

Cross-border tax in Africa: 2020 and beyond

Reflecting on recent developments in cross-border taxation, and considering what 2021 may bring

2020

At the start of 2020, there were certain trends we were expecting to see, ranging from developments in how to tax digital services to an uptick in tax controversy related to cross-border transactions. However, none of us could have predicted the impact that the COVID-19 pandemic would have on accelerating and catalysing change in the tax world.

This report, based on both our research and anecdotal experiences at Graphene Economics, serves to round up some of the significant themes from the year, as well as looking forward at what the future holds.

Assessing the impact of COVID-19

The world headlines have been dominated by the coronavirus pandemic and this will likely continue for the months ahead as countries deal with the fallout of the economic impact. This has been compared to the Great Depression. While governments work to meet healthcare obligations and protect their countries' economies as best they can, companies are, in many cases, having to make rapid and yet significant decisions to survive.

Organisations like the Organization for Economic Co-operation and Development (OECD) and Africa Tax Administration Forum (ATAF) have produced guidance for members to try to help navigate these difficult times, but the truth is that nobody knows exactly what the best course of action will be. As almost every communication has said over the past few months, these are unprecedented times. We've seen the US oil price dropped to below \$0 a barrel for the first time in history, many developing nations managing the health crisis more effectively than their developed counterparts, and supply chains being turned on their heads almost overnight. Bloomberg Tax reported that,

"The OECD has warned that COVID-19 is the greatest danger to the world economy since the 2008 financial crisis. It is therefore to be expected that the COVID-19 epidemic will have a negative bearing on the operating income of multinational enterprises (MNEs), and impose a considerable burden on the cash flow of an MNE as well as its individual subsidiaries."

- Bloomberg

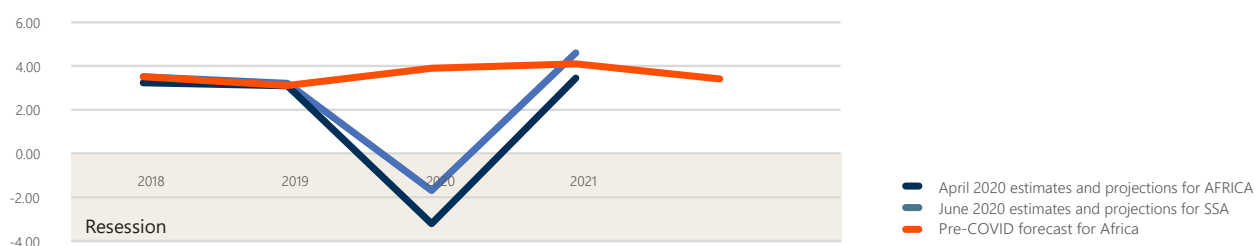
The history of international taxation shows that tax tends to shift substantially after a major world event. For example, the most important catalysts for the development of international taxation and its governing bodies were the two world wars. Similarly, after the 2008 financial collapse, countries were forced to critically reconsider how cross-border transactions are taxed, leading to the largest reaction to aggressive tax planning in history. We believe that given the effect of COVID-19 on economies, we are likely to see another shift in international taxation and transfer pricing (TP) over the coming months and years. Prof Keith Engel, CEO of the South African Institute of Tax Professionals (SAIT), says,

"If we look back at the 2008 global financial crisis, it was only in 2013 that the OECD started formally working to address the significant issues of BEPS, so there was quite a lag. What is perhaps different now is that the OECD was already working on various policies prior to 2020."

- Prof Keith Engel

He believes that key global tax trends emerging from this period will include governments becoming more indebted and revenue authorities therefore looking for new "pockets" they can tax and potentially adopting more protectionist mentalities.

