



**TAX JUSTICE
NETWORK
AFRICA**

DANGERS OF DOUBLE TAX AGREEMENTS IN FINANCING DEVELOPMENT IN AFRICA



**DANGERS OF DOUBLE TAX
AGREEMENTS IN FINANCING
DEVELOPMENT IN AFRICA**

CASE STUDIES

Ghana, Nigeria, Tanzania, Uganda & Zambia

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List of Acronyms

AAAA	Addis Ababa Action Agenda
AfCFTA	African Continental Free Trade Area
ATAF	African Tax Administration Forum
ATI	Addis Tax Initiative
ATO	African Tax Outlook
AU	African Union
BEPS	Base Erosion and Profit Shifting
BTT	Bilateral Tax Treaties
CTPD	Centre for Trade Policy and Development
CISLAC	Civil Society Legislative Advocacy Centre
CIT	Corporate Income Tax
DRM	Domestic Resource Mobilisation
DTA	Double Taxation Agreement
FDI	Foreign Direct Investment
GDP	Gross Development Product
GII	Ghana Integrity Initiative
IMF	International Monetary Fund
LDC	Least Developed Countries
MLI	Multilateral Instrument
MNC	Multinational Companies
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
PE	Permanent Establishment
PIT	Personal Income Tax
SEATINI	Southern and Eastern Africa Trade Information and Negotiations Institute
SDG	Sustainable Development Goals
SSA	Sub-Saharan Africa
TIEA	Tax Information Exchange Agreement
TJN-A	Tax Justice Network Africa
TRA	Tanzania Revenue Authority
UNCTAD	United Nations Conference on Trade and Development
UN	United Nations
URA	Uganda Revenue Authority
UN	United Nations
VAT	Value Added Tax
WHT	Withholding Tax



Executive Summary

To meet the *Sustainable Development Goals (SDGs)* Africa ought to be self-reliant and re-orient itself from unreliable sources of development finance such as aid and debt to more sustainable domestically mobilised funds of which taxation is key.

Unfortunately, efforts to mobilise the domestic resources remain elusive owing to, partly, the growth in complexity of the international taxation regime which has subsequently permitted tax evasion and avoidance thereby eroding the much-needed tax base. One of the fundamental issues with international taxation is instances of double taxation that may arise where firms operate in more than one tax jurisdiction. Most noteworthy, the mandate to tax rests on power, however the challenge of who has the power to tax given income is often difficult to determine considering the asymmetries in national tax regimes.

To remedy this cross-border problem of double taxation or non-taxation, countries have signed **Double Taxation Agreements (DTAs)** with the sole purpose of allocating taxing rights between contracting states. However, DTAs are surprisingly used as tools of attracting **Foreign Direct Investment (FDI)** by incorporating preferential tax rates and other incentives specifically applying to investors from contracting states. This trend is widespread among developing countries in Africa yet there is no tangible evidence to justify that this practice attracts FDIs and eventually lead to increase in **Domestic Resource Mobilisation (DRM)**. Instead, DTAs have opened doors to massive abuses ranging from treaty shopping, round tripping, tax avoidance and tax evasion all of which deprive African countries their rightful share of tax revenues and consequently hamper efforts of financing own development which are enshrined in the Agenda 2030.

Against the foregoing, the study is mainly aimed at unearthing the dangers of DTAs in financing development in Africa. More precisely, the study sought to: Clarify the fact that DTAs do not foster FDI inflows into developing countries, establish levels of negotiations process between contracting states, capacity of negotiators and transparency in treaty negotiation process and finally provide practical policy recommendations towards signing

of DTAs that will work towards promoting financing for development. To achieve its objectives, the study synthesised five country-specific studies from Ghana, Nigeria, Tanzania, Uganda and Zambia which evaluated the dangers of DTAs in financing development using select DTAs signed in the specific countries as case studies. The synthesis was undertaken using two main methods of synthesising qualitative research namely; meta-study and meta-ethnography. The former involves analysing the findings, methods and theory in the studies being synthesised while the latter brings separate parts of the studies together to form one which is superior to the sum of its parts.

The study concluded that, DTAs do not lead to more FDI inflows, DTAs negatively affect DRM in Africa, domestic revenue has generally been insufficient to meet financing needs, some African countries do not involve a parliamentary approval to ratify a treaty and finally the dangers of DTAs in financing development is exacerbated by the lack of technical skills in tax treaty negotiations. From these findings and conclusions, the study recommends that there is need for comprehensive review of DTAs to ensure that enough safeguards like limitation of benefits rules are incorporated in DTAs, renegotiation of current DTAs especially those that are archaic and contain outdated provisions which no longer reflect the current economic dynamics and enhance the capacity of tax treaty negotiators of the African developing countries. This should simultaneously go along with enhancements in management information systems and data capturing related to DTAs so that developing countries are able to undertake cost and benefit analyses of DTAs.

The report also warns developing African countries to exercise extreme caution while signing or at best avoid signing DTAs with developed countries. Furthermore, the study beseeches African countries to promote transparency in treaty negotiations by including parliamentary approvals and engaging relevant stakeholders in DTAs.

DTAs have opened doors to massive abuses ranging from treaty shopping, round tripping, tax avoidance and tax evasion.

Background

In this 21st Century, international development is arched in the 2002 Monterrey Consensus¹, the 2008 Doha Declaration² and the 2015 Addis Ababa Action Agenda (AAAA)³. These UN championed initiatives underscore the strong global political commitment to address the challenge of financing and creating an enabling environment for sustainable development. These documents and the AAAA in particular, recognize “the importance of addressing the diverse needs and challenges faced by countries in special situations, in particular African countries.”

The AAAA identifies domestic resource mobilization and international private business i.e. investment as some of the seven action areas that are key to the achievement of the post-2015 development agenda and the Sustainable Development Goals (SDGs)⁴. The African Union (AU) also established the Agenda 2063 which is a strategic framework for the socio-economic transformation of the continent over the next 50 years⁴. One key pillar on which the initiative rests is that Africa should be self-reliant and finance its own development. Further to this, the 2030 agenda reiterates the un-paralleled importance of DRM with taxation as central in financing development.

Sustainable means of financing development are critical owing to the fact that inclusive growth and development has been poor in Africa. Thus, despite being dubbed as a rising continent, inequality and some human development indicators remain unimpressive. For instance, the UN (2013) estimates that the number of people living on less than USD 1.25 a day in Africa increased from 290 million in 1990 to 414 million in 2010. Worse still, the World Bank⁵ estimates that over half of the extreme poor live in Sub-Saharan Africa (SSA) and if the trend remains unchecked, nearly 9 out of 10 of the extremely poor will be in Sub-Saharan Africa by 2030.

According to Baum et al. (2017), Low Income Countries (LICs) will need to increase their annual public expenditure by 30% of Gross Domestic Product (GDP) in order to achieve the SDGs. Africa, which inhabits a lot of LICs will have to rely on efficient and effective taxation more than before.

In light of the foregoing and in view of the budgetary constraints and the unreliability of development aid, African countries ought to strengthen and explore options of mobilizing domestic resources to finance productive activities and the ever-increasing social demands. DRM through taxation is envisaged as a critical tool to ensure that governments have enough finance to provide for public services to the masses, redistribute the national income and ultimately achieve inclusive growth and development. This is mainly because unlike aid and debt, taxation is the most reliable source of financing development. It is further expected that DRM will contribute to between 70% and 80% of the financing needs of the Agenda 2063⁶.

Despite its importance, DRM is marred with numerous challenges ranging from tax evasion and tax avoidance which are exacerbated by incoherent international tax regimes, weak tax systems as well as lack of clear nexus between tax policy and administration. These problems are bleeding Africa a lot of revenue which would have otherwise been used to finance its development. For example, illicit financial flows largely comprised of tax avoidance, tax evasion, and trade mis-invoicing is estimated to be bleeding Africa USD 100 billion annually⁷. One of the problems with the international tax regime that is eroding much of African tax administration’s tax base is double taxation or non-taxation where cross-border investments are concerned. To rectify this problem tax treaties which are sometimes referred to as Double Taxation Agreements (DTAs) are used to “make

more certain and set limits to” the taxation of cross border investments. DTAs, also commonly known as bilateral tax treaties (BTT), are defined as bilateral agreements between states that establish a common framework for taxation of cross border activity. To this end, they set out the allocation of taxing rights between contracting states with the aim of avoiding fiscal evasion related to taxation of income and capital. Specifically, DTAs include provisions specifying maximum rates of Withholding Tax (WHT) on interest, dividends, royalties and other payments from source countries.

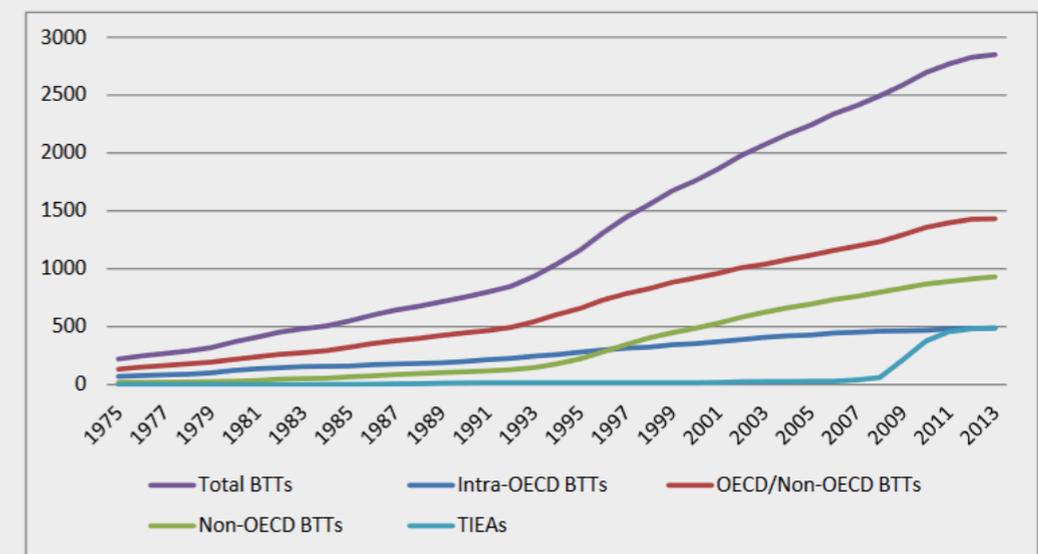
In recent years, there has been a steady increase in DTAs signed by SSA countries such that as of 2015, there were over 300 DTAs in force in the region many of which were with capital exporting developed countries. As further illustrated by (IMF, 2014), as of 2013, there were over 3000 DTAs in the world many of which are between OECD and non-OECD countries hence highlighting the power struggle in the signing of DTAs. This boom in DTAs has also triggered tax information exchange agreements (TIEAs) especially since 2009. Thus, the motive in the DTAs has not only been limited to prevention of double taxation but also an attempt to foster foreign direct investment (FDI). Just like with corporate tax rates, the obsession for FDIs has led to the trending down of WHT rates in both

As of 2015, there were over 300 DTAs in force in the region many of which were with capital exporting developed countries.

treaties and domestic law. This is problematic to Africa’s tax base as a lot of revenues are given away in return for FDIs yet there is no significant evidence to suggest that that the revenue costs are outweighed by the benefits from FDIs. This practice has opened doors of all sorts of tax treaty abuse like treaty shopping, round tripping all of which have ultimately led to loss of revenue especially to the capital importing countries which are mainly developing countries. This deprives Africa of the much-needed revenues and obstructs efforts by African governments to mobilise resources domestically to finance public goods and eradicate poverty which remains a stubborn problem in both absolute and relative terms.

