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# DOUBLE TAXATION AGREEMENTS AND THEIR RELEVANCE FOR DEVELOPING COUNTRIES ON THE AFRICAN CONTINENT

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Abstract

Double Taxation Treaties have been developed and primarily used as a mechanism to remove double taxation between two independent states. With the onset of increased international or cross border trade it has become critical that governments engage in initiatives to avoid double taxation. African states have not been excluded from this phenomenon, as cross border trade and investment has been seen as a source of economic development for poor African states, and it is for this reason that the development or perhaps expansion of the tax treaty regime is a priority in Africa[1]. However, given the tax abuses that have beleaguered tax treaties and resulted in tax leakages, coupled with the fact that some tax treaties favour developed rather the developing states.

The aim of this research report is to assess whether double taxation agreements are still relevant and whether these agreements provide any benefits for developing countries on the African continent. The research report will do this by reviewing the advantages and disadvantages of DTA's, including the impact of DTA's on Foreign Direct Investment and tax leakage on the African continent. The study will assess the different tax abuse's that have beleaguered DTA's. The research report will provide recommendations on how to deal with the current treaties in place and where there are no treaties what is the best course of action .

The research methodology of this study will follow an analytical approach. This will be achieved by reviewing and analysing Secondary Data, such as Tax Treaties, research reports, textbooks, websites and opinions in articles to determine if double taxation agreements are still relevant and provide any benefits for developing countries on the African

[1] Chrisa Onyejekwe, 2018. *Rebalancing Double Tax Treaties in favour of African States in Rebalancing International Investment Agreements in Favour of Host States*. United Kingdom: Wildy, Simmons and Hill Publishin

continent. The research report will conclude by providing recommendations on how to deal with the current treaties in place and where there are no treaties what is the best course of action. This will be based on the analyses and interpretation of the secondary data.

**Key words:** “double taxation agreements”, “relevance”,”delevoping” “african continent”.

## 1. Introduction

There has been significant appropriation, of double taxation agreements. A vast array of literature indicates that there are about 3000 comprehensive tax treaties that are in effect worldwide. Quak and Timmis (2018), noted that about 1000 – 2000 of these agreements involve at least one developing country.

> ‘Braun and Zagler (2018) opined that a DTT between a developing and an industrialized economy is most likely asymmetric, having a larger flow of capital towards the developing and a larger opposing flow of capital revenues towards the industrialized economy than the other way around. In particular, asymmetric tax treaties inevitably reduce the tax base of developing countries, so that we can and should expect some form of compensation from the industrialized to the developing economy in case a treaty comes into effect.’

Developing Countries on the African continent have been known to use tax treaties as a means of attracting foreign direct investment. Double taxation agreements have been proned to many forms of tax abuse. According to Hearson there is growing attention on the question of tax treaties signed by developing countries. The costs of tax treaties to developing countries have been highlighted in recent years by NGOs such as ActionAid and SOMO (2015). During 2014, an influential IMF paper warned that developing countries would be well-advised to sign treaties only with considerable caution, and the OECD, as part of its Base Erosion and Profit Shifting (BEPS) project, proposes to add text to the commentary of its model treaty to help countries decide whether a treaty should be concluded with a State but also, whether a State should seek to modify or replace an existing treaty or even, as a last resort, terminate a treaty.

Research Question

It is against this backdrop that this research report seeks to asses whether double taxation agreements are relevant to countries in the African Continent? The paper will do so considering the following related questions.

Subproblem

1. The conceptual nature of Double Taxation agreements and model treaties.
2. What are the advantages and disadvantages or the different model conventions
3. Do double taxation agreements increase in foreign direct investments given that countries on the African Continent place a great reliance foreign capital ?
4. Are double taxation agreement prone to certain tax abuses ?
5. Have double taxation agreements resulted in tax losses/revenue leakage for countries on the African Continent?

Research Methodology

These questions will be addressed by following an analytical approach. Secondary data such as tax treaties, research reports, textbooks, websites and opinions in articles will be reviewed and analysed, to determine if double taxation agreements are still relevant and provide any benefits for developing countries on the African continent. The study will conclude by providing recommendations on how to deal with the current treaties in place and where there are no treaties what the best course of action is.

International trade has long been a reality since the 5$^{th}$ century AD, where Asian silk products appeared in the European markets. True globalization and international trade gained momentum in the 19$^{th}$ century in what is known as the phase of the First Industrial Revolution. This wave of International cross

border trade often gave raise to double taxation. The OECD defined double taxation as the imposition of comparable taxes in two or more States on the same taxpayer in respect of the same subject matter for identical periods.[2]

Bilateral Tax Treaties have been in existence for some time in different forms.

In 1872, Great Britain and Switzerland (Canton of Vaud) concluded an Agreement (the 1872 Agreement) for the prevention of double taxation in respect of death duties. The 1872 Agreement holds a significant place in tax treaty history as, according to the records of the League of Nations and the United Nations, it is the first agreement between countries which solely and directly addresses the issue of double taxation, albeit in a limited manner.[3]

According to Arburtunia and Kovacevic, "in 1889, the first international conventions on avoiding of double taxation (double taxation convention(s), hereinafter: DTC, DTCs) were concluded in what is now Germany, as treaties between certain component states of Prussia. The first Bilateral Tax Treat (BTT) or what is commonly referred to as Double Taxation Agreement was entered into by Prussia and Austria in 1899. A Double Taxation Agreement was concluded between Hungary and Austria in 1909. However, few Double Taxation Agreements were entered into from then until the 1920s, when after World War I Germany embarked upon forming a number of Double Taxation Agreements with its neighbours."[4]

Tax treaties have since developed and been primarily used as mechanism to remove double taxation between two independent states. With the onset of increased international or cross border trade it has become critical that

[2] OECD 1977. Model Double Taxation Convention of Income and Capital

[3] Sunita Jogarajan (2012). The Conclusion and Termination of the "First" Double Taxation Treaty. British Tax Review, Volume 3, 2012

[4] Hrvoje Arburtunia and Ntasa Zunic Kovacevic (2014). The History of double taxation conventions in Croatia. *Financial theory and practice*, 38 (2): 221-245

governments engage in initiatives to avoid double taxation. If this was not the case entities or natural person who engage in cross border trade would be taxed in their country of residence and by the source country, as a result of this additional tax burden this would negatively impact their profits and make such cross-border activities less attractive. There are other purposes that double taxation agreements fulfil.

Whilst there are many model treaties that have been developed, tax treaties are predominately predicated on two models the OECD model which follows a residence-based approach and the UN model which is underpinned by source based approached. This underscores the incongruency in the requirements of the countries, as the developed nations prefer the OECD model as this allocates taxing rights to the residence, whilst developing countries prefer the UN Model as they are mostly capital importing, rather than exporting nations. There has been significant growth in the number of tax treaties that have been agreed and signed. A vast array of literature indicates that there are about 3000 comprehensive tax treaties that are in effect worldwide.

Quak and Timmis, noted that about 1000 – 2000 of these agreements involve at least one developing country[5]. There is a school of thought that indicates that the international tax regime is one of inequality, where double taxation agreements are known to favour developed rather than developing countries. This holds true given two factors.

1) Double Taxation Agreements allocate taxing rights to one country by removing the taxing rights of another state. Whist most treaties are based on the OECD model which is a residence-based tax model this means

[5] Evert- Jan Quak and Hannah Timmis (2018). Double Taxation Agreements and Developing Countries. *K4D Helpdesk Report. Brighton, UK: Institute of Development Studies*

capital importing countries will forgo their taxing rights to Capital Exporting countries losing much needed tax revenue.

2) Double Taxation Agreements signed between country pairs with Asymmetric trade tend to ensure that one country is the net loser in the relationship which tends to be the capital importing country. This due to Foreign Direct Investment flowing out of the capital importer far outweighing the Foreign Direct Investment flowing from the same country to the capital exporter.

3) This poses a challenge because due to the Double Taxation Agreements that has been negotiated there is a reduction in the withholding tax charged which developing country largely depends on.

> Baker[6], put it this way the unbalanced Foreign Direct Investment flows between developed countries and LDCs, as they provide an opportunity for the developed country to shift tax revenue from the LDC to itself. By negotiating lower withholding taxes, there is a smaller foreign tax credit that the developed country needs to allow for against the domestic taxes levied on repatriated income, which increases the amount of tax that it collects. Even where the developed country uses an exemption mechanism over repatriated income, the lower withholding taxes allow for more income to be repatriated home, which creates the opportunity for greater tax on subsequent domestic income payments.

Developing Countries on the African continent have been known to use tax treaties as a means of attracting foreign direct investment and demonstrating to the international community that there is some degree of certainty in their tax laws, and they are evolving their strategy when comes to the international tax

[6] Paul. L. Baker (2014). An Analysis of Double Taxation Treaties and their Effect on Foreign Direct Investment. Int. J. of the Economics of Business, 2014 Vol. 21, No. 3, 341–377

system. There is no empirical evidence to suggest that entering into double taxation agreements does in fact attract foreign direct investments. A study by Neumayer on the impact on developing countries when they enter into Double Taxation Agreements with developed countries with regards to their ability to attract Foreign Direct Investment. The study found that by succumbing to the restrictions on their authority to tax corporate income from foreign investors typically contained in Double Taxation Agreements does have the desired payoff in terms of higher Foreign Direct Investment.[7]

Whilst tax treaties are so widely proliferated worldwide, they have been besieged by their own set of challenges, such as treaty shopping, rounding tripping, tax avoidance and evasion. Given the complexity of the schemes and that these schemes are mostly employed by sophisticated Multinational Corporation within the ambit of double taxation and the international tax regime, it has created a challenge for tax authorities especially those in developing countries, resulting in tax leakage. Plowgian, Riccardi and Mueller noted that "in 2013, the Organisation for Economic Co-operation and Development (the "OECD") and G20 published an Action Plan on Base Erosion and Profit Shifting (the "BEPS Action Plan") to strengthen international tax standards. 1 The BEPS Action Plan was driven by the perception that weaknesses in the current international tax rules and standards create opportunities for base erosion and profit shifting by multinational businesses and investors.2 Action 6 of the BEPS Action Plan identifies treaty abuse, and in particular treaty shopping, as one of the most important sources of BEPS concerns".[8]

[7] Eric Neumayer (2006). Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries? Journal of Development Studies, Vol. 43, No. 8, 1501–1519.

