

Taxing the Digital Economy: Options Available for African Countries

by

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*We acknowledge and respect the lək'əḡən (Songhees and Esquimalt)
Peoples on whose territory the university stands, and the lək'əḡən and W̱SÁNEĆ Peoples
whose historical relationships with the land continue to this day.*

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Abstract

Tax authorities have always assessed and enforced taxes based on the physical address of businesses over the years. Nevertheless, the idea of tax jurisdiction has taken on a new meaning with the development of information and communication technology, and its profound impact on every facet of human existence – including but not restricted to trade and business. This development has undoubtedly increased capital mobility, especially in corporate form, and exposed more the weaknesses in national tax laws by enabling the artificial relocation of important economic components and potential exemption from taxes. Since it is getting harder to separate the digital economy from the rest of the economy for taxation reasons, the process of digitalization has emerged as one of the primary growth drivers. This expansion, together with aggressive tax planning strategies used by multinational enterprises (MNEs) to move revenues to low-tax jurisdictions and the development of business models requiring less physical presence, has increased the workload for tax administrators; furthermore, it has reduced governments' capacity to raise funds in the traditional manner.

In this regard, I assess how “adequate” the selected African countries' frameworks are vis-à-vis the ongoing OECD and UN negotiations. Beyond the consultations, I call for a more inclusive and Africanised approach and the need for African countries to improve their tax administration mechanisms.

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List of Abbreviations

ADS	Automated Digital Services
AI	Artificial Intelligence
ATAF	African Tax Administration Forum
AU	African Union
B2B	Business-to-business
B2C	Business-to-consumer
BEPS	Base Erosion and Profit Shifting
CAMA	Companies and Allied Matters Act
CFC	Controlled Foreign Corporation
CIT	Companies Income Tax
CITA	Companies Income Tax Act
CODA	Coalition for Dialogue on Africa
DAT	Digital Advertising Tax
DBCFT	Destination Based Cash Flow Taxation
DST	Digital Services Tax
DTA	Double Taxation Agreement
ETR	Effective Tax Rate
EU	European Union
FIRS	Federal Inland Revenue Service
GDP	Gross Domestic Product
GFA	Global Formulary Apportionment
GloBE	Global anti-Base Erosion
ICT	Information Communication Technology
IF	Inclusive Framework
IIR	Income Inclusion Rule
IMF	International Monetary Fund
IT	Information Technology
ITA	Income Tax Act

ITO	International Tax Organization
KRA	Kenya Revenue Authority
LMIC	Low- and middle-income countries
MAAC	Mutual Administrative Assistance in Tax Matters
MLC	Multilateral Convention
MLI	Multilateral Instrument
MNE	Multinational Enterprises
NRC	Non-Resident Companies
OECD	Organisation for Economic Co-operation and Development
PE	Permanent Establishment
PST	Profit Shifting Tax
RRA	Rwanda Revenue Authority
SDG	Sustainable Development Goals
SEP	Significant Economic Presence
SME	Small-and Medium Enterprises
STTR	Subject to Tax Rule
TP	Transfer Pricing
TJN	Tax Justice Network
UPE	Ultimate Parent Entity
UTPR	Undertaxed Profits Rule
UN	United Nations
VAT	Value Added Tax
VPN	Virtual Private Network

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Dedication

Dedicated to God Almighty and to the many people who tried but their effort was unnoticed.

CHAPTER 1: GENERAL INTRODUCTION

1.1. The growth and leverage of multinational corporations in world trade

The private sector, particularly multinational enterprises (MNE), are important actors in the contemporary global economy. According to the Organisation for Economic Co-operation and Development (OECD), in 2018 MNEs produced more than half of global exports, generated 28% of the world GDP, and employed 23% of the world's labour force.¹ The benefits of multinational investments and activities in global south countries have been a source of debate for decades, with the expansion of global supply chains and the growth of the digital economy raising new questions about the appropriateness of various regulatory systems, particularly tax systems. One main problem that has surfaced in terms of tax systems is the fact that increased digitization of the economy has exacerbated the limitations of the current nexus requirement of a permanent establishment (PE), which has intensified the debate surrounding the fair allocation of taxing rights and the need for fundamental reform. The challenges of taxing the digital economy can generally be summarized by two key tax policy questions: first, how to establish taxing rights (nexus) in jurisdictions where foreign businesses have significant commercial presence with little or no physical presence and, second, how and where to allocate the taxable profits of MNEs.²

Many multinational corporations shift income to low-tax jurisdictions more easily using a variety of tax avoidance schemes such as transfer pricing (TP), excessive levels of debt, and transfers of its intangible assets (such as trademarks or copyright) to another company B, and company A then pays royalties to company B to use these assets. Royalties are typically a deductible cost to company A and thus reduce its profits, while increasing the profits of company B, which is typically located in a lower tax jurisdiction. Such royalty payments may be commercially rational but often can be artificial and unjustified.³ The challenge is the way international corporate income

¹ OECD, "Multinational Enterprises in the Global Economy Heavily Debated but Hardly Measured," (2018), online: <https://www.oecd.org/industry/ind/MNEs-in-the-global-economy-policy-note.pdf>.

² European Commission, "COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL: A Fair and Efficient Tax System in the European Union for the Digital Single Market", (2017), online: <<https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:52017DC0547>>.

³ Miroslav Palanský, "How multinationals continue to avoid paying hundreds of billions of dollars in tax", (25 November 2019), online: <<https://www.wider.unu.edu/publication/how-multinationals-continue-avoid-paying-hundreds-billions-dollars-tax>>.

is taxed. The current system is based on an approach developed almost a century ago; at a time when the global economy was structured very differently than it is today. Today, individual entities that make up a multinational run separate accounts as if they were independent companies and most MNEs exploit the weakness of the laws/rules of the present international tax system in order to optimize its tax liabilities.⁴

While the growth of MNEs and the sophistication of profit-shifting activities present challenges for most countries, the problems are particularly acute in the developing world. African countries are not diversified in terms of revenue generation – what is at stake for global south countries is that unless there is a global tax reform, it may lead to an uncertain future for developing countries. It seems like an offshoot of neocolonialism where revenue and profits are generated in a particular place and are repatriated elsewhere.

1.2. The rise of a new digital economy

The advent of the internet has accelerated many trends, one of which is the digital economy. The “third industrial revolution” is based on information technology and has set the stage for the fourth.⁵ The digital economy is one collective term for all economic transactions that occur on the internet. The advent of Information Technologies (IT) has aided the process of globalization, where the digital and traditional economies are merging into one.⁶ There has been a tremendous growth of digital platforms and their influence on our lives. One of the distinguishing features of recent years has been the exponential growth in the aggregation of machine-readable information, or digital data, over the Internet. This has been accompanied by an expansion of big data analytics, artificial intelligence (AI), cloud computing and new business models (digital platforms). The development of Information Communication Technology (ICT) has not only stimulated demand and supply but has expanded the entire global economic system, resulting in faster-accelerating

⁴ Ibid

⁵ McKinsey & Company, “What Are Industry 4.0, the Fourth Industrial Revolution, and 4IR?,” *McKinsey & Company*(2024), online: <https://www.mckinsey.com/featured-insights/mckinsey-explainers/what-are-industry-4-0-the-fourth-industrial-revolution-and-4ir>.

⁶ “Digital Economy”, (23 November 2018), online: <<https://www.toppr.com/guides/business-environment/emerging-trends-in-business/digital-economy/>>.

economic growth.⁷ The development of IT is regarded as a critical factor for the establishment of the digital economy and the expansion of ecommerce business models.⁸ The role of IT is growing alongside the expansion of complex global supply chains. Such changes will continue, and reforms to tax systems and other regulatory systems are required. Indeed, the expansion of digital business in recent years linked to the covid-19 pandemic demonstrates the need for system reform.

1.3. Principles of taxation as they relate to the international tax system.

There are several broad tax policy considerations that have traditionally guided the development of taxation systems which are: equity, neutrality, efficiency, certainty and simplicity. Tax laws enacted by countries often reflect the decisions by their policy makers on the relative importance of each of these principles and will also reflect wider economic and social policy considerations outside the field of tax. As outlined above, the growth of the digital economy has drawn attention to weaknesses in the tax system, and the need for systems reform in accordance with these policy principles.

1.3.1 The taxation of cross-border income under domestic corporate income tax law

State sovereignty discussions often center on two key aspects: jurisdiction and population. Jurisdiction defines the geographic area and subject matters where a state can make and enforce laws. Population refers to the people the state governs. State sovereignty also encompasses fiscal sovereignty, which includes the power to levy taxes. Schön believes that taxes should confine themselves to taxable subjects and objects that maintain a connection with the imposing state. Law and policy makers over the years have agreed that a legitimate tax claim ought to be either based on the relationship to a personal attachment or a relationship to a territory (i.e., a “territorial attachment”).⁹ These features of sovereignty have contributed to the formulation of the principles, which are driven by concerns for the enforcement, administration, and collection of taxes and

⁷ Tai-Yoo, Kim., Jihyoun, Park., Eungdo, Kim., Junseok, Hwang., The Faster-Accelerating Digital Economy, TEMEP Discussion Paper No. 2011:73

⁸ Lyotard, Jean-Francois, 1984. The Postmodern Condition: A Report on Knowledge. Manchester: Manchester University Press. Fu, F., Liu, L., Wang, L., 2008. Empirical analysis of online social networks in the age of Web2.0. Physical A, vol. 387, no. 2-3, pp. 675-684

⁹ Schön, Wolfgang. "Persons and Territories: On International Allocation of Taxing Rights." *British Tax Review* (2010): 554-562.

which came to limit the traditional notion of sovereignty.¹⁰ Domestic tax rules for the taxation of cross-border corporate income generally address two situations: the taxation of outbound investments of resident companies, and the taxation of inbound investments of non-resident companies, which are premised upon determination of residence. This is the origin of the residence principle, which simply means that all trades of residents of one jurisdiction are taxed, irrespective of whether they trade on their home market or on the foreign market.¹¹ Residence of a corporation based on formal criteria such as place of incorporation.

A foreign branch is not treated as a separate entity for tax purposes and its income therefore forms part of the taxable income of the corporation and it may claim the same allowances and deductions. The foreign branch may credit its allowable foreign income taxes directly against the headquarters taxes due from the corporation.¹²

Large MNEs have organized foreign business through subsidiaries formed abroad, since companies formed abroad are not liable to parent company tax at all on business profits earned abroad. However, dividends remitted to the parent company are subject to taxes, but the parent company's jurisdiction may exempt them from tax or may allow the parent company to credit against them the foreign income tax paid on the underlying income, i.e., the proportion of foreign income taxes paid which the dividend represents of the total profits before tax. Thus, earnings retained abroad in a foreign subsidiary are not liable to parent tax, until repatriated as dividends. What has made the subsidiary and branch profit a problematic field is that a foreign tax is an income tax allowable for credit. This can lead to complex interactions and negotiations.¹³

Historically, there have been two broad approaches: worldwide and territorial. Under the worldwide approach, all income of domestically headquartered companies is subject to tax,

¹⁰ Tadmore, Neil. "Source Taxation of Cross-Border Intellectual Supplies: Concepts, History and Evolution into the Digital Age." *Bulletin for International Taxation* (2007): 2-16.

¹¹ Jürgen Huber et al., "Market/Versus Residence Principle: Experimental Evidence on the Effects of a Financial Transaction Tax," *The Economic Journal* 127, no. 605 (2017): F610–31, <https://doi.org/10.1111/econj.12339>.

¹² Surrey, Stanley S. "Reflections on the Allocation of Income and Expenses Among National Tax Jurisdictions." *Law & Policy in International Business*, (1978) vol. 10, pp. 409-460.

¹³ Sol Picciotto, "International Business Taxation a Study in the Internationalization of Business Regulation," (2013), <https://taxjustice.net/cms/upload/pdf/Picciotto%201992%20International%20Business%20Taxation.pdf>.

including income earned abroad. To avoid double taxation of the same income base, the approach provides credits for taxes paid to foreign governments.¹⁴ In contrast, the territorial approach involves a country collecting tax only on income earned within its borders. This is typically accomplished by exempting from the domestic tax base the dividends received from foreign subsidiaries.¹⁵ Generally, MNEs are not taxed on income earned by foreign subsidiaries unless and until they are repatriated to the parent company as dividends.¹⁶ The rationale for the exemption is that the underlying profits from which dividends are paid are assumed to have been taxed as the corporate income of the subsidiary.¹⁷ Most times, the distinction between worldwide and territorial systems is not as clear-cut. Some provisions in existing systems, such as the deferral of dividend tax obligation until repatriation or the use of excess credits from high-tax countries to offset taxes on dividends from low-tax countries (cross-crediting), tend to soften the bite of worldwide taxation.¹⁸ Territorial exemption is not complete, however. Measures such as Controlled Foreign Company (CFC) rules extend domestic taxation rights for both worldwide and territorial systems by taxing foreign passive income immediately. These rules provide for the taxation of various kinds of income – usually passive or mobile income – earned by non-resident companies.

CFC rules are applicable to specific income generated by foreign subsidiaries of a domestic company. CFC rules vary globally due to their implementation by individual countries. What constitutes a CFC in one country might not meet the criteria in another. Typically, CFC laws fall into three main categories: strict regulations applying to all offshore companies, rules targeting passive companies, and absence of CFC regulations. Some other countries impose withholding taxes on outbound income payments, such as interest, royalties, and dividends.¹⁹ The OECD

¹⁴ William Barker, "International Tax Reform Should Begin at Home: Replace the Corporate Income Tax with a Territorial Expenditure" (2010) 30:3 *Northwestern Journal of International Law & Business* 647, online: <<https://scholarlycommons.law.northwestern.edu/njilb/vol30/iss3/25/>>.

¹⁵ *Ibid*

¹⁶ Thornton Matheson & Victoria Perry & Chandara Veung, 2014. "Territorial versus worldwide corporate taxation: Implications for developing countries," Chapters, in: Richard M. Bird & Jorge Martinez-Vazquez (ed.), *Taxation and Development: The Weakest Link?* chapter 5, pages 147-169, Edward Elgar Publishing.

¹⁷ Li Liu, Tim Schmidt-Eisenlohr & Dongxian Guo, "International Transfer Pricing and Tax Avoidance: Evidence from Linked Trade-Tax Statistics in the UK" (2017) 2017:1214 *International Finance Discussion Paper* 1–39, online: <<https://www.federalreserve.gov/econres/ifdp/files/ifdp1214.pdf>>.

¹⁸ Sebastian Beer, Ruud A de Mooij & Li Liu, "International Corporate Tax Avoidance: A Review of the Channels, Magnitudes, and Blind Spots", (2018), online: *IMF* <<https://www.imf.org/en/Publications/WP/Issues/2018/07/23/International-Corporate-Tax-Avoidance-A-Review-of-the-Channels-Effect-Size-and-Blind-Spots-45999>>

¹⁹ *Ibid*

defines a CFC as a foreign company that is either directly or indirectly controlled by a resident taxpayer-it varies from jurisdiction to jurisdiction.²⁰

In determining how taxes for offshore companies are calculated, CFC rules will first examine the relationship between a domestic company in the home country and its foreign subsidiary which will be in another jurisdiction. This is to establish the relationship and whether that subsidiary is a CFC of the domestic entity. In Europe, a foreign subsidiary is deemed a controlled foreign company when a domestic company holds more than 50% of the subsidiary's shares. Afterward, a set of conditions outlines the CFC rules for taxing the income of a foreign subsidiary (considered a CFC) domestically in the home country where the parent is situated.²¹ The rules typically follow one of three approaches:

- **Tax Rate Differential:** CFC rules apply if the foreign jurisdiction's tax rate on the CFC is lower than the parent company's home country.
- **Passive Income Focus:** CFC rules may also apply if the CFC earns mostly passive income (e.g., interest, royalties) rather than active income (e.g., manufacturing, sales).
- **Blacklist Approach (Less Common):** In some countries, CFC rules automatically apply to subsidiaries located in blacklisted jurisdictions, typically tax havens like Panama or Seychelles. However, this approach is declining in popularity.

1.3.2 VAT on cross-border transactions – The destination principle

In contrast to the prevailing system of Cross Border Corporate Taxation, there is the destination principle. A Destination Based Cash Flow Taxation (DBCFT) has two distinct attributes: a cash-flow tax base which is net receipts arising in a business, and a destination basis.²² The principle of a DBCFT is that it would be based on sales of goods and services in the country less expenses incurred in the country: so, receipts from exports are not included in taxable revenues and imports are taxed. The fundamental policy issue in relation to the international application of the Value

²⁰ OECD (2014), "Addressing the Tax Challenges of the Digital Economy- Chapter 2 Fundamental principles of taxation."

²¹ "An Overview of Controlled Foreign Corporation Rules (CFC Rules)", online: *BBCIncorp - Offshore* <<https://bbcincorp.com/offshore/articles/guide-to-controlled-foreign-corporation-rules>>.

