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# The G-20 Tax Agenda and Africa's Taxation Needs

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**South African Institute of International Affairs**

African perspectives. Global insights.

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## **ABSTRACT**

The rapid growth of the global economy in recent years has meant that international tax laws have not kept pace with changes in the global business environment, with the consequence that multinational corporations (MNCs) are not necessarily taxed appropriately. For Africa and the rest of the world, a healthy public finance system is a necessary condition for equitable and sustainable economic growth. Against this background, this paper examines the need for global standards of taxation that are beneficial to developing countries. More specifically, the paper reviews the G-20 agenda on taxation and the Organization for Economic Cooperation and Development (OECD)/G-20 Base Erosion and Profit-Shifting (BEPS) project, and looks at how these initiatives can benefit African countries.

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## ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
AIDC	Alternative Information and Development Centre
ATAF	African Tax Administration Forum
BEPS	base erosion and profit shifting
GDP	gross domestic product
IMF	International Monetary Fund
MIREM	Mozambique Ministry of Mineral Resources
MNC	multinational company/corporation
MNE	Multinational Enterprises
OECD	Organization for Economic Cooperation and Development
TNC	transnational corporation
UNECA	UN Economic Commission for Africa

## INTRODUCTION

Maintaining community and business trust in governments is one of the essential components of well-functioning domestic and international tax systems. Taxpayers and businesses either have to pay more tax or accept a reduced level of government services in instances where the tax burden is not spread fairly or there are loopholes in tax laws that allow some companies to avoid paying their fair share.<sup>1</sup>

The rapid growth of the global economy in recent years has meant that international tax laws have not kept pace with changes in the global business environment, and has resulted in multinational companies (MNCs) not necessarily being taxed appropriately. For Africa and the rest of the world, a healthy public finance system is a necessary condition for equitable and sustainable economic growth.

According to Richard Bird, 'The tax system constitutes one of the most important instruments of development policy in any country.'<sup>2</sup> Countries need sufficient revenue to finance basic services, such as primary healthcare, primary education and security; to permit the government to help finance public investment; and to obviate the need for inflationary financing. Government should also be financed in an efficient way, using a well-designed tax system that is not overly reliant on taxes on trade.<sup>3</sup> Such a tax system should ensure that<sup>4</sup>

- revenue is raised in an equitable manner;
- the costs of revenue collection are kept to a minimum;
- it encourages economic growth; and
- it is transparent enough to encourage and facilitate honest and responsive government.

Against this background, this paper examines the need for global standards of taxation that are beneficial to developing countries. More specifically, the paper reviews the G-20 agenda on taxation and the Organisation for Economic Cooperation and Development (OECD)/G-20 Base Erosion and Profit Shifting (BEPS) Project, and looks at how these can benefit African countries. The paper is divided into three main sections. The first focuses on the role of taxation and its importance to Africa. Some of the issues covered are the current state of taxation and the reasons why Africa has a low tax revenue base compared with other regions. The second section explores the G-20 tax agenda, and more specifically the BEPS process and action plan. Africa's tax challenges are highlighted by means of case studies that illustrate instances of revenue that has been lost through tax avoidance. The paper concludes with recommendations on how these concerns can be addressed at the national, regional and global level.

## ROLE OF TAXATION AND ITS IMPORTANCE TO AFRICA

The importance of taxation goes far beyond providing income to finance the public sector, investments and people's basic needs. The establishment of states is partly attributed to the tax system, which contributes to promoting the state's legitimacy, helps strengthen democracy and creates economic well-being for the general population.<sup>5</sup> Fiscal policy

shapes the environment in which trade and investment take place. Therefore, it is important to the current economic development agenda that taxation should provide a stable flow of revenue to finance development priorities, both physical (eg, infrastructure) and socio-economic (eg, social protection measures), among others.

An important function of taxation is that it promotes the accountability of government to the public, who demand to know what their taxes are being used for. The development of representative states and democracies in Western countries is partly explained by the concept of the fiscal social contract. Experiences from Western Europe and North America show that taxation has contributed to making the authorities more representative and accountable by opening up the dialogue between the state and civil society on taxation.<sup>6</sup>

Most states depend on tax income from a broad range of taxpayers, including individual citizens and corporate entities. Often the challenge for developing states is how to extend their tax administration systems so they can efficiently register citizens and businesses in remote rural areas.<sup>7</sup> In this sense, the challenge for poor countries is not necessarily how to collect more tax, but how to tax a larger share of the general populace and business communities. This issue will be discussed further in the sections to follow.

### **Current state of taxation in Africa and impact on development**

Africa has recorded high economic growth rates in the past decade. But despite the continent's impressive growth, poverty remains high and the pace of its reduction slow. Recent statistics show that one in two Africans still live in extreme poverty.<sup>8</sup> Taxation has not yielded enough revenue to eradicate poverty and prevent hunger in Africa.