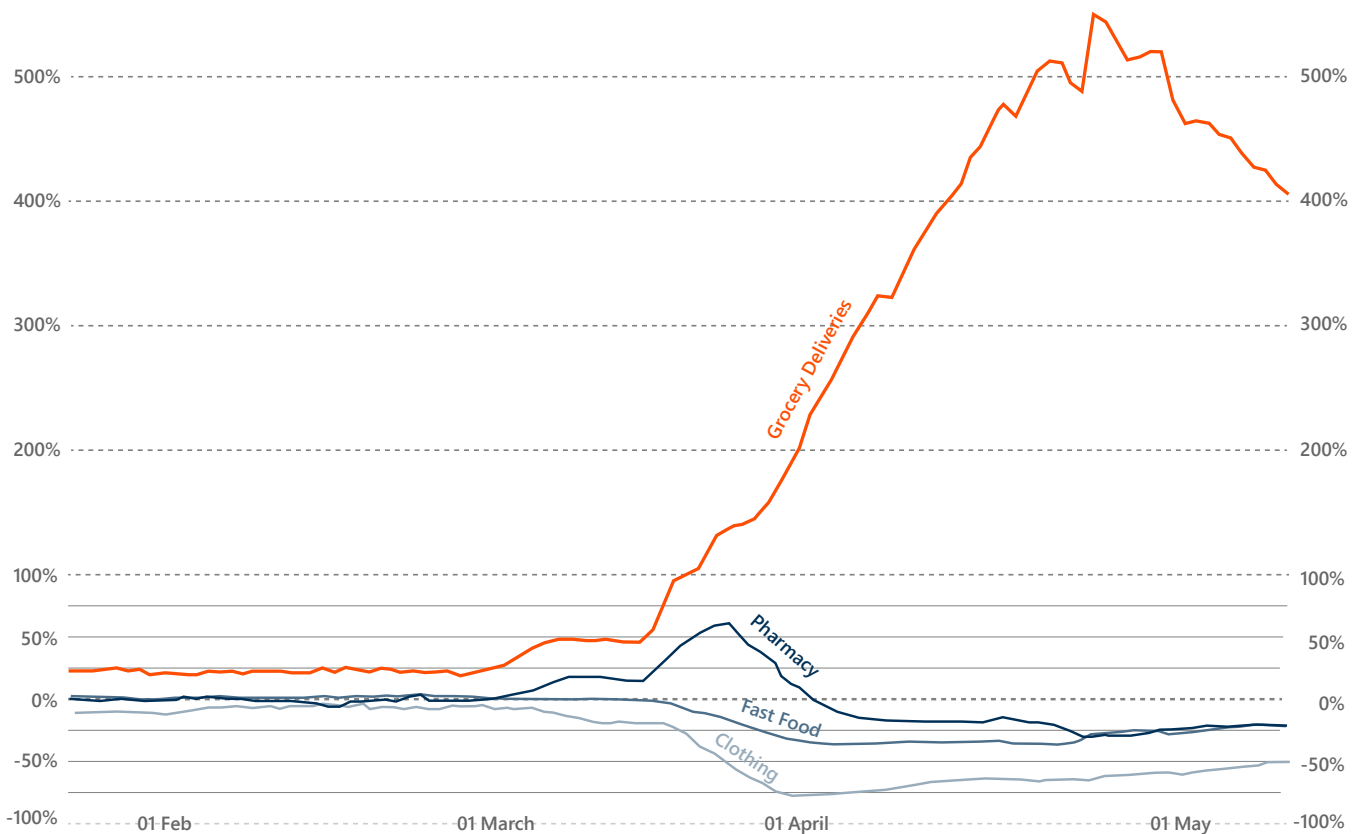
Comparison of GDP growth forecast for Africa pre and post COVID-19



OECD/AUC/ATAF (2020), Revenue Statistics in Africa 2020, OECD Publishing, Paris, <https://doi.org/10.1787/14e1edb1-en-fr>.