²² Auerbach, Alan Jeffrey, Michael P. Devereux, Michael Keen, and John Vella. 2017. "Destination-Based Cash Flow Taxation." Oxford Legal Studies Research Paper No. 14/2017, Saïd Business School WP 2017-09, Oxford University Centre for Business Taxation WP 17/01. online: <http://dx.doi.org/10.2139/ssrn.2908158>.

Added Tax (VAT) is whether the levy should be imposed by the jurisdiction of origin or by the jurisdiction of destination. VAT is generally expected to be levied in accordance with the destination principle. This means that the total tax paid in relation to a commodity is determined by the rate levied in the jurisdiction of its final sale (as a proxy for the location of consumption); and, moreover, that all the revenue accrues to the government in the jurisdiction where that sale occurs. This contrasts with the “origin principle.”²³ The origin principle means commodities are taxed only in the exporting country; as exports are taxed just like domestic sales and imports are not taxed, no need exists for border controls. Eric Kemmeren argues the origin principle to be the best because only the origin state has the right to tax the income or gains because of the direct benefit principle.²⁴ In a bid to prevent double taxation or non-taxation of cross-border transactions, the choice of states is between taxing the supply of a good or service either in the country of production (origin principle) or in the country of consumption (destination principle).²⁵ While the destination principle is widely accepted, measures like ensuring there is no conflicting claims from two or more jurisdictions over the same taxable amount should be put in place to ensure there is no double taxation.

1.3.3 The taxation of cross-border income under double tax treaties

Tax treaties represent an important aspect of the international tax rules of many countries. Over 3,000 bilateral income tax treaties are currently in effect, and the number is growing. Tax treaties are important because the exercise of tax sovereignty may entail conflicting claims from two or more jurisdictions over the same taxable amount of income or capital, which may lead to juridical double taxation. Double taxation is detrimental to international exchange of goods and services and cross-border movements of capital, technology, and persons. The overwhelming majority of these treaties are based on the United Nations Model Double Taxation Convention between Developed and Developing Countries²⁶ or the Organisation for Economic Co-operation and

²³ Ebrill, Liam P., Michael Keen, and Victoria J Perry. “The Modern VAT”, (USA: International Monetary Fund, 2001) online: <https://doi.org/10.5089/9781589060265.071>

²⁴ Kemmeren, Eric. “Principle of Origin in Tax Conventions: A Rethinking of Models.” (2001).

²⁵ Robert Brederode, “Destination vs origin principle in Value Added Tax”, (5 September 2017), online: *Oman Observer* <<https://www.omanobserver.om/article/74034/Business/destination-vs-origin-principle-in-value-added-tax>>.

²⁶ United Nations, Department of Economic and Social Affairs, United Nations Model Double Taxation Convention between Developed and Developing Countries (New York: United Nations, 2011)

Development Model Tax Convention on Income and on Capital.²⁷ Bilateral tax treaties based on these models address instances of double taxation by allocating taxing rights to the contracting states. Bilateral tax treaties confer rights and impose obligations on the two contracting states, but not on third parties such as taxpayers. However, tax treaties are obviously intended to benefit taxpayers of the contracting states. Whether treaties do so or not depend on the domestic law of each State. Reciprocity is a fundamental principle of implementing tax treaties. Most treaties provide for taxation of business profits derived by an enterprise in the state of residence. When the enterprise carries on business in another state through a PE, the source state may tax only the profits that are attributable to the PE. The PE concept is thus used to determine whether or not a contracting state is entitled to exercise its taxing rights with respect to the business profits of a non-resident taxpayer.²⁸ The principal benefits of tax treaties for MNEs include reduction of source country withholding rates on passive income such as interest, dividends and royalties, elimination of double taxation, tax administration cooperation, and a mechanism for resolving tax disputes between the treaty partners.²⁹

1.4. The development of the digital economy and the broadening business models

Platformization is the main driver of the digital economy. As early as the 2000s, there was an emergence of digital platforms around the world using data-driven business models, thereby disrupting existing conventional industries in their wake. Platforms and platform-based ecosystems established markets where none previously existed. The power of platforms is reflected in the fact that seven of the world's top eight companies by market capitalization use platform-based business models.³⁰ The broadening of these models has stressed the importance of value creation. Value creation is one of the most prominent terms in the current debate on international tax policy as it relates to the digital economy taxation.³¹ For the international community to agree on a taxing method for an economic activity, it is important to have a common understanding and

²⁷ Organisation for Economic Co-operation and Development, Model Tax Convention on Income and Capital (Paris: OECD, 2014)

²⁸ Ibid

²⁹ Céline Azémar & Dhammika Dharmapala, "Tax Sparing Agreements, Territorial Tax Reforms, and Foreign Direct Investment", (2018), online: <<https://thedocs.worldbank.org/en/doc/281751559591312068-0050022019/original/celineAzmar.pdf>>.

³⁰ United Nations Conference on Trade and Development, Digital Economy Report 2019, Value Creation and Capture: Implications for Developing Countries

³¹ Ibid

a defined notion of value creation. A business is said to create value if the revenues exceed the corresponding costs. Thus, both the revenue and cost sides should be considered when trying to identify important elements of a value chain.³² A digital business model is made up of content, structure, and governance of transactions designed to create value through the exploitation of business opportunities. This is better expressed by saying: the value creation of a digital business model is to be seen as a way of generating revenue by using data and information in a specific form of products or services. For instance, when a multinational firm is operating in the digital economy and uses the Internet to produce and transmit its final product to the consumers around the world, the firm creates a global product. In this case the value chain of the firm is truly global. The complex nature of the business models in the digital economy was not anticipated by the current tax (treaty) system.

The present model adopted for the allocation of taxing rights in relation to multinationals is influenced by the UN Model, the OECD Model and their historical predecessors, which are based on three principles.³³ First, individuals and entities within states are involved in cross-border commercial activities and, therefore, participate in economic exchange. States stimulate this exchange by their national and international trade, investment, and tax policies. Therefore, the overall goal of the state tax policy is to ensure continuous flow and international exchange of goods, services, and capital. The second principle is that income from various cross-border economic activity creates economic connection with more than one state. Therefore, to reduce a risk of double taxation, states should decide “where a person ought to be taxed or how the division ought to be made as between the various sovereignties that impose the tax”.³⁴ The third principle (or belief) is that entities of every multinational firm are separate taxpayers.

³² David Stewart, “‘Value Creation’ Understanding Key to Transfer Pricing’s Future | Tax Notes”, (2015), online: <<https://www.taxnotes.com/tax-notes-international/transfer-pricing/value-creation-understanding-key-transfer-pricings-future/2015/07/27/sp9p>>.

³³ Victoria Plekhanova. “Not Addressing the Tax Challenges of the Digital Economy: A Response to Action 1 of the 2015 Final Report of the OECD/G20 Base Erosion and Profit Shifting Project” (2016) PhD project, Faculty of Law, University of Auckland.

³⁴ League of Nations, “Report on Double Taxation” submitted to the Financial Committee by Professors Bruins, Einaudi, Seligman and Sir Josiah Stamp (Geneva, 15 April 1923) 20

Given the global nature of digital services and products, the traditional notion of "cross-border activity" may not be entirely applicable. Production processes for these services and products often occur without geographical constraints, involving contributors from various nations, including internet users, MNEs, and third-party suppliers. Moreover, the outcome of digital services and products doesn't necessarily physically cross the borders of market states as singular entities originating from specific foreign territories.³⁵

1.5. Purpose and Rationale of thesis

In a study in 2016, researchers estimated that the global digital economy was worth \$11.5 trillion, which is 15.5% of global GDP – representing 18.4% of GDP in developed economies and 10% of GDP in developing economies, on an average.³⁶ In a similar study by the United Nations Conference on Trade and Development, developing economies were observed to be more affected, having suffered an estimated \$100 billion loss annually due to tax avoidance schemes by MNEs. To this end, governments are seeking ways to rectify this situation and restore their tax bases.³⁷ Evolution of the digital economy has diminished government's ability to raise revenue through conventional means,³⁸ making this topic an area of concern because of strain on revenue potentials and tax administrations. It is of no doubt that enhanced mobility of capital, particularly in the corporate form, may allow tax avoidance in national tax systems in that it allows valuable components of economic interest to be artificially relocated and possibly to go untaxed.³⁹ In reaction to the emerging digital economies, countries have been forced continuously to improve on their laws and policies in order to prevent tax avoidance. However, tax legislation is constantly challenged by developments in the human societies which they serve, and constantly faces the choice between fitness, stability and adaptability, and between tweaking and fundamental

³⁵ Jinyan, Li. "Consumption Taxation of Electronic Commerce: Problems, Policy Implications and Proposals for Reform" *Canadian Business Law Journal* (2003) pp. 425-465

³⁶ "Digital Spillover: Measuring the true impact of the Digital Economy", (2017), online: <<https://www.huawei.com/minisite/gci/en/digital-spillover/index.html>>.

³⁷ UNCTAD, "World Investment Report 2015: Reforming International Investment Governance," (2015), online: https://unctad.org/system/files/official-document/wir2015_en.pdf.

³⁸ Jonathan Bick "Implementing E-commerce Tax Policy." *Harvard Journal of Law & Technology* (2000) 13 (3): 517-617

³⁹ Geoffrey Loomer, "Reformulating Corporate Residence: A Coherent Response to International Tax Avoidance," (2011). online: <https://ora.ox.ac.uk/objects/uuid:1f515456-3d87-4942-9600-b9cfe73c6662/files/mbb032de9df0b17eabaf5e0a99d4a8b9a>.

reforms.⁴⁰ In this thesis, I take on the challenge of assessing the viability of the measures being proposed by the OECD, the United Nations, as well as unilateral efforts by selected African countries such as Nigeria, Kenya and Rwanda in curbing tax leakage from businesses that operate in the digital economy. In light of these important changes in the global economy, specifically the rise of the digital economy and the need for tax reforms, this thesis explores the consequences of the proposed rules and their potential in the global evolution of the international tax system, finding that their application will not completely resolve the thorny issues of digital economy taxation especially for developing countries.

1.6. Research Question(s)

Tax avoidance in the digital economy is having, and will continue to have, detrimental effects across jurisdictions. More importantly, it is undoubted that the challenge of taxing the digital economy would remain if significant actions were not taken by states – especially developing states, to effectively address its root cause. The OECD is at the forefront of developing new rules to tax the digital economy through its Base Erosion and Profit Shifting project. This is why this thesis primarily examines the implications of the OECD's proposals, before turning to the UN proposals. To this end, this thesis seeks to address the following questions.

1. What are some of the core problems / limitations with the current tax system associated with the growth of the digital economy, and what key proposals have emerged to address these problems?

In answering the above question, the thesis will explore the below questions:

- i. What efforts are being taken by African countries to effectively tax the digital economy?
- ii. What are the strengths and weaknesses of the OECD/UN proposals?
- iii. How applicable/beneficial are the OECD/UN proposals?
- iv. What are the responses of African countries to the OECD/UN proposals?

⁴⁰ Báez Andrés, and Yariv Brauner. "Taxing the Digital Economy Post BEPS ... Seriously." University of Florida Levin College of Law Research Paper No. 19-16 (2019). online: <http://dx.doi.org/10.2139/ssrn.3347503>.

In this thesis, I will analyze three African countries (Nigeria, Kenya, and Rwanda) to assess ongoing efforts to tax the digital economy. Additionally, I will scrutinize the OECD/UN proposals in the context of the selected countries.

I have selected the above countries because they have taken steps ahead of the OECD/UN in taxing its digital economy. For instance, Nigeria is one of the largest economies in Africa and has initially amended its Companies Income Tax Act to broaden the tax scope for non-resident entities, encompassing companies engaged in digital operations within Nigeria. Tax obligations for these entities are contingent upon achieving a minimum turnover of 25 million Naira (approximately 64,320 USD). In addition to this, Nigeria has been a policy lead in the African Tax Administration Forum (ATAF). ATAF plays a pivotal role of steering the work of various African countries in the development of practical guidance and solutions on tax policy and administration matters. Similarly, Kenya has been selected because it is committed to reassessing domestic taxation laws concerning cross-border business to ensure alignment and to protect its taxation authority over digital enterprises. According to E-commerce in Africa - statistics and facts⁴¹, Kenya is regarded as one of Africa's most competitive markets leading to the boom of online retail operations and marketplaces. Rwanda is considered ideal for this study due to its significant advancements in digital economy taxation. Rwanda believes that capturing digital services in the tax net not only expands the tax base but ensures fair treatment of all Rwandans. Rwanda has introduced some taxes on the digital economy, including a VAT on digital services. Goods and services sold online by a Rwandan or foreign resident to a recipient who resides in Rwanda will be taxable.

1.7. Literature review of Pillar One and Pillar Two of OECD Proposals

The OECD launched its project to address base erosion and profit shifting (BEPS) in 2013 with an Action Plan of 15 Actions. Action 1 encompasses identifying difficulties the digital economy poses for applying existing international tax rules and developing options to address them. Under current international tax rules, an enterprise generally is not taxed in a country in which it does not have a physical presence. With the economy having evolved so that business can be conducted over the internet with no physical presence in a country, companies have been able to avoid taxation in

⁴¹ Saifaddin Galal, "E-commerce in Africa", (2023), online: <<https://www.statista.com/topics/7288/e-commerce-in-africa/#topicOverview>>.

many jurisdictions from which they generate significant income. The OECD issued a final report on Action 1 in 2015⁴² and a subsequent report in 2018⁴³ yet has failed to recommend a solution to address the physical presence issue. Various countries and the European Union have grown impatient with the OECD and have taken matters into their own hands, with countries and the European Commission (EC) proposing or enacting legislation to address head on the issue of non-taxation of multinational digital companies, tax authorities assessing tax against multinational companies under the existing rules, and the EC bringing actions against countries for illegal state aid.⁴⁴ In May 2019, the OECD released a work programme that involved undertaking a comprehensive review of profit allocation and nexus rules. The OECD labeled this work as "Pillar One" of a two-part work programme. The work programme presented the skeletal outlines of various proposals to reallocate corporate cross-border income taxing rights. It also included a basic work plan to address technical issues that need to be resolved if any proposal is to be operationalized. The goal of the work plan was to provide input to a political decision on the outlines of a proposal for a consensus-based reallocation of taxing rights.

Given the need and the pressure from state actors for a change to profit allocation rules, it is important that, at every stage, the Framework considers what legal and political instruments would be required to implement and stabilize any given proposal under Pillar One. According to the OECD, Pillar One should “adhere to the concept of net taxation of income, avoid double taxation, and be as simple and administrable as possible.” The central premise of the OECD’s proposal is that companies aren’t paying enough tax in jurisdictions where they have market-facing activities.⁴⁵ For instance, while Facebook has users in every country, it doesn’t have physical operations in every country. A country like Kenya might have millions of Facebook users; advertisers are targeting those users, and Facebook is earning revenue and profit from those

⁴² OECD (2015), *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, <https://doi.org/10.1787/9789264241046-en>.

⁴³ OECD (2018), *Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, <https://doi.org/10.1787/9789264293083-en>.

⁴⁴ Monica Gianni. “OECD BEPS (In)Action 1: Factor Presence as a Solution to Tax Issues of the Digital Economy.” *Proceedings. Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association*, vol. 111, (2018), pp. 255–298. online: www.jstor.org/stable/26939394

⁴⁵ Valentiam Group, “Pillar 1 And Pillar 2 OECD Blueprints: An Overview”, (2021), online: <https://www.valentiam.com/newsandinsights/pillar-1-pillar-2-oecd>.

advertisers. However, since Facebook has no physical presence in Kenya, the company pays no tax there.

On October 9, 2019, the Secretariat of the OECD published a "Proposal for a 'Unified Approach' under Pillar One," designed to address the tax challenges of digitalization and grant new taxing rights to market jurisdictions.⁴⁶ This proposal seeks the establishment of a new taxing right which will be independent of physical presence and will be applied through global and market revenue thresholds. The proposal set forth a new rule that would allocate a share of a foreign company's deemed residual (non-routine) profits to the market jurisdiction. On October 14, 2020, the OECD released a "Report on Pillar One Blueprint" providing foundation for a future agreement on international tax reform. To this end, Pillar One of the OECD proposals has three main components which include: a new taxing right for market jurisdictions over a portion of residual (non-routine) profits calculated at the MNE-group level; a fixed return for baseline marketing and distribution functions that physically transpire in the market jurisdiction; and dispute prevention and resolution mechanisms. In all, the goal of Pillar One is to address the tax challenges of digitalization while recognizing the difficulty of characterizing what is digital and what is not, which is a major tax policy consideration.

On the other hand, Pillar Two on minimum taxation was initially envisaged as a complementary anti-BEPS instrument, in contrast to the first pillar on a genuine realignment of the international tax system. This was reflected in the name for the new minimum tax concept: "GloBE" the abbreviation for "Global anti-Base Erosion" proposal.⁴⁷ The GloBE approach has a more far-reaching objective of international minimum taxation. Some scholars have argued that it could not only make BEPS less attractive but will also establish a floor for international tax competition for foreign direct investment. The GloBE concept calls for a "top-up tax" on foreign-sourced profits of large MNEs whose effective tax rate (ETR) is below the politically agreed minimum tax rate of fifteen percent.⁴⁸ For the purpose of calculating the ETR, the profits of all group entities domiciled

⁴⁶ OECD, Public Consultation Document: Secretariat Proposal for a "Unified Approach" under Pillar One, at 6 (2019), <http://www.oecd.org/tax/beps/public-consultation-document-secretariatproposal-unified-approach-pillar-one.pdf>.