Most African countries are low-income developing nations, which collect tax revenues that are on average equivalent to a mere 13% of their gross domestic product (GDP). This compares with an average figure of 35% in OECD countries. According to UN estimates, if tax revenues were equivalent to 20% of GDP in low-income developing countries, the fight against hunger could be combatted and the UN's Millennium Development Goals attained, including reducing the number of people living in hunger by half. To be able to achieve meaningful and sustainable development, African countries and the rest of the developing world should strive to generate tax revenues equivalent to at least 20% of GDP.<sup>9</sup>

Research has also demonstrated that taxation has an indirect impact on the well-being of Africa's people. For instance, lower levels of undernourishment were associated with African countries with higher tax collections. Countries collecting more than 20% of their GDP in tax recorded on average a 15% level of undernourishment for the period 2005–2008, whereas African countries that collected less than 10% of their GDP in tax recorded on average a 32% rate of undernourishment.<sup>10</sup>

Experience from a number of countries has shown that taxpayer behaviour can be changed by reforming the tax system. For example, the authorities in Ghana, Tanzania and Uganda have all increased their fiscal space<sup>11</sup> through higher domestic revenue mobilisation in the period 2000–2006.<sup>12</sup> This has given the public a more positive attitude to the tax system and has led to the mobilisation of interest groups that demand better public services.

## Revenue sources and state of tax reforms

In Africa, a significant portion of the increase in tax revenue in recent years stems from natural resource taxation; at the same time, other tax revenue streams have increased by less than 1% of GDP over 25 years.<sup>13</sup> From 2008 to 2011, the share of resource tax in Africa increased from 35 to 40% of total tax collection compared to 2000–2004 period. In 2011 resource taxes accounted for half the increase in total tax collections.<sup>14</sup> This high proportion reflects the low levels of formal employment outside the resource sector in these countries, partly due to the fairly low levels of industrialisation, which restrict the creation of decent jobs.

Despite these revenue increases, a major challenge for African countries is finding the optimal balance between a tax regime that is sufficiently business- and investment-friendly, and one that can still generate enough revenue to fund public services and meet the government's legal and developmental obligations to the people.

A review of reforms undertaken in Africa since 1990 reveals that competition among developing countries for foreign investment, especially in the mining sector, saw the governments of many resource-rich African countries scaling down corporate income tax liabilities and royalty rates, and providing more specific fiscal allowances aimed at reducing the general tax liabilities of mining sector operators (known as the race to the bottom). Other forms of tax, such as mineral duties, import duties and foreign exchange tax, which contributed significantly to government revenue, have been either reduced or scrapped.<sup>15</sup>

These reforms were undertaken as a measure to create a more favourable investment climate. In reality, however, they have meant that states' capacity to raise revenue has been curtailed and this has hampered national development. Over the past 25 years, tax revenues in sub-Saharan Africa have largely stagnated at levels around 15% of GDP, albeit with some exceptions in sub-Saharan Africa – notably in resource-rich countries where revenue growth is mainly attributable to governments capturing the benefits of natural resources.<sup>16</sup>

## Why the low tax base in Africa?

The low tax base that is characteristic of most African countries is not easy to explain. There are several reasons for the phenomenon, including the economic structure and history of each particular country. Most African countries have a large informal sector (ie, the unregistered part of the economy), which is difficult to tax. Tax avoidance is also rampant, especially in circumstances where taxpayers perceive taxes as unfair and where a large degree of coercion is needed to collect the taxes (e-toll taxes in South Africa are a good example). In many poor countries, taxes that are deemed unfair are common, often only a small proportion are paid and the cost of collection is high. Such taxes have also hindered the development of a fiscal social contract (referred to earlier) because the authorities have had no appetite to engage in a dialogue or negotiate with organised groups and civil society. In recent years, however, there has been a drive to invest substantial resources in changing the attitudes and behaviour of tax administrations towards taxpayers.<sup>17</sup>

Resource-rich developing countries whose income is derived mainly from natural resources, such as oil and minerals, as opposed to revenue from taxing their citizens, in

general have a history of bad governance. This is because such states' revenue sources are not derived from taxing their citizens and businesses, which puts them at risk of becoming detached from their citizens.<sup>18</sup> Without oversight mechanisms, substantial revenue is lost in the process. Relying on large amounts of foreign aid can also lead states to becoming detached from their citizens, reducing the need for tax reforms.

Tax incentives are another major factor that have been shown to prevent African governments from maximising tax revenues. Governments have invested a lot of money in tax incentives on the premise that such incentives promote economic development. Ironically, most of these governments do not conduct due diligence on the economic impact of these incentives to determine whether they will get a good return on their investment, while others do not examine this at all.<sup>19</sup> The problem is evident in the extractives sector, especially in mining in sub-Saharan Africa, where there are several race-to-the-bottom investment incentives offered mainly to large Multinational Enterprises (MNEs) without proper cost-benefit analyses having been conducted.