How did consumers spend differently during COVID-19 lockdown

COVID-19 has impacted everything from routine business travel to consumer spending habits, and many of its ripple effects are yet to be felt. In these uncertain times, solid guidance has often been difficult to find.



source:1010Data, powered by AI platform Exabel

What this means for MNEs

Sebastien Gonnet, director at Accuracy and founder of Transfer Pricing Economists for Development (TPED), says that while national guidance remains limited, organisations should focus on:



Doing what you need to do for your business to survive.



Documenting contemporaneously (the decisions you make now may be difficult to justify later, in a different context)



Ensuring you are working according to arm's length principles. Decisions need to be commercially rationalised and financial and economic analysis should be at the basis of any documentation of these restructuring or transfer pricing considerations.

Michael Hewson, director at Graphene Economics, adds that companies also need to pay attention to potential risks and manage these. Risks may include:

Abnormal losses

Benchmarking – risk profiles of comparables

Cash-flow

Corporate residency implications

Intra-group contracts

Shifting supply and value chains

Supply and value chains, especially those in the healthcare sector, were some of the most immediately affected business areas as the coronavirus pandemic spread throughout the globe.

As an example, Bonface Fundafunda, an independent consultant with experience of working in health policy, planning, strategy, operational systems and business development, currently working with the Africa Resource Centre, explains that supply chains in Africa were affected as African countries enforced lockdown measures. Even when goods were being allowed into countries, logistics companies were facing shutdowns, which meant that the local legs of the supply chain were often facing bigger challenges than the international ones.

MJ Schoemaker, Director of ProscE2E Pty Ltd, says the challenges experienced were similar around the world, but in countries where local supply chain infrastructure was already difficult or underdeveloped, these problems were more apparent.

Globally, many countries have begun to relook at localising supply chains. Fundafunda says that this is a form of protectionism that will in turn affect tariffs levied, as well as VAT and GST as policy around rules of origin adapt.

Hewson adds that the focus has shifted from minimising costs to securing supply, which may also result in higher production costs being passed on to consumers.

Duane Newman, Joint MD at Cova Advisory, believes there are short-term and long-term implications for tax revenue. In the longer term, he says the priority will be to stimulate economies, while he foresees short-term pro-growth interventions, such as tax incentives.

"I think a lot of countries will be looking to make their policies more pro-growth, but also more inclusive. Bear in mind that for developed economies, tax revenue collections from trade is around 1% of total tax collection, whereas for developing economies, it's an average of about 10%."

- Duane Newman

This disparity may result in emerging economy countries increasing protectionist measures, including customs duties.

Mzukisi Qobo, Head: Wits School of Governance and member of the Presidential Economic Advisory Council, says that these sorts of policy shifts will be rationalised as helping to build local supply chains and industries. He foresees arguments being made for infant industry protection, specifically with regards to PPE and medical supplies.

"I think governments need to think more strategically and carefully about the kind of industries they want to promote as new sources of growth, such as your green industry, and digital industry infrastructure linking to socioeconomic development. And they need to overlay this with tax and other incentives to promote growth, because relying on the old sectors is not going to help economies to recover from the ravages of COVID-19."

- Mzukisi Qobo

Given the lasting impact of COVID-19, there may be a shift in taxation patterns over the next few years and even beyond.