⁴⁷ Englisch, Joachim, International Effective Minimum Taxation – analysis of GloBE (Pillar Two) (April 18, 2021). Available at SSRN: <https://ssrn.com/abstract=3829104> or <http://dx.doi.org/10.2139/ssrn.3829104>

⁴⁸ Ibid

or established in a particular tax jurisdiction would be determined as an aggregate amount based on financial accounting standards. They would then be put in relation to the total burden of income taxes and similar “covered taxes” attributable to those profits.⁴⁹

Among other commentators, Harpaz has argued that international tax reform ought to be implemented through a multilateral approach and that unilateral measures will leave the international tax framework in disarray. He further recommended a multilateral solution without global revenue thresholds that explicitly target U.S.-based companies,⁵⁰ as well as applying the new tax nexus through market thresholds. In a similar vein, Harpaz asserts that the Pillar Two proposal would reduce profit shifting and generate substantial tax revenues, without having an adverse effect on the attractiveness of countries as a location for foreign direct investment.⁵¹

According to Grinberg,⁵² if the Pillar One approach is based on a multilateral treaty, it will fail if the approach attempts to incorporate traditional TP principles within the new taxing right. This is because the amount of the new taxing right must be defined without regard to facts and circumstances relating to TP if there is to be any hope of stabilizing the new tax regime. He reiterated that incorporating arm's length TP into the definition of the boundary between various components of the new taxing right would be highly problematic. Bauer⁵³ in his paper raised a contrary opinion to the claims made by the OECD on the implementation of the Pillar One and Two proposals: he argued that it would not improve the global allocation of capital. He stated that Global trade and investment flows would still be subject to tax competition and widespread trade and investment barriers. The OECD's current proposals would likely incentivize the governments of large countries to maintain long-standing barriers to trade and investment or to erect additional barriers that would restrict market access for companies from small open economies. This work

⁴⁹ Nogueira, J, ‘GloBE and EU Law: Assessing the Compatibility of the OECD’s Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market’ (2020) 12 World Tax Journal 465.

⁵⁰ Asaf Harpaz, "Taxation of the Digital Economy: Adapting a Twentieth-Century Tax System to a Twenty-First Century Economy" (2021) 46:1 Yale J Int'l L 57.

⁵¹ Ibid

⁵² Itai Grinberg, “Stabilizing “Pillar One”: Corporate Profit Reallocation in an Uncertain Environment” (2019 Florida Tax Review, Vol. 23, Issue 1, 130.

⁵³ Matthias Bauer, “Unintended and Undesired Consequences: The Impact of OECD Pillar I and II Proposals on Small Open Economies” (2020) Ecipe Occasional Paper 04/2020

shows the weakness of the OECD proposals in benefitting African countries and other developing economies.

In work published by Cobham, Faccio, and FitzGerald, they take the view that reallocation of taxing rights towards “market jurisdictions”, as it is currently understood, is likely to be of little benefit to non-OECD countries. Indeed, they argue that the proposal is likely to reduce revenues for a range of lower-income countries as it emphasizes a sales-only approach, which produces more losers among developing countries than one that incorporates sales and labor.⁵⁴ Hearson,⁵⁵ in analyzing how this may affect African countries, stated the importance of looking at the winners and losers producing that average result when the OECD work is published. He reiterated that the eventual package proposal from the Inclusive Framework (IF) is likely to include a moratorium on measures like introducing a unilateral tax, which may limit lower-income countries’ ability to comply effectively. He also stated that the text of the secretariat proposal makes clear that all participating countries will be subject to mandatory and binding dispute settlement procedures, which would mean that, regardless of how well the eventual settlement works for them, lower-income countries that join may be unable to deviate from it. The OECD secretariat has stated, in its response to the Tax Justice Network’s claims that developing countries would not gain from its proposals, that developing countries are now at the table. In particular, the OECD has said, “We now serve all these countries, and a compromise will have to be found among all of them”.⁵⁶

Silva sees the GloBE concept as difficult to understand, as it is a clear diversion from addressing tax avoidance issues by instead addressing tax competition through restricting the sovereignty of jurisdictions to freely set their corporate income tax rate. The research further reiterated the inefficiency that may be brought about by the legislative complexity, uncertainty, and coordination

⁵⁴ Cobham, Alex, Tommaso Faccio & Valpy FitzGerald. “Global inequalities in taxing rights: An early evaluation of the OECD tax reform proposals”, (2019), online: osf.io/preprints/socarxiv/j3p48.

⁵⁵ Martin, Hearson. “The OECD’s digital tax proposal: untangling the impact of ‘Pillar One’ on developing countries” (2019), online: https://martinhearsen.net/2019/10/14/the-oecds-digital-tax-proposal-untangling-the-impact-of-pillar-one-on-developing-countries/amp/?_twitter_impression=true

⁵⁶ International Centre for Tax and Development (ICTD), “The OECD’s Digital Tax Proposal: Untangling the Impact of Pillar One on Developing Countries,” *ICTD*, (2019), online: <https://www.ictd.ac/blog/the-oecds-digital-tax-proposal-untangling-the-impact-of-pillar-one-on-developing-countries/>.

of this principle.⁵⁷ Silva argued that it would be better to adopt a worldwide, annual taxation regime without tax deferral. If the goal is to address income-shifting activities, this solution allows all income to be taxed as earned, without deferral for offshore income. In the alternative to the minimum tax recommendation, jurisdictions could adopt broad CFC regulations which he argues is preferable to the minimum tax proposal under the GloBE.⁵⁸ Getting a means to compute the annual profits of companies as suggested by Silva without access to their records will be an impediment towards generating an accurate tax assessment. The OECD⁵⁹ is currently carrying out some work on the sharing and gig economy which focuses on platforms and how information received from platforms could improve compliance in the sharing and gig economy. Although the work is focused on direct taxation, it has features that will be useful for indirect taxation such as VAT, particularly from the transactional information generated from the platforms. The OECD suggests that tax administrations of countries can enter into agreements with platform owners to integrate their systems such that they are able to receive information on transactions and also work to reduce the compliance burden of the platform owners. This would provide transaction information and audit trails which would be useful for both direct and indirect taxation.⁶⁰

Christians and Magalhaes⁶¹ argued that, regardless of the proposal ultimately adopted, it is likely that some states will derive minimal or no benefit from the consensus developed in the BEPS digitalization project. It was further reiterated that states are not expected to continuously go along with a consensus that does not benefit them. It begs the question: Can the states of the world unite in the backing of one common system to share taxation rights between all the different states? Can states agree on a common enforcement body to ensure the effective implementation of such a taxation system? The authors argued for the need to reconsider the overall structure of the rules that allocate taxing rights among residence and source states as well as assessment of various model of taxing rights to ensure a fairer tax system among residence and source states.

⁵⁷ Bruno da Silva, "Taxing Digital Economy: A Critical View around the GloBE (Pillar Two)" (2020) 15:2 *Frontiers L China* 111.

⁵⁸ *Ibid*

⁵⁹ OECD (2019b) *The Sharing and Gig Economy: Effective Taxation of Platform Sellers – Forum on Tax Administration*, Paris: OECD Publishing

⁶⁰ Mustapha Ndajiwo, "The Taxation of the Digitalised Economy: An African Study" (2020) ICTD Working Paper 107, Brighton: IDS

⁶¹ Allison Christians and Tarcisio Diniz Magalhaes, "A New Global Tax Deal for the Digital Age" (2019), 67:4, 1153 – 78 *Canadian Tax Journal* <https://doi.org/10.32721/ctj.2019.67.4.sym.christians>

1.8 Structure of the thesis

This thesis proceeds as follows. Chapter one sets the stage for the discussion. Here, I provide a background to the thesis, explaining briefly what the issues are and how they came up. I explain the tradition and principles of international taxation and their relevance in today's global economy and activities of MNEs.

In chapter two, I examine the problem of determining the meaning of a nexus in a digital economy, determining the existence of a PE in a digital economy and where value creation occurred. I undertake an in-depth study of determining factor presence to establish a nexus; I consider the user based approach, the investment based approach, as well as the approach of the courts where I evaluate the case of *South Dakota v. Wayfair Inc.*, where the United States Supreme Court ruled that physical presence should not be required for a state to compel out-of-state sellers to collect state sales tax on sales to customers in a state. The chapter concludes by showing how taxation should be done according to value creation.

In chapter three of this thesis, I present the efforts of the global community (the OECD and UN proposals) to reform the existing international tax system. It unpacks the reforms of the OECD, especially through the BEPS Project. It considers the activities of the UN through its tax committee in addressing tax avoidance. I compare the efforts by the OECD and the UN while discussing the possible impediments of the two approaches in African countries. I argue that moving away from physical presence nexus rules toward a revenue-based nexus rule is a step toward change of the century-old international tax laws.

Chapter Four provides a detailed analysis of the efforts by selected African countries. It begins by examining interim and unilateral measures such as DST, DAT, and various indirect taxes (including VAT, withholding tax, and excise duty) adopted by these nations. The chapter then offers an overview of source-restricting provisions in tax treaties. In its latter section, the focus shifts to ongoing reform initiatives, particularly those led by the African Tax Administration Forum and the African Union. The chapter argues that the expedience of expanding the current tax systems to

capture the digital economy should not jeopardize the discourse towards creating a new multilateral framework.

In chapter five of this thesis, I focus on the response of African countries to the OECD/UN proposals and explore the possibility of having a new international tax organization to supplant the OECD because the OECD is not seen as the legitimate organization to negotiate new rules for international tax cooperation by African countries. I discuss the legal and political steps necessary for achieving a shift to new international tax rules and having an inclusive international tax framework. I conclude by re-emphasizing my support for the OECD approach, arguing that the UN approach which is currently being favored by African countries should imbibe many of the reforms proposed by the OECD.

CHAPTER 2: NEXUS IN A DIGITAL ECONOMY: NATURE OF THE PROBLEM

2.1. Introduction

The OECD final report of 2015 in Action Plan 1 identified the broader tax challenges faced by policymakers in the digitalization era.⁶² These challenges include the concept of a new nexus, massive use of data, and characterization for direct tax purposes, which often overlap with each other.⁶³ Locating the income tax base in the digital economy is increasingly difficult because MNEs now provide goods and services in countries without a physical or legal presence; MNEs have greater opportunities to sell goods and services to customers in a country without having a significant presence in such countries that meets the threshold under current tax rules for a taxable presence (in particular, the PE test under tax treaties).⁶⁴ The OECD has categorized tax challenges arising from the digital sector into the following classes:

- i. Nexus: The possibility to conduct business without physical presence thanks to technological advancements.
- ii. Data: The difficulty to attribute value to data generated by using personal information of end-users.
- iii. Characterization: The creation of new products and new ways of delivery, which make the characterization of payments uncertain in new digital business models, such as cloud computing, which facilitates storage of data and programmes at external services, and thus saves space on the consumer's own computer.⁶⁵

Since most digital products such as patents or other intellectual properties are of an intangible form, assessing value becomes difficult to calculate in comparison with physical goods. This is a prompter for questions like: (i) where is the economic-commercial activity carried out? (ii) where is the economic value created? and (iii) where (or what) is the taxable income stemming from that value located? This chapter would seek to answer these questions and will further evaluate these questions in line with the permanent establishment rules and the various approaches to determining a factor nexus presence.

⁶² OECD, Addressing Tax Challenges of the Digital Economy, Action 1 (OECD Publishing, Paris, 2015) 98

⁶³ Ibid., p. 100.

⁶⁴ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 3.

⁶⁵ OECD Final Report (2015) Addressing the Tax Challenges of the Digital Economy, Action 1, p. 99

This chapter examines the problem of establishing a nexus in a digital economy as well as determining the existence of a PE in a digital economy and where value creation occurred. I undertake an in-depth study of determining factor presence to establish a nexus; I consider the user based approach, the investment based approach, as well as the approach of the courts where I evaluate the case of *South Dakota v. Wayfair Inc* where the United States Supreme Court ruled that physical presence should not be required for a state to compel out-of-state sellers to collect state sales tax on sales to customers in a state. The chapter concludes by showing how taxing should be according to value creation. I argue for taxation to occur where value is created ultimately in the reallocation of taxing rights.

2.2. Determining value and presence in the digital economy

The foundational principle of the international tax system today should be to tax profits in the location of value creation. TP, as the system we use to try to assess value creation in different jurisdictions, does not work very well because no value is attributed in places where the MNE does not have a subsidiary or a PE. Although some of the value drivers have changed in the digital economy, assessing their relative value contribution and how this value is created remain relevant considerations. There is no doubt that there are new value drivers in the digital economy and business models are transforming businesses. However, there is little evidence to suggest that digital companies are paying their fair share of taxes in comparison to traditional companies ('brick and mortar' companies). Many governments have been slow to develop longer term strategies to address the growth of the digital economy and instead simply introduce short term measures to impose additional taxes on digital transactions.⁶⁶

The core of the digital economy is the 'digital sector': the IT/ICT sector producing digital goods and services. Given the increase in digitally enabled economic activity and its growing economic importance, defining and measuring the digital economy is an essential process⁶⁷ for the purpose of the arguments in this chapter. The true 'digital economy' – defined as "that part of economic output derived solely or primarily from digital technologies with a business model based on digital

⁶⁶ OECD (2014), Addressing the Tax Challenges of the Digital Economy, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing. <http://dx.doi.org/10.1787/9789264218789-en>

⁶⁷ Bukht, Rumana, and Richard Heeks. "Defining, Conceptualising and Measuring the Digital Economy." Development Informatics Working Paper no. 68, August 3, 2017. online: <http://dx.doi.org/10.2139/ssrn.3431732>.

goods or services” – consists of the digital sector plus emerging digital and platform services.⁶⁸ Recognizing that there is currently no clear definition of the digital economy and that coming up with one may take some time, an approach taken by several economies and organizations is to limit the scope to certain technology-intensive sectors (e.g., ICT), e-commerce, or digital trade. The idea is twofold: (1) narrowing the scope simplifies the measurement issue; and (2) since statistics pertaining to some sectors are more widely available, they can serve as a proxy and therefore can be indicative of the broader digital economy. For example, a recent study by the International Monetary Fund (IMF) on measuring the digital economy focuses on the digital sector, defined as comprising online platforms, platform-enabled services, and suppliers of ICT goods and services.⁶⁹ E-commerce may also be used as a proxy to estimate the size of the digital economy. It is defined by the OECD as the “sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing of orders.”⁷⁰ From the foregoing, we can define the digital economy as “that part of economic output derived solely or primarily from digital technologies with a business model based on digital goods or services”. The definition has a blurred boundary, but it is also flexible enough to incorporate digital and digital business model innovation over time.

Beyond defining the digital economy, there are various challenges related to the technicalities of measuring the digital economy which is further complicated by the process of establishing a feasible measurement framework. These challenges include: suitability of existing measures such as GDP; difficulties in separating digital and non-digital activities; overestimation and underestimation pitfalls; measuring services; and barriers on data sharing between organizations for various reasons including data privacy and security.⁷¹ These digital transformations have changed the way economic actors interact and transact with one another. For instance, the development of ride sharing providers such as Uber has disrupted the established relationship

⁶⁸ Erik Brynjolfsson & Brian Kahin, “Understanding the Digital Economy: Data, Tools, and Research” (2000) directmitedu, online: <https://direct.mit.edu/books/book/2422/Understanding-the-Digital-EconomyData-Tools-and->

⁶⁹ <https://www.imf.org/en/Publications/Policy-Papers/Issues/2018/04/03/022818-measuring-the-digital-economy>

⁷⁰ OECD, ‘OECD Glossary of Statistical Terms: Electronic Commerce’, updated 17 January 2013, <https://stats.oecd.org/glossary/detail.asp?ID=4721>

⁷¹ Peter Lovelock and Australian APEC Study Centre, “Digital Economy: Measurement, Regulation and Inclusion” Workshop on the Digital Economy: Measurement, Regulation and Inclusion, (2019), online: http://mddb.apec.org/Documents/2019/EC/WKSP2/19_ec_wksp2_002.pdf

between taxi service providers and their customers, hence affecting statistical bodies' ability to accurately measure their contribution to the transport service sector of the economy through tax data and surveys of the taxi industry. Similarly, Instagram and Facebook have introduced stores, which allow users to integrate their product catalog with their Instagram or Facebook profile. These inventions have made it challenging to measure the true contribution of the social media services sector to the economy. Another controversy worthy of note is that platforms such as Facebook seem to be providing access for free, while they generate profits through targeted advertisements based on the user information collected. This has deepened the debate on how to measure the value of user information and attribute a value to 'free' digital products and services, in a way that captures their growing economic importance.⁷²

To ensure African economies reap the benefits of the digital economy, policymakers must analyze relevant policies, regulations, and their potential consequences. Making this analysis is crucial because effective laws and regulations need to balance various objectives. For example, while improving data privacy is a legitimate public policy objective, compliance with privacy laws have been used by firms to justify restricting access to data⁷³ even when there are valid reasons to make the data available, such as the need to better measure the digital economy.⁷⁴ To perform the needed analyses, governments and MNEs need to put in place comprehensive database policies that are updated and reviewed at regular intervals to allow interested organizations to obtain data that may be used to measure the digital economy. Addressing the measurement issues requires a more consistent and transparent method of measurement and data collection. Coordination between different organizations and economies is needed to improve data quality and comparability. Given the increase in digitally enabled economic activity and hence its growing economic importance, measuring the digital economy is an essential process.⁷⁵

⁷² Australian Bureau of Statistics, "Measuring Digital Activities in the Australian Economy", (2019), online: <https://www.abs.gov.au/websitedbs/D3310114.nsf/home/ABS+Chief+Economist++Full+Paper+of+Measuring+Digital+Activities+in+the+Australian+Economy>.

