**TAX BASE EROSION AND CORPORATE PROFIT SHIFTING: AFRICA IN INTERNATIONAL COMPARATIVE PERSPECTIVE**

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***Abstract***

*Each year, base erosion and profit shifting cost governments worldwide between US$100bn and US$600bn, which undermines financing for development and deepens inequality. This article examines how African nations in comparison to other countries contribute to and counter base erosion and profit shifting by multinational companies through analysis of the lowest available corporate income tax rates, tax exemptions, transparency provisions, anti-avoidance measures, and double tax treaty networks. To do this, the article draws on the Corporate Tax Haven Index dataset produced by the Tax Justice Network in 2019, in which the legal framework and practices of 64 jurisdictions including nine African countries are assessed to measure the risks of tax avoidance, base erosion and profit shifting, profit misalignment, and the race to the bottom in corporate income taxation. The findings show that, on average, African countries contribute much less to the problem of tax avoidance than EU and OECD member states and their dependencies. In contrast, however, African countries offer more profit-based tax incentives, including tax holidays and economic zones, in a bid to attract foreign direct investment but often with unintended consequences. Further, transparency and anti-avoidance measures are not as robust in African countries as in the EU and OECD, which signals space for policy improvements to curb corporate tax abuse. The Corporate Tax Haven Index also reveals the distortions introduced in academic studies and development policy that rely on the highest statutory corporate tax rates and disregard reductions that may be extended to a company based on the business size, sector, location, or other factors.*

 ***Key words:*** *tax havens, tax incentives, illicit financial flows*

# INTRODUCTION

Globally, governments lose out on an estimated US$100bn to US$600bn in revenues annually through corporate tax abuse (Cobham & Janský, 2018, 2020, pp. 96–97; Crivelli et al., 2016; OECD, 2015f). Illicit financial outflows from the African continent alone have been estimated to amount to US$50bn each year (AUC & UNECA, 2015, pp. 33–34). In almost half a century, between 1970 and 2015, Africa lost approximately US$1.4 trillion in capital flight. This is far more than the total stock of debt owed as of 2015 (US$496.9 billion) and the cumulative amount of foreign aid received in the same period (US$991.8 billion) (Ndikumana & Boyce, 2018). To further contextualise the revenue losses through corporate tax avoidance in sub-Saharan Africa, these were equal to between one- and two-thirds of its total official development assistance in 2014 (Moore et al., 2018, p. 65). With insufficient revenue, African nations are not able to finance development, they will not be able to adequately respond to the economic impacts of the COVID-19 pandemic, and inequality is exacerbated: *“[t]hese problems impede the ability of states to finance the sustainable development goals (SDGs), poverty alleviation, development and to achieve and maintain fiscal self-sufficiency”* (Waris, 2019, p. 6).

To compound challenges faced by governments in revenue mobilisation, tax competition in the age of globalisation has shifted the burden from the taxation of capital to labour. In a bid to attract foreign portfolio and direct investment through lowering tax rates on income earned by foreign companies, revenue collected through corporate income tax is threatened (Avi-Yonah, 2020). Even though state and non-state actors assert that tax havens are responsible for facilitating corporate tax avoidance, there has been no consistent definition of what constitutes a (corporate) tax haven (Ates et al., forthcoming; Cobham et al., 2015). In order to tackle the related issues, a definition of corporate tax havens and framework to assess these are required to understand how different jurisdictions contribute to tax avoidance and the race to the bottom in corporate taxation. To address this gap, the Tax Justice Network published the inaugural Corporate Tax Haven Index in 2019 (Tax Justice Network, 2019b). The index assesses how “successful” a jurisdiction is in pursuing a corporate tax haven strategy. This includes how intensely a jurisdiction abuses its autonomy in setting corporate income tax rules, which enable and incite tax spillovers that affect other jurisdictions in their own rule setting and tax mix autonomy (Tax Justice Network, 2019c, p. 3).

The Corporate Tax Haven Index measures the tax avoidance risks of tax rules, other laws and documented practice across 20 indicators, grouped into five categories. Thereby, the index outlines a comprehensive set of policies that are relevant for countering illicit financial flows stemming from multinational corporate tax avoidance. Using the Corporate Tax Haven Index, this article assesses how African jurisdictions are responding to the challenge of base erosion and profit shifting. It focuses on the nine African jurisdictions covered in the index: Botswana, Gambia, Ghana, Kenya, Liberia, Mauritius, Tanzania, the Seychelles and South Africa.[[2]](#footnote-3) The rules and regulations in these countries are compared to those in the European Union (EU) and Organisation for Economic Co-operation and Development (OECD) and their dependencies.[[3]](#footnote-4) In section two, this article proceeds to explain the methodology of the index. The findings from a comparative analysis of the five categories of haven indicators are discussed in section three (the lowest available corporate income tax rate, loopholes and gaps, transparency, anti-avoidance and double tax treaty aggressiveness). Section four concludes the article.

# METHODOLOGY[[4]](#footnote-5)

Each of the 64 jurisdictions in the Corporate Tax Haven Index receives an overall value to determine its ranking. This value is calculated by a formula combining the values of two components, the haven score and the global scale weight. The haven score measures the potential risk that a jurisdiction becomes a destination for profit shifting, eroding the tax base of other jurisdictions, which contributes to a race to the bottom in taxing companies. The actual risk of a jurisdiction having these negative effects is determined by combining the haven score and the global scale weight. The global scale weight is the quantitative component that measures the relevance of each jurisdiction for foreign direct investment (FDI). Over 80% of the world’s total FDI stock is booked in the 64 jurisdictions included in the index (Ates et al., forthcoming, p. 137).

The haven score is derived from 20 indicators which are grouped into five categories, as presented in Figure 1 below. The haven score is the average of the five categories. Section three provides more details about how the score for each category is calculated. In general, a jurisdiction receives a score of between 0 and 100 for each indicator: 0 corresponds to there being no tax avoidance risk or zero corporate tax haven attributes, and 100 signifies full corporate tax haven attributes and maximum spillover risk. Data is collected for each of the numbered IDs, drawing from laws, regulations and documented practices in each jurisdiction. The themes of most of these indicators overlap with the OECD’s 15 actions under the Base Erosion and Profit Shifting (BEPS) project, and particularly Action 5 on harmful tax practices, and with the International Monetary Fund’s (IMF) spillover approach (International Monetary Fund, 2014). They serve as benchmarks for countries to tackle illicit financial flows stemming from base erosion and profit shifting by multinational companies.

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| --- | --- | --- | --- | --- |
| **LACIT**  | **Loopholes and Gaps**  | **Transparency** | **Anti-Avoidance**  | **Double Tax Treaty Aggressiveness**  |
| **1** Lowest Available Corporate Income Tax (LACIT)IDs 505, 506, 507,541, 542, 543, 544 & 545 | **2** Foreign Investment Income TreatmentIDs 552, 553, 554 & 555 | **9** Public Company AccountsIDs 188, 189 & 201 | **15** Outbound intra-group payments - Deduction-Limitation InterestsIDs 517, 518 & 519 | **20** Double Tax Treaty AggressivenessID 571 |
| **3** Loss UtilisationIDs 509 & 510 | **10** Public country-by-country reportingID 318 | **16** Outbound intra-group payments – Deduction-Limitation – RoyaltiesID 520 |  |
|            |
|   |           | **4** Capital gains tax rateIDs 513 & 514 | **11** Robust local filing of country-by-country reportingID 419 | **17** Outbound intra-group payments – Deduction-Limitation – ServicesID 521 |  |
|   | **5** Broad ExemptionsIDs 524, 525, 526, 527, 528, 529, 530, 531, 532, 533, 534, 535, 536, 537 & 538 | **12** Unilateral cross-border tax rulingsIDs 363, 421, 561, 562, 563 & 564 | **18** Outbound payments – Withholding Taxes – DividendsID 508 |
|   | **6** Tax Holidays and Economic ZonesIDs 501, 501, 503, 504, 539 & 540 | **13** Reporting of tax avoidance schemesIDs 403, 404, 405 & 406 | **19** Controlled Foreign Company RulesID 522 |
|   | **7** Patent BoxesID 515 | **14** Tax Court SecrecyIDs 407, 408, 409 & 410 |  |  |
|   |  |
|   | **8** Notional interest deductionID 516 |  |  |

