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International Tax

Africa

Evolving Tax Landscape

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Snapshot

After Senegal, now Zambia has unilaterally terminated its Double Taxation Avoidance Agreement with Mauritius. Apart from witnessing unilateral termination of tax treaties for seeking fair share of taxes, countries from the African region are making significant progress in fighting tax evasions, curbing illicit financial flows and dealing with base erosion and profit shifting.

Various countries in the region are adopting or reforming Transfer Pricing regulations and making more detailed and stringent scrutiny to tackle tax avoidance issues. Transfer pricing regulations are being developed in lines with OECD guidelines with emphasis on principles like *DEMPE* in case of intangibles. Tanzanian regulations denying royalties for locally developed intangibles transferred and licensed back for use in Tanzania is a notable instance.

Judicial pronouncements have also been on the track where transactions designed for tax avoidance are disapproved.

More and more African jurisdictions have pledged to implement BEPS and other programmes at international forums. These are remarkable trends visible in the region which is also witnessing significant growth in economic development and foreign financial flows.

Countries from the region are moving towards higher level of tax transparency and focusing on exchange of information, including through implementation of Country-by-Country Report filings. There is significant increase in the number of exchange of information requests made by African countries, which has translated into additional tax revenues.

This Note captures select but important and trend-setting changes in tax policies from African region, highlighting evolution of African tax regimes:

- **Tax Treaty Renegotiations**
- **Transfer Pricing Reforms**
- **Judicial Approach to Curb Tax Avoidance**
- **BEPS Implementation and Multilateral Instrument**
- **Tax Transparency Measures**

These actions do not appear to be stray cases but appears to be part of larger picture where the African tax authorities have started demanding their fair share of revenue and heavy crackdown on tax avoidance through dubious means.

While these actions are currently visible in couple of jurisdictions in Africa, we anticipate that the other jurisdictions would also pick up a clue from their neighbours and implement such measures sooner than later in a bid to protect their tax bases from eroding.

Therefore, the MNCs having business presence in Africa should evaluate their strategies and prepare themselves for the new approach of African tax authorities.

Background and Coverage

The African continent comprises of 54 countries with diverse set of geopolitical environment and varying stages of economic development. The region has, in recent years, been witnessing significant economic growth emanating from various initiatives for socio-economic development, increasing domestic demand and increasing foreign investments.

Many African governments and regional organisations have been closely working with international forums like Organisation for Economic Development (OECD), United Nations (UN), European Commission, etc. to achieve 'Economic transformation', the core of Africa's development agenda and for design and implementation of policies in areas of economic and social well-being, political governance, development of external financial flows and mobilisation of domestic resources, industrialisation and entrepreneurship, global value chain initiatives, etc.

As per Report of the OECD on Africa's Development Dynamics 2019 (Published in November 2019), the African continent recorded 4.6% annual gross domestic product (GDP) growth between 2000 and 2018, which is second fastest after Asia. Increase in domestic demand for processed products, which is expanding faster than world average has been the most important driver for growth in GDP. African Continental Free Trade Area was also launched in July 2019, to enable growth through expansion of market opportunities and better resource allocations in the region.

These factors have contributed to increasing financial flows from foreign jurisdictions in the region. Apart from socio-economic and political developments, there has been increasing participation from African countries in creating awareness and making policy changes for economic as well as tax reforms. The region has been making significant progress in fighting tax evasions and illicit financial flows and actively introducing reforms to its policies. Unlike various developed countries, where individual taxes, social insurance taxes and property taxes play a significant role, African countries' tax structure places relatively higher reliance on corporate and consumption taxes.

Tax Treaty Renegotiations

In its Cabinet meeting held on June 22, 2020, Government of **Zambia** approved termination of Double Taxation Avoidance Agreement (DTAA) with **Mauritius**, citing intentions for negotiation of a new DTAA with shared taxing rights and anti-abuse clauses.

The DTAA which came into force from June 15, 2012, is proposed to be terminated with effect from December 31, 2020 in Zambia and June 30, 2021 from Mauritius perspective.

Currently, the DTAA between Zambia and Mauritius gives exclusive taxation rights to country of residence with respect to certain incomes (For e.g. Technical service fees and Capital gains in absence of specific article on the same) and restricts taxing rights of source country with respect to certain items of income such as 5% / 15% in case of dividends, 10% on interests, 5% on royalties, etc.

