighted three key ingredients as 'essential' for effective tax administration in any country: 'the political will to administer the tax system effectively, a clear strategy for achieving this goal and adequate resources for the task'.⁴¹ The latter 'ingredient' is needed to effectively tax digital entities in a jurisdiction. In order to develop a clear and effective taxation strategy regarding the digital economy, technical resources in the form of information systems and human expertise (legal and fiscal related areas) are required. This is critical for assessing the potential tax base for African economies. Identifying entities that may be subject to tax from conducting taxable activity or rendering services in a country involves designing and developing risk management strategies and legislation to adequately tax and address non-compliance.

A number of areas of improvement that African tax administrations need to undertake rely on resourcing. Under BEPS, the EOI is critical to the Action 1 agenda.

The ATAF recognizes that EOI rules require three particular resources in establishing EOI units in tax administrations.⁴² One is human resources that is dependent on the volume of exchanges and requires tax officials with varied expertise (legal and accounting with domestic taxes experience) conversant in administrative procedures. Another is possessing the financial resources to cover costs of creation and maintenance of an EOI data base, websites, collection of information, and training. Last, information technology resources for the EOI Unit should have the technical ability to register and monitor EOI cases and develop and maintain the system. There is also a growing interest from multilateral and bilateral donors to provide financial support to fund African countries' participation in the AExchange of Information (EOI) which is part of the BEPS agenda.⁴³

Taxing the digital economy will require resourcing in critical areas such as technology for digital information, and monitoring performance, electronic filing, and payments have been one such method of doing so. This would be required for registering and monitoring MNEs, receiving tax returns and information, and systematically examine transactions of local companies or persons transacting on particular digital services to establish the revenue that has been made. African tax authorities are relatively not as modernized as the rest of the world; attaining this would require resources. However, there are African tax administrations that have utilized technology in various areas to enhance compliance and enforcement, such as Kenya, Mauritius,⁴⁴ Uganda, and Zimbabwe.⁴⁵ The objective of modernization is for information management systems to process, store, and analyse enormous amounts of data related to taxpayer accounts thereby streamlining operations and making them more effective.

The number of African tax organization countries seeking to modernize their tax administration processes is steadily growing. Those practicing information and communication technology (ICT)-based tax collection increased yearly between 2012 and 2017 from eighteen to twenty-four.⁴⁶ African countries, burgeoned by the ATAF, International Monetary Fund (IMF), and World Bank resourcing and their own efforts are improving their respective fiscal policies and modernizing administrations. The above notwithstanding, a considerable amount of

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⁴⁰ OECD BEPS Pillar Two. This rule calls for the development of a co-ordinated set of rules to address ongoing risks from structures that allow MNEs to shift profit to jurisdictions where they are subject to no or very low taxation.

⁴¹ R. M. Bird & J. S. Wilke, *Designing Tax Policy: Constraints and Objectives in an Open Economy*, International Centre for Public Policy, International Center for Public Policy Working Paper, 16 (12–24 Apr. 2012).

⁴² ATAF, *A Practical Guide on Exchange of Information for Developing Countries* 34 (2013).

⁴³ Global Forum on Transparency and Exchange of Information for Tax Purposes, *Tax Transparency in Africa 2020 Africa Initiative Progress Report: 2019* 40 (2019).

⁴⁴ ATAF, *Africa Tax Outlook* 95 (2019). Mauritius' revenue authority has harnessed information technology for greater efficiency and has improved the collection of social security contributions and enforced compliance.

⁴⁵ United Nations, *Fiscal Policy for Financing Sustainable Development in Africa, Economic Report on Africa* (2019). Three countries have made electronic filing compulsory for all taxpayers; at 113.

⁴⁶ *Ibid.*, at 150.

investment would be needed to modernize African tax administrations to effectively be equipped to develop a comprehensive taxation strategy for the digital economy. This presents a challenge for developing countries for securing resources. This may be caused by multiple-factors that may include prioritization of finances in the advent of COVID-19. African countries may not be willing to prioritize human, financial, and technological spending to develop digital taxation policy, information tools, and legislation.

The OECD's 2014 Low Income Report⁴⁷ further indicated capacity building as one of the most significant challenges faced by developing countries. The consultations in the report stated that 'BEPS solutions for developing countries may need to be tailored to this reality, and concrete technical support will be needed to enable developing countries increase their capacity to improve their domestic resource mobilization'.⁴⁸ Burger and Mosquera specified that the areas of capacity needs relate to 'technical resources, personnel capacity, technical knowledge and economic means of developing countries'.⁴⁹ Capacity and training is critical for implementing DST tax laws and for undertaking precursory steps of determining the costs and benefits of either waiting for and undertaking BEPS proposals relating to digital taxation or imposing a unilateral DST. The absence of technical capacity could result in African countries implementing non-beneficial, low-revenue collecting, and redundant legislation.

3.1[e] Tax Policy Prioritization in Africa

One of the most salient issues when considering a unilateral DST that should be up for consideration by African states and tax administrations is the question of whether the DST is and should be a priority in the domestic context.

In attempting to answer that question, Ogtutu provides direction by succinctly establishing an approach that African countries should adopt in protecting their tax base, stating that they should be 'aware of the special needs and perspectives of the country in question, such as the state of development of the tax system and its administrative capacity'.⁵⁰ Ogtutu highlighted that issues of importance are those that relate to limiting base erosion via interest deductions and other financial payments, preventing treaty abuse, preventing artificial avoidance of permanent establishments, transfer pricing, disclosure

of aggressive tax planning, and transfer pricing documentation.⁵¹ None of these issues relate to DST. While the importance of DST revenue and its current and future intention to raise much needed capital in Africa is undisputed, the question remains of whether this should be a priority for African states.