⁷³ Cate, Fred, Cullen, Peter; and Mayer-Schonberger, Viktor, "Data Protection Principles for the 21st Century", (2013). Books & Book Chapters by Maurer Faculty. 23. online: <https://www.repository.law.indiana.edu/facbooks/23>

⁷⁴ Economides, Nicholas and Lianos, Ioannis, Restrictions on Privacy and Exploitation in the Digital Economy: A Market Failure Perspective (January 27, 2021). Journal of Competition Law and Economics, Forthcoming, NET Institute Working Paper No. #20-05, NYU Stern School of Business Forthcoming, Available at SSRN: <https://ssrn.com/abstract=3686785> or <http://dx.doi.org/10.2139/ssrn.3686785>

⁷⁵ House of Commons. "The Digital Economy, House of Commons Business, Innovation and Skills Committee, London", (2016)

2.3. Designating taxing rights and allocating profit

Under most tax treaties, a company that sells goods and services to foreign markets can have its profits taxed by the foreign tax authority if the company maintains a PE within the foreign jurisdiction (the "source country") and profits are attributable to this PE. A more significant way that international businesses are structured in practice is where the parent entity in a MNE establishes a subsidiary in the foreign/source state. The subsidiary is a taxable entity.⁷⁶ However, with MNEs operating in the digital economy (e.g. Google, Facebook), they can operate from wherever and avoid having a subsidiary or a PE in the source state. This chapter focuses on PEs and the possible expansion of the PE concept.

In the absence of any PE, the source country is not permitted to levy its income tax on any profits arising from the international transaction and the country where the company is based (the "residence country") will generally tax all the profits. A PE is further explained within each tax treaty and generally involves fixed places of business such as a branch, an office, or a factory.⁷⁷ The definition of a PE is additionally extended to cover the activities of a dependent agent within a source country as long as the agent habitually exercises authority to conclude contracts. Taken as a whole, the definitions of PE found in tax treaties suggest the need for some geographic and temporal permanence that enables foreign businesses to conduct significant business activities within source countries and also for the purpose of designating taxing rights.⁷⁸ In other words, the PE must have some tangible physical presence within a source country and the presence cannot be temporary in nature.

⁷⁶ Phillips, Richard, Petersen, Hannah, and Palan, Rolen. "Group subsidiaries, tax minimization and offshore financial centres: Mapping organizational structures to establish the 'in-between' advantage", *J Int Bus Policy* 4, 286–307 (2021). online: <https://doi.org/10.1057/s42214-020-00069-3>

⁷⁷ OECD (2017), Article 5 Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, Paris, https://doi.org/10.1787/mtc_cond-2017-en.

⁷⁸ OECD (2017), "Commentary on Article 5", in Model Tax Convention on Income and on Capital: Condensed Version 2017, OECD Publishing, Paris, online: https://doi.org/10.1787/mtc_cond-2017-8-e

Under the existing system, taxing rights are allocated to the country where the ‘supply side’ activities take place. Amendments to PE rules⁷⁹⁸⁰ have expanded their scope so that storage and delivery places could also be deemed to be PEs, to consider some demand-side activities.⁸¹ Paragraphs 2-8 of the convention have a list and consider the facts and circumstances of every case where it can be concluded whether a PE exists in each jurisdiction. However, these activities are still insufficient considering the way the digital economy operates. A company carrying out its operations mostly from cyberspace is not liable to taxation if its cyber activities are unaccompanied by significant physical and economic presence.⁸² A new nexus would alter the traditional PE threshold by establishing a taxable presence allowing source taxation of business profits even in the absence of a fixed place of business, which would be conditional to a certain degree on significant economic presence (SEP) through technology and other automated tools. The introduction of this new nexus would reflect the benefits principle⁸³ and assign taxing rights to the jurisdiction where sales take place.⁸⁴ One of the objectives of this principle is to reduce the

⁷⁹Article 5 of the 2017 OECD Model convention which is the most recent convention of the OECD introduced a new definition of permanent establishment that will address strategies used to avoid having a taxable presence in a country under tax treaties. These changes will ensure that where the activities that an intermediary exercise in a country are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise will be considered to have a taxable presence in that country unless the intermediary is performing these activities during an independent business. The changes will also restrict the application of a number of exceptions to the definition of permanent establishment to activities that are preparatory or auxiliary nature and will ensure that it is not possible to take advantage of these exceptions by the fragmentation of a cohesive operating business into several small operations; they will also address situations where the exception applicable to construction sites is circumvented through the splitting-up contracts between closely related enterprises.

⁸⁰The most notable change to the definition of permanent establishment in Article 5 of the 2021 United Nations Model Tax Convention is the concept of beneficial owner, which is a person or enterprise that is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company’s shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company’s shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises.

⁸¹Ana Paula Dourado “Digital Taxation Opens the Pandora Box: The OECD Interim Report and the European Commission Proposals.” *Intertax* 46, no. 6&7 (2018): 565-572. online: <https://ssrn.com/abstract=3370588>.

⁸²Sánchez-Archidona Hidalgo, Guillermo. "Reflections on Multilateral Tax Solutions in a Post-BEPS Context." *Intertax* 45, no. 11 (2017): 714-721. online: <https://kluwerlawonline.com/journalarticle/Intertax/45.11/TAXI2017061>.

⁸³Alessandro Turina, "Which ‘Source Taxation’ for the Digital Economy?" *Intertax* 46, no. 6 (2018): 495-519. online: <https://kluwerlawonline.com/journalarticle/Intertax/46.6/TAXI2018053>.

⁸⁴Ana Paula Dourado, *Supra* @ note 81

prejudice that exists in differentiating tax treatment of digital and physical transactions by introducing a more consistent form between the two.⁸⁵

In determining significant economic presence, it is much better to adopt quantitative thresholds, as qualitative thresholds are likely to cause disputes, tax unpredictability and double taxation. Setting minimum thresholds could be an optimum way to provide for a level playing field for Small-and Medium Enterprises (SMEs).⁸⁶ Finding the appropriate profit attribution rules could be challenging in case of a new nexus, hence, the PE dilemma. It is important to understand the details of this along with relevant case law as businesses and countries often get into disputes whether a business operation falls under the exemption list of the treaty article or constitutes a PE. Such activities or business operations are referred to as preparatory or auxiliary services i.e., an activity which is not considered intensive and is of supporting nature. Many businesses must set up a supporting activity to help their main business operations. Therefore, these activities should not lead to PE. However, the above explanation will not stand if such supporting activities go past the preparatory or auxiliary nature, in which case, all these activities may constitute a PE. Thus, where a business activity does not play a significant role in the overall business operations of the enterprise it is not deemed to constitute a PE. It is, therefore, necessary to consider this on the facts and circumstances of each case. It is important to identify the core activity of a business and the characteristics of the activity to be considered under the exemption.

Hoffart suggested that an access to market approach may provide a more dynamic system of allocating taxing jurisdiction that is better able to respond to continuing evolution of the Internet economy.⁸⁷ A non-resident company's access to a host country's market also largely supports allocation by point of sale or consumption. Thus, the "market approach" has many of the same factors as the "location of value creation" approach. The key principle in this approach is that a direct tax nexus should exist whenever a foreign enterprise receives a payment from an in-country

⁸⁵ Alessandro Turina, *Supra @ note 83*

⁸⁶ Anton Baumann, "Digital Economy: The Future of International Taxation of Business Income" (2018) *Duouiono*, online: <https://www.duo.uio.no/handle/10852/60534>.

⁸⁷ Benjamin Hoffart, "Permanent Establishment in the Digital Age: Improving and Stimulating Debate Through an Access to Markets Proxy Approach", 6 *Nw. J. Tech. & Intell. Prop.* 106 (2007), online: <https://scholarlycommons.law.northwestern.edu/njtip/vol6/iss1/6>

payor. The European Union Commission in 2018⁸⁸ proposed that Member states would be able to tax profits generated in their territory even if a company did not have a physical presence there. A taxable 'digital presence' or a virtual PE in a member state would be determined if at least one of the following criteria were met in a taxable year for an enterprise: its annual revenue was higher than €7 million; it had over 100 000 users in a member state; or more than 3 000 business contracts for digital services had been made between the company and business users. Having established that such a virtual nexus existed, a proportionate share of company's profits would then become taxable in the country where it had a nexus, at a level equivalent to bricks and mortar companies. Furthermore, the Commission proposed that rules on allocation of profits be modified to better reflect how companies can create value online, considering factors such as user data. A purposeful and sustained interaction with a country's economy using technology such as the internet would be sufficient to subject the entity to taxation. The supply of digital services is considered here to include the supply of services through a digital interface by an MNE's associated enterprises in aggregate. The profits attributable to the significant digital presence are restricted to those that it would have earned if it had been a separate and independent enterprise, in particular in its dealings with other parts of the enterprise.⁸⁹ The proposal excludes the creation of a taxable nexus based on the place of consumption only by excluding the mere sale of goods or services through the internet from its definition of a digital service. Selling access to a digital marketplace for buying and selling items is a digital service, but the sale of an item itself via such a website is not. Amazon's direct retailing business, for example, would not fall under this tax.⁹⁰ Another aspect of the EU proposal is the 3% equalization levy, which would be a tax on the turnover of the non-resident digitalized business.

As of August 2019, there was no agreement within the EU on any of these proposals. This has led several EU countries to take unilateral measures, as discussed in more detail in Chapter 3. In Africa, there are no such proposals, and the administrability of such a "digital presence" tax would

⁸⁸ Marcin Szczepański, "Corporate Taxation of a Significant Digital Presence," (2018), online: [https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/623571/EPRS_BRI\(2018\)623571_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/623571/EPRS_BRI(2018)623571_EN.pdf).

⁸⁹ EUROPEAN COMMISSION, "COMMISSION RECOMMENDATION of 21.3.2018 Relating to the Corporate Taxation of a Significant Digital Presence," (2018), online: https://taxation-customs.ec.europa.eu/system/files/2018-03/commission_recommendation_taxation_significant_digital_presence_21032018_en.pdf.

⁹⁰ Solomon Rukundo, "Addressing the Challenges of Taxation of the Digital Economy: Lessons for African countries", Working Paper 105, (2020) International Centre for Tax and Development

be difficult due to issues such as lack of information, inability to enforce against companies that are not physically present, and the possibility of the tax burden being shifted to the customers. For this proposal to be effective, a lot of work would be required, and perhaps this is one of the reasons why some EU member countries refuse to agree with it.⁹¹

The OECD recommended three possible approaches to determine whether an entity has a SEP: first, using the amount of revenue earned from the country; second, using digital factors such as use of a local domain name, creation of a local digital platform and provision of local payment options; and third, considering user-based factors such as the number of monthly users, or the number of contracts concluded by the MNE, or the amount of data collected by the MNE, in that jurisdiction.⁹² Ponomareva opined that the problem with the concept of digital PE⁹³ is that its application requires entering into agreements with third countries. Revenue alone cannot be a sufficient factor for establishing a tax threshold, and therefore, as reflected in the proposal of the European Commission, it should be supplemented by other factors. In addition, the use of income as a factor can provide a high degree of tax certainty for cross-border activities. The OECD in its PE work stated⁹⁴ that, where the activities that an intermediary exercise in a jurisdiction are intended to result in the regular conclusion of contracts to be performed by a foreign enterprise, that enterprise will be considered to have a taxable presence in that jurisdiction unless the intermediary is performing these activities in the course of an independent business. A deemed PE considers scenarios in which a foreign entity may not have a physical office in another state, but there is someone in that state conducting business on its behalf; this is known as agency PE. This gives further insight into digital PE thresholds since the current definition is limited to the formal conclusion of contracts. The OECD has widened it to also include situations in which an agent habitually plays the principal role leading to the conclusion of contracts that are then routinely

⁹¹ Krishen Mehta, Esther Shubert, Erika Dayle Siu. "Tax Justice and Global Inequality: Practical Solutions to Protect Developing Country Revenues", ZED Books, (2020)

⁹² OECD, Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project (OECD, 2015) at 64

⁹³ Karina Ponomareva. "The Concepts of Legal Status of the Permanent Establishment in the Era of Digital Economy" (2019) Journal of Siberian Federal University. Humanities & Social Sciences. 2079-2090.

⁹⁴ Action 7 Permanent establishment status <https://www.oecd.org/tax/beps/beps-actions/action7/> 1

concluded without material modification by the foreign enterprise, but even the widened concept of an agency PE would not apply to most digital business activities.⁹⁵

Moreover, looking at the active work of the OECD and the European Commission, we can infer that the most important criteria to determine the existence of a PE based upon significant economic presence in the state include: 1) implementation of activities to provide digital services; 2) reaching the threshold of the number of users in a given state; 3) achievement of a temporary threshold of regularity (duration) of activity in the given state; 4) reaching the minimum income threshold. There is a need for continuous research in this grey area of international taxation so as to avoid confusion between the traditional economy and the digital economy in the near future. To the extent that there are any changes to the PE definition and any new nexus based on the criteria for “significant economic/digital presence”, there should be a clear threshold in each country under which no PE is created. Without such a minimum threshold, a business model may create a scenario where, under the proposed options, there are numerous small PEs across multiple countries.

2.4. What is meant by a factor presence nexus in a digital economy?

The challenges of determining a factor presence nexus in digital transactions are explained as follows by Klemm, Perry and de Mooij:

“The nature of digital service provision sees the user play a dual role in their exchange with the service provider: the user is a producer of valuable information and a consumer of digital services. It is the potential difference between the values of these two legs of the exchange that many governments implicitly contest. They see users in their countries being insufficiently compensated for the inputs they supply in return for a service that has a marginal near-zero cost to provide within the host country. The uncompensated value accrues to the firm exploiting the information, boosting their rents, which on most occasions lies beyond the legal reach of the government.”⁹⁶

⁹⁵ OECD. “Additional Guidance on the Attribution of Profits to Permanent Establishments, BEPS Action 7”, (2018), online: www.oecd.org/tax/beps/additional-guidance-attribution-of-profits-to-a-permanent-establishment-under-bepsaction7.htm

⁹⁶ Alexander D Klemm, Victoria J Perry and Ruud A. de Mooij, “Corporate Income Taxes Under Pressure”. International Monetary Fund, (2021) online: <https://www.elibrary.imf.org/view/book/9781513511771/9781513511771>.

As discussed in 2.3 above, ways to solve the challenges posed by the PE concept have been extensively evaluated during the past decades due to changes in business methods and the development of technology.⁹⁷ As far back as 1978, Stanley Surrey recognized that technological advancements required reassessing traditional PE norms. Surrey claimed that “modern methods of business and communication” made some requirements of the OECD Model Tax Convention obsolete.⁹⁸ According to him, developing countries had accepted the PE concept, yet sought to expand the PE definition and narrow the extent to which it limited source taxation. Such expansion would allocate more taxing rights to market jurisdiction and therefore benefit developing countries. Arthur J. Cockfield on the other hand proposed a modification to the PE principle to account for the fact that non-resident firms are allowed to generate revenue in foreign markets without the need for a physical presence.⁹⁹ Cockfield argued that a PE based on quantitative economic presence would be consistent with historic PE rationales and could restore a balanced sharing of tax revenues among countries.¹⁰⁰ The proposed concept of factor presence nexus would expand the definition of “business connection” in a bid to incorporate a new digital nexus to tax business profits of foreign businesses. In other words, a nexus would exist even without physical presence.

2.5 What would a factor presence nexus cover?

While revenue generated on a sustained basis is the basic factor for determining factor presence, it is not always sufficient to establish a nexus. Thus, for the revenue to be used to establish the nexus required for SEP in the country concerned, one or more of the following factors may be considered relevant to constitute the kind of purposeful and sustained interaction with the jurisdiction via digital technology and other automated means:

- i. “the existence of a user base and the associated data input;
- ii. the volume of digital content derived from the jurisdiction;

⁹⁷ Michael Kobetsky, “International Taxation of Permanent Establishments: Principles and Policy” (2011) (1st ed) Cambridge University Press, p.110

⁹⁸ Stanley Surrey, “United Nations Group of Experts and the Guidelines for Tax Treaties Between Developed and Developing Countries” (1978) *Harvard International Law Journal*, vol. 19, 1978, pp. 1–220.