Against this background and the need to understand the likely dangers associated with DTAs in financing development, TJNA in collaboration with its members; Southern and Eastern Africa Trade Information and Negotiations Institute (SEATINI-Uganda), Civil Society Legislative Advocacy Centre (CISLAC) from Nigeria, Ghana Integrity

Figure 1: Spread of DTAs over the past 30 years



Sources: International Bureau of Fiscal Documentation database.

1. <https://www.un.org/esa/ffd/monterrey/MonterreyConsensus.pdf>
 2. http://www.un.org/esa/ffd/doha/documents/Doha_Declaration_FFD.pdf
 3. https://www.un.org/esa/ffd/wp-content/uploads/2015/08/AAAA_Outcome.pdf
 4. <https://au.int/en/agenda2063>
 5. <https://www.worldbank.org/en/topic/poverty/overview>
 6. http://www.un.org/ga/search/view_doc.asp?symbol=A/RES/70/1&Lang=E
 7. <https://www.uneca.org/stories/experts-call-combined-forces-stem-illicit-financial-flows>

Initiative, Policy Forum (PF-Tanzania) and Centre for Trade Policy and Development (CTPD) from Zambia with support from Open Society Foundation (OSF) carried out country level studies on the dangers of DTAs in financing development in Africa covering Ghana, Nigeria, Tanzania, Uganda, and Zambia. This synthesis report consolidates findings from the national reports of the five country studies⁸ with the aim of understanding the policy drive behind increased signing of various tax treaties in Africa despite them being subject to abuse and not guaranteeing FDIs. The study provides recommendations on the best policy practice associated with use of DTAs as fiscal policies.

The countries that are of central focus in this study were chosen as there are countries in which TJNA has partners with whom it actively collaborates to advocate for stronger and fair tax systems. It is expected that experiences of some of these countries can provide us with good practice on use of DTAs as fiscal tools in Africa. The study is further expected to increase awareness among decision makers on the risks of DTAs in mobilizing revenues for development and it beseeches the policy makers to take action on DTAs i.e. renegotiating unfavourable DTAs.

The synthesis therefore purports to achieve the following objective: To provide a consolidated synthesis report on the danger of DTAs towards financing development in Africa based on country reports of Ghana, Nigeria, Tanzania, Uganda and Zambia.

More specifically the study aims at:

- Clarifying the fact that DTAs as tools do not necessarily foster foreign direct inflows into developing countries.
- Establishing the levels of negotiations between the contracting states in terms of capacity of negotiators and transparency of the negotiations.
- Contributing to existing literature on the dangers of DTAs towards domestic resource mobilisation in developing countries.
- Estimating revenue forgone due to various DTAs signed.
- Providing policy recommendations and considerations towards signing of DTAs that will work towards promoting financing for development.

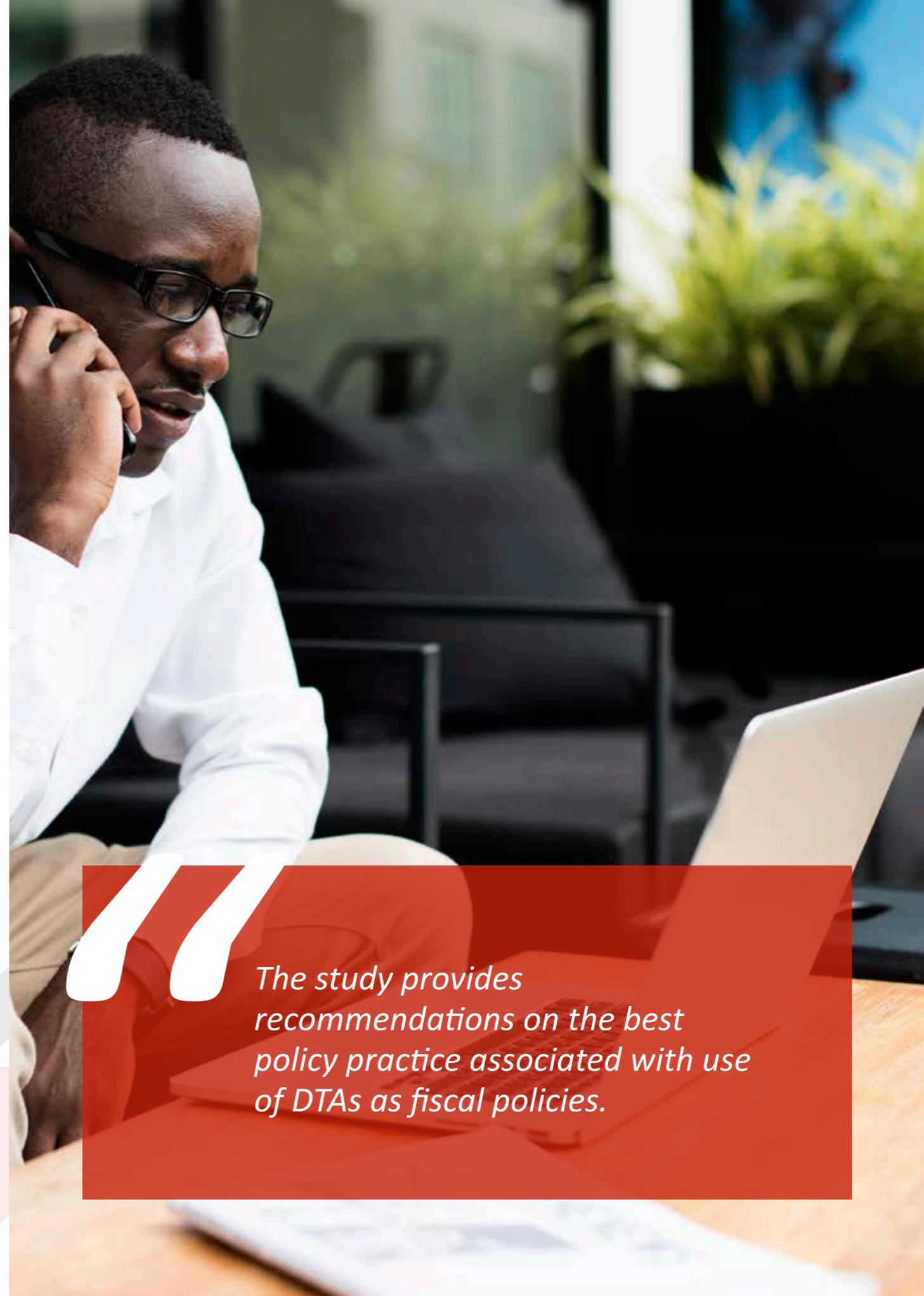
The study employs two main methods for the synthesis of the qualitative research through literature review. The first one is meta-study where prior to the analysis, there is meta-data analysis (*analysis of the findings*), meta-method analysis (*analysis of methods*) and meta-theory (*analysis of theory*). These components of analysis are conducted concurrently across the five country studies to finally come up with a synthesis. This approach is complemented with meta-ethnography as proposed by Noblit (1988). It involves bringing separate parts or studies together to form one which is superior to the sum of its parts.

This approach involves translation of concepts from individual studies into one another, explaining and exploring contradictions between studies and then finally builds up a complete picture. This methodology is warranted because it is interpretative and allows us to reveal key differences and similarities which inform us on the dangers of DTAs in financing development in Africa.

This report is divided into the following sections: **Chapter two** looks at the need to finance development and the role of DRM, specifically taxation in financing for development and achieving other development agenda in the countries under study.

The **third chapter** answers the question as to whether DTAs foster FDIs and the subsequent section (**chapter four**) evaluates the state of play of tax treaties in Africa with reference to the five country studies.

Chapter five describes the actual dangers of DTAs in financing development and finally **chapter six** concludes and provides policy recommendations with regards to the dangers of using DTAs to finance development in Africa.



The study provides recommendations on the best policy practice associated with use of DTAs as fiscal policies.

8. Box 1 to 5 in the appendix provide summaries of the five country studies

Domestic Resource Mobilisation and Development Financing

It is a stylised fact that DRM is central to a functioning state and the capacity to effectively mobilise these resources has a large bearing on the development of a country. Countries collect public revenues through taxes and fees in order to meet various needs including infrastructure, healthcare, education and general delivery of other public services. Taxation accounts for the largest component of DRM followed by non-tax revenue sources like user fees, aid and royalties and resource rents from extractive industries⁹. However, in Africa as of 2016, the average tax to GDP ratio (for 25 ATO countries¹⁰) was at 16.4% and is the lowest in the World's regions and as such, finances are often inadequate to finance development essentials. Therefore, it is a tall order for most African countries to finance the gap for achieving the SDGs which is estimated to be in excess of USD 2.5 trillion for developing countries alone.

2.1 The Need for Domestic Resource Mobilisation

DRM is essential to African countries for a number of reasons. Firstly, it is critical in the sense that it has the potential of providing long term and sustainable financing to Africa's economic growth and development thereby fleeing it from the shackles of long-term foreign aid dependence. This financing argument of DRM is the most apparent and primary role. Governments need the revenues to finance immediate needs like provision of healthcare, education, infrastructure, public order and other services for their citizens and businesses¹¹ all of which have a large bearing on poverty. Revenues are also critical to the maintenance of institutions and governance structures which augment economic prosperity of countries.

In a country where resources are sufficiently collected locally, there is a sense of predictability and this strengthens long term fiscal planning, stable financial institutions and this ultimately ensures that resources are allocated to priority sectors and are translated into outcomes. Generally, the core function of DRM is to finance sustained and inclusive development. The UNCTAD (2014)

argues that increased DRM is expected to fill the gap that exists between the available resources and those needed to finance the SDGs. However, Junquera-Varela et al (2017) are quick to caution that domestic resources cannot automatically lead to improved development if they are not translated into productive and beneficial public expenditure and this is why it is imperative to always comprehensively consider both the revenue and expenditure policies.

Secondly, DRM provides possibilities of more social spending which are critical for the improvement of human development which remains poor in African countries. When countries fail to mobilise enough revenues, this translates into a constraint to more spending on critical areas of development like health, education, social protection and ultimately the achievement of the SDGs. In relation to this function, taxation is also key to achieving redistribution where the poor people are lifted out of poverty. Albeit being a secondary function of taxation, redistribution is key to poverty alleviation and sustainability of human development especially in Africa which is the second most inequitable region in the world after Latin America. Contending with this, TJNA & Christian Aid (2014) argued that increased reliance on regressive tax systems by some SSA countries exacerbated inequality and as such tax systems ought to be reformed to ensure progressivity.

Taxation and governance are intricately related as the former can play a pivotal role in improving social contract hence enhancing state building.

DRM is also important for governance and state building in the sense that tax systems provides an opportunity for interface between the government and citizenry thereby ensuring a responsive, accountable and capable state. Taxation and governance are intricately related as the former can

play a pivotal role in improving the social contract hence enhancing state building. According to OECD (2009) taxation can increase state capacity, accountability and responsiveness in the sense that when governments depend on a significant population of the nation for revenue, they are incentivized to uphold affluence and develop institutions. As further propounded by Moore (2007), this bargain makes governments more accountable and responsive to their citizens and ultimately achieves state building.

This intricate relationship allows tax payers to negotiate with the government in exchange for an increased tax compliance and this brings in an efficient and predictable taxation process. Junquera-Varela et al., (2017) further argues that taxation may help introduce good practices in the various parts of the government as tax reforms help in building databases and systems that are essential for broader economic and administrative management.

