



Working Paper 105

Addressing the Challenges of Taxation of the Digital Economy: Lessons for African Countries

Solomon Rukundo

January 2020

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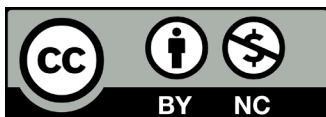
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Solomon Rukundo

Summary

The rapid growth of the digital economy in many African countries has led to concerns about whether their tax regimes are equipped to deal with this new phenomenon. The shift from a traditional bricks and mortar commercial environment to one that is electronic and information-based poses serious and substantial challenges to traditional tax regimes. African revenue authorities face the daunting task of protecting their revenue base without hindering either the development and use of new technologies or the involvement of the business community in the emerging e-market place. This paper examines legislative and policy approaches to taxing the digital economy adopted by different jurisdictions around the world and the lessons that African countries can draw from these experiences. The paper argues that African countries should participate in the multilateral discussions on the reform of international taxation needed to deal with the challenges of the digital economy. However, they must also acknowledge that their challenges are different from those of developed countries and therefore their final solutions will have to be uniquely African.

Keywords: digital tax; international taxation; digital economy; Africa.

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Acronyms

A4AI	Alliance for Affordable Internet
ALP	Arm's length principle
ATAF	African Tax Administration Forum
B2B	Business-to-business
B2C	Business-to-consumer
BEPS	Base erosion and profit shifting
CIT	Corporate income tax
DST	Digital service tax
DTA	Double taxation agreement
EU	European Union
EUR	Euro
GATS	General Agreement on Trade in Services
GloBE	Global anti-base erosion
HMRC	Her Majesty's Revenue and Customs, UK
MNE	Multinational enterprise
MSME	Micro, small and medium enterprise
OECD	Organisation for Economic Co-operation and Development
PE	Permanent establishment
PST	Profit shifting tax
SEP	Significant economic presence
UK	United Kingdom
US	United States
USD	United States Dollars
VAT	Value added tax
WTO	World Trade Organisation

Introduction

Around the world, the digital economy is experiencing massive growth. Preference for a single provider of online services in a similar category and network effects lead consumers to choose services already made popular by other users resulting in large digital multinational enterprises (MNEs) such as Google, Facebook and Amazon dominating this space.¹ Emerging markets in developing countries where millions of people are coming to the internet for the first time are quickly becoming important to digital MNEs. Facebook, for example, currently has 200 million users in Africa and about 21 million Africans now do regular online shopping (UNCTAD 2018). Between 2014 and 2018, the penetration of Sub-Saharan smartphone connections increased from 10 per cent to 30 per cent and data traffic in Africa is growing at a rate of 41 per cent per year, signalling greater access to digital MNE services on the continent (UNCTAD 2019). Despite this phenomenal growth, taxing digital MNEs remains a major challenge.

This paper explores the options available for African countries to protect their tax base in the face of a burgeoning global digital economy. The paper uses a qualitative research methodology relying on document review for analysis and interpretation of literature on the taxation of the digital economy. The paper draws on the work of the Organisation for Economic Co-operation and Development (OECD), African Tax Administration Forum (ATAF) and European Commission along with recent legislative and policy measures introduced by selected countries, and concludes with lessons that African countries can draw from these different multilateral and unilateral efforts at taxing the digital economy. The chief lesson to be drawn is that African countries will need to take on the challenge of taxation of the digital economy in their own unique way as their challenges differ from those of the more developed OECD countries.

1 Digital MNE business models

Google, Facebook, and YouTube use the advertising model. Advertising is sold when the advert is viewed or clicked upon. The advertising client pays for users' personalised attention, which the MNE accesses through the collection and analysis of personal data. The users' online activity generates this data, creating value for online advertising (Fuchs 2018). Data driven business models have led to an increase in the value of data such that the news magazine, *The Economist*, declared in 2017 that 'The world's most valuable resource is no longer oil, but data' (The Economist 2017).

Merchant model websites like Amazon allow users to purchase and ship items into the country thereby bypassing retailer middlemen and reducing costs. The merchant model adapts the traditional retail business model to the online world.

The brokerage model is used by websites such as eBay and Airbnb. This model brings the sellers and buyers together online and usually involves the collection of a commission on the transactions. Airbnb, for example, links international travellers to people willing to lease or rent short-term lodging in their destination country.

¹ Google has 90 per cent of the online search market, Facebook has two-thirds of the global social media market and Amazon commands a 40 per cent share of the world's online retail activity, while its Amazon Web Services similarly accounts for a 40 per cent share of the global cloud infrastructure services market (UNCTAD 2019).

2 Taxing digital MNEs

Two rules of international taxation pose a challenge to taxing the global digital economy. First is the permanent establishment (PE) rule which allocates taxing rights to a country where an MNE creates a sufficient physical presence. Sufficient physical presence includes a place of management, a dependent agent, branches, and so on, excluding storage, delivery of goods and mere preparatory or auxiliary functions. Second is the profit allocation rule based on the arm's length principle (ALP) which itself hinges on the separate entity principle. The ALP requires that conditions between associated parties in their commercial transactions match those that would exist between independent parties. Applying the ALP involves analysis of the functions performed, assets used and risks assumed by each associated enterprise and determination of the distinct contributions of each to the creation of value reflected in the profits. The contribution each associated enterprise makes is the proxy used to reflect real economic activities and value creation. Profits are then allocated based on value created.

African countries have long applied these rules through domestic laws and bilateral double taxation agreements (DTAs) to ensure that MNEs are taxed on services performed in the country. However, the framework established under these two rules envisages a bricks and mortar business environment focusing on aligning taxing rights with the location of economic activities undertaken by MNEs. Digital MNEs, however, can operate with only a web presence. For example, Facebook opened an office in Johannesburg in 2015, its first and only African office, despite having 200 million users in Africa. Even when there is a physical presence, transactions in the digital economy may be concluded in low tax jurisdictions. Google had 1,300 staff in the UK and earned US Dollars (USD) 18 billion in revenue from there between 2006 and 2011 but only paid USD 16 million in UK corporate income tax (CIT) in that period because advertising sales to UK clients technically took place in Ireland and Google lacked a PE under the Ireland-UK tax treaty (House of Commons 2013). Digital MNEs using multisided business models gain value from externalities generated by free products challenging prevailing notions of where and how value is created. Digital MNEs can use aggressive tax planning through existing international tax rules to pay less tax, thereby eroding the base of traditional taxes like CIT and value added tax (VAT). For example, taxes paid abroad by Facebook in 2017 amounted to only 2.9 per cent of the profits it generated outside the United States (UNCTAD 2019).

