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Tax treaties in Sub-Saharan Africa

A critical review

Acknowledgement

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A critical review

March 2015

Author: Martin Hearson

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Tax Justice Network-Africa (TJN-A) is a pan-African initiative and a member of the Global Alliance for Tax Justice. TJN-A seeks to promote socially just and progressive taxation systems in Africa, advocating for pro-poor tax regimes and the strengthening of tax regimes to enhance domestic resource mobilisation.

Our vision is a new Africa in which tax justice prevails and ensures an equitable, inclusive and sustainable development which enables all its citizens to lead a dignified and fulfilled life.

TJN-A's mission is to spearhead tax justice in Africa's development by enabling citizens and institutions to promote equitable tax systems. We do this through applied research, capacity building and policy influencing. We work with members in Africa and partners in other parts of the world.

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Tax Justice Network-Africa (TJN-A)
P. O. Box 25112-00100, Nairobi, Kenya
Tel: + 254 (0)20 247 3373
Email: info@taxjusticeafrica.net

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Key terms and acronyms

Active income.	Income earned from direct investments. Generally the taxing right rests with the source country if there is a permanent establishment.
African Tax Administration Forum (ATAF).	International organisation for collaboration between African tax administrations.
Capital gains tax.	Tax levied on the sale of an asset, a percentage of the increase in value of the asset since it was purchased or created by the seller. As opposed to a property transfer tax, which is a (smaller) percentage of the total price paid.
Common Market for Eastern and Southern Africa (COMESA).	International organisation incorporating 19 African countries from Egypt in the North to Zimbabwe in the South.
East African Community (EAC).	International organisation incorporating Burundi, Kenya, Rwanda, Tanzania and Uganda.
Foreign tax credit.	Reduction in a taxpayer's liability in their home country corresponding to the amount of tax that has been paid abroad.
Indirect transfer.	Sale of an asset located in one country that takes place through the sale of a holding company resident in another country, often to avoid Capital Gains Tax in the first country.
Management fees/ technical service fees.	Many developing countries impose a withholding tax on these payments. The term is usually a short hand for all fees of a technical, consultancy or managerial nature.
Organisation for Economic Cooperation and Development (OECD).	International organisation whose members are 34 wealthier democracies, and which describes itself as the "market leader" in international tax standard-setting
Passive income.	Income earned from sources such as portfolio investment and royalties. Generally, the taxing right rests with the residence country, although treaties grant a limited right to the source country.
Permanent establishment.	Concept in tax law that defines a minimum threshold of economic activity above which a foreign company starts to incur source taxation of active income. Traditionally, this has been based on having a physical presence for a minimum length of time.
Residence taxation.	Tax levied by a government on a taxpayer on the basis that they reside in a country. Especially, in this context, tax on an outward investor's income from abroad.
Source taxation.	Tax levied by a government on a taxpayer on the basis that they earned income within a country. Especially, in this context, tax on income earned within a country by a foreign investor.

Southern African Development Community (SADC).	International organisation incorporating 15 African states covering the whole of Southern Africa, as far North as the Democratic Republic of Congo and Tanzania.
Tax Information Exchange Agreement (TIEA).	Bilateral agreement creating legal authority and obligation to exchange taxpayer information between the tax administrations of two countries.
Tax sparing credit.	Special provision in a tax treaty that extends the foreign tax credit in one country to include taxes that would have been paid to the other country had they not been reduced or exempted under a tax incentive.
Tax treaty.	Sometimes referred to as double taxation treaties (DTTs) or double taxation agreements (DTAs), these are predominantly bilateral agreements between states that establish a common framework for taxation of cross-border activity. They are generally titled "Agreements for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital."
Territorial taxation.	Taxation of a country's residents limited only to their income earned at home, that is, exempting income earned abroad. This is now the dominant system among OECD countries for active income.
United Nations Tax Committee.	Formally known as the Committee of Experts on International Cooperation in Tax Matters, this is a group of 25 people nominated by UN member states to develop international tax standards and to "give special attention to developing countries and countries with economies in transition." Its most important output is the UN model tax treaty.
Withholding tax (WHT).	Tax levied on the recipient of a payment, but collected from the payer. Typically countries may levy WHT on dividends, interest payments, royalties and technical service fees.
Worldwide taxation.	Taxation of a country's residents on all their income earned at home and abroad, usually (but not always) with a foreign tax credit.

1 Introduction

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.[1] During 2014, an influential IMF paper warned that developing countries "would be well-advised to sign treaties only with considerable caution,"[2] 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."[3]

Meanwhile, some developing countries seem recently to have become concerned by the negative impacts of some of their treaties. Rwanda and South Africa have successfully renegotiated their agreements with Mauritius. Argentina and Mongolia have cancelled or renegotiated several agreements. Responding to this pressure, two of the developed countries whose treaty networks have raised concerns, the Netherlands and Ireland, have begun a process of review.[4]

To investigate this apparent shift in opinion among policymakers, and to see what lessons can be drawn by other developing countries, Tax Justice Network Africa (TJN-A) commissioned this study of current policy towards tax treaties in Uganda and Zambia, two countries that appear to be questioning past decisions. Fieldwork, which consisted of interviews with government officials and private sector tax advisers, took place in Kampala and Lusaka in September 2014. Uganda has announced a review of its policy towards tax treaties,[5] while Zambia is renegotiating several of its treaties. The Ugandan review has several motivations, according to finance ministry officials. 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."[6] 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.

Zambia, it seems, is keen to update very old treaties that were negotiated on poor terms by over-zealous officials in the 1970s. But a recent treaty signed with China on poor terms has created a difficult precedent, dragging down the terms of its recent negotiation with the UK.[7] Zambia is also encumbered with several colonial-era treaties that need urgent attention.

This report is divided into four following sections. Section two (2) describes the historical development

[1] Mike Lewis, Sweet Nothings: The Human Cost of a British Sugar Giant Avoiding Taxes in Southern Africa (London: ActionAid UK, 2013); Katrin McGauran, "Should the Netherlands Sign Tax Treaties with Developing Countries?," SOMO, 2013, http://somo.nl/publications-en/Publication_3958/at_download/fullfile.

[2] IMF, Spillovers on International Corporate Taxation (Washington, DC, 2014).

[3] OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing, 2014), doi:10.1787/9789264219120-en.

[4] Netherlands Ministry of Finance, Government's Response to the Report from SEO Economics Amsterdam on Other Financial Institutions and the IBFD Report on Developing Countries, vol. 2012, 2013; Irish Ministry of Finance, Public Consultation: Spillover Analysis - Possible Effects of the Irish Tax System on Developing Economies (Dublin, 2014).

[5] Ismail Musa Ladu, "Govt Suspends Double Taxation Pacts," Daily Monitor, June 06, 2014.

[6] Interviews for this project were conducted in Kampala and Lusaka in September 2014. Across the two countries, the author spoke with ten current and former government officials, eight private sector tax advisers, and a number of other stakeholders. Comments are attributed in such a way as to avoid identifying interviewees who requested anonymity.

[7] The newly renegotiated treaty with the UK is discussed in Martin Hearson, "Time We Scrutinised China's Tax Treaty Practice, Too," Tax, Development and International Relations, 2014, http://martinhearson.wordpress.com/2014/07/02/time-we-scrutinised-chinas-tax-treaty-practice-too/.

of sub-Saharan Africa's tax treaty network, including some of the reasons given for its development. Uganda and Zambia are used as examples. Section three (3) looks at some of the core vulnerabilities in the content of tax treaties signed by African countries, set in the context of weaknesses in their domestic laws. Section four (4) provides a critical perspective on recent initiatives taken by individual countries, regional organisations and other international organisations.

Section five (5) provides recommendations for African countries. In summary, they should:

1) Review all their existing tax treaties and domestic legislation, to identify areas where they are most vulnerable to revenue loss. This should include permanent establishment definitions, protection from treaty shopping, and withholding and capital gains taxes.
2) Formulate ambitious national models by applying a "best available" approach to existing models (EAC, COMESA, and UN), current treaties, and domestic legislation, none of which are currently adequate.
3) Identify red lines for negotiations from within these models.
4) Based on investment and remittance data, request renegotiations of treaties that have the greatest actual (or potential in terms of capital gains) cost. These renegotiations should be conducted on the basis of an improved distribution of taxing rights, not a "balanced" negotiation.
5) Cancel these high-impact treaties if the red lines cannot be obtained.
6) Incorporate an assessment of tax foregone due to tax treaties into an annual breakdown of tax expenditures.
7) Ensure that all tax treaties are subject to parliamentary approval as part of the ratification process.
8) Ensure that future updates to provisions of the UN and OECD model treaties, or to their commentaries and reservations/observations, reflect the positions set out in their national models.
9) Strengthen the African model treaties (EAC, COMESA, SADC) so that they act as opposite poles to the OECD model, rather than compromises between the UN and OECD models.

2 The development of sub-Saharan Africa tax treaty networks

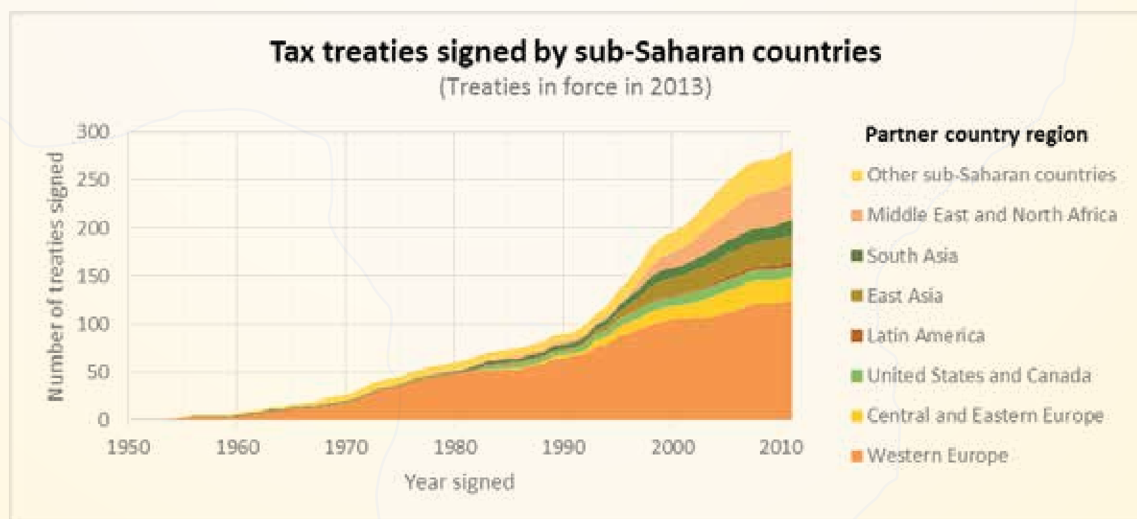
African countries' patchwork tax treaty networks today are the product of 50 years of changing power relations, policy fashions and tax measures. Analysing the processes that led to the treaties in force today reveals that in many cases they do not fulfil the original role that may have been envisioned by developing countries who signed them. This section outlines the growth of sub-Saharan countries' treaty networks and analyses some of the main drivers, based on research in Zambia, Uganda and the UK.