Against this backdrop, it is unsurprising that development partners at the 3rd Financing for Development Conference in Addis Ababa in 2015 formed the Addis Tax Initiative (ATI) with the aim of enhancing mobilisation and effective use of domestic resources towards sustainably funding the 2030 Agenda. Basically, it intends to generate substantially more resources for capacity building in the field of taxation as well as more ownership and commitment for the establishment of transparent, fair and efficient tax systems. Through this initiative, development partners will assist least developed countries to achieve their revenue potential as well as legal certainty in taxation.

2.2 Challenges to financing for development

Notwithstanding the unmatched importance of DRM to development financing, there remains challenges that have hampered the maximisation of the country's revenue potential. This section discusses some of the cross-cutting and Africa specific challenges.

2.2.1 Weak tax systems

Most tax systems in Africa are characterized by inadequate administrative and organisational capacity which is epitomized by the inability to track taxpayers, poor quality data, limited reporting, low levels of technical expertise, low staffing levels and non-compliance. These challenges provide fertile grounds for capital

flight and other forms of illicit financial flows which is estimated by UNECA (2015) to be bleeding African countries revenues that exceed foreign aid inflows.

2.2.2 Informality of the economies

Informality is one other inherent problem that hinders DRM in Africa and this narrows the tax base. This implies that few taxable economic activities are at the disposal of the tax administrations. According to Bersley et al (2014), *"the combination of an informal economic structure, reliance on income from specific commodities and natural resources, and the availability of aid pushes many low-income countries into a low tax to GDP ratio associated to a narrow tax base and a narrow set of taxable individuals."* This problem is worsened by high compliance costs due to cumbersome tax procedures like too much time taken to file a tax return, use of manual tax systems and numerous payment components.

2.2.3 Ineffective tax policies

Effective tax policies are key to enhanced revenue collection and improved compliance which may assist in tapping into the informal sector thereby increasing the tax base. However, most policies that are pursued by African countries are too revenue centric and are often deficient of innovation and are not backed by comprehensive research and analysis of the tax policy environment. This is why most of them yield minimal impact. For instance, Oxfam Novib et al (2012), noticed that in Uganda, tax policies largely failed to account for non-revenue performance objectives and indicators such as commitment to progressive taxation, curbing tax evasion and enhancing tax compliance which often play second fiddle. Instead, just like most African countries, Uganda was more focused on meeting revenue targets and this oversight greatly affected DRM.

2.2.4 Tax incentives and exemptions

Most African countries use tax incentives as a tool for attracting and promoting Foreign Direct Investment (FDI) and this entails giving away a lot of taxable base associated to the tax revenue forgone. However, IMF (2015) notes that tax incentives are not the primary determinants of the decision to invest. Instead, they distort resource allocation leading to some

9. Henceforth, DRM will be synonymous to taxation

10. African Tax Outlook (ATO) is a publication of tax statistics from tax administrations in Africa by ATAF

11. <http://www.worldbank.org/en/topic/governance/brief/domestic-resource-mobilization>

sub-optimal investment decisions ultimately resulting in rent-seeking behavior. Tax incentives also risk attracting footloose firms which propagate tax evasion and avoidance and to a large extent they are harmful to long-term growth potential.

As further lamented by Policy Forum (2018), *“many multinationals enjoy foreign tax credit at home and giving them tax incentives may have minimal impact on their profit which in effect allows the developed home country to be the final beneficiary of the tax break”*.

2.2.5 Tax Evasion and Tax Avoidance

Tax evasion is an illegal arrangement of a taxpayer’s affairs where tax liability is hidden or ignored while tax avoidance refers to the legal tax arrangement that is intended to reduce a tax liability¹². These twin problems are a major obstacle to Africa’s development financing because they undermine DRM. Cobham & Jansky (2017) argue that the intensity of revenue losses due to tax avoidance alone is high in low income countries and Sub-Saharan Africa. Some of the causes of tax avoidance and evasion include rampant corruption, lack of rule of law, low transparency and accountability of public institutions and low quality of service delivery in return of taxes.

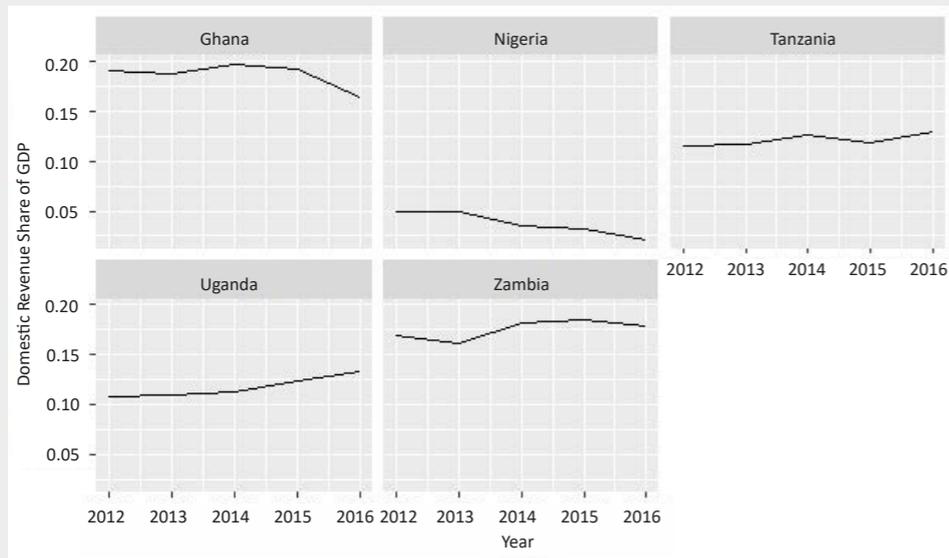
2.3 Macroeconomic status of the country case studies: Ghana, Nigeria, Tanzania, Uganda and Zambia

This section undertakes a comparative analysis of key macroeconomic variables in the five countries under review. Firstly, a trend analysis of the share of domestic revenue in GDP is performed on the country case studies. Then, another trend analysis of the share of tax to GDP ratio is also done in order to envision how the countries perform. The final part of the section illustrates the structure of taxation in the five countries. These indicators best illustrate the capacity of each case study country to effectively and efficiently mobilise DRM.

2.3.1 Domestic revenue share in GDP in five selected African countries

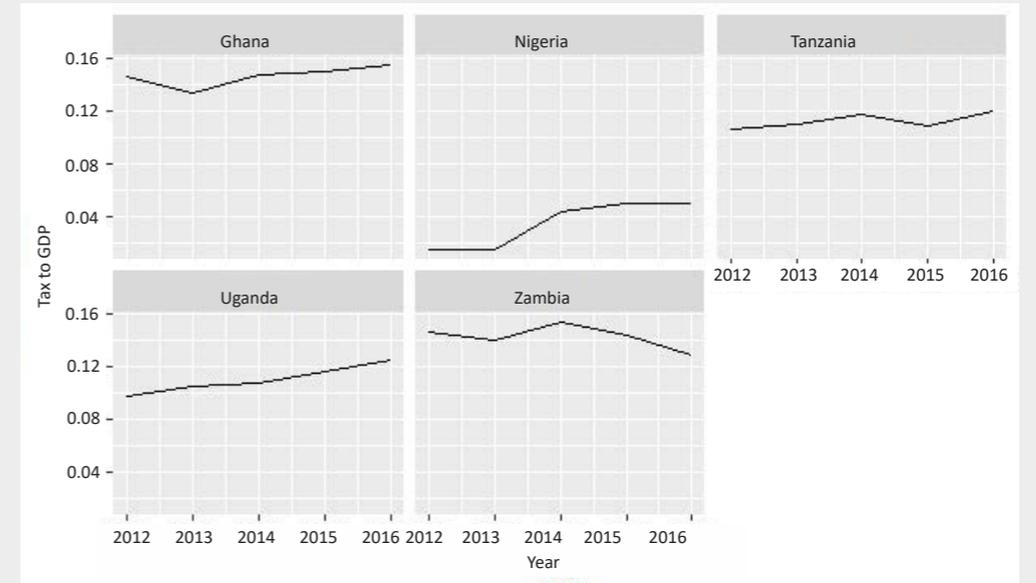
Domestic revenue is total government revenue comprising tax and non-tax revenue generated in a country. This excludes grants and social contributions. The share of domestic revenue in GDP denotes the extent to which tax and non-tax revenue is collected in the *“available economic capacity”*. Among the five countries under study, Ghana reported the highest share of domestic revenue in GDP over the five year period hitting as high as 20% and Nigeria reported the lowest, going as low as 2%. It is highly likely for countries like Nigeria, that rely heavily on oil revenue to finance the fiscus, to

Figure 2: Domestic revenue share in GDP in five selected African countries from 2012 to 2016



Source: Government Revenue Dataset (GRD)-UNUWIDER

Figure 3: Tax revenue share in GDP in five selected African countries from 2012 to 2016



Sources: Government Revenue Dataset (GRD)-UNUWIDER & African Tax Outlook (2016, 2017, 2018) - ATAF

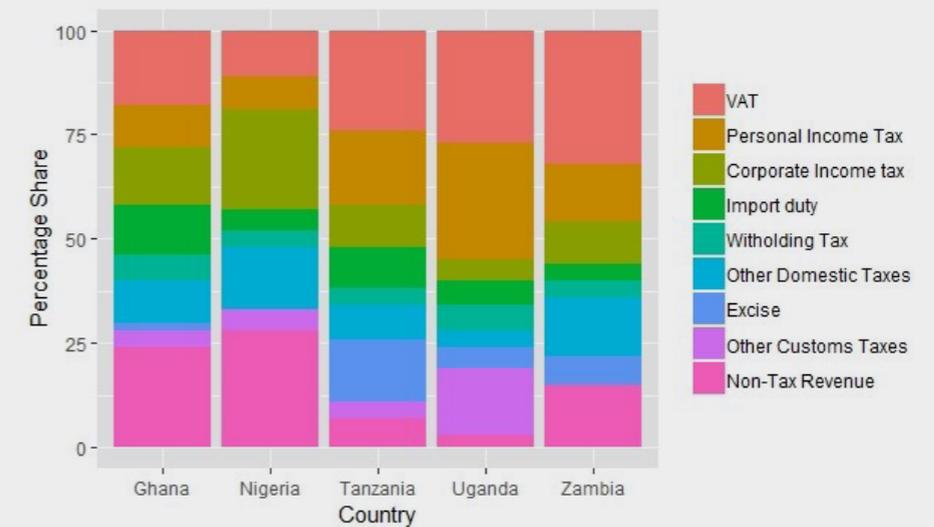
report lower than average domestic revenue share of GDP.

Despite Ghana topping the list, it has, recently, registered a decline in the domestic revenue share of GDP. This nose-diving trend has also been experienced in Nigeria. On the other hand, Zambia, Tanzania and Uganda have registered sharp increase in domestic revenue share of GDP in the past three years, 2014 to 2016.

2.3.2 Tax revenue share in GDP in five selected African countries

As can be observed in Figure 3, Ghana and Zambia have highest shares of tax-to-GDP ratios (both reaching as high as 15%) with Zambia’s share declining in the years 2014 to 2016. Nigeria has the lowest tax-to-GDP ratios among the five countries under study and the possible explanation about dependence on oil revenue may also play a role in the dismal ratios. Despite the lowest ratios, Nigeria

Figure 4: Composition of Tax Revenue in five selected African Countries in the year 2016



Source: African Tax Outlook (2018) -ATAF

12. <http://www.oecd.org/ctp/glossaryoftaxterms.htm#E>

registered a steady increase in the tax-to-GDP ratio from 2013 to 2016. In terms of continental performance, most African countries report tax-to-GDP ratios in the range of 12% to 15%.