There is a multiplicity of issues that include and exclude those within the BEPS Project that erode the tax base in African countries and impair the ability to raise revenue. Mosquera *inter-alia* highlighted non-BEPS-related important issues for developing countries as transparency in respect of the extractive industry; the consequences of the repeal of tax incentives regarding bilateral investment treaties; training required for tax treaty negotiations; and the usefulness (or not) of a multilateral instrument to modify tax treaties for countries that are in the early stages of concluding tax treaties.⁵² Given the importance of the issues above and the fact that many of them still remain unresolved, it is imperative for African countries to prioritize areas, projects, or issues that are to be addressed and efficiently dedicate [scarce] resources to the challenges.

The answer to the question above requires an empirical economic, legal, and political costs benefit assessment of which issues require dedicated technical and financial resources. This includes considering the potential revenue flows as well as legislative and administrative challenges of undertaking unilateral DST laws. The same approach should be adhered to when African countries consider joining the BEPS Inclusive Framework and implementing the BEPS Action Plan. Burger and Mosquera captured the overarching issue by stating that 'international organisations and tax scholars have concerns regarding whether all BEPS Actions are relevant for developing countries, and on the feasibility of implementing BEPS Actions in developing countries'.⁵³ In general, the issue of a DST, BEPS, and relevance to developing countries is multi-faceted and should be examined by individual states with careful introspect to resources (technical), administrative capabilities, priorities, and potential costs and benefits.

3.2 Caught in Two Minds: Unilateral DST or Global Approach

It was stated in Chapter 1 that the BEPS Inclusive Framework, the United Nations Model Double Taxation Convention between Developed and Developing Countries

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⁴⁷ OECD, Two-Part Report to G20 Developing Working Group on the Impact of BEPS in Low Income Countries, Report (Paris: OECD Jul./Aug. 2014).

⁴⁸ *Ibid.*, at 37.

⁴⁹ I. Burgers & I. Mosquera, *Corporate Taxation and BEPS: A Fair Slice for Developing Countries?*, 10(1) Erasmus L. Rev. 32 (2017).

⁵⁰ A. W. Ogtutu, *OECD's Action Plan on Tax Base Erosion and Profit Shifting: Part 1 – What Should Be Africa's Response?*, 69 Bull. Int'l Tax'n 11 (2015).

⁵¹ BEPS Action 4, 6, 7, 10, 11 and 13.

⁵² I. J. Mosquera Valderrama, *Legitimacy and the Making of International Tax Law: The Challenges of Multilateralism*, 7(3) World Tax J. 343 at 382 (2015).

⁵³ Burgers & Mosquera, *supra* n. 49, at 35.

(United Nations Model Convention) has made significant headway in developing a solution to the DST challenge. The July 2021 Statement on a II Pillar Solution marks a significant milestone with 130 countries agreeing on an approach that includes *inter-alia* a new special purpose nexus rule permitting allocation of an amount to a market jurisdiction when the in-scope MNE derives at least EUR 1 million in revenue from that jurisdiction.⁵⁴ For smaller jurisdictions (with a GDP lower than EUR 40 billion euros which applies to most African countries), the nexus will be set at EUR 250,000.

Another noteworthy development in developing a global solution can be found with The UN Tax Committee⁵⁵ which undertook the task of developing a digital services article in the UN Tax Treaty in 2018, releasing the first draft of Article 12B in August 2020.⁵⁶ The UN approved its final version, Income from Automated Digital Services, after consultations with *inter-alia* the OECD, EU, and African Tax Administration Forum on 20 April 2021.⁵⁷ Article 12B is a simple and easily administrable provision that poses a positive solution for developing countries, as it 'neither takes away any taxing right enshrined in the existing provisions of the UN MTC nor does it fetter the tax sovereignty of States in terms of applying curbs on their domestic laws'. The main disadvantages, however, are political will, time involved, and costs (to African states) relating to renegotiating tax treaties with states that house technology giants.

The ATAF, in representing Africa, has been active in developing proposals for a global approach. Under BEPS Pillar 1, the ATAF sent revised Pillar One proposals on 12 May 2021. The advanced proposals were in accordance with the needs of African states for simplified rules and to redress inequalities in the October 2020 proposal. One of the proposals was to adopt a single global threshold rule to cover all MNEs that generate global sales revenue above a certain amount.⁵⁸ The new rule would apply to all such MNEs irrespective of their business activities. The proposal follows the US simplified proposal for which the reallocation of profits would be calculated as a portion of the MNEs total profits instead of its residual profit. This is a significant detraction to the OECD BEPS approach agreed in July where between 20–30% of residual profit defined as profit in excess of 10% of revenue will be

allocated to market jurisdictions.⁵⁹ This notwithstanding, a significant number of African states joined the OECD/G20 BEPS Inclusive Framework in releasing the statement, showing confidence in the approach.

The global approach, however, does have disadvantages. A multilateral approach may come with rules that diverge with tax policy and design objectives of African states. An example of this is that Nigeria and Kenya refused to endorse the US unilateral proposals on taking the position that the new the minimum corporate tax rate is too low.⁶⁰ The opposition comes from the perspective that the new rules threaten to further deteriorate the already low revenue tax positions of African countries. This is a reminder of the slanted dichotomy that exists under the BEPS Inclusive Framework (IF); specifically, G7 countries constitute only 10% of the world's population, and their proposal influence (positive and negative) impacts over 150 developing countries' tax jurisdictions that rely heavily on corporate tax revenue. African countries that may seek for a more equitable and just digital tax regime may consider undertaking unilateral measures, particularly when they will benefit from a unilateral DST than under a global regime. Nigeria is the most populous country in Africa and an economic leader in West Africa with a higher GDP than a number of OECD countries⁶¹ and MNE technology hubs in the region. Kenya is the economic superpower of East Africa and second most populous country in the region. Both have a burgeoning economy and technology sector as well as a substantial population of data consumers and users that technology MNE's leverage for profit, as will be examined below under Part 4.