The taxation challenge posed by digital MNEs is heightened by their disruptive nature. Resident businesses providing similar services bear the burden of CIT while digital MNEs go untaxed. Mobile communications applications like WhatsApp are becoming the main means of communication among smartphone users in Africa, replacing traditional voice and messaging services which were the main source of revenue for many telecom operators. In 2016 South Africa's two largest telecommunications operators, MTN and Vodacom, testified before a parliamentary committee that their profits were being hurt by falling voice and SMS revenues, and yet the data-based messaging apps which were responsible were untaxed (SA Parliament 2016). The growing digitalisation of businesses is also disruptive. Newspapers that employ hundreds of workers in printing and distribution facilities are becoming obsolete with the emergence of online news sites and news aggregators to which local advertisers are shifting *en masse*. Music, e-books, films, software and video games are now digital products which are traded across borders without payment of customs duties. In 1998 the World Trade Organisation (WTO) instituted a two-year moratorium on imposing customs duties on electronic transmissions. This moratorium, which has since been renewed every two years, is estimated to cost Sub-Saharan African countries up to USD 2.6 billion annually in uncollected revenue (Banga 2019). Further, developing countries are net importers with negative trade balances and this is likely to be exacerbated by a growth in cross-border e-commerce. Unless addressed, tax revenues shall continue to decline due to reduced land use and unemployment brought about by the digitalisation of the economy.

3 Multilateral approaches to taxation of the digital economy

3.1 The Organisation for Economic Co-operation and Development

The Organisation for Economic Co-operation and Development (OECD) in its 1998 Ministerial conference in Ottawa stated that the same five traditional canons of taxation that apply to conventional commerce should apply to the digital economy.

- (1) Neutrality – taxation should be neutral and equitable between the digital and conventional economies; and digital business models that are similar to each other should be taxed in the same way.
- (2) Efficiency – the administrative and compliance costs of any digital tax regime should be low.
- (3) Certainty and simplicity – tax rules for the digital economy should be clear and easy to understand.
- (4) Effectiveness and fairness – the potential for tax avoidance and evasion should be limited.
- (5) Flexibility – a digital tax regime should be able to keep pace with technological and commercial developments (OECD 2001).

In 2013, the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project was launched. It focused on 15 action areas that facilitate MNE tax avoidance in the international tax system. Action 1 considered digitalisation challenges (OECD 2013).

In 2015 the OECD issued a report on the challenges of taxation of the digital economy (OECD 2015a). The report noted three aspects of digital MNEs that make them uniquely difficult to tax. First, it is easier for them to sell in foreign markets with little to no physical presence there than it is for conventional businesses. Second, digital MNEs increasingly rely on intangible assets, especially intellectual property like brand names, patented inventions, trade secrets, algorithms and designs, as a source of company value. Compared to tangible assets, these are much easier to transfer between jurisdictions, but harder to value when being sold or leased. Third is the involvement of users in value creation. Some digital MNEs derive significant value from the active participation of their users, from user data, and from network effects. Yet such value is not recognised by the current profit allocation rules. The OECD noted the difficulty in attempting to 'ring-fence' the digital economy for tax purposes because of the increasingly pervasive nature of digitalisation. Instead three options were identified: (1) a new nexus based on non-physical significant economic presence; (2) a withholding tax on digital transactions; (3) an equalisation levy. However, none of these three options was recommended for adoption. The OECD instead committed to reconsidering taxation of the digital economy in 2020 but recommended that countries adopt the proposed solutions while still respecting any existing treaty obligations (OECD 2015a).

The OECD/G20 Inclusive Framework on BEPS (OECD-IF) was established in 2016 to ensure that interested countries, including developing economies, can participate in the development of standards on BEPS-related issues. 134 countries, 24 of which are African, are members of this Inclusive Framework (OECD 2019a). In March 2018, the OECD-IF issued an interim report on the taxation of the digital economy (OECD 2018). The report noted three approaches adopted by different groups of countries. The first group viewed digital economy tax issues as a unique challenge for the international tax framework and advocated targeted changes to the nexus and to profit allocation rules. The second group viewed the challenge as wider than just the digital economy and advocated much broader

solutions. The third group maintained the status quo as the current rules were working well following the OECD's BEPS project (OECD 2018). In January 2019 the OECD-IF published a policy note that divided proposed solutions into two complementary pillars and subsequently published a public consultation document. Over 2,000 pages of written comments were received and a public consultation with over 400 participants from business, academia and civil society took place in March 2019. The OECD-IF agreed on a programme of work to lead to a global solution to the digital economy taxation challenge to be delivered by 2020 (OECD/G20 2019).

In early October 2019 the OECD Secretariat released a proposal on Pillar One based on a 'Unified Approach' (OECD 2019b). Public consultation meetings on this proposal were held in November 2019. The proposal focuses on consumer-facing highly digital businesses and seeks: to reallocate taxing rights in favour of the user/market jurisdiction; a new nexus rule independent of physical presence in the user/market jurisdiction; to go beyond the ALP and depart from the separate entity principle (though ALP-based rules would be retained where they are considered to be working as intended); and simplicity, stabilisation of the tax system, and increased tax certainty in implementation. The proposal includes a three-tier mechanism for profit allocation: Amount A – a share of deemed residual profit allocated to market jurisdictions using a formulaic approach, i.e. the new taxing right; Amount B – a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction; and Amount C – binding and effective dispute prevention and resolution mechanisms relating to all elements of the proposal, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B.

Pillar Two is also known as the Global Anti-Base Erosion ('GloBE') proposal. The proposal focuses on the creation of co-ordinated rules that address current risks from structures that allow MNEs to engage in profit shifting to low tax jurisdictions. GloBE comprises four components: (i) an income inclusion rule that subjects the income of a foreign-controlled entity to tax where it was subject to tax at an effective rate below a minimum rate; (ii) an undertaxed payments rule whereby deduction is denied or source-based taxation (including withholding tax) imposed where payment to a related party was taxed below a minimum rate; (iii) a switch-over rule to be included in tax treaties permitting a residence jurisdiction to switch from an exemption to a credit method where the profits attributable to a PE or derived from immovable property (which is not part of a PE) are taxed below a minimum effective rate; and (iv) a subject to tax rule that would complement the undertaxed payment rule by subjecting a payment to withholding or other taxes at source and adjusting eligibility for treaty benefits on certain items of income where the payment is not subject to tax at a minimum rate. These rules would be implemented through amendments to domestic tax law and international tax treaties and would include a co-ordination or ordering rule to avoid the risk of double taxation.

3.2 The African Tax Administration Forum

The African Tax Administration Forum (ATAF) issued its first technical note on digitalisation and taxation in 2019, noting that the outcomes of the OECD/G20 BEPS project were inadequate as artificial profit shifting done by digital MNEs is too complex to effectively administer and the project outcomes are not comprehensive enough to address the challenges (ATAF 2019a). ATAF subsequently issued a second technical note which considers the issues raised by the OECD-IF (ATAF 2019b). ATAF issued a third technical note summarising the discussions between the ATAF and OECD held in early July 2019 seeking a consensus-based proposal that meets the needs of African countries. The discussion dealt with three issues: i) new nexus rules, ii) new profit allocation rules and iii) a new global anti-base erosion rule. ATAF considers that tax treaty changes should be through a new standalone provision and not through revisions to the existing PE provisions due to the technical complexities of such revisions and the need for consequential revisions (ATAF

2019c). ATAF then issued a fourth technical note on the changes needed to the global tax rules. Regarding new nexus rules, ATAF recommends adoption of country-specific thresholds adjusted to the relative size of the economy to ensure that smaller economies are not excluded. Regarding new profit allocation rules, ATAF considers a fixed minimum return rule a high priority for African countries. ATAF argues that for the GloBE proposal to be effective, the minimum tax rate must be high enough to remove incentives for profit shifting (ATAF 2019d).