Various factors contribute to the variations in tax-to-GDP including: Per capita income, size of the tax base, and structure of the economy. Other variations in the tax-to-GDP ratios also arise due to variations in the composition of tax revenue and the differences in the tax lines that are influential for each country. For instance, if a country relies heavily on Personal Income Tax (PIT) and has implemented a revenue-enhancing reform in PIT either through a rate or tax policy change, the country may register an improvement in the tax-to-GDP ratio. That is why we explore the revenue composition of the five countries under study to appreciate the tax components driving these tax-to-GDP shares.

2.3.3 The structure of tax revenues in the five case study countries

The composition of tax revenues has a significant impact on long term growth hence development financing of a country. Using the most recent data available from the 2018 African Tax Outlook, we evaluated the tax structure of the five African countries that prevailed in the year 2016. Tanzania, Uganda and Zambia registered highest component of Value Added Tax (VAT) confirming Bodin & Koukpaizan (2009) and Bird & Gendron (2007) assertion that VAT is on the rise in Africa and other transitional economies. Zambia has registered the largest share of VAT collections among all countries, but this may also signify a larger share of unpaid refund claims which were on the rise between 2015 and 2016. Nigeria seconded by Ghana had the least revenue contributions from VAT but on the contrary, the two countries recorded highest shares of non-tax revenue in the revenue component highlighting their over-reliance on revenues from natural resources.

The other three countries (*Tanzania, Uganda, and Zambia*) exhibited highest reliance on tax revenues with the largest shares of Personal Income Tax (PIT) and CIT. Combined, PIT and CIT accounted for over 50% of the tax revenues in Uganda in the year 2016. This may reveal underlying high-income tax rates for these two taxes in the case of a narrow base, otherwise,

a broad base encompassing individuals and corporations. Uganda has registered a higher increase in the share of PIT due to a recent move to tax high-net worth individuals (*Kangave, Nakato, Nalukwago, & Zzimbe, 2018*).

2.4 The role of DTAs in Development Financing

DTAs primarily aim at minimising the extent to which a taxpayer will be subjected to taxation twice on a given income. Specifically, Miller & Oats (2014), identify six (6) main purposes of DTAs including: Providing ways of uniformly settling problems in international juridical taxation, preventing tax evasion through the provisions of information exchange and assistance in tax debt collection owed to the treaty partner as well as protecting taxpayers from direct or indirect double taxation.

This third purpose of DTAs hinges on the premise that DTAs ought not to make a taxpayer worse off than under domestic tax law. Thus, treaties can never introduce tax liabilities where none exists under domestic law and can only reduce or eliminate domestic tax liabilities. Furthermore, DTAs prevent discrimination between taxpayers, provide fiscal and legal certainty in international operations and most importantly DTAs prevent tax from being a deterrent to free flow as well as transfer of international trade, investment and technology.

Most countries in Africa and other least developed countries, use a mixture of tax incentives, DTAs and other tax breaks as means of primarily attracting investment but there is sufficient evidence to suggest otherwise. Thus, this practice is done at the peril of development financing because in most cases the cost in form of forgone revenue outweigh the benefits. A study by Awasthi (2012) also refutes the claim that DTAs, tax breaks and associated incentives attract FDI to developing countries. The study, whose setting was in Rwanda, Burundi, Tanzania and Uganda, set to measure the effectiveness of tax incentives on investment decisions.

Out of the 683 cases, over 92% of them responded they were not motivated by tax and other fiscal incentives to invest in a jurisdiction. Unfortunately, the proliferation of tax and fiscal incentives still prevails. This happens at the expense of development finance which would have otherwise been invested in critical sectors of the economies.



DTAs primarily aim at minimising the extent to which a taxpayer will be subjected to taxation twice on a given income.

Do DTAs Really Foster Foreign Direct Investment?

There is a dichotomy of objectives when countries enter into DTAs depending on their economic standing. A developed country enters bilateral investment treaties to protect investors from paying taxes in two jurisdictions while in developing countries, most bilateral investment treaties are geared towards attracting FDI and this does not exclude DTAs.

According to Bonanomi & Saithi (2013), DTAs help to create a favorable environment for foreign investment. DTAs facilitate the international flow of capital, technology, goods and services by eliminating double taxation of income and other taxes in international transactions through a bilateral or multilateral resolution of conflicts among overlapping tax jurisdictions. FDI is regarded as a major driver of growth in developing countries because it provides financial

resources which are most often in short supply in developing countries (Abdualai, 2005)¹³. Figure 5 shows the scatter plots of FDI and GDP in a sample of five countries.

All the scatterplots are exhibiting a positively sloped relationship signifying that FDI and GDP are positively correlated and partly supporting the assertion that indeed FDI may be a major driver of growth in these developing countries.

Consequently, African countries have predominantly signed DTAs with countries that are sources of FDI and aid as well as countries within Africa that are regarded as hubs for FDI for instance, Mauritius and South Africa. However, there are some treaties with newer sources of investment outside the Organisation for Economic Cooperation and Development (OECD) such as India and China.

There have been mixed findings from studies that have attempted to determine the impact of DTAs on FDI. Ultimately, it is difficult to ascertain whether the existence of DTAs leads to increased FDI. The major challenge is to determine whether in the absence of DTAs, FDI will still be attracted to a jurisdiction because of the economic activity and opportunities to invest capital. Indeed, there are other main attractions of FDI such as predictable macro-economy, political stability adequate infrastructure and cost of production.

Developing countries could have enhanced efforts in these options to boost FDI rather than take the DTA-route. Again, from a tax perspective, other cases of double taxation can be eliminated through domestic provisions without the need for tax treaties. Other measures apart from DTAs to foster competition for FDI include: Removing or reducing some restrictions imposed on investors regarding, for instance, profit repatriation, bilateral measures and red tapes. In addition, there are other factors that influence the influx of FDI that are not easily amendable to policy. This is either because they are unalterable, like natural endowment of physical resources, and geographic proximity to major source countries, or because changing them is a very long-term process, as in the case of the efficiency of political institutions, market size or the education and productivity of the local labour force. However, despite all the aforementioned competing alternatives to attracting FDI, why do developing countries still opt for DTAs at the expense of their taxing rights?

Since DTAs involves countries sacrificing revenues, it would make economic sense if the revenue foregone would be compensated for by the positive economic effects from an increase in FDI as a result of the DTAs. If DTAs reduces tax barriers to FDI, then an increase in FDI activity after enforcement of a DTA can be expected. Hearson (2012) claims that investors are encouraged by stability of their investment when the taxing right is given to a developed country after a DTA is signed because the municipal laws will not override the provisions of the treaty¹⁴. While the effect of tax concessions on FDI is postulated to depend on the sector which is receiving the investment, empirical evidence which

There is no credible evidence in the data that tax treaties have significant positive effects on FDI activity.

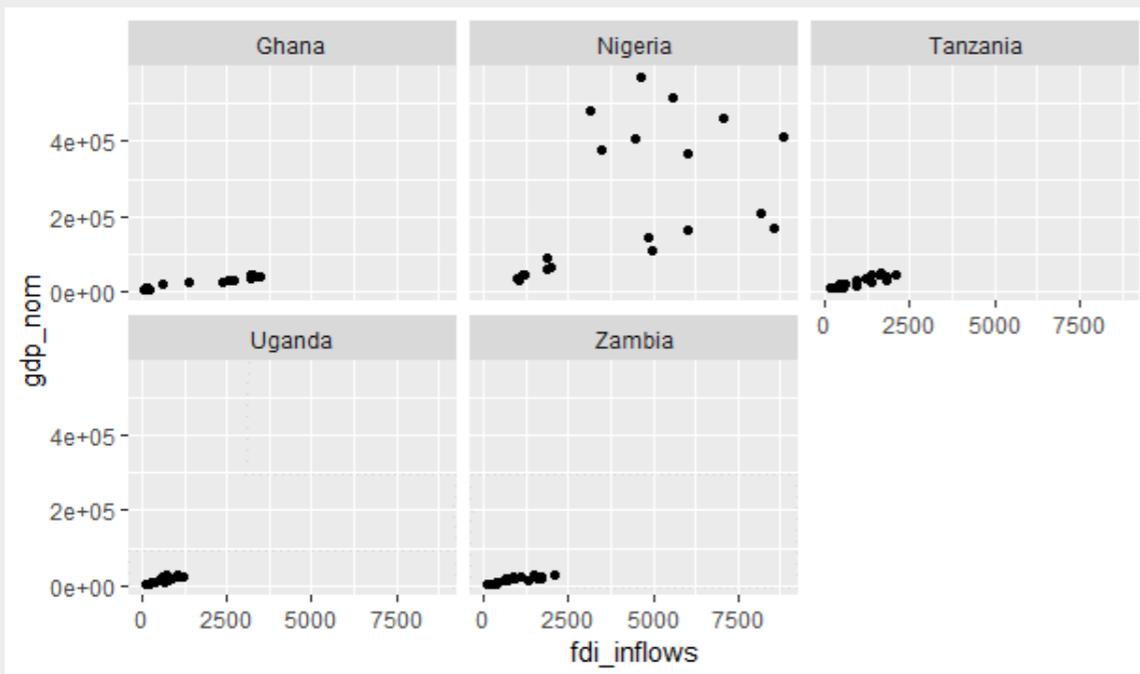
has excluded sectoral analysis of gains from DTAs has pointed in different directions.

Barthel, Busse & Neumayer (2009) applying econometric models to test determinants of FDI on a largely unpublished dataset on bilateral FDI shocks (*spanning a representative sample of host and source countries*), find that DTAs lead to higher FDI stocks. However, Blonigen and Davies (2002) state that “there is no credible evidence in the data that tax treaties have significant positive effects on FDI activity”. Egger, Larch, Pfaffermayr & Winner (2006) go further to conclude that there is no significant effect of DTAs on FDI, rather, new implementation of DTAs often leads to a reduction in FDI. To that end, Brooks and Krever (2015) describe DTAs as a “poisoned chalice” for developing countries, because the treaties transfer tax revenue from developing countries to developed countries without necessarily increasing FDI in the host country¹⁵.

The top 10 countries with the highest FDI to Uganda do not necessarily have a DTA with Uganda, for instance Kenya and Australia (*refer to Table A1 in appendix*). Most developing countries offer lower withholding tax rates for countries with whom they have DTAs aimed at incentivizing investors. However, the United Kingdom has similar withholding tax rates similar to those in the Uganda’s tax laws yet it is also a very significant source of FDI to Uganda.

During the first-half of 2015, major sources of FDI in Zambia were: Canada, UK, Australia, Switzerland, China and South Africa which collectively account for 73.3% of total foreign direct investments. Half of these have DTAs with Zambia and have shown mixed contributions to FDI. Compared to China and South Africa, Zambia collects less revenues from trade with Switzerland and in some years, Switzerland brings in more FDI into Zambia (*refer to Figure A1*). Yet, in other years, Swiss FDI was

Figure 5: Scatterplot of FDI and GDP in selected African Countries (US\$ Millions)



Source: Author using data from World Development Indicators (WDI)-World Bank

13. “Sectoral Analysis of Foreign Direct Investment in Ghana” (2005) available at https://www.bog.gov.gh/privatecontent/Publications/Staff_Working_Papers/2005/wp-15.pdf

14. M Hearson “Do Tax Treaties Increase Foreign Direct Investment in Developing Countries” available at <https://martinhearsen.wordpress.com/2012/11/27/do-tax-treaties-increase-foreign-investment-in-developing-countries/>

15. Brooks, K., & Krever, R. (2015). *The troubling role of tax treaties*. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2639064

lower than China's FDI despite continuously implementing Swiss-Zambia DTA allowing for lower taxes compared to China. This key finding from the Zambia case study confirms that DTAs do not guarantee FDI or increased revenues.