⁹⁹ Arthur J Cockfield. “Reforming the Permanent Establishment Principle through a Quantitative Economic Presence Test.” *Canadian Business Law Journal*, vol. 38, no. 3, 2003, pp. 400-.

¹⁰⁰ *Ibid*

- iii. billing and collection in local currency or with a local form of payment;
- iv. the maintenance of a website in a local language;
- v. responsibility for the final delivery of goods to customers or the provision by the enterprise of other support services such as after-sales service or repairs and maintenance.
- vi. sustained marketing and sales promotion activities, either online or otherwise, to attract customers”.¹⁰¹

In terms of solution, the first obstacle to overcome is the assignment of taxing rights to data-producing (user/market) countries through revised nexus rules (for example, a new PE concept). The second challenge is to design revised profit allocation rules which reflect user contribution.¹⁰²

2.5.1 User- based approaches

In proposals to extend the PE concept to include the location of the user and their data, a few approaches focus on characteristics of the market. The OECD sets out options for modifying and expanding the PE definition to include a range of quantitative and qualitative benchmarks, such as the number of registered users, the number of active users, the amount of revenue earned within a market, the level of expenditure, or the existence of a local domain, a dedicated local digital platform and local payment options.¹⁰³ Scholars like Hongler and Pistone argue in support of the creation of a new PE nexus by appealing to the idea that users enhance the value of digital services.¹⁰⁴ As explained by Aqib and Shah:

“The idea that virtual access to a catalogue of people (for example, Facebook); products (for example, Amazon or eBay); services (for example, Airbnb or Uber); or other websites (for example, Google) could be equivalent to an individual visiting a physical shop— in this case corresponding to social clubs, department stores, letting agents and taxi services, or public libraries— and browsing these items in person is a powerful notion. The devices

¹⁰¹Veronica Grondona, Abdul Muheet Chowdhary, Daniel Uribe. “National measures on taxing the digital economy”, (2020) Research Paper, No. 111, South Centre, Geneva

¹⁰² Alexander D Klemm, Victoria J Perry and Ruud A. de Mooij, *Supra @ note 96*

¹⁰³ OECD “Tax Challenges Arising from Digitalisation—Interim Report: Inclusive Framework on BEPS. OECD/G20 Base Erosion and Profit Shifting Project” (2018). Paris: OECD Publishing.

¹⁰⁴ Peter Hongler and Pasquale Pistone. “Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy” (2015). WU International Taxation Research Paper Series No. 2015 - 15, online: <http://dx.doi.org/10.2139/ssrn.2591829>

that provide users with mobile market access and the opportunity to browse goods and services from any location— computers or mobile phones— could therefore form the basis for location- specific PE based on the location where the user is when they use a service.”¹⁰⁵

While the user-based approach is appealing, there are several loopholes to this, as there are several ways users circumvent and make inaccurate the exact way to calculate the number of users of a particular service in a location. For instance, the ability to use a Virtual Private Network (VPN), which allows customers to change their IP address and appear as if they’re connecting from a different location, is an argument against a user-based approach.¹⁰⁶

2.5.2 Investment- or Asset- based approaches

While the approach described above is focused on the company’s access to a market and capacity to develop its customer base, the investment approach on the other hand will view a digitalized business as taxable if it can be proved that it has invested capital in a specific market. Schön contends that, because this investment is made to ensure access to a specific customer base, this investment can give rise to taxing rights in the respective market country, not simply because there is a market with customers ordering goods or services, but because the company has invested into that market and expects a return on this investment.¹⁰⁷ Schön concedes that “however, to avoid the proliferation of small PEs around the world, one would have to introduce a meaningful qualitative and quantitative threshold on that investment, such as singling out specific digital elements of that investment or setting a minimum level of investment to bring forward the right to tax.”¹⁰⁸ It would also require separating the part of the firm’s investment that is of a general nature or for the day to day running of the business and the part that is devoted to individual markets. The challenge with this approach is that these “country- specific” investments may be targeted at a local customer base, but they are not dependent on any spatial relationship to the market country, or to any specific public goods provided by the market country.

¹⁰⁵ Aslam Aqib and Alpa Shah. “IMF Working Paper: Tec(h)Tonic Shifts: Taxing the ‘Digital Economy.’” (2020) *Proceedings (Conference on Taxation)*, vol. 113, 20, pp. 1–81.

¹⁰⁶ <https://www.forbes.com/advisor/business/software/what-is-a-vpn-and-how-does-it-work/>

¹⁰⁷ Schön Wolfgang. “Ten questions about why and how to tax the digitalized economy.” (2017) *Bulletin for International Taxation* 72(4–5): 278

¹⁰⁸ Ibid

2.5.3 Courts' approaches

Recent judicial developments have also provided glimpses into the way that users can qualify as a form of nexus. The reasoning in *South Dakota v. Wayfair, Inc* case is seen as a turning point with regards to taxing businesses with no physical presence because, at least in the United States, companies must now discern which goods and services are subject to taxation in different jurisdictions, understand their sourcing rules, and be aware of the applicable tax rates. In the landmark case of *South Dakota vs. Wayfair, Inc.*¹⁰⁹ case, the United States Supreme Court ruled in June 2018 that physical presence should not be required for a state to compel out-of-state sellers to collect state sales tax on sales to customers in a state, thereby overturning its own precedent dating back to 1992¹¹⁰. In other words, a company can now be obliged to collect sales tax from the consumer for the jurisdiction in which that consumer is located, even if the seller has no physical presence there. Specifically, the wording of the majority opinion noted that “a business may be present in a state in a meaningful way without that presence being physical in the traditional sense of the term.” The opinion goes on to say that “it is not clear why a single employee or a single warehouse should create a substantial nexus while ‘physical’ aspects of pervasive modern technology should not. For example, a company with a website accessible in South Dakota may be said to have a physical presence in the State via the customers’ computers.

Similarly in Nigeria, the lacunas in the laws have, expectedly, led to legal disputes between taxpayers and the Federal Inland Revenue Service (FIRS). The Nigerian courts appear to have neglected the provisions of the VATA, and gone ahead of the legislature to adopt the OECD’s VAT/GST destination principle (which ought not to be binding, but persuasive) in determining chargeability of cross-border transactions to VAT.

For instance, in *FIRS v. Gazprom Oil and Gas Nigeria Limited*¹¹¹, Gazprom contracted various Non-Resident Companies (NRCs) to supply it with consultancy and advisory services. These services were provided from outside Nigeria and Gazprom did not account for VAT on the basis that the NRCs were not carrying on business in Nigeria. The Federal High Court (FHC) held that

¹⁰⁹ 138 S. Ct. 2080 (2018)

¹¹⁰ *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992)

¹¹¹ Suit No: FHC/ABJ/TA/1/2015

“carrying on business” is not limited to the physical presence of an NRC in Nigeria and that the service was chargeable to VAT in Nigeria because it was consumed by Gazprom in Nigeria.

Similarly, the Court of Appeal upheld the decision of the FHC in *Vodacom Business Nigeria Limited v. FIRS*.¹¹² The basis for the decision was that “the physical presence of the NRC in Nigeria is of no moment ... since its services are used in Nigeria.” While the OECD’s persuasive Guidelines are desirable, they are non-binding recommendations which countries are advised to domesticate in their respective laws before implementing.

Equally, the FIRS appears to hold the view that a service provider must be physically present outside Nigeria for a service rendered to a person outside Nigeria to qualify as “exported services.” This is notwithstanding that the VATA does not have provisions relating to the “place of supply,” though it provides for reverse charge, requiring Nigerian customers of NRCs to withhold and remit VAT on services provided by the NRCs.

2.6 Challenges, objections, and arguments against factor presence nexus

The main objection to the factor presence standard is that it is too major a change to make. The OECD’s inability to reach a solution on Action 1 clearly shows that divergent interests of countries have prevented any change to the foundation of an outdated system of international taxation. Methods of doing business changed without an international consensus, however.¹¹³ To continue to apply rules that were made to deal with an entirely different form of doing business ignores the realities of the present economy. Objections to fundamental changes are also made based on the difficulties of implementing reforms. Adopting a nexus standard that is not based on physical presence, but is instead based on economic presence, would certainly require changes in the domestic laws of countries, as well as to treaty obligations. Change, however, is inevitable. Laws will have to be revised at some point as the digital economy is only going to continue to grow. Professor Hellerstein raises a commonly neglected point which is that: if a PE based on factors

¹¹² Suit No: CA/L/556/2018

¹¹³ Paul A. Blay. “Reviving Transfer Pricing Enforcement Through Formulary Apportionment”, (2017) 7 Tax Dev. J. 28

other than physical presence is instituted, how is collection of the tax enforced?¹¹⁴ In particular, the scholar notes that “the ability to enforce a tax based on a virtual PE is likely to depend in substantial part on the political will to use the means that are available, reinforced by significant penalties for non-compliance [such as blocking a company’s virtual presence], to ensure effective enforcement based on the virtual PE.”¹¹⁵ While this issue should be recognized and addressed when countries enact laws to change nexus rules, it is not any more of an impediment to tax collection than, for example, a nexus based on the conclusion of a contract in a country by one person where the company has no assets other than perhaps rented office space and some equipment. Also, the OECD recognizes that there is no consensus “on whether, and the extent to which [data and user participation] should be considered as contributing to a firm’s value creation and therefore, any impact they may have on the international tax rules.”¹¹⁶ This has led to endless arguments as to what creates value, vis-à-vis the value an activity has to a particular taxpayer.¹¹⁷

2.7 Taxing according to value creation

The ever-evolving nature of MNEs and the changes in the localization of value across production necessitates the convergence of the international tax community towards better alignment of tax systems to ensure that profits are taxed where economic activities generating the profits are performed and where value is created. As straightforward as this principle seems, the process of allocating jurisdiction to tax business profits of MNEs with human capital deployed across borders is a highly complex one. It is made complex by the difficulty in understanding the notion of an enterprise under international tax law, as well as different interpretations of the rules governing PEs and transfer pricing, which were developed at a time when value chains were less elusive and considerably less complex.¹¹⁸ Amid widespread discussions on the effects of digitalization on the global economy and the equitable distribution of taxes among countries, new metrics such as sales,

¹¹⁴ Walter Hellerstein, “Jurisdiction to Tax in the Digital Economy: Permanent and Other Establishments”, (2014) 68 Bull. for Int’l Tax’n 346, online: https://research.ibfd.org/#/doc?url=/document/bit_2014_06_o2_3

¹¹⁵ Ibid

¹¹⁶ Monica Gianni. “OECD BEPS (In)Action 1: Factor Presence as a Solution to Tax Issues of the Digital Economy.” *Proceedings. Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association*, vol. 111, National Tax Association, 2018, pp. 255–98, online: <https://www.jstor.org/stable/26939394>

¹¹⁷ Allison Christians and Laurens van Apeldoorn. “Taxing Income Where Value Is Created” (2018). 22 Florida Tax Review 1, 2019, online: <https://ssrn.com/abstract=3132538>

¹¹⁸ Michael Lennard, “Act of creation: the OECD/G20 test of ‘Value Creation’ as a basis for taxing rights and its relevance to developing countries,” (2018) *Transnational corporations*, vol. 25, no. 3, pp. 55.

personnel, or data are being proposed as more suitable for taxing profits derived from digital activities, whether through income tax or other tax forms.¹¹⁹ Scholars argue that a comprehensive re-evaluation of the concept of value could result in changes to the existing consensus on profit allocation.¹²⁰

One reason taxing in accordance with value creation has become a readily acceptable principle, especially among the high-income countries, is that the old intentional tax compromises were designed primarily to prevent double taxation, not to prevent double non-taxation. Taxing in accordance with value creation is seen as a better alternative to this issue with a neutral-sounding process.¹²¹

2.8. Conclusion

As digitalization progresses, the question as to whether value creation tied to physical presence can continue to form the basis of income allocation will have to be posed anew. The OECD has made significant progress while striving to improve fairness, as well as fortify the existing international tax system and reallocate taxing rights. The Pillar One blueprint shows tremendous progress in approaching MNEs' profits on a group basis which in theory is about allocating residual profits of large MNEs to market jurisdictions. The launch of the OECD BEPS Project and the efforts of tax reform through Pillar One and Pillar Two are testaments to the existence of a consensus on the need for better internationally coordinated tax rules that require MNEs to pay their fair share of taxes. In all, repurposing Pillar One towards an increased global tax on MNEs for the common goal of fighting global crises serves two critical purposes. The first one is to prevent a possible deadlock in the negotiation of the practical details and political negotiation of the blueprint. The second is to commit the tax to such a common purpose that it can provide a win - win outcome for governments, MNEs and the planet.

¹¹⁹ Werner Haslechner and Marie Lamensch (ed.) "Taxation and value creation" (2021): EATLP annual congress Vienna, 18-20 June 2020. Amsterdam: IBFD. EATLP international tax series, Volume 19. ISBN 978-90-8722-687-9

¹²⁰ Allison Christians and Laurens Van Apeldoorn "Taxing Income Where Value is Created,"(2023) *Florida Tax Review*: Vol. 22: No. 1, Article 1. online: <https://scholarship.law.ufl.edu/ftv/vol22/iss1/1>

¹²¹ Allison Christians. "Taxing According to Value Creation" (2018). *Tax Notes International*, Vol. 90, 2018, online: <https://ssrn.com/abstract=3230370>.

CHAPTER 3: DIFFERENT APPROACHES TO DIGITAL ECONOMY TAXATION: THE OECD PROPOSALS, UN PROPOSALS, AND EVALUATION OF EACH APPROACH

3.1 Introduction

Increased international digital trade has shaken established tax rules and the various methods adopted by countries for international taxation, as discussed in the previous chapters. As stated recently by World Bank authors: “In the absence of an international digital tax system and a global tax authority, the digital discourse demands multilateral cooperation and compromise from all parties involved—mainly from digital producers, consumer countries and also from multinational corporations in the digital services sector.”¹²² A rising number of governments are opting to follow their own path notwithstanding the efforts made by over 130 nations within the OECD to develop a multilateral approach to digital taxation.¹²³ Although unilateral arrangements are being peddled as a temporary fix, in the long run they will complicate the eventual outcome of a multilateral approach, especially in countries with complex legislative bureaucracy.¹²⁴ This chapter examines the combined effort of the OECD and UN in coming up with an approach which will be equitable and accepted by a majority of countries towards the creation of a framework for the taxation of the digital economy. The OECD and UN hope that a multilateral approach will avoid the distortion of economic outcomes, reduced growth, possible trade retaliation, and a destabilization of tax and trade regimes that may be occasioned by the proliferation of unilateral measures such as digital services taxes. Disputes relating to these matters have even arisen among certain G20 members, further highlighting the urgency to develop a global solution.

This chapter starts with a background of the BEPS project and is divided into two parts. The first part examines the OECD proposals including a synopsis of the components of Pillar One and Pillar Two. The chapter also examines the alternative to Pillar One, which is Global formulary

¹²²Cristian Oliver Lucas-Mas and Raúl Félix Junquera-Varela. “Tax Theory Applied to the Digital Economy: A Proposal for a Digital Data Tax and a Global Internet Tax Agency”, (2021) The World Bank, online: <https://documents1.worldbank.org/curated/en/615591614758099110/pdf/Tax-Theory-Applied-to-the-Digital-Economy-A-Proposal-for-a-Digital-Data-Tax-and-a-Global-Internet-Tax-Agency.pdf>.

¹²³ Josh Kallmer, “Digital Tax: The Critical Importance of a Multilateral Approach”, (2017) Transatlantic Take online: <https://www.gmfus.org/sites/default/files/Digital%20Tax%20-%20The%20Critical%20Importance%20of%20a%20Multilateral%20Approach.pdf>

¹²⁴ Patrick Low “The case for multilateral agreement on digital taxation” online: <https://iit.adelaide.edu.au/news/list/2020/12/16/the-case-for-multilateral-agreement-on-digital-taxation>.

apportionment (GFA), which is an approach to allocate the global profits of an MNE group on a consolidated basis among the associated enterprises in different countries based on a predetermined formula. It is more general and not just restricted to digital companies.

The second part of the chapter considers the elements of the UN proposals in the ongoing global efforts at addressing the erosion of tax bases of countries and shifting of profits from high tax jurisdictions to low or no tax jurisdictions, specifically for digitalised businesses. In the last part, I compare the efforts by the OECD and the United Nations while discussing the possible impediments of the two approaches in African countries. I argue that the moving away from physical presence nexus rules toward a revenue-based nexus rule is a step toward change of the century-old international tax laws.