[8] Michael H Plowgian, Christopher A. Riccardi & Martin L. Mueller, Jr (2017) Treaty Benefits for Investment Vehicles in a Post-BEPS World: Part 1. Vol 14. Issue 4

Tax authorities on the African continent have struggled to counter these challenges and avoid tax leakages. According to Hearson “There is growing attention on the question of tax treaties signed by developing countries. The costs of tax treaties to developing countries have been highlighted in recent years by NGOs such as ActionAid and SOMO. During 2014, an influential IMF paper warned that developing countries would be well-advised to sign treaties only with considerable caution, and the OECD, as part of its Base Erosion and Profit Shifting (BEPS) project, proposes to add text to the commentary of its model treaty to help countries decide whether a treaty should be concluded with a State but also whether a State should seek to modify or replace an existing treaty or even, as a last resort, terminate a treaty”.[9]

Therefore, the objective of this research paper is to assess whether double taxation agreements are still relevant and whether they provide any benefits for countries on the African continent.

## 1.2 History of DTA’s

As stated in the preceding paragraph, double taxation agreements have been in effect since 19th century, in some shape or form. The first double taxation agreement was concluded between Britain and Switzerland in 1872, to prevent the double taxation of death. According to Jogorajan the British Government was concerned about the treatment of British subjects who had property in the Canton of Vaud at the time of death and who were being made subject to legacy or succession duties in Vaud on all of their property, not just property located in Vaud. The Cantonal authorities enforced the imposition of these duties by placing an embargo on any property located within the Canton. In some cases,

[9] Martin Hearson, (2015). Tax treaties in sub-Saharan Africa: a critical review. *Tax Justice Network - Africa, Nairobi, Kenya*: 2 – 34.

this practice proved particularly problematic as the executors of an estate could not enter property located within the Canton to determine if there were any testamentary documents located in the property. In 1872, Great Britain and Switzerland (Canton of Vaud) concluded an Agreement (the 1872 Agreement) for the prevention of double taxation in respect of death duties. The 1872 Agreement provides for relief from double taxation through co-ordinated exemption by both jurisdictions as the imposition of succession duties was limited to property situated within the jurisdiction.[10]

The above mentioned Double Taxation Agreement was rather a form of what was to come in terms of Double Taxation Agreement as its focus was mainly on taxes as result of death.

> According to Arburtunia and Kovacevic, in 1889, the first international conventions on avoiding of double taxation (double taxation convention(s), hereinafter: DTC, DTCs) were concluded in what is now Germany, as treaties between certain component states of Prussia. The first Bilateral Tax Treat (BTT) or what is commonly referred to as Double Taxation Agreement was entered into by Prussia and Austria in 1899. A Double Taxation Agreement was concluded between Hungary and Austria in 1909. After World War 1, the League of Nations initiated a project to develop a model tax treaty that could be used globally[11]. The League of Nations predated what we know as the United Nations today.

A group of economists, government officials and technical experts undertook a number of conferences to develop the model treaties. This effort resulted in the first model double taxation treaty in 1928. The model favored the allocation of taxing rights to the country of residence of the taxpayer. According to Arnold, these Model Conventions were not unanimously accepted, and the work of

[10] Jogarajan 2012: 284

[11] Arburtunia and Kovacevic (2014): 221-245

creating an acceptable model treaty was taken over by the OECD and, a few years later, the United Nations[12]. There were regional conferences held in the early 1940's in Mexico City that conference was attended by representatives from North and South America. The culmination of the conference produced what is to be known as the Mexico draft, this was a model treaty which predominantly assigned the taxing rights to the source country rather than the tax-payers country of residence.

The Mexico conference was followed by the London conference which produced what was called the London Draft, model convention in 1946. This model convention had a predisposition towards a residence-based tax allocation, moving the taxing rights to the resident country rather than the source, which was diametrically opposed to the position taken the Mexico draft.

According to Holmes, the Organisation for European Economic Cooperation (the OEEC) established a Fiscal Committee in 1956, which worked on a draft model bilateral DTA, which was intended to be acceptable to all member countries. In 1960, the OEEC transformed into the Organisation for Economic Co-operation and Development (the OECD).[13] Nowadays, the OECD is the predominant body driving international development of DTAs.

## 1.3 What is DTA

Double Taxation Agreements, are agreements that normally bilateral in nature and signed by two independent states. There are instances where double

[12] Brian. J Arnold 2016. *International Tax Primer*. Third Edition. Kluwer Law International

[13] Kevin Holmes 2014. *International Tax Policy and Double Tax Treaties, An Introduction to Principles and Application*. 2nd ed. Amsterdam: IBFD, 2014

taxation agreements take the form of multilateral agreements such as the East African Community agreement on double taxation, the parties to this specific agreement are Burundi, Tanzania, Uganda, Kenya and Rwanda. However, in the main most double taxation agreements are Bilateral in nature. Article 2 of the Vienna Convention on the law of Treaties states that a treaty is an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation (United Nations, 1969). Based on the definition as outlined in the Vienna Convention treaties can designated by any naming convention. Double taxation agreements are known as bilateral tax treaties, conventions or simply double taxation agreements.

## 1.4 Purpose of double taxation agreements

The primary function of tax treaties is in the case of international trade, to avoid the double taxation of foreign companies doing business in another jurisdiction. Without this intervention this will make international trade unattractive or uncompetitive. No company will have an incentive to trade in a foreign jurisdiction if this will result in the profits being eroded as result of the company being taxed in the residence and source country.

> Braun and Zagler put it this way undoubtedly, every double taxation treaty has a particular reason why it came into existence. The main motivations may vary, but typically include encouraging cross-border economic activity, preventing international tax avoidance and evasion, and, more generally, strengthening political ties with the partner country.[14] This stance aligns with the view from

[14] Julia Braun and Martin Zagler (2014). An Economic Perspective on Double Tax Treaties with (in) Developing Countries. *World Tax Journal*: 242 – 281.

> Rixen who stated that double taxation results from an overlap of jurisdiction to tax between a residence state, where the recipient of income lives, and a source state, where the income was generated. If both exert their power to tax to the full extent, the total burden on transborder economic activities is prohibitively high. In order to obtain the benefits of liberalization, governments have a common interest in avoiding such double taxation.[15]

Most tax systems of developed and some developing countries are based on the worldwide taxation principles, hence the residence of these countries being juristic or natural persons, these persons would have the burden of double taxation. This would stifle cross border trade, it is this negative impact and the opposed effect that double taxation agreements are trying to address.

There have been opposing opinions on the efficacy of tax treaties to encourage international trade.

> According Holmes, who opined that however, this belief has always been questionable, even during the era of the League of Nations. For example Sir Percy Thompson, a member of the Fiscal Committee, submitted the following resolution in 1930:That the prevalent view that an undesirable economic result, viz., the creation of an artificial barrier which impedes the free flow of capital into the channels in which it can be most usefully and profitably employed, is produced by double taxation is fallacious: that origin taxation is solely responsible for this undesirable economic result which would remain

[15] Thomas Rixen, (2008). The institutional design of international double taxation avoidance. *WZB Discussion Paper*, No. SP IV 2008-302, Wissenschaftszentrum Berlin für Sozialforschung (WZB), Berlin United Nations 1969 – Treaty Series vol 1155 p.331

unaffected if all taxes based on residence were everywhere abolished and in consequence double taxation ceased to exist.[16]

This holds true in the sense that double taxation agreements alone do not provide relief to entities or natural persons that engage in cross border trade. A fair majority of countries have what is called foreign tax credits built into their tax legislation, these foreign tax credits allow countries to reduce their worldwide taxable income in their country of residence by claiming credits for foreign taxes already paid. This in itself mitigates the impact of being taxed twice in relation to the same tax revenue.

Samantara also described and interesting methodology for tax relief outside of Double Taxation Agreement when she stated that Exemption involves an agreement in which two countries agree that incomes arising from different sources which are likely to be taxed in both the countries as per their respective income tax law should either be taxed in one of these two countries or that a specified portion of such incomes should be taxed by each country so that there is no overlapping taxation in this case. This kind of agreement results in a complete avoidance of double taxation of the same income in both the countries.[17]

Even though these opposing views exits tax treaties are in the main still viewed as tool to encourage cross border trade. Double taxation agreements are also seen as mechanism to allocate the taxing rights between two independent states. In addition to the motives put forward, tax treaties are designed to prevent tax avoidance and evasion. Arnold states that The OECD model Double

[16] Holmes 2014:39

[17] Rabinarayan Samantara 2020. International Double Taxation Relief Provisions in India: A Critical Analysis. VISION: Journal of Indian Taxation Vol. 7 (2), Jul-Dec 2020, pp. 45-58 doi: 10.17492/jpi.vision.v7i2.722038

Taxation Agreement (2010) addresses this anti-avoidance and evasion objective primarily in four articles:[18]

Article 7 - Business profits;

(Article 7 of the OECD Model) stipulates that when a company is resident in one state generates business profits in the other DTT partner country, the profits are only taxable in the first state. However, in the case where there is a PE (i.e., a substantial business presence through a fixed place of business or a dependent agent) in the other signatory country, this other country has the right to tax profits attributable to the PE.[19]

Article 9 - Associated enterprises;

This article deals with transactions that may be entered into by related party companies such as two subsidiaries within a Group or a parent and subsidiary. Whereas such transactions are not entered into at arms- length, the article stipulates the adjustments that can be made for tax purposes. The OECD – Commentary) model provides that the taxation authorities of the Contracting States may for the purpose of calculating the tax liability of an associated enterprise, re-write the accounts of the enterprise, if as a result of the special resolutions between the enterprises, the accounts do not show the true taxable profits of the enterprise. [20]

Article 26 - Exchange of information;

The (OECD 2017 – Commentary) states the article embodies the rules under which information may be exchanged to the widest possible extent, with a view of laying the proper basis for the implementation of the domestic laws of the

[18] Arnold 2016:6
[19] OECD 2017: C (7).1
[20] OECD 2017: C(9).1

Contracting states and the application of the specific provision of the Convention. With the increase in globalisation, it is important that there is a sharing of information between contracting states to ensure that the rules of the convention are being adhered to and more so that the domestic tax laws are being respected.[21]

Article 27 - Assistance in the collection of taxes.

The (OECD, 2017) states the contracting states shall lend assistance to each other in the collection of tax to the extent needed to ensure that any exemption or reduced rate of tax granted under this convention shall not be enjoyed by persons not entitled to such benefit.[22]

Another objective which is much more subtle reason and more prevalent in developing countries is the Double Taxation Agreements are seen to provide legal certainty for foreign entities or investors looking at investing in the host countries. Developing countries have also been known to use Double Taxation Agreements as tool to attract Foreign Direct Investments this is achieved by including preferential tax rights in the Double Taxation Agreements.