Figure 1. Haven indicator categories in the Corporate Tax Haven Index 2019 (Tax Justice Network, 2019b, p. 8)

The BEPS Action 5 framework is the main international standard for trying to limit spillovers from tax incentives. The framework has been criticised for resulting in the “normalisation and proliferation of ‘acceptable incentives,’” such as patent boxes or special economic zones (ICRICT, 2019, p. 9), and its institutional setup challenged as “disjointed and dysfunctional” (ICRICT, 2018, p. 13) because access to decision making in the Inclusive Framework was opened to non-OECD members only after key decisions on the BEPS measures had been taken by OECD members. The Action 5 framework is administered by the Forum on Harmful Tax Practices which reports to the Inclusive Framework at the OECD and periodically publishes peer reviews on the potentially harmful tax regimes (OECD, 2019a; OECD Inclusive Framework, 2019). The peer review reports dispense with a reasoned evaluation for the decisions taken, resulting in concerns about the integrity and lack of transparency of reviews, such as, around the distinctions made between potentially or actually harmful tax regimes. The peer reviews might thus encourage the proliferation of regimes not found harmful by the review process and thus increase the avenues for tax avoidance.

As the entire review of potentially harmful tax regimes only focuses on what the OECD qualifies as high risk *“geographically mobile business income”* (OECD, 2019a, p. 13), it ignores any other economic activities that might equally result in base erosion and profit shifting and exert downward pressure on corporate taxes (Heady & Mansour, 2019; International Monetary Fund et al., 2015, p. 22; Mansour & Keen, 2009; Meinzer et al., 2019, p. 11). The Action 5 framework does not require robust and clearly defined economic substance except for patent boxes through the modified nexus approach. This may result in scenarios where countries create substance rules which are easy to comply with without materially changing the gross disproportion between substance or expenditure, and profits attributed. For example, under Dutch law, a company is regarded as having substance if it has a physical office, local directors, and annual salary costs of at least €100,000 (Ku & Mulder, 2018), enabling billions of profits to be attributed. Another flaw of the Action 5 framework consists in weaknesses in its ring fencing approach by condoning broad exemptions or low tax for all foreign source income in territorial tax systems (OECD, 2019a, pp. 38–39). For example, the risks arising from territorial tax systems in Gibraltar, Hong Kong, Panama and Singapore are ignored.

The Corporate Tax Haven Index overcomes these flaws of Action 5 and establishes more robust and demanding criteria for the indicators that form the haven score. It acknowledges that any zero or low tax system can result in tax spillovers and base erosion and profit shifting as long as transfer pricing is used for attributing profits between related parties. To calculate the Corporate Tax Haven Index value, which is the actual risk of a jurisdiction becoming a destination for profit shifting, the cube of the haven score is multiplied by the cube root of the global scale weight.[[5]](#footnote-6) Jurisdictions are ranked based on this value. The highest ranked jurisdictions ranked are those “that contribute most to: (i) the global race to the bottom in corporate taxation; (ii) the erosion of corporate income taxes globally; and (iii) constraining the tax policy space elsewhere” (Tax Justice Network, 2019c, p. 5). When presented in tables and figures, the haven scores of the jurisdictions follow the colour codes described in Figure 2 below.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Maximum RiskHaven Score 100 | Haven Score76 – 99 | Haven Score51 – 75 | Haven Score 26 – 50 | Haven Score1 – 25 | Minimum RiskHaven Score 0 |

 Figure 2. Colour coding for haven scores

As with the limitations of any index, the Corporate Tax Haven Index reduces complex information into single numbers (the combination of the haven score and the global scale weight to form Corporate Tax Haven Index value), which is based on the choice of indicators and formulas. This invariably involves decisions taken to exclude potentially relevant aspects of tax avoidance, yet the remedy to this is the transparency and the full referencing of the data and decisions made for the Corporate Tax Haven Index, which make each data point verifiable. The indicator selection during the development of the index was guided by the methodological preference to create an index to comprehensively, robustly and directly measure the cross-border profit shifting and tax avoidance in any jurisdiction. Yet in the evaluation of existing econometric measurement techniques to assess tax avoidance, no good enough direct measure of all tax avoidance with broad enough geographical coverage was identified.

This justified instead the approach taken in the Corporate Tax Haven Index, like the Financial Secrecy Index also published every two years by the Tax Justice Network (Tax Justice Network, 2020), to construct a measure of a jurisdiction’s effort to attract tax avoidance and the scale of these efforts. This includes ascertaining legal factors that drive a jurisdiction’s efforts in this regard, integrating a qualitative and ultimately subjective assessment in the measurement, i.e. a standard. The indicators, as presented in the detailed methodology (Tax Justice Network, 2019c), have been included where there is convincing theoretical and empirical evidence that a legal characteristic may contribute to tax avoidance, tax evasion and the race to the bottom in corporate taxation.

As explained above, to enhance an indicator’s validity and plausibility, maximum transparency has been designed into the construction and assessment of indicators to enable objective measurement, verification and comparison. By enabling access to the wealth of legal data included in the index at no cost to other researchers, the indicators can be used to design alternative ways to assess the contribution of jurisdictions to the problem of profit shifting. A statistical audit by the European Commission’s Joint Research Centre is planned for the Corporate Tax Haven Index as was conducted for the Financial Secrecy Index (cf. Becker & Saisana, 2018).

Data availability constraints also affected the research, especially since established institutions including the OECD, IMF and World Bank are not successfully collecting all relevant data for examining corporate profit shifting (Cobham, 2020a). This has been highlighted by the United Nations High-level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda (FACTI), which suggests improved data standards, collection and publication are required, as currently “there is no one source with the responsibility of publishing consistent and reliable data on taxation for the entire world. Such publication, from a neutral and authoritative source, could assist in monitoring progress, guiding enforcement efforts, and incentivizing better policies” (FACTI Secretariat, 2020, p. 31). No institution is ultimately identifying profit shifting by econometric means in real time. This would be aided by, for example, requiring public country by country reporting as well as more comprehensive metrics beyond withholding tax rates to assess the aggressiveness of treaties (cf. Hearson, 2016).

# AFRICA IN THE CORPORATE TAX HAVEN INDEX

African countries on average create less tax avoidance risks than member states of the EU and the OECD and their dependencies (Figure 3). The average haven score for African countries is only slightly smaller than the average of other regions, yet when combined with the global scale weight, it results in an average Corporate Tax Haven Index (CTHI) value significantly smaller than the EU and the OECD values. This signifies that there is a lower risk of African countries becoming destinations for profit shifting.