ATAF has also issued an opinion in support of the Pillar One unified approach initiatives (ATAF 2019e). ATAF showed particular support for the Amount B proposal allocating a fixed remuneration for tax purposes to routine marketing and distribution activities in a market jurisdiction reflecting an assumed baseline activity. ATAF noted that this proposal would address many pressing transfer pricing disputes in Africa and increase tax certainty for both tax administrations and taxpayers.

4 Unilateral approaches to taxation of the digital economy

4.1 Significant economic presence

The OECD proposed the creation of a significant economic presence (SEP) threshold (OECD 2015a). A purposeful and sustained interaction with a country's economy using technology such as the internet would be sufficient to subject the entity to taxation. The OECD recommended three possible approaches to determine whether an entity has a SEP. First, using the amount of revenue earned from the country. Second, using digital factors such as use of a local domain name, creation of a local digital platform and provision of local payment options. Third, considering user-based factors such as the number of monthly users, or the number of contracts concluded by the MNE, or the amount of data collected by the MNE, in that jurisdiction.

On 21 March 2018 the European Commission of the European Union (EU) issued a proposal for a council directive laying down rules relating to taxation based on a significant digital presence (European Commission 2018a). Under the proposal, a 'significant digital presence' shall be considered to exist in a jurisdiction if:

- (1) The business is carried on through an enterprise consisting wholly or partly of the supply of digital services through a digital interface.
- (2) The proportion of total revenues obtained from the supply of those digital services to that jurisdiction's users exceeds 7 million Euros (EUR).
- (3) The number of users of one or more of those digital services who are located in that jurisdiction exceeds 100,000.
- (4) The number of business contracts for the supply of the digital service concluded by users located in that jurisdiction exceeds 3,000.

The supply of digital services is considered here to include the supply of services through a digital interface by an MNE's associated enterprises in aggregate. The profits attributable to the significant digital presence are restricted to those that it would have earned if it had been a separate and independent enterprise, in particular in its dealings with other parts of the enterprise (European Commission 2018a).

The proposal excludes the creation of a taxable nexus based on the place of consumption only by excluding the mere sale of goods or services through the internet from its definition of a digital service. Selling access to a digital marketplace for buying and selling items is a digital service, but the sale of an item itself via such a website is not. Amazon's direct retailing business, for example, would not fall under this tax.

In April 2016, Israel released an administrative circular stating that online services provided by an MNE to customers in Israel may create a taxable presence if these activities constitute a SEP (Israel Tax Authority 2016). This approach is applied only when the supplier of the online services is resident in a country with no DTA with Israel. Criteria similar to the three recommended by the OECD are used and can be applied separately or cumulatively, with no revenue threshold requirement based on local sales.

India introduced amendments to its tax laws that cater for the SEP concept. Section 4 of the Finance Act No. 13 of 2018 amends the Indian Income Tax Act to provide for a SEP based on two thresholds: first, when the aggregate of payments arising from digital transactions exceeds a prescribed amount; second, based on 'systematic and continuous' soliciting or engaging in interaction with a prescribed number of users in India, through digital means. These thresholds create a direct tax liability in India irrespective of the location and/or residence of the taxpayer.

4.1.1 Discussion

The PE concept is premised on the idea that engaging in business in a state and using its economic infrastructure to gain profits gives the source state a legitimate claim to tax such profits. In principle, each country has a right to tax the totality of benefits and services received by MNEs that interact with its residents. A state is entitled to tax revenues from advertisements shown to its residents and sales of its residents' personal data. Further, digital MNEs enjoy the benefits of the services and infrastructure in the source state and ought to contribute to its public expenditures, such as education, law enforcement, utilities, and so on. These infrastructure, facilities and services directly and indirectly generate and support the market for digital services and without them the MNEs would be unable to earn their revenues. However, currently many digital MNEs are getting a free ride in the economy, violating the economic allegiance and benefit theories. The SEP approach is meant to address this anomaly.

The SEP approach's biggest hurdle is incompatibility with most DTAs, which often require some form of physical presence in order for an MNE to qualify as a PE. Any amendment to domestic laws introducing the SEP provision would therefore be inapplicable to MNEs based in countries with which the market jurisdiction has a DTA. The European SEP proposal notes that it would only apply to MNEs established in the EU and in non-EU countries which have no DTA with an EU member state (European Commission 2018a).

The Indian Finance Act provision makes reference to the 'systematic and continuous soliciting of business' in India by an MNE as a condition to qualify for SEP.² This wording is somewhat vague and will likely lead to litigation by MNEs denying that they qualify. The Indian SEP approach is thus limited in certainty and simplicity.

SEP is only applied to profits or income from transactions that are deemed to accrue or arise in the market jurisdiction. This requires an MNE to maintain separate accounts that record its branch activities in the market jurisdiction. This might be tedious and costly for the MNE where multiple jurisdictions adopt a SEP approach with a similar requirement. Where an MNE does not maintain satisfactory separate accounts and records for its branch activities in

² Section 4 of the Indian Finance Act No. 13 of 2018.

India, the Indian government proposes to use ‘fractional apportionment’ which involves treating an MNE’s operations within India holistically and thereafter apportioning such profits using a formula. This is a departure from the traditional ALP approach which treats entities making up the MNE as separate and then determines the profits made by each as they trade with each other and with third parties. The Indian approach is complicated and only serves to highlight the need for an international solution to the challenge of taxation of the digital economy.

4.2 Withholding tax on digital goods and services

The second OECD recommendation was a withholding tax on digital transactions (OECD 2015a). The tax could be imposed as a standalone gross-basis final withholding tax on certain payments to digital MNEs or, alternatively, as a primary collection mechanism and enforcement tool to support the application of the SEP option as net-basis taxation. The tax has been applied in two forms: withholding by businesses and withholding by third parties.

4.2.1 Withholding by businesses

This approach has been adopted in India, which introduced an equalisation levy that applies to digital transactions in its Finance Act of 2016. The tax is a 6 per cent levy on online advertisement valued at more than 100,000 Indian Rupees (INR) (USD 1500) in a year supplied by MNEs without PEs in India, deducted by a recipient of the service resident in India. The lack of PE requirement ensures that no payment is subject to both the 6 per cent levy and India’s CIT. The tax only applies to cross-border business-to-business (B2B) transactions. India reportedly earned the equivalent of USD 47 million from this tax for the period covering June 2016 to March 2017 and USD 76 million for the 2017/2018 period (Srivats 2019).

4.2.2 Withholding by third parties

The city of Buenos Aires in Argentina in 2014 introduced a 3 per cent withholding tax, popularly dubbed the ‘Netflix tax’ because it targets online content suppliers like Netflix. Resolution No. 593/2014, which created the tax, requires issuers of the credit and debit cards involved in processing payments to the MNEs to act as withholding agents. The law establishing the tax also requires the MNE supplying the services to absorb the cost of the tax without passing it onto the consumer (Férdeline 2017).

