Digital Sales Tax in Africa and the Covid-19 Pandemic

By:

Mbakiso Magwape

April 14, 2021

The Covid-19 pandemic has accelerated the usage of technology in Africa. The African Continent, like many parts of the world, has adjusted to utilising unconventional digital means to replace every-day physical activities through mediums such as digital education, online banking, virtual conferencing and meetings, and online sale of goods. African Leaders and policy makers have taken cognisance of this, placing this as the main theme at the upcoming fifty-third session of the Conference of African Ministers of Finance, Planning and Economic Development, titled; 'Africa's sustainable industrialization and diversification in the digital era in the context of Covid-19'.

The emergence of technology and digital services, presents an even larger opportunity for the expansion and growth of market share of multi-national enterprises (MNEs). This raises questions and issues of regulation, taxation and technology spillovers in various African Countries. Digital taxation has been one of the areas at the forefront of global tax policy discussions, particularly under the Organisation for Economic Co-operation and Development's (OECD)

Inclusive Framework on Base Erosion and Profit Shifting (BEPS) initiative.

International taxation and Africa Taxation regimes have been unable to tax digital MNEs effectively over the past few decades. MNEs tend to carry out business in African countries with no, or very limited physical presence in those particular countries. The elimination of physical presence means that the new model of digital business deprives African States of traditional taxes which they have levied, such as income tax (as the companies would not be Permanently established in those States), employment taxes, environmental taxes, property and land taxes. This results in significantly reduction or removal of tax liability within these Countries. Technology MNEs have expanded their physical and digital footprint and services to Africa, establishing regional hubs in strategic countries within the continent, actively increasing their market-share and usage of services and products. The MNEs undertake global digital sales and services online in Business-to-Business such as Slideshare, which offers presentations, infographics, documents, and videos and Business to Consumer markets such as Facebook with targeted online adverts and and bookings.com which offers hotel and tourism booking services. The MNEs are developed from highly protected and patented algorithms, offering technically complex, novel and dynamic global solutions and services. This has resulted in record-breaking valuations of the companies, and soaring profits, with seven out of the top ten largest companies in the world by market capitalization companies being technology and data orientated MNEs. They have access to vast financial and technical resources which include tax planning experts, resulting in complex business operations globally. African tax administrations have been reported to be the antithesis of the above; under-resourced, and slow to adapt to the rapid changes to international tax landscape.

There are two over-arching approaches to taxing the digital economy. The first, is a global approach spearheaded by the OECD, through its Unified Approach to taxing the digital economy under the Base Erosion and Profit Shifting framework. This approach seeks to allocate income taxing rights to local markets, regardless of the presence of relevant jurisdictions and was due to be agreed in 2020. The objective is to allocate taxing rights between jurisdictions, address permanent establishment and the applicability of the arm’s length principle, prevent aggressive unilateral measures and the intense political pressure to tax highly digitalised MNEs as proposed.

The above has been met with delays which has, in the interim, led to the second approach, specifically the unilateral approach of imposition of digital services tax by Countries. Individual States, such as Kenya, Nigeria, United Kingdom and France have imposed unilateral taxation legislation to taxing the digital economy. Nigeria and Kenya have incorporated the tax into their respective Income Tax and VAT instruments, France captures DST in VAT returns, and the UK has prescribed for the tax separately in the Finance Act 2020. Digital services tax, presents an opportunity for African Countries to expand their tax base regarding digital sales and services, which has been eroded significantly over the years. There are, however significant challenges which cut across most countries, brought about by the unique nature of the digital economy and international taxation, such as permanent establishment rules, characterisation and allocation rules, and developing data and protection rules. The challenge with permanent establishment rules is that MNEs are currently able to avoid tax liability due to lack of adequate rules establishing whether a taxpayer, property, or activity has sufficient connection with a State in order to be subject to that State's tax jurisdiction. Characterisation and allocation rules are currently insufficient, in that rules which determine which portions of revenue or profits should be taxed or allocated to a source jurisdiction are absent. Data rules pose challenges as there is no legislation that subjects highly digitalised business to liability where the MNE uses the data and user-generated content with no taxable presence in the jurisdiction. These challenges will require significant tax policy and legislative interventions in order to realise the desired outcomes from the tax.

The African Tax Administration Forum has led the charge in Africa, in the efforts to address taxation of the Digitalized economy. It has issued technical notes on key issues regarding digitalisation and taxation, particularly on establishing a consensus-based proposal that meets the needs of African countries. The discussion dealt with three issues: i) new nexus rules, ii) new profit allocation rules and iii) a new global anti-base erosion rule. ATAF further published a Suggested Approach to drafting legislation on digital services Tax Services prepared by the Secretariat and ATAF's Cross-border Taxation Technical Committee, to assist African countries implement digital service tax to tax transactions of highly digitalised businesses.

Digital services tax presents a unique challenge for the world, and Africa, in the need to develop relevant robust, enforceable tax strategies and legislation to empower tax administrations to effectively tax digital sales. Synthesising simple solutions for complex digital transactions in a tall feat, however, this presents an opportunity for increased revenue for a continent that has the potential to significantly increase tax base, and add to Africa's development.

African Countries have started implementing, or have indicated plans to start implementing forms of digital tax. The ten African Countries to date include Kenya, Nigeria, South Africa, Egypt, Tanzania, Mauritius, Uganda, Cameroon, Ghana and Zimbabwe as reported by ATAF. Zimbabwe's Minister of Finance & Economic Development, Mthuli Ncube, proposed a Unilateral Digital Services Tax which encompasses both digital service and online retailers. Nigeria amended its Companies Income Tax Act through The Finance Act making non resident companies subject to its legal scope and profits which undertake inter-alia electronic commerce, application store, high frequency trading, electronic data storage, online adverts, participative network platform, online payments. This is indicative of the acknowledgement of the high consumption of digital services in leading African economies, and the potential to raise revenue from MNEs trading within the countries. It is imperative that a strategy and approach be undertaken to address these MNE business models and challenges regarding taxing the digitalized economy, and that legislative measures are enacted to preserve or expand Africa's tax base. Overall, the potential gains from Digital Sales Tax are significant, as inclusion of digital services tax, may subsequently increase revenue that may be utilised for developing States, particularly at a time of high State expenditure to alleviate the economic and social impact of Covid-19. You could include some benefits from countries that have imposed unilateral taxation legislation highlighted above to showcase the potential gains.

View online: Digital Sales Tax in Africa and the Covid-19 Pandemic

Provided by Afronomicslaw