One of the key findings from the Ghana case study is that DTAs alone are not a critical factor influencing FDI since over 68.94% of investments made by the top ten investor countries were made without the existence of a DTA between Ghana and those investor countries. Further observing the FDI data from September 2004 to September 2017 (Table A2 in the appendix), some inference can be drawn.

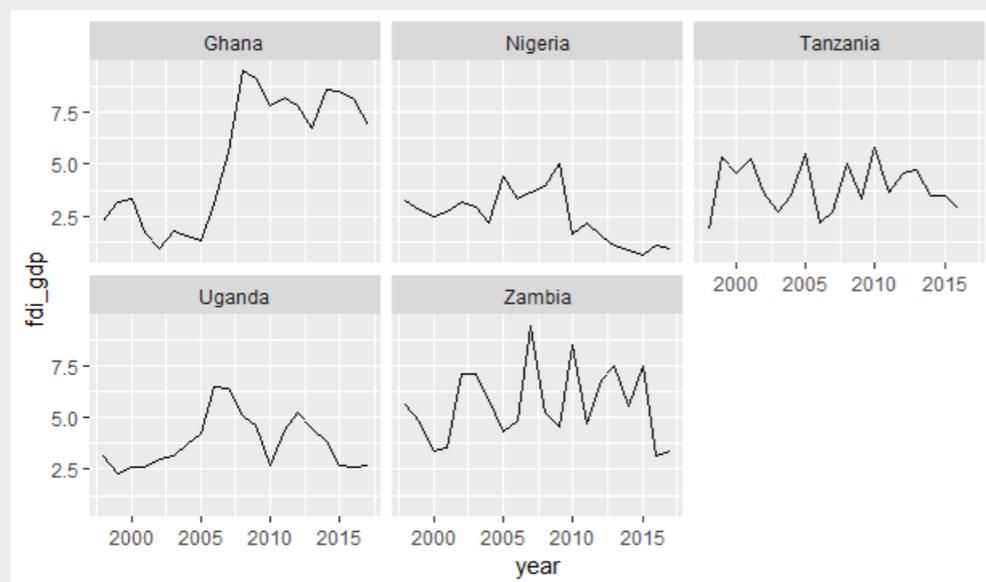
Ghana has a DTA with UK and Netherlands (FDI Total: USD 9.51m) and no DTA with South Korea and

USA yet FDI Total is USD 9.40m. Thus, no significant difference in the FDI despite not having DTA with other countries. Overall, we observe that in most cases, countries that have no DTA with an African country are actually contributing more FDI than those which have DTAs (Further refer to Table A3 in the appendix).

Figure 6 shows the trend of FDI as a share of GDP in five African countries. Given the large number of tax treaties signed with an aim to boost FDI, the plausible expectation would be an ever-increasing or constant level of FDI taking into account new treaties being signed as well as current treaties which are fairly constant overtime.

However, from Figure 6, all countries exhibit rapid fluctuations in the share of FDI in GDP signifying

Figure 6: Trend of FDI as a share of GDP in selected African Countries



Source: Author using data from World Development Indicators (WDI)-World Bank

that even in years where the treaties were still in force, countries could still experience a decline in the FDI-GDP ratio.

Ghana's FDI-GDP ratio experienced a very sharp rise between the years 2005 and 2007 like none other amongst the countries under study and Acheampong & Osei (2014) attributed

fluctuations of FDI in Ghana to natural resource endowments¹⁶ while Zakari (2013) attributed the sharp rise to "improvement in political stability and macroeconomic variables" and not tax treaties¹⁷.

Thus, from Figure 6, in addition to the results in Table A3 in the appendix, we can conclude that tax treaties have not been effective in propelling FDI.



Ghana's FDI-GDP ratio's sharp rise is due to improvement in political stability and macroeconomic variables and not tax treaties.

16. <http://www.sciedu.ca/journal/index.php/ijfr/article/viewFile/3963/2334>

17. https://issuu.com/zack792003/docs/impact_analysis_of_foreign_direct_investment_on_ec

State of Play of Treaty Negotiations in Africa

4.1 Process of Treaty Negotiation

The process of treaty negotiation varies slightly among countries in Africa. A ratification score is conceptualized as the institutional “hurdle” that stands in the way of ratifying a treaty¹⁸. It provides an indication of the breadth of the political support necessary for ratification of a treaty. “The broader the political support necessary for ratification, the higher the hurdle and the higher the ratification score¹⁹”. Table 1 provides an indication of the ratification scores of the five African countries under study: Ghana, Nigeria, Tanzania, Uganda and Zambia.

Country	Ratification Score	Interpretation Score
Tanzania & Zambia	1	Individual chief executive or cabinet decision (<i>Discretionary</i>)
Uganda & Ghana	2	Majority consent of one legislative body
Nigeria	3	Super-majority in one body or majority in two separate legislative bodies

Table 1: Ratification Scores in a selected number of African Countries

From Table 1, we observe that Nigeria is the one with the most “hurdles” regarding treaty ratification while in Tanzania and Zambia, the process is relatively easily attainable. In Uganda, a majority consent of one legislative body is required for ratification.

In addition to the constitution, the Treaties Act 2004 and the Companies Income Tax Act (CITA) also govern the process of treaty-making in Nigeria. According to the Nigerian Constitution 1999, no treaty between the Federation and any other country shall have the force of law except to the extent to which any such treaty has been enacted into law by the National Assembly.

Any bill shall not be presented to the president for assent unless it is ratified to by the majority of all the Houses of Assembly in the Federation. This requirement encompasses the ratification of Double Tax Agreements in order for them to be enacted in Nigeria. Similarly, Tanzanian law prescribes that any treaty to which Tanzania will be a part of must be presented to the National Assembly first to give it domestic legal force²⁰.

On the other hand, the Zambian law (*Income Tax Act of 1996 and the Income Tax Amendment Act of 2008*) gives the overall mandate to enter the Double Taxation Agreements (DTAs) to the President. This means ministers or ministries of the

government can only enter into DTAs with express delegated mandate from the President.

In terms of the entering into effect of DTAs, for the Zambian case, the law provides that DTAs must be presented to the Cabinet for ratification. Zambian Double Taxation Agreements are formulated as follows; firstly, the initiating ministry prepares a Cabinet Office Memorandum (*Cab Memo*), which is then submitted to the Cabinet office and circulated to all ministries. Secondly, the Ministry of Finance receives instructions to act on the Cab Memo and therefore undertakes the technical work of formulating the draft DTA.

The technical drafting of the DTA involves the negotiation of the content with the bilateral DTA partner. Once this is completed the DTA is sent to the Ministry of Justice for legal drafting. The legal drafting of the DTA is mainly to ensure the legal soundness of the document and that it does not contradict or inadvertently contravene Zambian Laws, International treaties or Laws of the bilateral partner country.

Once this is completed the DTA is then ready for signing and thereafter for ratification. The Main implementing agent of the duly signed and ratified DTAs in Zambia is the Zambia Revenue Authority (ZRA).

18. https://scholar.harvard.edu/files/bsimmons/files/APP_3.2_Ratification_rules.pdf
 19. https://scholar.harvard.edu/files/bsimmons/files/APP_3.2_Ratification_rules.pdf
 20. See E. Seaton & S. Maliti, *Tanzania Treaty Practice* (1971)



Figure 7: Legal Framework for DTA formulation in Zambia.

Source: Centre for Trade Policy and Development (CTPD) (2018)

In the case of Uganda, ratification is governed by the Constitution of the Republic of Uganda (1995) and the ratification of Treaties Act Cap 204. Section 2 of the Ratification of Treaties Act.

“All treaties shall be ratified as follows: by the Cabinet in case of any treaty other than a treaty referred to in paragraph (b) of this section; or by Parliament by resolution - where the treaty relates to armistice, neutrality or peace; or - in the case of a treaty in respect of which the Attorney General has certified in writing that its implementation in Uganda would require an amendment of the Constitution.”

Thus, save for the provisions in (b) above, treaties in Uganda are ratified by the Cabinet²¹. The ratification process is provided in summary in **Figure 8**:

The DTA policy of Ghana is contained in a document

titled *“Policy Guidelines for Negotiating Double Taxation Agreements”* prepared by the Tax Policy Unit of the Ministry of Finance in 2016. A review of the document shows that Ghana’s DTA policy is anchored on four main pillars of political and Socio-Economic Relations, Trade and Investment, Economic Benefit and Tax Revenue.

Each pillar has been assigned a weight or score such that the total weight or score adds up to 100. Ghana will only take a decision to negotiate a DTA with a country if the evaluation report generated based on the above pillars produces a minimum score of 60. In Ghana, ratification of a treaty is by Act of Parliament or vote of more than one-half members of Parliament²².

4.2 Weaknesses in Treaty Negotiation

Treaty negotiation involves dealing with a broad range of complex matters. As observed by Hengsle (2015), a DTA ought to meet the political

and economic interests of both parties as far as possible and this ensures that it works smoothly in practice and it avoids creating a strenuous relationship among relevant authorities. Cognizant of the foregoing, ATAF developed an *“ATAF Model Agreement for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income”*.

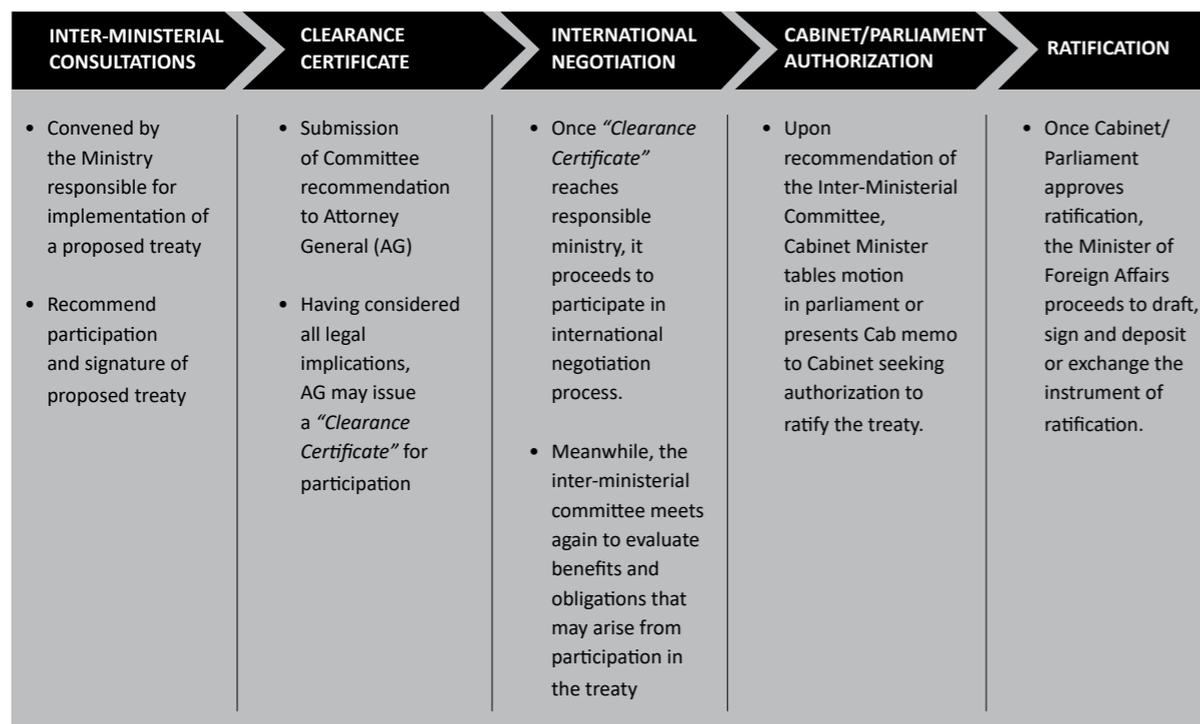
This tool was further necessitated by the existence of archaic DTAs in Africa which do not permit equitable distribution of taxing rights and most importantly lack of technical expertise in developing a treaty policy in most African states. Thus, while being a hybrid of the UN and OECD Models, the ATAF model accounts for the political and economic dynamics that exist in Africa.