3.2 The BEPS project on the digital economy

The OECD has brought together more than 135 countries, including all G20 members, on an equal footing in the G20/OECD Inclusive Framework on BEPS. Since 2016, its members have been implementing a 15-point action plan to tackle tax avoidance by multinationals, developed between 2013 and 2015. The BEPS project has been the first major multinational effort, other than the development and publication of the OECD model tax convention in 1963, to reform international tax rules since they were first designed in the 1920s. While substantial progress is being made on countering BEPS risks in several areas, there are tax challenges arising from digitalization, which go beyond BEPS and are yet to be addressed. The result of the BEPS project has been the acceptance of recommendations to be implemented voluntarily at the single state and tax treaty level in a bid ensure uniformity and to remedy the various gaps in the international tax architecture.¹²⁵ As important as taxes are to the sovereignty of a country, international cooperation is necessary to achieve a unanimous agreement capable of tackling tax evasion and avoidance. To achieve this, countries may need to sacrifice a part of their fiscal sovereignty. The overarching issue is the development of global tax governance.

¹²⁵ William Morris “International Tax Reform: What Will the Future Be?”, (2018), Tax Journal, online: <https://www.taxjournal.com/articles/international-tax-reform-what-will-future-be->

In its present state, the international tax system requires reformative action to avoid the likelihood of an “international tax war”. Not to understate the efforts of the BEPS project, but it appears countries require a timely resolution of issues including how profit is meant to be distributed within the context of digitalization. The urgency from countries to resolve this is predicated on the need to fashion a tax approach which allows countries to collect their fair share of tax while maintaining a good tax outlook able to attract investments.¹²⁶

3.3 The OECD Proposals

In a bid to put forward international negotiations to ensure large and highly profitable MNEs, including digital companies, pay tax wherever they have significant consumer-facing activities and generate their profits, the OECD has published proposals which have gone through several consultations from various sectors in the international tax system. This is aptly captured when the OECD described “the proposals on taxing the digitalized economy are part of wider efforts to restore stability and certainty in the international tax system, address possible overlaps with existing rules as well as lessen the risks of double taxation.”¹²⁷

3.3.1 The unified approach to replace unilateral taxes

Companies no longer need not to be present in every region where they trade, which is why the existing allocation model of corporate income tax is considered outdated– at least for the larger business-to-consumer (B2C) digital companies. The current allocation model prioritizes physical presence within a jurisdiction to allow it to execute its taxing rights, whereas under the ‘Unified Approach’, a ‘digital presence’ alone allows jurisdictions to execute their taxing rights. Because most MNEs carry out digital activities, it may prove quite burdensome to delineate those enterprises to which the new nexus approach will apply.

¹²⁶ Sol Picciotto “The G20 and the “Base Erosion and Profit Shifting (BEPS) Project” (2017), Discussion Paper/German Development Institute, online: https://www.idos-research.de/uploads/media/DP_18.2017.pdf.

¹²⁷ OECD 2019 “OECD leading multilateral efforts to address tax challenges from digitalisation of the economy” online: <https://www.oecd.org/tax/oecd-leading-multilateral-efforts-to-address-tax-challenges-from-digitalisation-of-the-economy.htm/>.

In January 2020, the IF decided to negotiate the Pillar One solution based on a "Unified Approach" architecture sketch, which was suggested by the Secretariat.¹²⁸ By modifying the profit allocation and nexus rules that apply to business earnings, Pillar One aims to modify the international income tax system to accommodate new business models. In this context, it broadens the taxation authority of market jurisdictions (which, in certain business models, correspond to the jurisdictions where the users reside). This new model plan tries to devise the idea of a middle ground between the positions of three different groups of countries: Europe, the United States, and non-OECD members, specifically a coalition of developing countries known as the Group of Twenty-Four (G24).¹²⁹ As summarized by van Leeuwen and van der Heiden:

“This Approach introduces a new ‘nexus’ i.e., having a certain level of ‘digital sales’ in a jurisdiction rather than a physical presence. It is not envisaged, however, that this new “nexus” will replace the old one; it should merely be considered a supplement to the already existing model. Furthermore, the ‘Unified Approach’ suggests a three-tier allocation of profits, i.e., so-called Amount A, Amount B and Amount C.”¹³⁰

Amount A introduces a ‘new taxing right’ that does not require a physical presence because it allocates profits by means of a formula. Under this model, profit would be allocated to the market/user country. This new taxing right would not fully replace the current allocation of profits to countries where income is produced under existing source rules, arm’s-length pricing allocations, and income tax treaties. For the market country to receive an allocation of a portion of profits, a threshold number of sales or other revenues, such as advertising revenues, must occur in (or be attributable to) that country. The allocation to the A model is limited to large MNEs that have more than a threshold of €750 million to €5 billion amount of in-scope revenue in the

¹²⁸ OECD, “Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project”, (2020) OECD Publishing, Paris, online: <https://doi.org/10.1787/beba0634-en>.

¹²⁹ Allison Christians. “A Unified Approach to International Tax Consensus” (2019) *Tax Notes International* 96:497-500, online: <https://www.taxnotes.com/tax-notes-today-international/digital-economy/unified-approach-international-tax-consensus/2019/11/25/2b3f5>

¹³⁰ Patrick van Leeuwen and Patrick van der Heiden “The unified approach under Pillar One as suggested by the OECD” online: <https://www.bakertilly.nl/en/inzichten/kennisartikel/the-unified-approach-under-pillar-one-as-suggested-by-the-oecd#:~:text=The%20'Unified%20Approach'%20introduces%20a,to%20the%20already%20existing%20model.>

market/user country. Amount B is a fixed return for certain baseline marketing and distribution activities. to companies with marketing and distribution functions. This only applies where a company engages in physical activities in a jurisdiction. Amount C allows the market country to challenge Amount B using the TP regulations.¹³¹ Due to the substantial reallocation of taxing rights from low-tax to higher-tax nations, Amount A is anticipated to have beneficial worldwide revenue implications.¹³² I agree with the OECD’s view that Amount A enhances tax certainty, which is likely to improve international investment conditions by curbing the proliferation of disorganized DSTs and similar measures, and by reducing the risk of escalating trade tensions.¹³³

3.3.2 Global Anti-Base Erosion (GloBE) Proposal

The Global Anti-Base Erosion (GloBE) Rules are the central point of the Pillar Two component of the OECD proposals. They are meant to systemize the international tax system in such a way that multinational enterprises (MNE) pay a minimum level of tax on the income arising in each of the jurisdictions where they operate. The GloBE rules do so by imposing a top-up tax on profits arising in a jurisdiction whenever the effective tax rate, determined on a jurisdictional basis, is below the minimum rate which was pegged at 15%.¹³⁴ The proposal is designed to extend the BEPS project to further combat profit shifting and to reduce tax competition. There have been suggestions from various scholars that the GloBE proposal will allow for greater development because MNEs are likely to invest more in countries where they are able to maximize profits; more so, since the second objective is against tax competition, it requires a better structure in place than the first which is targeted only at profit shifting.¹³⁵ There are ongoing negotiations on the possibility of streamlining the proposal to only tackle the issue of profit shifting and not tax competition.¹³⁶ The OECD has also proposed a substance based carve

¹³¹ Parada Leopoldo, “The Unified Approach Under Pillar 1: An Early Analysis” (2019), Tax Notes International, Vol. 96 No. 11, online: <https://ssrn.com/abstract=3522027>

¹³² Pierce O’Reilly, Tibor Hanappi, Samuel Delpuch, Felix Hugger, and David Whyman. “Update to the economic impact assessment of pillar one: OECD/G20 Base Erosion and Profit Shifting Project”, (2023), *OECD Taxation Working Papers*, No. 66, OECD Publishing, Paris, online: <https://doi.org/10.1787/7c35a55c-en>.

¹³³ Ibid

¹³⁴ OECD. “Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS”, (2021), OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, online: <https://doi.org/10.1787/782bac33-en>.

¹³⁵ Michael Devereux, Bares Francois, Sarah Clifford, Judith Freedman, Irem Güçeri, Martin McCarthy, Martin Simmler, and John Vella. “The OECD global anti-base erosion proposal.” (2020) PwC report, Oxford University Centre for Business Taxation.

¹³⁶ Ibid

out to protect certain low-tax profits that are earned in low-tax countries. The main goal of this substance-based carve-out on tangible assets and wages is to isolate the jurisdiction's substantial activity from the BEPS Pillar Two regulations.¹³⁷ “The use of Payroll and Tangible Assets as indicators of substantive activities is justified because these factors are generally expected to be less mobile and less likely to lead to tax-induced distortions.”¹³⁸ Focusing on “excess income,” especially intangible income, which is most at risk of BEPS concerns, is the main objective.

As the GloBe rules are becoming the preferred approach in most OECD countries (but not the US yet), some countries may be able to collect more tax revenues which could stem from sanctioning a domestic minimum tax and the revision of existing tax incentives. Maintaining the existing incentives and tax structures for taxpayers outside the scope of GloBE while claiming the minimum tax on companies within the GloBE scope may be the preferred approach for many countries.¹³⁹ Satisfyingly, the taxes under this proposal are not restricted to the corporate tax but could also be extended to include the income of shareholders. Although by default, the country entitled to top-up tax on income is the jurisdiction where the company is resident.¹⁴⁰

The GloBE rules apply irrespective of whether the undertaxed constituent entity subscribes to the rules or not¹⁴¹ or whether there is a tax treaty signed or not with the low tax constituent entity’s jurisdiction.¹⁴² The GloBE rules are to be implemented under domestic law¹⁴³ and considering that it is a tax on residents, it is difficult to have it restricted by tax treaties. This is further strengthened

¹³⁷ OECD (2023), Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), July 2023, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosionrules-pillar-two-july-2023.pdf.

¹³⁸ OECD. “Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)”, (2022) OECD, Paris, online: <https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf>.

¹³⁹ Allison Christians, Thomas Lassourd, Kudzie Mataba, Eniye Ogbebor, Alexandra Readhead, Stephen Shay, Stephen and Zachee Pougá Tinhaga, “A Guide for Developing Countries on How to Understand and Adapt to the Global Minimum Tax: Draft for Consultation” (2022). International Institute for Sustainable Development and International Senior Lawyers Project, December 2022, online <http://dx.doi.org/10.2139/ssrn.4317112>

¹⁴⁰ Ibid

¹⁴¹ Belisa Liotti, Joy Ndubai, Joy Waruguru, Ruth Wamuyu, Ivan Lazarov, and Jeffrey Owens. “The Treatment of Tax Incentives under Pillar Two” (2022). *Transnational Corporations Journal*, Vol. 2, No. 2, 2022, online: <http://dx.doi.org/10.2139/ssrn.4132515>

¹⁴² Belisa Liotti, Joy Ndubai, Joy Waruguru, Ruth Wamuyu, Ivan Lazarov, and Jeffrey Owens, *Supra @ note 141*

¹⁴³ Jinyan Li, “Introducing a Global Minimum Tax (Pillar Two) in Canada: Some Knowns and Unknowns” (2023). *Articles & Book Chapters*. 2973, online: https://digitalcommons.osgoode.yorku.ca/scholarly_works/2973

by Art 1(3) of the OECD and UN model convention.¹⁴⁴ Although, the resident state is required to provide tax credit in line with Art 23 of the convention. The component of the GloBE rules are discussed in the paragraphs below

3.3.2.1 Income Inclusion Rule

The Income Inclusion Rule (IIR) is almost like the CFC rules as discussed in chapter one of this work. Under the IIR, top-up tax is paid at the parent entity level based on its proportion of ownership interests in entities with low-taxed income.¹⁴⁵ The IIR is not a stand-alone proposal; it is designed to co-exist with the GloBE rules that apply in other jurisdictions where the MNE operates to ensure there is no over taxation profits that have not been subject to the appropriate tax.¹⁴⁶ There may be a modification on Undertaxed Payments Rule to allow for occasions where the minimum tax paid is not covered after the application of Income Inclusion Rule. This allows for an increase in tax paid at the constituent entity level.¹⁴⁷ If the parent company is in a tax jurisdiction that does not implement the Income Inclusion Rule, the next intermediate holding company will perform the calculations and pay the top-up taxes to its low-tax counterparty tax jurisdictions.¹⁴⁸ As the aim of the income inclusion rule is to target low or non-taxed income in foreign subsidiaries, I believe many African countries introducing such a rule may eventually treat comparable situations differently, i.e. inflicting a restriction on cross-border establishments. Given the fact that the GloBE Proposal – including the income inclusion rule – aims at combatting not only base erosion and profit shifting but, more fundamentally, also tax competition as such, it is not surprising that the proposal may constitute the basis for a long line of diverse policy considerations and opinions. With insights from research conducted in the EU, it was concluded that developed economies have the most revenue at stake under IIR and developing economies

¹⁴⁴ This Convention shall not affect the taxation, by a Contracting State, of its residents except with respect to the benefits granted under [paragraph 3 of Article 7], paragraph 2 of Article 9 and Articles 19, 20, 23 A [23 B], 24 and 25 A [25 B] and 28.

¹⁴⁵ Peter Koerver Schmidt, “A General Income Inclusion Rule as a Tool for Improving the International Tax Regime – Challenges Arising from EU Primary Law”, (2021). Intertax, 2020, vol. 48, issue 11, pp. 983-997, Kluwer Law International, Alphen aan den Rijn, Copenhagen Business School, CBS LAW Research Paper No. 21-06, online: <https://ssrn.com/abstract=3931343>

¹⁴⁶ OECD (2021) Supra @ note 134

¹⁴⁷ Renee Leung “Global minimum tax? A rundown of the Pillar Two model rules” online: <https://www.wolterskluwer.com/en-nz/expert-insights/global-minimum-tax-pillar-two-model-rules>

¹⁴⁸ Ibid

have more to gain. It was estimated that EUR 154 billion would be lost in top up tax since most MNEs have their headquarters in the G7 countries.¹⁴⁹

3.3.2.2 Undertaxed Payments Rule

The undertaxed profits rule (UTPR), which is like the IIR, is one piece of the OECD global tax deal aimed at limiting multinational corporate tax avoidance by changing international tax policy. The UTPR is an anti-base erosion rule targeting intra-group payments to low-taxed entities while ensuring that the application of the GloBE rules does not result in the MNE Group being subject to tax on its income in those jurisdictions where it operates more than the minimum rate.¹⁵⁰ These rules are designed to apply to MNEs with more than €750 million (US \$789 million) in total global revenues.¹⁵¹ The OECD explains the interaction of the UTPR and the IIR as follows:

“The UTPR requires a UTPR taxpayer that is a member of an MNE Group to make an adjustment in respect of any top-up tax that is allocated to that taxpayer from a low-tax Constituent Entity of the same group. Where there is no basis for IIR to be fitting at the Ultimate Parent Entity (UPE) level, the IIR can apply at a sub-holding level. In terms of hierarchy, the IIR has priority over the UTPR¹⁵² in the sense that no top-up tax is expected to be allocated under the UTPR if that low-tax Constituent Entity is controlled, directly or indirectly by a foreign Constituent Entity that is subject to an IIR which has been implemented in accordance with the GloBE rules. A top-up tax may be allocated under the UTPR from Constituent Entities located in the UPE if the MNE’s ETR in that jurisdiction is below the agreed minimum rate.”¹⁵³

There are arguments that the UTPR is a clear departure from the international consensus and tax treaties, especially with the modification of “undertaxed payments rule” to “undertaxed profits

¹⁴⁹ Mona Barake, Theresa Neef, Paul-Emmanuel Chouc and Gabriel Zucman. “Revenue effects of the Global Minimum Tax under Pillar Two” (2022), online: <https://www.taxobservatory.eu/publication/2938/>

¹⁵⁰ OECD (2021) *Supra* @ note 134

¹⁵¹ OECD. “Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS”, (2020) OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, online: <https://doi.org/10.1787/abb4c3d1-en>.

