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Cross-Border Taxation: Implications for Africa

African Priorities on Base Erosion and Profit Shifting (BEPS)

An ATAF Policy Brief – December 2014

Leading Africa in Tax Administration

AFRICAN TAX ADMINISTRATION FORUM

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1. Executive summary

This policy brief sets out ATAF's views on the international tax issue of base erosion and profit shifting (BEPS), the relevance of BEPS to African countries and proposals for how Africa might respond to the challenges it faces from BEPS issues.

BEPS is an issue that adversely impacts on domestic resource mobilisation in both developed and developing countries and arises due to deficiencies in the current international tax rules and standards. It is a global problem that requires global solutions.

The OECD/G20 BEPS project recognises the risks BEPS poses to the tax base of all countries and in July 2013 launched an Action Plan to address deficiencies in the tax rules and standards. The Action Plan identifies 15 specific actions needed in order to equip governments with the domestic and international instruments to address this challenge. The plan recognises the importance of addressing the borderless digital economy, and will develop a new set of standards to prevent double non-taxation.

African countries face many of the same challenges as other countries but also face some challenges that are not faced by, for example, many developed countries. It is therefore critical that African countries:

- Are directly involved in the OECD/G20 BEPS process to ensure the new intentional tax rules are implementable and effective in African countries.

- Focus their limited resources on the BEPS Action Items in the OECD/G20 Action plan that are of highest priority to African countries

- Recognise that there are other base eroding issues of high priority to African countries which are not included in the BEPS action Plan and focus resources on these issues.

2. Introduction

2.1 What is BEPS?

Multi-national enterprises (MNEs) now represent a large proportion of the global economy and cross-border trade between members of the same MNE constitutes a growing proportion of global trade. In addition, the service component of the global economy is growing in importance as is the digitalisation of the global economy. All of these changes have made it much easier for businesses to locate many productive activities in geographic locations that are distant from the physical location of their customers. These developments have opened up opportunities for MNEs to greatly minimise their tax responsibilities and, coupled with increasing sophistication of tax planners in identifying and exploiting the legal arbitrage opportunities and the boundaries of acceptable tax planning, this has created significant risk to the tax base of both developed and developing countries.

This risk to the tax base of all countries has been recognised at the highest political levels and led to the G20 Finance Ministers calling on the OECD to develop an

Action Plan to address the base erosion and profit shifting issues in a coordinated and comprehensive manner. Specifically, this Action Plan should provide countries with domestic and international instruments that will better align rights to tax with economic activity.

The aim of the OECD/G20 Action Plan ("Action Plan") is to address the base erosion and profit shifting issues arising from aggressive tax planning structures used by MNEs and will result in revisions to international instruments such as the OECD Model Tax Convention and Transfer Pricing Guidelines and recommendations for changes to domestic tax legislations. This will be a coordinated approach of the concerned States because unilateral and un-coordinated action will not address these issues and may well exacerbate the situation. The Action Plan consists of 15 action items aimed at producing global solutions to a global problem.

As mentioned above, the OECD BEPS initiative is concerned with legal but aggressive tax planning of multinational firms that leads to double non-taxation. The lack of coherence of corporate income taxation at the international level and the interaction of domestic tax rules leads to gaps and frictions in international taxation that provide legal tax arbitrage opportunities for MNEs. The Action Plan identifies three major pillars of work to address BEPS: (1) coherence of corporate income tax at the international level, (2) a realignment of taxation and substance and (3) transparency coupled with predictability and certainty. All of the action items in the Action Plan fall into these three pillars with the exception of the work on the taxation of the Digital Economy (Action 1) and the development of a Multilateral Instrument (Action 15) which apply across all of the three pillars.

- *Coherence*: The Action Plan calls for the development of international standards to ensure the coherence of corporate tax at the international level. This relates to the need to complement existing rules to prevent double taxation with instruments that prevent double non-taxation in areas previously not covered by international standards. Actions in this area include developing instruments to neutralize the effect of hybrid instruments and entities, strengthening Controlled Foreign Company (CFC) rules, and limiting base erosion through interest expense payments.

- *Substance*: The Action Plan calls for a realignment of taxation and substance. This is about addressing the use of conduit companies and about transfer pricing where current rules do not always produce appropriate results. Actions in this area include addressing treaty abuse, addressing artificial avoidance of Permanent Establishment (PE) status, and changes to the transfer pricing rules to address intangibles, capital, risk, and other high-risk transactions.

- *Transparency*: Addressing BEPS requires transparency, coupled with certainty and predictability. New mechanisms are needed to make sure that governments obtain timely information regarding MNEs' tax planning strategies. At the same time, mechanisms should be implemented to provide businesses with the certainty and predictability they need to make investment decisions. Actions in this area include mandatory disclosure of aggressive schemes, transfer pricing documentation requirements to