2.1 Africa's growing tax treaty network

Summary: Sub Saharan countries continue to sign treaties with traditional investor countries at a steady rate, but they have more recently begun to conclude treaties with emerging economies and other developing countries. This includes a growing number with low-tax countries that are risks for treaty shopping.

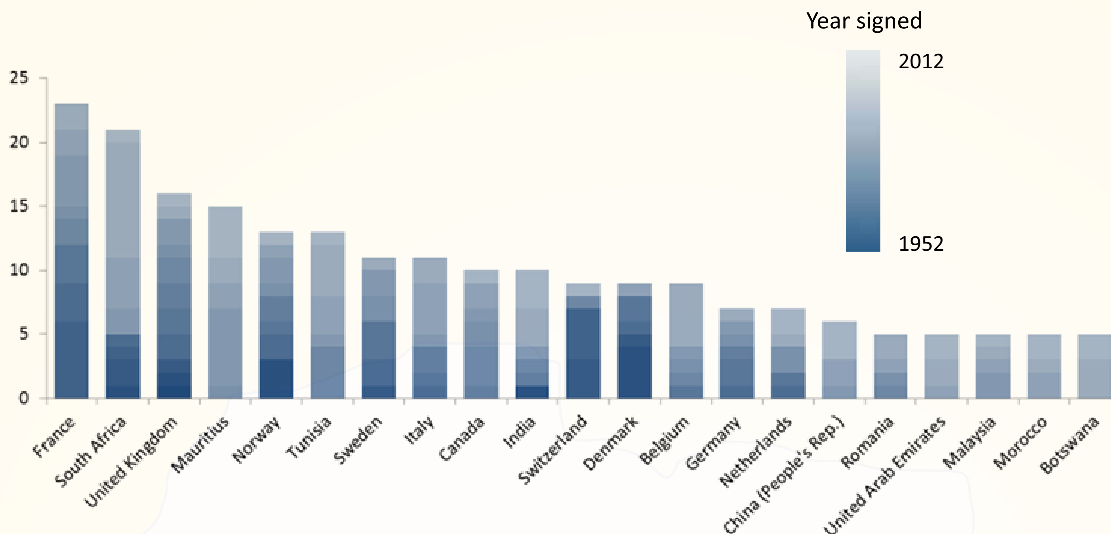
There are almost 300 tax treaties in force in sub-Saharan Africa countries. About half of them are with Western European countries, chiefly with former colonial powers and Nordic countries. The number of treaties with Western Europe has been growing steadily, and continues to grow at the same pace. The 1990s showed a sharp increase in the rate at which African countries signed treaties, as they began to sign with countries in other parts of the world, not least other African countries: South Africa, Mauritius and Tunisia all emerged as significant treaty partners for sub-Saharan countries during the last two decades.

Figure 1: tax treaties signed by sub-Saharan countries



All South African countries, excludes renegotiations

Figure 2: Countries having signed five our more treaties with sub-Saharan African countries



Source: International Bureau for Fiscal Documentation, analysed by the author[8]

This historical pattern needs to be taken into account when comparing treaties. About 100 treaties, most of them with countries of Western Europe that are sources of foreign direct investment and aid, are more than 20 years old. Half of these were signed before the United Nations model tax treaty was first published in 1980. Ideas about the content of tax treaties, patterns of investment, tax rates and systems, forms of tax planning, and political priorities on the continent have all changed considerably since these treaties were concluded.

These older treaties may present very different challenges when compared with those – around 100 – signed since 2000. This latter group includes a large number with South Africa and Mauritius, the main hubs through which investment enters the region. It also includes treaties with newer sources of investment that are not OECD members, such as India and China. These treaties may be more up-to-date in areas such as provisions for administrative cooperation between tax authorities, and can be regarded as treaties between developing countries. But they are also treaties between countries with asymmetric investment flows, which means the underlying policy concerns do not differ greatly from treaties signed with European countries. Officials interviewed for this research were under no doubt about the pressure to make concessions from these countries. "[Our treaty with] India had the WHT on management fees in it, then ten, 15 years down the line they want it out," said one, while "China you know is a powerhouse. They come and say 'for us to further this investment, we need a treaty.' That's what it's about: bluffing."

2.2 Uganda and Zambia as case studies

Summary: Zambia is an example of a country with a lot of treaties dating from the 1970s, while Uganda's treaties are more recent, mostly concluded in the late 1990s and 2000s. Zambia has decided to renegotiate some of the treaties that are most at risk of abuse, while Uganda has announced a freeze in new treaties while it formulates a clear policy.

[8] Because they have a specific role in terms of tax treaties, these figures exclude South Africa and Mauritius from the list of sub-Saharan African countries

Uganda and Zambia have contrasting patterns of treaty signature. Zambia went to great lengths to negotiate treaties in the 1970s, and most of its treaty network today consists of agreements signed around 40 years ago. For 25 years, no new treaties were concluded, although officials indicated that negotiations have been taking place throughout, or at least since 2000. The first new treaties were actually signed from 2010, with China, Botswana, the Seychelles and Mauritius.

Zambia has begun to renegotiate some of its older treaties, including with the UK, Netherlands, India and Ireland (the latter a particularly bad deal for Zambia). Even if these renegotiations produce good outcomes, some problematic treaties will remain. Its agreements with Switzerland and France are extensions of treaties signed by the UK in the 1950s, during the colonial era. The Swiss treaty prevents Zambia from imposing any tax on interest, royalty and management fee payments to Swiss residents.

More recent Zambian treaties with Mauritius and the Seychelles – countries commonly used for treaty shopping – do not contain anti-abuse provisions, and the treaty with China sets low withholding taxes that are likely to drag down Zambia's taxing rights in any (re)negotiations, as they have already done with the UK. According to an official, the Mauritius and Seychelles treaties were negotiated many years before they were signed. "The process of approval took too long such that by the time the agreements were signed, the agreements were 'out of tune' and therefore lacked the standards we now insist upon."

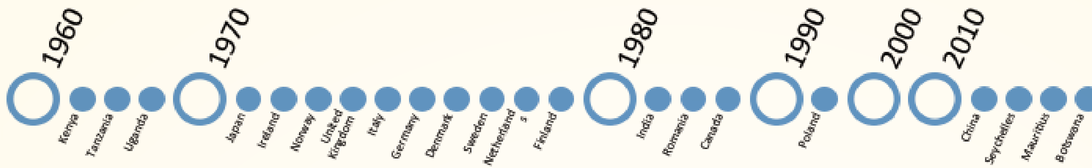
Uganda, in contrast, did not sign any tax treaties (apart from with Zambia) until 1992. From 1997 until 2007 it signed a handful, mostly with European countries, and a treaty with China (on terms similar to Zambia's) is agreed but not yet ratified. While Uganda's treaties retain greater rights for it to tax foreign investors than Zambia's do, there are still weak spots, in particular the treaties with the Netherlands and Mauritius. The former has much lower source taxing rights than Uganda's other treaties, and neither contains an anti-treaty shopping provision.

Uganda's treaties tend to have more provisions that protect its taxing rights than do those of Zambia, although the latter's more recent treaties are an improvement. This may be because many of Zambia's earlier treaties were negotiated before the UN model tax treaty was published. The UN model sets out wording that is more suited to developing countries than the other major model, that of the OECD. Important differences between the UN and OECD models include the definition of permanent establishment, which defines when a company's activity in (say) Uganda becomes significant enough to incur tax on its profits. In addition, Uganda seems to have been keen from the start to retain the right to levy a withholding tax on technical service fees, something that neither the UN nor OECD model currently provides for. In both countries, there has been a trend towards lower withholding tax rates in the most recent treaties.

Figure 3: tax treaties signed by Uganda and Zambia

Uganda

Zambia



2.3 Some past explanations for tax treaty negotiation

Summary: Tax treaties reflect the political, legal and economic environments of the time at which they were concluded. This includes colonial relations, the fashion for 'tax sparing credits', and the era before recent developments in tax information exchange. All countries now need to re-examine their treaties in the light of current political, economic and legal realities.

The original argument in favour of tax treaties, as indicated by their formal name, was the elimination of double taxation on cross border investors. That is, reconciling the competing claims to tax the same income of the home and host country so that taxpayers do not pay tax twice on income that crosses the border. This argument has been criticised in theoretical academic papers,[9] and the counter-argument is articulated in new text proposed for the commentary to the OECD model tax treaty: "A large number of cases of…double taxation can be eliminated through domestic provisions…without the need for tax treaties."[10]

This point can be tested by looking at the specifics of given treaty partners. It is hard to see evidence of potential double taxation on a scale that might really be holding back investment into African countries, because all Uganda and Zambia's treaty partners do indeed have domestic provisions to prevent double taxation on their outward investors.[11] It is, therefore, not surprising that double taxation was rarely cited as a problem by officials or tax advisers in Uganda and Zambia, and when it was, few tangible examples were available.

While some of Zambia and Uganda's historical tax treaties may have been the product of political alliance-building, most are consistent with the policy towards investment promotion that was present in these countries at the time of signing. The rest of this section discusses several key eras in tax treaty policy.

Colonial legacy

When African countries became independent, they could choose whether or not to inherit the agreements put in place by their colonial parents. Some, such as Uganda and Tanzania, preferred to let the colonial legacy lapse without replacing it, apparently prioritising tax revenue over investor-friendliness. Others, 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. In some others, such as Zambia and (until very recently) Malawi, a few colonial-era agreements stayed in force where renegotiations were not completed.