Figure 3. Comparison of Africa, the EU and OECD countries and dependencies in the Corporate Tax Haven Index 2019

The data on African countries is broken down by jurisdiction in Table 1 (next page). Mauritius’ high haven score (80) points to this jurisdiction’s role as a dedicated corporate tax haven in the region. With the exception of Seychelles, all other African jurisdictions receive a haven score of around 50. The remainder of this section explores in greater detail the comparative findings on specific pathways for tax spillovers by examining the haven indicator categories and highlighting some individual indicators.

| **Africa Rank** | **CTHI Rank** | **Jurisdiction** | **CTHI Value**[[6]](#footnote-7) | **CTHI Share**[[7]](#footnote-8) | **Haven Score**[[8]](#footnote-9) | **Global Scale Weight**[[9]](#footnote-10) |
| --- | --- | --- | --- | --- | --- | --- |
| 1 | 14 | Mauritius | 950 | 2.50% | 80 | 0.65% |
| 2 | 42 | South Africa | 184 | 0.48% | 47 | 0.54% |
| 3 | 44 | Seychelles | 163 | 0.43% | 68 | 0.01% |
| 4 | 56 | Botswana | 74 | 0.20% | 55 | 0.01% |
| 5 | 57 | Liberia | 71 | 0.19% | 49 | 0.02% |
| 6 | 58 | Kenya | 60 | 0.16% | 51 | 0.01% |
| 7 | 60 | Ghana | 56 | 0.15% | 49 | 0.01% |
| 8 | 62 | Tanzania | 40 | 0.11% | 46 | 0.01% |
| 9 | 63 | Gambia | 9 | 0.02% | 48 | 0.00% |
| Territories marked in light blue are British Commonwealth territories which are not Overseas Territories (OTs) or Crown Dependencies (CDs) but whose final court of appeal is the Judicial Committee of the Privy Council in London (see here for more details: <http://www.taxjustice.net/cms/upload/pdf/Privy_Council_and_Secrecy_Scores.pdf>). |

 Table 1. African jurisdictions in the Corporate Tax Haven Index (CTHI) 2019

## *Lowest available corporate income tax[[10]](#footnote-11)*

Revenues from corporate income tax make up about 15 per cent of revenues in developing countries (International Monetary Fund, 2014, p. 7; McNabb & LeMay-Boucher, 2014, p. 17). Yet corporate income tax rates have fallen across the world, including in developing and emerging economies, contributing to a race to the bottom in corporate taxation. This downward trend in corporate taxation harms society since tax systems become more regressive as a result, shifting the tax mix away from capital towards less mobile labour and consumption (Avi-Yonah, 2020; Hakelberg & Rixen, forthcoming; Tax Justice Network, 2015). Furthermore, tax rate differentials incentivise profit shifting (Tørsløv et al., 2018, p. 32).

Moreover, there is often a discrepancy between the statutory corporate income tax rates—the highest available rate usually reported in datasets used for research and policy analyses—and the real, legally documented lowest corporate income tax rates available in a country (Abbas & Klemm, 2013). Focusing on active business income of subsidiaries of multinational companies, the first haven indicator determines the lowest available corporate income tax rate (LACIT) through legal analysis. The statutory, oft reported rate is corrected for any reductions accessible to multinational companies based on the business size, sector, or state or sub-region where it operates. Subsequently, further adjustments are made for tax reductions relating to the distribution or retention of profits, the company type, territoriality and documented unilateral tax rulings. Over one-third of jurisdictions (22 of the 64) in the Corporate Tax Haven Index offer a zero per cent LACIT (Tax Justice Network, 2019j, para. 25).

In Africa, Mauritius and the Seychelles offer a zero per cent LACIT, which is much lower than the statutory tax rate of 15 and 30 per cent, respectively, as shown in Figure 4. For example, while Mauritius usually records a 15 per cent statutory corporate income tax rate, its legal framework continues to enable tax-exempt companies to be established. The Global Business License company regime is in the process of being amended,[[11]](#footnote-12) but Mauritius allows so-called authorised companies to be taxed on a territorial basis (PricewaterhouseCoopers, 2018). Authorised companies are not technically tax exempt, yet they are considered non-resident for tax purposes and therefore do not fall within the scope of Mauritius’ corporate income tax (Ernst & Young, 2018).

Thus, as long as these Mauritius-incorporated companies are only engaged in foreign operations, they are fully exempt from tax. These companies are barred from providing specific financial services but can otherwise operate in any other economic sector (PricewaterhouseCoopers, 2018). As a result, the LACIT is recorded as zero per cent. This is highly problematic given Mauritius’ extensive treaty network, discussed at more length in section 3.5, resulting in revenue losses for other sub-Saharan African countries (Beer & Loeprick, 2018; Picciotto, 2019).

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| --- |
|  |
| Maximum RiskLACIT 0% | LACIT Rate between 0 and 8.8% | LACIT Rate between 8.9 and 17.4%  | LACIT Rate between17.5 and 26.2% | LACIT Rate between 26.3 and 34.9% | Minimum RiskLACIT Rate 35% |

Figure 4. Statutory and lowest available corporate income tax (LACIT) rates, 2019

The difference between tax rates on corporate income across jurisdictions is a driver of profit shifting and the race to the bottom in corporate taxation (Crivelli et al., 2016). Significant differentials in the corporate income tax rate incentivise the manipulation of transfer prices for shifting profits from high to low tax jurisdictions. Existing transfer pricing guidelines based on the arm’s length principle are inadequate to prevent such profit shifting (Serrano et al., 2019). Therefore, a low or nil tax rate creates tax avoidance risks for any jurisdiction with a higher corporate income tax rate.

To comparatively measure the intensity of such spillover risks emanating from any country’s lowest available corporate income tax rate, a reference rate against which to measure this lowest rate is necessary. The distance from this reference rate serves as a proxy for the intensity of the spillover risks stemming from a country’s lowest tax rate. In the absence of an internationally agreed default corporate income tax rate, the Corporate Tax Haven Index identified the highest available corporate income tax rate in a democracy based on the premise that any lower rate risks undermining the democratic choices of the electorate of this jurisdiction. Following the analysis, the reference rate was set at 35 per cent based on the rate in India, where capital gains are included in corporate income. The haven score for this first category is calculated by scaling the lowest available corporate income tax rate of each country against the spillover risk reference rate of 35 per cent.

The average lowest available corporate income tax rate and the statutory rate across the nine African countries are 21 and 26 per cent respectively. These are almost 15 and 10 per cent lower than the spillover risk rate. These low rates may result in inward profit shifting, potentially undermining the tax base of other countries in Africa and beyond, and entice other countries to follow suit. This likely affects the tax mix by shifting the burden of taxation onto less mobile taxpayers. Nevertheless, the OECD and the EU’s average statutory and lowest available corporate income tax rates are lower than those available in African jurisdictions, which implies countries in these blocks create more spillover risks. This is reflected in the lower average haven score for African jurisdictions compared to the average for the OECD, the OECD and dependencies and the EU, as presented in Figure 5.

Figure 5. Corporate tax haven scores for Africa and averages – Category 1: Lowest available corporate income tax rate

## *Loopholes and gaps*

The second category of indicators referred to as “loopholes and gaps” in the Corporate Tax Haven Index considers the exclusions and exemptions that are in place and can be used by multinational companies to reduce the tax rate or tax base. This category consists of seven indicators and the overall score presented in Figure 6 is the arithmetic average of the seven indicators. The indicators include an assessment of sectoral exemptions, tax holidays and economic zones that reduce corporate taxation. Capital gains tax, foreign investment income treatment and rules around loss utilisation, fictional interest deduction and patent box regimes are also considered.

Figure 6. Corporate tax haven scores for Africa and averages – Category 2: Loopholes and gaps

Figure 6 reveals that there is a wider range of scores for African countries than in the first category where the lowest available corporate income tax rate was assessed. Kenya appears to be an outlier. This may be because the country is positioning its capital city Nairobi as a new financial centre for East and Southern Africa as outlined in Kenya’s Vision 2030 (Mwanyumba et al., 2017; Ndubai, 2018). As assessed in the Corporate Tax Haven Index, Kenya exempts foreign investment income in the form of dividends from its corporate tax base (Tax Justice Network, 2019h). Further, the lowest available capital gains tax rate is zero per cent because an exemption applies for domestic securities with shares listed on the Nairobi Securities Exchange and gains from the disposal of foreign securities is not taxable in Kenya because of its territorial tax system (Tax Justice Network, 2019h, n. 15).

