Briefing Paper

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PAY UP!
International Tax Issues in Africa

Governments use domestic resources to meet set development goals. As countries continue to lose tariff revenues due to global and regional trade liberalisation agreements; and offer tax concessions to foreign investors, it is imperative that citizens hold their authorities accountable for wastage and unfairness in tax administration as well as question certain tax concession deals. This Briefing Paper presents tax issues in Africa including tax evasion, illicit financial outflows and tax competition and what can be done to stop tax money from disappearing into thin air.

Background

Tax is a human rights issue! Governments use tax revenue to provide, *inter alia,* public services and social amenities such as roads, electricity, clean water, free education, quality healthcare and security. Taxes are used as a tool of wealth redistribution in order to reduce the gap between the rich and the poor and to generally enhance welfare.

To meet sustainable development goals, domestic resource mobilisation is seen as the most viable source of revenue to governments as opposed to loans and grants. External assistance not only limits the policy space of a country as it comes usually with conditions but also tends to dampen national pride.

Countries are losing certain important sources of domestic revenue. Trade tariff revenues have been declining due to various trade liberalisation agreements both at multilateral and regional levels. Another dwindling source of tax revenue is the tax due from foreign investors. Presumably in an effort to attract more foreign direct investment (FDI), countries appear to engage in harmful tax competition.

The fact that developing countries, particularly African countries, continue to lose some sources of taxation provokes one to raise questions on why these countries choose to engage in tax competition and why some of the existing loopholes are tolerated. This paper is intended to brief the reader on various issues around international taxes in Africa and offer plausible recommendations.

Context

Arguably, taxation levels could be one indicator for a country's level of economic development and social security. In many developed countries, almost all incomes, goods and services are taxed; and that tax revenue has higher share in total production, as measured by the Gross Domestic Product (GDP). Furthermore, efforts are made to make the structures fair and the collection procedures transparent; while citizens are more or less able to hold their governments accountable for anything on the contrary.

The share of tax revenue in developing countries and more so in sub-Saharan Africa (SSA) is low- generally less than one-fifth of GDP. Similarly, the amount of tax money available for the government to spend for each person (tax per capita) is very low whereby in certain African countries, for instance Ethiopia, Democratic Republic of Congo and Guinea Bissau, the estimated annual per capita taxes is as low as US$11 per person. The implication of such low level of tax is that governments must heavily rely on other sources, including external assistance to finance development.

A myriad of reasons explain the low level of domestic resource mobilisation in SSA –all of which are somehow related to loopholes that result in collection inefficiency, corruption and tax evasion by rogue companies.

Illicit Financial Outflows

On average, SSA losses around 5.7 percent of GDP annually from illicit capital outflow, which is more than the world average of 3.9 per cent. African and Middle East owned assets held offshore are estimated to be more than five times compared to European assets held abroad. Many of the offshore financial institutions, such as Swiss banks, are accused of aiding tax evaders by asking few questions, if at all any, on the source and amount of money being transacted.

In an attempt to evade paying taxes, some multinationals are accused of underreporting profits, some even reporting losses for years; as well as underreporting volumes of production. What is even more shocking is the involvement of reputable global consulting and auditing companies in this scam by advising their clients on how to dodge taxes. To benefit from unfair transfer pricing, some corporations are accused of operating subsidiary companies in countries considered as tax havens so that they sell at very low prices to subsidiaries and remain with low tax bills.

Corruption, which is the main cause of so many other social and economic problems ailing the continent, can also be blamed partly for the large scale illicit financial outflow witnessed in Africa. It facilitates illicit financial outflows, especially tax evasion, since companies and individuals know they can get away with fleecing poor nations without being held accountable.

Tax Competition

Some African governments, including resource-rich countries, compete to offer tax incentives and exemptions to corporations in an attempt to attract FDI. However, such unhealthy competition has resulted in losses whereby, for instance, the EAC continues to lose about US$2.8bn every year while Uganda alone loses double of the amount it budgets for its healthcare sector.

Foreign investors are attracted to African countries for a number of reasons including the very presence of natural resources and not necessarily the favourable policy environment. If the latter was to be true then countries that are highly ranked in the 'Doing Business' report would have the highest FDI inflow. However, it is evident that many investors flock to countries that are resource abundant, which could even be politically unstable, such as the Democratic Republic of Congo and South Sudan. In short, it can be argued that tax exemptions may not necessarily be the best trigger of FDI and should be minimised.

On the other hand, contracts entered on extractives are usually guarded with high secrecy and the public is not aware if the nation is getting a raw deal or whether it is getting appropriate tax dues from its natural resources.