In Zambia's case, its agreements with France and Switzerland are actually ancient United Kingdom treaties, based on negotiations by the UK in 1950 and 1954, and extended to its colonies. These treaties have long been superseded in the UK by new treaties, but as the updates were signed after Zambia's independence, the old agreements remain in force as

[9] A commonly cited example is Tsilly Dagan, "The Tax Treaties Myth," New York University Journal of International Law and Politics 32 (2000): 939.

[10] OECD, Preventing the Granting of Treaty Benefits in Inappropriate Circumstances.

[11] An exception is Kenya, which has a treaty with Zambia. But there is little Kenyan outward investment into Zambia.

far as Zambia is concerned. When the UK and France recently terminated a past treaty and replaced it with a new one, the Zambia Revenue Authority (ZRA) questioned whether it should continue to honour the 1950 agreement, but according to Zambian officials, the French position was that the treaty remained in force.

The Zambia-Switzerland treaty is perhaps of more concern, given the considerable volume of trade between the countries, the use of Switzerland in tax avoidance and evasion schemes, and the presence of Swiss investors, especially Glencore. The treaty prevents Zambia from levying any withholding tax on interest, royalty and management fee payments to Switzerland, and it has an out-of-date exchange of information provision that is likely to be ineffective. Zambia has tried to renegotiate it in the past, officials said, but requests have been rebuffed and the treaty is now slated for termination.

Tax sparing and tax competition

Many African countries were very busy negotiating tax treaties during the 1970s, predominantly with European countries. As observed above, sometimes these were renegotiations of treaties currently in force or recently cancelled, while at other times they put in place arrangements where none had existed since independence.

One major objective of these treaty negotiations was to secure 'tax sparing' credits. These were provisions that gave investors resident in one country a credit against their home country tax bill not only for taxes they had paid abroad, but also for taxes that they would have paid, had they not been 'spared' through tax incentives. The objective was to ensure that the benefits of tax incentives accrued to the investor, rather than being cancelled out by higher tax obligations at home.

From 1970 to 1984, Zambia concluded 11 treaties with OECD member countries, and one with India. Of these, ten provided for tax sparing credits, while the other two exempted dividends paid to direct investors from tax in the home country entirely, which had the same effect. Negotiations with the UK in 1971 were instigated by Zambia, with the tax sparing motivation noted upfront in the formal request for negotiations: "Zambia would, in particular, wish to discuss matters arising from the operation of the Zambian Pioneer Industries (Relief from Income Tax) Act."[12]

Apart from its 1968 agreement with Zambia, Uganda did not sign any treaties until 1992. Soon after signing its first treaty, with the UK, Uganda's Minister for Finance, Planning and Economic Development announced that the government would "embark on negotiating double taxation agreements with identified major trading partners."[13] As the Minister explained, the purpose of the treaties was to "ensure that the effectiveness of current incentives is not eroded by the absence of complementary tax credits" because "in the absence of any complementary tax holidays with the home countries of foreign investors, the revenue foregone by reducing a company's tax liability in Uganda represents a revenue gain by the Ministry of Finance in the home country" with no benefit to the company concerned.[14] Its treaties with the UK, South Africa, Mauritius and Italy also include tax sparing provisions.[15]

There are a number of reasons to question the value of tax sparing provisions. In 1998, the OECD published "Tax Sparing: a Reconsideration", which highlighted the potential negative impacts of tax sparing arrangements in tax treaties, in particular that they could potentially be abused, and that they created an incentive to repatriate profits quickly, rather than reinvest them in a country.[16] This OECD report on its own did not halt the spread of tax sparing provisions,

[12] Document with the author on file

[13] Mr. J. Mayanja Nkangi, quoted in Hansard, 25.6.93

[14] ibid

[15] Historical notes of negotiations between the UK and developing countries indicate that one priority for many developing countries at this time was to expand their taxing rights in areas that older colonial era treaties restricted (for example, withholding taxes on royalties, and taxes on foreign shipping). Some negotiations, for example Uganda and Tanzania's talks with the UK, failed because agreement on these matters could not be reached. Zambia, too, was willing to sacrifice the UK's offer of tax sparing credits to retain a ten percent withholding tax rate on royalties, only for the UK to later agree a protocol to the treaty that allowed it both.

[16] OECD, Tax Sparing : A Reconsideration., ed. OECD (Paris: Organisation for Economic Co-operation and Development, 1998).

although it did suggest some 'best practice' in the area.

Furthermore, there is a growing empirical evidence base questioning the effectiveness of tax incentives, in particular fixed term tax holidays of the kind that many tax sparing clauses in tax treaties refer to specifically. Incentives may attract foreign investment, but it is often transitory and crowds out domestic investment.[17]

Tax sparing clauses are usually framed as a concession by the latter in a context of competition for inward investment by developing countries. British civil service correspondence during the peak era of tax sparing clauses, the 1970s, reveals that there was actually a vociferous lobby by British businesses for tax treaties with sparing clauses, or even for unilateral tax sparing by the UK, to strengthen their position against competitors from other countries for outward investment opportunities.[18] In this reading, by concluding a tax treaty with the UK, a developing country would have been helping British firms to outcompete their rivals, not necessarily bringing in investment that would not otherwise have come.

Perhaps a more important development than the growing consensus of skepticism towards tax incentives and tax sparing clauses has been the spread of 'territorial' tax systems. As more and more countries have exempted foreign-source dividends from tax altogether (sometimes limited to those from direct investors), tax sparing provisions in treaties have become redundant. All but one of the OECD countries with which Zambia has concluded a tax treaty now employs a 'territorial' tax system that exempts foreign-source dividends.

Table 1: Zambia's treaties with OECD member states

Country	Year signed with Zambia[1]	Year territorial tax system introduced[2]
Japan	**1970**	**2009**
Ireland	1971	-
Norway	**1971**	**2004**
Italy	**1972**	**1990**
United Kingdom	**1972**	**2009**
Denmark	**1973**	**1992**
Germany	**1973**	**2001**
Sweden	**1974**	**2003**
Netherlands	1977	1914
Finland	1978	1920
Canada	1984	1951
Poland	**1995**	**2004**

Treaties in bold have tax sparing provisions

Treaties as tax incentives

In the context of territorial tax systems, tax treaties played a different role. Increasingly, they were not tools to increase the effectiveness of tax incentives: they were tax incentives. If a multinational firm retains the benefits of, say, lower withholding tax rates, this lowers the overall tax cost of investing in one country, relative to another. This is the core logic of tax competition.

However, because treaty benefits only accrue to multinationals based in the treaty partner country, they distort the pattern of inward investment in favour of firms from the treaty partner. In this sense, tax treaties are also a form of tax competition by capital exporting countries: by lowering the tax costs of their firms, they give those firms a competitive edge in the developing country market.

[17] For a discussion see pages 21-22 of Alexander Klemm, Causes, benefits, and risks of business tax incentives, IMF Working Paper WP/09?21 (Washington D.C. January 2009).

[18] Documents with the author on file.

[19] IBFD, "IBFD Tax Research Platform," 2014, http://online.ibfd.org/.

[20] PWC, *Evolution of Territorial Tax Systems in the OECD*, 2013.

Just as the consensus among international tax advisers seems to be that most tax incentives are ineffective,[21] there was a startling consensus across the local stakeholders interviewed for this paper that tax treaties were not a primary consideration for investors in deciding whether or not to invest in Uganda and Zambia. A Zambian finance ministry official stated that "the argument that…treaties can be used to attract investment into Zambia is always a difficult premise to advance." His Ugandan counterpart concurred that "nobody comes to invest because you have a tax treaty. When you see the rationale to attract investment, it sounds laudable. But when you look at the evidence, it's not the case."

According to an accountant in a tax advisory firm, "it is a secondary factor you take into account in terms of structuring." A tax lawyer agreed:

> It would seem to me that tax is a secondary consideration. From our experience we have seen investors are looking to the economic drivers: business-based, rather than tax-based. A business will say 'now we have decided where we are going to work, let's get a tax expert to structure it'.

Promotional literature from Uganda and Zambia's investment authorities do not mention their networks of tax treaties.[22] An official at the Uganda Investment Authority (UIA) told us that investors are not interested in tax treaties: "to most of them it is not an important thing." Indeed, tax treaties are not mentioned anywhere in a comprehensive survey of investors conducted by the UIA and Uganda's National Bureau of Statistics.[23]

Despite this apparent consensus, there is also no doubt that, as with other tax incentives, individual investors lobby for tax treaties. A tax adviser said that potential investors do often ask about them. According to an official in the COMESA secretariat, "the initiative for negotiating a DTA comes from the multinationals. It's the large companies that are behind it. They are operating behind their government." A finance ministry official agreed: "if you look at all these [treaties] that have been signed, you can probably link it to a very major company that came into this country."

While it is hard to pin down specific examples, a number of stakeholders interviewed suggested that airlines are particularly keen to see tax treaties negotiated, to prevent incurring tax liabilities everywhere that they have a ground operation or sell tickets. This may explain the growing treaty networks of Ethiopia, the United Arab Emirates and Kenya, for example. "The only reason they were doing that [asking for a treaty] was because of the airline," said one negotiator referring to a treaty with a country with a major airline. It is important to realise, however, that standalone air and/or shipping tax treaties can be concluded without the need for a full agreement.

Officials in both countries indicated that they have no country-specific evidence base on the effects of tax treaties. There is, however, a significant volume of academic study on the effect of tax treaties on foreign direct investment, using increasingly sophisticated methods and data. Consistent with the views expressed above, many of these studies have failed to find a result for developing countries. The best we can say on the basis of current evidence is that tax

[21] For example, four international organisations argued that, "where governance is poor, [incentives] may do little to attract investment – and when they do attract foreign direct investment (FDI), this may well be at the expense of domestic investment or FDI into some other country. Tax-driven investment may also prove transitory." (IMF et al., Supporting the Development of More Effective Tax Systems: A Report to the G-20 Development Working Group by the IMF, OECD, UN and World Bank, 2011, 19. And in a survey of African tax officials, participants "underscored that tax incentives and exemptions have been over-emphasized as investment promotion tools" and "have not necessarily

[22] See, for example, the list of "Reasons for investing in Uganda" at *http://www.ugandainvest.go.ug/index.php/investment-guide*

[23] Uganda Bureau of Statistics, *Investor Survey Report 2012* (Kampala, 2012).

treaties have a short-run effect encouraging investors to establish new companies in developing countries, but they do not affect the size of investments in the long run.[24] Importantly, however, even these studies struggle to distinguish between genuine increases in overall investment into a developing country, distortive competition effects that change the composition but not the total volume of investment into a country, and apparent changes in investment flows that are the result of tax planning structures.

