QDD.

A Question of Development
Synthesis of AFD studies and research
SEPTEMBER 2022
N° 58

E-commerce tax: an opportunity for Africa?

The digital transformation does away with the need for multinational enterprises to be physically present in the countries where they operate. This poses a major challenge in terms of taxation and lost revenues for African economies. The reform of the international taxation of multinational enterprises, which resulted in the adoption of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) initiative in October 2021, has received support from 23 African countries. A study financed by AFD on this issue offers arguments to African policymakers in order to promote their more active involvement in international negotiations on the subject.

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A major challenge at the time of Africa's digital transformation

In 2019, the African Union (AU) adopted its Digital Transformation Strategy for Africa (2020-2030). It aims to create an integrated and inclusive digital society and economy in order to improve the quality of life of African citizens. And this falls within a context where the technological transformation is changing the way companies operate, with new commercial models that no longer require a physical presence in a country.

While these developments have provided access to larger markets and reduced costs, they do pose major challenges in terms of adapting international taxation, as digital companies benefit unfairly from the fact that there is no direct obligation to pay taxes in countries where they are not residents.

A number of African countries are therefore seeking a balance between modernized tax laws, the allocation of effective taxing rights and maintaining an environment conducive to investment and growth. Nigeria, Kenya and Zimbabwe now have legislation which directly taxes the digital operations of non-resident multinational enterprises. Eighteen countries have also adopted an indirect taxation on digital operations.

In 2016, the comprehensive OECD/G20 Action Plan on Base Erosion and Profit Shifting (BEPS) was implemented to develop benchmarks for issues related to BEPS. It includes 134 member countries, 25 of which are African.[1] In October 2021, a solution was approved through this inclusive framework based on two pillars to address the tax challenges arising from the digitalization of the economy.

[1] Angola, Benin, Botswana, Burkina Faso, Cabo Verde, Cameroon, Congo, Côte d'Ivoire, Democratic Republic of the Congo, Djibouti, Egypt, Eswatini, Gabon, Liberia, Mauritius, Morocco, Namibia, Senegal, Seychelles, Sierra Leone, South Africa, Togo, Zambia, Kenya, Nigeria.

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The first pillar focuses on tech companies that are in direct contact with their clients. It aims to reallocate taxing rights towards the jurisdiction of the relevant market, regardless of whether there is a physical presence.

The second pillar focuses on creating coordinated rules to address the current risks from financial schemes whereby multinational enterprises can transfer profits to low-tax jurisdictions. It thus proposes the adoption of a minimum tax rate.

E-commerce booming...

The joint definition adopted by the OECD, WTO and IMF defines e-commerce as "all trade that is digitally ordered and/or digitally delivered". In this context, goods and services can be digitally ordered, while the delivery is limited to services. Yet it is precisely the provision of cross-border digital services which, as they have until now very often fallen outside the scope of taxes (Setser, 2020), could offer new sources of tax revenues, provided they are properly implemented.[2] Imports of services using information and communication technologies (ICT) by AU Member States have increased significantly, from about $19 billion in 2007 to $37 billion in 2017 (TISMOS data).

...in a context of inappropriate or poorly applied tax systems

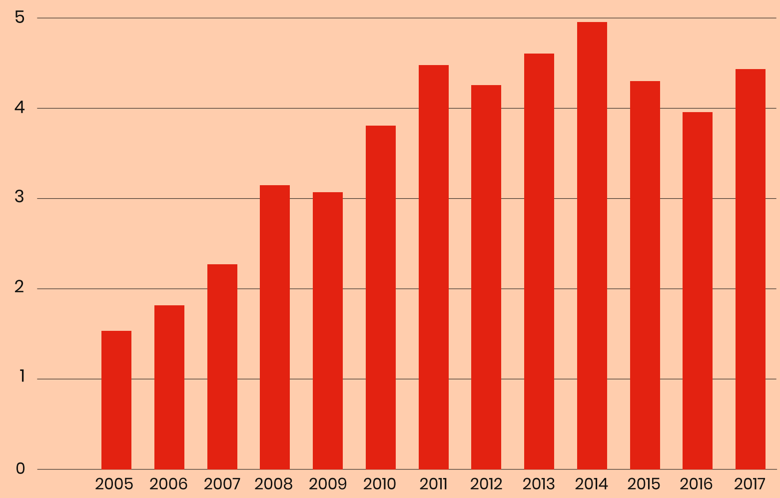
The tax systems used in cross-border transactions for ICT-related services mainly concern five types of rules: transfer pricing rules, rules on controlled foreign companies, undercapitalization, withholding tax and, finally, rules against tax treaty shopping. In reality, these tax laws are restricted by the requirement of the physical presence of companies. When systems provide for the taxation of cross-border transactions, the tax can therefore only be collected when one of the parties involved in the transaction is a company that is resident in an AU Member State (AUMS).

