SERIES ATAF POLICY BRIEF

TAXING DIGITAL FIRMS IN AFRICA

AFRICAN TAX ADMINISTRATION FORUM

FORUM SUR L'ADMINISTRATION FISCALE AFRICAINE

JANUARY **2024**

1. INTRODUCTION

Over recent years an increasing number of ATAF members have reported difficulties in taxing highly digitalised businesses operating in their countries. Their economies are rapidly becoming increasingly digitalised, and that digitalisation often enables multinational enterprises (MNEs) to carry out business in African countries with no or very limited physical presence in those countries. This trend increased due to the use of digitalised processes and systems as a result of advancement in technology as well as challenges created by the COVID-19 pandemic that saw some MNEs with physical presence in a country close their premises and move to online trading. This digitalisation makes it difficult for countries to establish taxing rights over the profits the MNE is making from those business activities in their country.

This is due to the current international tax rules which only allocate taxing rights to a country where a non-resident enterprise creates sufficient physical presence in that country i.e. creating a "nexus" in that country. Business models that enable an MNE to carry out business in an African country with no or very limited physical presence in that country, therefore, represent a significant risk to the country's tax base. Examples of such business models include social media platforms, search engines and online marketplaces.

The current global tax rules are no longer fit for purpose in an increasingly digitalised global economy and the domestic rules of most countries are also not appropriate for the taxation of such businesses. In response to these issues in June 2020 ATAF published a **Policy Brief** designed to assist ATAF members in their tax policy considerations regarding the taxation of highly digitalised businesses operating in Africa countries.

Since the publication of the 2020 ATAF Policy Brief there have been significant developments in the global tax debate on how to tax such digitalised businesses and this Policy Brief aims to provide ATAF members with an update on the current status of the global tax debate while providing legislative policy options available to members for taxing these businesses in Africa.

2. UPDATE OF THE STATUS OF THE GLOBAL TAX DEBATE

The 27 African countries that are members of the OECD/G20 Inclusive Framework have, with assistance from ATAF, over the past few years been negotiating the so-called Amount A Multilateral Convention (MLC) and on 11th October 2023 the Inclusive Framework released the text of the Amount A MLC which reallocates certain taxing rights to market jurisdictions with respect to a share of the profits of the largest and most profitable MNEs operating in their markets, regardless of their physical presence. A significant part of the largest and most profitable MNEs are digital firms.

In its release the Inclusive Framework states that this text reflects the consensus achieved so far among Inclusive Framework members but notes there are different views on a handful of specific items by a small number of jurisdictions. The OECD states that "*the text of the MLC provides governments with the basis for the co-ordinated implementation of this fundamental reform to the international tax system and represents significant progress towards opening the MLC for signature. Countries now have the means to swiftly move forward with the steps necessary to secure signature and ratification*."

In December 2023 the Inclusive Framework published an updated timeline for the MLC stating that "*recognising that the work to resolve the remaining issues will have to go on into next year, including with respect to the standstill on new Digital Services Taxes and other relevant similar measures, members of the Inclusive Framework reaffirm their commitment to achieve a consensus-based solution and to finalise the text of the MLC by the end of March 2024, with a view to hold a signing ceremony by the end of June 2024*".

3. OPTIONS FOR TAXING DIGITAL FIRMS IN AFRICA

3.1. OPTION 1 - WAIT FOR THE AMOUNT A MULTILATERAL CONVENTION TO COME INTO FORCE

The first policy option is for a country to wait for the Amount A Multilateral Convention to come into force and accordingly tax digital firms in accordance with the Amount A rules. However, there are uncertainties as to when and whether Amount A will be implemented.

Article 48 of the published MLC states that the MLC shall enter into force after 30 jurisdictions have signed and ratified it and the jurisdictions that have signed and ratified the MLC represent a total of 600 points or more as set out in Annex I of the MLC. The allocation of these points reflects the number of Ultimate Parent Entities (UPEs) of Groups estimated to be in scope for Amount A in each jurisdiction. Bearing in mind that the MLC will only now be open for signature in June 2024 and the number of jurisdictions that need to sign and ratify the MLC for it to come into force it is highly unlikely that it will enter into force until at least 2026 and possibly 2027.

Some ATAF members are concerned at these further delays to the MLC coming into force and are also concerned at the length and complexity of the Amount A rules as the published MLC and Explanatory Statement is over 800 pages long.