There is ample evidence in Africa to suggest that significant revenue is lost through tax incentives. According to the OECD, incentives on average were equivalent to 33% of the total value of tax collections in six African countries. In Ghana, a country review produced by the OECD revealed that special tax provisions and exemptions granted in that country resulted in substantial revenue loss of 6.13% of GDP.<sup>20</sup> Estimates reveal up to \$2.8 billion is lost annually in countries such as Kenya, Uganda, Tanzania and Rwanda from tax incentives and exemptions. These losses deprive African countries of critical revenue to help reduce poverty.<sup>21</sup>

**Box 1: Summary of factors that help explain the low tax base in developing countries**

In general, the causes of the low tax base endemic in developing countries can be summarised by the following factors.<sup>22</sup>

- Corruption and tax evasion is not only an African problem but a global one, with some studies in developing countries showing that corruption and tax evasion are responsible for more than half of taxes due not reaching the state coffers.<sup>23</sup> MNCs play a central part – for instance, by manipulating transfer prices to avoid taxation. Tax evasion by domestic taxpayers is also widespread in poor countries and this is probably one of the factors that contribute most to corruption in the public sector.
- The political and economic elite in many developing countries are often not part of the tax base because of tax exemptions and/or tax evasion, and abuse of power.
- Trade liberalisation over the past two decades has led to a decline in customs revenue in developing countries. This has exacerbated the problems associated with mobilising domestic resources.
- Agricultural-based economies in poor countries pose a challenge for the collection of tax because the tax bases are often small while the cost of collecting is large. Personal income is also seasonal and unstable.



- The informal sector is large, particularly in towns, and this makes tax collecting difficult.
- Lack of resources and capacity for building effective tax collection systems are constraints on the efforts of tax collectors, so it is not surprising for tax collectors to concentrate their efforts on the small number of taxpayers who have the ability to pay, but who lack the political contacts who can 'protect' them against taxation.
- Tax contributions are collected from a small number of sources in many developing countries. In Tanzania, for example, which has a population of more than 40 million, 286 companies contribute about 70% of domestic tax revenue, while in Kenya only 0.4% of taxpayers pay 61% of the total domestic tax bill.
- Other financial sources have a negative impact on recipient countries' incentives to generate revenue through domestic resources. This is typical of countries that are dependent on foreign aid or where substantial revenue is channelled into debt repayments in the case of commercial loans. The ensuing debt burden will probably hurt the poor most, since public spending on the social sectors and investment in infrastructure must be cut to service the debt.
- Capital flight and tax havens contribute to entrenching the tax structures in developing countries. Capital flight has contributed most strongly to the erosion of the tax base, and therefore reduces the resources available for financing the development of public institutions, social services and infrastructure.

Source: Tax Justice Network Africa and Christian Aid, *Tax Competition in East Africa: A Race to the Bottom?*, 2012, [www.actionaid.org/sites/files/actionaid/eac\\_report.pdf](http://www.actionaid.org/sites/files/actionaid/eac_report.pdf)

Although these factors and challenges contribute to the low tax base that is characteristic of African countries, one should note that the situation is different for each country, partly because each country has a unique economic structure and history. Furthermore, the factors raised here are not exhaustive and should not be viewed as such. However, the issues of capital flight and tax havens in the African context are worth exploring further.

### Capital flight and tax havens

Capital flight can be broadly defined as unrecorded capital flows between a country and the rest of the world. These capital flows are not subject to tax and therefore deprive the country of much-needed revenue. Tax havens are jurisdictions that use secrecy and low tax rates as a selling point to attract businesses to their financial service industries. The banking secrecy that prevails in such countries makes it almost impossible to find out who the account holders are.

MNCs are the main perpetrators of capital flight and the reason for tax havens flourishing. Capital flight in the corporate world has led to the disappearance of between an estimated \$1.26 trillion and \$1.44 trillion from Africa on an annual basis.<sup>24</sup> This figure, which is unreported, is equivalent to 10 times the amount of annual global aid paid to developing countries and twice the amount of debt servicing. In the sub-Saharan region, capital flight is a major constraint to growth and development. A study conducted in

33 sub-Saharan countries estimates that in the period 1970–2010, a total of \$814 billion was lost.<sup>25</sup>

The consequences of illicit capital flight are reduced local resources for investment, less collected tax in the state coffers, increased income gaps, damage to competitiveness, undermining of trade and a drain on currency reserves. If properly harnessed, such lost revenue would have the potential to contribute considerably to development objectives and make a major difference in the fight to combat poverty. This is why the OECD/G-20 BEPS process is important for Africa.

## THE G-20 AND ITS AGENDA ON TAXATION

### Overview

The G-20 is an international group of 19 countries plus the EU, with representatives from the International Monetary Fund (IMF) and the World Bank. It was established in 1999 initially as a forum of finance ministers and central bank governors in response to the Asian financial crisis of the late 1990s. It was created<sup>26</sup>

as a new mechanism for informal dialogue in the framework of the Bretton Woods institutional system, to broaden the dialogue on key economic and financial policy issues among systemically significant economies and to promote cooperation to achieve stable and sustainable world growth that benefits all.