It is interesting to note that Press Release on the said termination mentioned that Zambia does not retain taxing rights to tax dividends, interest and royalties arising in Zambia and payable to residents of Mauritius, which appears to be inadvertent. Considering that the DTAA already provided for limited taxing right in the source country, it appears that Zambian Government may be proposing to have right to tax certain incomes at a rate higher than that mentioned in current treaty.

It is worth noting that earlier this year, **Senegal** had unilaterally terminated its DTAA with Mauritius (decision was conveyed to Mauritius in June 2019) with a view to renegotiate a new DTAA. The Mauritius-Senegal DTAA which exempted incomes from interest, dividend, royalty, etc. in the Source country, has been terminated in Senegal with effect from January 01, 2020 and in Mauritius from July 01, 2020.

A new tax treaty was also signed between **Kenya** and Mauritius in April 2019, followed by a protocol in October 2019. The new DTAA was a fallout of a decision of High Court of Kenya in March 2019 citing that the Kenya-Mauritius DTAA signed in 2012 was null and void and that the treaty never entered into force because Kenya did not notify Mauritius of the completion of the ratification procedures.

Interestingly, as per a press release issued by Government of **Netherlands** on May 29, 2020, the Dutch Government has expressed willingness to amend tax treaties with 47 less developed nations to give them fair share of taxes by incorporating 'source state taxation rights' on technical service fees. Source state taxation will enable these developing countries to levy tax on fees for managerial, technical, consultancy services arising in these jurisdictions to residents of Netherlands. The list of countries impacted by these proposals of Dutch Government includes more than 30 African countries.

Transfer Pricing Reforms

Transfer pricing regulations in most African countries are at a nascent stage and has been focusing on certain industries like mining. Many African countries are however taking part in the global transfer pricing debates, especially regarding requirements for service transactions, capital-rich and low-function entities, and analyses of intangibles based on Development, Enhancement, Maintenance, Protection, and Exploitation (DEMPE).

South Africa's transfer pricing legislation was introduced in 1995 and overhauled as of April 2012 to align more with the OECD's guidelines. Recently, in 2019-20, South Africa has introduced draft interpretation notes for withholding tax on interest and royalty payments, proposals on interest limitations, updated interpretation note on connected persons and associated enterprises, updated guidance on mutual agreement procedures.

The **Democratic Republic of Congo** has introduced various changes to its transfer pricing laws effective from January 2020, including:

- Introducing provisions for advance pricing agreements (APAs) for 4 years;
- Clarifying that taxpayers may need to justify arm's length price during audits at request of tax authorities and transfer pricing documentations may not suffice.

Transfer pricing regulations in **Botswana** took effect in July 2019.

Tanzania issued regulations in 2018 for filing of transfer pricing documentation with return of income for companies, with a threshold of USD 4.3 million along-with penalty provisions for non-compliance. The new rules include certain important provisions like:

- No royalties for locally developed intangibles that are transferred outside the country and then licensed for use in Tanzania (sale and lease back of intangibles)
- Remuneration for Service transactions to be on Cost basis
- The use of a tested party outside Tanzania is allowed only when the party's all relevant information, including financial statements, is provided
- Comparable uncontrolled price method and use of "quoted spot price" prescribed as the appropriate method for commodity transactions
- Rewarding a person other than legal owner at arm's length consideration based on DEMPE functions

Kenya, in 2018, expanded the scope of the country's transfer pricing rules to cover transactions of resident parties operating in beneficial tax regime with associated resident parties not operating in beneficial tax regime as well as transactions with related or unrelated non-resident parties in preferential foreign tax regimes and also transactions with non-residents, wherein either the transaction or the non-resident lacks economic substance. Other new rules require annual contemporaneous documentation, use of a prescribed method for commodity transactions, rejection of negative transfer pricing adjustments and acceptance of secondary transfer pricing adjustments. Transfer pricing has become a point of focus of the Kenya Revenue Authority (KRA) with increasing foreign investments.

Nigeria's transfer pricing regulations were revised in 2018, aligning with OECD recommendations, and introducing new requirements on procurement and intra-group service transactions, guidelines on pricing of commodities, limitation of deduction on royalty payment, clarification that only pricing arrangements approved by the tax authority (and not other government agencies) qualify for a safe harbour and strict penalties for non-compliance.