Losses can be carried forward without restrictions and backward allowing companies to reduce their tax bill, for example, through unfavourable intra-group trades. Although carrying losses backward is not generally allowed, there is an exception granted to the petroleum exploration industry. Losses may be carried forward for all sectors for nine years without an annual ceiling and the cabinet secretary has the discretionary powers to extend the period for losses to be carried forward. Kenya also offers a raft of sectoral tax exemptions. For example, in special economic zones and export processing zones, the corporate income tax rate is either nil or significantly lower than the statutory rate.

Figure 6 shows that the difference between the average haven scores of African nations and the EU and OECD is much smaller than in the first category (LACIT) described above. However, breaking down the findings into specific indicators is revealing (Figure 7). On the one hand, African countries perform better on average than the OECD and the EU on the indicators for capital gains taxation, sectoral exemptions, fictional interest deduction, foreign investment income treatment and patent boxes. On the other hand, African countries have higher haven scores on average for two indicators: loss utilisation, which assesses the availability of unrestricted loss carry forward and loss carry backward, and tax holidays and economic zones.

Figure 7. Comparison of Loopholes and Gaps Indicators for African countries, EU and OECD

The greatest difference in haven scores between African countries and those countries in the OECD and EU is observed for economic zones and tax holidays, where African nations have on average higher haven scores than the other blocs. This finding confirms earlier research showing the wide proliferation of economic zones and tax holidays in Africa (International Monetary Fund et al., 2015, p. 9; Stausholm, 2017). For example, African nations on average offer three profit-based tax incentives, such as economic zones and tax holidays, for every one cost-based tax incentive while European nations on average offer a near one-to-one ratio of tax incentive types (Meinzer et al., 2019). Cost-based tax incentives aim to lower the cost of capital by allowing deductions related to investment and as a result, they may encourage investment that would not have otherwise been made.

However, profit-based tax incentives reduce that tax on income; so instead of encouraging new investment, profit-based tax incentives make profitable projects even more profitable (International Monetary Fund et al., 2015, p. 20). In Kenya, Ghana, Tanzania and Mauritius, special tax incentives in a limited geographical area— such as in freeports, export processing zones, special economic zones, and so on—or special tax holidays available over a set period of time receive high haven scores. For example, in Tanzania, companies in the free zone under the Zanzibar Investment and Promotion Act of 2004 are exempt from corporate income tax for the first 20 years and investors in Tanzania’s export processing zones are exempt from corporate income tax for the initial 10 years.[[12]](#footnote-13)

The objectives of these geographically-confined tax incentives are usually to attract FDI, develop disfavoured or rural regions or certain sectors, increase government revenues, encourage skills upgrading, technology transfer, innovation, and improve the productivity or domestic enterprises (Douglas Zhihua Zeng, 2010). However, the available evidence shows that tax incentives are often ineffective in attracting new greenfield FDI, especially in developing countries (Klemm & van Parys, 2009). Investment climate surveys for low-income countries show that tax incentives are not as decisive for investors in reaching a decision to invest. Rather good infrastructure, an educated labour pool, the rule of law, and macroeconomic stability are among conditions that are more important to investors. Evidence also suggests that providing geographically-confined tax incentives imposes pressure on policymakers to provide the same benefits to other geographic areas, increasing revenue loss and social distortions (Mansour & Keen, 2009). Further, free trade zones may be vulnerable to illicit activity and be abused through transfer pricing strategies given typically weak enforcement of financial regulations, lack of transparency and inadequate customs control (FATF & Egmont Group, 2013; FATF, 2010).

Time-bound tax incentives have the tendency to attract footloose investments, mostly profitable during the tax holiday period. Indeed, they can induce rent-seeking behaviour including tax avoidance with round-tripping when existing companies use sophisticated techniques to reinvest their capital in creating a new company just to benefit from the tax holiday (OECD, 2015c). For example, if tax incentives are only granted to new companies, foreign entities may attempt to register new companies for already established operations in order to take advantage of those incentives. Ghana offers several time-bound tax holidays that reduce the statutory corporate income tax rate of 25 per cent significantly; tree crops, cattle farming, rural banks and venture capital financing companies are all taxed at one per cent for the first 10 years, while cocoa by-production processing, construction of residential housing, agro-processing, livestock (other than cattle) farming, fisheries and cash crops are taxed at one per cent for the first five years.

Furthermore, there are fundamental flaws in how FDI data continues to be collected (cf. Meinzer et al., 2019): there is no differentiation between greenfield investment and mergers and acquisitions data (International Monetary Fund, 2014, pp. 16–17), data fails to account for so-called roundtripping capital (Haberly & Wójcik, 2015), and some data may just capture flows through countries with stops in a country often for tax optimisation purposes (International Monetary Fund, 2014, p. 18; United Nations Conference on Trade and Development, 2015). This is problematic since, “even the few studies showing a positive relationship between tax incentives and net FDI inflows are not valid evidence for arguing an unambiguous effect of tax incentives on desired greenfield investment, whether it is by tax rate cuts, tax holidays, tax exemptions, or tax treaties” (Meinzer et al., 2019, p. 6). For example, merger and acquisitions are often counted as FDI, yet research shows that “most mergers do not create value for anyone, except perhaps the investment bankers who negotiated the deal” (Schilling, 2018, p. 186).

Patent box regimes,[[13]](#footnote-14) assessed in the category “loopholes and gaps”, are particularly pertinent given the digital transformation of the global economy, which has shaken the foundations of the century-old international taxation system. Digitalised business models rely on investment in intangible assets, especially intellectual property assets, such as algorithms and software that supports website and online platforms. These intangible assets may be owned by a subsidiary of a multinational company (OECD, 2019c, p. 3). By transferring intangible assets to jurisdictions with preferential regimes for the tax treatment of income related to intellectual property, corporate tax bases can be easily eroded in countries where the multinational company operates (Diaz, 2019). These preferential regimes are referred to as “patent box regimes” even though they are used more extensively than for patent incentives alone (Cobham, 2015). As the evidence below shows, patent box regimes are exposing the tax base of particularly developing countries to risk as these countries may be used only as low profit manufacturing platforms, while their tax base is eroded through royalty payments ending up in low taxed patent box regimes.

A patent box regime provides tax privileges for highly profitable businesses and enables cross-border profit shifting into these tax regimes, undermining the tax bases of jurisdictions elsewhere (Shaxson, 2014b). Promises to spur innovation, tax revenues and growth through the introduction of patent boxes have failed to materialise in empirical data. In contrast, available evidence suggests that patent box regimes are effective only for raising multinationals’ share prices(Guenther, 2017, p. 19). Empirical research published by the Max Planck Institute for Innovation and Competition analysed the effects of the introduction of patent box regimes in 13 European countries between 2000 and 2014. According to the research, given that a patent box regime subsidises output rather than input, it benefits mainly companies that have already had success with their invention. And while it may encourage other companies to undertake such inventions, this can be done in better, more efficient ways (Gaessler et al., 2018).

Further, they are not the most effective way to stimulate innovation and research and development (Alstadsæter et al., 2018). In fact, it appears that jurisdictions without such patent box regimes have been more successful in attracting and fostering innovative businesses (CPB Netherlands Bureau for Economic Policy Analysis, 2014). Beyond not having the desired outcomes for stimulating innovation and inventions, they often have a deleterious effect even on the public finances of jurisdictions hosting the patent boxes. For example, in 2015, the Dutch government found that its innovation box resulted in a tax loss of €361m to the Netherlands in 2010. In 2012, this sum was almost double, increasing to €743m (Berkhout, 2016). A report published by the Centre for European Economic Research in 2013 further confirmed that the “[e]mpirical evidence that simulates the Benelux and UK IP [intellectual property] Boxes finds that the increase in IP income locating in the countries is insufficient to outweigh the lower tax rate” (pp. 38–39).