In any event, any evaluation of the likely or actual effect of a tax treaty should start with a solid grounding in the tax systems of the two countries. This should indicate whether a treaty will solve real double taxation problems, whether it will create treaty shopping opportunities, whether its main role will be as a tax incentive, and if that is the case, whether this is consistent with national policy towards tax incentives.

Responding robustly to requests from other countries really does require a political steer, for negotiators to be able to stick to evidence-based decisions and accept the potential consequences. One former official explained the dilemma. "I know there's empirical evidence that it [a treaty] has no effect on investment, but the reality country-to-country is that there's a bluff that goes on, and countries don't want to take the risk of losing big investments."

24 "Do Tax Treaties Affect Foreign Investment? The Plot Thickens," accessed October 20, 2014, http://martinhearson.wordpress.com/2014/06/19/do-tax-treaties-affect-foreign-investment-the-plot-thickens/. See also IMF, *Spillovers on International Corporate Taxation* (Washington, DC, 2014).

3 Key concerns in the content of tax treaties

Not all tax treaties are the same. This section runs through a selection of the provisions of tax treaties that raise the most concerns. It is not intended to be exhaustive. After a discussion of how the legal and economic context makes particular provisions more or less significant, it then discusses treaty rules that set limits on withholding taxes, the permanent establishment definition that sets out when a country is entitled to tax a foreign investor, rules around capital gains tax, and finally anti-abuse rules that can be built into tax treaties.

3.1 Tax treaties in context

Summary: Understanding the gains and losses from a particular treaty begins by placing it in the legal and economic context of each treaty partner. This includes their tax laws and the investment flows between them, the ways in which these might change in the foreseeable future, and the precedent any unusual feature of a treaty creates for future negotiations.

A tax treaty cannot be read in isolation from the tax laws of the countries that sign it, the trade and investment flows that it affects, or indeed the treaties signed by competitor countries. A focus on individual countries, as in this report, makes it possible to incorporate all these factors into the analysis.

One reason why it is important to consider national tax laws is that, while a tax treaty may prevent a developing country from levying certain taxes, in most cases it cannot create a liability where one does not exist. Sometimes, therefore, it might seem irrelevant whether or not a particular article from an international model has been included in a treaty, because it creates a source taxing right that the developing country does not take up. This may be the case, for example, where countries do not levy capital gains taxes.

Conversely, a treaty may prevent a developing (source) country from taxing some income that the treaty partner (the residence country) chooses not to tax itself. If the treaty partner takes up its residence taxing right, the effect is to redistribute tax revenue to it from the developing country. But if it does not, the effect may instead be to create double non-taxation. This latter situation can be exploited in tax planning schemes. Capital gains tax provisions in developing countries' tax treaties with Mauritius (which does not levy capital gains tax on international companies) are a good example of this scenario.

In other cases, an article may pertain to a type of economic activity that hardly exists between two countries (or indeed, a treaty may be signed between two countries with negligible trade and investment prospects). An example may be the article covering shipping and airlines where a country is landlocked or there are no direct flights between them.

In these situations, treaties need to be considered holistically. This means taking into account three kinds of impact:

- **Actual economic impact.** The treaty's effect on fiscal revenue and on investor behaviour. As noted earlier, there is only weak evidence in general terms that treaties signed by developing countries increase economic activity, but anticipating any effect will surely depend on the interaction of a treaty with specific elements of the two countries' tax systems.
- **Precedent.** When Denmark agreed to include a clause on technical fees in its 1973 treaty with Kenya, this probably had only a small effect on tax revenue in Kenya. But Kenya was able to point to the Danish concession in its negotiations with the UK, its main trade and investment partner, eventually persuading it to

include a similar – and probably more valuable - provision.[25] Conversely, Zambia's 2012 treaty with China included lower withholding tax rates than any of Zambia's previous treaties. The cost of this concession was more significant than just tax revenue from Chinese investors: the rates in that treaty became a benchmark in subsequent renegotiations with the UK as well, because, as a British High Commission official observed, "it's hard enough to compete against Chinese businesses in Africa as it is."

- **Fiscal policy space.** In most countries, tax treaties take precedence over domestic law. Tax systems evolve with political and economic changes, but treaties do not, unless they are renegotiated. So negotiators should consider their tax system and economy not only as it exists, but also as it might change in the foreseeable future. To implement some withholding taxes in the 1970s, African countries such as Uganda, Kenya and Nigeria had to cancel treaties they inherited at independence that placed limits on their taxing rights. Zambia recently raised some withholding tax rates, but will not see any increased revenue from payments to treaty countries, because treaty rates are capped well below the new domestic rates.

3.2 Withholding taxes

Summary: Over time, treaties signed by African countries have capped the rates of withholding taxes (WHTs) that they can apply at lower and lower rates. Although this partly reflects a fall in statutory WHT rates in some countries, Zambia is an example of a country where the revenue that can be raised by from recent increases in statutory WHTs will be limited by the limits imposed in its treaties.

Withholding taxes (WHTs) are taxes levied by a country on certain types of payments made to overseas companies. Most African countries levy some withholding taxes on dividends, interest, royalties and technical service fees. Technically, WHTs are levied on the company overseas that receives the payment, but they are 'withheld' by the local company sending it. Tax treaties set maximum thresholds on the level of WHTs that a country can levy on these payments, and in some cases – especially technical service fees – they prevent them from levying these taxes altogether.

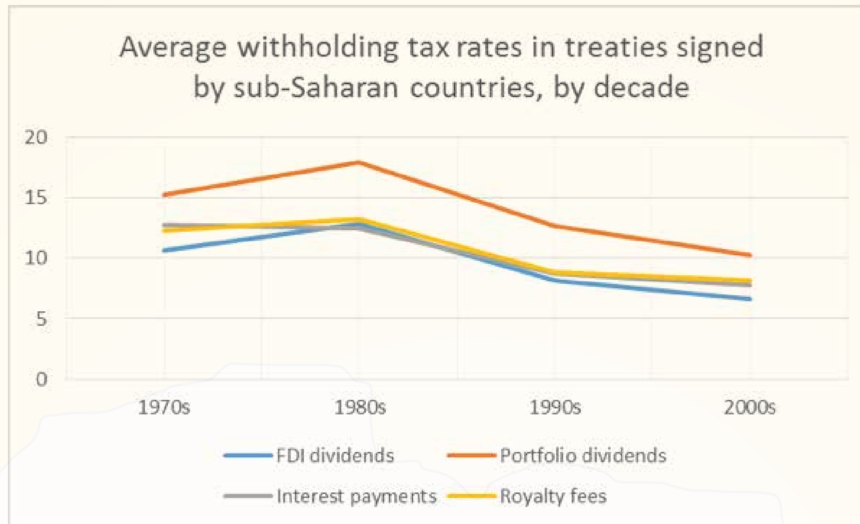
Withholding taxes have several functions. First, they allow a developing country to tax income that a foreign company receives from residents of the developing country. This means that the developing country is gaining a share of the profits generated from, for example, lending money to its residents, or exploiting intellectual property in its markets.

Revenue-raising is not the only role played by withholding taxes, a point that is often forgotten when they are discussed. A second role is as anti-avoidance measures. WHTs discourage multinational companies from shifting profits out of the country through these payments, or at least they ensure that the developing country gains some tax revenue when they do. "We realised that a lot of money was flying out through management fees," a Ugandan official said, explaining why this was a priority for his country.

Thirdly, withholding taxes also influence companies' behaviour. A withholding tax on dividends may encourage foreign investors to reinvest the profits they make in a developing country, rather than repatriating them or moving them offshore. A tax on technical service fees paid overseas may encourage them to look for – or help create – expertise within the country, rather than offshoring it.

[25] This can be seen in minutes of the UK-Kenya negotiations, available from the UK national archives

Figure 4: Average with-holding rates in treaties signed by sub-Saharan countries, by decade



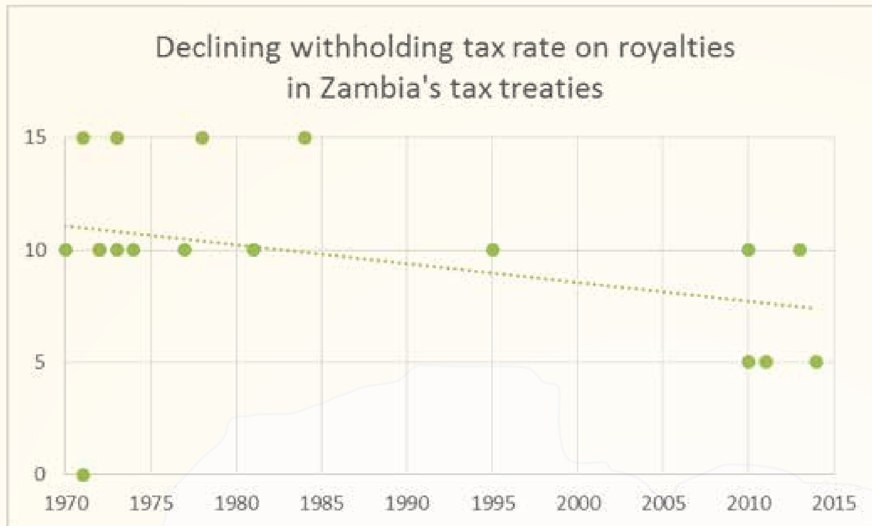
Maximum withholding tax rates on all forms of income in African countries' tax treaties have declined over time, by at least five percentage points from the 1980s to the 1990s (Figure 4). The decline could be considered as benign, since it corresponds to a fall in statutory rates in many countries: compare, for example, Uganda's current 15 percent rates to the 40 percent it charged on some forms of income in the 1970s. But it is of more concern when countries do try to increase withholding taxes as Zambia has recently done, increasing taxes on royalties and management fees from 15 to 20 percent.