However, only Nigeria, Kenya and Zimbabwe have legislation that directly taxes the operations of non-resident digital multinational enterprises (MNEs). Kenya imposes a 1.5% tax on the income of a digital service provider, whether or not it is a resident, which provides or facilitates the provision of "listed services" to a Kenyan consumer. Zimbabwe, for its part, levies a direct tax of 5% on the turnover generated by foreign satellite broadcasting services and e-commerce platform services. Nigeria also levies income tax of between 20 and 30% on the profits of non-resident companies that provide digital services.

However, some imports of services using ICT can already be taxed indirectly under the consumption tax system (OECD, 2017). Eighteen AUMS[3] have thereby proposed (or are already implementing) an indirect tax on the digital operations of multinational enterprises (between 12 and 20%). It is possible to estimate the potential tax revenues which could be levied by each country on imports of ICT-related services by applying their legal VAT and consumption tax rate by sector to the e-commerce flows of the sectors measured in the TISMOS (Trade in Services Data by Mode of Supply) database. However, we should remember the difficult implementation of cross-border tax collection mechanisms on services. The 2018 report of UNECA (United Nations Economic Commission for Africa) estimates that the tax gap for VAT (difference between the potential revenues and actual revenues) exceeds 50% in half of the 24 countries in Africa (with a gap exceeding 20% for all of them). But this difference is certainly greater for cross-border services. The following estimates therefore represent an upper bound[4].

In 2017, all the AUMS could have collected up to $5.14 billion in consumption taxes from imports of services related to information and communication technologies. On average, between 2005 and 2017, the potential revenues for AUMS would have reached 0.22% of GDP if these taxes had been applied. Beyond that, AUMS would also have been able to raise between 1 and 4% of their total tax revenues from indirect taxes on digital trade imports.

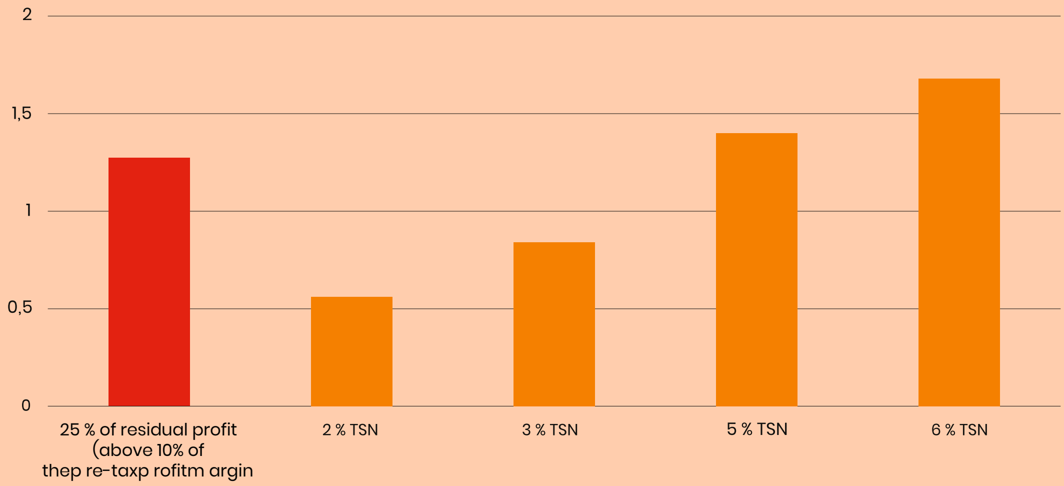
Figure 1 — Potential tax revenues from the consumption tax on imports of ICT-related services, in $ billion, 2017



Source: Calculations based on the WTO's TISMOS and the most recent consumption tax rates.

[2] Trade in digitally ordered small parcels is also probably a significant potential source of revenues, but a study on digitally ordered and physically delivered small parcels would require cooperation with customs administrations or delivery services to have access to this information.
[3] Algeria, Cameroon, Côte-d'Ivoire, Egypt, Ghana, Kenya, Madagascar, Morocco, Mauritius, Nigeria, Rwanda, Seychelles, Sierra Leone, South Africa, Tanzania, Tunisia, Uganda, Zambia and Zimbabwe.
[4] Especially as 80% of global flows of digital trade are through companies that benefit from the refund of VAT.