According to Kalizinje, Double Taxation Agreements are surprisingly used as tools of attracting Foreign Direct Investment by incorporating preferential tax rates and other incentives specifically applying to investors from contracting states. This trend is widespread among developing countries in Africa yet there is no tangible evidence to justify that this practice attracts Foreign Direct Invest and eventually lead to increase in Domestic Resource Mobilisation (DRM).[23]

[21] OECD 2017: C(26).1
[22] OECD 2017:C(29).1
[23] Frank Kalizinje,2020.The Dangers of Double Taxation Agreements in Development in Africa. *Tax Justice Network Africa*: 6 – 44

Samantara 2020 stated that Double Taxation Agreements also help in reducing harmful international tax competition from tax havens.[24] These tax treaties include certain regulations such as the permanent establishment rule, provisions against treaty shopping etc. which help in limiting the number of beneficiaries and reducing the opportunities for channelizing incomes through tax havens.

## 1.5 Conclusion

In this Chapter we explored the history of double taxation agreement, we unpacked what are double taxation agreements and the objective of double taxation agreements. It is clear from the evidence that double taxation agreements have been around for a significant amount time and their proliferation has increased substantially since inception.

> Rixen articulated the objective of Double Taxation Agreements as follows Double taxation results from an overlap of jurisdiction to tax between a residence state, where the recipient of income lives, and a source state, where the income was generated. If both exert their power to tax to the full extent, the total burden on transborder economic activities is prohibitively high.[25]

In the following chapter we will explore the model treaties, contents and objectives.

[24] Samantara 2020:51
[25] Rixen 2008:6

## 2. Model Treaties

Model treaties have been developed as a framework on which bilateral model treaties are based and have been used as starting point to negotiate bilateral tax treaty agreements. According to Holmes, there are two primary factors that led to the development of the model double taxation agreements. First, there was disagreement between countries as to the appropriate provisions to be inserted in bilateral double taxation agreements as a policy matter. Second, there was ambiguity of language selected in bilateral double taxation agreements to achieve the desired result.[26]

Countries are not bound to use all of the clauses or articles in the model treaties but can opt to select the points which are most pertinent. The important point about Model treaties is that they are not prescriptive and are not designed to interfere or override the domestic tax law. The most commonly used model treaties are the OECD and the UN Model treaty. There have been other tax treaties that have been developed across the world, as Benshalom (2010), opined in Africa alone, SADC (the Southern African Development Community), COMESA (the Common Market for Eastern and Southern Africa) and the EAC (the East African Community) have each developed their own model tax treaties.[27]

The OCED model treaty has been largely seen to favour capital exporting countries. This model is based on the residence tax system, whereby it assigns

[26] Holmes 2014:65

[27] Ilan Benshalom (2010). The new poor at our gates: Global justice implications for international trade and Tax law. New York University Law Review: 85: 1-82

the taxing rights to the resident country and requiring the source country to forgo their taxing rights. The OCED consists of predominately capital exporting countries. There are currently only 38 countries who are members of the OECD, the majority of which are developed countries. These countries being mostly comparable in terms of their development status and largely capital exporting in nature, thus the predisposition towards residence rather than source. There are not many developing countries in the OECD, therefore they did not adequately participate in the drafting of the OECD.

> Arnold, opined that the OECD Model Convention favours capital-exporting countries over capital-importing countries. Often it eliminates or mitigates double taxation by requiring the source country to give up some or all of its tax on certain categories of income earned by residents of the other treaty country. This feature of the OECD Model Convention is appropriate if the flow of trade and investment between the two countries is reasonably equal and the residence country taxes any income exempted by the source country. However, the OECD Model Convention may not be appropriate for treaties entered into by net capital-importing countries.[28]

This can also be aligned to Braun & Fuentes who stated that with respect to active business income, the double taxation treaty business profits provision (Article 7 of the OECD Model) stipulates that when a company resident in one state generates business profits in the other double taxation treaty partner country, the profits are only taxable in the first state. However, in the case where there is a PE (i.e. a substantial business presence through a fixed place of business or a dependent agent) in the other signatory country, this other country has the right to tax profits attributable to the PE. [29]

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[28] Arnold 2016:4

[29] Julia Braun and Daniel Fuentes 2016.The effects of double tax treaties for Developing countries. A case of Austria's double tax treaty network *Public Finance and Management Volume 16, Number 4, pp. 383-433 2016*

This is also the case when comes to passive income where the OECD Model Convention is clear that the residence country has the right to tax all forms of passive income. Royalties are taxable in the residence state the source state is granted limited taxing rights on elements such as dividends and interest payments. This will negatively impact developing countries who are so reliant on charging withholding taxes on these elements, as the Multinationals will expatriate their funds from developed countries via these methods of passive income.

This demonstrates the position of the OECD model highly leaning towards a residence rather than source form of taxation. This diminishes the taxing rights and results in revenue tax loss for the capital importing countries as the trade is mostly asymmetric between the developed and developing country.

Owing to the framework of the OECD model and its predisposition towards the residence tax, developing countries approached the United Nations to draft a model treaty that would take the source countries interest into account and not excessively limit the source countries taxing rights. The United Nations model treaty framework is based on the OECD model but deviates from the model as its premise is to allocate the taxing rights to the source country, rather them limiting these rights as with the OECD model. This allocation of taxing rights to the source countries bodes well for capital importing countries such as developing nations.

Quak and Timmis noted that the important difference between the Models is the process by which they are revised. The decision on changes in the OECD

Model and Commentary are taken by a sub – committee called Working Party 1 This Group consists of senior tax officials from member countries.[30]

In contrast the UN Model and its Commentaries are revised and maintained by the UN's Committee of Experts on International Cooperation in Tax Matters.[31] The UN Committee of Experts are made up of tax officials nominated by their respective Governments and appointed by the Secretary General. A small majority of members are from the developing countries.[32]

Again Quak and Timmis opined that although the UN Model is more advantageous for developing countries than the OECD Model, negotiations to date using the UN Model have not been too successful. Furthermore, despite being in a majority, developing countries lack influence in the UN's Committee of Experts, while the OECD's Committee of Fiscal Affairs has considerably more resources and technical capacity than the UN Committee.[33]

Rixen, summed up this conflict well when he opined that despite these successes in confronting the issue of double tax avoidance, the development was not without conflict. The most important conflict among governments is that between the residence and source principle of taxation (see below)[34].

The above view was supported by Fitzgerald who stated that Developing countries would benefit most from a multilateral tax treaty based on the source principle for two reasons. First, the gains from taxing income of foreign investors would be greater than the loss from not taxing income from their own residents' assets held abroad, because a developing country has a net external liability

[30] Arnold 2016: 4
[31] Quak & Timmis 2018:7
[32] Arnold 2016: 5
[33] Ibid: 2
[34] Rixen 2008:7

position. Second, even the full taxation of those assets held abroad by residents of developing countries by the authorities in the destination country would make capital light much less attractive.[35]

Resident based

In general, developed countries are in favour of the residence principle, whereas developing countries prefer the source principle because it allocates a larger share of the transnational tax base to them. This form of taxation is linked to the residency of the taxpayer and they will be taxed based on all the income irrespective of where that income was earned.

Source

Whilst most countries, more so developed countries make use of the resident-based system to tax their taxpayers. As this will tax both the local and worldwide income of their tax residents, this becomes of lesser importance to developing countries who tax residents do not have significant investments offshore. Most of the tax revenue for developing countries is derived from inward bound investments as these countries are mostly capital importing. The tax administration of developing countries is also not as sophisticated in order to trace and locate their tax residents, foreign income. Therefore, most developing countries opt for the source base form of taxation. This type of taxation is based on the concept that there is link between the country where the tax was generated versus where this income will be taxed. It is thus very important that the definition of Permanent Establishment is clear in the double taxation agreement as this impacts the source country's ability to tax.

[35] Valpy Fitzgerald 2002: International Tax Co-operation and Capital Mobility; Oxford Studies Volume 30, No 2

2.1 Differences in the UN and OECD model.

The Canadian tax journal 2013 outlined some key distinguishing features between OECD model and the UN model convention the features are as follows:

First, the role of the UN model is to help countries, especially developing countries, "make informed sovereign decisions regarding tax policy and administration based on: (1) their development plans, an understanding of the Likely consequences of different decisions on the revenue financing public aspects of development; and (2) the impact on that private investment that may also find development.

“Second, unlike the OECD model and commentaries that represent the work of the OECD, the UN model is a project undertaken by the committee of experts in their personal capacity and therefore does not represent the views of any particular country or tax administration. There is no mechanism for UN member countries to register their views on the commentaries

Third, omissions of OECD text in the UN model may mean different things. In general, provisions of the OECD model that were found to be particularly relevant for developing countries are included in the UN model. When the text is incorporated from the OECD model, the commentaries on the UN model explicitly highlight any differing views held by the committee; alternatively, in some cases they exclude certain text.

Fourth, the UN model reflects the philosophy that the developmental role of tax treaties is often best achieved when, on balance, source country taxation rights are preserved under a tax treaty.[36]

Whilst the OECD and UN Model convention are the mostly widely used model conventions, there are other regional or localised model tax conventions. The

[36] Canadian Tax Journal 2013: The UN Model (2011) Special Issue Vol 61:1

United States has their own US Model Convention and on the African continent, we have a regional Multilateral treaty in the East African Community Double Taxation agreement. The parties to this treaty are Burundi, Tanzania, Kenya and Rwanda. Birungyi Barata & Associates noted that the treaty seeks to eliminate double taxation among the states by imposing an obligation on the resident state to give credit for the source state tax against the resident state tax on income or exempt the income from tax. This Double Taxation Agreement is based on the source model whereas amounts will be taxed where the activity takes place[37]. In addition we have the COMESA the Common Market for Eastern and Southern Africa) model treaty which has a far wider country representation than EAC model.

## 2.1. Content of Model Treaties

Model treaties were developed to create framework of the contents tax treaties, model treaties are often used as starting point in bilateral negotiations. Model Conventions are non -binding therefore when countries use the model treaties, they do not have to use each and every article which is contained in the model treaty, parties to the negotiations are at liberty to choose which articles will be included and excluded. It is therefore important to understand the articles contained in the model treaties. These articles include the following;

Definitions

- Articles 3 General Definitions
- Articles 4 Resident
- Articles 5 Permanent Establishment

Taxation of Income

- Articles 6 Income from Immovable property

[37] Birungyi Barata & Associates (2015). The EAC Double Taxation Treaty explained. International Financial Law Review. 1/5/2015, p1-1

- Articles 7 Business Profits
- Articles 8 Shipping, inland waterways transport and air transport
- Articles 9 Associated enterprises
- Articles 10 Dividends
- Articles 11 Interest
- Articles 12 Royalties
- Articles 13 Capital Gains
- Article 15 Income from employment
- Article 16 Director's fees
- Article 17 Artistes and sportsmen
- Article 18 Pensions
- Article 19 Government Services
- Article 20 Students
- Article 21 Other Income

Taxation of Capital

- Article 22 Capital

Methods for elimination for double taxation

- Article 23A Exemption Method
- Article 23B Credit Method

Special provision

- Article 24 Non- discrimination
- Article 25 Mutual agreement procedure
- Article 26 Exchange of information
- Article 27 Assistance in collection of fees
- Articles 28 Members of diplomatic missions and consular posts
- Articles 29 Territorial extensions

Final Provisions

- Articles 30 Entry into force
- Articles 31 Termination

## 2.3 Negotiating Treaties

The process of negotiating a tax treaty begins with the two parties (countries) considering factors such as the level of investments and benefits of entering into a tax treaty. Once the benefits of entering into a tax treaty have been identified, the countries will commence with the process of entering into the negotiations. The process will normally begin by the countries exchanging the model treaties of their choice, this will form the basis of the negotiations. The parties will review the model treaties on a clause-by-clause basis and removing those clauses which will not be applicable in the current contracting requirements.