Median tax revenue by type of tax, 2016

Percentage of GDP

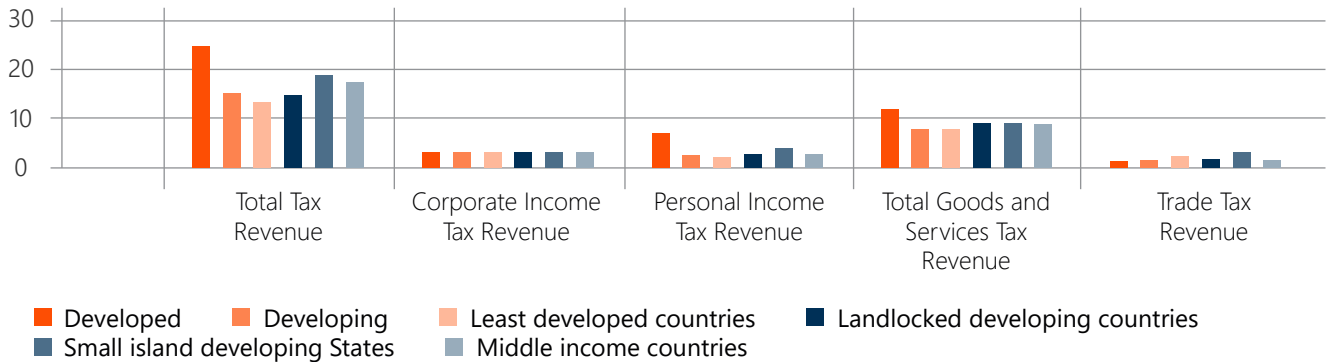


Chart downloaded on 2020-06-08 06:06:37 from <https://developmentfinance.un.org>, based on data from IMF, World Revenue Longitudinal Dataset. Original available at <https://developmentfinance.un.org/chart/1752>

What this means for MNEs

Graphene Economics asked various experts for their recommendations. These were the suggestions that emerged:



Implement robust business health checks: Schoemaker suggests assessing business processes across all pillars of an organisation, rather than within silos, and developing a business continuity plan, to be reviewed on a regular basis.



Reassess existing supply and value chains: Fundafunda says key questions to ask are “Why is this supply chain set up this way?” and “Is this still serving us well?” He added that both government and private sector players need to re-look each part of the chain and question the status quo.



Seek partnership: Fundafunda emphasises the need to partner in building effect supply and value chains, while Qobo suggests there's a missed opportunity by African countries on the African Continental Free Trade Agreement front: “This is the time in which they should be accelerating implementation, and out of the 54 countries that have signed I think only 28 have ratified the agreement. Only 18 or less have actually presented their tariff offers and this does not augur well for accelerated integration.”



Be prepared to defend decisions taken now later: Hewson says that while businesses need to prioritise cash-flow now, it's important that they document decisions taken in preparation for tax audits later on



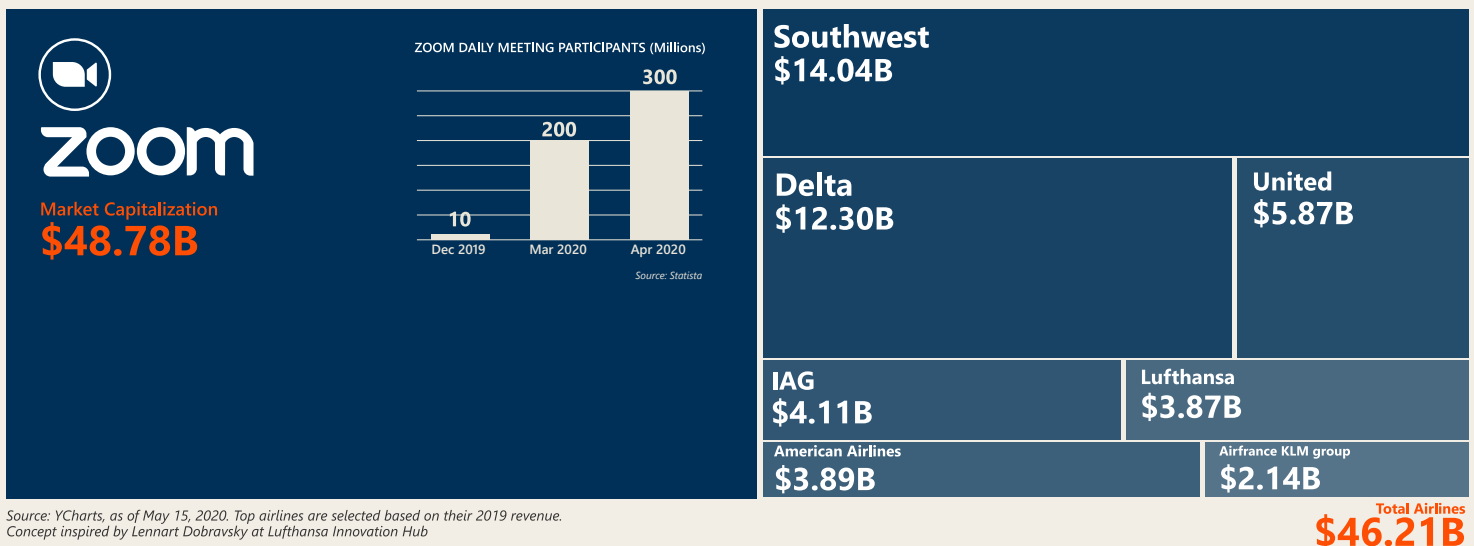
Use data and digitisation more effectively: Data allows for transparency in the supply chain system, which can drive optimisation. Newman notes that as digitisation increases, however, taxation policies will also adapt (for example, when France moved to implement 3% digital tax on US-based digital companies, the US responded by increasing tariffs on French products). This will in turn impact how supply chains are set up. Governments need to think carefully and to work with business to develop pro-growth policies that factor in digitisation.