¹⁵² *Ibid*

¹⁵³ *Ibid*

rule”.¹⁵⁴ The implication of replacing the word “payments” with “profits” in the model UTPR may not mean so much, but in “income tax law, those words represent very different concepts. In international taxation, the replacement is tantamount to creating a new basis for a country to tax profit that is not earned by its resident company or sourced in its jurisdiction.”¹⁵⁵

3.3.2.3 Subject to Tax Rule

The Subject to Tax Rule (STTR) is a key component of Pillar Two but not part of the GloBE rules. The STTR could be applicable regardless of the group's size, meaning that the EUR 750 million requirement might not be applicable. The STTR is a treaty-based rule, and its focus is on source jurisdictions by allowing source jurisdictions to tax the gross amount of interest, royalties and a defined list of other payments received by a connected company, up to a globally agreed 9% minimum rate. This applies even if a relevant tax treaty only permits the source country to impose withholding tax on the payment at a rate below 9% or allocates exclusive taxing rights over the payment to the recipient’s country of residence. The STTR allows a country to impose a higher rate of withholding tax than the treaty rate on certain base-erosion payments (including interest and royalties) made between related entities in cases where the payment is subject to tax at a nominal rate below 9% in the recipient’s country.¹⁵⁶

The STTR overrides tax treaty benefits for certain intra-group related party payments (e.g., royalties and interest payments) that are often shifted from “Low- and middle-income countries (LMICs) to lower tax jurisdictions. The STTR will allow these source countries to apply a top up tax of up to 7.5-9 % if the equivalent rate is not imposed in the country or jurisdiction where the MNE has shifted this taxable income”.¹⁵⁷ The STTR is however immersed in a lot of uncertainties because Pillar Two gives the priority to residence taxation (via IIR) over source taxation (via UTPR/STTR), it is appears as though it is fashioned for the benefit of the G20 countries over the

¹⁵⁴ Jinyan Li, “The Pillar 2 Undertaxed Payments Rule Departs from International Consensus and Tax Treaties” (2022). Articles & Book Chapters. 2881, online: https://digitalcommons.osgoode.yorku.ca/scholarly_works/288

¹⁵⁵ Ibid

¹⁵⁶ OECD (2021) Supra @ note 134

¹⁵⁷ Julie McCarthy. “A bad deal for development: Assessing the impacts of the new inclusive framework tax deal on low- and middle-income countries”, (2022), Brookings Institution, online: <https://policycommons.net/artifacts/4135973/a-bad-deal-for-development/4944003/>

developing countries.¹⁵⁸ This is why some African countries have expressed concerns in developing another multilateral instrument to facilitate the implementation of the STTR. The OECD has explained the priorities of developing countries in designing the framework, i.e., the inclusion of all intragroup service payments within the scope of the rule and the inclusion of a qualified domestic minimum top-up tax (QDMTT) are important to many developing countries.¹⁵⁹ Nonetheless, some developing countries seem bent on renegotiating provisions that will eventually lead to international tax cooperation with the UN.

3.4 Role of safe harbors

A safe harbor is an administrative simplification which is in principle optional for taxpayers. It consists for instance of a simplification when determining arm's length prices by using a pre-established TP method and margin rates and/or of an alleviation of the TP documentation requirement.¹⁶⁰ The OECD, in its 2017 TPGs, defines a safe harbor as “a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country's general TP rules.”¹⁶¹ Safe harbors are established to reduce the burden of tax compliance and ease administration of the tax system, while at the same time providing tax certainty. For taxpayers subject to TP rules of taxing jurisdictions, safe harbor regimes have the potential to reduce the compliance burden involved in establishing an arm's length price for transactions entered into with related entities. For tax authorities in developing countries, safe harbor regimes can help to ensure effective management of limited resources needed for tax enforcement. They may be used to secure and increase corporate income tax of taxing jurisdictions.¹⁶² Countries use safe harbor regimes to achieve efficiency in their tax administration and reduce the compliance cost and burden for taxpayers.¹⁶³ Though safe harbors

¹⁵⁸ Reuven Avi-Yonah and Young R. Kim. “Tax Harmony: The Promise and Pitfalls of the Global Minimum Tax” (2022), 43 MICH. J. INT'L L. 505 (2022)

¹⁵⁹ OECD. online: <https://www.oecd.org/tax/beps/sttr-mli-at-a-glance.pdf>

¹⁶⁰ Alain Charlet, Caroline Silberstein and Gerard Pointe, “Transfer Pricing Study on the Feasibility of Introducing Safe Harbour Provisions in ECOWAS Countries: Results and Analysis of the Questionnaires Sent to Governments, Businesses and the Civil Society” (2016), Luxembourg: Publications of the European Union.

¹⁶¹ OECD (2017) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2017. OECD Publishing, Paris, para 4.102 at 205.

¹⁶² Alexander Ezenagu, “Unitary Taxation of Multinational Enterprises for a Just Allocation of Income: Nigeria as a Case Study of Africa's Largest Economies”, Doctoral Thesis, McGill University.

¹⁶³ Para 4.109 of Section E, Chapter IV of OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017

may not take into account the individual facts and circumstances of each individual taxpayer, they are recommended for African countries as they achieve a compromise between the need to protect the tax base (through strict adherence to TP rules), and to reduce the compliance and administration burden on taxpayers and tax authorities.

The second set of Administrative Guidance on the Global Anti-Base Erosion (GloBE) rules, which were published on July 17, 2023, describes how the safe harbor applies to the Pillar Two proposal. It includes various much needed and welcomed guidelines, most notably the new transitional under-taxed profits rule (UTPR) safe harbor. Under the new transitional UTPR, taxpayers may choose not to be subject to the UTPR for the first two years of the GloBE regulations if their UPE is domiciled in a jurisdiction having a statutory corporate income tax rate of at least 20%.¹⁶⁴

African countries have received pointers on being cautious in the application of the safe harbor guidelines. Aside from the fact that its application to SMEs is almost impossible because they do fall within the threshold for compliance with the TP rules, it also gives room for potential tax planning.¹⁶⁵ The safe harbor regime will be of benefit to African countries in the wake of international tax cooperation as countries hope to harmonize accounting methods to ensure balance in comparability between countries the initial stage.

3.5 Alternative to Pillar One (Global Formulary Apportionment)

Global formulary apportionment (GFA) is an approach to allocate the global profits of an MNE group on a consolidated basis among the associated enterprises in different countries based on a predetermined formula. It is more general and not just restricted to digital companies. Under the GFA, a multinational corporation would allocate its profits across countries based on its sales, payroll, and capital base in each jurisdiction.¹⁶⁶ For instance, a corporation in Canada would pay the Canadian corporate tax on the share of its worldwide income allocated to Canada. This has led

¹⁶⁴ OECD. “Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)”, (2023), OECD/G20 Inclusive Framework on BEPS, OECD, Paris, www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosionrules-pillar-two-july-2023.pdf.

¹⁶⁵ Alexander Ezenagu. “Safe Harbour Regimes in Transfer Pricing: An African Perspective”, (2019), ICTD Working Paper 100, Brighton, IDS

¹⁶⁶ Gerhard Vorwold “The Global Formulary Apportionment (GFA) Model - Concept of Changed Structures in the Taxation of Multinational Enterprises”, (2021), online: <http://dx.doi.org/10.2139/ssrn.3762403>

to calls for Unitary Taxation with formula apportionment where MNEs are treated as a single entity and not as a loosed entity with offices over the world ¹⁶⁷ To ensure better transparency, companies with business presence in more than one country should submit a Combined and Country by Country Report (CaCbCR) to each tax authority which would include: (i) consolidated worldwide accounts for the firm as a whole, taking out all internal transfers; (ii) details of all the entities forming the corporate group and their relationships, as well as of transactions between them; and (iii) data on its physical assets, employees, sales (by destination), and actual taxes paid, in each country where it has a business presence. With the CaCbCR, countries can decide on an appropriate apportionment of the profit.¹⁶⁸ This practice is expected to ensure revenue agencies in countries have details on activities of MNEs on a local and international basis, other authors are of the view that companies can lower their tax rate by exploiting and over reporting activities that are deductible from taxable income.¹⁶⁹

Putting this into practice will require an agreement among the major economies to scrap the current separate-entity system and to agree on how to allocate corporate income among jurisdictions. It would also require agreement on common accounting methods for measuring corporate profits. On a positive note, it could lead to the elimination of profit shifting using improper transfer prices are eliminated. Examples of where the elimination of profit shifting will be seen are mostly from intangibles i.e., the sale/leasing of goods, trademarks, logos and algorithms within the international departments of one single firm or the use of intra-group finance transactions, where affiliates in low tax countries grant loans to affiliates in high tax countries¹⁷⁰. While the OECD has faulted the GFA model saying, “it would not be immune from manipulation and could not ensure that profits are truly aligned with value.”¹⁷¹

¹⁶⁷ Sol Picciotto, “Towards Unitary Taxation: Combined Reporting and Formulary Apportionment”,(2016), in Thomas Pogge, and Krishen Mehta (eds), *Global Tax Fairness* (Oxford, 2016; online edn, Oxford Academic, <https://doi.org/10.1093/acprof:oso/9780198725343.003.0010>,

¹⁶⁸ Ibid

¹⁶⁹ Rosanne Altshuler and Harry Grubert. “Formula Apportionment: Is it better than the current system and are there better alternatives?”, (2010) *National Tax Journal* 63, no. 4 (2010): 1145–84. online: <http://www.jstor.org/stable/41791096>.

¹⁷⁰ Reuven Avi-Yonah. “Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation.” *World Tax J.* 2, no. 1 (2010): 3-18, online: <https://repository.law.umich.edu/articles/1181/>

¹⁷¹ <https://www.oecd.org/tax/beps/faq/>

3.6 The United Nations Proposals

Discussions in the international tax arena have proposed tax treaty approaches for consideration by countries to address the taxation of income generated without a physical presence. One approach is the two-pillar solution, as developed at the G20/OECD Inclusive Framework level. Another is the new Article 12B of the UN Model Double Taxation Convention, developed by the Committee of Experts on International Cooperation in Tax Matters, to address the taxation of income from automated digital services in bilateral situations. The article was introduced during the 21st session of the Committee of Experts on International Cooperation in Tax Matters, held between October 20 and 29, 2020 where members voted to include an article 12B on automated digital services (ADS) in the 2021 Model Convention.¹⁷² As UN Member States continue to call for more concerted effort at all levels to strengthen international tax cooperation as a way to help build the trust and spur the transformations envisioned in the Addis Ababa Action Agenda and the 2030 Agenda which is to provide a new global framework for financing.¹⁷³ This is why it is important to discuss the work of the United Nations to support developing countries towards building policy and administrative capacity for the effective and efficient taxation of the digital economy. Developing countries have called on the UN for new rounds of negotiation as they say, “Tax havens and corporate lobbyists have had too much influence on global tax policy at the OECD for too long.”¹⁷⁴ The UN framework convention is expected to move decision-making on global tax rules from the OECD to the UN.

3.6.1 Income from Automated Digital Services

The general definition of Automated Digital Service provided in Article 12B states the following: “The term “income from automated digital services” as used in this Article means any payment in consideration for any service provided on the internet or an electronic network requiring minimal human involvement from the service provider. The term “income from automated digital services”

¹⁷² Committee of Experts on International Cooperation in Tax Matters Report on the twenty-first session (virtual session, 20–29 October 2020). E/2021/45/Add.1-E/C.18/2020/4, pp. 18-21.

¹⁷³ United Nations Economic and Social Council Economic and Social Council forum on financing for development follow-up (2022) E/FFDF/2022/L.1 para 18.

¹⁷⁴ Mark Bou Mansour “UN adopts plans for historic tax reform” online: <https://taxjustice.net/press/un-adopts-plans-for-historic-tax-reform/#:~:text=%E2%80%9CThis%20is%20a%20historic%20victory%20delivered%20by%20the%20countries%20of,that%20affect%20all%20of%20us.>

does not, however, include payments qualifying as “royalties” or “fees for technical services” under Article 12 or Article 12A.” In the Commentary, a list of services and activities that are considered ADS is provided and includes: Online advertising services, Sale or other alienation of user data, Online search engines, Online intermediation platform services, social media platforms, Digital content services, Online gaming, Cloud computing services; Standardized online teaching services.¹⁷⁵

As Chand explains, “taxing business income under the UN proposal is hinged on the supply – demand logic. This means both production and market countries are entitled to tax business income of a global enterprise.” This is different from what the OECD is proposing which is to adopt to tax corporate income based on the “*supply*” framework. Now, the question is whether Member States of the OECD will accept this conceptual foundation.¹⁷⁶ Pillar one of the OECD proposal appears to consolidate the competing views of both “*supply*” countries and “*supply – demand*” to ensure these various factors are considered in its design. “Impressively, the new Art. 12B does not provide any revenue thresholds; this means any taxpayer that performs ADS, no matter its global revenue or its profitability will fall into the scope of the article and be subject to tax. It also does not require a threshold such as a PE, fixed base, or minimum period of “revenue presence in a Contracting State”. This may lead to disproportionate administrative burdens for both taxpayers and tax administrations and may create an unbalanced playing field for small and medium-sized enterprises with cross-border activities, as they may not have sufficient resources to meet this burden compared to larger MNE groups. The OECD proposals on the other hand provide a global revenue threshold.”^{177 178}

¹⁷⁵ UN Committee of Experts on International Cooperation in Tax Matters, *twentieth session, Update on work on taxation issues related to the digitalization of the economy* (UN, E/C.18/2020/CRP41, October 2020) available here https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-10/CITCM%2021%20CRP.41_Digitalization%2010102020%20Final%20A.pdf

¹⁷⁶ Vikram Chand “The UN Proposal on Automated Digital Services: Is It in the Interest of Developing Countries?” online <https://kluwertaxblog.com/2021/03/05/the-un-proposal-on-automated-digital-services-is-it-in-the-interest-of-developing-countries/>.

¹⁷⁷ Ibid

¹⁷⁸ Andres Báez. “Because not always B comes after A: Critical Reflections on the new Article 12B of the UN Model Tax Convention on Automated Digital Services” (2021), online: <http://dx.doi.org/10.2139/ssrn.3923508>

There have been several discussions that Article 12B of the UN Model is the most viable alternative for developing countries to the OECD's Pillar One global proposal as it would be a simpler option in its implementation, operating through a system of withholding taxes, which could generate fewer disputes arising from its interpretation. This proposal could also mean higher revenues for source states than what is offered by Pillar One by attributing a significant portion of revenues to the jurisdiction of the payer and Pillar Two which is more about income from countries where OECD has operations. Article 12B provides insight into how to avoid double taxation that could arise from unilateral measures, should they continue over time pending the implementation of the IF. The UN suggests that tax rate should be bilaterally negotiated, by having a modest rate such as 3 or 4% of tax on the income from automated digital services under paragraph 2 of Article 12B. It also presents some elements that need attention, such as (i) the uncertain definition of the concept of "payer"; (ii) the use of gross income as the basis for calculation.¹⁷⁹ While this proposal has its weaknesses, it appears to be a very good option for developing countries as it gives allowance for self-determination of taxes meant for the digital economy within its jurisdiction.

3.6.2 Net Basis taxation

Article 12B para 3 is an alternative approach which is the net basis annual taxation instead of a gross basis taxation. The net basis taxation allows the beneficial owner to choose the tax level that will apply to relevant income by using a pre-determined formula.¹⁸⁰ Article 12B (3) of the proposal allows the beneficial owner to choose between net-base taxation or gross income taxation.¹⁸¹ In the event that the beneficial owner of the digital service income demands net basis taxation, the state where the automated digital service income originates may be required to tax its qualified profits for the relevant fiscal year at the rate specified by that state's domestic laws. This would entail deducting 30% of the amount obtained from applying the profitability ratio of the automated digital business segment or the beneficial owner's profitability ratio, if available, to the gross annual revenue from automated digital services derived from the Contracting State where

¹⁷⁹ Betty Andrade, "Developing Countries and the Proposed Article 12B of the UN Model: Some Known Unknowns" (2021). *International Tax Studies*. - Amsterdam. - Vol. 4 (2021), no. 6; 22, online: <https://ssrn.com/abstract=4231077>

¹⁸⁰ *Ibid* @199

¹⁸¹ Yvette Lind, "Revisions of the UN Tax Treaty Model – An Introduction to (Global) Inclusion and Equity from the Perspective of Developing States" (2021). *Svensk skattetidning* nr 10 2020, pp. 595-610, online: <https://ssrn.com/abstract=3774463>

such income arises.¹⁸² In explaining the logic behind the net basis approach, the drafting group explained that “the option is meant to provide relief in those cases where the taxpayer may have a lower tax liability than the liability determined as per withholding tax mechanism as also in cases where it has a global business loss or a loss in the relevant business segment during the taxable year.”¹⁸³ The gross approach on the other hand provides a greater degree of tax certainty. The committee provided a backdrop for this approach and explained that “Many developing countries have limited administrative capacity and need a simple, reliable, and efficient method to enforce tax imposed on income from services derived by non-residents. Such a method of taxation may also simplify compliance for enterprises providing services in another State since they would not be required to compute their net profits or file tax returns unless they themselves opt for net income basis taxation.”¹⁸⁴ I am supportive of this approach not only because of its simplicity but because it acknowledges the tax administration challenges of developing countries.

3.7 Comparison of the UN and OECD proposals

It is worthy of concern to have countries adopting divergent approaches while putting aside the OECD/UN agreement. This may lead to multiple taxation and place an unnecessary burden on MNEs. This is why a multilateral solution will be a win for all if properly harnessed and if all countries see there is an unprejudiced decision in ensuring fairness for all countries. With the aim of making better international trade, countries opted to negotiate the future of the international tax system and come up with suggestions on how to better coordinate the interaction of countries’ tax systems. Countries eliminated double taxation in the past by using bilateral tax treaties based on a common model that reduced the rates of source-based withholding taxes for non-residents, guaranteed that business profits would not be taxed at source unless a defined level of activity was undertaken in the source country, and provided tax credits and deductions to residents for taxes paid at countries of source.¹⁸⁵

¹⁸² UN Committee of Experts on International Cooperation in Tax Matters, *Twentieth session, Update on work on taxation issues related to the digitalization of the economy* (UN, E/C.18/2020/CRP41, October 2020), online: <https://financing.desa.un.org/document/work-taxation-issues-related-digitalization-economy-ec182020crp25>

¹⁸³ Ibid

¹⁸⁴ Ibid

¹⁸⁵ Canada - Nigeria: 1992 Income and Capital Gains Tax Agreement and Final Protocol, articles 7 and 23.