4.2.3 Discussion

A withholding tax approach is favourable to developing countries because it allows them to increase their revenue collection abilities through a form of ‘country ownership’ of a consumer market for goods and services or a digital infrastructure. Developing countries are largely consumer markets and therefore arguably gain the right to tax without the need for physical presence in the markets (UN Committee of Experts on International Cooperation in Tax Matters 2017).

However, the withholding taxes above are gross taxation of income, therefore business models with ongoing expenses are taxed inappropriately. To mitigate this, the withholding tax rates need to be low. Where an MNE is subject to the full brunt of CIT in its country of residence, the withholding levy becomes inequitable if the MNE cannot claim a tax credit. Further, if interpreted as a substitute for income tax, the underlying assumption of the tax seems to be that all digital MNEs have a uniform rate of profit or income and that they do not incur losses. Imposing the tax on loss-making businesses would be potentially in conflict with the ability to pay principle.

Similar to the SEP approach, the withholding tax would be limited because most DTAs cap withholding tax rates or eliminate them altogether. The Indian levy differs from the OECD proposal because it is collectable by the service recipient rather than a local intermediary, making it similar to an income tax. Such a tax may therefore fall under a country's DTA. Therefore, any rate to be applied would be limited by the DTAs in force or would only be applicable to MNEs resident in countries without DTAs with the market jurisdiction.

A withholding tax would be fairly easy to apply in B2B transactions where resident businesses could reasonably be expected to comply with the withholding obligation. A business making online purchases is likely to deduct the payment in computing its income, thereby reducing its CIT liability. It is, however, difficult to apply in the case of business-to-consumer (B2C) transactions which would require withholding by individual consumers with little incentive to comply. Enforcing the collection of small amounts of withholding from large numbers of individual consumers would be administratively challenging (OECD 2015a). Third-party payment processing intermediaries can be used to address the challenge of withholding in the B2C context. However, intermediaries do not generally have access to transaction-identifying information, especially for low value transactions. Accessing such information and using it for an auxiliary purpose like taxation raises issues of privacy. Globally, the legislative trend is to treat the protection of personal data as a basic human right which can only be infringed upon under very exceptional circumstances (van Zyl and Schulze 2014).

There is a risk that the tax may be passed on to the consumers, shifting the tax burden to them and increasing their cost of doing business. For a service like online advertising, this may limit the international reach of local start-ups. Prohibiting the MNE from passing on the tax, as was done in Argentina, is unlikely to be effective as it would be difficult to enforce. Moreover, it would be unfair to MNEs that might have narrow margins of profit or are making losses.

Finally, the use of withholding tax is undermined by the emergence of cryptocurrencies like Bitcoin which are gaining popularity in many African countries, especially for use in cross border e-commerce (BBC News 2018). These enable the exchange of value without third party intermediaries and many transactions are difficult to trace.

4.3 Digital service tax (DST)

The third recommendation by the OECD was an equalisation levy (OECD 2015a). In the countries in which it has been implemented, the equalisation levy is often dubbed a digital service tax (DST).

In March 2018, while laying out its SEP proposal, the European Commission also proposed an interim 3 per cent revenue-based DST that targets revenues gained through monetisation of user input (European Commission 2018c). This approach includes not just benefits derived from utilisation of user data but also the increase in value of the service due to network effects that result from active and sustained user engagement. The tax would be a deductible expense when the MNE is accounting for CIT in the EU.

The DST's place of supply challenges are dealt with as follows: for services involving the use of user data for advertising, or the sale of data, the place of supply shall be where the advertisement is displayed or where the users that supplied the data that is being sold are located. For services involving making available digital platforms/marketplaces to users, the place of supply shall be the location of the user paying for access to the platform or concluding a transaction within the platform. Taxing rights are therefore given to the EU State where the user is located, even when the user has not contributed money to the generation

of revenue for the MNE, because the user's activity, such as viewing adverts, generates value even when the user makes no payment.

The entities to be taxed must meet two criteria.

- (1) The entity must earn in excess of EUR 750 million in total worldwide revenues in one financial year.
- (2) The total amount of taxable revenues obtained by the entity within the EU must exceed EUR 50 million.

In July 2019 France introduced the DST as a 3 per cent levy on sales of any digital company with revenue of more than EUR 750 million, of which at least EUR 25 million is generated in France. The tax is expected to yield up to EUR 400 million. The tax was expected to affect at least 30 companies most which are US, Chinese, German, Spanish and British. The US government has threatened retaliatory tariffs against France (BBC News 2019).

In July 2019 the UK revenue and customs department (HMRC) published a policy paper on the DST. The UK DST will be at 2 per cent, and focus on the revenues of search engines, social media platforms and online marketplaces. The tax will take effect from April 2020 (HMRC 2019). The policy paper noted that the UK government is committed to dis-applying the DST once an appropriate international solution is in place. Legislation will be introduced in the Finance Bill 2019-20 to establish the DST. New Zealand, Austria, the Czech Republic, Italy and Spain have also announced plans to introduce DSTs (Robertson and Nash 2019).

4.3.1 Discussion

The DST is unlikely to be passed on to users of digital MNE services which are usually free. MNEs may, however, pass the tax on to third parties who pay for online advertising. For example, Amazon announced that it would pass along the costs of the French DST to its third-party sellers (Fung 2019). However, where the digital MNE directly charges its customers, the tax might be passed on. The European Commission's impact assessment report for its proposed DST considered that between 30 per cent and 50 per cent of the DST would be passed on (European Commission 2018b).

The DST has also been attacked as running contrary to the WTO rules (Hufbauer and Lu 2018). In particular, the high revenue thresholds which effectively target only massive digital MNEs like Google and Facebook exclude most European firms from its application, creating *de facto* discrimination against US digital MNEs. This violates the EU's requirement of national treatment under Article XVII of the General Agreement on Trade in Services (GATS). The WTO has long shown an aversion to special tax treatment for the digital economy. The WTO Ministerial Conference in December 2017 issued a joint statement favouring non-discriminatory regulatory environments for e-commerce (WTO 2017). Although the DST is a tax, to the extent that its effect is to discriminate against foreign firms, it arguably acts like a 'tariff' (Hufbauer and Lu 2018).

The OECD noted that an equalisation levy risked subjecting the same income to both CIT and the levy (OECD 2015a). While the DST would be a deductible expense when the MNE is accounting for CIT in the EU, this may not necessarily apply where the MNE is not resident within the EU. The MNE will experience double taxation if its income is subject to CIT in its country of residence and the levy is not creditable against it.

The tax is premised on the fact that users create value in the market jurisdictions. It has been argued that the bulk of value is actually created by the MNEs, which invest heavily in improving software code and in research and development (Kennedy 2019). The second premise, that MNEs collect data from users for free, has been argued to be equally wrong.

Data, it is argued, is provided in exchange for receiving the ‘free’ service that the MNE provides (Kennedy 2019). Ordinarily, the user would pay directly for the digital service through subscription fees with currency. With some MNEs, however, the user pays for the service by providing their personal information, which might be used for more targeted and valuable ads. In both transactions the MNE is being paid to sell a service – in the former, with cash from the user; in the latter, with cash from the advertiser or data or attention from the user (Kennedy 2019).