Digitisation and all things related

Digitisation has been a buzzword for some time now, but the pandemic has resulted in accelerated digital developments. As COVID-19 has opened the eyes of the world to the ability to stream educational programmes, shift towards online purchases and run businesses (as far as possible) online, in ways never previously experienced, it makes sense that the ongoing conversations about taxation of digital services are being pushed to the fore.

For the past few years, the OECD has focused on taxation of the digital economy and has been considering the implementation of an additional taxing right on companies with a digital presence in other countries. This is partly a response to unilateral measures taken by many countries to introduce their own taxation on companies operating digitally in their countries. The intention by the OECD has been to limit the proliferation of unilateral measures. In Africa there are mixed views regarding whether the OECD's unified approach or the unilateral approach of digital services taxes are most appropriate. Certain countries have proceeded with announcing the introduction of digital services taxes while others are applying a "wait and see position". During 2021, we are expecting that this will be a hot topic among tax policy leaders and politicians as the taxing rights over technology related income streams will certainly have an impact on international trade deals.

Few could have predicted that in 2020 the market capitalisation of Zoom, the video communications company, would outstrip the combined market capitalisation of the largest seven airlines globally.



What this means for MNEs



Beyond the far-reaching tax aspects of digitisation, there is also likely to be a distinction in success between companies that can quickly become more digital and those that can't. Extending this to countries, those that encourage and stimulate their service economy, and notably, those that foster the development of technology by companies in their countries, will be at an advantage.



We can expect greater buy-in to OECD's work on the taxation of the digital sector as more countries want a share of the pie. Jeffrey Owens, the former head of the OECD, recently recounted advice he once received from Trevor Manuel which is to, "Never waste a crisis". Given the rapid increase in the awareness and appreciation of the use of technology, coupled with the benefits associated with the extent of the services economy, perhaps South Africa, and other emerging economies would do well to focus on supporting business in the service and technology sectors. Graphene Economics is encouraged by the acknowledgment by President Ramaphosa's 4IR Commission that technology has been identified as a priority sector in the country and that there are various plans underway to fast-track its development.