Figure 2 — Potential tax revenues for the AU (in $ billion) for the largest digital service companies (with income > $20 billion)



DST: Digital services tax

Source: Calculations based on the financial reports of the ITU and World Bank.

The BEPS initiative: an opportunity for Africa?

Base Erosion and Profit Shifting (BEPS) refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. This results in revenue losses for public authorities (OECD, 2020).

Based on the BEPS proposal and using ORBIS company data, it is possible to model the scenarios of Pillar 1 which only apply to profits exceeding a margin of 10%, but which would redistribute 25% of these residual profits.[5] (AU, 2021).

Twenty-five AUMS are already members of the OECD Inclusive Framework,[6] and 23 have signed the BEPS tax agreement.[7] Figure 2 compares the baseline scenario for Pillar 1 (reallocation of 25% of pre-tax profits, beyond a pre-tax profit margin of 10%) with other scenarios in the AU. The potential tax revenues for the 55 AUMS in the BEPS scenario amount to $1.3 billion a year, i.e. 0.05% of GDP.

These results should be compared with the rates of the digital services tax (DST) on gross profits which are applied in non-AU countries. Indeed, this tax exists in about 20 countries and in Africa, Kenya, Nigeria and Zimbabwe have had tax regulations on digital services for three years now.

In this context, we can see that the scenario would generate more revenues than a digital services tax of 2 or 3% on the gross incomes of the main service companies using ICT in the AUMS and would be equivalent to a DST of 4.5%. While DSTs above 5% would generate higher revenues, the current proposals of the first BEPS pillar extend beyond digital service companies and will probably generate other substantial revenues which would not pertain to a DST. It should be noted that the countries which have joined the tax agreement will have to stop taxing digital services at national level, in accordance with the agreement.[8]

Impact remains low for African economies

Pillar 1 states that to be eligible for this taxing right, countries must derive at least €1 million in revenue from each relevant multinational company. This de facto excludes African economies from this tax revenue allocation model, with the exception of the continent's 12 largest economies in terms of GDP.[9]

That being said, the Inclusive Framework provides for an exception for economies whose GDP is below €40 billion, by allocating them a taxing right above a threshold of €250,000. Despite this broadening of the scope, the OECD estimates that the reallocation of profits under Pillar 1 will only apply to about 100 multinational companies. However, in addition to its digital companies, this Pillar 1 also includes all MNEs when they use digital distribution channels. While they are the largest companies, the provision does provide for an extension of the scope to other MNEs after seven years.

It is for this reason that the estimates of the study financed by AFD indicate that the revenues would be much lower than those generated by a consumption tax (for the record, 0.22% of GDP, against 0.05% in the AU). This would be the case for each African country (Figure 3).

[5] The accounting standards used for profits are not specified in the BEPS proposal, but it is possible to follow the OECD's calculations which use the "pre-tax profit".
[6] Angola, Botswana, Cameroon, Côte-d'Ivoire, Democratic Republic of the Congo, Egypt, Eswatini, Liberia, Mauritania, Mauritius, Morocco, Namibia, Senegal, Seychelles, Sierra Leone, South Africa, Tunisia and Zambia.
[7] Kenya and Nigeria have not yet signed.
[8] However, the BEPS agreement does not preclude the introduction of indirect taxation.
[9] Algeria, Angola, Côte d'Ivoire, Egypt, Ethiopia, Ghana, Kenya, Morocco, Nigeria, South Africa, Sudan and Tanzania.

Conclusions and recommendations

While there has been a considerable increase in imports of digital services by AUMS, tax revenues remain low. Direct taxes on incomes are often only collected if one of the parties to the transaction physically resides in the jurisdiction of an AUMS, while only three African economies have introduced a direct tax on non-resident MNEs.

At the same time, 18 economies have introduced indirect taxation on the consumption of digital services. Yet there could be significant potential revenues for Africa from a comprehensive collection of indirect consumption taxes: $5.1 billion over the last ten years (0.22% of the AU's GDP). But the actual revenues from these consumption taxes are often less than half the amount. A first policy recommendation promotes support measures to make up for the VAT tax gap, for example, by implementing the OECD's VAT Guidelines which in fact have much greater revenue potential than the revenues of Pillar 1 of the BEPS.