The G-20 was established as a deliberative rather than a decisional body, but one designed to encourage ‘the formation of consensus on international issues and a mandate to promote international financial stability’.<sup>27</sup> Annual meetings of the G-20 have been held by its finance ministers and central-bank governors since its inception. The 2008 global financial crisis made the participation of heads of state and government imperative at the group’s annual meeting, given the sheer scale of the crisis. The forum met at the highest level when its first so-called leaders’ summit was convened in Washington in November 2008 by President George Bush.<sup>28</sup>

The G-20 has no permanent secretariat and the chair rotates among members, selected from a different regional grouping of countries each year. The incumbent chair establishes a temporary secretariat for the duration of its term, co-ordinates the group’s work and holds its meetings. The work of the G-20 is divided into two main streams, or tracks: the ‘sherpa track’, which prepares for the leaders’ summits, and the ‘finance track’, which prepares for finance ministers and central-bank governors’ meetings.

The G-20 has become a forum for addressing a broad range of issues – economic, financial, social and cultural in nature. Much of the forum’s work, however, has revolved around three key areas:<sup>29</sup>

- policy co-ordination between members in an effort to achieve global economic stability and sustainable growth;

- promoting global financial regulation to reduce risks and prevent future crises; and
- reform of the international financial architecture/international monetary system.

### **The role of emerging economies and South Africa**

The influential role played by emerging economies, such as the BRICS grouping, comprising Brazil, Russia, India, China and South Africa, cannot be overemphasised. The declaration that the G-20 has become the premier forum for international economic co-operation, effectively replacing the G-7 at the 2009 G-20 Pittsburgh summit, attests to the recognition by the traditional Western powerhouses of the contribution made by emerging economies to global economic growth, crisis prevention and resolution initiatives. It is also evidence of their potential to provide resources to help contribute to global financial stability.

South Africa's membership of the G-20 provides enormous opportunities for Africa, albeit with some challenges. In terms of the opportunities, South Africa's membership serves to influence the development of international policies that represent the needs of the region and the continent. However, South Africa has no formal mandate from other African countries, which puts it in a precarious position. Therefore, the South African government 'is careful not to assume that it speaks for the continent, although many outside Africa often believe that it does and thus consider Africa to be represented in informal groupings such as the G20'.<sup>30</sup> Another challenge for South Africa in its membership of the G-20 is that while trying to raise broader African concerns, it also has to tread carefully to ensure that its own interests are advanced, and these may not always align with the rest of Africa's concerns. Therefore, the effectiveness of South Africa's role will be measured by the influence it is able to exert on behalf of the region as a whole.

### **The G-20 tax agenda**

The global financial crisis exposed major weaknesses in financial and macroeconomic policy co-ordination, which led global leaders to recognise the need to reform the global regulatory architecture to ensure that the financial system can absorb shocks while continuing to function efficiently. In response to the crisis, the G-20 met at the Washington leaders' summit to agree on a comprehensive strategy to restore trust in the financial system, and limit the fallout from the crisis on the global economy and employment.<sup>31</sup> The driving force behind this collective effort was mainly attributed to the fact that<sup>32</sup>

- 'countries were experiencing fiscal deficits;
- there was a focus on stimulus spending to get out of the crisis and renewed focus on the contribution from business; and
- the issue was receiving a great deal of attention from politicians and the media.'

The result was that the G-20 leaders tasked the OECD through its Committee on Fiscal Affairs with the following mandate, as stated in the Tax Annex of the 2013 G-20 St Petersburg Leaders' Declaration:<sup>33</sup>

- To work with policymakers from the OECD countries, with other bodies, such as the IMF and the UN Tax Committee, and independent tax experts to explore alternatives

to the ‘arm’s-length principle’ (ie, a transaction in which the buyers and sellers of a product act independently and have no relationship to each other).

- To move away from damaging tax competition among themselves and foster regional co-operation in tax matters.
- To stand together to enforce multilateral adoption and implementation of measures to end financial and corporate secrecy.

The G-20 St Petersburg Summit led to the endorsement of the BEPS project, which aims to close loopholes in international tax systems.<sup>34</sup>

### **The BEPS project**

The G-20 and OECD BEPS project is an ambitious and constructive effort to strengthen the international corporate-tax system. The OECD’s Action Plan on BEPS was published in July 2013 with a view to addressing perceived flaws in international tax rules.<sup>35</sup> The goal of the BEPS project is to focus on what is referred to as double non-taxation (or less than single taxation), which has come about through ‘cracks’ in the interaction of domestic tax systems. It also aims to address situations where corporations’ profits are perceived as geographically divorced from their activities.<sup>36</sup>

Building on the central role that the OECD has played in developing and maintaining the international system, and the unique expertise this has given it, the Action Plan on BEPS aims to make progress on 15 identified key areas by 2015. The plan is squarely focused on addressing these areas in a co-ordinated, comprehensive manner.