In order to mitigate spillover risks to other jurisdiction’s tax bases emanating from patent box regimes, the OECD and G20 adopted a so-called modified nexus approach for differentiating harmful and legitimate patent box regimes. The condition for a legitimate use of patent boxes is that substantial activities are tied to the development of the intellectual property (OECD, 2015b). The qualifying intellectual property assets under the modified nexus rules are limited to patents and to functionally equivalent and legally protected intellectual property rights, such as software copyrights. Brands and trademarks count as “marketing intangibles” and are excluded from receiving patent box benefits under the rules (OECD, 2015a). The rules require a link between the income benefiting from the intellectual property tax regime and the underlying research and development activities that generate the intellectual property (Cobham, 2015; OECD, 2015a; OECD, 2015d). The approach seeks to allow taxpayers to benefit from an intellectual property regime to the extent that they can link the proportion of income that stems from the intellectual property to the proportion of expenditures incurred, such as on research and development (either by the taxpayer itself or by outsourcing it to a third party, i.e., qualified research and development activities) (OECD, 2017; Sanz Gomez, 2015, pp. 18–19).

The modifications of these aforementioned original nexus rules include the following three main changes. The first one in particular has reduced the likely effectiveness of the rules. In the first change, up to 30 per cent uplift of qualifying expenditures can be considered in determining the nexus ratio in limited circumstances. To determine the share of profits eligible for privileged patent box taxation, this additional 30 per cent allows companies to more easily obtain the whole patent box tax reduction without having to incur all expenditures for its development in the jurisdiction of the patent box. For example, if a company has developed a patent for a total cost of US$1.3m and it can demonstrate eligible expenditure costs for the development of this intellectual property of US$1m within the same jurisdiction, it can add an additional US$300,000 of costs (i.e. 30 per cent) that may be provided as inputs to the intellectual property development by another company abroad in the same corporate group “[…] without losing the right to receive the whole benefit” (Sanz Gomez, 2015, p. 24).

The second change to the original nexus approach set 30 June 2016 as the last date to introduce new entrants to patent box regimes that were not consistent with the nexus approach. Third, a grandfathering provision for existing non-compliant intellectual property regimes was implemented by setting 30 June 2021 as the last date by which benefits under those regimes could be claimed. As of May 2019—the launch of the Corporate Tax Haven Index—in cases where a jurisdiction introduced grandfathering rules that enable companies which entered the regime earlier to continue benefitting from the old patent box regime (without nexus constraints) until 30 June 2021, the preferential regime is still available and assessed as such.

The OECD nexus approach may be seen as a step in the right direction by at least preventing the use of trademarks and brands for legitimising profit shifting into patent boxes. However, the constraints set out by the approach are not sufficient to prevent the abuse of patent boxes as part of tactics in base erosion and profit shifting and may have even served to legitimise a race to the bottom (Diaz, 2019). This is because profits from the use of patents are taxed at a lower rate, and the amount of qualifying profits may be unlimited (Shaxson, 2014a). Further, implementing and enforcing the nexus requirements are obstacles which are near impossible to overcome in order to prevent the abuse of patent boxes for inward profit shifting. Not only does the patent box jurisdiction have little incentive to reduce the attributable profits to the patent box, but also the criterion for demonstrating “substantial economic activities” as a condition for profit attribution can be met easily by ticking the right boxes or following professional advice.

Governments will need to make sure that national rules comply with the agreed standard and that tax authorities are able to trace which of the expenditures is considered as “qualifying expenditure” (Shaxson, 2014b). This may be an invitation for disastrous sweetheart deals (Cobham, 2014)  as were disclosed in the Lux Leaks revelations (ICIJ, 2014) and the European Commission’s decisions on illegal state aid from countries including Ireland, Luxemburg and the Netherlands (cf. European Commission, n.d.). Furthermore, as long as thresholds set by any nexus rules permit entitlement to full tax benefits, the amounts of profit to be attributed to the patents can be easily manipulated under the existing indeterminacy of transfer pricing rules. Therefore, the abuse of patent boxes with a nexus constraint can hardly be prevented. Nonetheless, we acknowledge that the nexus approach has so far only been implemented for a short period and there is not enough robust evidence and studies to confirm our arguments for its inadequacy.

In acknowledging the lack of empirical validation of the nexus’ rules inefficacy, the Corporate Tax Haven Index reduces the haven score by 10 for jurisdictions that offer patent box regimes in line with the OECD nexus approach. A haven score of zero for this indicator is provided only if the jurisdiction has not introduced any patent box regime at all. A haven score of 100 is given if the jurisdiction offers a patent box regime without OECD nexus constraints or if the patent box regime is irrelevant for the jurisdiction in cases where a jurisdiction imposes no corporate income tax or a zero statutory tax rate. As presented in Figure 8, in Africa, five jurisdictions do not have preferential patent box regimes, while Mauritius, Seychelles and Botswana have these in place. Here, it is evident again that the responsibility for addressing tax avoidance risks primarily lies with OECD and EU countries.

Figure 8. Haven Indicator 7: Patent Boxes

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## *Transparency*

The category on transparency in the Corporate Tax Haven Index consists of six haven indicators that probe whether corporations and governments are able to hide their financial affairs and decisions regarding taxation, such as unilateral tax rulings and tax court proceedings and rulings, and if companies are required to file their accounts and make them publicly available. In addition, regulations for public and local country by country reporting are assessed because jurisdiction-level breakdown of activities, declared profits and taxes paid enable tax authorities to mitigate tax avoidance risks and provide data to the public to hold both large multinational companies and tax administrations to account. The haven score for this category is the arithmetic average of the six indicators. As Figure 9 shows, African countries on average have a very high haven score in this category, although scores in the EU and the OECD and their dependencies are elevated as well.

Figure 9. Corporate tax haven scores for Africa and averages – Category 3: Transparency

Figure 10 shows the performance of African countries for each indicator compared to the OECD and the EU. African countries perform worse than the OECD and the EU on the indicators for publicity of company accounts, country by country reporting and local filing of country by country reporting. No African country ensures all company accounts are published online for free, and only Ghana and Mauritius require all companies to submit annual accounts to a public authority. Furthermore, there are no regulations on country by country reporting for multinationals companies headquartered within their borders to publish country by country reports, and there are no robust local filing obligations for subsidiaries of multinational companies operating in their country. As for the reporting of tax avoidance schemes, haven scores for the OECD and the EU are as high as the African average. South Africa is the only country that requires taxpayers to report tax avoidance schemes they have used and tax advisers to report tax avoidance schemes they have marketed or sold. No African countries require taxpayers or advisers to report uncertain tax positions for which reserves have been created in annual company accounts.

For tax court transparency and the publication of tax rulings and disclosure of extractive industries contracts (where applicable), on average the haven scores of African countries are slightly lower than in the other indicators of this category, yet still higher than its average in categories 1 and 2. Secrecy in unilateral tax rulings and extractive industries contracts may enable governments to deviate from the rule of law, going beyond their legal mandate, and for these actions to go undetected. As such, administrations may enter “odious contracts” in the extractives that may be “against the interests of the people, without their consent, and with the full awareness of the creditor” (Le Billon, 2008, p. 5). The risks to the tax base of other jurisdictions as a result of the non-publication of tax rulings is that they may not be noticed and remain unchallenged by tax administrations (Ates et al., 2020). Contract disclosure in the extractive industries is important for the enforcement and oversight of the rights, revenue collection and responsibilities of parties to a contract. The positive spillover effects of disclosure include “exposing harmful treaties to public scrutiny thus reducing the likelihood of entering into future harmful treaties and, second, by providing additional contextual information for analysis of the tax affairs of multinational companies, especially for the interpretation of country-by-country reporting” (Ibid. 2020, p. 393).