BEPS Pillar 1 and 2 and the UN Proposal may not bear significant gains aligned with tax policy in the respective states. Therefore, each African member country will have to elect which path grants greater rewards between following the global approach or undertaking a domestic DST.

3.3 Common Global Challenges With Taxing the Digital Economy

There are a number of challenges that a majority developed and developing countries face when undertaking a form of digital taxation. The OECD identified a number of global challenges encountered by the 'digitalization of

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⁵⁴ OECD/G20, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* 2 (1 Jul. 2021).

⁵⁵ United Nations Committee of Experts on International Cooperation in Tax Matters.

⁵⁶ United Nations Committee of Experts on International Cooperation in Tax Matters, Coordinators' Report, 11 Oct. 2020 E/C.18/2020/CRP.41, at 4.

⁵⁷ Article 12B prescribes that 'Income from automated digital services arising in a Contracting State, underlying payments for which are made to a resident of the other Contracting State, may be taxed in that other State'; with the rate of tax that may be imposed on such income generally limited to an agreed percentage of the gross amount of the payment under Art. 12B(2) between contracting states. The UN Tax Committee recommended a 'modest' rate of between 3 and 4% for income from such services.

⁵⁸ ATAF Website, <https://www.ataftax.org/ataf-sends-revised-pillar-one-proposals-to-the-inclusive-framework> (accessed 23 Sep. 2021).

⁵⁹ OECD/G20, *supra* n. 54, at 2.

⁶⁰ AFROPOLI Website, <https://afropoli.org/what-does-the-g7-proposal-on-taxation-of-the-digitalised-economy-mean-for-african-countries> (accessed 23 Sep. 2021).

⁶¹ World Bank Website, <https://databank.worldbank.org/data/download/GDP.pdf> (accessed 23 Sep. 2020).

the economy' which resulted in the 2015 BEPS Action 1 Report. A majority of these challenges apply in both multilateral international taxation settings and unilateral measures adopted in applying a DST.

3.3[a] Permanent Establishment Rules

The first unique challenge that the digital economy presents is that it enables MNEs to carry out business in African countries with no or very limited physical presence in those particular countries. Advances in ICT have dramatically expanded the scale at which such activity is now possible⁶² with companies now being able to make millions to billions of dollars without establishing a company or physical office in a jurisdiction. The elimination of physical presence means that the new model of digital business would deprive African states of traditional taxes that they have levied such as employment taxes, environmental taxes, as well as property and land taxes. This results in significant reduction or removal of tax liability within these countries. This, in summary, means that digital businesses erode the tax base of African countries if those enterprises that conduct business without a limited physical presence remain untaxed.

The OECD Committee of Experts on International Cooperation in Tax Matters identified the tax challenges of the digitalization of the economy. One is fundamentally related to the inability of source jurisdictions (under the physical presence criteria of tax treaties) to tax business profits of certain new business models not requiring a physical presence in the market to derive such profits.⁶³ The limited physical presence also raises the challenge of the ability of countries to tax non-resident enterprises and the question of legal rights to taxing companies in foreign countries. This would need administrative capacity and legislative changes of taxation rules to adapt to the new digital business models. This also therefore raises challenges for international taxation and brings in double-taxation rules, which will be examined in detail further below. The 2015 BEPS Report⁶⁴ summarizes the challenges posed by the digital economy into three elements, i.e., the nexus rule, data, and characterization.

The nexus rule is the keystone of international taxation. The rule determines whether a connection or link with a jurisdiction for tax purposes is evident. The rule

has been succinctly explained by Mines, as '*nexus describes whether a taxpayer, property, or activity has sufficient connection with a state to be subject to that state's tax jurisdiction*'.⁶⁵

The rule is relevant and at the heart of digital tax debates as many countries worldwide currently do not tax income derived by a non-resident enterprise from remote sales to customers located within their country unless the digital company maintained some degree of physical presence in that jurisdiction. This would result in base erosion, as the MNEs would be able to derive significant income in sales or services and would avoid tax liability due to lack of adequate rules generating a permanent establishment. An *a priori* limitation on taxing powers of countries regarding a DST is that international customary law prohibits income taxation in the absence of both a personal and a territorial nexus.⁶⁶ African countries would have to undertake policy and legislative changes to address this issue with modifications of the Permanent Establishment (PE) definitions and provisions as a priority. This will be further elaborated in the subsequent section.

3.3[b] Data Value

Data presents challenges to the existing nexus and profit allocation rules as highly digitalized businesses that use the data and user-generated content have little or no taxable presence in the jurisdiction where the users are located.⁶⁷ Current digital technology enables the remote collection, storage, and use of data at greater distances from the market than previously; from users, consumers, or other sources of information; or indirectly via third parties. The primary question is whether profits attributable to the remote gathering of data by an enterprise should be taxable in the state from which the data is gathered.

The particular problem is that this raises issues of the intangible value of data that may not easily be reflected in profits and the balance sheet of a business or that may be too complex for countries to comprehend. Data protection and privacy legislation has been passed in many African countries, as will be examined in the next segment below, however, this has been in isolation to taxation rules. User participation in technology applications, particularly social media, may not necessarily fall within the ambit of rendering a 'service'. However, the social media

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⁶² OECD/20 Base Erosion and Profit Shifting Project, Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report, at 98.