For the G-20, the BEPS initiative will attempt to ensure that profits made by companies are taxed in the countries where the economic activities that generate those profits are performed and where their value is created. In so doing, governments are putting in place instruments to reduce tax avoidance and improve the coherence of the global tax system, in consultation with business and other stakeholders.<sup>37</sup>

Progress thus far indicates that the G-20 finance ministers agreed to and approved seven of the 15 areas, or actions, in September 2014, although the proposed measures are not yet finalised, as they may be impacted by further deliverables. The seven approved elements of the action plan focus on helping countries to:<sup>38</sup>

- address the tax challenges of the digital economy (action 1);
- ensure the coherence of corporate income taxation at the international level, through new model tax and treaty provisions to neutralise hybrid mismatch arrangements (action 2);
- counter harmful tax practices (action 5);
- realign taxation and relevant substance to restore the intended benefits of international standards and to prevent the abuse of tax treaties (action 6);
- ensure that transfer pricing outcomes are in line with value creation, through actions to address transfer pricing issues in the area of intangibles (action 8);
- improve transparency for tax administrations, and increase certainty and predictability for taxpayers through improved transfer pricing documentation and a template for country-by-country reporting (action 13); and

- facilitate swift implementation of the BEPS actions by means of a report on the feasibility of developing a multilateral instrument to amend bilateral tax treaties (action 15).

It is expected that all 15 actions will be completed by December 2015. But it is also expected that it may take considerably longer for the impact of these changes to be fully applied in practice. However, it is important to highlight that the BEPS project and related developments are 'already leading to the need for business to take action (in some cases, urgent action) both to comply with new requirements and to consider the ways in which they do business in different countries'.<sup>39</sup> Table 1 summarises the 15 action plans and their expected outcomes.

**Table 1: Summary of the OECD Action Plan on BEPS**

Type of action	Description	Expected outcome
<b>Action 1 Address the tax challenges of the digital economy</b>	Identify the main difficulties that the digital economy poses for the application of current international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation	Report identifying the issues and possible actions to address the issues by September 2014
<b>Action 2 Neutralise the effects of hybrid mismatch arrangements</b>	Develop model treaty provisions and recommendations for the design of domestic rules to neutralise the effect of hybrid instruments and hybrid entities (eg, double non-taxation, double deduction and long-term deferral)	Revise OECD Model Tax Convention and make recommendations regarding the design of domestic rules by September 2014
<b>Action 3 Strengthen rules for controlled foreign company</b>	Develop recommendations regarding the design of rules for controlled foreign companies	Recommendations for design of domestic rules by September 2015
<b>Action 4 Limit base erosion by means of interest deductions and other financial payments</b>	Develop recommendations for best practices in the design of rules to prevent base erosion through the use of interest expense (for example, by using related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments)	Recommendations regarding design of domestic rules by September 2015; changes to transfer pricing guidelines by December 2015

Type of action	Description	Expected outcome
<b>Action 5 Counter harmful tax practices more effectively, taking into account transparency and substance</b>	Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring 'substantial activity' for any preferential regime	Complete review of member-country regimes by September 2014; establish strategy to expand participation to non-OECD members by September 2015; revise criteria for identifying preferential regimes by December 2015
<b>Action 6 Prevent abuse of tax treaties</b>	Develop provisions for model treaty recommendations for the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances	Changes to the OECD Model Tax Convention and recommendations for domestic rules by September 2014
<b>Action 7 Prevent the artificial avoidance of permanent-establishment status</b>	Develop changes to the definition of permanent establishment to prevent the artificial avoidance of this status in relation to BEPS, including through the use of commissionaire arrangements and specific activity exemptions	Changes to the OECD Model Tax Convention due by September 2015
<b>Action 8 Ensure that transfer pricing outcomes are in line with value creation and intangibles</b>	Develop rules to prevent BEPS by moving intangibles among group members, including adopting a broader and clearer definition of intangibles; ensuring that profits associated with the transfer of intangibles are associated with value creation; developing special rules for hard-to-value intangibles; and updating guidance on cost contribution arrangements	Changes to the OECD transfer pricing guidelines and the Model Tax Convention due September 2014–September 2015
<b>Action 9 Ensure that transfer pricing outcomes are in line with value creation, risks and capital</b>	Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members, including adopting rules to prevent inappropriate returns from accruing to entities solely on the basis of provision of capital or contractual assumption of risks	Changes to transfer pricing guidelines and possibly the OECD Model Tax Convention by September 2015

Type of action	Description	Expected outcome
<b>Action 10</b> <b>Ensure that transfer pricing outcomes are in line with value creation/ other high-risk transactions</b>	Develop rules to prevent BEPS by engaging in transactions that would not occur, or would occur only rarely between third parties, including adopting re-characterisation rules; clarifying the application of transfer pricing methods in global value chains; and protecting against base eroding payments, such as management fees and head-office expenses	Changes to transfer pricing guidelines and possibly the OECD Model Tax Convention by September 2015
<b>Action 11</b> <b>Establish methodologies to collect and analyse data on BEPS, and the actions to address it</b>	Develop recommendations on the indicators of the scale and economic impact of BEPS, and ensure tools are available to assess the effectiveness and impact of measures to address BEPS	Recommendations on data to be collected and analytic methodologies by September 2015
<b>Action 12</b> <b>Require taxpayers to disclose their aggressive tax planning arrangements</b>	Develop recommendations for the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses, and drawing on experiences of the increasing number of countries that have such rules in place	Recommendations for the design of domestic rules by September 2015
<b>Action 13</b> <b>Re-examine transfer pricing documentation</b>	Develop rules for transfer pricing documentation to increase transparency, including a requirement that MNEs provide all 'relevant governments' with information on global allocation of income, economic activity and taxes paid among countries, in accordance with a common template	Changes to transfer pricing guidelines and recommendations for the design of domestic rules by September 2014
<b>Action 14</b> <b>Make dispute resolution mechanisms more effective</b>	Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under Mutual Agreement Procedures, including the absence of arbitration provisions or denial of access to Mutual Agreement Procedures in certain cases	Changes to the OECD Model Tax Convention by September 2015
<b>Action 15</b> <b>Develop a multilateral instrument</b>	Analyse tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement BEPS measures and amend present bilateral treaties	Report on relevant public international law and tax issues by September 2014; develop a multilateral instrument by December 2015