The tax is also premised on the idea that digital MNEs are earning infra-marginal returns³ with very low marginal costs (Robertson and Nash 2019). However, this is not always the case. The turnover tax would disproportionately affect companies, such as Amazon, which have relatively thin profit margins (Blenkinsop 2018).

If the DST is passed on, as it likely will be to some degree, it may lead to production inefficiency for micro, small and medium enterprises (MSMEs) that rely on the relatively low costs of most digital MNE services. Where a service like advertising is itself used as a business input by MSMEs, increasing the cost of the service becomes a source of production inefficiency. However, the DST may reduce the tax-induced competitive advantages MNEs enjoy over domestic companies in the same industry, such as advertising targeted at domestic consumers, thereby equalising treatment between domestic and foreign suppliers (IMF 2019).

4.4 Bit tax

The 2014 version of the OECD Action 1 report contained a brief paragraph that considered the possibility of introducing a tax based on the volume of bandwidth used by MNEs’ websites (OECD 2014). To be progressive, different tax levels would apply depending on the MNE size or turnover. A threshold of annual bandwidth used to qualify for the tax would be set to ease administration. To maintain equity between the digital economy and traditional businesses, the tax would be creditable against CIT (OECD 2014). However, this proposal was not addressed further in the final 2015 OECD report.

Hungary introduced a bit tax in 2014 with a levy set at 150 Hungarian Forints (HUF) (USD 0.60) per gigabyte of data traffic. The tax proved to be extremely unpopular, attracting massive protests, and the government was forced to roll it back (BBC News 2014). In May 2013, France considered the enactment of a 1 per cent ‘internet tax’ on accessing the internet through smartphones and tablets. The declared objective was to help the development of French cultural content. However, strong opposition from device manufacturers led to the proposal being scrapped in September 2013 (Katz 2015). In September 2015, Pakistan introduced a 19.5 per cent tax on broadband usage where the total bill is above Rs. 1,500 (USD 20) and internet speed above 2 Mbps (Abbasi 2015).

4.4.1 Discussion

This type of tax was first proposed by Cordell and Ide (1997) who dubbed it the bit tax. It is essentially a tax on internet traffic whereby the tax is levied on the quantity of bits transmitted and/or received. Cordell (1997) explains that the tax can be very low (up to 0.000001 cents per bit) and automatically collected by telecommunications companies, which poses fewer challenges than most direct and indirect taxes.

A bit tax can be viewed as part of taxation of consumption in general, which is widely accepted. Traditional telephony is subject to taxation therefore there is no reason to treat internet traffic differently. However, the bit tax has been condemned as likely to force the

³ The amount above the return that the investor needs in order to make the investment.

internet service providers (ISPs) to charge a higher price which will discourage the growth of e-commerce (Basu 2007). Further, the justification for a bit tax approach is unclear and would require clarifying a link between the technological infrastructure and value creation of digital MNE business models (Olbert and Spengel 2017).

4.5 Profit shifting tax (PST) or diverted profit tax

The UK Finance Act 2015 contains provisions designed to limit tax avoidance by digital MNEs like Google which make profits in the UK while paying taxes in another country. The PST provisions target two main types of avoidance schemes: first, where profits accrued in the UK are diverted away by an MNE taking advantage of PE rules; and second, where tax advantages are created by means of transactions using foreign entities lacking economic substance (Cunha 2017).

The tax only applies if UK sales are above £10 million or UK related expenses are above £1 million in a 12-month accounting period. Thresholds of an annual turnover of more than EUR 50 million or an annual balance sheet not exceeding EUR 43 million and more than 250 employees have been set, thereby exempting MSMEs. For the PST provisions to apply, the Act requires that it is reasonable to assume that there is either a “mismatch condition” or a “tax avoidance condition”.⁴ The mismatch condition is met if tax paid in a foreign jurisdiction on profits generated in the UK is at a rate of less than 80 per cent of what the tax would have been in the UK and the transaction(s) have insufficient economic substance. The tax avoidance condition is met if the transaction involves arrangements whose primary purpose is to avoid a charge to tax in the UK. The rule applies where the non-resident company has arranged its affairs so as to separate the substance of its activities from the place where the business is formally done in order to avoid the creation of a permanent establishment (HMRC 2018). Where these conditions have been met, a levy of 25 per cent is applied on the profits produced by a branch of an entity within the UK, irrespective of where the head office is located. In the UK in 2015/2016 the tax yielded £31 million and in 2016/2017 the tax yielded £281 million (HMRC 2017). UK CIT for 2017, 2018 and 2019 was 18 per cent and 17 per cent for 2020. The fact that the CIT rate is lower than the PST rate is supposed to encourage companies not to divert profits generated in the UK abroad to avoid taxes (Fuchs 2018).

Australia has adopted similar PST provisions in its Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015, targeting MNEs with an annual global income of 1 billion Australia Dollars (AUD) (USD 750 million). France attempted to introduce a PST at the close of 2016 but its Constitutional Council struck it down as unconstitutional (Anghileri 2017).

4.5.1 Discussion

The UK and Australian PST taxes are consistent with the ability-to-pay principle which provides that the higher the amount of income a taxpayer earns, the higher the taxpayer's contribution to public expenses should be. They use a minimum threshold exempting non-resident MSMEs thereby ensuring that only powerful MNEs which are in a better position to pay the tax are charged (Cerioni 2015).

The PST appears to be effective in compelling digital MNEs to reorganise their structure. In March 2016, only months after its introduction in the UK, Facebook announced that it would change its policy and cease routing transactions through Ireland. Facebook made similar changes in Australia (Hadzhieva 2019).

⁴ Sections 89, 90 and 91 of the UK Finance Act 2015 Cap 11.

The PST may not be compatible with DTAs as the MNE's state of residence is not obliged to credit the tax against domestic income tax. In the UK it has been criticised for contradicting DTAs by deeming business profits should be taxed in the resident jurisdiction in the absence of a PE. This creates the risk of double taxation (Hadzhieva 2019).

Finally, the PST uses a complicated legal framework, making it burdensome for the taxpayer to predict tax liability. If applied in every jurisdiction, it would lead to uncertainty and impair global trade (Hadzhieva 2019).

4.6 Social media and mobile application taxes

Taxes targeting users of social media and mobile applications have been introduced in a few African countries. The primary rationale offered for these taxes is that revenue from taxes on traditional voice and messaging services offered by telecoms has reduced as more people switch to mobile applications (Stork and Esselaar 2018).

In July 2018, a daily excise duty charge of 200 Ugandan Shillings (UGX) (USD 0.05) for using mobile applications and social media sites like WhatsApp and Facebook was introduced in Uganda. The chief justification was that many taxes on phone calls were no longer effective because many people have started using mobile applications for communication. The tax was expected to raise the equivalent of USD 80 million but raised only the equivalent of USD 14 million in its first year, largely due to evasion by way of virtual private networks by many social media users (Kayiwa 2019).

In August 2018, Zambia introduced a 30 Ngwee (USD 0.03) charge day tariff on internet voice calls. The government press statement announcing the measure claimed that 80 per cent of Zambians were using WhatsApp, Skype, and Viber to make phone calls. This, it was claimed, was threatening the telecommunications industry (Lusaka Times 2018).