⁶³ OECD, *Committee of Experts on International Cooperation in Tax Matters*, Eighteenth session, New York (5 Apr. 2019), Item 3 (j) of the provisional agenda, Tax Issues related to the Digitalization of the Economy, E/C.18/2019/CRP.12, at 2.

⁶⁴ *Ibid.*, at 99.

⁶⁵ P. Mines, *Nexus*, in *The Encyclopedia of Taxation & Tax Policy* 269 (Joseph J. Cordes, Robert D. Ebel & Jane Gravelle eds, The Urban Institute 2005).

⁶⁶ S. Gadzo, *The Principle of 'Nexus' or 'Genuine Link' as a Keystone of International Income Tax Law: A Reappraisal*, 46 Intertax 208 (2018).

⁶⁷ OECD, *Base Erosion and Profit Shifting Project Public Consultation Document Addressing the Tax Challenges of the Digitalisation of the Economy* 6 (13 Feb.–6 Mar. 2019).

platforms may be populated by user-generated content with its volume and quality being a key factor in their ability to generate revenue from those users or from paid-for advertising targeted at those users.⁶⁸ This, in essence, would mean that participation of, for example, a community in the African country of Botswana on a social media platform, for example, Instagram, would make them a commodity in the ability of the MNE to derive revenue from the participation of the community. Sponsored advertisements can also be directed at them. Currently, this value generated by user participation is not captured in user jurisdictions under the existing international tax framework.⁶⁹

At the heart of the issue surrounding data is the argument that users in the destination countries create value which justifies countries where the users are based to tax revenue generated from that value. Most of the value, however, is generated from the MNE. The destination principle, which had been a VAT principle, has been applied to the context of a DST. This principle provides that tax is ultimately only levied on the final consumption that occurs within the taxing jurisdiction.⁷⁰ Data (which can be considered a services or intangible) is not subject to border controls in the same manner as goods which are easier to monitor. The OECD Pillar Two solution agreed on this approach stating 'Revenue will be sourced to the end market jurisdictions where goods or services are used or consumed. To facilitate the application of this principle, detailed source rules for specific categories of transactions will be developed'.⁷¹ This is a significant shift in policy in which Corporate Income Tax (CIT) revenue will be redirected to the destination countries (end market jurisdictions) notwithstanding the fact that most of the value is taxed in the source countries where productive activity occurs. It is critical to consider that the primary concern of the destination principle is that, together with the already existing sourcing rules, mismatches may occur that result in increased double taxation of the same income for which there may not be adequate relief in the form of tax treaties.

As complex as the above may be, a solution or approach would be required to be developed to address this complex data challenge. This may be accomplished through developing proposals that may include quantifying or attributing value to intangibles that join as a

user and offer data, taking a simpler approach of a flat tax on the MNEs, or a introducing a levy on information or data usage.

3.3[c] Characterization and Allocation Rules

Characterization related challenges relate to how to characterize the digital economy for income tax purposes. This raises fundamental questions of how enterprises in the digital economy add value and make their profits and relates to the concepts of source and residence. The challenges are created by new digital products or means of delivering services that creates uncertainties in relation to the proper characterization of payments made in the context of new business models.⁷² In order to effectively levy a goods and service tax or a VAT or income-based tax for the cross-border supply of digital goods and services, it is imperative that [African] countries understand the nature of specific digital sales, services, or transactions and the various business models in particular digital sectors. This greatly impacts strategies employed in taxation and raises issues such as whether to subject DST as a source taxation by creating a new category of income that is subject to withholding tax for direct tax purposes.

Another challenge identified by BEPS that is to be addressed not only at a domestic level by African countries but by the OECD and members of BEPS signatories is how taxing rights on income generated from cross-border activities in the digital age should be allocated among jurisdictions. This is closely related to the nexus rule and profit allocation rules as MNEs' global profits are allocated between jurisdictions primarily using transfer pricing rules. This is one of the primary justifications for the OECD's 'holistic' approach to addressing digital taxation under multilateral rules as countries are interconnected and unilateral rules would result in divided opinions on profit allocation. A non-coordinated approach by African countries could result in double taxation over the same transactions. The allocation among jurisdictions should be addressed by both unilateral and multilateral taxation rules to ensure this is sufficiently addressed.

3.3[d] Double Taxation Agreements

Double taxation agreements or double taxation avoidance agreements are primarily bilateral agreements between

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⁶⁸ *Ibid.*, at 9.

⁶⁹ *Ibid.*, at 10.

⁷⁰ OECD, *Fundamental Principles of Taxation*, in *Addressing the Tax Challenges of the Digital Economy* 43 (OECD Publishing, Paris 2014).

⁷¹ OECD/G20, *supra* n. 54, at 2.

⁷² *Ibid.*

states to lessen or eliminate double taxation. There have also been multilateral Double Taxation Agreement's (DTA) that have been entered into between states.⁷³ Model DTA conventions have been developed by the OECD and the United Nations with the latter model double taxation convention structured to address DTAs between developed and developing countries.⁷⁴

DTAs ensure that MNEs are taxed on services performed in the state, therefore, there are critical interpretative issues to resolve in the text. Treaties usually define important terms such as 'person', 'enterprise', and 'permanent establishment' within the text⁷⁵ to determine which state is due to receive taxable amounts of income. These terms are critical to the issue taxation of the digital economy as PE rules in DTAs raise similar hindrances to taxing MNEs as discussed in the section above on PEs.

The challenge with DTAs and the digital economy is that DTAs traditionally provided that income from services derived by an enterprise of a state was taxable exclusively by the state in which it was resident. This was valid unless it conducted business through a permanent establishment in the other state or provided professional or independent personal services through a fixed base in the source state.⁷⁶ With the advent of digitalization, MNEs have been able to provide cross-border services or maintain a 'significant economic presence' in another state without permanently being established there.