> According to Arnold after presentations by both sides about their domestic tax systems, the negotiations proceed on an article-by-article basis. Aspects of the text that cannot be agreed on are usually placed in square brackets, to be dealt with later. Once the wording of the treaty is agreed on, the parties initial it. After such agreement has been reached, arrangements will be made for the treaty to be signed by an authorized official (often an ambassador or government official). After signature, each State must ratify the treaty in accordance with its own ratification procedures. The treaty is generally concluded when the countries exchange instruments of ratification. The treaty enters into force in accordance with the specific rules in the treaty (Article 29).[38]

Given this process one can only but imagine that there are significant costs, complexities and time involved when negotiating these tax treaties. As there

[38] Arnold 2016: 3

would be officials from both government revenue authorities involved, international attorneys and other government authorities involved in the process. Once this process has been concluded and consensus has been reached. Each country would need to follow their internal process of having the double taxation agreement adopted by their relevant authorities.

## 2.4 Impact of Treaties on Domestic Law

Double taxation agreement in them of themselves do not override the domestic law. As stated above once a Double taxation agreement is negotiated there is an internal process that must be followed to ensure that the Double taxation agreement is approved and can form part of the domestic legislation. There are two prominent opinions in terms of how double taxation agreement will form part of domestic law as du Plessis put it is important to determine the method by which DTAs are incorporated into South African law.[39] For example, if DTAs are self-executing, taxpayers and the relevant revenue authorities will be able to rely on the relevant DTA as soon as it has been approved by both houses of Parliament and they would not have to wait for its enactment into law by national legislation DTAs are incorporated into South African law through section 108(2) of the Income Tax Act[40].

[39] Izelle du Plessis, I. (2015). The Incorporation of Double Taxation Agreements into the South African Domestic Law. P.E.R volume 18 No 4
[40] Income Tax Act Section 108

Section 108 of the Income Tax Act No 58. Of 1962 states[41].

1) The National Executive may enter into an agreement with the government of any other country, whereby arrangements are made with such government with a view to the prevention, mitigation or discontinuance of the levying, under the laws of the Republic and of such other country, of tax in respect of the same income, profits or gains, or tax imposed in respect of the same donation, or to the rendering of reciprocal assistance in the administration of and the collection of taxes under the said laws of the Republic and of such other country.
2) As soon as may be after the approval by Parliament of any such agreement, as contemplated in section 231 of the Constitution, the arrangements thereby made shall be notified by publication in the Gazette and the arrangements so notified shall thereupon have effect as if enacted in this Act.

Section 231 of the South African Constitution provides that International agreements become binding only after they have been approved by the National Assembly the National Council of provinces.[42] Once the approval takes place on both these houses of parliament and the DTA is published in the Government Gazette then this DTA will be enacted as part of the law. Oliver and Honiball, agrees with the view that once a treaty is published in the Government Gazette, the provision have the same force as domestic law in South Africa. [43]

[41] Ibid: 108
[42] South African Constitution Section 231
[43] Lynette Olivier and Michael Honiball. International Tax a South African Perspective (5th edition) Siber Ink: Cape Town (2011)

Therefore, DTA's do not override the domestic legislation but rather should be negotiated in such a manner as to align to the legislation or if there is a willingness by local authorities to allow for change in certain elements of the legislation as result of the new DTA this can be negotiated in the process and forming part of the DTA, which will override elements of the current legislation. It is important to note that Model DTA are not prescriptive but rather a guideline and the rest remains negotiated by the parties. There have been some conflicting views in courts on the status of DTA's in terms of domestic law and which of the two takes precedence when there is a conflict.

According to Bloem O, 2017 In the matter of the AM Moolla Group Ltd v The Commissioner of the South African Revenue Service the court held that in the case of conflict between an Act and the Treaty the Act must prevail. In the matter of the Commissioner of the South African Revenue Service v Tradehold the court held a view that the treaty modifies the domestic law and must prevail over the domestic law. In the matter of Glenister v the President of the Republic of South Africa the minority expressed the view that in the case of conflict between treaty and domestic law, "the conflict must be resolved by the application of the principles statutory interpretation and superseding of legislation.[44]

Interpretation issues and conflict between DTA's and domestic law remains a challenge. According to Janse Van Rensburg 2019 the OECD MTC defines only a few of the terms used therein and, in respect of the interpretation of undefined terms, includes the general *renvoi* clause, article 3(2). All South African DTAs also include a version of this clause.2

Article 3(2) currently reads as follows:3

> As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires or the competent authorities

[44] Ockert Johannes Blom 2017. The legal status of tax treaties in South Africa, University of Pretoria

agree to a different meaning pursuant to the provisions of Article 25, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

The inclusion of a provision in a treaty that deals with the interpretation of undefined terms is somewhat unusual, but there are a number of reasons for including such a provision in treaties aiming to grant relief against international juridical double taxation. There is, namely, a need for DTAs to closely interact with the contracting states' domestic tax laws, since DTAs place a restriction on the contracting states' right to levy taxes under these domestic tax laws. [45] Basically, the general Renvoi doctrine is where one country applies the laws of another country in resolving a legal dispute. However there may arise a further challenge in Private International Law when the law of country A as rule of dispute points to country B's laws and in terms of the law of country B, country B refers the dispute back to the laws of country A. There have been some interesting legal cases that have been presented before the courts to explore the issue of interpretation of the DTA's. I will make reference to two specific matters.

Krok Case

Gauteng High Court had previously granted a preservation order under a double taxation agreement in respect of debt owed by Australia by a South African expatriate M Krok.

South Africa and Australia concluded a double taxation agreement (the DTA) for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income on 1 July 1999.

The Australian Tax Office (ATO) made requests to SARS under the agreement in January 2012 and February 2013 for the collection of income

[45] Enelia Jansen van Rensburg The Application and Interpretation by South African Courts of General *Renvoi* Clauses in South African Double Taxation Agreements" *PER / PELJ* 2019(22) - DOI http://dx.doi.org/10.17159/1727-3781/2019/v22i0a4402

taxes in the sum of Australian $25 361 875.79 (approximately R235 705 169.19) plus interest, which were allegedly due by Mr Krok to the Australian Commissioner of Taxation for the income period from 30 June 2004 to 30 June 2009.

Acting on the request received from the ATO, SARS approached the Gauteng Division of the High Court, Pretoria on an ex parte basis. It sought a preservation order coupled with an order for the appointment of a curator *bonis* in terms of sections 163 and 185 of the Tax Administration Act 28 of 2011 read with the DTA and the protocol for the preservation of Mr Krok's assets situated in South Africa in order to meet his tax liability to Australia. The High Court granted the preservation order and ancillary relief and subsequently confirmed the order Mr Krok had inherited considerable capital assets valued at R71 713 807 as at February 2003. The saga began when he emigrated to Australia in April 2002. Prior his departure, he had sought professional advice on the tax implications relating to his assets which eventually led to him setting up an elaborate scheme to avoid adverse exchange control implications. The scheme involved him, inter alia, vesting the beneficial interests in both the assets and the income in a British Virgin Islands company through a series of agreements. In consequence to all his transactional activity, according to Mr Krok, he ceded all his South African income and assets to a company except for the bare ownership thereof, and he had no income or capital gains on which he could be taxed by the ATO under the agreements. On 29 December 2008, Mr Krok again emigrated from Australia to the United Kingdom. He set up a similar tax avoidance scheme in respect of which he purported to transfer to the second appellant, Jucool Enterprises Inc. (Jucool), a company incorporated in the British Virgin Islands, his assets situated in South Africa. In 2009, the ATO launched an audit of Mr Krok's taxation affairs as part of a government initiative investigating participation by Australians in internationally promoted tax arrangements to identify taxpayers involved in

significant offshore transactions or large transfers of funds to or from Australia. Resultantly, the ATO held Mr Krok liable for $25 361 875.79 plus interest. The SCA rejected the arguments made on behalf of Mr Krok and Jucool that: (a) that the relevant provisions of the DTA can only be invoked if the taxes claimed by the ATO arose on or after 1 July 2009 – after the protocol came into effect and (b) that Jucool was the beneficial owner of Mr Krok's South African assets. The court was clear that they are no times limits on the new article 25 and once a DTA is enacted by section 108 of the income tax, approved by the legislator and published in the government gazette it become part of the domestic legislation.[46]

Another interesting case is the is Tradehold case v the Commissioner of the South African Revenue Services The respondent, an investment holding company incorporated in South Africa andlisted on the Johannesburg Stock Exchange, successfully appealed to the Tax Court against an additional assessment raised by the Commissioner based on a taxable capital gain. The Commissioner averred that this tax arose as a result of a deemed disposal by the respondent of its shares in Tradegro Holdings Ltd, a holding company of the respondent, in terms of para 12(1) of the Eighth Schedule to the Income Tax Act 58 of 1962 (the Act). In 2002, it was decided by the respondent's board of directors that all further meetings of the respondent, would be held in Luxembourg. This essentially entailed that the respondent would be effectively managed in Luxembourg, the respondent nevertheless remained a 'resident' of the Republic of South Africa, in terms of the Act. Subsequently, the Act was amended in 2003 and the respondent ceased to be a resident. The respondent's only relevant asset was its 100 per cent shareholding in Tradegro Holdings. The Commissioner contended that when the appellant relocated its seat of effective management to Luxembourg and when it ceased being a

[46] *Krok v CSARS* (20230/2014 and 20232/2014) [2015] ZASCA 107 (20 August 2015)

resident in terms of the Act, it was deemed to have disposed of its only relevant asset, namely its 100 per cent shareholding in Tradegro Holdings. This resulted in a capital gain being realised in an amount of R405 039 083 during the 2003 financial year.