Table 2: Withholding tax rates in 2014

	Uganda	Zambia
FDI dividends	15%	15%
Portfolio dividends	15%	15%
Interest	15%	15%
Royalties	15%	20%
Technical service fees	15%	20%

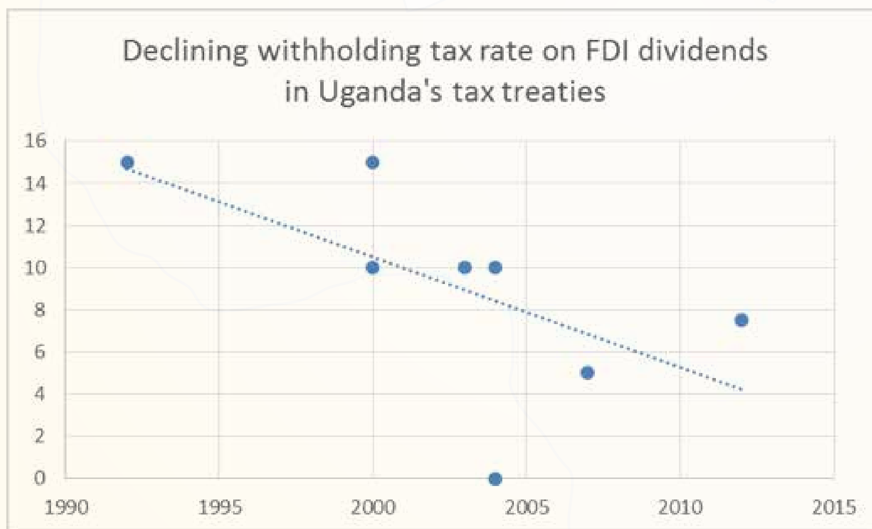
In Zambia's case, royalty WHT rates in treaties have been declining, to as low as five (5) percent in some recent treaties, in contrast to a domestic rate which is now 20 percent.

Figure 5: Declining WHT rate on royalties in Zambia's tax treaties



In Uganda's case, the FDI dividend rate has fallen over time, to well below the 15 percent in current domestic law.

Figure 6: Declining WHT rate on FDI dividends in Uganda's tax treaties



Uganda has usually insisted on a clause permitting a WHT on management fees (although it seems to be becoming less successful at this) while this doesn't seem to have been a priority for Zambia. Yet in current domestic legislation, the WHT rate on management fees in Zambia is higher than it is in Uganda. According to one Zambian official, "in the past [our priority] was just royalties, but now we've realised we are losing on management fees too."

Figure 7: WHT rate on management fees in Uganda and Zambia's tax treaties

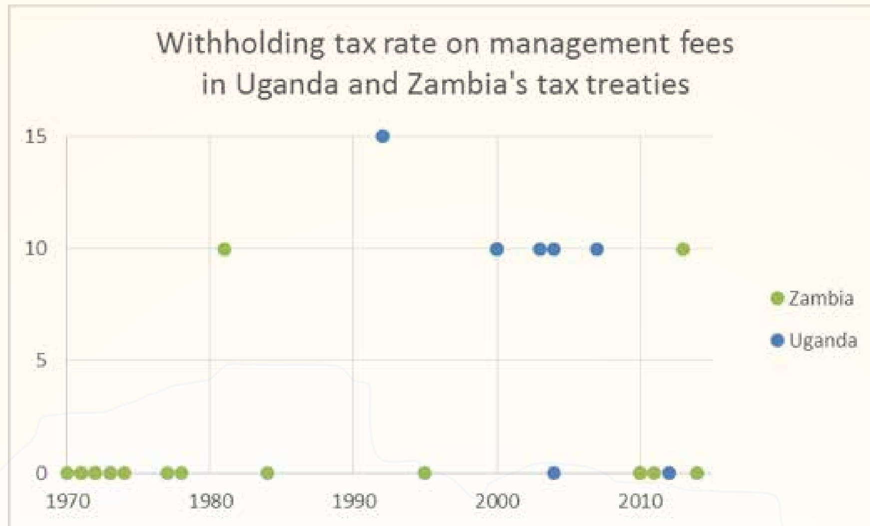


Table 3: Estimated annual revenue foregone due to reduced withholding taxes on remitted FDI earnings

UGANDA	Estimated cross-border payment (US$m)		WHT discount in treaty (%)		WHT foregone (US$m)	
	Dividends	Interest	Dividends	Interest	Dividends	Interest
Netherlands	106.7	5.7	0%*	5%	16.0	0.3
Mauritius	10.9	2.5	10%	10%	0.6	0.1
India	2.8	0.2	10%	10%	0.1	0.0
South Africa	1.8	1.3	10%	10%	0.1	0.1
Norway	0.8	0.0	10%	10%	0.04	0.0

ZAMBIA	Estimated cross-border payment (US$m)		WHT discount in treaty (%)		WHT foregone (US$m)	
	Dividends	Interest	Dividends	Interest	Dividends	Interest
United Kingdom	112	66	10%ˆ	5%	11.2	3.3
China	51	53	10%	5%	5.1	2.7
Netherlands	42	32	10%	5%	4.2	1.6
Switzerland	23	32	15%	15%	3.5	4.8
Mauritius	12	12	10%	5%	1.2	0.6
Ireland	14	1	15%	15%	2.1	0.1
France	7	2	15%	15%	1.1	0.3

Source: Investment stocks reported by Uganda and Zambia to the 2012 IMF coordinated direct investment survey, primary return on FDI in 2012 from World Bank's World Development Indicators[26]

**Treaty rate is most likely 0%, but for some companies it may be 15% (for companies not composed of shares).*

ˆThe new treaty rates have been used for illustrative purposes, although this treaty was not in effect in 2012, the year to which the data refer.

[26] Assumes that the primary return on FDI (totals: Uganda $252m, Zambia $1.03bn) is at a constant rate across all investments

It is difficult to estimate the total revenue foregone through these withholding tax reductions because the data on most cross-border flows are not publicly available. But publicly available data do allow us to estimate a portion of the revenue foregone, specifically the cost of reduced WHTs on dividends and interest payments to direct investors. Table 3 gives estimates of the withholding tax foregone in this way, for the most costly treaties signed by each country.

As can be seen, the vast majority of revenue foregone by Uganda on these types of payment is through a single treaty, with the Netherlands. In contrast, Zambia foregoes significant revenue through a number of different treaties. These figures do not include the revenue given up through treaty reductions in capital gains tax, portfolio dividends and loans, royalties and management fees, or restrictions on levying corporate income tax. They do, however, illustrate how estimates of revenue foregone can help to identify priorities for treaty reviews as well as informing public debate.

3.3 Permanent establishment

Summary: Countries' domestic laws define the threshold at which a multinational business becomes liable to tax on the profits it makes there. Tax treaties usually restrict this definition more than domestic law, but in other cases the model treaties suggest areas in which domestic law could operate with a lower threshold.

The 'permanent establishment' (PE) provisions in countries' domestic laws and in tax treaties set out the conditions in which a foreign investor operating through a branch (rather than an incorporated subsidiary) in a developing country is liable to tax. If the company doesn't meet these criteria, then the developing country can't tax it. This makes managing 'PE risk' an important part of tax planning for multinational companies. "Withholding tax rates are nothing," according to a finance ministry official. "You can have high rates and then you've given out a lot in PEs."

There are a lot of possible variations within the model treaties' PE definitions, but here we briefly review three important areas for developing countries at present. The first is the threshold for how many days a construction site must exist before it constitutes a PE. In all Uganda's treaties, the answer is six months (twice as much as domestic law, which says 90 days), while Zambia's vary between three and twelve months (domestic law says 183 days). Both countries may have given away too much in an environment where, as one government official remarked, "the Chinese can do things in three months."

Figure 8: UN model permanent establishment provisions in Uganda and Zambia's treaties in force

Article	Description	Uganda (of 10 treaties in force)	Zambia (of 18 treaties in force*)
5(3)(a)	**Length of time for a construction site**		
	Less than 6 months (better)	0%	6%
	6 months	100%	56%
	More than 6 months (worse)	0%	39%
5(3)(a)	Supervisory activities included?	80%	94%
5(3)(b)	Service permanent establishment	30%	28%
5(4)(a)	Delivery not excluded	60%	6%
5(4)(b)	Delivery not excluded	70%	6%
5(5)(b)	Stock warehouse included	30%	33%
5(6)	Insurance company included	20%	17%

**Two non-standard treaties excluded*

The second issue concerns supervisory activities connected to a construction site. Here both countries have done well at maintaining the right to tax, with only a few exceptions, such as the Uganda-UK treaty.

The third issue is the provision of services where there is a 'fixed base', i.e. a consistent physical presence. Zambia's domestic law definition explicitly permits it to tax these profits if the presence lasts six months, but Uganda's does not. The large number of Zambian treaties that don't include a service PE provision is therefore more concerning than those of Uganda, where the position is less clear.

In these and other areas of PE definition, Uganda has generally done better than Zambia at retaining its taxing rights, but these gains may be frustrated by its domestic law definition, which is strong in terms of the short number of days it applies, but narrow in the list of activities, especially the lack of an explicit mention of the 'service PE'. Conversely, Zambia has a strong domestic definition that mostly follows the UN model convention, but this is often restricted by concessions in its tax treaties.

3.4 Capital gains

Summary: Capital gains tax could be an important source of revenue for many developing countries. But tax treaties frequently create possibilities for avoidance by multinational investors. Countries that don't currently have capital gains tax should not ignore these provisions of tax treaties, in case they decide to introduce a capital gains tax at a future date.

Capital gains tax is levied when a company or individual sells an asset for a higher value than it receives it. It can be complicated to administer, especially in countries where inflation rates are high, which may explain why some developing countries do not currently have this tax.[27] Because foreign investors own a large proportion of Africa's large companies, especially those with large assets such as mines, tax treaties can have a big impact

[27] Instead, they may have a property transfer tax, which is charged at a lower rate on the whole value of the sale.

on their ability to implement or introduce a capital gains tax. Kenya, for example, announced plans to introduce a capital gains tax, at the same time as it concluded a tax treaty with Mauritius opening up new opportunities to avoid it.

Uganda and Zambia are in very different positions, because Uganda already has a capital gains tax, while Zambia does not. Uganda's capital gains tax applies to gains from the sale of moveable and immovable property (the latter might include a mine, a factory, or a mobile phone mast). To prevent tax avoidance using shell companies, it also applies to sales of shares in 'property rich' companies whose value comes principally from such immoveable property.

Unfortunately, most of Uganda's tax treaties frustrate this desire, because, while they allow it to tax gains from the sale of property by foreign investors, they don't include the 'property rich' companies provision, even though it is in Uganda's domestic law and in the UN and OECD models. This allows foreign companies with large amounts of assets in Uganda to avoid a capital gains liability by structuring a sale through an indirect transfer of shares in a treaty partner country.