The above therefore means that African states that have DTAs with other states that provide digital services (for example, the United States) may have rules that prescribe that a state can only tax a multinational on its business income if the MNE has a sufficient taxable presence or is permanently established there. Further, there may be a requirement that the MNE's profit should be attributable to that taxable presence. This would bar an African country from establishing a nexus required to tax an MNE which may demonstrate that it has neither a taxable presence nor is permanently established there.

An example of the above is the DTA between South Africa and the United States entered into in 1997⁷⁷ which

provides for PE rules under Article 5.1. A PE is defined as meaning 'a fixed place of business through which the business of an enterprise is wholly or partly carried on'. Article 5.2 then provides a description of physical places which may evidence a PE which includes inter alia 'a place of management, a branch, an office, a factory and a workshop'.

Under the DTA, an MNE that offers digital services would be exempt from paying business profits due to Article 7.1 of the bilateral agreement which provides, 'The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein'. The article further prescribes that 'the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment'. This would exclude US digital businesses that do not have physical branches that conduct business activity from the purview of being taxed in South Africa.

The above scenario indicates the challenge that Africa has in taxing digital businesses with DTAs excluding such services from taxation within African jurisdictions and consequently eroding the tax base. The United States has currently only entered into two DTAs with African countries,⁷⁸ i.e., Egypt and South-Africa. The above notwithstanding, Sub-Saharan countries continue to sign treaties with traditional investor countries (Western European countries, chiefly with former colonial powers, and Nordic countries) at a steady rate and have recently begun to conclude treaties with emerging economies and other developing countries.⁷⁹

Unilateral services tax on digital services (not attributable to profits) presents a possible solution for African countries to increasing the tax base from digital services which ordinarily would not be taxable on account of DTAs. The challenge in such provisions is that they may amount to double taxation where companies face the threat of an additional tax burden resulting from increasing taxation of gross income in source countries

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⁷³ Multilateral DTAs that have been entered into, include *inter-alia*:

(a) the Agreement to Avoid Double Taxation between the Member Countries of the Andean Community of Nations – Decisión 578 Régimen para evitar la Doble Tributación y Prevenir la Evasión Fiscal (4 May 2004);

(b) the Nordic Multilateral Double Taxation Convention - Nordic Multilateral Double Taxation Convention with respect to Taxes on Income and Capital (23 Sep. 1996); and

(c) the Double Taxation Agreement of the Caribbean Community (CARICOM) – Agreement among the Governments of the Member States of the Caribbean Community for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Profits or Gains and Capital Gains and for the Encouragement of Regional Trade and Investment (6 Jul. 1994).

⁷⁴ UN, *UN Model Double Taxation Convention Between Developed and Developing Countries*, Department of Economic & Social Affairs ST/ESA/PAD/SER.E/213 (2017).

⁷⁵ A. Miller & L. Oats, *Principles of International Taxation* (Bloomsbury Professional, 3d ed. 2016), Ch. 7 Double tax treaties.

⁷⁶ UN, *supra* n. 74.

⁷⁷ Convention Between the Republic of South Africa and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, 15 Dec. 1997, INCOME TAX ACT, 1962 (South Africa).

⁷⁸ Swiss Banking website, https://www.swissbanking.org/de/themen/steuern/fatca-foreign-account-tax-compliance-act/us_treaties_english.pdf (accessed 4 Mar. 2021).

⁷⁹ Tax Justice Network, *Tax Treaties in Sub-Saharan Africa – A Critical Review*, Tax Justice Network Africa (Mar. 2015).

without corresponding tax credits in the country of residence.⁸⁰ A multilateral approach under the OECD, on the other hand, is designed to reduce or minimize double taxation while addressing taxation of the digital economy. Pillar Two OECD (Global Anti-Base Erosion GloBE proposal) coordinates tax laws to reduce risks from structures that allow MNEs to engage in profit shifting to low tax jurisdictions while reducing the risk of double taxation.⁸¹ Multilateral agreements, however, have still not been concluded which results in a continued eroded tax base from digital services in Africa from the current dispensation where DTAs prevent taxation of MNEs in resident African states.

3.4 Opportunities of Unilateral Digital Services Tax Measures

There are significant opportunities for developing countries in taxing digital MNEs notwithstanding challenges identified in the previous section. Worldwide digital internet advertising made revenue of USD 333.8 billion in 2019 which consists of inter alia advertisements in results pages of search engines, advertising in social media networks in the form of paid digital classifieds.⁸² The top ten most valuable firms as determined by market capitalization in 2018 share a common feature that each had established a digital platform to create value through facilitating exchanges between two or more interdependent groups.⁸³ These digital platforms are utilized in many African countries through applications on mobile phones and the internet offering services and undertaking ecommerce. A few of these MNEs have established a physical presence in the continent, usually through technology hubs,⁸⁴ that do not offer services subject to taxation. There is no legal nexus to tax a subsidiary of a group company that provides these types of services. Unilateral digital services' tax legislation may finally afford African countries an opportunity to tax MNEs in relation to business activities in their respective jurisdiction and finally bring the entities under the purview of their legislation.

3.4[a] Expansion of the Tax Base in Africa

There are current significant opportunities for African countries. The most notable and important is the potential to expand their respective tax base through various policy and legislative interventions. The profits or income derived from their respective markets through remote business models from MNEs (and domestic companies where tax policy enables this) may be subjected to taxation by African countries. Consequently, this expands the tax base through the introduction of a new form of taxation that the states had previously been unable to tax.

