Fiscal Social Contract and Taxation in a Post COVID-19 Pandemic Africa

By:

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"You can't clap with one hand." Having infected millions, killed over half a million and disrupted social and economic activities at a global scale, COVID-19 crises is making folks call in help wherever they could get one. One of the options available to the taxpaying public is their Social contract. Social contract is an agelong hypothetical compact between the government and the governed. Fiscal social contract is a shade of social contract which posits that citizens are under obligation to pay taxes to the government while the government is under a corresponding obligation to utilize the proceeds of such taxes for societal development. It gives the citizens recourse to the government in times of need. There are two parties to a fiscal social contract: the taxpaying public and the government. The taxpayers generate revenue while the government is responsible for utilizing the revenue mobilized through budgetary appropriations and project execution. For a contract to be successful, each of the contracting parties must execute their obligation as laid out by the contract. African economies are said to be disproportionately affected by the pandemic. This essay seeks to highlight what the two parties to

the fiscal social contract must do to ensure effective execution of the social contract in a post-COVID 19 Africa.

Though it is historically hypothetical, fiscal social contract is very portent, and a breach of the contractual obligations has led to dire consequences. For instance, taxation without representation, a phrase used to depict a breach of the fiscal social contract between the colonized Americans and their British colonialist, was said to have helped start the American revolution of 1756-1763. It has also been shown in a recent OECD research across Africa, Asia and Latin America that satisfaction with services such as health, education, water and sanitation influences tax morale or willingness of people to pay taxes. Another research focused on Kenya, Uganda, Tanzania, and South Africa found that tax-compliance attitude is positively correlated with the provision of public services in all the four countries.

People with poor or no public services are more likely to view the government as having reneged in carrying out its obligation under the contract. As such, rightly or wrongly, they see the contract as already determined, thereby freeing themselves from further obligation. However, where the government failed to provide basic amenities due to paucity of fund resulting from the failure of the people to pay taxes, is it not correct to say that lack of basic social amenities, in such instances, is a consequence of non-performance of the contract by the people? While this may sound plausible, it has been found that taxpayers' frustration with an opaque tax system, deplorable socio-economic condition, and non-functioning tax audit system constitute the bane of tax revenue mobilization in developing countries in Africa. The research further argued that the massive tax noncompliance in developing countries might be better understood as "tax boycott" arising from taxpayers' frustration with the fiscal social contract they have with their governments.

Accordingly, the idea that tax payment obligation must come with a corresponding obligation on the government to provide social amenities has found some footing in some tax laws in Nigeria. The Rural Investment Allowance, for instance, sought to provide tax breaks for businesses who developed their own roads, provided electricity and water for themselves and are situated in a location 20km away from similar amenities provided by the

government. Similarly, the Nigerian government recently issued Executive Oder 007, which enables any company which has an approval to construct the road leading to its factory to claim back the cost of such road as tax credit.

The above development is in line with modern treatment of Fiscal Social Contract, which shows that it is basically of two forms: Explicit and Implicit. The explicit fiscal social contract includes contracts whose terms have been reduced to writing or could be expressly deciphered, example, by the provision of the statutes or legislation while other instances where the obligation are instead implied is implicit social contract. Either of the two has ramification for both domestic and international dimensions of taxation in the post-COVID-19 era.

In domestic taxation, the government must account to the taxpaying public how their tax monies were utilized to assist them during the heydays of the pandemic. Did the government procure and equip the hospitals to treat patients? Were there monetary or other palliatives sent to the citizens during the lockdown? Where the monies were applied in helping businesses, the government must demonstrate that those businesses were fiscally responsible in paying taxes pre-COVID-19 crises. Bailing out businesses that avoided taxes by shifting profits to tax havens, for instance, would raise a fiscal equity issue which may dampen the morale of other businesses that eschewed such practices. The government, post-COVID 19, has to show some level of democratic accountability which is key in generating voluntary tax compliance. Accountability is also a key building block for trust. Trust has been found to be a critical ingredient in the realization of the mutually enforcing fiscal contract between the government and the people. Trust has been found to result in considerable higher revenue yields. As such, government looking to raise higher revenue to rebuild the economy post-COVID-19 must take the issue of accountability and trust seriously.

The terms of fiscal social contract with respect to International taxation has been said to be subject of great uncertainty. “If an international social contract exists”, argues Professor Allisson Christians, “its terms should be explicitly articulated so that national responsibilities to the international community can be acknowledged and confronted in domestic tax policy deliberations”.