Neither Uganda nor Zambia has ever signed a tax treaty that permits it to tax gains from the sale of shares in ordinary companies, even though this is a provision in the UN model convention. At present, neither levies such a tax, just as Zambia does not tax capital gains at all. If they were to change this policy, they would find their tax treaties a significant obstacle.

3.5 Treaty shopping/anti-avoidance

Summary: Tax treaties, especially those with low-tax jurisdictions such as the Netherlands and Mauritius, create significant risks for tax avoidance. Domestic rules may not be enough to prevent this, but developing countries' tax treaties rarely contain specific or general anti-abuse rules.

The use of tax treaties for Base Erosion and Profit Shifting (BEPS) has a growing profile, not least in Zambia following a report by ActionAid that highlighted the use of the country's treaties with Ireland and the Netherlands.[28] The concern here is companies' exploitation of tax rules (for example on permanent establishment) to prevent profits made in a developing country from being taxable there, or to shift those profits from the developing country to an offshore location. A full armoury of defences against these practices requires both specific rules to target particular known practices and general rules that widen the net. To be most effective, rules in domestic law and in tax treaties need to be designed to work together.

Uganda, for example, has a general 'limitation of benefits' rule in its income tax law, which specifically denies tax treaty benefits to companies whose underlying owners are not mostly residents of the treaty partner. The URA has only recently begun to use this rule to deny treaty benefits, and so far taxpayers have accepted its view, said URA officials. But the prevailing view in both the private sector and the URA is that this provision might not stand up to a legal challenge, because international treaty law generally prevents domestic law from overriding treaty commitments.

Zambia has a general anti-avoidance rule in its tax law, but this has never been used by the ZRA to deny treaty benefits to a taxpayer, government officials said. The same lack of certainty about the legal status of a 'treaty override' may underpin the ZRA's reticence.

In any event, both countries' treaties overwhelmingly lack anti-abuse provisions. General anti-abuse provisions in tax treaties are not currently common, although it is likely that they will become more so thanks to current work ongoing at the OECD. However, successive updates to the model tax

28 Lewis, *Sweet Nothings: The Human Cost of a British Sugar Giant Avoiding Taxes in Southern Africa.*

conventions have already introduced specific provisions that prevent the abuse of certain aspects of the treaties. These provisions appear in hardly any of the treaties signed by Uganda and Zambia.

Table 4: Examples of specific anti-abuse rules from the UN model in Uganda and Zambia's tax treaties in force

Article	Description	Uganda (of 10 treaties in force)	Zambia (of 18 treaties in force*)
5(5)(b)	Dependent agent maintaining stock	30%	33%
7(1)(b&c)	Limited force of attraction	0%	17%
13(4)	Capital gains – 'property rich'	10%	21%^

**Two non-standard treaties excluded*

^ Treaties with no capital gains article excluded

This is not an abstract point. Uganda would be in a much certain position in its $85m dispute with Zain had it secured article 13(4) of the UN and OECD models in its treaty with the Netherlands;[29] anti-abuse rules in the Zambia-Ireland treaty may have prevented the 'Dublin dog's leg' highlighted by ActionAid in the case of Zambia sugar. As a Zambian official said, "[treaties with] Ireland and the Netherlands have really messed us up" because of treaty shopping.

3.6 Administrative cooperation

Summary: Officials in both countries indicate that one reason for negotiating new tax treaties and renegotiating old ones is to obtain administrative cooperation between tax authorities. This is undoubtedly important for tackling offshore tax evasion and for auditing multinational companies. But comprehensive tax treaties may not be the best way to achieve it.

Cooperation between tax authorities on international tax matters often requires some kind of treaty. Modern bilateral tax treaties bring with them the authority to cooperate in two important ways: information exchange and assistance in the collection of taxes. Other forms of mutual assistance, are generally obtained through multilateral conventions.

Officials in both countries regard information exchange as an important benefit from tax treaties. But it is important to be discriminating about which treaties provide real benefits in this regard. Revenue officials said that Uganda makes at the most "maybe one request per year" using the existing tax information powers in its tax treaties. In Zambia, officials indicated that they do make use of these powers, but not all tax treaties are with countries from which they really need information. For another African country, Kenya, the most important partners for information exchange are low tax jurisdictions that contain subsidiaries of multinationals that conduct transfer pricing transactions with sister companies in Kenya. It has been pursuing tax information exchange agreements, rather than tax treaties, with these countries.[30]

A second area of administrative cooperation, cited frequently by officials, is the legal basis created by modern tax treaties for the tax authority of one country to collect taxes on behalf of the other. This is very important in cases where a taxpayer no longer has any assets in the developing country at the time

29 Court of Appeal of Uganda, Commissioner General, URA versus Zain International BV (2012).

30 Interview with KRA official, Nairobi, September 2013

that an assessment is raised by the tax authority – large capital gains cases, for example, or cases of short duration permanent establishments. As Table 2 shows, however, Uganda and Zambia's treaty networks are somewhat patchy in their provision of this benefit.

Table 5: Fiscal cooperation provisions in Uganda and Zambia's tax treaties in force

	Uganda (of 10 treaties in force)	Zambia (of 18 treaties in force*)
Information exchange	100%	100%
Collection of taxes	40%	0%

*Two non-standard treaties excluded.

As noted earlier, Kenya is seeking information exchange through standalone TIEAs, rather than through tax agreements. Both information exchange and assistance in the collection of taxes are also available to African countries through multilateral agreements, which also provide for other forms of mutual assistance, such as joint auditing of multinational firms across several countries at once.

Zambia and Uganda are both signatories to the ATAF multilateral convention, which has the advantage of including Mauritius, but is not yet in force.[31] They could also follow Ghana in joining the multilateral convention initiated by the OECD and Council of Europe, which is in force and covers the vast majority of their tax treaty partners.[32]

31 ATAF Multilateral Convention on Mutual Assistance

32 The Multilateral Convention on Mutual Assistance, formerly the OECD/Council of Europe Multilateral Convention on Mutual Assistance

4 Examples of recent initiatives

4.1 Cancellations and renegotiations: what was achieved and why?

Summary: There are a number of examples of developing countries that have cancelled or sought to renegotiate particular tax treaties. Cancellations may improve the prospects for renegotiation, or they may follow from a failure to renegotiate. In any event, the results of renegotiations have been mixed for developing countries.

Cancelling tax treaties is far from unprecedented. It has usually come about because countries want improved terms: either as part of a renegotiation strategy, or because renegotiations failed. As Table 6 illustrates, cancellations in recent years have tended to relate to concerns about treaty shopping. But in the 1970s, Kenya and Nigeria – for example – terminated the tax treaties they had inherited from colonial times, as part of a strategy to negotiate better terms.[33]

The decision to cancel a tax treaty should not be taken lightly. While in broad terms there does not seem to be a compelling benefit from most tax treaties, to balance out their costs in terms of tax revenue, countries should still consider any particular characteristics of their tax systems and those of their treaty partners that might make a specific treaty valuable. They should also consider whether the revenue benefits of cancelling a treaty are significant enough to justify the reputational cost of such a dramatic move.

Table 6: Some recent tax treaty cancellations

Terminating country	Partner country	Year terminated	Reason given
Germany	Brazil	2005	Non-standard transfer pricing rules in Brazil; new Brazilian taxes not included; no need for matching credits.
Indonesia	Mauritius	2006	"There was an abuse that was inflicting a loss upon Indonesia"
Argentina	Austria	2008	Suggested to be due to treaty shopping
Rwanda	Mauritius	2012	Appears to have been part of renegotiation strategy
Mongolia	Luxembourg	2012	Treaty shopping by mining companies; slow response to request to renegotiate
Mongolia	Netherlands	2012	Treaty shopping by mining companies; refusal to meet renegotiation terms
Argentina	Chile	2012	
Argentina	Spain	2012	Appears to have been part of renegotiation strategy
Argentina	Switzerland	2012	Appears to have been part of renegotiation strategy
Malawi	Netherlands	2013	Appears to have been part of renegotiation strategy

[33] The notes of termination with the UK are on file with the author

Most renegotiations do not begin or end with a unilateral treaty cancellation; instead a new treaty supersedes the old one, or a protocol amending the previous treaty is agreed. A number of recent renegotiations provide better and worse examples from which developing countries can draw lessons.

Rwanda-Mauritius (2013). This renegotiation produced a significant improvement in terms for Rwanda. With withholding taxes set at zero, it was perhaps the case that "the only way was up"! But Rwanda's new terms were among the best that any sub Saharan country had obtained in a treaty with Mauritius, with higher withholding taxes and low permanent establishment thresholds.

Table 7: High-risk provisions in sub-Saharan countries' treaties with Mauritius, signed after 2000

Country	Rwanda	Senegal	Uganda	Zambia	Kenya	Rwanda
Year	2001	2002	2003	2011	2012	2013
Construction PE (months, lower is better)	12	9	6	9	12	6
Supervisory activities included	Yes	Yes	Yes	Yes	Yes	Yes
Services PE (months, lower is better)	12	9	4	No	6	6
Max dividend WHT	Exempt	Exempt	10	5	5	10
Max interest WHT	Exempt	Exempt	10	10	10	10
Max royalties WHT	Exempt	Exempt	10	5	10	10
Max management fees WHT	Exempt	Exempt	10	Exempt	Exempt	12
Capital gains: property rich companies provision	No	No	No	NA	No	No
Capital gains on sales of ordinary shares	No	No	No	NA	No	No

Zambia-UK (2014). This renegotiation appears to have been the product of mutual desires to see changes. The result is a "balanced" negotiation that if anything leaves Zambia with fewer taxing rights, not more. As British and Zambian officials both confirmed, a key concern for the UK was to match the favourable withholding taxes given to Chinese investors in the 2012 Zambia-China agreement. In return, Zambia obtained a services permanent establishment provision, and it will benefit from information exchange and assistance in the collection of taxes provisions.

Zambia-Netherlands/Ireland (ongoing). Zambian officials indicated that the country's renegotiations with the Netherlands and Ireland have produced significant improvements over the previous treaties, the result perhaps of political pressure on these two countries from civil society campaigns and the OECD BEPS project. These treaties can't be evaluated, as they aren't yet public.

Argentina-Spain/Switzerland (2013/4). Following its treaty cancellations in 2012, Argentina negotiated replacement treaties with Spain and Switzerland. These new treaties included significant improvements for Argentina. Both were changed to allow Argentina to levy its personal assets tax on residents of the other country. The Swiss treaty introduced a modern exchange of information clause. The new Spanish treaty removed a most favoured nation clause, and was accompanied by a memorandum of understanding that included several anti-abuse provisions.