Source: KPMG, *Summary of OECD BEPS Action Plan*, 2013, <https://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Tax-and-Legal-Publications/Documents/OECD%20BEPS%20Action%20Plan.pdf>

## BEPS and its relevance for Africa

With increasing recognition of Africa's urgent need to reduce its dependence on external aid and mobilise its own revenue streams to finance the continent's development, there is a perception that government revenue (especially revenue from the extractive industries) is not fully optimised in many African countries. This is a result of over-generous fiscal incentives, aggressive tax strategies by MNEs, corruption and a lack of transparency that has gone unchecked.

This situation has led to calls for tax-policy reforms, so the BEPS process comes at an ideal time for African governments. To achieve an optimal tax mix, the challenge that African policymakers face is how to balance the following imperatives:<sup>40</sup>

- mobilising domestic resources and broadening the tax base to secure steady revenue streams for development financing and diversify revenue sources;
- fighting tax evasion caused by tax havens, regulatory weaknesses and certain corporate practices;
- improving the investment climate for enterprise development, largely shaped by the tax regime; and
- promoting good governance, underpinned by effective taxation that promotes the accountability of governments to their citizens and the investment community.

An example of the types of incentives and concessions that erode government revenue can be seen in the case of Mozambique. Box 2 is an extract from a case study that examines the distribution of the proceeds from Mozambique's natural-gas resources, published by Mozambique's Centre for Public Integrity.<sup>41</sup>

### **Box 2: Let's make the resources work for us: Time to call multinational corporations to order**

'Natural gas is said to be Mozambique's future, but the first gas project – Pande Temane – has generated virtually no government revenue. By removing production sharing from the petroleum agreement and agreeing to an abusive pricing formula, the government gave away most of its share at the start. Aware of these unfair terms, Mozambique's Ministry of Mineral Resources, the IMF and the World Bank still forecast substantial government revenues that have never arrived. The annual sale value of Mozambique's gas in South Africa is now more than \$800 million per year while total government revenue over the first eight years of the project is less than \$50 million.'

It is now the time to call governments to act. Southern African Development Community (SADC) member states should:<sup>42</sup>

- plug illicit flows of income from extractives (\$64 billion leave Africa annually);
- reform extractives concessions and abolish harmful tax incentives;



- scale up transparency in managing foreign direct investment;
- end tax evasion;
- end secretive mining deals; and
- demonstrate political will to promote nationalisation processes where applicable.

Source: Adapted from the Centre for Public Integrity, [http://www.cip.org.mz/cipdoc/274\\_Pande%20Temana%20Gas%20exports%20to%20South%20Africa%20by%20Sasol.pdf](http://www.cip.org.mz/cipdoc/274_Pande%20Temana%20Gas%20exports%20to%20South%20Africa%20by%20Sasol.pdf)

As noted, the role of the BEPS project is relevant in the African context. Issues of tax avoidance have plagued Africa since long before the 2008 global financial crisis. Now, with increased attention given to tax avoidance in the developed world, it is an opportune moment to ensure that unfair tax practices are abolished in Africa and that an international standard on how to approach this problem is adopted.

Another example that demonstrates the extent to which illicit financial flows – a target of the BEPS process – are prevalent is that of South Africa. The case study (see Box 3) is taken from the Alternative Information and Development Centre's 2014 analysis, which was derived from the Marikana Commission of Inquiry. Box 3, an extract from this text, summarises the extent to which one of the mining companies in South Africa has over a period of time managed to shift profits from South Africa to Bermuda, which is regarded a tax haven.

### **Box 3: Lonmin, the Marikana massacre and the Bermuda connection**

1. On June 2 AIDC [Alternative Information and Development Centre] issued a press statement in which we raised the concern of the Platinum Cartel's possible involvement in transfer pricing in respect of under-selling their metals.
2. Our concerns regarding Lonmin's involvement in possible transfer pricing is greater than ever. Tuesday hearings of the Marikana Commission showed that Lonmin needs to clarify the role and relationship of several of its subsidiaries, not least Lonmin plc (the parent company), Western Platinum Ltd, Eastern Platinum Ltd, Lonmin Management Services (Pty) Ltd and Western Metals Sales Limited, located in the tax haven of Bermuda.
3. Contradictory answers have been provided both to the Marikana Commission and to journalists in relation to revelations made.
4. In sum, Lonmin, just for the years 2008 to 2012 transferred in commission fees \$160 million [ZAR 1.23 billion] to a Lonmin subsidiary, Western Metals Sales Limited based in Bermuda, a well-known tax haven. A further \$155 million [ZAR 1.17 billion] was paid in management fees to Lonmin Management Services.
5. These amounts were shifted from Lonmin's South African operations and effectively put out of reach of possible wage demands, meetings of its social labour plan

commitments and beyond what would have been 'taxable income'. It is necessary to ask if this a case of the so-called 'illicit financial flows' that [have] so worried African heads of state and prompted the Economic Commission for Africa and the African Union to establish the High Level Panel on Illicit Financial Flows.