Similarly, in September 2018 the Benin government introduced a tax at the rate of 5 CFA Francs (XOF) (USD 0.008) per megabyte of data while using apps such as Facebook, Twitter, Skype, and Instagram. The tax attracted widespread condemnation and protests and was withdrawn within only five days (Stork and Esselaar 2019).

4.6.1 Discussion

Significantly, these taxes are consumption taxes in the nature of excise duty. Profit-based taxes on capital-intensive sectors like telecommunications yield revenue with a lag due to high deductions for depreciation and expenses. Many countries, especially in Sub-Saharan Africa, have therefore re-examined the revenue-substituting potential of excise taxation (Cnossen 2005). Telecom excise duties are used to ensure a significant, up-front revenue yield from the sector. Excise duties are relatively easy to administer which makes them the preferred tool for countries with low administrative capacity (Matheson and Petit 2017).

However, the use of such taxes in the telecommunications sector in general has been questioned. They are in the nature of a 'sin tax' and therefore usually applied to goods and services with negative externalities. In its *Advice to Low-Income Countries on Tax Policy*, the IMF (2015a) notes that excise duties are levied on luxury goods or on 'sin' products such as alcohol and tobacco. When excise duties are levied on particular goods or services, this raises their prices relative to other goods or services, thereby suppressing their consumption. Where the good or service has less own-price elasticity, this effect is less pronounced. Even where the demand for the good or service is highly inelastic, taxing it more heavily than other goods or services distorts consumption due to cross-price elasticities (Matheson and Petit 2017). Excise duties are therefore usually confined to goods and services that are both price-

inelastic and have negative externalities, such as alcohol, tobacco, and petroleum products. Services like social media and mobile applications are therefore ill-suited for excise duties.

Moreover, these taxes are chiefly premised on the idea that telecom companies are losing service revenues because people no longer use traditional voice and text messaging, opting instead to use mobile applications. However, even this premise is questionable. A 2019 study of the abortive Benin tax proposal noted that while telecom companies in that country had their revenues decline by 30 per cent between 2016 and 2017, the main cause was not use of mobile applications but rather, market consolidation, regulatory uncertainty and price wars. Telecom revenues picked up again at the close of 2017 when these conditions subsided (Stork and Esselaar 2019). An analysis of African telecom companies' performance based on publicly available, audited financial statements actually suggests that the vast majority of them have experienced considerable revenue growth largely due to data revenues that have resulted from an increase in the use of social media between 2013 and 2018 (Stork and Esselaar 2019). The growth in data revenue outpaces decreases in voice and text messaging revenues. The few telecoms with declining revenues have insufficient 3G or greater network coverage, excessive regulation, or experience adverse economic conditions. Telecoms that continued using a 2G network are vulnerable to losses in domestic and international voice and text message revenues because they are unable to generate data revenues. Telecoms with extensive 3/4G coverage increase their data revenues, compensating for any losses in voice or SMS (Stork and Esselaar 2019).

Finally, these taxes have been widely condemned as an infringement on the right to freedom of expression. Communication tools such as social media and mobile applications advance the rights to freedom of expression and access to information which are increasingly best exercised online. As such, taxes which would tend to limit their use are considered infringements on these rights (Kakungulu-Mayambala and Rukundo 2018).

4.7 Value added tax

VAT is a broad-based tax on consumption imposed at different stages of the supply chain on the value added at each production and distribution stage. Through this process, VAT ideally flows through the businesses to taxable supplies made to final consumers. VAT on supplies made by digital MNEs is applied by requiring collection by suppliers, customers or intermediaries.

4.7.1 Supplier collection

Here the digital MNE is required to register for, charge and remit VAT and comply with reporting obligations. A number of African countries have attempted to apply this tax to the supply of electronic services by digital MNEs. In South Africa, the Taxation Laws Amendment Act, Act No. 31 of 2013, requires non-resident entities which supply electronic services to a recipient in South Africa to register for VAT and account for it if their supply to South Africa exceeds 50,000 South African Rand (ZAR) (USD 4000) in a month. Similarly, in August 2019 the Kenya Revenue Authority (KRA) announced that provision of online platforms for use by third parties is a taxable supply under the Kenyan Value Added Tax (VAT) Act 2013. The KRA announced that it would focus on payments made for the download of apps and would work with the Communications Authority of Kenya to obtain transactions data from resident and foreign-based app developers doing business in Kenya (The East African 2019). The Uganda Revenue Authority (URA) published two public notices, one in December 2018 and another in October 2019, informing non-resident suppliers of electronic services of their obligation to register for and remit VAT (URA 2019).

4.7.2 Customer collection

Here the resident customer is liable to account for any tax due on a supply by a non-resident digital MNE. The customer is typically required to declare the VAT due on the supply received from the foreign supplier as output tax on the relevant VAT return. The rate to be applied is the rate applicable in the customer's jurisdiction. The customer is then entitled to input tax deduction to the extent allowed under the rules of their jurisdiction (OECD 2017).

4.7.3 Intermediaries

Here intermediaries involved in some way in the digital supply chains engage in collecting and accounting for VAT on behalf of foreign suppliers. In early 2019, Nigeria's Federal Inland Revenue Service announced that it would direct all banks in Nigeria to withhold 5 per cent VAT on online transactions for purchase of goods and services (Egbejule 2019).

4.7.4 Discussion

Charging, collecting and remitting VAT, and the associated reporting obligations, are traditionally the responsibility of suppliers. This works effectively when the supplier is located in the jurisdiction of taxation where the tax administration can impose and enforce collection and related obligations upon the supplier. When the digital MNE supplier is in another jurisdiction, although the market jurisdiction may possess legal authority to require registration and compliance, it may lack the ability to effectively enforce this. The URA's public notices (see 4.7.1 above), for example, have so far gone largely ignored by digital MNEs operating in Uganda (Hearson 2019). The tax administration may also face basic challenges such as establishing that the digital MNE has made supplies that are subject to VAT in their jurisdiction under the destination principle. Further, traditional follow-up enforcement actions, such as accessing books and records and creating auditing and collection procedures for outstanding taxes, may be a challenge.

The obligation for digital MNEs' suppliers to register and account for VAT in a jurisdiction where they lack a physical presence may be burdensome, particularly when such a requirement arises in multiple jurisdictions. Simplified registration and compliance regimes are therefore necessary to make this feasible. The reverse charge mechanism of the customer collection method is only feasible in a B2B supply scenario and would be ineffective for B2C. The use of intermediaries requires access to transaction data which MNEs may not have access to; it also raises issues of personal data and privacy.

5 Lessons for Africa

African countries are seeking ways to tap into the revenues earned by digital MNEs through taxation. There are a number of lessons that they can learn from the various efforts discussed above.

5.1 Africa's digital taxation challenge is unique

The growing digital economy poses a greater risk for the tax base of developing countries than for that of developed countries. CIT and VAT, which are the taxing mechanisms most threatened by the digital economy, form a much larger portion of the total tax revenues in developing countries than in developed countries. Moreover, developing countries will have a much harder time replacing any reduction in their CIT and VAT as the personal income tax remains weak and reliance on trade taxes is already high (IMF 2019). Furthermore,

developing countries are net importers of digital goods and services therefore loss of tax revenue is more urgent and real for them.