In the country case studies, the political process is largely similar but inhabit inherent and general weaknesses. One key weakness that prevails across the five country case studies is the lack of clear guidelines and understanding of DTAs by policy makers.

published and made available to the public.

In the same vein, Ghana has in place a National DTA Policy but as lamented by (GII, 2018), the remaining challenge is to ensure that the principles contained in the policy are adhered to in the process of deciding whether to conclude a DTA with a country or not. Furthermore, Policy Forum (2018) argues that since DTAs are binding national laws, it is imperative to encourage public participation and subject the DTAs to more scrutiny before they are concluded.

Figure 8: Ratification Process in Uganda



Source: Kigenyi (2010) & www.euclid.int

The challenge is to ensure that the principles contained in the policy are adhered to in the process of decision making.

Being a political process, treaty negotiations involve both technocrats and policy makers like parliamentarians. Since DTAs negotiations are largely technical, they end up not being thoroughly scrutinized from the perspectives of the policy maker and the technocrats. The weak competence of these key groups of treaty negotiators plays to the disadvantage of most African countries when the DTAs are concluded. Secondly, there is lack of transparency in the political process of treaty negotiations and re-negotiations. For instance, SEATINI (2018) notes that in Uganda the process of treaty negotiation is often kept a secret and there is less information sharing and limited stakeholder consultations such as with Parliament and the civil society. It is against the foregoing that SEATINI is lobbying for a National DTA policy which should be

21. <https://www.deniva.or.ug/docs/Reports/eac/InternationalInternalRatificationTreatiesUganda.pdf>

22. https://scholar.harvard.edu/files/bsimmons/files/APP_3.2_Ratification_rules.pdf

Dangers of DTAs in Financing Development

The study was unable to measure and quantify the extent of revenue forgone attributed to DTAs in the country case studies. This was due to unavailability of data as it would require us to obtain details of the individual tax returns. Nevertheless, the study was able to pinpoint potential effects of provisions in DTAs and other instances that allow leakage of revenue in the signed DTAs.

Despite their noble importance, DTAs inherently pose as a risk to development financing in Africa in the sense that they skew taxing rights away from African countries, are now subject to abuse that eventually erodes the tax base and they are associated with declining withholding taxes on payments made to companies outside the residence countries.

Pursuant to this risk, the IMF (2014) strongly cautions countries against signing DTAs and further encourages governments to renegotiate the current DTAs. This section summarises general dangers of DTAs in development financing with reference to the country case studies.

5.1 Skewed distribution of taxing rights

DTAs originally intend to provide a conducive environment for investment by allocating taxing rights between the capital importing ‘source countries’ and the capital exporting ‘resident countries’ so that income accruing from the investment should not be taxed twice in the two states.

However, despite the justification for having DTAs in place is honourable, there is no significant evidence to justify that they have a positive effect on investment flows into developing countries hence DRM. Most noteworthy, the mandate to tax is about power, however, the challenge of who has the power to tax a given income is always difficult to determine considering the existing differences in national tax regimes.

As noted by Hearson (2015), it is often developing countries that seek tax treaties with developed countries in order to allegedly attract investment and as such the former is at mercy of the latter. For developing countries, the outcome of committing to DTAs largely rests on their negotiation skills

Non-OECD countries impose fewer restrictions on the taxing rights of developing countries compared to OECD countries.

to overcome power asymmetry. The global distribution of taxing rights is skewed from resident countries to source countries because most of the DTAs are based on the OECD model which depresses developing countries’ taxing rights.

Against the foregoing, DTAs are consequently becoming dangerous to financing development as they keep on eroding the tax base thereby reducing revenues which developing countries would have used to finance its development.

A study by Hearson (2016), reveals that non-OECD countries impose fewer restrictions on the taxing rights of developing countries compared to OECD countries when concluding DTAs thereby leading to the latter increasingly limiting the ability of developing countries to tax foreign income.

Furthermore, 26 out of 34 OECD countries have now adopted territorial taxation which implies that income earned by their MNE in the source countries is no longer usually taxed at home thereby exacerbating profit shifting from source countries by MNEs.

5.2 Low rates of Withholding Taxes

Withholding tax is an advance payment of income tax that is retained from specified payments by a third party on behalf of the government. Many jurisdictions use this system on employment income, interests, royalties or rents. In DTAs withholding taxes are levied by a contracting state on certain types of payments made to offshore companies like dividends, interest, royalties and technical service fee.

Withholding taxes serve several functions which include: Acting as an anti-avoidance measure by discouraging MNEs from shifting profits out of the developing country thereby enabling them to get tax revenues. Secondly, withholding taxes also permit developing countries to tax incomes

received by foreign companies which emanates from the developing country itself and thirdly this tax encourages reinvestment of the earned profits. Unfortunately, withholding tax rates of DTAs in Sub-Saharan Africa have been trending downwards in a fashion similar to that of corporate income tax rates and as such further restricting African country’s ability to realise tax revenue from foreign income.

For instance, Hearson (2015) shows that withholding tax rates on royalties in Zambia’s tax treaties signed from 1970 to 2015 have been declining. Ultimately, capital importing states end up reducing their tax revenues at various levels of FDI. In Africa, this trend is more pronounced in DTAs signed with OECD member countries (ibid).

In this case, it is the African states that end up losing a lot because they forego tax revenues which would have otherwise been used to provide for public services and thereby curb poverty. **Table 2** below for instance shows estimates of revenue (*Uganda Billion Shillings*) lost as a result of low rates of WHT contained in DTAs for Uganda.

The table below gives an estimate of the revenue foregone as a result of the reduced dividend and interest withholding tax rates stipulated by tax treaties. It indicates that for these taxes the Dutch treaty may dwarf all others, with a cost of between **22 billion and 63 billion shillings** per year (**around US\$8 million to US\$24 million**). Only the Mauritius treaty comes close, at **2.6 billion shillings (about US\$1 million)**. These figures exclude the cost of lower withholding taxes on royalties and management fees, where data is not available, but which are likely to create further significant costs. It is worth noting that a lot of revenue is lost due to transfer of management fees²³.

On the other hand, in the case of Ghana, royalties were subject to a withholding tax rate of 10%²⁴ in 2013 after which the rate increased up to 15% effective 2014. However, the Ghana DTAs with South Africa and United Kingdom provide for taxation of royalties at 10% and 12.5% respectively. This implies that Ghana is giving away 5% and 2.5% marginally of WHT for any royalty paid to either South Africa or United Kingdom respectively.

Table 2: Estimates of forgone revenue due to reduced WHTs in Uganda

	FDI Stock in Uganda		Estimated return on FDI		WHT Foregone	
	Equity	Debt	Dividends	Interest	Divide	Interest
Netherlands	9,899	525	414	22	21 to 62	1.1
Mauritius	1012	229	42	9.6	2.1	0.5
India	263	23	11	1.0	0.5	0.0
South Africa	169	119	7.1	5.0	0.4	0.2
Norway	77	1.9	3.2	0.1	0.2	0.0
Denmark	9	30	0.4	1.3	0.0	0.1

Source: ICTD working paper 50: A Review of Uganda’s Tax Treaties and Recommendations for Action

23. (Hearson & Kangave, 2016) A Review of Uganda’s Tax Treaties and Recommendations for Action, ICTD working paper No. 50.

5.3 Permanent Establishments

Permanent establishments (PE) are provisions in a country's DTAs and its domestic law which specify conditions in which a foreign investor operating through a branch in a developing country is liable to tax.

Some of the examples under this is where a threshold is set as to how many days a construction site must exist before it constitutes a PE and right to taxation of supervisory activities to construction sites. In the five country studies, it has been observed that PE's definitions that are assumed have a large bearing on tax revenues hence need to be redefined.

A case in point is found in the Ghana case study and it relates to the duration required before a building is sited or construction or installation becomes a PE. As noted by GII (2018), in Article 5(4) of Ghana's DTA with both UK and South Africa, activities deemed to be of "preparatory or auxiliary character" are excluded and this poses a risk because persons residing in UK or South Africa can easily plan to escape creation of PE in Ghana.

5.4 Treaty Shopping

Treaty shopping entails multinational enterprises routing their investment in source countries through low tax jurisdiction that have more favourable DTAs with such countries in order to minimise tax liability.

Effectively, a DTA with one country becomes a DTA with the rest of the world. For instance, Quak & Timmis (2018) points that Netherlands and the United States of America's treaties with non-OECD and developing countries led to forgone revenue amounting to **EUR 770 million** in 2011 and **USD 1.6 billion** in 2010 respectively.

Furthermore, a study by Hong (2017), shows that tax treaty shopping poses a risk to DRM efforts in that it has significant effect on tax deductions on dividends incurred by multinational investors hence bring about plausible tax revenue losses. Clearly, treaty shopping deprives other countries of tax revenues for development financing. In the same vein, SEATINI & Action Aid (2017) argue that Uganda is losing a lot of revenue due to treaty

shopping specifically through the Netherlands, Mauritius and Bermuda route (see Box 1).

To counter the problem of treaty shopping, some DTAs include anti-abuse clauses but the downside is that such clauses are reliant on the information availability and capacity of the tax administrations to challenge tax avoidance which are often complex.

5.5 Round Tripping

According to OECD (2008), round tripping refers to

Box 1: Treaty Shopping; the Case of Zain, Uganda

In September 2014 an Appeals Court in Uganda ruled in favor of the Uganda Revenue Authority (URA) in the Zain case. Shares in a Netherlands company (Zain Africa BV) that owned 100% of a Ugandan telecommunications provider were transferred between two Netherlands companies (from Zain BV to Bharti A BV) and it was argued that even if taxation was allowed under domestic law, under the Netherlands – Uganda tax treaty, Uganda had no taxing right preserved (there was no equivalent to the UN or OECD Article 13(4)).

Uganda's tax authorities successfully applied Section 88(5) of Uganda's Income Tax Act to preserve its taxing right. This provides that: "Where an international agreement provides that income derived from sources in Uganda is exempt from Ugandan tax or is subject to a reduction in the rate of Ugandan tax, the benefit of that exemption or reduction is not available to any person who, for the purposes of the agreement, is a resident of the other contracting state where 50 percent or more of the underlying ownership of that person is held by an individual or individuals who are not residents of that other Contracting State for the purposes of the agreement."

The Court ruling overturned an earlier High Court decision that Uganda had no jurisdiction to tax. It does not finally dispose of the case, but the matter was sent back to the URA to consider whether and if so what amount of gain was sourced in Uganda and taxable.