It was expounded above [under challenges] that the digital economy erodes a tax base due to the lack of physical presence (in reduced or non-payment of employment taxes, environmental taxes, and land taxes). A DST is therefore a needed intervention by African states to improve revenue growth at a time when the digital economy threatens or actually causes avoidance or declines in revenue. The expansion of a tax base by the inclusion of a DST may subsequently increase revenue that may be utilized for developing states, particularly at a time of high state expenditures to alleviate the economic and social impact of COVID-19. The second opportunity, therefore, which is closely linked to the first, is that this provides a solution to expand the tax base of African countries that may have been eroded due to the digitalization of the economy.

Unilateral approaches further offer an immediate (and interim) solution to a longstanding multilateral consensus based solution to a DST. Multilateral approaches, on the other-hand, under the proposed OECD's proposed framework are still ongoing and have taken a significant amount of time since the introduction of the BEPS agenda in 2015.⁸⁵ While it may be prudent to undertake reforms in accordance with the BEPS initiative, unilateral action by African countries may mitigate the present risk of base erosion and tax avoidance by MNEs. Members of the OECD and G20, France, and the United Kingdom that are main drivers to the BEPS Pillar 1 initiative and adopting a multilateral solution have similarly adopted the logic of imposing unilateral legislative measures.⁸⁶ The approach adopted is that a DST is a 'narrowly-targeted and proportionate interim measure to ensure digital businesses pay UK tax reflecting the value they derive from UK users, and that

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⁸⁰ OECD, *Tax Challenges of Digitalisation*, Comments Received on the Request for Input – Part I, 4 (25 Oct. 2017), <https://www.oecd.org/tax/beps/tax-challenges-digitalisation-part-1-comments-on-request-for-input-2017.pdf>.

⁸¹ OECD, *Global Anti-Base Erosion Proposal ('GloBE') – Pillar Two*, Public Consultation Document, 7 (8 Nov. 2019–2 Dec. 2019).

⁸² <https://www.statista.com/study/42540/digital-advertising-report/>, Digital Advertising Report 2020.

⁸³ Apple, Alphabet, Amazon, Facebook, Tencent, and Alibaba.

⁸⁴ GSMA website, <https://www.gsma.com/mobilefordevelopment/blog/618-active-tech-hubs-the-backbone-of-africas-tech-ecosystem/> (accessed 3 Feb. 2021). There are 618 active technology hubs in Africa, with Google, Facebook, IBM, Microsoft and Airbus amongst companies establishing the hubs.

⁸⁵ Digital Services Tax, *Commons Library Briefing* 24 (17 Nov. 2020). The government is supportive of OECD efforts to secure global agreement by 2020. However, there are significant differences between the views of several countries and, while compromise is achievable, agreement may take some time.

⁸⁶ French National Assembly, https://www.assemblee-nationale.fr/dyn/15/textes/l15b1737_projet-loi (accessed 3 Feb. 2021). On 6 Mar. 2019, France introduced a DST for which the French Senate approved a 3% DST that applies retroactively with effect from 1 Jan. 2019, to revenues from digital services earned in France by groups with revenues in excess of EUR 25 million in France and EUR 750 million worldwide.

all types of businesses make a fair contribution to the public finances' and is pending a multilateral consensus.⁸⁷ While retaliatory action may be a major concern, the prospective revenue gains may offer a larger incentive for adopting an interim unilateral DST for African countries. Administrative and enforcement mechanisms, however, may be a particular concern for African tax administrations, which will be addressed further below in this article.

The digital economy has affected many industries that also include African tourism. Booking websites (such as bookings.com and agoda.com) facilitate tax evasion of accommodation and tour operators with payments made online directly from the customer to the MNEs, and financial records are maintained outside African countries.⁸⁸ The digital service providers themselves are untaxed notwithstanding rendering reservations services from African jurisdictions. Tourism is very important in countries such as Botswana, contributing 13.1% to its GDP in 2019 and in the context of the drive for diversification, employment creation, and export-led growth.⁸⁹ The sector also brings economic activity to rural areas and provides employment and earning opportunities to communities that may have few alternatives. Taxing digital services that provide booking services may raise revenue for African states and monitoring transactions could potentially increase the VAT and corporate income tax of domestic tourism service operators.

A unilateral DST is a needed intervention for African states to improve revenue growth at a time when digital economy threatens or actually causes avoidance or declines in revenue. The inclusion of a DST to the tax base of African countries may subsequently increase revenue that may be utilized for developing states, particularly at a time of high state expenditure to alleviate the economic and social impact of COVID-19 as stated earlier in this article.⁹⁰

3.4[b] Opportunity to Update Tax Policy and Legislation

The introduction of a DST will require customized solutions and strategies specific to the respective states,

legislative reforms, technical ingenuity (of businesses), political will, and enforcement mechanisms to ensure efficient execution. The development of a unilateral taxation policy may therefore be a critical step in addressing pertinent taxation issues in African countries. A further opportunity for them in adopting to introduce a unilateral DST is that it presents the prospect of developing a domestic tax policy through specific individual solutions and strategies for the respective states based on their digital consumption and business environment (to the extent that the rules are consistent with international tax laws).

The development of tax policy and legislation will require African states to address issues that are beyond the strict scope of digital services that are pertinent to taxation within the respective states. These include *inter-alia* PE rules, arm's length rules that aid in addressing general challenges faced when taxing MNEs and, for those parts of the BEPS Inclusive Framework, information exchange rules such as the CbCr. This may mean that countries would have to consider legislating proposed Inclusive Framework rules to strengthen the effectiveness of DST legislation and consequently potentially improving their taxation policy and legislation beyond the strict scope of a DST.