The BEPS issues and challenges faced by African countries differ from those faced by developed countries. The OECD's BEPS debates have primarily focused on the use of complex and sophisticated legal structures to avoid tax classification as a PE. For African countries, the digitalisation of the tax base is itself the challenge. The challenge posed by digitalisation is not artificial legal structures created by use of the existing rules but rather that the income generated is not captured by these rules (IMF 2019). It is as a result of these concerns that ATAF noted that the OECD/G20 BEPS project would be inadequate (ATAF 2019a).

African countries therefore have to go beyond BEPS and take advantage of the international community's concerns with this issue to change international tax rules rather than attempting to fit the digital economy into these rules.

5.2 Administrative challenges should be considered

While the various international proposals address the legal challenges to taxation of digital MNEs, they generally do nothing to alleviate the administrative challenges involved. The SEP and DST regimes, for example, would require registration and filing of returns by MNEs. Some African countries, as we have seen, have previously announced requirements for MNEs to register for taxes such as VAT and been ignored. Consideration should be made of practical administrative measures to ensure compliance with any digital tax regime adopted. Simplified registration procedures, with required information kept to a minimum and availability of online registration at the tax administration's website, are necessary.

The resource-constrained circumstances of many of Africa's revenue administration bodies should be considered in the development of reform proposals. The practical application of the tax measures targeted at the digital economy will likely require the setting up of new infrastructure and capacity building by the revenue authorities and other relevant government agencies. This would include significant expenses with regards to administrative systems and training and skilling of staff to 'police' the MNEs. HMRC, for example, announced that it would incur costs of up to £8 million to enable new IT systems and processes to be developed as well as to hire and train additional staff to monitor and administer the new DST tax (HMRC 2019). Many African countries have limited capacity to do this. Further, international tax specialists, who will be needed for administration, are often in short supply in African revenue administrations because they take time to train and their skills are in high demand, making experienced staff difficult to retain given the gap between public sector salaries and pay rates in advisory firms (IMF 2015b). The new rules need to be straightforward in their application so as to be easily operable by resource-constrained tax administrations and relatively inexperienced staff with less expertise.

Revenue administration bodies in Africa also have to contend with political interference and corruption (IMF 2015b). Rules that are more mechanical and formulaic, with less room for subjective considerations and discretion, are less susceptible to political interference and corruption. Tax administrators are sometimes pressured by government ministry overseers to 'go easy' on well-connected MNEs considered to be important players in the economy. Resisting such pressure is especially difficult when applying rules involves considerable professional judgement and the exercise of discretion. Approaches with high potential for mechanistic or formulaic application should be considered, such as the residual profit allocation using formulary apportionment proposal (Amount A), use of withholding taxes, and use of SEP.

Data relating to digital MNE transactions in an African jurisdiction will be necessary. Applying transfer pricing rules, for example, involves comparing related party transactions and similar transactions between unrelated parties. MNEs may not always be willing to share this data or there may be a need to verify the data submitted. Developed economies have well established systems of financial reporting which has enabled the compilation of private databases of commercial transaction information on the profitability of enterprises and commodity and service prices. Access to this information comes at a price, which is affordable for tax administrations in developed economies but a challenge for tax administrations in developing economies. African tax administrations will need to consider investing in access to such information. Governments working with the OECD have introduced a number of tools that tax authorities can use to access MNE information. However, concerns remain about the extent to which developing countries can benefit from these tools. The BEPS Package for Reform (Actions 11–13) reporting requirements, which involve local MNE entities providing a master file that includes an overview of the MNE's operations and country-by-country reporting obligations, have made access to information easier (OECD 2015b). However, only a handful of very large MNEs do country-by-country reporting and the stringent conditions for accessing these reports, such as capacity to meet international standards on data confidentiality, sometimes form a barrier for developing economy tax administrations (Clavey, Pemberton, Loeprick and Verhoeven 2019).

5.3 Tax should not hinder growth of the global digital economy

African countries should ensure that the tax measures they adopt do not hinder the growth of the digital economy. The internet services provided by digital MNEs are cost-saving tools that ease business for many MSMEs. Relatively affordable adverts through social media platforms give MSMEs a wide reach that was previously the preserve of large businesses that could afford expensive broadcasting airtime. Using digital platforms, MSMEs in developing countries are able to compete favourably in domestic and international trade through greater market access for customers, supply chains and competitors, and lower trade costs (UNCTAD 2019). Using mobile applications rather than voice and text messaging is also more affordable. An internet voice call for several minutes may use up no more than a single MB of data. Low-income users benefit from the greater access to communication services these systems provide and gain incentive to join networks that serve their needs in affordable and useful ways. This increases efficiencies and results in deeper specialisation and division of labour and greater variety and predictability for all players, as well as lower costs and prices of inputs and final products. There is evidence that much of the productivity growth in developed countries can be attributed to the use of ICT technologies and the internet in particular (Lee-Makiyama and Verschelde 2016). The World Bank in its 2016 report *Digital Dividends* notes that the internet creates opportunities for access to new markets, removes information asymmetry and builds trust and transparency in many transactions (World Bank 2016). The internet, through tools such as social media and mobile applications, reduces the cost of availing and acquiring information thereby facilitating transactions.

The services provided by digital MNEs improve marketing efficiency which improves the profits of local businesses thereby increasing the taxes they pay. It could be argued that this mitigates the taxes not paid by digital MNEs (Govindarajan, Srivastava, Warsame and Enache 2019). Any tax approach adopted should consider the impact the tax may have on the use of the beneficial services provided by the digital MNE or the internet in general. For example, the social media tax in Uganda led to a drop in internet users from 18.5 million (47.4 per cent penetration) to 13.5 million (35 per cent) in the first six months (UCC 2018). Similarly, it has been estimated that the social media tax in Benin would have resulted in a forgone GDP growth of USD 260 million and taxes of USD 40 million (Stork and Esselaar 2019). According to the Alliance for Affordable Internet (A4AI), internet users in Africa already pay the highest rates in the world for access as a proportion of income. The A4AI

considers 1GB of mobile broadband data at no more than 2 per cent of average monthly income as affordable. Across the African continent, the average cost of 1GB is 7.12 per cent and in some instances as much as 20 per cent of average monthly earnings (A4AI 2019). Tax proposals likely to increase the cost of access to the internet should be avoided.

5.4 Tax should not unduly burden home-grown digital MNEs or MSMEs

Any tax regime adopted should not hinder the growth expansion of home-grown MNEs and local MSMEs. A number of home-grown platforms are rising to challenge the dominance of global online platforms like Netflix, Amazon and eBay. IROKOTV, for example, is a Nigerian-based online platform providing paid-for Nigerian movies popular all over Africa on demand. Jumia is a vast e-commerce marketplace present in six African countries connecting sellers with consumers and providing a logistics service with shipment and delivery of packages. Such developing platforms could be challenged by the expense involved in complying with measures targeted at larger digital MNEs such as equalisation levies.