*Figure 10. Comparison of Transparency Indicators for African countries, EU and OECD*

## *Anti-avoidance*

In the fourth category of the Corporate Tax Haven Index, the anti-avoidance measures that jurisdictions put in place to constrain base erosion and profit shifting by multinational companies are examined (Ates et al., 2020). Some jurisdictions may intentionally not limit these practices as they seek to attract profit-shifting activity; in other cases, it may be a matter of jurisdictions not updating and ensuring the right policies are in place to address harmful tax practices. The arithmetic average of five indicators make up the anti-avoidance score. In this category, the rules limiting deductions for interest, service payments and royalties from the corporate tax base are considered alongside domestic withholding tax rates applied on dividends and controlled foreign company rules.

Figure 11. Corporate tax haven scores for Africa and averages – Category 4: Anti-avoidance

Just as all regions received high haven scores in category 3 on transparency in the Corporate Tax Haven Index, high haven scores are observed across regions for the fourth category on anti-avoidance measures as shown in Figure 11.

Again, the African average is higher than the average in the OECD and EU blocks, even when their dependencies are included. When focusing on individual anti-avoidance policies and indicators, some heterogeneity becomes visible. As shown in Figure 12, the average haven scores in Africa are similar to the averages of the OECD and the EU on the indicators for withholding taxes on dividends and deduction limitation for interests, royalties and service payments. However, African jurisdictions perform significantly worse than the OECD and the EU on the indicator for controlled foreign company rules.

Figure 12. Comparison of Anti-Avoidance Indicators for African countries, EU and OECD

Most of the African countries also allow zero per cent withholding taxes on outbound dividend payments under certain scenarios. These payments are made by a subsidiary of a multinational enterprise to its headquarters or intermediate holding in another jurisdiction. Only Liberia and Tanzania impose a withholding tax, but only at five per cent. The withholding tax rate on dividends influences cross-border tax planning opportunities and can play an important role in countering tax avoidance especially in lower income countries (van’t Riet & Lejour, 2014). The level of withholding taxes, along with the level of corporate income taxation and tax treaties, are used as parameters by multinational corporations to determine which countries are used as investment platforms in repatriation strategies, acting as conduit countries (Loretz et al., 2017, p. 33).

Controlled foreign company (CFC) rules allow countries to tax the foreign profits of locally-based headquarters and its controlled foreign affiliates where they have generated profits in corporate tax havens or secrecy jurisdictions and this income has not been taxed properly or at all. Only South Africa and Tanzania have some form of CFC regulations, although Tanzania’s rules follow the weakest version of CFC rules by relying mainly on the arm’s length principle. Deduction limitation rules for interest, royalties and service payments are weak across African countries. Deductions enable multinational companies to reduce their local taxable income.

Research shows that developing countries are prone to the erosion of their tax base through outbound intra-group interest payments because of their dependence on FDI, which is mostly financed by loans (Ault & Arnold, 2017, p. 11).[[14]](#footnote-15) The absence of rules limiting the deduction of royalty payments for intellectual property or intangibles between intra-group companies from the corporate income tax base put countries at great risk, especially when considering the proliferation and legitimisation of patent boxes through the OECD’s modified nexus rules (see 3.2). As Figure 13 shows, the majority of African countries do not limit the deduction of intra-group royalty payments; the case of South Africa is described below. Nevertheless, the average haven scores of OECD and EU countries and their dependencies are even higher in this indicator than African countries’ average score.

Figure 13. Haven Indicator 16: Deduction limitation for royalties

Royalties are payments for the right to a temporary use of intellectual property (Ault & Arnold, 2017, p. 44).[[15]](#footnote-16) Similar to interest payments, royalties are normally considered deductible expenses for the taxpayer and are often abused by companies that engage in profit shifting to reduce their taxable profits. When a company that deducts royalties from its income is based in a high tax jurisdiction and its subsidiary that receives the royalties is in a low (or zero) tax jurisdiction or in a country with a patent box, then the multinational company may end up paying very low or no tax. This is because the deduction of royalties lowers the tax base of the payer company in the high tax jurisdiction while very low or no tax is levied on the royalties’ income in the jurisdiction of the receiving payee. Such cross-border royalty payments result in significant base erosion and profit shifting and have become increasingly prevalent given the large sums that multinational companies claim to derive from the exploitation of intellectual property (HM Revenue & Customs, 2016, p. 4). As discussed earlier, this is of particular pertinence in the increasingly digitalised economy.

The risk that royalty deductions will erode the tax base is of primary concern in cases where a tax treaty limits the taxing rights on royalties in the payer’s jurisdiction. The payer’s country where royalties are deducted is more exposed to risks of base erosion and profit shifting than the payee’s country. In addition, mismatches between the characterisation of a transaction involving royalty payments under the domestic law of two countries may enable taxpayers to structure hybrid transactions to exploit these mismatches (Ault & Arnold, 2017, p. 44). The arm’s length principle requires that royalties should be tax deductible only up to the arm’s length price. However, in many cases this does not limit the scale of profit shifting. This is because no comparable transactions between unrelated parties exist for royalty payments given that these payments are usually related to intangible property which can be argued to be unique and thus not comparable (Centre for European Economic Research, 2013, pp. 4–5).

The OECD does not recommend a specific limitation rule for the deduction of outbound intra-group royalty payments. Nevertheless, some countries have already adopted measures to limit the deduction of intra-group royalty payments related to intellectual property regimes. For example, in Germany, new legislation—Act against Harmful Tax Practices with regard to Licensing of Rights of 2 June 2017—has resulted in the introduction of a new provision, Sec. 4j of the Income Tax Act (Ditz & Quilitzsch, 2017, p. 823). The provision limits the deductibility of royalty payments at the level of the licensee only in cases where the corresponding royalty income is paid to a preferential regime that is not in line with the OECD nexus approach (Heinemann et al., 2017, p. 40). All other license payments remain fully deductible.

Another approach to limit the deduction of intra-group royalty payments has been introduced by South Africa. If the intellectual property was developed in South Africa, intra-group royalty payments are allowed only if a withholding tax rate of at least 10 per cent is applicable. In case of a 10 per cent withholding rate, one-third of intra-group royalty payments can be deducted, while half of the intra-group royalty payments can be deducted when the withholding tax is 15 per cent (Hattingh, 2019). Yet the condition to demonstrate that intellectual property was developed in South Africa is restricting this provision’s applicability to situations where the OECD’s nexus requirements are fulfilled in South Africa.

As these requirements cannot be fulfilled simultaneously in more than one jurisdiction for one single intangible asset without risking a dispute over the taxing right, the rules are likely applicable mainly to payments made to patent boxes which are not compliant with OECD nexus requirements. Several countries have gone further and introduced rules that limit the deductibility of intra-group royalty payments regardless of whether the intellectual property regime complies with the nexus approach.

