

FIGHTING BEPS IN AFRICA: A REVIEW OF COUNTRY-BY-COUNTRY REPORTING

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EXECUTIVE SUMMARY

Multinational enterprises (MNEs) can shift profits away from jurisdictions with comparatively high tax rates to jurisdictions with lower to no tax rates, and so avoid paying their fair share of taxes without breaking any single jurisdiction's laws. This is in part possible owing to the restricted exchange of information between national tax authorities, which limits these authorities' capacity to conduct accurate MNE audits.

By creating standard reporting templates and model legislation to collect MNEs' relevant business information, Action 13 of the Organisation for Economic Co-operation and Development ([OECD/G20 Base Erosion and Profit Shifting Action Plan – Transfer Pricing Documentation and Country-By-Country Reporting](#)) – is seen as part of the solution to addressing MNE tax evasion. While representing a substantial step forward, the proposed set of recommendations has a limited scope and is technically onerous to implement in poor developing countries, where revenue authorities are severely resource-constrained. These issues are reviewed in relation to African resource mobilisation needs, and with an eye to the 2020 review of country-by-country reporting (CbCR) implementation.

POLICY RECOMMENDATIONS

- 1 By the time of the 2020 review MNEs will be more aware of this process, and it is possible that the idea of lowering the EUR 750 million revenue threshold will find a more receptive audience.
- 2 Given the trust barriers to lowering exchange of information requirements it is not clear that this issue can be resolved in favour of those African states currently not able to comply. Consequently, African countries need to upgrade their institutional capacities and legal frameworks. Official development assistance could be targeted at this area.
- 3 As Action 13 reports are submitted over the next two years a much more informed assessment of the strengths and limitations of CbCR should emerge. This should enable the refinement, and possibly the extension, of the system.
- 4 The application of CbCR to include other taxes paid by MNEs, beyond corporate income tax, could also be considered.
- 5 The transparency of CbC reports will, no doubt, feature in the 2020 review and African revenue authorities will need to engage with the issue, as it could bridge a lot of their constraints.

INTRODUCTION

Following the Panama Papers leak and numerous press reports of aggressive tax planning by MNEs around the world, there has been a concerted effort, notably in developed countries, to combat MNE tax avoidance and increase international cooperation in tax matters. As MNEs operate across borders they can use multi-jurisdictional tax planning, in combination with transfer pricing, to limit their tax obligations. Unfortunately, some MNEs aggressively plan an operation around these tax structures to avoid paying their fair share of tax. This is mostly legal, as MNEs generally do not breach any single tax jurisdiction's laws. However, such practices have a negative impact on the countries in which they are operating, regardless of whether they are legal or not.

MNEs that operate across borders can use tax planning to gain a competitive advantage over enterprises that operate at a domestic level

MNEs that do not pay taxes where these taxes are due, are avoiding their designated and expected tax contributions to the public sector. This reduces their host nation's tax revenues, undermining the provision of public services to all citizens in the host country, including MNEs. Furthermore, MNEs that operate across borders can use tax planning to gain a competitive advantage over enterprises that operate at a domestic level.

A key responsive measure to address aggressive MNE tax planning has been the [OECD/G20 Base Erosion and Profit Shifting \(BEPS\) Package](#). Its aim is to close loopholes between various national tax authorities that allow MNEs to unjustifiably shift profits across borders. Within this, a key component, and part of the minimum BEPS action requirements, is Action 13: Transfer Pricing Documentation and CbCR.

In its current iteration, Action 13 aims to provide a standard on documentation and exchange of information that revenue authorities can use to better understand MNEs' operational structures and subsequently enhance transfer pricing risk assessments. It should also assist in identifying where auditing resources should be deployed.

Considering the increase in information and transparency, Action 13 reports could help revenue authorities to collect taxes from MNEs, which, in turn, would enhance domestic resource mobilisation (DRM), a problematic area for African states. However, a few developed countries have raised some issues with regard to the broader BEPS package, concerning the possibility that it could be used to unfairly single out their MNEs as targets for enhanced revenue collection, as well as fears over the confidentiality of taxpayer information. This complex political economy inevitably constrains what could be achieved through the G20 in relation to BEPS, and CbCR in particular.