Judicial Approach to Curb Tax Avoidance

Intra-group transactions within multinational groups are being subject to more detailed and stringent scrutiny by revenue authorities and tax avoidance transactions by African entities are being viewed more strictly by the African judiciary in recent times.

In the case of a leading mining company Mopani Copper Mine Plc. (MCMP or Taxpayer), **Zambian Supreme Court** upheld the decision of Tribunal, confirming invocation of Anti-Avoidance provisions u/s 95 of the Income-tax Act by Zambian Revenue Authorities (ZRA) on international transactions undertaken by MCMP with its Swiss parent Glencore International AG (AE).

The taxpayer had exported copper to its AE and prices for export of minerals were determined based on London Metal Exchange (LME) Copper A Grade cash settlement over a quotational period. However, based on ZRA's assessment it was found that the prices charged by the Taxpayer to its Swiss AE were much lower than prices charged to other parties. Accordingly, ZRA had proposed significant price adjustment u/s 95 of Zambian Income-tax Act which deals with transactions designed to avoid tax liability, which was upheld by order of the Tribunal.

Appeal filed by the Taxpayer, against the Tribunal ruling in favour of ZRA, was dismissed by SC and price adjustments done by ZRA were upheld. SC also ruled that opinion from M/s Deloitte & Touche confirming arm's length nature of the transactions, relied upon by taxpayer, was not binding on the revenue authorities. In its detailed judgement dated March 3, 2020, SC also heard various international judicial decisions from Indian, French and English Courts.

Nigeria's Tax Appeal Tribunal has recently, on February 19, 2020, issued its first ruling on transfer pricing issue. The ruling concerns the appropriate transfer pricing method to be applied by a Nigerian company, Prime Plastichem Nigeria Ltd, engaged in trading of plastics and petrochemicals.

The taxpayer had used different methods for determining the arm's length price of its purchase of petrochemical products from an offshore related party, namely, Comparable Uncontrolled Price (CUP) Method in 2013 and Transactional Net Margin Method (TNMM) in 2014.

The Tax Appeal Tribunal ruled in favour of Nigeria's Federal Inland Revenue Service (FIRS), rejecting CUP Method and upholding TNMM for determination of arm's length price due to failure on the part of taxpayer to provide sufficient and reliable information for the application of the CUP method and due to inconsistency in methods adopted by taxpayer in different years. The Taxpayer was issued an assessment for NGN 1.74 billion including interest and penalties.

BEPS Implementation and Multilateral Instrument

28 of 135 members of the OECD's Inclusive Framework are African jurisdictions and have been keen to implement the minimum standards laid by the Base Erosion and Profit Shifting (BEPS) Project of OECD. Many African countries are taking steps to implement the OECD's recommendations for countering harmful tax practices, Prevention of treaty abuse, Country-by-Country reporting, through coordinated international tax rules and enforcement efforts.

Action Plan 13 of the BEPS Project recommends exchange of information of multinational enterprise groups in form of **Country-by-Country Report (CbCR)** and suggests maintenance of Transfer pricing documents in form of **Master file** and **Local file**. CbCR is a snapshot of country-wise information of key indicators of MNE groups including revenues, profits, assets, employees, capital, accumulated profits, and taxes. Master file provides details of business activities, intra-group transactions with respect to intangibles, services and finance and transfer pricing policies of the group. 6 African countries, **Cote d'Ivoire, Egypt, Gabon, Mauritius, Nigeria and South Africa**, have legislated regulations relating to CbCR as per Action Plan 13 of BEPS. Legislations relating to maintenance of Master file by MNE groups have been introduced in 5 countries - **Egypt, Gabon, Nigeria, South Africa, and Zambia**. While, **Botswana, Kenya, Namibia, Rwanda and Uganda** have introduced draft laws or expressed intentions for implementation of reporting and exchange of CbCR and transfer pricing documentations in form of master file and local file.