Source: Daniel K. Kalinaki (2014).
The East African (13 September 2014)

"the channeling abroad by direct investors of local funds and the subsequent return of these funds to the local economy in the form of direct investment". Thus, from the standpoint of the local economy, domestic companies re-register in the jurisdiction of treaty partners and disguise as external investors.

The companies can benefit from advantageous treaty terms, e.g. exclusion of source taxation on capital gains from the alienation of shares. This is particularly appealing if the other country has a low tax regime. For example, a company with operations in Uganda may register a holding company in Mauritius which will in turn invest the same assets in Uganda as a foreign company.

This is often driven by the desire to take advantage of lower personal tax of 22.5% as compared to Uganda's 30%, or corporate tax of 15% as compared to 30%, respectively. Round tripping also allows domestic companies to take advantage of incentives their country of origin only offers to foreign investors.

Box 2: Instance of Round tripping in Uganda

The Panama leaks (2016) revealed how billions of dollars had been hidden by wealthy figures and Uganda was no exception. The leaks showed how Heritage decided a month to the execution of its Sale and Purchase Agreement with Tullow to move its domicile from Bahamas to Mauritius with a view of avoiding to pay Capital Gains Tax.

While it informed Ugandan courts that the move was for "better time zones" in England in its case with Tullow, Heritage admitted that the purpose was to avoid paying capital gains tax. Uganda earned up to USD 434 million in capital gains tax after protracted court battles locally and internationally.

Source: Daniel K. Kalinaki (2014).
The East African (13 September 2014)

24. Paragraph b of Part V of the First Schedule to the Internal Revenue Act, 2000 (Act 592) as amended by the Internal Revenue (Amendment) (No.2) Act, 2013 (Act 871).

Conclusions and Recommendations

6.1 Conclusions

The study has drawn some conclusions as follows:

- Over the years, **domestic revenue in general has been insufficient** to meet the financing needs of a number of African countries.
- **DTAs do not lead to more FDI:** Despite having tax treaties with developed countries, a higher share of FDI in the treaty partner countries is outside the treaty network. Additionally, despite increasing number of tax treaties over the years, the FDI-GDP ratio has not experienced an ever-increasing trend. Instead, it has fluctuated in some years exhibiting a decline despite the stable nature of DTAs.
- There are still some African countries which **do not require parliamentary approval to ratify a treaty.** Nigeria and Ghana is the one with the most “hurdles” regarding treaty ratification as they require the involvement of parliament and are governed with existing policies. However, in Zambia and Uganda the ratification process is relatively easily attainable only requiring approval of the President and cabinet.
- **DTAs negatively affect revenue mobilization in Africa** in the sense that they skew global tax distribution away from capital importing states, allow for tax avoidance and evasion all of which undermine the much-needed DRM in Africa.
- The dangers of DTAs in development financing is exacerbated by **lack of technical skills in tax treaty negotiations.** Most DTAs in Africa are with OECD states who have superior technical capacity in treaty negotiations compared to African tax administrations and as such much of the taxing rights are given away.
- Apart from Ghana and Nigeria, the other countries evaluated lack an elaborate policy that guides the negotiation, and basis on which the various tax treaties are drafted and implemented. For instance, Ghana will only take a decision to negotiate a DTA with a country if the evaluation report generated based on the selected pillars produce a minimum score of 60 in line with the Policy Guidelines for Negotiating Double Taxation Agreements.

6.2 Policy Recommendations

From the aforementioned findings and conclusions, the study makes the following recommendations:

6.2.1 Protection of the narrow tax base

Domestic revenue has been found wanting in meeting financing needs in Africa. Further, exacerbating the limited resources is a shrinking tax base due to some of the exemptions arising due to tax treaties. In addition to tax exemption, reduced withholding taxes on dividends, interest and royalties; and a foreign tax credit or exemption to eliminate double taxation are some of the tax advantages offered by treaties. These tax advantages are liable to attract the attention of tax planners. The following are some common examples of transactions involving potential abuse of tax treaties:

- Treaty shopping and the use of conduit companies
- Income shifting
- The international hiring-out of labour
- Circumventing treaty threshold requirements
- Changing the character of income
- Tax sparing abuses. Some tax treaties with developing countries provide for a tax sparing credit. This is a credit given in the country of residence of the investor, not just for tax paid to the developing country, but a “*shadow-credit*” for tax that would have been charged in the host country except for tax-incentive legislation which offered a reduced rate or an exemption from tax for activities seen as encouraging economic development.

Tax authorities in Africa should ensure that the tax treaty is not abused, and the benefits are not accessible by persons for whom it is not intended. Thus, it is paramount that the tax base is protected. This can be done by ensuring that there are sufficient safeguards to be built into the DTA to ensure that DTAs are not abused by the use of aggressive tax planning schemes.

6.2.2 Consideration of level of economic development prior to signing DTAs

Tax treaties between developing countries and industrialized economies are asymmetrical having a larger flow of capital towards developing countries and a larger opposing flow of capital revenues towards the industrialized economies. Therefore, it is recommended that African countries should avoid signing DTAs with developed countries.

However, since DTAs among nations with the same or similar level of development, does not cause loss of revenue, and can act as an instrument of economic cooperation among the countries of the same geographical area, African countries should encourage DTAs with countries of the same level of economic development.

However, with increased championing of the African Continental Free Trade Area (AfCFTA), African governments do not have to enter into DTAs amongst themselves because the current domestic/regional/continental tax laws are sufficient enough to deal with cases of double taxation.

6.2.3 Re-negotiation of current DTAs

Most of the DTAs in Africa are archaic and as such they contain outdated provisions which no longer reflect the prevailing economic conditions and heavily skew taxing rights towards the capital exporting state. Taxing rights such as the right to levy withholding tax are critical for Domestic Resource Mobilization.

As such, African countries should renegotiate old DTAs and even modern DTAs that have unfavourable withholding tax rates which facilitate tax revenue losses. For example, in Tanzania, the current DTAs are outdated and contain ring-fenced taxation rules that undermine Tanzania’s taxing powers.

Such treaties are largely harmful and costly to Tanzania and need to be reviewed. In Uganda, there is a need to urgently renegotiate its DTA with Netherlands in order to stop revenue loss through treaty shopping that is currently being conducted via Mauritius and Bermuda.

The review is necessary to determine if

the country is actually benefitting from the existence of these DTAs. In reviewing the existing DTAs, it is imperative to strengthen Africa based model treaties like the ATAF, COMESA and SADC in order to match the OECD model rather than a hybrid of the UN and OECD models.

Furthermore, such renegotiated DTAs ought to include limitation for benefit clauses in domestic laws too. These provisions can provide critical protection in the sense that it limits reduced withholding rates from applying only to companies that meet specific threshold of having genuine presence in the treaty country.

6.2.4 Improve Transparency and levels of Treaty negotiation to include the Parliament

Some African countries such as Uganda and Zambia do not require parliamentary approval to ratify a tax treaty. In such countries, treaties are ratified by the cabinet only leaving out input from the crucial representatives of the citizens. This will ensure adequate scrutiny of the tax treaties as they can have serious revenue implications for the country. African countries should also ensure that there is disclosure of information on the negotiation and re-negotiation of DTAs.

For instance, in Uganda, the process of treaty negotiation has often been kept a preserve of the top technical and political officials in Uganda Revenue Authority (URA), Ministry of Finance and Cabinet. This is so because DTAs have been thought of as a rather complex issue best left to the experts. There has been less information sharing on the processes and limited sharing of opinions of other key stakeholders such as Parliament, Intelligence Agencies and civil society.

To foster transparency, it is imperative that governments should put in place National Policy to guide in the negotiation and implementation of Double Tax Agreements. This will help in promoting transparency in the treaty development process and ensure that governments engage in what will be deemed productive. As in the case of Ghana, threshold consultations have been set that must be met before any negotiation is done.

6.2.5 Enhance management information systems and data capturing related to DTAs

Data constraints in terms of both availability and quality, deter estimation of revenue losses due to DTAs. Some countries like Zambia and Uganda report withholding tax revenue broken down into cross-border and domestic. Current estimates of costs to governments due to DTAs are often based on crude methods and fail to account for revenue forgone due to reduced rates of withholding taxes on royalties as well as technical service fees.

It is therefore imperative for revenue authorities to maintain sound management information systems that enable accurate and timely capturing and storage of data on DTAs. This would enable cost and benefit analysis of DTAs and thereby able to determine whether a particular DTA with a specific country erodes a lot of revenue for the state or not.

6.2.6 Building Capacity of Tax Treaty Negotiators

African countries must develop a comprehensive plan to build the capacity of persons who negotiate tax treaties on behalf of their respective country. The criteria for selecting persons to join the team of negotiators should be transparent and as far as practicable, the team should be made up of experts representing stakeholders from both the public and private sector.

There is need for governments to strengthen the competence of the representatives in the DTA negotiations so that they extract treaties from the other contracting countries that meet the country's interests and expectations. This is premised on the consideration that the quality of DTAs is largely influenced by the competence of the bureaucrats. Having a well-resourced and well-trained team of negotiators who are experts drawn from various sectors will ensure that the negotiated and concluded DTA addresses the needs and concerns of the country.



There is need for governments to strengthen the competence of the representatives in the DTA negotiations.

Table A1: Performance of FDI sources in Uganda

FDI Flows by top 10 source countries 2007 - 2016 (US\$ millions)											
Country	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	
Netherlands	21.85	16.76	16.24	121.52	164.41	611.19	493.51	491.41	236.67	278.43	
Kenya	116.21	94.21	55.49	86.12	172.55	99.37	44.49	109.56	61.70	230.10	
United Kingdom	262.30	249.72	227.78	126.74	115.81	116.81	78.86	250.31	4.47	80.94	
Switzerland	38.77	35.67	41.18	26.14	43.76	-12.92	2.64	28.87	7.87	37.38	
Australia	178.19	163.92	189.27	120.12	201.13	203.09	81.77	81.94	60.09	32.09	
South Africa	66.86	51.14	89.53	16.85	14.40	24.95	11.43	-71.37	47.40	17.78	
India	29.02	27.41	18.77	38.13	19.15	39.32	18.73	18.06	10.60	17.50	
Bermuda	59.66	50.36	87.41	11.62	38.00	-13.36	0.49	10.29	9.36	10.69	
Norway	4.72	4.35	5.02	3.18	5.33	2.88	5.56	-4.12	-1.90	5.38	
Nigeria	16.84	15.49	17.88	11.35	19.00	5.24	-3.71	9.19	-9.98	5.00	

Source: Bank of Uganda, 2018

Table A2: Total Registered FDI in Ghana (September 2004 to September 2017)

Values in US\$ Million						
Country	Total FDI	Agriculture	Manufacturing	Service	Others	
1 Britain	5,738.63	28.11	5,081.74	170.88	457.90	
2 Korea	5,045.50	15.24	17.98	24.05	4,988.24	
3 USA	4,360.68	57.35	2,321.67	950.92	1,030.75	
4 Netherlands	3,775.71	25.88	2,555.44	993.49	200.90	
5 China	2,838.00	13.07	1,727.99	584.74	512.20	
6 United Arab Emirates	2,128.70	0.55	20.19	23.25	2,084.72	
7 Lebanon	1,806.47	1.32	1,590.46	12.94	201.76	
8 British Virgin Islands	1,742.50	14.93	23.74	81.08	1,622.75	
9 Nigeria	1,629.79	2.97	8.76	702.56	915.49	
10 Mauritius	1,563.74	100.00	18.44	137.27	1,308.03	
11 Others	17,585.62	1,251.46	1,381.37	5,004.47	2,919.19	
Total	48,215.33	1,510.87	14,747.78	8,685.65	16,241.91	