For example, Ecuador limits intra-group royalty payment deductions up to 20 per cent of the taxable base and up to 10 per cent of the asset value in cases where the company is in a pre-operational stage provided there is a taxable income (Guerra, 2019). In Rwanda, a new provision, which came into force in April 2018, limits the deduction of royalties paid by local companies to their related non-resident companies to two per cent of their turnover (Law No 016/2018 of 13/04/2018 Establishing Taxes on Income, 2018, sec. 26(9); Niwenshuti, 2019). Tanzania also disallows any deductions for royalty payments for the purpose of calculating the taxable income of a company conducting extractive activities (Logunov, 2018).The United States has also recently introduced an alternative way to limit intra-group royalty payments regardless of the nexus approach. The Tax Cuts and Jobs Act of 2017 introduced the base erosion and anti-abuse tax in order to disallow excessive deductible payments (including interest, royalties and management fees) made by certain US firms to related non-US firms (Morse, 2018). The base erosion and anti-abuse tax is a minimum tax that is imposed at a rate of 10 per cent[[16]](#footnote-17) on certain taxpayer’s modified taxable income (Baker Mckenzie, 2018, pp. 17–18), calculated by adding back most categories of related-party deductible payments (Morse, 2018).

These measures are a significant step in curbing profit shifting by certain taxpayers, but they remain open to abuse by multinational companies for tax avoidance purposes. One difficulty in implementing these measures is that tax authorities require significant resources to examine whether there is sufficient evidence for the contribution of the related parties to intellectual property development. The evidence will often be submitted only upon the request of tax administrations. As such, due to capacity constraints of tax administrations, it is likely there will be many cases where the deduction of intra-group royalty payments will not be prohibited by the tax administration only because they did not manage to assess the specific tax file.

Lastly, the question of whether the deduction of a specific royalty payment is in line with the nexus approach (or similar approaches), and hence justified, is often not clear. Thus, the decision may be subject to the arguments of the multinational companies’ lawyers and accountants or to the discretion of a tax inspector, both of which may lead to an unfair, unlevel playing field. For all of the above reasons and the high risk of base erosion and profit shifting as a result of a deduction of royalties paid to non-resident group affiliates, the ideal approach would be to completely disallow the deduction of these payments rather than to limit the deduction.

The Corporate Tax Haven Index considers jurisdictions that apply no limits on the deduction of intra-group royalty payments as corporate tax havens and they receive a score of 100. The haven score of a jurisdiction is reduced to 75 if the jurisdiction applies a deduction limitation or disallows certain intra-group royalty payments for intangible and intellectual property only if they are not compliant with the OECD nexus rules (“restricted nexus”), as explained above. The haven score is further reduced to 50 if a jurisdiction applies a deduction limitation or disallows certain intra-group royalty payments irrespective of whether the intellectual property regime complies with the OECD nexus approach (“restricted tight”(. A zero haven score is granted if a jurisdiction does not permit any deductions of intra-group royalty payments whatsoever. Consequently, as presented in Figure 13 above, only South Africa and Tanzania have reduced haven scores.

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## *Double tax treaty aggressiveness[[17]](#footnote-18)*

When a multinational enterprise based in one jurisdiction invests in or earns income in another jurisdiction, the question arises as to which jurisdiction gets to tax the income. Double tax treaties were designed to address the problem of double taxation by determining how cross-border payments get taxed, by which jurisdiction and at what rate. However, desperate for FDI, many developing countries have given away their taxing rights in negotiating tax treaties that override domestic tax laws and impose very low or zero tax rates. They also often include other weaknesses that allow multinationals to reduce their tax bill (Hearson, 2018). Beyond typically reducing the withholding tax rates on payments of investment income (dividend, interest and royalties), treaties may also reduce source taxing rights by constraining the definition of permanent establishments and capital gains taxation (Hearson, 2016; Millán-Narotzky et al., Forthcoming). Revenue losses arise often in developing countries where the genuine economic activity is taking place. Treaty shopping exacerbates these losses, whereby multinational companies exploit the vast network of treaties negotiated by corporate tax havens and “shop” around to find the lowest taxed route for payments by adjusting their corporate subsidiary structure across jurisdictions and by creating conduit companies (Beer & Loeprick, 2018; Weyzig, 2013).

This fifth category in the Corporate Tax Haven Index consists of one indicator which assesses the impact of a jurisdiction’s network of double taxation agreements on the withholding tax rates in interest, dividend and royalties in treaty partner jurisdictions. It measures how aggressive a jurisdiction’s treaty network is on average in pushing down the withholding tax rates in partner jurisdictions. It does this by comparing the analysed jurisdiction’s withholding tax rates with each treaty partner’s average withholding tax rates across the total treaty network. Tax treaties create a special tax regime for multinational companies within national law and, as Picciotto writes, they are powerful because of the limitations they place on host state sovereignty to tax foreign investors and the enforceable legal rights they create at the national level upon incorporating the treaty into domestic law (2019, p. 8).

In Africa, Mauritius and South Africa stand out with their aggressive double tax treaty networks, as shown in Figure 14. Mauritius, in particular, has been negotiating very aggressive treaties. In an analysis of the Kenya-Mauritius tax treaty in the first edition of this journal, Picciotto argues that “Any benefits to Mauritius are also highly disproportionate to the damage they cause to other countries. Essentially, this amounts to providing facilities that enable an MNE [multinational enterprise] to avoid tax in countries such as Kenya where they have substantial activities, in exchange for the creation of a few relatively well-paid professional service jobs in Mauritius. This can fairly be described as a beggar-thy-neighbour policy. Yet by signing this treaty Kenya would be accepting or even colluding in this policy” (2019, p. 16). Given the risks posed by Mauritius’s double tax treaty network, in June 2019, Senegal announced it would cancel its treaty with Mauritius to stop the associated revenue losses (Orbitax, 2020). Our analysis of that cancelled treaty confirms its highly aggressive revenue reduction potential. Senegal’s treaty withholding tax rates are above 10 per cent on average for all types of income, but its treaty signed in 2002 with Mauritius, effective as of 2005, accorded zero per cent withholding tax for all payments. With these very aggressive treaty rates, Mauritius had reduced the tax base of Senegal and sent a signal to multinational corporations that Mauritius is an advantageous hub to shift profits out of Senegal.[[18]](#footnote-19)

Figure 14. Corporate tax haven scores for Africa and averages - Category 5: Double tax treaty aggressiveness

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# CONCLUSION

Corporate tax rules undermine the ability of African governments to raise revenue to finance public expenditure. As the Corporate Tax Haven Index reveals, African nations are on average more exposed to tax avoidance risks than responsible for creating these risks, especially compared to higher income regions. When focusing on the details of the tax avoidance risk categories and policies, we find substantial heterogeneity in the relative performance across political and geographic groupings. Figure 15 shows how African nations have less aggressive treaty networks, have protected higher corporate income tax rates and have fewer loopholes and gaps in their taxation systems that facilitate profit-shifting activity and the race to the bottom in corporate taxation. Yet in the categories of anti-avoidance and transparency, African countries are performing below the average of the OECD and the EU.

Figure 15. Comparison of five corporate tax haven categories for Africa, the EU and OECD

The individual policy categories and indicators in the Corporate Tax Haven Index indicate concrete policies and steps African nations can take unilaterally in order to address tax avoidance across all sectors and to improve taxation particularly in the digital economy. For example: improvements in transparency will assist African tax administrations in prioritising and conducting audits of multinational companies with local subsidiaries and build trust with citizens. This includes requiring all companies to submit accounts and for these to be freely available online, to file country by country reports locally in all cases, and to report tax avoidance schemes or uncertain tax positions. Public access is vital; tax courts and decisions, any unilateral tax rulings issued and contracts for mining and petroleum projects should all be freely accessible to the public. Anti-avoidance measures can be improved to reduce the risk of base erosion and profit shifting. Robust controlled foreign company rules and withholding taxes on outbound dividends can act as a backstop for shifting untaxed profits to secrecy jurisdictions and zero tax havens.