Trends as seen through a revenue authority lens

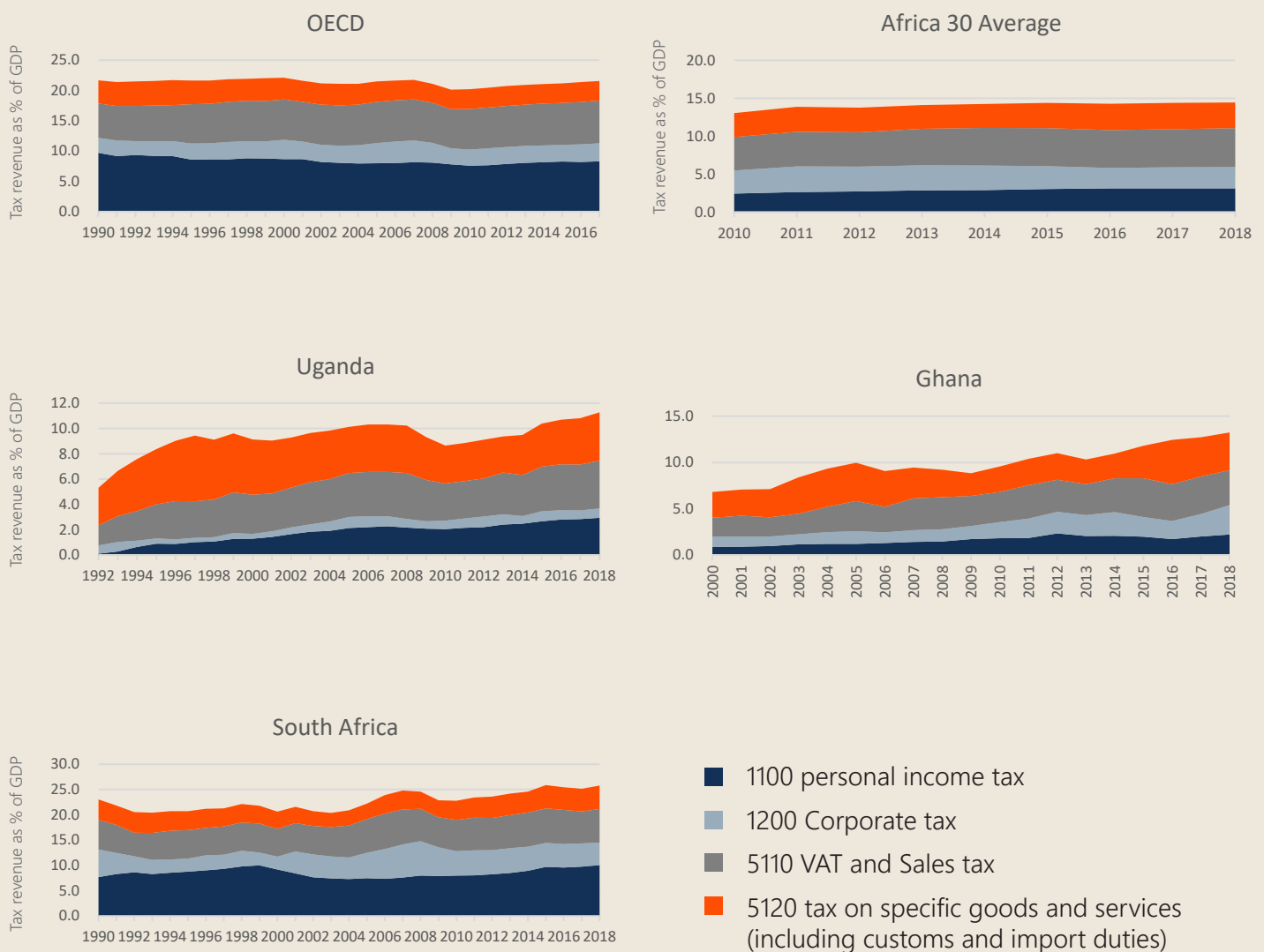
To understand how to plan for a changing tax landscape, it's helpful to understand the perspective of revenue authorities. For example, Anthony Kibirige, Team Leader: International Taxation and Transfer Pricing at the Uganda Revenue Authority, explains that revenue authorities are weighing up how to balance the need for increased revenue to cover emergency aid with the need to stimulate economic growth.

Emily Muyaa, Member of the United Nations Transfer Pricing Subcommittee and Managing Principal for Sub-Saharan Africa in the IBFD Africa and Middle East Department, adds that there is also increased collaboration between the various arms of government and between revenue authorities.