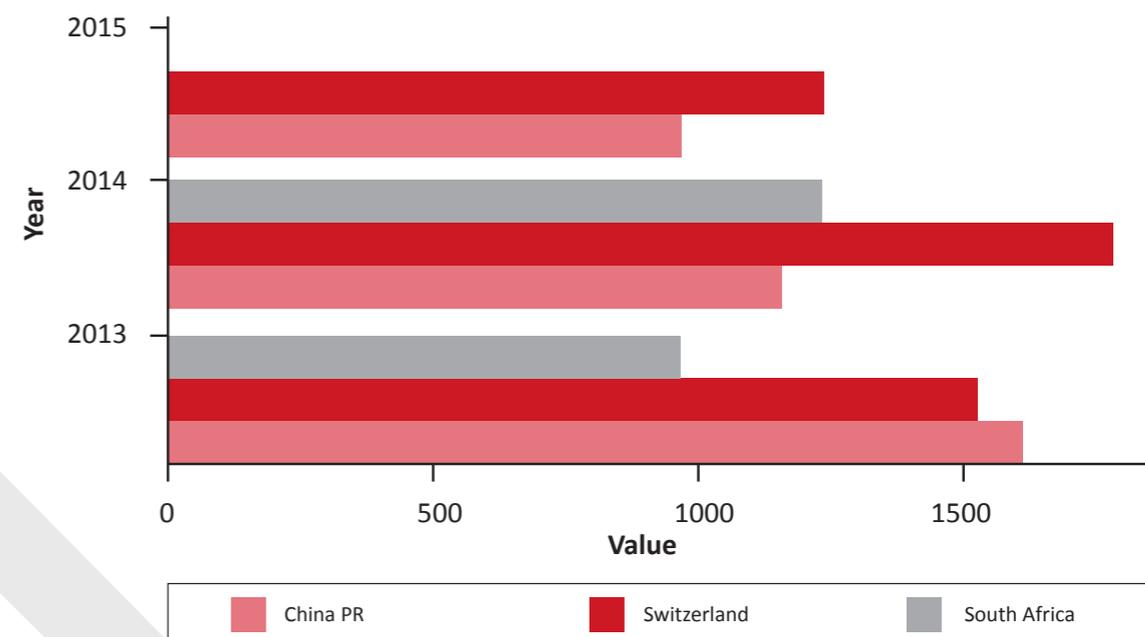
Source: Ghana Investment Promotion Centre

Table A3: FDI and DTAs in selected African Countries (2009 - 2011)

	Ghana		Nigeria		Tanzania		Uganda		Zambia	
	FDI	DTA?	FDI	DTA?	FDI	DTA?	FDI	DTA?	FDI	DTA?
Australia		✓					473.62		393.20	
Belgium				✓						
Bermuda							77.05			
Botswana					25.50					
British Virgin Islands	2,161.77									
Canada	636.63			✓	1,004.10	✓			1,112.10	✓
China				✓					440.80	✓
Denmark		✓			66.20	✓				
France	2,488.50	✓		✓	18.70				76.70	✓
India	113.64					✓				✓
Ireland									209.90	✓
Japan					69.30					✓
Kenya				✓	219.80				251.47	✓
Luxembourg	140.00									
Mauritius	100.40	✓		✓	421.10	✓				✓
Netherlands		✓		✓	146.60				235.40	✓
Nigeria	955.33									
Norway	354.63				87.00	✓				✓
Singapore				✓						
South Africa	3,307.32	✓		✓	1,147.80	✓				✓
Sweden				✓		✓			40.20	✓
Switzerland	359.11	✓			175.00					✓
Uganda					30.60					✓
United Arab Emirates				✓					72.00	
United Kingdom	3,314.64	✓		✓	779.80				305.33	✓
United States					216.80				316.40	✓

Source: UNCTAD FDI/TNC Database

Figure A1: Zambia Stock of FDI Liabilities by Source Country (US \$ Million) 2013 - 2014



Source: Foreign Private Investment Report-2015

Box A1: Dangers of DTAs in Financing for Development: Case Study of Ghana

The study used qualitative methodology to review key aspects of Ghana's DTAs with the United Kingdom (UK) and the Republic of South Africa (RSA). This was done to determine the impact of the DTAs on the tax base of Ghana and the threat they pose to Ghana's efforts to raise DRM to finance its development.

The study could not estimate the actual revenue sacrificed as a result of the DTAs due to data limitations. The analysis mostly analysed provisions of the two DTAs relating to permanent establishment, dividend, interest, royalties and management fees because these have a direct impact on the domestic tax base of the treaty partners.

The key findings were as follows:

- *Firstly*, DTAs alone are not a critical factor influencing FDI since over 68.94% of investments made by the top ten investor countries were made without the existence of a DTA between Ghana and those investor countries.
- *Secondly*, in Ghana's DTAs with the UK and RSA, PE definition excludes "preparatory auxiliary character" and these exclusions provide loophole for persons resident in the UK and RSA plan in order to escape creating a PE in Ghana.

Overall, it was found that due to economic power variances, Ghana is sacrificing a lot of revenues because the DTAs do not reflect a mutually beneficial tax revenue sharing relationship. The study recommended that extensive reviews and re-negotiations of the existing DTAs ensure that Ghana benefits. Ghana must also build capacity of its personnel in treaty negotiation skills.

The review also recommended that Ghana should review its model DTA to incorporate some Base Erosion and Profit Shifting (BEPS) recommendations and also revise provisions relating to PE, interests, dividends, royalties and fees.

Source: Ghana Integrity Initiative (2018)

Box A2: Dangers of DTAs in Financing for Development: Case study of Nigeria

The study analysed and compared Foreign Direct Investment (FDI) and Price Earnings Ratio (PE Ratios) which measures return on investment in the stock market. Two key assumptions made were that all FDI into Nigeria goes directly into the stock exchange and these investments are disposed at the end of the year.

Secondly, it was also assumed that PE ratio is the minimum earning earned by the foreign entities. It specifically analysed global FDIs, FDI from China and those from South Africa to Nigeria.

It was found that using PE Ratios, an investor making use of the double tax treaties analyzed will pay significantly less taxes under the DTA than under domestic tax legislation. Nigeria was found to be bleeding significant revenues through the various loopholes created by Double Taxation Agreements.

The study also discovered that there are significant lost opportunities in relation to missing treaty articles which may provide an opportunity to improve or increase taxation rights for source countries.

The analysis recommended greater monitoring, review and re-negotiation of existing DTAs that Nigeria has with other states. It also suggested inclusion of limitation of benefit rules in its DTA with China and South Africa in order to curtail treaty shopping.

Finally, the study recommended provision of capacity building to treaty negotiators especially on how they can use the Multilateral Instrument (MLI) to the advantage of Nigeria.

Source: Civil Society Legislative Centre (2018)

Box A3: Dangers of DTAs in Financing for Development: Case study of Tanzania

This report critically reviewed DTAs signed by Tanzania with India and South Africa to sift possible dangers that they pose towards financing development in Tanzania. The study used desk research literature review and analysis of data derived from major DTA negotiation models commonly adopted across the globe including the OECD, UN, and ATAF model agreement. The two countries were chosen because they have a significant trading partnership with Tanzania hence they have major tax implications for Tanzania's tax base and ultimately financing for development.

The research study found that when powerful and weaker states are involved in a DTA negotiation, there is financial imbalance and a lack of bargaining power on the side of the weaker economy. It further established that Tanzania's DTAs that are currently in force are archaic and outdated hence harmful and costly to Tanzania as they favour the treaty partners.

In the context of Tanzania, it was found that DTAs with South Africa and India do not directly and conveniently help investors to assess their potential tax liabilities on economic activities. It was also discovered that Tanzania is less equipped to handle complex tax treaty avoidance practices.

The study recommends that there is no point in capital importing countries signing DTAs with capital exporting countries because they simply put the capital importing country at a disadvantage. It was further recommended by the study that Tanzania ought to sign the MLI for it can act as an appropriate vehicle in implementing tax policy reforms which include renegotiation of the existing DTAs signed by Tanzania.

Finally, the study suggested that a comparative analysis of prevailing rates in all the DTAs should be done in order to establish impact and implications to the country.

Source: Policy Forum (2018)

Box A4: Dangers of DTAs in Financing for Development: Case study of Uganda

Cognizant of the fact that DTAs signed by Uganda are often taken advantage of by unscrupulous Multi-National Companies (MNCs), SEATINI undertook this study in order to establish the dangers of DTAs in financing development in Uganda. Specifically, the study analysed DTAs that Uganda signed with South Africa and India. This was done by undertaking key informant interviews with officials from the ministries, banks and Uganda Revenue Authority (URA).

Furthermore, the study reviewed secondary data and analytical studies from various sources. An attempt to quantify the revenue forgone due to various DTAs proved futile due to data unavailability.

The study found that there is a need to review clauses within the DTAs that Uganda signed with India and South Africa in order to match the provisions within Uganda's tax regime such as: The revision of withholding tax rates to 15%, provision for the taxation of capitals from the source state as well as the emphasis of beneficial ownership among others. The research study recommends that Uganda should protect its tax base by building safeguards in DTAs like limitation of benefits clauses in order to guard against aggressive tax planning schemes. It also suggested that in its DTA with South Africa, Uganda should consider re-negotiating a higher rate of 15% for beneficial owners of dividends and 20% for other owners.

In the India DTA, the study recommends that all payments made within source state should be subjected to withholding tax in the source state. It also cautions the government against negotiating away taxing rights in priority sectors like petroleum, gas and mining as they are revenue intensive and they drive the economy.

Most importantly, the study calls for disclosure of information on the re-negotiation of DTAs and recommends the central bank, ministry and revenue administration to analyse and negotiate DTAs through the lens of tax.

Source: SEATINI (2018)

Box A5: Dangers of DTAs in Financing for Development: Case study of Zambia

Zambia, just like other capital importing states, sign DTAs in a fashion that gives away tax rights on income flows on the expectation of increased FDI from the contracting partner. This is detrimental to development financing as there is no sufficient evidence to suggest that FDI accrue due to DTAs. The study performed a comparative analysis of Zambia's benefits and losses from tax treaties, using tax treaties with Switzerland, South Africa and China as case studies.

The research study found that Zambia's DTAs with capital-exporting nations like Switzerland contain unfavourable withholding tax rates which lead to considerable revenue losses. Furthermore, the analysis showed that Switzerland-Zambia DTA has too many exceptions while the South African-Zambia DTA has better tax policies.

In terms of tax revenues, Zambia collects less revenue in percentage terms from Switzerland than the DTAs with China and South Africa. It also established that the losses seem to be comparatively greater than the benefits of Foreign Direct Investment inflows. It further asserts that states which lower tax rates do indeed bring in more FDI but it does not outweigh the tax revenues.

The study confirms that DTAs do not necessarily lead to increased FDI. Therefore, Zambia should review its existing stock of DTAs in order to upgrade all its withholding tax rates because the revenue losses from such tax treaties are not justified by FDI inflows.

Zambia also needs to strengthen the provision concerning the exchange of information in its DTAs, involve the parliament in the ratification process and avoid contracting DTAs which conform to the OCED framework. Therefore, re-negotiations should involve using modified model tax treaties like the ATAF model which is friendlier to the capital importing least developed countries.

Source: Centre for Trade Policy and Development (2018)



Zambia collects less revenue in percentage terms from Switzerland than the DTAs with China and South Africa.

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The dangers of DTAs in financing development is exacerbated by the lack of technical skills in tax treaty negotiations.

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