Nevertheless, there is a sense in which international fiscal social contract could be viewed as an arrangement through which the governments secure predictable or bargained tax revenues from organized taxpaying groups like MNEs or citizens from a given treaty country, in return for providing those groups with some form of tax certainty, tax benefits and enabling operating environment. Some terms of this contract are found in double tax agreements, multilateral tax instruments, Advance Payment Agreements (APAs) and other international norms. The Base Erosion and Profit Shifting project and the ongoing work on taxation of the digital economy are all testaments that the international fiscal social contract has been far from perfect especially when viewed from the perspective of MNEs resident in developed company doing business and reaping profits from developing countries.

This contractual arrangement has been subject to continued unilateral abuse and breach from the MNEs. These abuses manifest in various ways. Sometimes, it comes by way of shifting profit from the developing countries where the real economic activities producing such profit took place, to tax haven where the said profit is subject to little or no tax. Other times, it could be by outright tax evasion, illicit financial flow or tax avoidance or minimization by exploiting the loopholes in the law as seen in the case of Automated Digital Services like Facebook, Amazon and Netflix or Consumer-Facing Businesses.

The COVID-19 pandemic has further complicated the fiscal social contract between governments in developing countries and their taxpaying constituents in the international community. The crises have created new issues and exacerbated the existing ones. For example, what could be the treatment of cross-border workers or individuals who are stranded in a country that is not their country of residence? Would the 183day threshold provided in Articles 15 of the OECD and UN models apply to bring them to tax as residents of the country where they are stranded? What of other employees dislocated to countries other than the country in which they regularly work, who are working from their homes during the COVID-19 crisis. Will working from home create a “permanent establishment” (PE) for them in those countries, which would trigger new filing requirements and tax obligations?

Other issues include: what treatment that may be accorded to unilateral and

bilateral APAs given that they operate based on some critical assumptions which may have been eroded by the COVID-19 crisis, what becomes of the existing APAs? Should they be cancelled, suspended or amended? Could MNEs plead COVID-19 as force majeure in respect of intra-group payment for royalties or performance guarantees? To what extent, if any, would limited risk entities be exposed to a reduction in profit arising from MNEs' losses resulting from COVID-19? What would be the tax treatment for payment of service fees or royalties by loss-making entities? What transfer pricing method would be adopted in the allocation of losses resulting from COVID-19?

The above issues and many more upend the foundation of the already battered international fiscal contract. These issues when put side by side with the huge funding gap the crises have created for the governments, the MNEs' history of tax avoidance and aggressive tax planning and the trust gap between the MNEs and the governments the tone is set for a careful review of the terms of the fiscal contract in a post-COVID-19 era. The MNEs must be willing to become more fiscally responsible by allowing profits to be taxed where they are produced and also not blocking some meaningful anti-avoidance reforms of the government. The governments, on the other hand, must be willing to accommodate some common-sense concession to help caution the effect of COVID-19 crises on the MNEs. Both parties must approach the issues resulting from COVID-19 with loads of good faith.

Generally, parties to a contract must have or build capacity to enforce the contract. In a domestic tax setting, ICTD found that in some countries in Africa, the poorest quintile pay as much as 16% of their income as tax while the top quintile pay only 7%. This is indicative of the fact that the crux of the tax burden is borne by the poor who usually would have less capacity to hold the apparatus of governance to account for the performance of their obligation under the social contract. The top quintile comprising of big businesses, political office holders, High-Net-Worth individuals with all the resources needed to side-step or minimize taxes are not motivated to hold the government to account. In the international tax system, it is equally doubtful whether the African governments have the capacity to hold the MNEs, some of whose annual turnover is bigger than the governments' several years budgets, to account.

Nevertheless, there are actions both parties to the fiscal contract must take post-COVID-19 to make the contract work. The citizens must first commit to paying their taxes. Thereafter, they must band together to democratically demand of government the performance of the government's part of the bargain. The government on its parts must build trust with her citizens. A sure way of building trust is through tax transparency and accountability. The hospitals must be manned and equipped not just to fight off the pandemic but equally to provide the much-needed healthcare for the citizens. Aggressive tax planning and the culture of tax haven should be terminated together with the COVID-19 virus. African nations must build capacity in audit and tax administration. Nations must band together with allies to forge a fairer international tax system where Africa is no longer unduly exploited. Progressive taxes must be adopted to breach the gaps between the rich and the poor (a gap which has been exacerbated by the pandemic) while progressive tax policies must be adopted in the ongoing work to remake international tax rules given that the pandemic has equally widen the gap between the developed and developing countries.

In conclusion, for the fiscal contract to be effective post-COVID-19, all parties to the contract must actively seek to engage on fairer terms. The terms must be implemented, in good faith and, with consideration to the economic and social realities created by the pandemic. A one-sided execution of the contract either by the government or the taxpayer would not cut it. After all, it takes two to tangle, and *you can't clap with one hand*.

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