6. Lonmin's Bermuda connection is one piece in a complex inter-company labyrinth and [gives a] picture of excessive dividend payments before the 2008 crash, exorbitant executive salaries as well as yearly management fees to head offices.
7. This is an important part of the background to the August 16 Marikana massacre and shaped Lonmin's response to the wage demands of rock drill operators and other workers at its operations.
8. That Lonmin has something to hide became clear in the last days of evidence at the Marikana Commission of Inquiry. When questioned on these transfers and the relations between Lonmin, its South African subsidiaries and its overseas subsidiaries, its Executive Director, Mr M Seedat, seemed to suffer from severe memory loss and could only provide general information that was contradictory. Nevertheless, he was forced to admit in reference to the Lonmin subsidiary in Bermuda, Western Metal Sales Limited, that 'a structure like this is normally set up to be optimal from a tax perspective'.
9. Further to this, Mr Seedat told the Commission that the 'Bermuda operation' was closed in 2008, yet financial reports audited by the international firm KPMG, records the flow of money to Bermuda up until 2012. A decision was made by Lonmin to rewrite its business history in June 2012 in relation to these payments and retrospectively decree (in June 2012) the closure of Western Metals Sales Limited in 2008.
10. A research report on the issue of Lonmin's affordability will soon be lodged at the Marikana Commission.
11. Perhaps it is legal to rewrite a company's financial history without a comment in the audited books, however, AIDC calls on SARS and the South African government to urgently establish a major and detailed investigation into Lonmin's financial operations and more generally into other mining transnational corporations and the problem of transfer pricing, illicit financial flows that also may be contributing to South Africa's worsening capital account deficit and balance of payment problems.

Source: Extract from Alternative Information and Development Centre press statement, 18 September 2014, <http://www.aidc.org.za/media-room/press-releases/84-aidc-press-release-energy-and-development-commitments-in-the-sona-reflect-an-outdated-discredited-and-dangerous-vision-for-the-future>

These two examples show the negative impact of aggressive corporate-taxation strategies, and the tax incentives and concessions that governments apply, which have led to a significant reduction in the fiscal revenue base. The BEPS process is an opportunity for some of these unfair practices to be avoided and for some of them to be eradicated.

Nevertheless, in Africa there are numerous concerns with the process. For example, a survey conducted by the Economic Justice Network on the BEPS process reveals that:<sup>43</sup>

The majority of organisations interviewed for this study have expressed their concerns regarding the exclusive nature of the BEPS project leading to the preliminary conclusion that it risks failure to address information asymmetry, the major fault line of the international tax system.

The varying levels of development of the tax systems of a majority of developing countries and the capacity constraints thereof, mean that there could be no meaningful participation without concerted efforts to raise the profile and understanding of the BEPS issues amongst senior policy makers, tax administrations and civil societies.

### **What needs to be done for Africa to benefit from the BEPS process?**

According to the Australian prime minister, Tony Abbott, 'Taxes need to be fair as well as low in order to preserve the legitimacy of free markets.' He added that 'the essential principle is that you should normally pay tax in the country where you earn the revenue'.<sup>44</sup> From a civil-society point of view, taxation should be just and fair. Their interest in current taxation discussions has led civil-society organisations to monitor the BEPS process closely and mobilise public opinion to ensure that governments live up to their promises and deliver effective solutions. To this end, civil-society groups have called upon the G-20 and OECD to:<sup>45</sup>

Take effective steps to ensure that developing countries can participate in the BEPS process on an equal footing, and assist them in implementing measures to stem their losses from international tax avoidance that deprives governments of badly needed revenues.

Undertake – jointly with other organisations, policy makers from developing and developed countries, and independent experts – a rigorous study of the merits, risks and feasibility of more fundamental alternatives to the current international tax system, such as unitary taxation, with special emphasis on the likely impact of these alternatives on developing countries. Under a unitary tax system, the profits of the various branches of an enterprise or the various corporations of a group are calculated as if the entire group is a unity.

Implement additional measures to tackle financial and corporate secrecy, including the requirement for TNCs [transnational corporations] to provide public combined and country-by-country reports, the establishment of comprehensive multilateral automatic exchange of tax information, and the public disclosure of the beneficial owners of companies, foundations and trusts.

In South Africa and other African countries, tax-justice campaigns are calling for effective, transparent measures that will ensure governments receive what is due to them and stop illicit financial outflows.

