ICTD Research in Brief
Issue 54 • June 2020

Review of Tax Treaty Practices and Policy Framework in Africa

Summary of ICTD Working Paper 102 by Catherine Ngina Mutava

The problem with tax treaties

Tax treaties are agreements through which two countries agree to assign and restrict taxing rights on economic activities that span both countries. They were traditionally concluded mainly to avoid double taxation and create a favourable investment climate. However, in recent years, tax treaties concluded by sub-Saharan African countries – with OECD countries in particular – have often resulted in them slowly ceding their taxing rights over income earned within their jurisdiction. This revenue loss is not comparable to the expected benefits from foreign investment. Increased awareness of the impact of unfavourable tax treaties on state revenue has seen some sub-Saharan African countries cancel, suspend and or renegotiate some treaties. This paper proposes that sub-Saharan African countries develop and implement a tax treaty policy framework to ensure that they safeguard their interests when concluding tax treaties. It considers the role of tax treaty policy, what factors should inform such a policy, and how to develop an effective negotiating strategy. The study reviewed literature on the history of tax treaties and their impact on developing countries in Africa and interviewed key stakeholders in seven countries.

The importance of negotiating appropriate treaties

Tax treaty negotiations between developed and developing countries often result in unequal exchange, with developing countries giving more concessions. A well-crafted negotiating strategy can significantly reduce disparities in the outcomes, regardless of the powers involved.

Tax treaties are often associated with investment promotion in African countries. Even though a tax treaty often results in some loss of tax revenues these countries assume that the losses will be offset by the investment inflows that result. Where attracting foreign investment is a key objective, the tax policy should embody this objective and provide guidance on how this should be achieved. However, it should not be the sole objective as several studies indicate that this link is far from clear. The role of treaties is trivial compared to other measures that a developing country could take in improving investment fundamentals, such as enforcing robust laws and establishing an effective tax administration.

It is therefore important for developing countries to have a broader objective for concluding tax treaties, away from the traditional roles of eliminating double taxation and giving away taxing rights to attract foreign investment since both of these can be achieved through other means.

If sub-Saharan African countries are to safeguard their tax bases, they must rethink their approach towards treaty negotiation. They must first determine if tax treaties are necessary. They must further insist on mutually beneficial outcomes, and only conclude treaties whose benefits outweigh the costs. A tax treaty policy would go a long way in ensuring this is achieved.

> "For sub-Saharan African countries to safeguard their interests, they must put in place mechanisms to guide and direct the entire negotiation process."

The need for a tax treaty policy

Many sub-Saharan African countries do not have a tax treaty policy that informs their treaty negotiation. Of the countries reviewed, South Africa, Mauritius and Ghana have such a policy in place, and at the time this research was conducted, Kenya, Uganda, Tanzania and Rwanda were in the process of developing one. The officials interviewed from countries without a policy felt they needed more guidance on how and what to negotiate for. They also felt they needed protection from the whims of the executive as well as greater negotiating power. They felt that lack of a policy created ambiguity on who should be involved in negotiations, which countries are viable treaty partners, and the minimum tax treaty terms that a country should contend for.

For sub-Saharan African countries to safeguard their interests, they must put in place mechanisms to guide and direct the entire negotiation process. This begins with the crafting of a tax treaty policy, which should:

- protect the domestic tax base
- provide a framework for developing a country model tax treaty
- provide guidance on how to identify treaty partners
- provide clarity on who should negotiate treaties
- ensure transparency and guards against sectional/political interests.

The policy should take into account economic circumstances, existing domestic policies, available technical capacity, and the cost of treaty negotiation and implementation.

Recommendations

Most sub-Saharan African countries do not have a tax treaty policy that informs their treaty negotiation. The text adopted in a treaty is therefore sometimes determined not by their needs but by the treaty partner. Countries need to develop a policy outlining their minimum acceptable treaty terms, which would ensure consistency and accountability. It should also indicate the factors to consider in the choice of a treaty partner. These countries should bear in mind that tax is not the greatest motivator for location of businesses. Rather, factors such as markets, legal protection, economic and political stability rank higher, and so they should focus on improving these areas rather than concluding lopsided treaties that have an adverse impact on their tax base.

There is need to build capacity among tax treaty negotiators in sub-Saharan African countries. Negotiation teams should be well-trained and have the authority to walk away if the treaty terms are not favourable, and oversight bodies should be well-trained and empowered to review tax treaties. This can be achieved if there is a treaty policy which takes into account the country's particular circumstances as well as the potential impact of treaties on tax revenue.

Sub-Saharan African countries should take advantage of the current global efforts to reduce treaty abuse by signing up to the MC-BEPS. Amending an existing treaty is often a lengthy and expensive process, but the MC-BEPS will be faster and more efficient. It also provides various measures to counter treaty abuse, enabling countries to seal loopholes contained in already concluded treaties.

Sub-Saharan African countries must realise that it is not only important to have a wide treaty network, but vital that treaties do not erode their tax base and that their interests are always protected. Thus, it is imperative that prior to commencing negotiations, the country must know what they want and what they are willing to cede. To ensure consistency and accountability, this knowledge must be documented in a policy document providing guidance on all matters pertaining to treaty negotiations.

Further reading

Citation: Mutava, C.N. (2019) *Review of Tax Treaty Practices and Policy Framework in Africa*, ICTD Working Paper 102, Brighton, IDS.

Credits

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The ICTD is funded with UK aid from the UK Government and by the Bill & Melinda Gates Foundation; however, the views expressed herein do not necessarily reflect the UK Government's official policies, nor those of the Bill & Melinda Gates Foundation.

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