On appeal to the Tax Court, the respondent contended that if there was a deemed disposal of the investment, the capital gain that resulted from that disposal was not taxable in South Africa but in Luxembourg due to the fact that at the time the capital gain arose, the respondent was deemed to be a resident of Luxembourg in terms of Article 4(3) of the Double Tax Agreement (DTA) entered into between South Africa and Luxembourg. The issue before the SCA was whether the term 'alienation' as used in the DTA, included within its ambit gains arising from a deemed disposal of assets. The SCA held that the term is widely cast and includes capital gains derived from the alienation of all property, and does not have a restricted meaning. It encompassed both actual and deemed disposals of assets giving rise to taxable gains. The SCA however, held that when the respondent relocated its seat of effective management to Luxembourg, and taking into account that the respondent ceased being a resident of the Republic during the salient taxable year of the capital gain, the provisions of the DTA became applicable and Luxembourg had exclusive taxing rights in respect of the respondent's capital gains. The appeal by the Commissioner herefore fell to be dismissed.[47] This is yet another clear example of interpretation of the DTA, in place.

## 2.5 Conclusion

In this Chapter we explored the different Model treaties especially the two that are predominately in use being the OECD and the UN Model convention. It is clear that there has been need and rationale for establishing model conventions

[47] *Commissioner for the South African Revenue Service v Tradehold Ltd* (132/11) [2012] ZASCA (8 May 2012)

however, these conventions are a starting point for negotiations are not prescriptive to the contracting parties. We also looked at the process of negotiating model conventions and established that this is a long drawn out and costly process. Finally we explored the impact that DTA's will have on the domestic law and do the provisions of the treaty if there is a conflict override the domestic law. It was interesting to note that even in our court systems and amongst tax scholars there is disagreements in terms do DTA's override the domestic legislation.

3. Tax Evasion and Tax Avoidance

There is difference between tax evasion and tax avoidance. Tax evasion is the effort by taxpayers, be they companies, individuals or any other taxpayer employing illegal schemes to pay less or no tax. Whilst tax avoidance (tax planning) be it moderate or aggressive tax planning is the organization or arranging of one's tax affairs in legal manner to reduce the overall tax liability. Tax avoidance is not illegal as long as it done within the ambit of the law. Tax avoidance is not favoured by revenue authorities around the world. De Koker and Williams defined it as follows 'Tax avoidance'4 connotes stratagems which are *prima facie* lawful, that is to say, which are lawful unless proscribed by the Act. By contrast, 'tax evasion' connotes inherently unlawful methods, such as incorrect statements in income tax returns (such as the non-disclosure of income or the exaggeration of expenditure claimed as a deduction) and sham or disguised transactions.[48]

In Court case, which often used to illustrate Tax planning Lord Tomlin famously remarked.

> (*Inland Revenue Commissioners v The Duke of Westminister* [1936] AC 1 at 19):'Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Act is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioner of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay increased tax.

[48] Alwyn de Koker & RC Williams *Silke on South African Income Tax* 70th ed (Durban: LexisNexis 2021)

Therefore, tax avoidance cannot be treated as tax evasion, even though these terms are at times used interchangeably.

Tax evasion on the other hand as mentioned above, is the process of employing illegal schemes that result in the paying of no to minimum tax. The OECD has been working on different methodologies in order to combat this scourge. In the current model convention treaties the information exchange article (Article 26 OECD Model) is one such method that this used to curb tax evasion. According to Arnold Governments have sought to challenge tax evasion in the international arena with information exchange agreements for a very long time.[49] The OECD has been working hard in the development of rules for administrative assistance in tax collection and information exchange, and in 2003 included a whole new article 27 in the Model dealing with assistance in tax collection. Basically, this article stipulates that the contracting states should lend assistance to each other in the collection of revenue claims.[50]

## 3.1 Treaty Abuse

Whilst the primary objective of tax treaties has been to encourage cross border trade by removing the burden of double taxation of those involved in these exploits. Tax treaties have other secondary objectives such as preventing international tax avoidance and evasion, and, more generally, strengthening political ties with the partner country. Not to say that whilst the intention of policy makers, international organisations, revenue authorities and governments in establishing these tax treaties has been good, these tax conventions have been prone to a number of abuses. (Beer and Loeperick 2018) opined that while DTTs serve more purposes and often also come with a range of complementary political objectives, the avoidance of double taxation is at their core[51]. However,

[49] Arnold 2016: 10
[50] OECD 2003
[51] Sebastian Beer and Jan Loeperick 2018. The Cost and Benefits of Tax Treaties with Investment Hubs: Findings from Sub-Saharan Africa. IMF Working Paper Fiscal Department.

these bilaterally negotiated agreements can, by restricting taxing rights and through the abuse of treaty networks using shell companies, also contribute to the loss of a country's tax base and facilitate tax avoidance.

With all the noble intentions with which Tax treaties have been established for, these treaties have been prone to a number of abuses such as.

1) Treaty shopping, the OECD (2019) defines Treaty shopping as the attempt by a person to indirectly access the benefits of a tax treaty between two jurisdictions without being a resident of one of those jurisdictions[52].

   According to SEATINI – Uganda and ActionAid International routing financial flows through a number of different tax jurisdictions allows companies to avoid withholding tax on cross-border transfers whether or not there is a bilateral treaty between the country in which the income is generated and the final destination country; this is known as treaty shopping page 9 ActionAid's exposé of tax avoidance by the international food giant Associated British Foods (ABF) demonstrates treaty shopping in practice (ActionAid, 2013a). Zambia Sugar, ABF Zambian subsidiary, took a loan from a UK bank to finance their operations. Under normal circumstances, interest payments of 17% would have been subject to 10% WHT on leaving Zambia for the UK. However, on paper, the loan was routed through an Irish subsidiary, which meant that, under the terms of the Zambia-Ireland DTT, no WHT was liable. ActionAid estimates that the strategy of routing the loan through Ireland may have deprived the Zambian exchequer of up to US$3 million (ZK13.5 billion) in withholding taxes.[53]

[52] OECD 2019. Action 6 Prevention of tax treaty abuse.

[53] SEATINI – Uganda and ActionAid International. 2014. Double Taxation Treaties in Uganda Impact and Policy Implications. *SEATINI – Uganda and ActionAid International.* 5- 28

2) Round Tripping –

A report by SEATINI – Uganda and ActionAid International (2014), noted that another common strategy is for domestic companies to avoid tax by re-registering in the jurisdiction of a treaty partner, presenting themselves as if they are external investors; this is known as round tripping. These investors can benefit from advantageous treaty terms, e.g. exclusion of source taxation on capital gains from the alienation of shares. This is particularly appealing if the other country has a low tax regime. For, the period 2008 to 2013, Mauritius contributed just above 40% all inward FDI to India. Far more than traditional sources such as Singapore, UK, US, Japan and the Netherlands, whose combined FDI contribution still only amounted to 35%; lower than what Mauritius channelled to India[54].

The India-Mauritius DTT provides for taxation of capital gains arising from alienation of shares only in the country of residence of the investor. Since capital gains are fully exempt from taxation in Mauritius, an investor routing his investment through Mauritius into India does not pay capital gains tax either in India or Mauritius.

Many commentators believe that this high level of investment from Mauritius is not FDI but rather domestic Indian investment which is routed through Mauritius (round tripping) to avoid capital gains tax on the alienation of shares and to benefit from Indian tax incentives only available to foreign investment, and not to domestic investment

[54] SEATINI and ActionAid International. 2014: 10

3) Tax Avoidance or evasion

Musviba defines these abuses as tax avoidance involves using tax deductions, changing one's business structure through incorporation or establishing an offshore company in a tax haven.[55]

By contrast tax evasion is the general term for efforts by individuals, firms, trusts and other entities to evade the payment of taxes by illegal means.

4) Alienation of Shares

The UN model and, since 2003, the OECD model also include a provision that covers the sale of shares in property rich companies that have been formed as vehicles to own real property. This is excluded by the Uganda-Mauritius treaty. Without this provision, it is quite easy to structure the ownership of, say, a mine or large business in such a way as to avoid capital gains tax entirely when it is sold. The Uganda-Mauritius treaty also omits a provision found in the UN model, article 13(5), which permits a country to levy CGT on sale of shares when a foreign resident sells its stake in a domestic company if that stake exceeds a certain threshold. Without this provision, investors are free to structure FDI so as to be immune from CGT if they pull out . [56]

[55] Nayasha Musivia n.d: Tax Avoidance vs Tax Evasion – the differences South African Tax Guide https://www.sataxguide.co.za/tax-avoidance-and-tax-evasion-the-differences/

[56] SEATINI and ActionAid International. 2014: 10

These abuses have been proliferated by well-resourced Multinationals Corporations who have employed sophisticated schemes and methodology's largely assisted by, armies of technically astute tax consultants/attorney's. The Global Financial Integrity (GFI) in Washington show that developing countries lose on average $542 billion every year through illicit financial flows, and trade mis invoicing makes up 80 percent of this at or $424 billion. [57]

According to Hearson there is growing attention on the question of tax treaties signed by developing countries. The costs of tax treaties to developing countries have been highlighted in recent years by NGOs such as ActionAid and SOMO.[58]

The Uganda and ActionAid International (2014), sited an example of such abuses whereas they stated following the network of double taxation treaties is one of the mechanisms used by companies to avoid paying taxes, leading to illicit financial flows and tax losses for Uganda.[59]

During 2014, an influential IMF paper warned that developing countries would be well-advised to sign treaties only with considerable caution, and the OECD, as part of its Base Erosion and Profit Shifting (BEPS) project, proposes to add text to the commentary of its model treaty to help countries decide whether a treaty should be concluded with a State but also, whether a State should seek to modify or replace an existing treaty or even, as a last resort, terminate a treaty.

The issue of tax treaty abuse is not new and has been identified by the OECD as early as 1977. According to the OECD (2019) in 1977, the Commentary on Article 1 of the OECD Model was also updated to include a section on the improper use of tax agreements.[60] Onyejekwe the use of these schemes is detrimental to both the home and host country because of the reduced tax revenues and distorted investment

[57] Global Financial Integrity (2014): Hiding in plain sight Trade Misinvoicing and the impact of revenue loss in Ghana, Kenya, Tanzania, Mozambique and Uganda 2002:2011, May 2014

[58] Martin Hearson (2015). Tax treaties in sub-Saharan Africa: a critical review. *Tax Justice Network - Africa, Nairobi, Kenya*: 2 – 34

[59] SEATINI and ActionAid International. 2014: 24

[60] OECD 1977: 45

inflows. Most schemes are created by more developed countries and as such, a higher percentage of investment profits are remitted to them, to the detriment of the underdeveloped or developing source country.[61]

The risk of entering into DTA's and the resulting revenue leakages need to be carefully considered before countries enter into DTA's. The tax abuses that DTA's are prone to can result in significant tax losses for the developing countries. South Africa has not been sparred this fate Mosupa opined the South African Revenue Service (SARS) has in the past attacked many schemes regarded as constituting 'abuse' of DTAs. Our courts have not had an opportunity to decide a case involving the 'abuse' of a tax treaty; only once has the Supreme Court of Appeal considered the interpretation of a tax treaty (*Secretary for Inland Revenue v Downing* 1975 (4) SA 518 (A)).[62] But SARS could rely on two measures to counteract these schemes: the fraus legis doctrine, and now repealed section 103 replaced the new General Anti Avoidance Rule (GAAR) of the Income Tax Act.