South Africa-Mauritius (2013). Perhaps the best example of a renegotiation that took place without a prior cancellation, South Africa achieved major gains from its recent renegotiation with Mauritius. This included the right to tax capital gains from the sale of South African assets by Mauritian-owned 'property-rich' companies, and to impose withholding taxes on royalties and interest, as well as a higher tax on dividends. The treaty also makes it harder for South African-managed companies to qualify as tax resident in Mauritius.

It is worth noting that many more tax treaty renegotiations have taken place than are visible in new treaties. In Zambia, in particular, renegotiated treaties have in the past become jammed in the process of cabinet approval. "You send it to the minister for permission, and it just sits there," said one official. Zambia's outdated treaty with South Africa is a concern for businesses, as one adviser explained. "The treaty with South Africa is very old, it can't be implemented in places. It is 15 years since they renegotiated that treaty. Each side blames the other [that it has not yet been ratified]." Zambian officials indicated that this treaty has now received cabinet approval and is just awaiting signature.

4.2 Developments in African organisations

Summary: The EAC, COMESA and SADC have all formulated model treaties for negotiations with each other or with third countries. Although each model has one or two more ambitious provisions than the UN model, they are all on average less source-based than the UN model. An ambitious opening position for an African country should therefore pick the best available provisions from existing treaties, African models and the UN model.

Tax treaty negotiations take as their starting point model conventions. Historically, the two most influential model tax conventions have been those of the OECD and the United Nations, although many countries have their own national models, and some regional economic organisations have also formulated models. This proliferation is perhaps a little confusing for countries that might potentially use more than one model treaty. The model treaties each have strengths and weaknesses, which means that an African country seeking a good outcome could adopt a "best available" approach in selecting provisions to use for its own national model.

Capital exporting countries are most likely to start negotiations from the OECD model, and will expect African countries to make compromises from their own opening positions. To obtain a result with strong protection for their taxing rights, it therefore makes sense for African opening positions to be formulated on a more ambitious basis than the compromise outcome they are willing to accept. The UN model tax treaty is such a compromise position between developed and developing countries, which means that African regional models and countries' national models should look to set out a stronger position, with the UN model as a reserve position.

The EAC model

As well as a multilateral tax treaty amongst its five members, the East African Community (EAC) has formulated a model tax treaty for negotiations with third countries. The EAC model has some strengths when compared to the UN model. For example, it includes a general 'limitation of benefits' clause, which tries to prevent the application of the treaty where the company concerned has been using it for treaty shopping. This is similar to, but clearer than, the rule found in Uganda's domestic legislation.

Another strength of the EAC model is the inclusion of an article permitting a ten percent withholding tax on management fees. This article is quite common in treaties signed by some African countries, but for the time being it is missing from both the UN and OECD models.

The EAC model is weaker, however, when it comes to the quantitative thresholds specified throughout.

Here, it seems to give a compromise position rather than marking out a more ambitious position with the expectation that it will be knocked down in negotiations. It specifies withholding tax rates of 7.5 percent on FDI shares (although with a high threshold of 50 percent ownership), which is lower than the rate in most treaties currently in force in EAC countries. Withholding tax rates on interest and royalty payments are capped at 15 percent, but this is reduced to ten percent for related parties, a concession that would surely be better made during the horse trading of negotiations. The ten percent on management fees is well below the rate many EAC countries have in their domestic legislation.

The EAC model draws tighter restrictions on the circumstances in which African countries can tax inward investment as 'permanent establishment' than the UN model. For example, it follows the OECD model in excluding delivery locations. It proposes that construction projects and service providers should not be taxed unless they are present in a country for six months (no figure is specified in the UN model). In Uganda, officials seemed aware that many projects covered under these provisions may not be taxed, because they can be accomplished in less. "The Chinese can do things in three months," a Finance Ministry official pointed out.

As for capital gains, the EAC model omits the UN paragraph 13(5) permitting source country taxation of on capital gains from the sale of general shares. It also uses the weaker OECD definition of a 'property rich' company in paragraph 13(4), which can be avoided through the use of a partnership or trust, rather than the stronger definition in the UN model.

Finally, the EAC model takes the unusual step of including a most favoured nation (MFN) clause in its withholding tax articles. This is the clause in article 14:

> If after the signature of this Agreement under any Convention or Agreement between a Contracting State and a third State, the Contracting State should limit its taxation at source on management or professional fees to a rate lower or a scope more restricted than the rate or scope provided for in this Agreement on the said items of income, then as from the date on which the relevant Contracting State Convention or Agreement enters into force the same rate or scope as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention.

An MFN clause can strengthen a country's position in subsequent negotiations, because both sides appreciate the costs of it agreeing to a lower rate. But once triggered, those costs can be significant. A significant issue with respect to this clause is that it is bilateral: in a treaty with a capital exporting country, it seems that the clause could be triggered by the capital exporter concluding a subsequent agreement with lower withholding tax, even though any benefits from the resulting lower rate would overwhelmingly accrue to the capital exporter.

Such an incident occurred with respect to the April 2003 Venezuela-Spain treaty. In May 2006, the bilateral MFN clause in its interest article was triggered through a kind of domino effect: Estonia and Netherlands signed a treaty granting exclusive residence taxation rights over interest; this activated the MFN clause in the September 2003 Spain-Estonia treaty, which in turn activated the MFN clause in the Venezuela-Spain treaty. As a result, "Venezuela's treaty with Spain has undoubtedly become the most favourable tax treaty executed by Venezuela to date".[39]

An MFN clause, just like a six month PE definition, a 7.5 or ten percent withholding tax, and numerous UN provisions that have not been carried across into the

[39] Leopold Escobar, "MFN Clause Activated in Spain-Venezuela Tax Treaty," *Tax Notes International*, 44 (2006), 846–847.

EAC model,[40] could have been kept in reserve, rather than included in the model, to be given up in return for something else during negotiations.

The COMESA model

The COMESA model tax treaty was developed by European consultants in 2010-12.[41] The project seems to have originated with a desire to conclude more treaties among COMESA members, but it has subsequently begun to be used by COMESA members in negotiations with developed countries as well, according to a COMESA official.

Like the EAC model, the COMESA model has some strengths in comparison to the UN model, but its protection of source taxing rights is weaker than both the EAC and UN models. For example, its PE definition omits both delivery units and dependent agents maintaining stock; it also follows the less-expansive OECD definition of royalties. The model doesn't specify withholding tax rates, which may be preferable to the compromise rates specified in the EAC model, but is less beneficial than higher rates would be. Unlike the EAC and SADC models, it doesn't include an article on technical service fees.

There are two main advantages to the COMESA model. The first is the inclusion of main purpose tests in some of the withholding tax articles; these are specific anti-avoidance provisions that complement the treaty's 'beneficial owner' and 'special relationship' provisions.[42]

Second, member states can enter reservations on the COMESA model. For example, Burundi, Malawi, Rwanda, Swaziland, Uganda and Zambia have all entered reservations indicating that they prefer to tax management fees in the same way as royalties. Notably, Mauritius has entered reservations stating that it does not wish to include certain anti-avoidance provisions in its treaties.

The SADC model

The SADC model was an important point of departure for the COMESA model, and the two are similar in many respects. Where they differ, the SADC model is usually more generous to capital importing countries. This includes the inclusion of a technical service fees article in the main text, a 'property rich' companies paragraph in the capital gains article, and a broader definition of royalties. Countries can also enter reservations on the SADC model, and there are quite a large number of reservations. The SADC model is thus less generous to capital importers than the UN model, but more generous than the COMESA model.

The SADC and COMESA models may have been foreseen more as a model for negotiations between member states (there is a SADC memorandum of understanding that encourages members to conclude treaties among themselves). But this does not mean that concerns about protection of source taxation rights are irrelevant. "There has been a relaxed approach to fellow African countries because you don't expect them to be killing you," one official said. "But they are." These organisations include among their memberships larger capital exporters (South Africa in SADC, Egypt in COMESA) and two tax havens (Mauritius and the Seychelles) as well as some countries that may be smaller scale capital exporters, such as Kenya.

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40 For example: source taxation of shipping in article 8 of the UN model, which is probably uninteresting for a landlocked country; inclusion of payments for the use of equipment within the definition of royalties; taxation of senior managers in article 16 of the UN model.

41 Roger Bunting, Peter Fawcett, and Caroline Makasa, *A Roadmap for Further Negotiations by COMESA Countries* (Brussels, 2012).

42 Notably, Mauritius has entered a reservation on these articles.

Table 8: regional model treaties compared to the UN model

UN model reference	Provision	EAC	COMESA	SADC
5(3)(a)	Construction PE (months)	6	Unspecified	Unspecified
5(3)(a)	Supervisory activities	Yes	Yes	Yes
5(3)(b)	Service PE (months)	6	Unspecified	Unspecified
10	WHT on FDI dividend (%)	7.5	Unspecified	Unspecified
10	FDI threshold (%)	50	Unspecified	Unspecified
10	WHT on portfolio dividend (%)	15	Unspecified	Unspecified
11	WHT on interest (%)	10 OR 15	Unspecified^	Unspecified
12	WHT on royalties (%)	10 OR 15	Unspecified^	Unspecified
12a	WHT on management fees	10	No*	Unspecified
13(4)	Capital gains – 'property rich'	No	No	Yes
13(5)	Capital gains – other shares	No	No	No
	General limitation of benefits	Yes	No	No
26	Exchange of information	Yes	Yes	Yes
27	Collection of taxes	Yes	Yes	Yes

Red indicates provision is worse (less source-based) than the UN model
Green indicates provision is better (more source-based) than the UN model
^ Includes main purpose test
* Among the reservations to the COMESA model, some countries, including Uganda and Zambia, reserve the right to include a separate article concerning technical service fees, similar to article 12

4.3 Developments in other international organisations

Summary: Both the UN and OECD are making improvements to their model treaties, some of which have been anticipated in one or other of the African models. But limited African participation in the work of the UN committee, together with the small number of observations entered by African countries on the OECD model, mean that African countries are not getting the most that could be achieved from these forums.

The United Nations

The UN model is formally titled the *"Model Double Taxation Convention between Developed and Developing Countries,"* and it is produced by a committee of experts with a mandate "to have regard to the special needs of developing countries."[43] It was first published in 1980, when it closely reflected the OECD model. Since then it has been updated twice, most recently in 2011, with a growing divergence between the two.