Lee Corrick, Technical Advisor on International Taxation at the African Tax Administration Forum, believes there is a need to improve tax certainty in many countries in the area of transfer pricing, for example, the use of Advance Pricing Agreements (APAs).

Tax composition in African countries from 1990-2018

These graphs demonstrate the difference in tax composition between OECD countries and various African countries over the past few decades. In the wake of COVID-19, corporate tax is likely to emerge as a stronger focus area for many African revenue authorities.



OECD/AUC/ATAF (2020), Revenue Statistics in Africa 2020, OECD Publishing, Paris, <https://doi.org/10.1787/14e1edb1-en-fr>.

Regulatory guidance

OECD

Addressing the tax challenges of the digital economy is a key priority in addressing base erosion and profit shifting (BEPS). Many of the tax challenges in the digital economy were first identified in the BEPS Project, which led to the 2015 BEPS Action 1 Report.

In March 2018, the Inclusive Framework, working through its Task Force on the Digital Economy (TFDE), issued an interim report titled Tax Challenges Arising from Digitalisation, recognising a need for a global solution.

The 137 member Inclusive Framework has since worked on the suggested global solution which comprises a two pillar approach:

- **Pillar One** is focused on new nexus and profit allocation rules to ensure that, in an increasingly digital age, the allocation of taxing rights with respect to business profits is no longer exclusively governed by reference to physical presence.
- **Pillar Two** explores an approach that is focused on the remaining BEPS challenges and proposes a systematic solution designed to ensure that all internationally operating businesses pay a minimum level of tax.

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ATAF

In late 2020, the African Tax Administration Forum (ATAF) announced the publication of a paper on the Suggested Approach to Drafting Digital Services Tax Legislation.

The paper notes that there is a significant risk for African countries in waiting to see whether the OECD Inclusive Framework can achieve an international solution to the tax challenges arising from the digitalisation of the economy. In particular, doing so could significantly delay enacting and implementing legislation to ensure countries obtain the appropriate taxing rights on the profits of highly digitalised businesses, which could cost African countries millions of dollars in tax revenue with many such businesses seeing significant increases in their profits during the COVID-19 pandemic.

Given the situation, the paper provides a draft legislation template for the introduction of a digital services tax (DST). This includes a suggested DST rate of 1% to 3%, with a suggested scope of revenue that includes the following:

- Digital services revenue attributable to the implementing country arising from online advertising services;
- Digital services revenue attributable to the implementing country arising from data services;
- Digital services revenue derived from users located in the implementing country arising from the provision of online marketplace or intermediation platform services, other than the following;
- Digital services revenue derived from users, no matter where located, in respect to the facilitation of rental or use of real property located in the implementing country;
- Digital services revenue derived from users, no matter where located, in respect to the facilitation of vehicle hire services which commence in the implementing country;

- Digital services revenue derived from users located in the implementing country arising from digital content services, online gaming services, and cloud computing services; and
- Digital services revenue attributable to the implementing country arising from any other digital services.

The draft legislation template also includes provisions for determining digital services revenue, de minimis thresholds based on worldwide and country revenue, duty to file returns, appointing local representatives, etc.Box:

What this means for MNEs



Despite the numerous challenges and adjustments that may be expected, ongoing tax compliance obligations largely remain in place. Transfer Pricing is likely to be elevated even further in the priority list of governments and tax authorities to secure revenue to support fiscal stimulus measures, including tax concession, rebates and incentives. MNEs should expect a structural shift.

Conclusion

One of the significant features of COVID-19 is that it has been a catalyst for accelerating various existing trends. Satya Nadella, CEO of Microsoft was quoted as saying that this year, “We saw two years of digital transformation in two months”.

With this development in technology and the need to fill gaps in government revenue, the rate of development within the tax environment has also accelerated considerably during 2020 and this will likely continue in 2021. The implication is that the role of the tax function will become increasingly challenging, and more important in managing uncertainty and potential risks.

If you would like to discuss recent cross-border tax developments and their potential impact on your organisation or industry, please contact Graphene Economics.

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