The Fraus legis doctrine derived from Roman Dutch law which basically means that one will be committing fraud against the law but this act will be committed indirectly rather than directly. Thereby disguising the substance of the transaction based on the current form.

The combating and prevention of treaty shopping has remained top of mind for policy makers, as this has been identified as one of the most important sources. This is evident on the Action Plan on Base Erosion and Profit Shifting report that was published OECD and G20 in 2013. BEPS Action plan was initiated to mitigate the weaknesses and strengthen international tax rules that create opportunities for base erosion and profit shifting by multi-national corporations and investors.

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[61] Chrisa Onyejekwe, 2018. *Rebalancing Double Tax Treaties in favour of African States in Rebalancing International Investment Agreements in Favour of Host States*. United Kingdom: Wildy, Simmons and Hill Publishing

[62] Mosupa F. nd A introduction to double taxation agreements. The quarterly law review for people in business Vol 11 part 3.

According Plowgian, Riccardi & Mueller The BEPS Action 6 2015 Final Report recommends three basic approaches to combat treaty shopping: First, a clear statement that the States that enter into a tax treaty intend to avoid creating opportunities for non- taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements will be included in tax treaties. Second, a specific anti-abuse rule, the LOBs rule, which limits the availability of treaty benefits to entities that meet certain conditions will be included in the OECD Model Tax Convention. These conditions, which are based on the legal nature, ownership in and general activities of the entity, seek to ensure that there is a sufficient link between the entity and its State of residence. Such limitation-on-benefits provisions are currently found in treaties concluded by a few countries and have proven to be effective in preventing many forms of treaty shopping strategies. Third, in order to address other forms of treaty abuse, including treaty shopping situations that would not be covered by the LOB rule described above, a more general anti-abuse rule based on the principal purposes of transactions or arrangements (the principal purposes test or PPT rule) will be included in the OECD Model Tax Convention. Under that rule, if one of the principal purposes of transactions or arrangements is to obtain treaty benefits, these benefits would be denied unless it is established that granting these benefits would be in accordance with the object and purpose of the provisions of the treaty.[63]

## 3.2 Conclusion

In this Chapter we explored the difference between tax avoidance and tax evasion. Where we noted that the former is legal means of organizing ones tax affairs in such manner as to pay less tax. The latter is illegal form of tax avoidance, governments and international institutes have been grappling with this for a long time. These schemes both on tax avoidance and evasions have impacted the tax treaty networks, as tax treaties whilst noble in their intentions to prevent double taxation and promote trade have been plagued by treaty abuse. The improper use of treaties was raised by the OECD as early as 1977. Such treaty abuse includes treaty shopping and round tripping. The OECD has attempted address this treaty abuses by the commentary on

[63] Plowgian, Riccardi & Mueller 2017:46

Article 1 of the OCED model and Article 26 and Article 27 the exchange of information and Assistance in the collection of taxes.

## 4. History of Tax Treaties in Africa

The world saw extensive growth in the tax treaties after the conclusion of the OECD Model convention and this trajectory was further catapulted as result of the liberalization of the world markets.

> Rixen opined that the growth rate of bilateral treaties increased strongly after the OECD MC was concluded. In 1958, 263 treaties were in force, gradually increasing to 333 by 1963 and 600 as of 1978. After the conclusion of the 1977 MC — and with the further liberalization of capital markets and increasing tax ratios in industrialized countries, which made the problem of double taxation more prevalent — the number of treaties increased rapidly to 1582 in 1998.[64]

Despite this proliferation there still remained a sense of disenfranchisement amongst the developing nations as the OECD model was based on the premise of resident-based taxing rights, which favored capital exporting countries. Hence the developing countries approached the United Nations and devised the own model convention under the auspicious of the UN. With the development of UN Model treaty which is similar in many aspects to the OECD model convention, with key difference being that this UN model convention is significantly skewed towards source based taxation, the growth rate of tax treaties has grown exponentially.

Based on various literature sources it is has been said that there are about 3000 tax treaties that are in force. Quak and Timmis noted that Between 1,000 and 2,000 of these agreements involve at least one developing country. Most of these were concluded within the last 20 years, while DTAs between advanced economies mostly date from before 1990.[65] What is interesting to note is that although the preference for developing countries to apply the UN Model, as basis for negotiations when entering to tax treaties, most of the provisions applied in the final agreed treaties for developing countries is OECD model.

[64] Rixen 2008: 7
[65] Quak and Timmis 2018: 2

Specially in the African context, post the African States achieving independence, many African countries embarked on process to renegotiate their previous tax treaties that were concluded during the colonial eras. Some of these treaties were concluded with the Colonising states, which would of course favour such states. According to Hearson African countries such as Kenya and Nigeria, kept their old agreements in place until they were ready to renegotiate in the 1970s, perhaps fearing a negative effect on investment if they cancelled.[66] In some others, such as Zambia and (until very recently) Malawi, a few colonial-era agreements stayed in force where renegotiations were not completed.

The International tax regime is complicated to say the least, with some African countries tax administration and capabilities, including their tax treaty negotiate capacity not being of the requisite calibre to deal with these complexities. This has resulted in poor negotiation and abuses of tax treaties, revenue losses as result of tax avoidance and evasion. The majority of international trade is dominated by Multinational Corporations, who generally lobby their resident country governments to inter into double taxation agreements, in additional these Multinational Corporations have the resources to employ tax advisors and legal practitioners to assist them with organising their tax affairs to reduce their tax burdens. According to Global Finance Integrity (2011) report DTTs have benefited developed countries more than developing countries because cross-border trade and investments are predominated by Multi-National Companies (MNCs) which are largely from developed countries and control more than 60%-65% of global trade. [67]

Developing countries and especially on the African continent have a heavy reliance on donor funding and more importantly Foreign Direct Investment, to stimulate growth and provide much need prosperity for its citizens. This is important, as many developing countries are capital importing countries, that are rich in mineral and other natural resources but in the main most of the items are imported. There is however no

[66] Hearson 2015: 11

[67] Global Financial Integrity (2011): Illicit financial flows from developing countries 2000-2009, January 2011

empirical evidence to suggest that entering to Double taxation agreements is a catalyst for attracting Foreign Direct Investment.

> Kalizinje (2020) opined that despite its importance, Domestic Resource Mobilisation is marred with numerous challenges ranging from tax evasion and tax avoidance which are exacerbated by incoherent international tax regimes, weak tax systems as well as lack of clear nexus between tax policy and administration. These problems are bleeding Africa of a lot revenue which would have otherwise been used to finance its development. For example, illicit financial flows largely comprised of tax avoidance, tax evasion, and trade mis-invoicing is estimated to be bleeding Africa USD 100 billion annually.[68]

As mentioned in the preceding chapter it was noted that as noble as the intentions for drafting and entering into tax treaties, such as the avoidance of double taxation and stimulating cross border trade. Double taxation treaties have been besieged by a fair number of challenges and developing countries have not been spared of these challenges. During 2014 the IMF has issued a warning that developing countries would be well-advised to sign treaties only with considerable caution. It is against this backdrop that this chapter is written, to assess why African countries enter into double taxation agreements and do these agreements really attract FDI and finally assessing the tax losses that have experienced in the continent due to DTA's.

## 4.1 Foreign Direct Investments and Tax Incentives

Given the above reality the question needs to be asked as to why countries, more so developing countries would enter into Double taxation agreements, if the same has been fraught with such abuses. Developing countries are in much need to of Foreign Direct Investments to sustain and grow their economies. The growth of Foreign Direct Investments has been on upward trend since the 1990's, Dunning opined that by the early 1990s, the sales of worldwide exports would be eclipsed by the sales of foreign

[68] Frank Kalizinje 2020.The Dangers of Double Taxation Agreements in Development in Africa. *Tax Justice Network Africa*: 6 – 44.

affiliates of MNCs. There is school of thought that holds the view that Double taxation agreement, are catalyst for attracting that much needed Foreign Direct Investments. [69]

Developing countries tend to rely on Foreign Direct Investments to foster economic growth and bolster the governments revenue inflows to better the fortunes of their citizens. According to the OECD 2002 FDI can boost capital accumulation, create job opportunities, increase integration into the international economy and contribute to the formalization of the host economy by extending value chains. As a result, also tax revenues may rise. Developed countries have traditionally received and dispersed the share lion's Foreign Direct Investment, this trend is evolving, according to a UNCTAD (2004) Although the developed countries remain both the dominating source and the major recipient of FDI, their dominance has decreased over time with developing countries in 2003 receiving almost 31 per cent of FDI as opposed to only about 20% in the 1980s

Some scholars, politicians and technocrats believe that double taxation agreements assist in attracting Foreign Direct Investment. According to Onyejekwe (2020) Economists and legal researchers indicate that low income and developing countries tend to enter into tax treaties in order to make their economy more sustainable by attracting Foreign Direct Investments. Even with the mirade of benefits for the host there is no empirical evidence that supports the view, that double taxation agreements attract Foreign Direct Investment, and some do not support this view. A study by Baker (2014) found that there was no empirical evidence to support the notion that DTA attract Foreign Direct Investment.

Baker (2014) in his conclusion noted the following This analysis shows that home countries unilaterally eliminate double taxation. This removes the key economic benefit of DTTs as it relates to the MNE decision-making process for FDI location. From the host countries' perspective, the analysis also indicates the trend for them

[69] John Henry Dunning, (1998) The changing geography of foreign direct investment, in: N. Kumar (ed.) Globalization, Foreign Direct Investment and Technology Transfers: Impacts On and Prospects for Developing Countries (New York: Routledge), pp. 43 – 89

to reduce their non-treaty withholding tax rates unilaterally. This removes the other potential benefit that a DTT would have in attracting FDI. The qualitative analysis also shows that DTTs should not have a disincentive effect on an MNE's FDI location. The DTT's inclusion of transfer pricing and exchange of information clauses is already provided for at the domestic level and applies regardless of any DTT. Furthermore, anti-treaty shopping clauses only restrict access to the benefits of a DTT which makes it irrelevant to the MNE that cannot take advantage of it.