The primary purpose of the global debate on taxation of the digital economy is to ensure a fair and equitable system for all companies, including home-grown digital MNEs and local MSMEs. Most local domestic enterprises are required to meet their tax obligations yet digital MNEs bypass this obligation. Digital MNEs are in effect subsidised through non-taxation, giving them an unfair advantage over home-grown businesses. An equitable approach that targets the digital MNEs without hindering growth of the local businesses is therefore necessary. One way to achieve this is to set high thresholds that only the international digital MNEs are likely to meet. For example, the EU's proposed DST had high thresholds targeting the large MNEs with the most opportunity to engage in aggressive tax planning. The high threshold also creates legal certainty as it is easier and less costly for businesses and tax authorities to determine whether an entity is liable for the tax. The high threshold also excludes MSMEs and start-ups which would bear a disproportionate compliance burden. Similarly, the Indian withholding tax threshold of USD 1,500 a year exempts smaller businesses from the application of the tax.

5.5 Multilateral action should be preferred

Political pressures to introduce some form of tax targeting digital services are strong in many African countries. However, the uncoordinated proliferation of various forms of digital taxation will likely result in unnecessary complexity and jeopardise global tax cooperation. The digital economy poses a global tax challenge therefore the final solutions will be global. Developing countries were not at the table at the inception of the current international tax system back in the 1920s. Since then there have only been mild efforts to modify the system to meet their needs as capital-importing countries. However, the current international effort against BEPS provides an opportunity for African countries to participate in the resolution of international tax problems. Opportunities such as the OECD-IF should be taken advantage of by African countries to push for real reform of international tax rules to reflect their situation. Regional approaches such as through the efforts of ATAF should also be considered. To protect their tax base while embracing the digital economy, African countries should participate in global debates through regional and international organisations to push for the development of international tax rules that can take into account their interests as source or market jurisdictions.

Unilateral tax measures are likely to result in double taxation if the MNE's country of residence does not provide full credit for their payment. This may result in differential treatments across different taxpayers and distort business decisions. Challenges like tax competition resulting in a 'race to the bottom' may emerge if unilateral measures are adopted. The uncertainty for MNEs as a result of varying and conflicting unilateral measures may discourage investment (Clavey *et al.* 2019). Such measures will also likely be resisted

by the MNEs affected. Unilateral measures should be clear and simple. Any ambiguity will be exploited by MNEs to question the legitimacy of the measure through litigation. Unclear taxes which combine elements of taxes on profits with elements of taxes on consumption are not easily classified in DTAs and may result in legal uncertainty and arbitrary distinctions. India's withholding equalisation levy has been criticised for its unclear status because it shares common features with both income tax and turnover tax. There is also uncertainty about the levy's scope as it is unclear if it covers all remotely concluded transactions or just those effectuated through a digital platform (Hadzhieva 2019).

Unilateral measures may also disrupt international trade. When France announced its DST, the USA immediately objected, announcing that it was launching a probe into the tax and could respond with retaliatory measures (Mauldin 2019). Ireland, which is the residence of many digital MNEs, similarly opposes such measures that would compel it to share taxes with other European countries.

Moreover, it should be remembered that although Africa is emerging as a key market, individual countries are relatively insignificant markets for these large digital MNEs. It is for this reason that they are able to ignore calls for registration for taxes when made by tax administrations of individual countries (Hearson 2019). African states acting in concert through regional bodies like ATAF have a better chance of leveraging their combined market potential to compel compliance by digital MNEs. Compliance can also be eased through collective action. For example, a single point of registration, return filing and payment may be easier for digital MNEs rather than them having to do this in each of Africa's 54 countries. In the EU, the VAT Mini One Stop Shop is an optional scheme that allows digital MNEs to account for VAT in just one EU country rather than each of the 28 individual EU member states (European Commission 2019). Other compliance enhancing mechanisms such as 'tax shaming' can be more effective if done at a continental level. Studies have shown that 'firms or their top executives face significant reputational costs from tax shelter involvement' (Gallemore, Maydew and Thornock 2013: 1127). The reputational damage that firms face when their tax avoidance or evasion is made public can cause them to reconsider their behaviour. There is hope that the rising tide of tax shaming against digital MNEs can result in a reform of their tax avoidance and evasion. However, given the relatively small size of the African market, this would be most effective if done in concert by African states.

5.6 Unilateral action should be limited and guided

If, however, as is likely the case, individual African countries make a go at taxing the digital economy through unilateral measures, there are some considerations to make.

Unilateral measures have to be compatible with existing domestic laws and DTA obligations and international rules. Although the WTO is generally hostile to discriminatory treatment, Article XIV(d) of GATS provides for an exception to the rule against difference in treatment where the measure is aimed at ensuring the equitable or effective imposition or collection of direct taxes. Taxes such as equalisation levies meant to ensure equal treatment of foreign and domestic supplies would be in conformity. Options such as the DST, which is not an income tax for DTA purposes, can be introduced unilaterally, without any international agreement. Unilateral measures should also conform to other branches of international law such as human rights. Approaches such as the social media taxes, which infringe on human rights, should be eschewed.

Preference should be given to extending existing tax schemes to cover the digital economy rather than inventing new ones. Measures akin to turnover and use taxes are already included in existing and generally accepted tax schemes such as VAT and sales taxes. The introduction of turnover taxes in addition to VAT should be discouraged given their

similarities. Moreover, it is easier and more legitimate to enforce existing taxes like VAT than to create potentially controversial new taxes.

5.7 An evolutionary approach should be preferred

An evolutionary approach is preferable to the introduction of a radically different tax regime for the digital economy. A radical approach targeting the digital economy and isolating it for special treatment would be ill-advised given how pervasive digital technologies are and their unpredictable future development. Measures seeking to 'ring-fence' a set of firms or activities would be inappropriate. Moreover, a radical approach is unlikely to receive international support. An evolutionary approach that considers the principles of neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility is necessary. A radical effort ring-fencing the digital economy violates the tax neutrality principle without any apparent policy or principled justifications (Li 2017).

A gradual evolutionary approach that considers the different digital MNE business models and how even these might evolve is necessary. The possible emergence of new technologies should also be borne in mind. For example, as was discussed, unregulated and difficult to trace payments can be made using cryptocurrencies which vitiates measures that target specific transactions such as use of withholding tax. Many of the current proposals that are most applicable in African countries use a one-size-fits-all approach to taxation of digital firms based on their gross revenues, and run the risk of double taxation. Such tools are blunt instruments that can at best be used only in the short run. Instead, a considered, measured and innovative approach targeting the fundamental design of the existing rules is necessary in order to allocate the international tax base fairly among countries.

6 Conclusion

The digital economy remains a major challenge for tax authorities in African countries. The current international and unilateral efforts at taxing it, though useful, are of limited application to Africa's unique situation. An overhaul of the nexus rules and profit allocation rules in international taxation are a necessary starting point. Developed countries, however, remain at an advantage and are able to take some unilateral steps. They have enough of the digital MNEs' market to leverage. Further, the digital MNEs will often have a presence beyond just a website, which can also be leveraged. Most African countries, however, lack any of these advantages. In the end, Africa may have to develop its own approach to taxation of these digital juggernauts. Such an approach would have to consider the still limited (though growing) digital market in Africa, the benefits that African MSMEs are getting from the use of digital platforms, the peculiar administrative challenges of African tax administrations and so on. This approach would need to be multilateral but focus on the concerns of developing economies.

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