



# Research in Brief

Issue 60 • December 2020

## The Taxation of the Digitalised Economy: An African Study

Summary of ICTD Working Paper 107 by Mustapha Ndajiwo

### Africa's challenge

African economies need adequate revenues for development, but weak tax laws, illicit financial flows and aggressive tax planning have made it difficult for them to attain their full potential in raising revenue. Furthermore, the advent of digitalised business models, although with considerable potential to improve trade in Africa, has greatly exacerbated the two central challenges of international tax. The first is the definition of taxable presence, and the second is the allocation of business profits of multinational enterprises (MNEs) among the different jurisdictions where they operate. This has generated much debate and has seen the rise in unilateral measures in different jurisdictions.

This paper is a case study of six African countries, namely Nigeria, Ghana, Senegal, Kenya, Rwanda, and Uganda. It examines the issue of nexus and profit allocation and the presence of digitalised businesses in Africa and recommends immediate and long-term options available to African countries.

### OECD and Inclusive Framework on BEPS

The advent of digitalisation and its consequent challenges to tax policies has seen a rise in unilateral measures in different jurisdictions. This led to pressure to find solutions by 2020, through the

Inclusive Framework on BEPS (IF-BEPS). This is reflected in the OECD's Policy Note of January 2019 which underlined that: 'in the absence of multilateral action there is a risk of uncoordinated, unilateral action, both to attract more tax base and to protect the existing tax base, with adverse consequences for all countries'.<sup>1</sup>

The OECD and the Inclusive Framework have continued this work and are currently considering a so-called unified approach with two main components: Pillar One, which addresses the nexus and profit allocation issues, and Pillar Two, which proposes a global minimum tax rate to address tax competition and the lowering of corporate tax rates, otherwise known as the race to the bottom.

**“The main problem of taxing highly digitalised businesses is not due to their lack of taxable presence in African countries but to the attribution of profits.”**

### Presence of digitalised businesses in Africa and their tax implications

The paper focuses on three types of digitalised businesses: online retail, taxi companies and online advertisements. It reveals that the main problem of taxing highly digitalised businesses is not due to their lack of taxable presence in African countries but to the attribution of profits.

For example, Uber has registered local subsidiaries with physical offices in four of the six countries studied. These subsidiaries are set up to provide administrative services

<sup>1</sup> OECD (2019) *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note*, OECD.

but do not own any intellectual property rights and do not receive any revenue from Uber application users. The intellectual property is owned by Uber's affiliate in the Netherlands, which receives the payments from users and pays the drivers while retaining 25 per cent of the revenues. The payments can be treated in the Netherlands as income for the licensing of the intellectual property rights, and hence suffer a minimised tax rate there.

Google supplies services in all six study countries and is physically present in four. Like Uber, Google has also employed a tax avoidance scheme, and its local subsidiary appears to be remunerated on a cost-plus basis for supplying support services.

Jumia has a taxable and physical presence in all six jurisdictions, although its corporate structure and tax arrangements are not clear.

Amazon has no physical or taxable presence in the jurisdictions studied. Although it may be considered to have a taxable nexus under the Ghana and Rwanda service permanent establishment provisions, it seems that no attempt has been made to apply this provision.

Based on the Companies and Allied Matters Act (CAMA), Nigeria can require Amazon, and other similar internet-based companies, to register a local affiliate as a condition of doing business in the country.

## Efforts by African countries to tax the digitalised economy

The study revealed that while generally the six jurisdictions studied are considering the taxation of profits arising from the digitalised economy, with Kenya and Nigeria introducing a digital services tax and significant economic presence respectively, efforts so far have focused on indirect taxation.

In Kenya, the government has imposed excise taxes on mobile transactions, internet

data and money transfers. Similarly, in Uganda, the government has imposed taxes on mobile transactions, internet data and over-the-top services. In Nigeria, stamp duties are imposed on point-of-sale transactions and bank transfers.

From both a legislative and administrative perspective, mobile transactions taxes seem easy choices for African countries because they are relatively simple to collect. However, evidence points to negative impacts on low-income earners due to the regressive nature of these taxes.

**“The best way forward for African countries would be to build on the G24 proposal under the Inclusive Framework on BEPS.”**

## What should African countries do?

African countries have the immediate advantage of collecting taxes from digitalised transactions through VAT due to its relative administrative ease and the existence of a legal framework, in comparison to corporate taxes. African countries should exercise caution in respect of transaction taxes; if they do decide to impose taxes on transactions, they should be progressive to reduce the regressive impact.

In the long term, the best way forward for African countries would be to build on the G24 proposal under the Inclusive Framework on BEPS, and press for simple formulaic methods which would allocate profits fairly between countries based on real activities in each.

## Conclusion

African countries urgently need a more comprehensive solution to the problems of taxing MNEs effectively. Digitalisation has exacerbated the defects of the rules, and these are now impacting also on OECD countries, which have been primarily responsible for formulating them. Now more than ever it is time for a re-evaluation of international tax rules which takes the perspectives of developing countries fully into account.

## Further reading

Citation: Ndajiwo, M. (2020) *The Taxation of the Digitalised Economy: An African Study*, ICTD Working Paper 107, Brighton, IDS.

## Credits

Mustapha Ndajiwo is currently Special Assistant (Technical) to the Executive Chairman of the Federal Inland Revenue Service of Nigeria. He is also the founder of the African Centre for Tax and Governance (ACTG) and the founder of Astound Consult Limited. Mustapha is a member of the Chartered Institute of Taxation of Nigeria (CITN), a member of the Base Erosion and Profit Shifting (BEPS) Monitoring Group, and an advisory board member of the Nigerian Tax Research Network (NTRN).

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.

Readers are encouraged to quote and reproduce material from the series. In return, ICTD requests due acknowledgment and quotes to be referenced as above.



ICTD is based at the Institute of Development Studies, Brighton BN1 9RE UK.

© ICTD 2020