This is contrary to a study by Nuemayer[70] which found that Developing countries with more DTTs with major capital exporting developed countries benefit from a higher overall FDI stock and share of stock and receive more FDI inflows as well as a higher share of inflows. The message to developing countries therefore is that succumbing to the restrictions on their authority to tax corporate income from foreign investors typically contained in DTTs does have the desired payoff in terms of higher FDI. To our knowledge, this is the first study to provide robust empirical evidence that DTTs increase FDI to developing countries. The study went on further to find that if one were to split the sample of developing countries between low income and middle income, Double Taxation agreements are more effective in the middle income countries. Clearly from the conflicting studies there is no guarantee that entering into a Double Taxation Agreements will translate into additional investments inflows by way of Foreign Direct Investments. Another issue to note that it is costly to negotiate and enter into double taxation agreements.

The costs associated with this are the actual negotiation and concluding the agreement. In some sense it appears that there is believe amongst developing countries that concluding double taxation agreements somehow creates the perception, that the developing country in question has elevated it's status in the international tax arena, thereby attracting Foreign Direct Investments. Given the fact that there is a limited pool of Foreign Direct Investments, there is bound to be some sort of competition to attract the Foreign Direct Investment.

[70]Eric Neumayer. (2006). Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries? Journal of Development Studies, Vol. 43, No. 8, 1501–1519, November 2007

> According to Barthel and Neumayer, the strong positive target contagion interdependence can explain why developing countries sign DTTs with OECD member countries, even though the treaties "systematically favour a distribution of the taxes generated from MNCs [Multinational Corporations] to the advantage of the capital-exporting residence country". The position developing countries find themselves in can be regarded as a classical prisoners' dilemma: Due to international competition for FDI, a country still can have an incentive to conclude such a tax treaty, because its own situation without a treaty deteriorates if other focal countries enter such treaties themselves and thereby gain a competitive edge Capital-importing countries are caught in a classical prisoners' dilemma: Each country would be better off refusing to sign a DTT, but signing a DTT is the dominant strategy given that the highest payoff occurs if one signed a DTT, but the others do not. The initiative used by developing countries to attract the much needed Foreign Direct Investments is signing Double Taxation Agreement and offering tax incentives to these countries.[71]

The tax incentives will range from special economic zones, tax breaks for certain Foreign Direct Investments and other types programs. This does unfortunately create a race to zero amongst developing countries tax regimes. In study by Seatini – Uganda Action Aid 2014 when assessing Uganda as case study in lowering taxes as part of a bid by developing countries to attract Foreign Direct Investment.

> Seatini – Uganda Action Aid 2014, noted Uganda as an LDC is placed in this precarious situation, needing to attract FDI to raise tax revenues, but at the same time offering such generous incentives in a misinformed attempt to attract FDI while it can end up losing the same in tax revenues. Some of the countries with the highest inward FDI to Uganda in 2011, including USA, Canada, Turkey, Sri Lanka and Iran have no DTT with Uganda. Uganda needs to make an objective analysis to establish the impact of DTTs on both FDI and revenue mobilisation.[72]

[71] Fabian Barthel and Eric Neumayer, (2012). Competing for Scarce Foreign Capital: Spatial Dependence in the Diffusion of Double Taxation Treaties, *international Studies Quarterly*, Volume 56, Issue 4, December 2012, Pages 645–660

[72] SEATINI and ActionAid International. 2014: 20

To take part in a race to the bottom, simply lowering taxes to compete with other developing countries also in need of revenue, will only benefit the investors, with the competing countries, and their citizens, losing out. A study by Awasthi contradicts, the notion that double taxation agreements, tax incentives attract Foreign Direct Investments to developing countries. The study found that out of 683 cases, over 92% of them responded they were not motivated by tax and other fiscal incentives to invest in a jurisdiction.[73] Hearson concluded all in all, we cannot say with certainty that tax treaties have generated new investment into their developing country signatories, nor can we say that there is a compelling legal rationale to motivate the conclusion of tax treaties given their costs.[74]

## 4.2 Tax Losses

Entering into and concluded Double Taxation Agreements can result in revenue losses for the developing country as the trade between developed and developing country is not asymmetric. Meaning that the developing country will risk losing tax revenue as result of having given up certain taxing rights, which are not always recovered from the Foreign Direct Investment. The forfeiting of tax revenues stems from the reduction and limitations of taxing rights, including withholding taxes that the developed country will be allowed to charge. The Actionaid 2015 report put it this way tax treaties narrow the ability of source countries to levy taxation in two ways. First by *narrowing the class of activities taxable at source*. For example, the definition of "permanent establishment" determines the breadth of source based taxing rights on business profits. Source country capital gains taxing rights are also narrowed in tax treaties. Second, treaties cap taxation *rates* on certain source based (withholding) taxes.[75] These countries really heavily on these tax revenue streams. There have been incidents noted where the signing of tax treaties removes the host countries right to collect tax when Multinational Corporations pay out dividends, this was specifically the

[73] Rajul Awasthi 2012. Investor Motivation Surveys in East Africa. Investment Climate. World Bank Group
[74] Martin Hearson 2018. When do developing countries negotiate away their corporate tax base? *Journal of International Development J. Int. Dev.* 30, 233–255
[75] ActionAid UK 2015. Taxation Rights Slipping through the cracks: How developing countries can get a better deal on their taxing right

with the tax treaty between Uganda and the Netherlands, this was noted by Onyejekwe .[76]

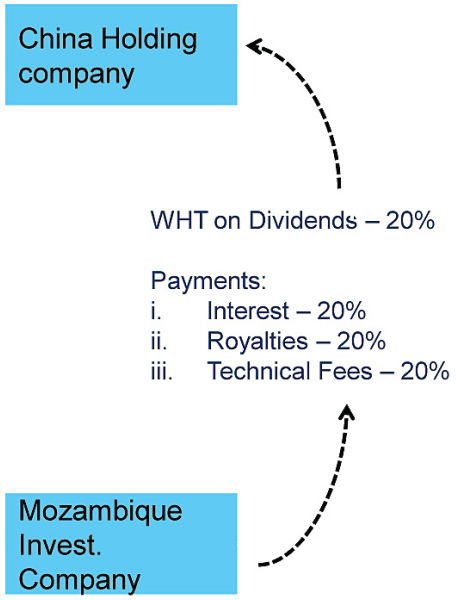
Tax loses have also been known to arise out of the restriction of taxes of capital gains, these restrictions are prevalent in the tax treaties signed by countries with Mauritius. This effectively means that companies that sell their shares, property or any other capital assets, if they have a permanent establishment in Mauritius will effectively pay lower taxes to the host countries. This results in significant revenue losses for the host countries which can go into the millions of dollars. A report by Actionaid. UK found that in 2013 an Italian Oil company was required to pay the Mozambique government $400million in capital gains tax. The below diagram from a Deloitte document highlighted the risk of revenue losses to host countries as result of signing double taxation agreements with Mauritius.[77]

[76] Onyejekwe 2018; 181

[77] ActionAid UK .2013; Deloitte in Africa – Advising big businesses on how to avoid tax in some of the world's poorest countries

Investing Directly in Mozambique

- **Case Study** – China Co investing directly in Mozambique



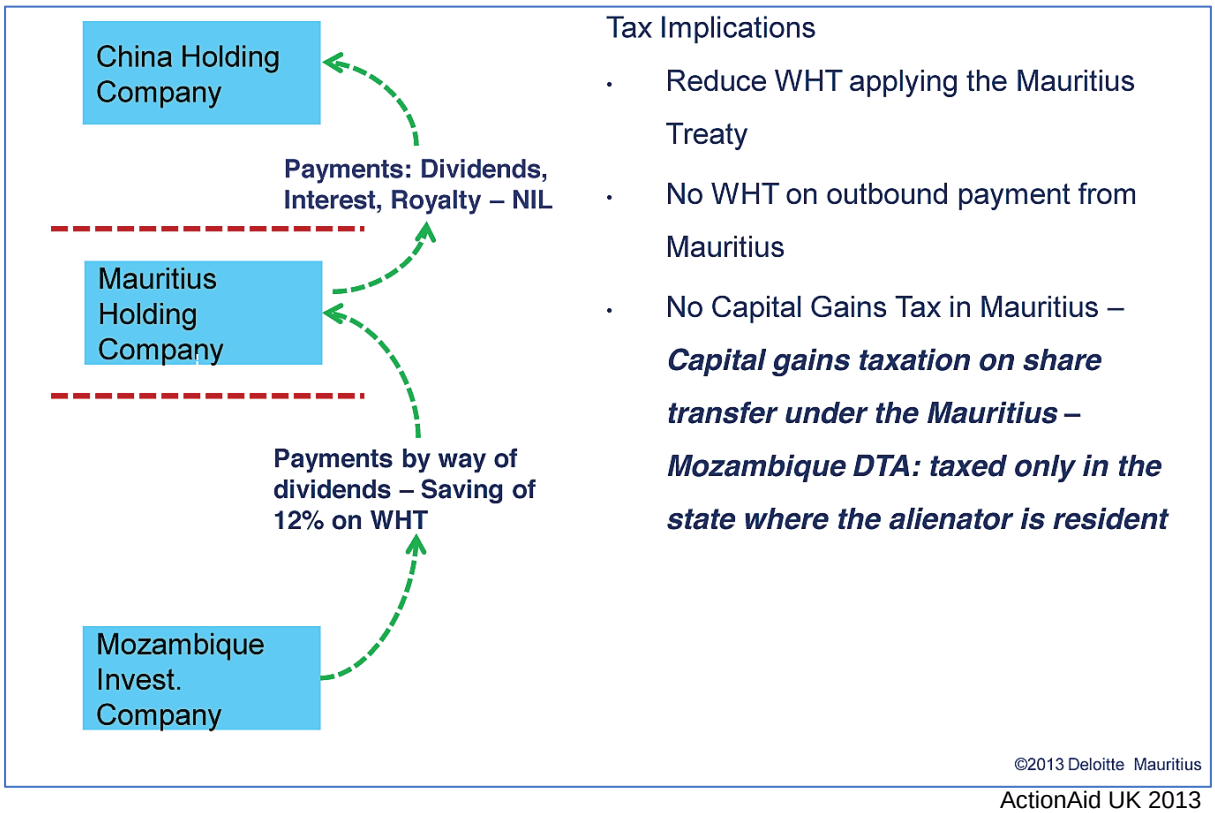

***Tax Suffered***

- Corporate Taxation at 32% in Mozambique
- WHT on dividend – 20%
- If China Holding Co disposes of its investment interests in Mozambique, this would trigger a capital gain tax of 32% in Mozambique

©2013 Deloitte Mauritius

ActionAid UK 2013

Investing in Mozambique through Mauritius




ActionAid UK 2013

According to Quak and Timmis 2018 studies show that treaties with the Netherlands led to foregone revenue for developing countries of at least EUR 770 million in 2011.[78] Similar, calculations suggest that US tax treaties cost their non-OECD country counterparts perhaps $1.6 billion in 2010.