Deduction limitation rules could be introduced or strengthened to prevent multinationals from deducting interest, royalties and certain service payments from their tax base if paid to other members of the same multinational. Any upcoming trade agreement on the African continent should ensure that such defensive measures remain compatible with the trade regime and regulations. The Rwandan and Tanzanian examples of limiting the deduction of outbound royalties are cases that warrant close examination by African peers. At the same time, African nations should withstand the false lure of introducing patent box regimes themselves, and consider appropriate reactions to countries that do, including Botswana, Mauritius and the Seychelles.

Beyond the domestic reform efforts, the Corporate Tax Haven Index underlines the important differences between members of the OECD and the EU, and the African countries included in the sample. These differences suggest that Africa so far is less engaged in a ruinous race to the bottom in corporate taxation than the OECD and the EU. Yet the stakes are high for African countries as their development rests on revenue mobilisation particularly from corporate income taxation (Oguttu, 2016).

Our findings underline the need for vigilance in the current negotiations in the “BEPS 2.0” process around the reform to the taxation of multinational companies under the inclusive framework of the OECD (Cobham, 2019; OECD, 2019b). The preference of OECD members for lenient corporate income tax rules, as documented in many of the haven indicators of the Corporate Tax Haven Index, is likely to influence, if not determine, the negotiation strategies of many member states. This may side-line more ambitious proposals for comprehensive reforms, such as those made by the Intergovernmental Group of Twenty-Four (G24), comprising developing countries, including 11 African countries, and by the Independent Commission for the Reform of International Corporate Taxation (ICRICT) (G24, 2019; ICRICT, 2019; Tax Justice Network, 2019). Preliminary analysis of the 2019 OECD pillar one proposal under the BEPS 2.0 process to reallocate taxing rights to market jurisdictions indicates little benefit to non-OECD countries and may even result in reduced revenues compared to the current standing for a number of lower income countries (Cobham et al., 2019).

In these negotiations under the Inclusive Framework, unitary taxation with formulary apportionment has become the leading alternative to the arm’s length approach to taxing the digital, if not the entire economy. The unitary approach is arguably the most promising alternative to replace the current global tax rules which have not kept up with the globalised or digitalised economy and have resulted in vast profit shifting and base erosion. Due to the arm’s length approach, there is massive misalignment between the location of multinational companies’ genuine economic activity and where their profits are declared for tax purposes (Cobham, 2017). The unitary approach has the potential to vastly improve the taxing rights of African countries if the factors for apportioning the profits of a multinational corporation take into account not only sales and consumption, but also production and employment. However, these more ambitious proposals have been ignored and replaced by an agreement reached in an exclusive manner between the US and France (Cobham, 2020b).

To prevent and pre-empt jurisdictions competing for the relocation of multinational activity by reducing corporate tax rates and the accompanied distortionary effects, global formulary apportionment would be best served with a minimum rate for taxing apportioned profits (ICRICT, 2018, p. 8). Pillar two of the current OECD BEPS 2.0 reform proposals endeavours to establish such a global minimum rate. Yet the approach taken is highly complex and fraught with similar challenges for lower income countries as pillar one. The effectiveness of rules would depend on the feasibility of devising a robust and unambiguous effective tax rate test and might “hinge ultimately to a large extent upon administrative capacity in the jurisdiction that wishes to challenge low taxation in another state” (Tax Justice Network, 2019a, pp. 9–11). Due to the likely ambiguity of an effective tax rate test, there is a risk of low taxation resulting from harmful tax regimes being detected and countered mainly in lower income countries, while leaving more sophisticated corporate tax havens alone.

Earlier attempts to introduce unitary taxation, first at the League of Nations almost a century ago were thwarted. At the first OECD BEPS project that commenced in 2013, this alternative was kept off the table by major actors insisting on applying and retaining the arm’s length principle (Tax Justice Network, 2019a). There are signs that the interests of developing nations and the African continent are being undermined once again under BEPS 2.0, especially since there are no African nation members in the OECD and perceptions of fairness in determining tax rules differ (Burgers & Mosquera, 2017). As conflicts over the distribution of taxing rights have arisen between OECD members and non-members, more inclusive fora, such as the Inclusive Framework on BEPS that involves 80 developing countries, appear to be relegated to footnotes or ignored (Cobham, 2020b; G24, 2019, p. 24), and the process and ensuing new rules will lack legitimacy (cf. Mosquera, 2018). Therefore, African countries may consider if their interests would be better served through the globally representative United Nations system (ICRICT, 2019), specifically the new United Nations High Level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda (2020), and a novel convention at the United Nations to counter illicit financial flows, including from multinational companies (Meinzer, 2019).

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2. Nine of the 64 jurisdictions covered in the Corporate Tax Haven Index are African. They were selected for inclusion in the Corporate Tax Haven Index because of their prior coverage in the Financial Secrecy Index 2018 (Tax Justice Network, *Financial Secrecy Index 2018 - Methodology* (London, 2018) <https://www.financialsecrecyindex.com/PDF/FSI-Methodology.pdf> [accessed 14 February 2018]). [↑](#footnote-ref-3)
3. Dependencies assessed in the Corporate Tax Haven Index 2019 include the overseas territories and crown dependencies of the United Kingdom and dependencies of the Netherlands. In alphabetical order, these are: Anguilla, Aruba (NL), Bermuda, British Virgin Islands, Cayman Islands, Curacao (NL), Gibraltar, Guernsey, Isle of Man Jersey, Montserrat, and Turks and Caicos Islands. [↑](#footnote-ref-4)
4. This section draws extensively from Tax Justice Network, 2019b. [↑](#footnote-ref-5)
5. For a detailed discussion of the formula combining the two components, see Ates et al., forthcoming, pp. 137–138 and Tax Justice Network, 2018, pp. 158–198. [↑](#footnote-ref-6)
6. The CTHI Value is calculated by multiplying the cube of the Haven Score with the cube root of the Global Scale Weight. The final result is divided through by one hundred for presentational clarity. [↑](#footnote-ref-7)
7. The CTHI Share is calculated by summing up all CTHI Values, and then dividing each countries CTHI Value by the total sum, expressed in percentages. [↑](#footnote-ref-8)
8. The Haven Score is calculated based on 20 indicators. For full explanation of the methodology and data sources, see Tax Justice Network, 2019b.   [↑](#footnote-ref-9)
9. The Global Scale Weight represent a jurisdiction's share in global foreign direct investment (inward and outward). For full explanation of the methodology and data sources, see Tax Justice Network, 2019b.   [↑](#footnote-ref-10)
10. This section draws on Tax Justice Network, 2015, 2019d, p. 10. [↑](#footnote-ref-11)
11. While the Global Business Companies (GBC2) regime was abolished in 2018, GBC2 issued on or before 16 October 2017 will be valid until 30 June 2021, and are thus still in place at the time of this assessment (Veerasamy, 2019). [↑](#footnote-ref-12)
12. For further information, see Tax Justice Network, 2019i. [↑](#footnote-ref-13)
13. This section draws from Tax Justice Network, 2019e. [↑](#footnote-ref-14)
14. As we noted above, applying limitations on interest payments of standalone entities rather than at a group ratio level also carry base erosion and profit shifting risks, see OECD, 2015c, p. 19. [↑](#footnote-ref-15)
15. This section draws from Tax Justice Network, 2019f, p. 16. [↑](#footnote-ref-16)
16. Note that the minimum tax will be increased to 12.5 per cent as of 2026 and was temporarily set to 5 per cent for 2018. [↑](#footnote-ref-17)
17. This section draws from Tax Justice Network, 2019g. [↑](#footnote-ref-18)
18. For a more in-depth discussion on double tax treaty aggressiveness in and affecting Africa in the Corporate Tax Haven Index, see, Millan-Narotzky et al., Forthcoming. [↑](#footnote-ref-19)