Informal Cross-Border Trade

Tax non-compliance from informal sector operators is a common problem across African

countries. Informal businesses are estimated to be 35 to 50 percent of GDP in many developing countries and in some countries hire as high as 90 percent of total population. It is believed that many informal sector operates do not comply with tax payments due to lack of capacity. At borders, informal cross-border traders, the majority of whom are women, use *panya* routes to transport tradable goods.

Apart from insecurity, sexual, verbal and physical abuse, such activities lead to loss of huge sums of tariff revenue. Furthermore, tax administration systems at border posts are weak because of lack of electronic systems, as they may not even have power supply; and staff poorly trained officers. One of the biggest problems is, however, the absence of tax structures that are tailored for the informal sector in general and informal cross border traders, in particular.

Conclusion and Recommendations

The opportunity cost of uncollected official tax has serious implication on the economic growth and sustainable development of countries. The whole objective of improving domestic resource mobilisation is to finance development and enhance welfare through fair and efficient tax structures and systems.

The development and policy space of nations are compromised by illicit financial outflows, mainly through transfer pricing and tax evasion by multinational companies, the same companies invited to spur growth. Thus, countries need examine if their tax incentives are attracting unscrupulous investors.

The following are plausible recommendations meant to stop tax money from disappearing into thin air.

i. Taxes on natural resources must result in economic benefits. Contracts should not be subject to confidentiality and the public should be aware if contracts are of mutual benefit to both the nation and the foreign investor; and need to be awarded competitively. Therefore, civil societies and the media should continue to agitate for full disclosure of information on natural resource contracts.

ii. World Bank's *Doing Business* Report ranks 189 economies and selected cities according to measures of business regulations on local firms. However, beyond ticking boxes on regulations, more indices need to be added on the report or a different global report needs to be produced to indicate responsible business practices and indices that can answer the question *business for who?*

iii. There is need for meaningful global co-operation among financial intelligence units to end financial secrecy. If it is possible to track and link money laundering to funding of terrorist groups, it certainly must be possible to identify companies that stash money in offshore accounts, abuse transfer pricing to evade taxes; and ultimately compromise the growth of poor nations. Offshore accounts are the favourite of many unscrupulous companies and individuals operating from Africa as they offer secrecy and anonymity. Disclosure of foreign accounts by law is one very important measure to stop stashing money in such accounts. For example, Finnish financial institutions have been obligated to institute due diligence procedures to establish when a new account is opened by a US citizen and notify the US government. African stakeholders need to borrow a page thus for bilateral agreements.

iv. Strengthening law enforcement against tax fraudsters begins with reducing the general level of corruption. As indicated above, corruption is the root cause of many vices in Africa, which requires a holistic approach from development practitioners, civil societies, the media and church, among others.Ever widening income gap; social and economic classes; cultural (positive) attitude towards materialistic gains and greed promote amassing wealth through any conceivable means. Thus, a whole cultural revolution is required for zero tolerance of

corruption. Development practitioners and policy advisors, on the other hand, need to work on narrowing income gaps, for instance through tax structures that favour the poor and make the rich contribute more.

v. In relation to the above point, tax authorities need to revise salary scales for their officers and offer better incentives to reduce rent-seeking behaviour and collusion with fraudsters.

vi. Research and advocacy need to be promoted with regard to taxes, economic losses and economic crimes. Not many people out there are aware of how much is lost from illicit financial outflows or tax exemptions; and if indeed some are aware, perhaps the findings may not be relatable. As an ordinary citizen, one would be interested to know the opportunity costs of forgone taxes in terms of say how many people living with HIV could not have access to antiretroviral drugs; how many kilometres of roads could not be built in a remote area; how many infants die per day; or how many people could not have access to electricity because some companies or some people decided not to pay up dues. Such a powerful knowledge is enough to put pressure on governments to tighten tax loopholes.

vii. In relation to the above, civil societies and the media need to play a crucial role in naming and shaming of individuals and companies as well as in agitating citizens to hold their governments accountable.

viii. SSA countries have to invest more in information technology (IT). Electronic information, registration, filing and payment need to be put in place for efficient tax collection and ease of administration.

ix. With regard to informal traders across borders, not only do countries lose taxes but so many of the informal traders, which happen to be women, suffer from physical, sexual and verbal abuse from law enforcers. It is high time that SSA governments and regional blocs try to integrate these traders by facilitating the total free movement of persons and tailoring the tax structure to suit small cross-border traders.

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