Hearson 2016 noted that the biggest study of tax treaty content to date compared 1,811 treaties on the basis of 30 standardised variations that affect how constrained a developing country is in its ability to tax inward investors (Wijnen and de Goede 2013).[79]

For almost all these possible variations, the majority of treaties between developed and developing countries included versions of clauses that were at the more restrictive end of the available options, imposing bigger curbs on developing countries' taxing rights.

[78] Quak & Timmis 2018:2
[79] Martin Hearson 2016: Measuring Tax Treaty Negotiation Outcomes: the ActionAid Tax Treaties Dataset ICTD Working Paper 47 First published by the Institute of Development Studies in February 2016. pp 3- 40

## 4.3 Conclusion

In this chapter we explored the notion whether double taxation agreements attract foreign direct investment. There does seem to be consensus in the literature in this regard nor is the empirical evidence support the notion. Further to this we uncovered that some developing countries implement tax incentive programs to lure the much need to foreign direct investment. This can result in tax competition amongst host countries and forgone tax revenues which are not always compensated by foreign direct investment. The concluding of double taxation agreements and the incentive programs does result in significant tax losses for the host countries. Therefore Chapter 5 will seek to answer the questions given all the evidence should developing countries enter in double taxation agreements and do the provide any benefit. In addition to the answer the questions recommendation will also be provided.

## 5. Recommendations and Conclusions

The international tax regime is complicated at best and difficult to navigate. This is more prevalent if as a country your tax administration, systems and management is not adequately geared for this. This tends to be the case with developing countries who need to contend with this reality. International trade has long been a fixture in the advancement of commerce even before the advent of globalization. No country operates in a vacuum, in order to grow, businesses have sought opportunities abroad. Double taxation can become an impediment to international trade, hence government and regulators have had to find a way to curb the impact of double taxation.

Whilst some countries have internal relief mechanisms built into their domestic tax legislation to curb the impact of double taxation such is known as unilateral relief which can consists of rebates and tax credits. An example of such in our domestic legislation as noted by De Koker & Williams where they state that the domestic law relief consists, amongst others, of a special rebate, or unilateral tax credit, for foreign taxes payable by residents (natural persons and legal entities; see §§ 5.2 and 5.2E) in respect of income from non-Republic sources. The rebate is available for set-off against the normal tax otherwise payable. Where a foreign country levies tax on income derived from a source in South Africa, relief is available not as a rebate but in the form of a deduction for the foreign taxes paid exemption method.[80]

Bilateral relief on the other hand is where there is an agreement between the two countries, by way of double taxation agreement.

> Where Samantara described this as follows this method involves an agreement in which two countries agree that incomes arising from different sources which are likely to be taxed in both the countries as per their respective income tax law should either be taxed in one of these two countries or that a specified portion of such incomes

[80] De Koker & Williams 2021: 179

should be taxed by each country so that there is no overlapping taxation in this case.[81]

This kind of agreement results in a complete avoidance of double taxation of the same income in both the countries.

Whilst the intentions of double taxation agreement are noble at their core, they have been besieged by the own challenges. These challenges have unequally, negatively impacted developing countries versus developed countries. Firstly, when countries that have asymmetric vs symmetric investment flows enter into double taxation agreements, the country that is capital importing stands the risk of forfeiting tax revenue.

Braun and Zagler's opined that asymmetric tax treaties inevitably reduce the tax base of developing countries, so that we can and should expect some form of compensation from the industrialized to the developing economy in case a treaty comes into effect. This form of compensation is foreign direct investments to compensate for the tax revenue losses.[82]

However, as we have seen in the preceding chapter there is contradiction in the literature as to the question that does entering into a double taxation agreement result in more foreign direct investment, where some scholars believe that this is the case and other disagree with this notion. However, there is no empirical evidence to suggest the former. Therefore, if you have asymmetric investments flows and you forfeit your taxing rights as the resident country which results in massive lost tax revenue on elements such as withholding taxes, royalities and other business and passive income streams, all in the hope of attracting the match needed Foreign Direct Investments. As an example, according to The International Monetary Fund (IMF, 2014) estimated tax revenue losses of US$ 1.6 billion in2010 for non-OECD countries that had tax treaties with the United States.[83] If such investment is not sufficient to make up for the losses or worse so does not materialise, does this approach make sense. Compounded to

[81] Samantara 2020: 2

[82] Julia Braun and Martin Zagler 2014: An Economic Perspective on Double Tax Treaties with (in) Developing Countries. *World Tax Journal*: 242 – 281.

[83] Peter Jansky and Marek Sedivy 2019: Estimating the revenue costs of tax treaties in developing countries. *World Econ.* 2019; 42:1828–1849

this, developing countries have also seeked to use tax incentives to attract the much-needed foreign direct investment, which in itself is flawed strategy that results in tax competition amongst the countries and race to zero.

Whilst entering into double taxation agreement is perceived by some developing countries as signalling to the international community and would be investors as to the progressive nature of the that host countries tax strategy, is this really the case. Coupled with the challenges already mentioned with double taxation agreements for developing countries, there are other sets of unique pitfalls that besieged these bilateral agreements which result in significant cost and tax revenue losses for developing countries. This is where governments and administers in developing countries especially on the African Continent need to ask the question are double taxation agreements relevant to the developing countries on the continent and do they provide any real benefit. Now to some governments it may seem beneficial enter into these bilateral tax treaties. To help answer these question and make informed decisions, I will put forward recommendations on how to mitigate the treaty abuses and costs associated with these agreements.

Negotiating and concluding a tax treaty can come at considerable costs due to the time and resources involved in this process. In addition, certain countries on the African continent have been known not to have the most experienced negotiators when it comes to negotiating the complexities of international tax treaties. According to Hearson one Ugandan official said the lack of a politically enforced policy to underpin negotiations is one concern. “When I go to negotiate, all I have is my own judgement,”according to a negotiator. “We thought that cabinet should express itself’ Officials are also concerned about the taxation of technical services provided by professionals in the oil industry, and are asking questions about the relatively poor deal Uganda got in its as yet unratified agreement with China.[84] According to Aukonobera (2012: 1084), ‘Uganda has a weak tax treaty negotiation team that

[84] Hearson 2015: 6

concludes treaties more intensively reflecting the position of the other contracting state'. [85]

## 5.1 Recommendation

It is critical the countries capacitate their treaty negotiation teams with the adequate skills and knowledge of the international tax regimes. Countries should not be hasty in concluding treaties with unfavourable terms as this may create a precedent for future negotiations with other countries. Finally, there must be a politically enforced policy to underpin negotiations, then there is clear mandate which negotiators will base their discussions on and as such the teams need to be aware of impact that the treaties will have on future tax policy making.

There are instances where countries have treaties currently in place which have unfavourably clauses. If this is the case developing countries should review the current treaties to assess if the treaties are meeting the set objectives such as stimulating cross border trade, eliminating double taxation amongst others. If this is not the case then the government should make it a priority to renegotiate or cancel these treaties. The have been instances were African and other developing countries have undertaken this exercise. According to Hearson 2015 South Africa, Rwanda, Argentina, Mongolia, Zambia and Malawi are among the developing counties who have cancelled or renegotiated tax treaties in recent years, while others, such as Uganda, are undertaking reviews. These reviews and renegotiations have resulted in these countries being considerably better off positions when comes to their taxing rights.[86]

## 5.2 Treaty Abuses

Treaty abuses have been known to result in significant tax losses. According to Quak & Timmis (2018) studies show that treaties with the Netherlands led to foregone

[85] Festus Aukonobera 2012 'Uganda', in M. Lang, P. Pistone, and J. Schuch (eds), *The impact of the OECD and UN model conventions on bilateral tax treaties*, Cambridge University Press

[86] Hearson 2015: 1

revenue for developing countries of at least EUR 770 million in 2011. Similar, calculations suggest that US tax treaties cost their non-OECD country counterparts perhaps $1.6 billion in 2010 as result of Treaty shopping. Round Tripping and thin capitalisation are also issues of concern for developing countries.[87] Thin Capitalisation is basically where the level debt (financial assistance by the foreign parent) in a local company is excessively compared to the fixed capital this result in high interest payments and reduced profits for the local entity, such payments are tax deductible. The guideline used by the Commissioner in South Africa is 3:1 financial assistance/fixed capital.

Recommendation

In order to mitigate the risk of treaty shopping, countries need to ensure that their domestic laws have anti – abuse provisions and the tax treaties also include anti-abuse clauses. According to a 2015 ActionAid report the following anti abuse clauses are become more prevalent and should be considered by developing countries

- **A "main purpose" article** denies the benefits of a treaty provision where taking advantage of it was the main purpose of an activity; this appears in a number of UK treaties. If treaty benefits are denied, income then becomes taxable under domestic law.
- "**Limitation of benefits" articles** deny treaty benefits to corporations which do not have an adequate connection to a treaty country.27 These clauses are pursued by US negotiators and are aimed squarely at combatting the use of conduit countries to minimise tax.
- "**Subject-to-tax" articles** remove treaty limitations to one jurisdiction's taxing rights over cross-border income if that income is not in fact subject to tax in the other jurisdiction. If the income is not taxed in one, it may be taxed in the other. [88]

It is important for countries to ensure that they improve their domestic tax legislation, administration and systems as first priority, as dealing with tax avoidance can be very

[87] Quak & Timmis 2018: 2

[88] Action Aid UK 2015: Taxation rights slipping through the cracks: How developing countries can get a better deal on their taxing rights

complex. Issues of double taxation and tax avoidance can be effectively dealt with in domestic legislation. If and when tax treaties are in place or there is need to enter into such treaties, I recommend that the following should be assessed, which some of the recommendations are aligned with the ActionAid (2015) report.

- There should be an in-depth analysis as to the costs vs benefit and the need of entering to the treaty. This should include potential lost revenue versus investment gain.
- All treaties must include anti-abuse clauses and the domestic tax legislation must also cater for this.
- A periodic reviews of existing tax treaties to asses if they are still meeting the initial objectives
- All Governments should cancel tax treaties with tax havens and refuse to sign new treaties with tax havens[89]
- Developing country negotiators should ensure that they get a good deal on: [90]

  A: Withholding taxes
  B: Permanent establishment definitions
  C: Capital gains tax
  D: Anti-abuse clauses
  E: Arbitration

Whilst double taxation agreements can bring significant benefits and also provide potential investor with some level of certainty which could attract investments. These instruments are a double edged sword which could result in significant tax losses and abuses if not managed properly. A country has to be clear on its objectives, negotiation strategy and benefits before entering into these agreements. As a first priority developing countries need to ensure that within their means they bolster their internal capabilities, systems and administration before entering into double taxation agreements. The IMF (2014) warned developed countries should sign tax treaties with considerable caution that itself is stark reminder of how to approach these bilateral agreements.

[89] ActionAid UK 2015: 5
[90] ActionAid UK 2015: 9

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