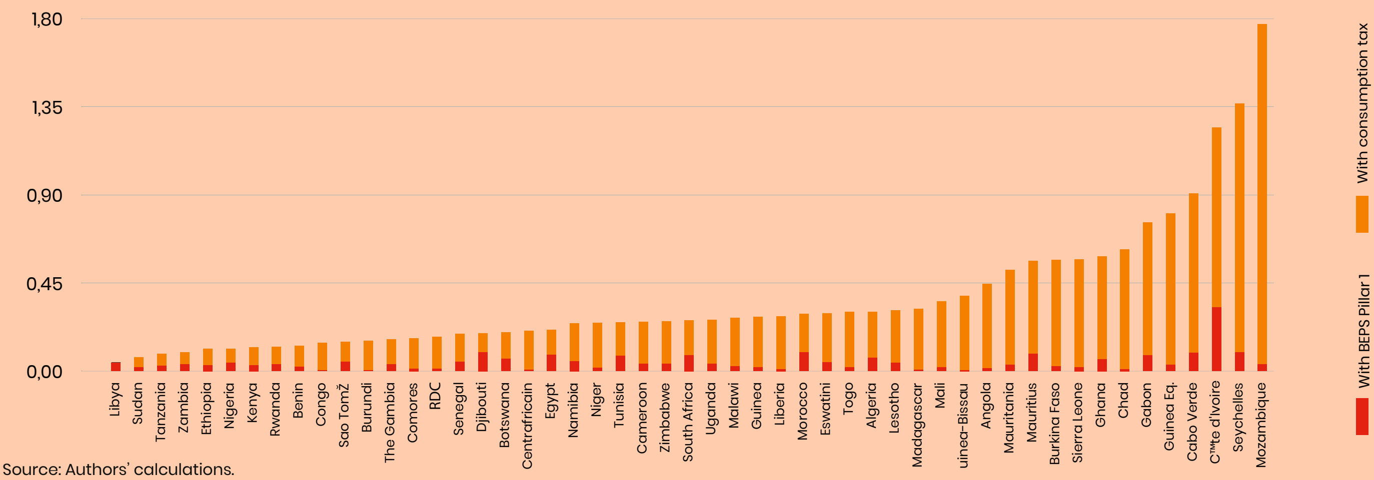
Under the BEPS proposal, AUMS could see taxable profits reallocated for the 40 largest automated digital service companies, with a maximum amount of $1.3 billion a year (0.05% of the AU's GDP). Comparatively, this amount is higher than the revenues that would be derived from a possible direct tax on digital services, i.e. less than 3% of gross revenues ($800 million).

While the full implementation of the existing cross-border collection of consumption taxes on imports of digital services could theoretically generate higher tax revenues than those from Pillar 1 of the BEPS program (according to our estimates), it should be noted that the proposals of the first pillar of the BEPS extend beyond digital service companies and will probably generate very substantial revenues. Furthermore, the revenues from the BEPS will be directly transferred to the Ministries of Finance to ensure that there is no loss of revenues due to problems of administration or national implementation.

It is therefore essential for a larger number of African countries to participate in the Inclusive Framework on BEPS, as multilateral action is more likely to produce conclusive results in a globalized economy. Especially since the difficulties experienced by G20 countries during these negotiations show, by analogy, the extent to which the negotiating capacity of AUMS alone against the giants in the sector would be diminished.

In this Inclusive Framework, the broadest possible coalition within the 55 AUMS remains the only way to ensure that African countries have sufficient weight to defend their interests, in particular in setting taxation levels for Pillar 1. On the contrary, an uncontrolled proliferation of digital services taxes is likely to result in an unnecessary complexity and undermine the overall cooperation. By joining the OECD/G20 Inclusive Framework on BEPS, the member countries de facto undertake to eliminate all unilateral measures, such as the DST and other direct taxes.

Figure 3 — Potential tax revenues for countries (as a % of GDP)



Source: Authors' calculations.

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Agence française de développement (AFD)
5, rue Roland Barthes | 75012 Paris | France
Publication Director Rémy Rioux
Editor-in-chief Thomas Mélonio
Graphic design MeMo, Juliegilles, D. Cazeils
Design and production Comme un Arbre !

Legal deposit 3rd quarter 2022 | **ISSN 2271-7404**
Credits and authorizations

Printed by the AFD Reprographics Department.