The Committee intends to produce a further update before its current four year term ends in 2016. Some significant changes in the forthcoming UN model are likely to be a proposed article allowing developing countries to tax technical service fees (as is already included in the SADC and EAC model treaties), a proposed article dealing with tax planning through 'hybrid entities', and improvements to the article on information exchange.

[43] An alternative perspective is given in John F Avery Jones, "Are Tax Treaties Necessary?," *Tax Law Review 53*, no. 1 (1999): 1–38. "There seems little need for a separate model for developing countries. All that is needed is an acceptance by OECD members of the developing countries' need for more source tax."

Renegotiating individual treaties to incorporate newer provisions of the UN model could be to developing countries' benefit, but should be approached with caution. There are two reasons for this. The first is that negotiations to date using the UN model have not been too successful. Although developing country negotiators frequently refer to the UN model as their starting point in negotiations, the actual treaties signed by developing countries contain on average many more OECD provisions than UN provisions.[44] This may be because developing countries' domestic tax laws are weaker than the UN model, because of the imbalance in negotiating power or because the UN model has not been updated as frequently as the OECD model, leading to a view that some provisions are out of date.

The second reason is the lack of African influence on the updates to the UN model. The UN committee suffers from a lack of resources, and it has faced some difficult disagreements between members from developed and developing countries, a notable current example being over the proposed article on technical service fees. As a former Zambian member of the UN committee said, "in the UN, there are big boys there, and that is the fight you have to face."

There are five UN committee members from Africa (Ghana, Zambia, Senegal, South Africa and Morocco), and a handful of other observers from Africa,[45] but nothing like the coordinated approach to influencing the UN instruments that can be observed from, in particular, the European Union countries. Far more developing countries attend the annual OECD Tax Treaties Meeting, which is primarily a talking shop, than the UN committee session, at which decisions are made. Given the number of countries that profess to rely on the UN model, this is a dangerous surrender of influence to other countries.

The OECD

Although the OECD model treaty is not designed with developing countries' needs in mind, the OECD has considerably more technical capacity than the UN, some of which is expended on improvements that benefit both developed and developing countries. This is manifested in the Base Erosion and Profit Shifting project, which will produce a number of changes to the OECD model tax treaty that will help reduce the risk of tax planning. This includes the introduction of an anti-treaty shopping provision, as is already included in the EAC model treaty.[46]

The OECD proposes to disseminate these changes through a multilateral convention, which would implement changes to all the existing bilateral treaties between signatories to the convention, subject to various opt-outs and opt-ins.[47] This may provide an opportunity for developing countries to update their treaties in ways that strengthen their protection against tax planning, but it may also carry the risk of substituting less advantageous OECD provisions into existing treaties negotiated by developing countries. This will depend on the eventual form of the multilateral convention.

Many African countries attend the OECD's annual tax treaties meeting, as well as participating in its task force on tax and development. But decisions about the OECD model tax treaty are taken at meetings of Working Party 1, which only South Africa is entitled to attend among sub Saharan countries. Non-members are, however, able to enter formal "observations" on the OECD model treaty and its commentary. As figure 1 below shows, Ivory Coast, Gabon and the Democratic Republic of Congo are the only sub-Saharan states to have entered observations on the OECD model.

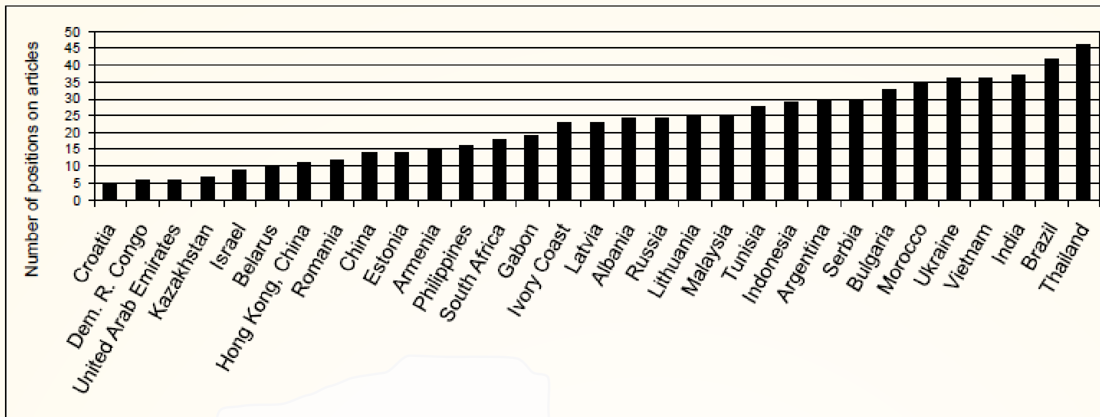
[44] Wim Wijnen and Jan de Goede, "The UN Model in Practice 1997-2013" (International Bureau of Fiscal Documentation, 2013).

[45] for example Tanzania, which has attended the last few committee sessions and spoke at both

[46] OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances.*

[47] OECD, "Action Plan on Base Erosion and Profit Shifting" (OECD Publishing, July 19, 2013), http://www.oecd-ilibrary.org/taxation/action-plan-on-base-erosion-and-profit-shifting_9789264202719-en.

Figure 9: Number of observations recorded on the OECD model by non-member countries



Source: Vega & Rudyck, 2011[48]

Because sub-Saharan countries frequently accept OECD model provisions in their treaties, it would be important for them to enter observations both to improve their negotiating stance and to prepare the ground for treaty disputes that might turn to the model treaty and its commentary.

For example, in 2010 the OECD made changes to article 7 of its model convention that substantially shifted the balance of taxing rights away from the operating countries of multinationals to their head office countries. Objections to this change were registered on behalf of Argentina, Azerbaijan, Brazil, Bulgaria, Colombia, Hong Kong, Indonesia, Latvia, Malaysia, Romania, Russia, Serbia, Singapore, South Africa and Thailand.[49] This declared opposition is surely useful for developing countries wishing to prevent the inclusion of the new OECD provision in a treaty, and sub Saharan countries would do well to register their objection to clauses such as this.

[48] Alberto Vega and Ilja Rudyk, "Explaining Reservations to the OECD Model Tax Convention: An Empirical Approach," Indret, 2011,

[49] OECD, *Model Tax Convention on Income and on Capital,* 2010th edn (Paris: OECD, 2010).1–19.

5 Conclusion and recommendations

Policymakers in African countries in 2015 have inherited tax treaty networks that are based on past priorities stretching back as far as 60 years. These treaties are not based on their present day needs or informed by today's evidence on their positive and negative effects. This leaves African countries vulnerable to unnecessary revenue loss, not only through tax treaty shopping, but also because past governments negotiated away taxing rights for which they now get no concessions in return.

There is no one-size-fits-all approach to fixing these problems. Some treaties may resolve real double taxation problems, or have clinched borderline investments. But we can be sure that all treaties in force in African countries, whether they are five or 50 years old, need an evidence-based review. A clear policy needs to guide renegotiations, cancellations and any new future treaties. It should take into account:

- Whether there is a real need, based on the two countries' tax systems, to protect investors from double taxation
- The actual or expected effect of a treaty on investment flows
- The revenue costs from the treaty, including from tax treaty shopping
- Any precedent set for future negotiations

With this in mind, African countries should conduct full reviews of their tax treaty networks. These may require external expertise, but if that is the case it should also raise questions about a country's readiness to negotiate new treaties at all. In the words of a COMESA secretariat official "Some countries don't know how important DTAs are. They are just signing them without knowing. If a DTA isn't negotiated fairly by the government, it is going to lose revenue."

African countries should:

1) **Review all their existing tax treaties and domestic legislation, to identify areas where they are most vulnerable to revenue loss. This should include PE definitions, protection from treaty shopping, and withholding and capital gains taxes.**

2) **Formulate ambitious national models by applying a "best available" approach to existing models (EAC, COMESA and UN), current treaties, and domestic legislation, none of which are currently adequate for this purpose. This might include:**

   a) All elements of the UN model PE definition, with short period of time for construction sites and service PEs, such as the 90 days in Ugandan law.

   b) 15% withholding tax rates across-the-board, including on technical service fees, as per Uganda's treaty with the UK and its domestic legislation, with main purpose tests for passive income as per the COMESA model.

   c) Include all capital gains provisions from the UN model, even where there is currently no capital gains tax.

   d) The Limitation of Benefits clause from the EAC model or the forthcoming new OECD provision.

   e) Exchange of information and collection of taxes provisions from the UN and EAC models.

3) **Identify red lines for negotiations. This should certainly include items c, d and e from the above list.**

4) **Based on investment and remittance data, request renegotiations of treaties that have the greatest actual (or potential in terms of capital gains) cost. These renegotiations should be conducted on the basis of an improved distribution of taxing rights, not a "balanced" negotiation.**

5) **Cancel these high-impact treaties if the red lines cannot be obtained.**

In some African countries, such as Zambia and Uganda, treaties are ratified by the cabinet, with no parliamentary scrutiny. This should be changed, so that democratic representatives can scrutinise the deal struck by negotiators. There is some welcome progress here, including in Uganda, where the government has committed to consulting as it formulates its new policy on tax treaties, and in Kenya, where Tax Justice Network Africa has issued a legal challenge to a tax treaty ratified without parliamentary scrutiny. Since tax treaties often seem to be revenue concessions granted with the idea of attracting foreign investment, they should be subject to the same scrutiny as should tax incentives.

African countries should:

6) **Incorporate an assessment of tax foregone due to tax treaties into an annual breakdown of tax expenditures; and**

7) **Ensure that all tax treaties are subject to parliamentary approval as part of the ratification process.**

Finally, African countries recognise the impact that changes to the two main international model treaties may have on them. Existing international models, including those developed among African countries, may not be as ambitious as they could choose to be. Following recommendation 2 above, they should:

8) **Ensure that future updates to provisions of the UN and OECD model treaties, or to their commentaries and reservations/observations, reflect the positions set out in their national models.**

9) **Strengthen the African model treaties (EAC, COMESA, SADC) so that they act as opposite poles to the OECD model, rather than compromises between the UN and OECD models.**

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tax justice network - Africa

PO Box 25112-00100,Nairobi, Kenya

T +254 20 247 3373 **C** +254 728 279368

info@taxjusticeafrica.net

www.taxjusticeafrica.net

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