DEVELOPING COUNTRY PRIORITIES

In 2014, recognising that BEPS manifests differently in developed and developing countries, the UN Tax Committee began a process of soliciting developing countries' views on 'fair and appropriate means of responding to the challenges imposed by base erosion and profit shifting'.²

In response to the question, 'If you are affected by base erosion and profit shifting, what are the most common practices or structures used in your country or region, and the responses to them?', respondents overwhelmingly identified transfer pricing practices as the most significant reason for base erosion and profit shifting.³ Unsurprisingly, respondents also noted that the most important BEPS action points revolve around issues of transfer pricing, notably actions 8 to 10, and Action 13.⁴

Currently one of the main issues is the inability of tax authorities to assess transfer pricing abuse, as information is neither readily available nor directly comparable. The exchange of information between tax jurisdictions, as found in Action 13's standardised documentary compliance, is necessary to bridge the information gap and achieve a more transparent global tax environment.

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While an important component of the BEPS package, Action 13 implementation can be demanding for developing countries already struggling with DRM. It requires that countries amend their domestic tax legislation – effectively placing an additional reporting burden on MNEs by requiring additional tax reporting to the tax authorities⁵ in whose jurisdiction they operate. It also requires countries to sign multilateral/bilateral exchange of information agreements, demanding that they comply with new tax information disclosure and information exchange requirements.

COMPLIANCE

The implementation package for Action 13 includes model legislation as well as implementation arrangements for the automatic exchange of country-by-country (CbC) reports.

A three-tiered standardised approach to transfer pricing documentation has been developed. First, the guidance on transfer pricing documentation requires the MNE's headquarters to provide tax administrations in which it is resident with a Master file, which should contain high-level information on its global business operations and transfer pricing policies. The Master file is to be available to all 'relevant' tax administrations in countries party to BEPS Action 13 in which the MNE operates. Second, detailed transactional transfer pricing documentation must be provided in a Local file specific to each country in which the MNE operates, by the MNE's subsidiaries based in the country concerned. Third, MNEs with revenues of over EUR⁶ 750 million (or \$850 million) per year in the preceding fiscal year must file a CbC report that will provide annually (via automatic exchanges, and for each tax jurisdiction in which they do business) the amount of revenue, profit before corporate income tax, and corporate income tax paid and accrued.

Some MNEs already have the required information to complete the three reporting tiers per country. However, this is not the case for all MNEs, which must now put data collection processes in place to comply.

On the government side, compliance might be even more complicated. Implementing these reforms to address aggressive tax planning (as it relates to transfer pricing) and increase tax transparency (via CbCR and the related exchanges) is complex at the national level,

Standardised documentary compliance, is necessary to bridge the information gap and achieve a more transparent global tax environment

as current reporting standards and diverging political interests can slow down the process. These reforms can also require such extensive changes, in order to integrate with national legislation, that they are no longer consistent with the OECD's proposed standards.

The automatic exchange of CbC reports is considered pivotal to effectively address transfer pricing abuse, but will only become operational under international agreements. In order to exchange CbC reports, countries have to sign, or express their intention to sign, the Convention on Mutual Administrative Assistance in Tax Matters (or the Convention amended by Protocol) under which such information exchanges will be secured through countries' ratifying the [Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports](#) (CbC MCAA), or through bilateral agreements such as double taxation treaties or tax information exchange agreements. This is to reassure co-signatories that their taxpayers' information will be treated with due care and confidentiality.

To facilitate the international comparability of tax information – another key component in assess transfer pricing abuse and profit shifting – CbC reports must

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be exchanged via a common schema in Extensible Markup Language (CbCR XML schema). However, some revenue authorities in developing countries might face capacity constraints in adopting the CbCR XML schema, especially the related information

technology requirements on methods for electronic data transmission, which include encryption standards.