The OECD and BEPS provide an inclusive forum to address international related tax issues as the OECD's Unified Approach provides external stakeholders [which includes African countries] an opportunity to provide input into the ongoing work.⁹¹ The main drivers of the BEPS initiative (OECD) still largely remain a European dominated group. The G20's tax agenda in 2009 was to 'take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems'.⁹² This is fused with domestic policy. Australia's leaders used its presidency of the G20 to drive a domestic agenda on corporate tax avoidance fuelled by its relatively high reliance on corporate tax revenue as a part of its total tax take.⁹³ BEPS further evolved from taxation of MNEs primarily being a G20 issue as it was well summated that '90% of MNEs are headquartered in the G20, and none

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United Kingdom Finance Bill 2020, passed on 22 Jul. 2020 House of Commons. The United Kingdom adopted a DST, applying a 2% tax on the revenues of certain search engines, social media platforms and online marketplaces.

⁸⁷ Digital Services Tax, *supra* n. 85, at 24. The government is supportive of OECD efforts to secure global agreement by 2020. However, there are significant differences between the views of several countries and, while compromise is achievable, agreement may take some time.

⁸⁸ See Botswana Sunday Standard website, <https://www.sundaystandard.info/tax-avoidance-rampant-in-tourism-sector-oco-academic/> (accessed 9 Apr. 2021). The newspaper article quoted a report by University of Botswana Professor of Tourism Studies at the Okavango Research Institute, Prof Joseph Mbaiva. The Report stated; 'It is difficult for the government of Botswana to obtain the necessary tax revenue when financial books are kept and audited outside the country. This indicates that businesses that have offshore earnings are more difficult to tax than businesses that receive most of their earnings from domestic sources'.

⁸⁹ Botswana Insurance Fund Management website, *Econsult Economic Review* 15, <https://www.bifm.co.bw/sites/default/files/Econsult%20Review%20Q1%202019.pdf>.

⁹⁰ ATAF, *Taxing the Digital Economy: COVID 19 Heightens Need to Expand Resource Mobilisation Base*, ATAF website, <https://www.ataftax.org/taxing-the-digital-economy-covid-19-heightens-need-to-expand-resource-mobilisation-base> (accessed 16 Feb. 2020). African Countries have started implementing, or have indicated plans to start implementing forms of digital tax. The ten African Countries to date include Kenya, Nigeria, South Africa, Egypt, Tanzania, Mauritius, Uganda, Cameroon, Ghana and Zimbabwe.

⁹¹ OECD, *Public Consultation Document Secretariat Proposal for a 'Unified Approach' Under Pillar One* 2 (9 Oct. 2019–12 Nov. 2019).

⁹² G20, *The Global Plan for Recovery and Reform*, G20.org, 2 (Apr. 2009).

⁹³ C. Berg & S. Davidson, 'Stop This Greed': *The Tax-Avoidance Political Campaign in the OECD and Australia*, 14(1) *Econ. J. Watch* 77 (2017).

of those countries have a tax rate below 20%, so if they taxed their MNEs currently on a coordinated basis and restricted the ability to move out most of the problem would be resolved.⁹⁴

African countries may not be able to realize particular areas of interest in the BEPS agenda due to a number of issues that range from technical incapacity in BEPS relates issues, lack of a common agenda, and low participation in the inclusive framework. Twenty-five out of one hundred and thirty-seven IF BEPS countries are African states.⁹⁵ The BEPS agenda may therefore fail to deliver a framework that is orientated to developing countries and specifically African countries' issues. The above notwithstanding, African countries will find that a significant number of rules, such as transfer pricing rules, will be useful for curbing revenue loss from the failure to effectively tax MNEs; this will benefit taxation in the countries in general.

Unilateral approaches by African countries would address substantive issues relating to MNEs and the specific challenge in those countries. In order for tax policy and laws to adequately address domestic challenges in Kenya, they must go beyond BEPS Pillar 1 DST issues and address individual digital money transactions to curb tax evasion on incomes from online sources. Optimal policy requires simultaneous consideration of the design of the tax code and of the administrative structure created to enforce it.⁹⁶ African countries should develop policy aligned to their administrations to effectively address DST. The development of unilateral taxation policy and legislation is therefore a critical step in addressing pertinent taxation issues in African countries that have been unresolved for a significant period of time.

3.4[c] Reduction of IFF

Digital transaction and internet based services have been drivers of IFF; the borderless nature and decentralized architecture of the internet combined with the complex dynamic ecosystem of the digital economy poses new challenges in effectively addressing the problem of IFF.⁹⁷ DSTs and taxation in general in Africa could potentially be key in reducing these. Tax transparency and exchange of information have a crucial role to play in helping African governments stem the flows and increase domestic revenue mobilization. Interventions, however, are predominantly addressed through bilateral and multilateral

agreements, which are also part of the BEPS agenda.⁹⁸ The challenge with regards to developing domestic policy and unilateral legislative instruments in relation to this is that most African countries that are party to BEPS are in early stages of implementing CbCr legislation and, furthermore, are not actively transmitting and receiving information on MNEs. This therefore means that policy and unilateral digital services legislation in Africa would be developed in the absence of information on MNE information on digital transactions in countries where their principal headquarters or businesses are based without CbCr laws that would provide insight on taxes and transactions in various countries.

Notwithstanding the slow implementation of BEPS CbCr legislation, a DST may quicken the process and result in African countries increasing membership in the BEPS package in order to receive information in relation to MNE profits and transactions. A significant potential opportunity of reducing IFF may arise from legislative measures related to a DST which actively increases the monitoring of digital services and transactions to a particular country outside the source African jurisdiction. This may significantly improve risk and strategy approaches regarding what may be deemed as 'suspicious' transactions. This may enable tax authorities to undertake control measures that may result in a reduced number of illicit flows.