Action Plan 15 of the Base Erosion and Profit Shifting (BEPS) Project of OECD recommends entering into 'The Multilateral Convention to

Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting', also known as **Multilateral Instrument (MLI)**. MLI is an instrument that proposes to modify over 1000 bilateral tax treaties in a synchronised, fast, and consistent manner. MLI provisions *inter alia* include mandatory provisions such as Article 6 of Preamble of Treaties and Article 7 on Prevention of Treaty Abuse and Articles on dispute resolutions. Until July 7, 2020, 12 African countries have become signatories to MLI, namely, **Burkina Faso, Cameroon, Côte d'Ivoire, Gabon, Kenya, Mauritius, Morocco, Nigeria, Senegal, Seychelles, South Africa, Tunisia**. And, 2 jurisdictions, **Algeria** and **Eswatini** have expressed their interest to sign MLI. However, as on July 7, 2020, only **Mauritius** has deposited instrument of Ratification and MLI has entered into force for Mauritian Tax Treaties from February 1, 2020. It is important to note that Mauritius has notified its tax treaties with 44 jurisdictions to which it intends to apply provisions of MLI, which however does not include India. Consequentially, India-Mauritius DTAA is not a Covered Tax Agreement and is therefore not subject to provisions of MLI.

Countries such as **Uganda, Benin, Botswana and Zambia**, are also imposing the OECD's new limitations on interest deductibility as a percentage of earnings before interest, deductions, taxes and amortization (EBITDA). South Africa proposes to limit interest expense deductions to 30% of EBITDA as per a discussion paper released in February 2020.

Tax Transparency Measures

'The Africa Initiative' is a focused programme, since 2014, by 32 African members of the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes created to curb tax evasions and high levels of illicit financial flows from African countries. The same was created in partnership with a number of of regional and international organisations including African Tax Administrative Forum, the African Union Commission, the African Development Bank Group, the European Union, World Bank Group, Finance (Ministry of Europe and Foreign Affairs), etc with an objective to unlock the potential of tax transparency and exchange of information for Africa.

The Annual Report - Tax Transparency in Africa 2020 was launched on June 25, 2020. The Report shows significant progress made on the two pillars of the Africa Initiative:

- raising political awareness and commitment in Africa and
- developing capacities in African countries in tax transparency and exchange of information.

The Report acknowledges that the exchange of information networks of African countries has further expanded to reach 3,262 bilateral relationships compared to 2,523 in 2018 which has significantly increased from merely 685 in 2013, which is mainly due to the growing number of countries joining the Convention on Mutual Administrative Assistance in Tax Matters.

There is significant increase in the number of exchange of information requests made by African countries, which has translated into additional tax revenue. In the year 2019, 5 African countries identified nearly USD 12 million additional tax as a direct consequence of the requests sent. Whereas, during the period of

2014 to 2019, a group of 8 African countries identified USD 189 million of additional taxes.

Apart from Exchange of Information on Request (EOIR), the programme has also been focussing on effective implementation of Automatic Exchange of Information (AEOI), expansion of staff's knowledge, the availability of beneficial ownership information and introduced measures including voluntary disclosure programmes.

AEOI with various jurisdictions has been operational in **Seychelles** and **South Africa** since 2017 and **Mauritius** since 2018, whereas, **Ghana** has joined AEOI initiatives since 2019 and **Nigeria** is proposing to implement the same from 2020.

Tax transparency and EOI initiatives is playing a crucial role in helping African governments stem illicit financial flows, increase domestic revenue mobilisation and improve its ranking in ease of doing business.

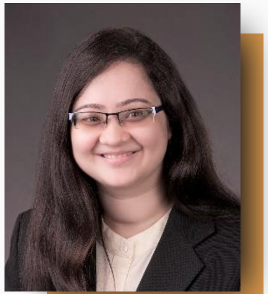
Concluding Thoughts

Many African countries are implementing series of measures for curbing tax evasions and towards tax transparency. Most of these countries have been actively participating in implementation of recommendations from OECD's BEPS project, especially in respect of exchange of information through CbCR, curbing harmful tax practices, transfer pricing of intra-group services, transfer pricing of intangibles using analysis of DEMPE, etc.

A definite trend is visible in African jurisdictions, trying to plug loopholes and seeking fair share of taxes. Though these trends are currently considerably visible in few jurisdictions, the same are bound to emerge in most jurisdictions from the region.

Indian MNCs having operations in African continent will have to give due considerations to intra-group transactions considering the increasing importance towards the aforementioned parameters coupled with the approach being adopted by Transfer Pricing authorities, both in India and in the African jurisdictions.

Should you need more information, kindly reach out to



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