When considered in conjunction with the recommended use of the CbC reports (in effect to see if there is any obvious transfer pricing and profit shifting abuse) it does not come as a surprise that only three African countries are signatories to the CbC MCAA. Indeed, CbC reports are not meant to be used as a shortcut to a tax audit – an outcome that certain developed countries were apparently keen to secure.

REACTIONS

In principle, the information available via the CbCR process could be of use to developing countries' tax authorities in increasing corporate income tax collection, and could ensure that audits of MNEs are more focused and effective in using local resources. However, there is also the potential that CbCR, or the related Master and Local file reporting, could increase the amount of transfer pricing audits required by developing countries, putting an additional strain on currently stretched tax authority resources.

Addressing African capacity constraints in CbCR should focus on access to information and the capacity to process that information

The [African Tax Administration Forum](#) (ATAF) also notes that African countries face challenges in exchanging information related to tax matters owing to insufficient legal instruments; insufficient domestic legislation; inadequate policies, processes and procedures; and a lack of skilled staff to manage and process exchange-of-information requests. While development partners are addressing these constraints via numerous long- and medium-term projects, the exchange-of-information challenges identified by ATAF may persist in the absence of the political will to change.

Furthermore, in the African context related but different concerns are currently occupying policymakers'

attention, as illustrated by the list of action plans considered to be of importance in tackling priority issues in developing states.⁷ Therefore, addressing African capacity constraints in CbCR should focus on access to information and the capacity to process that information.

The use of advanced technology to access and process information could provide much-needed relief to states facing technical capacity constraints. However, the issue of confidentiality of information and the legal issues around handling and accessing said information by third parties still need to be cleared up. Depending on the interpretation of secrecy articles in the MCAA, it could mean that developing states might not be able to use advanced technology to address their capacity constraints.

Developing countries also have an issue with the recommended thresholds for qualifying MNEs to file CbC reports, as well as concerns over the currencies in which information should be presented in the CbC report template and whether the taxes paid in each country should be reported on a cash or accrual basis.

Considering these technical and practical issues, states and non-state organisations have raised the question of whether publicly disclosing CbC reports might not do more for tax transparency – and simultaneously address the capacity constraints in developing states – as MNEs will carry the compliance burden of full public tax disclosure, instead of the developing country's tax authority. Full public disclosure of CbC reports will also address the limited capacity in some tax jurisdictions to fully assess MNE tax contributions, by simply opening the information to wider review.

That being said, as it stands CbCR has already achieved much in bringing attention to the need for cross-border tax authority cooperation. It has highlighted the basic requirements to conduct meaningful transfer pricing risk assessments and the need for a truly global approach to the problem. Nonetheless, the current state of the action plan is reflective of an agreement that has been carefully negotiated to have a wide appeal but which has had to make some, possibly substantial, concessions to achieve this.

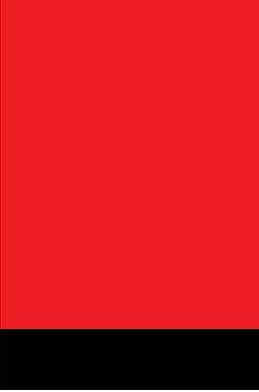
ENDNOTES

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- 2 Peters C, *Bulletin for International Taxation*, June/July 2015, p. 375.
- 3 *Ibid.*, p. 377.
- 4 *Ibid.*, p. 379. Action 8: Assure that transfer pricing outcomes are in line with value creation: intangibles; Action 9: Assure transfer pricing outcomes are in line with value creation: risk and capital; Action 10: Assure that transfer pricing outcomes are in line with value creation with reference to other high-risk transactions, in particular, management fees; Action 13: Re-examine transfer pricing documentation.
- 5 *Ibid.* Under Action 13 MNEs are required to record, report and file three additional tax reports, discussed in more detail in the 'Compliance' subsection, in addition to other tax administrative requirements.
- 6 Currency code for the EU euro.
- 7 OECD (Organisation for Economic Co-operation and Development), 'Part 2 of a Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries', 13 August 2014, <https://www.oecd.org/g20/topics/taxation/part-2-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf>, accessed 19 August 2016.

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