In ATAF's view African countries should now consider whether they should enact other measures to tax digital firms and not wait for the MLC to enter into force.

3.2. OPTION 2 - ENACT DST LEGISLATION THAT IS NOT AN INCOME TAX BASED ON THE ATAF SUGGESTED APPROACH TO DRAFTING DST LEGISLATION

Following the publication of the ATAF Policy Brief in June 2020, ATAF published its ***Suggested Approach to Drafting Digital Services Tax Legislation*** which sets out a model for drafting such legislation. The purpose of the Suggested Approach is to provide African countries that are considering introducing a DST with a suggested structure and content for their legislation. It provides a framework that draws from the various DST legislation enacted in other jurisdictions but is adapted to meet the specific challenges faced by African countries.

A DST is a legislative tool for collecting tax from highly digitalised businesses that present the greatest challenge to the current international tax framework, and which have been paying little or no tax in Africa. The size of the digital economy is rapidly growing as a proportion of the total economy of African countries and consequently, it is becoming increasingly important for African countries to ensure that the digital economy is taxed appropriately.

The ATAF Suggested Approach is designed not to be an income tax as the tax is levied on the supply of narrowly defined services (being those provided by in-scope business activities) and charged at a fixed rate by reference to the gross revenue derived from or attributed to users of in-scope business activities located in a country. It is therefore not a tax on

the net profit of the recipient, and it is not creditable against the country's income tax. In particular, the DST would be paid in addition to a country's income tax charge, so it is not in any way in lieu of income tax. In addition, as it cannot be credited against the country's income tax, it might be considered a business expense, and so would be deductible in accordance with the country's ordinary income tax deduction rules.

If the DST is not an income tax for Double Taxation Agreement purposes countries can introduce the DST unilaterally, without the need for international agreement. If a country's Double Taxation Agreements are consistent with Article 2 of the ATAF Model Tax Agreement the DST would be payable by a non-resident even if it did not have a physical presence in the country.

The ATAF Model Tax Agreement requires a non-resident to have a physical presence before a Contracting State can impose income tax on their sales income. However, Article 2 states that this only applies to income taxes or taxes substantially similar to an income tax. This means that a DST would not conflict with the ATAF Model Tax Agreement provided the DST is not an income tax or substantially similar to an income tax.

Benefits of a DST

A DST should be relatively simple to calculate, and it gives a country an opportunity to tax digital firms that have no or very limited physical presence in the country. While the revenue raised may not be particularly large for most African countries, a DST could have other benefits. Much of the recent public concern about the under-taxation of MNEs has focussed on high-profile digital companies that do not have a physical presence in countries and so are not subject to income tax. By taxing these companies, a DST could improve public confidence in the fairness of the tax system, which is an important factor underlying voluntary compliance.

Issues and potential drawbacks of a DST

Firstly, for domestic businesses the DST applies in addition to income tax and so could result in both DST and income tax applying to the same income of some firms, as they are already taxed in the country on all their income. Non-resident digital businesses pay low rates of income tax generally and are not currently subject to income tax on any income attributable to users in most African countries.

Secondly, as a tax on gross turnover, the DST would apply to firms in a loss position, or with low margins. This is something that can be partially mitigated with de minimis thresholds, as the larger firms tend to be more profitable. A lower DST rate also helps to mitigate this issue. However, these features cannot eliminate the issue altogether.

Thirdly, it is important that any DST does not reduce the growth of the digital sector in African countries, particularly start-ups and small and medium enterprises (SMEs). For this reason, any DST would need robust de minimis thresholds, to ensure it only targets established and profitable digital businesses.

Fourthly, a major issue with DST, whether or not it is an income tax, and also with alternative nexus rules, is the challenge of taxpayer registration and enforcement of the tax. Thus, countries considering introducing these measures should consider building the necessary capacities and establishing relevant administrative measures for addressing these challenges.

Fifth, countries should also note that the Office of the United States Trade Representative has in the past initiated investigations with respect to DSTs adopted or under consideration by countries. In some cases tariffs have been imposed by the US on these countries' exports to the US. It is possible the US might initiate similar investigations with respect to DSTs adopted or under consideration in African countries especially where such DSTs fall within the scope of Article 39(2)-(3) of the Amount A MLC as measures subject to removal.

3.3. OPTION 3 - ENACT DST LEGISLATION THAT IS AN INCOME TAX

Section 10 of the ATAF Suggested Approach enables countries to allow an offset of digital services tax