Unilateral DSTs will require considerable system and infrastructural support which may benefit risk and collection of taxes in general for African tax administrations. It was examined above that the collection of data within African countries continues to be a challenge as this requires deliberate changes in technological and strategic policies, information based administrations, and considerable investments in technological recordkeeping and systems. This has been a priority for the ATAF which entered into an MOU with the OECD in October 2012 agreeing to work together to improve tax systems in Africa. Information will be vital in developing relevant taxation legislation of the digital economy based on strategies emanating from empirical data. A considerable amount of investment would be needed to modernize African tax administrations to be effectively equipped to develop a comprehensive taxation strategy for the digital economy. This would improve information and risk units in the countries that may take necessary action to reduce IFF.

Notes

⁹⁴ R. S. Avi-Yonah & H. Xu, *Evaluating BEPS: A Reconsideration of the Benefits Principle and Proposal for UN Oversight*, 6(2) Harv. Bus. L. Rev. 194.

⁹⁵ African Union Website, https://au.int/sites/default/files/newsevents/workingdocuments/39572-wd-briefing_paper_on_global_tax_debate_for_1st_extraordinary_stc.pdf (accessed 12 Sep. 2021).

⁹⁶ *Institutional Elements of Tax Design and Reform* (J. McLaren ed., Washington, DC: World Bank 2003).

⁹⁷ T. Tropiana, *Do Digital Technologies Facilitate Illicit Financial Flows*, World Development Report 2016 Digital Dividends, 2.

⁹⁸ OECD BEPS Action 13 provides for country-by-country reporting which requires all large MNEs to prepare CbC reports with data on global allocation of income, profits, and taxes paid in jurisdictions in which they operate.

4 CONCLUSION

The global move to implement unilateral DSTs, which is beginning to gain momentum in Africa, is driven by efforts to redress base erosion of tax regimes by MNEs globally caused by their complex and disruptive nature. Further, delays in achieving a global consensus under the OECD BEPS Inclusive Framework and the realization of continuous revenue loss has resulted in states resolving to implement short-term measures to preserve revenue and expand their tax base. African countries are slowing joining.

It was established that many African countries are reliant on corporate income tax which means that they are more likely to be at a disadvantage as a result of MNE tax evasion and base erosion as well as disproportionate profit shifting compared to developing countries. It is therefore imperative that, pending finalization of the proposal under OECD BEPS Action 1, African states preserve or increase revenue from the digital economy through a unilateral DST.

The challenges in implementing a unilateral DST pose significant hurdles; some are unique in the African context. Not all African states, however, share the same challenges. These are IFF, information deficiencies, and deficiency in technical and financial resources to prioritize digital tax policy. It was also identified how African states face similar common impediments relating to the digital economy that jurisdictions around the world face. Jurisdictions will be required to amend existing nexus rules in domestic income tax or DST legislation. Ascertaining data value and data protection is a commonly undeveloped area where new policies will have to be developed in relation to taxation. Characterization and allocation rules that do not adhere to conventional taxation rules will have to be developed. Additionally, further DTA's that prescribe PE rules would ordinarily restrict African states from imposing a digital tax under income tax rules.

The potential outcomes or opportunities from DSTs, however, makes their implementation worthwhile. The first and most critical opportunity is that DSTs may be an opportunity to expand African countries' respective tax bases that have been eroded due to the digitalization of the economy. This may result in increased revenue collection that may be utilized for developing states, particularly at a time of high State expenditure to alleviate the economic and social impacts of COVID-19, as stated earlier in this article. The second opportunity is that a DST

presents an opportunity for African countries to develop relevant and robust enforceable tax strategies and legislation related to wider BEPS related issues. This could include *inter-alia* PE rules, arm's length rules, and information exchange rules such as the CbCr that are not strictly part of the DST agenda thereby facilitating increased efficiency and optimization of revenue collection. Lastly, this may enable states to [partly] address the scourge of IFF, as it was identified that digital transaction and internet based services have been drivers of them. Tax transparency and exchange of information rules coupled by DSTs could positively impact this challenge.

A unilateral DST for African countries is therefore is not a 'silver-bullet' to the digital challenge that MNEs pose as further interventions and measures must be coupled with the tax for effective implementation. Strong headway has been made in 2021 with the conceptual agreement in the BEPS 2.0 Project and the UN globally approving its tax treaty on Article 12(B) on automated digital services. However, It may take a few years until African countries benefit or gain revenue from the global solutions. This is due to the economies' lack of true global political will to commit to BEPS 2.0 combined with the cost of renegotiating treaties by African countries under the UN Tax Treaty Article 12B. This would result in untaxed DST revenue in Africa in the short-term while the global political cogs continue to rotate.

The opposition to the BEPS statement by African powerhouses, i.e., Nigeria and Kenya, adds another dimension to the DST issue, raising questions of whether the OECD BEPS Inclusive Framework has developing countries' interests in its agenda and is in accordance with their respective tax policies. It has also been shown how the ATAF diverged on critical points of the proposals, particularly regarding quantum (on the gross amount of profits as opposed to residual profits) and on adopting a simpler approach to benefit Africa's developing countries. African countries with adequate technical and financial resources may push for domestic tax options that are more favourable by avoiding the global inclusive framework and opting to seek revenue through unilateral DST efforts. A global holistic solution under the BEPS Inclusive Framework may prove to be more effective in the long-run, however, at present, a DST may be the only solution to temporarily prevent haemorrhaging of much needed revenue that is derived from digital business activities arising from African states.