Some of the actions advocated by the South African Tax Justice Campaign are<sup>46</sup>

- To change and enforce corporate law and have the political will to act.
- To demand a change in the law, so that corporations must pay more taxes than individuals. Over the years, TNCs and MNCs, have concealed their actual profits and continue to do so, by means of aggressive tax planning and escaping liability. This is a minefield and cannot easily be unscrambled by the corporations or tax authorities unless they are compelled to do so.
- Country-by-country reporting up to project level. This has proved to be a successful means of raising revenue and would require each TNC to provide the following information:
  - » the name of each country where it operates;
  - » the names of all its subsidiaries and affiliates in these countries;
  - » the performance of each subsidiary and affiliate, without exception;
  - » the tax charge in the accounts of each subsidiary and affiliate in each country;
  - » details of the cost and net book value of its fixed assets in each country; and
  - » details of its gross and net assets for each country.
- Transparency in tax-information exchange across borders.
- Ending tax breaks that encourage corporations to shift profits and jobs overseas.
- Requiring high-net-worth individuals to pay their fair share of taxes and to bring them within the confines of the tax net.

It is expected that information gathered from activities such as country-by-country reporting will make it easier to consider other tax options in the respective country, including unitary taxation. Those who advocate such activities demand that this information be made available publicly for the purposes of accountability and transparency, and that it is required of all companies.

## CONCLUSION AND RECOMMENDATIONS<sup>47</sup>

Tax revenues are important, predictable and sustainable sources of income for African countries. They are essential for the delivery of the social public goods provided by governments. Currently, however, governments are failing to harness their potential revenues – especially compared with their counterparts in developed countries. Without significant tax revenue, the fight against poverty and hunger in Africa cannot be won, and efforts to reduce inequality and sustainable development will remain a pipe dream.

The prevalence of illicit financial outflows in the form of tax evasion or tax avoidance makes Africa's tax situation worse. These illicit outflows divert scarce resources from productive activities, thereby lowering investment levels, undermining growth and exacerbating income inequality in the continent. For Africa to succeed and prevail economically, global financial systems must work effectively to eliminate the loopholes that are currently used for tax avoidance and evasion by some of the wealthiest and most economically successful corporate entities in the continent.

The OECD and the G-20 BEPS project is a step in the right direction, as African countries are the worst victims of the BEPS activities and therefore their involvement in this project is of crucial importance. Currently, the OECD has no African country member and only South Africa, in principle, is deemed to represent Africa at the G-20. This demonstrates how Africa is under-represented in both the institutions that are leading this important project. Consequently, African countries need to find a mechanism for having a greater voice in these institutions.

If developing countries are to reap the benefits of the G-20 tax agenda – as stated in the G-20 St Petersburg Declaration – then they must be able to shape new international tax rules. Developing countries are best represented in the UN Tax Committee and therefore they must ensure that the committee is robust and empowered with the resources to play a bigger role in setting new international tax rules. The OECD and G-20, and other members of the UN, must also ensure the UN Tax Committee has the resources and formal mechanisms needed to make the voices of developing countries heard. In addition, representatives of developing countries must be invited to participate on an equal footing in the working groups that will implement the Action Plan on BEPS.<sup>48</sup>

African tax administrators must support the African Tax Administration Forum (ATAF) to implement the agreements contained in the statement of outcomes for the consultative conference on the African BEPS process. They must ensure that the ATAF is a strong, well-resourced institution, so that it can implement these agreements and productively engage the OECD and the G-20 on the BEPS project. African tax administrations, through the ATAF, their respective governments and regional economic blocs must also work to harmonise tax policies and legislation regionally, so that tax rates are competitive but avoid the race to the bottom.

Civil society in Africa should work with the ATAF to<sup>49</sup>

- ensure that African countries co-operate to make their voices heard in the BEPS project; to make the process more inclusive and to ensure that the outcomes are beneficial to African countries;
- engage pan-African institutions, such as the African Union, UNECA and AfDB, to amplify African voices and further African interests by involving Africa in the BEPS project;
- closely engage the government of South Africa so that, as a member of G-20, it articulates Africa's interests in the BEPS project and the broader G-20 deliberations;
- explore options other than the arm's-length principle, and develop policy measures and reform tax rules to curtail fraudulent transfer pricing in Africa;
- depart from damaging tax competition among African countries and foster regional co-operation in tax matters;
- engage in processes, such as those of the UN subcommittees and advocacy groups, that are relevant to developing countries;
- enforce multilateral adoption and implementation of measures to end financial and corporate secrecy; and
- develop a reporting standard in the African tax context, to be lodged with government and made available in the public domain.

The New Partnership for Africa's Development and the chair of the African Union, which are represented in the BEPS process, can add weight to African countries' taxation needs. African countries should call for the BEPS process to be adopted with specific targets that can be monitored to ensure its effective implementation and accountability.

In conclusion, tax plays an important role in the functioning of all countries, including African states, and capital flight creates a higher burden for Africa than for other regions. Any action taken to stop illicit capital flight must be a concerted effort involving decision makers in Africa and the West if it is to succeed, because capital outflow from Africa and its absorption into Western economies deserve equal attention. Illicit outflows could be curtailed if greater transparency were present in the global financial markets. The BEPS process is one way to achieve this and it should be supported. However, Africa also needs to look at its own approaches to stopping such activities.

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