Although the OECD/UN negotiation is still in progress, some countries have gone ahead with the unilateral approach by imposing market-based income tax on MNEs transacting in their jurisdiction. The inclination towards multilateral coordination is to ensure consistency and equality. This collective approach is more desirable for MNEs, as it minimizes the risk of double taxation and inconsistent compliance obligations. The choice of cooperation or dissent is especially difficult for lower-income countries, in a global economic order that is dominated by high-income countries¹⁸⁶. What then is the incentive to cooperate for developing countries that are giving up their taxing rights?¹⁸⁷

The proposal of the OECD under Pillar One for the elimination of double taxation of profit allocated to market jurisdictions will be to relieve using either the exemption or credit method. The entity (or entities) that will bear the tax liability will be drawn from those that earn residual profit.¹⁸⁸ Under the second pillar, the IIR which is a component of this pillar could lead to double taxation. With the way the rule is designed to operate alongside the UTPR there may be transactions where income would be taxed under the IIR by the home country and the payment would be subject to the UTPR by another jurisdiction. Situations like this raise concerns on knowing which rule will apply to avoid double taxation.¹⁸⁹ There are fears the UTPR may be a form of withholding tax on transactions that penetrates the market of another country.¹⁹⁰ It will be important to know which of the rules should apply by having the IF set clear standards to avoid double taxation.

The UN pushed for a reform of the Model Convention to avoid double taxation by seeking to implement a relatively simple taxation rule on ADS that originate in one state and are paid by a resident of another state, which can be taxed in both jurisdictions, i.e. can be included in the country

¹⁸⁶ Philipp Genschel and Thomas Rixen, “Settling and Unsettling the Transnational Legal Order of International Taxation”, (2015) in TC Halliday and G Shaffer, eds, *Transnational Legal Orders* (Cambridge University Press, 2015), p. 154.

¹⁸⁷ Tarcísio Diniz Magalhães, “International Tax Law Between Loyalty, Exit, and Voice” (2021) 44 *Dal LJ* 49

¹⁸⁸ OECD. “Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy” (2021), OECD, Paris, online: www.oecd.org/tax/beps/statement-on-a-twopillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economyoctober-2021.htm.

¹⁸⁹ Daniel Bunn and Elke Asen “Tax Foundation Response to OECD Public Consultation Document: Global Anti-Base Erosion Proposal (“GloBE”) (Pillar Two)” online: <https://taxfoundation.org/blog/response-global-anti-base-erosion-pillar-two-proposal/>

¹⁹⁰ *Ibid*

from which the payment originates-if so provided by its legislation – and also in the country where the payment is directed – from where the service was provided. If the beneficial owner of the income is resident in the other state, a tax limit is established between countries, on gross income.¹⁹¹ If the beneficial owner of the income is resident in the other state, a tax limit can also be established between countries, on gross income. Another viable way would be for trading countries to have an automated means of exchanging information of companies. With this exchange between countries, the issue of double taxation and non-taxation will be easily avoided. Any international cooperation negotiation should have an exchange of information at the top of its agenda.

3.8 Limitations and shortcomings of the OECD and UN proposals

The prospect of the OECD proposal adoption has been met with resistance from various countries. This pushback has been influenced by economic and political factors. In the U.S., the proposal was met with opposition from Republicans and may require two-thirds of the Senate’s approval to pass.¹⁹² Similar to the proposed Multilateral Instrument in the broader BEPS initiative, implementing Pillar One and parts of Pillar Two of the Inclusive Framework deal will require a new multilateral convention (MLC) to be agreed on by all parties in order to facilitate the necessary tax treaty changes without having to renegotiate thousands of existing bilateral tax treaties individually.¹⁹³ EU tax laws require an undivided support from all 27 member countries. Some countries, like Estonia, Poland, and Hungary, have said they are reluctant to move forward on the global minimum tax (Pillar Two) unless the EU places equal priority on advancing digital taxation reforms.¹⁹⁴ These factors and several debates in the European Parliament on the prospect of the IF has shadowed the possibility of implementing the IF. On the part of major African countries, the reluctance to assent to the proposal is from being unable to use related OECD data to make a cost benefit analysis of each of the two pillars. This, for African countries, is like taking a leap into uncertainty and what could be harmful to its potential revenue from taxation. Beyond the varying

¹⁹¹ United Nations Model Double Taxation Convention between Developed and Developing Countries 2017 accessed from https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf

¹⁹² <https://www.politico.eu/article/oecd-chief-manal-corwin-republican-lawmaker-collision-course-global-tax-deal/>

¹⁹³ Joseph Morley, “Why the MLI Will Have Limited Direct Impact on Base Erosion Profit Sharing,” (2019) Northwestern Journal of International Law & Business, Volume 39 Issue 2, online:

<https://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=1843&context=njilb>.

¹⁹⁴ Ibid @ 187

issues, the key concerns in the two proposed pillars as they relate to African countries are summarized as follows: The first issue is where tax benefits accrue: the ATAF and other African countries have championed the need to prioritize market countries benefitting more in taxes than home countries of MNEs. They argued for source-based rules as it is believed this will discourage MNEs from shifting profits if all their profits are taxed in Africa. The forum in its negotiation has called for at least 35% of the residual profit to be allocated to market jurisdictions but so far has only been able to achieve 25%.¹⁹⁵ Downplaying the importance of market countries by allocating less is one of the shortcomings of the OECD proposals.

The second issue has to do with the enforcement and implementation. There are also challenges in the enforcement of taxation on the digital economy to ensure its effectiveness by ensuring proper tax filing and payment by companies that do not have physical presence in a market jurisdiction, and information filing on the requirements to be the nexus. The OECD proposals does not take into consideration the reality in many African countries. Worthy of note is the cost of corporate compliance and allocation of attributable profits to the nexus. Depending on whether the rules tilt to taxes in market countries or home countries, there is still a need to ensure information provided is verified and accurate to ensure proper tax filing and tax payments in the relevant jurisdiction by non-resident companies with no physical presences by tax authorities¹⁹⁶ Verifying is often difficult because this information is held by non-resident companies that conduct business through the internet without physical presence, and verification by tax authorities is difficult. Conducting tax audits then becomes tough as tax authorities are required to obtain transaction details.¹⁹⁷ The last issue is the calculation of attributable profits. Determining the factors of production in a digital space is confusing. Although it can be narrowed down to the internet and data. The BEPS project fosters a common understanding that taxes are levied where economic activity is carried out and value is created. There is common ground yet to determine where, by whom, and how value is created in global transactions. The BEPS Final Report (Action 8-10) “Aligning Transfer Pricing Outcomes with Value Creation”

¹⁹⁵ A New Era of International Taxation Rules—What does this mean for Africa?” ATAF Communication, Oct 08, 2021, <https://www.ataftax.org/a-new-era-of-international-taxation-rules-what-does-this-mean-for-africa>.

¹⁹⁶ Katsufumi Kurihar. “Taxation on the Digital Economy —Issues on Implementation and Enforcement” (2021) Public Policy Review, Policy Research Institute, Ministry of Finance Japan, vol. 17(1), pages 1-24, online https://ideas.repec.org/a/mof/journal/ppr17_01_05.html

¹⁹⁷ Ibid

does not define the notion of value creation for purposes of designing tax policy.¹⁹⁸ This lack of mutual understanding as to what value creation is makes it difficult to calculate the profit attributable to the market jurisdiction even after recognizing the nexus in digital existence. There are differing comments on the possibility of using the current TP regulations to calculate attributable profits.¹⁹⁹ In deciding this, it is necessary to consider the involvement of market countries in analyzing the value chain.

3.9 Conclusion

The ideas for Pillars One and Two, which are consensus-based, aim to address the different approaches used to tax the corporate incomes of the largest MNEs. By integrating the market element in profit allocation and moving away from the physical presence nexus rule and toward a revenue-based nexus rule, the work is a step toward change of century-old international tax laws. Countries that have implemented DSTs and other comparable measures might initially experience a decline in revenue because of DST transitional arrangements. Pillar Two is expected to affect MNEs because of the worldwide tax collections while reducing the turmoil brought on by the absence of global cooperation. The examination of these recommendations shows that there are still a lot of unresolved issues and that implementing them may be difficult for tax administrations. The GloBE regulations, for example, establish a pool of possible top-up taxes that a country or countries may be able to collect. In addition to taxes on the entity, some shareholder-level taxes on undistributed earnings will also be considered when calculating the pool of tax recoverable under GloBE. The ultimate parent entity, or the top-most parent entity in the multinational group, will be the collecting country by default. If the top-most country does not collect GloBE top-up tax, intermediary countries may. The major source of disagreement however is not in the top up taxes, it is in ensuring market countries get to tax transactions that penetrate their various markets. In comparison to Pillar One, the OECD's Pillar Two BEPS rule is slightly better because most developing nations would be better off implementing a Qualified Domestic Minimum Top-Up Tax considering the undertaxed profits rule and the income inclusion rule combined. In addition, Pillar

¹⁹⁸ Marcel Olbert and Christoph Spengel. "International Taxation in the Digital Economy: Challenge Accepted?" (2017) *World Tax Journal*, February 2017, pp.3-46.

¹⁹⁹ Petruzzi Raffaele and Briak Svitlana. "Addressing the Tax Challenges of the Digitalization of the Economy – A Possible Answer in the Proper Application of the Transfer Pricing Rules?", (2018), *Tax Notes International*, April 1, 2018, pp.91-116.

Two reduces the possibility of unhealthy tax competition between developing nations, at least with respect to tax rates. However, the disadvantage of Pillar Two is that the rate is too low, and that the Substance Based Income Exclusion rule and its refundable credits could lead to different forms of unfavorable tax competition among developing nations. In summary, the tax issues posed by the digital economy to developing nations are not adequately addressed by the OECD's two-pillar BEPS guidelines. It is therefore not surprising that there have been requests to go beyond the OECD's two-pillar strategy.

CHAPTER FOUR: LESSONS FOR AND FROM AFRICAN COUNTRIES

4.1 Introduction

In the thick of the digital economy wave, African countries, particularly their tax authorities, are worried about their readiness to not just widen their tax base but to defend it from the rapidly evolving digital economy. These countries also want a fair share of tax revenue from the digital economy without constraining the development of technologies that are modernizing trade and market activities. Proactively, some African countries like Nigeria and Kenya have introduced digital service taxes or related forms of digital taxes on digital activities, while others like Morocco and South Africa have expanded their existing taxes - mostly consumption and indirect taxes - to capture transactions happening in the digital space. There are concerns regarding the structure and plans for implementation of these DSTs vis-à-vis the ongoing design of OECD proposals. It then becomes important to ask what the best option is for African countries to adopt. This is keeping in mind the continuous revenue loss occasioned by the delay in finalizing the OECD consensus-based rules for international cooperation. There is also apprehension regarding whether the OECD guidelines will be fair to Africa in ensuring protection of tax bases and lessening the opportunities for tax avoidance by MNEs. This chapter will examine the efforts made by some selected African countries geared towards taxing the digital economy in a bid to propose the most suitable option for African countries based on their present tax administrative capacity.

The initial section covers interim and unilateral solutions, including DST, DAT, and various indirect taxes like VAT, withholding tax, and excise duty, employed by certain African nations. It also examines how these countries are adapting these measures to address the challenges of the digital economy. The chapter offers an overview of source-restricting provisions in tax treaties and includes a tabular summary of how different African countries are addressing the taxation of the digital economy. The chapter then proceeds to provide an in-depth analysis of selected countries' effort. I argue in this chapter that the expedience of expanding the current tax systems to capture the digital economy should not jeopardize the discourse towards creating a new framework.

4.2 The Interim proposal and Long-term solution

To avoid the proliferation of varying unilateral measures which may in the long run water down a permanent solution, the EU presented an interim solution.²⁰⁰ Klein, Ludwig and Spengel have summarized the interim solution as follows:

“The interim solution suggests the immediate introduction of an interim digital services tax (DST) of 3% on gross revenues from certain digital services of large digital firms, deviating from the current system of taxing corporate profits. The second proposal lays down the rules for taxing corporate profits that are attributable to a significant digital presence in the long run”.²⁰¹

The DST is expected to be imposed at 3% of the gross revenue.²⁰² Revenues from the provision of three types of digital services are taxable: first, the placement of advertising on digital interfaces targeted on users of that interface; second, the provision of digital interfaces to users, which allow users to find each other, to interact, and to exchange goods and services; and third, the transmission of user data generated from users’ activities on digital interfaces.²⁰³

The second proposal of the European Commission is for the long run. It is meant to establish a new taxable nexus for firms that maintain a non-physical but significant digital presence in one or more EU member states. Using a significant digital presence as a taxable nexus extends the existing physical PE concept by the concept of a “virtual PE.” According to the proposal, a significant digital presence exists in a member state if a firm supplies digital services through a digital interface and meets one or more of the following thresholds of digital activity in a member state in the tax period: first, revenues from supplying digital services to users exceed 7 million euros; second, the number of users of digital services exceeds 100,000; or third, the number of business contracts concluded for the supply of digital services exceeds 3,000²⁰⁴ While the EU is making

²⁰⁰ Marina Barata, “A consensus solution for the taxation of the digital Economy” (2021) UNIO - EU Law Journal. Vol. 7, No. 1, July 2021, pp 120-137.

²⁰¹ Daniel Klein, Christopher A. Ludwig, and Christoph Spengel, “Taxing the Digital Economy: Investor Reaction to the European Commission’s Digital Tax Proposals” National Tax Journal 2022 75:1, 61-92, online: <https://www.journals.uchicago.edu/doi/full/10.1086/717518>.

²⁰² Article 8 of European Commission, “Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services.” (2018e) online: <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018PC0148&from=EN>.

²⁰³ Article 3(1) @ Ibid

²⁰⁴ Article 8 of European Commission, “Proposal for a Council Directive on the Common System of a Digital Services Tax on Revenues Resulting from the Provision of Certain Digital Services.” Supra @ 202

efforts to achieve political agreement on the DST proposal which it refers to as a “quick fix” for the international tax framework, member states are yet to reach a collective understanding. The two proposals may be revived before the EU if no consensus at the level of the OECD is reached.²⁰⁵ Although the introduction of a DST means more revenue for EU member states, increasing the tax burden for innovative industry contradicts political initiatives of the EU to promote an attractive investment climate and foster innovation and economic growth.

4.3 The Introduction of Digital Services Taxes

Some countries have implemented a tax on digital services, ranging from online advertising and digital platforms to search engines and the trading of data. The tax is commonly called a Digital Services Tax. In Europe, Italy, Austria, Spain, France, and the United Kingdom all apply a tax rate varying between 2 and 5 % on these digital services.²⁰⁶ The DST is expected to be a destination-based turnover tax levied on gross revenues net of VAT (and other similar taxes) arising out of certain digital services. The adoption and proliferation of DST across Europe could be challenging as this could lead to significant legal uncertainty for a variety of reasons and could ultimately discourage cross border trade in the Member States where DST has been implemented.²⁰⁷ This is because the enacted DST will disrupt the Company Income Tax Systems of its which is at the very heart of the whole digital tax debate.²⁰⁸ The argument against the DST is that its enactment does not design a solution to address existing issues like inbound and outbound taxes in the CIT system; the bid to have another tax makes compliance to tax system complicated.²⁰⁹ Some scholars have argued in favor of the DST because it allows countries to tax “location-specific rent” associated with digital transactions; those policies show their disposition toward 'claiming a public share of economic rent. ²¹⁰ This is because countries know what to focus on to achieve a tax objective that is not dependent on any treaty. ²¹¹

²⁰⁵ Daniel Klein, Christopher A. Ludwig, and Christoph Spengel, *Supra @ note 201*

²⁰⁶Peer Schulze and Erik van der Mare. “Taxing Digital Services – Compensating for the Loss of Competitiveness”, (2021) No. 11, European Centre for International Political Economy, Policy Brief

²⁰⁷ George Kofler and Julia Sinnig. “Equalization Taxes and the EU's 'Digital Services Tax’” (2019) *Intertax, International Tax Review*, 47, no.2: 176-200.

²⁰⁸ *Ibid*

²⁰⁹ *Ibid*

²¹⁰ Wei Cui, “The Superiority of the Digital Service Tax over Significant Digital Presence Proposals” (2019) [unpublished].

²¹¹ *Ibid*

Notwithstanding that the DST plans on ensuring coordination and equal opportunity for businesses, especially in Europe, the enactment raises a few concerns regarding its compatibility with other international tax laws and EU tax laws.²¹² The introduction of this tax becomes tricky as this could lead to double and unfair taxation if countries impose 3% tax on gross revenue of a company that offer different online services to countries. A company can offer online streaming to one country and another, online advertising. Regardless of the criteria used to determine DST applicability, the instrument is inherently designed not to apply to all firms but rather to a subset that operates within the digital sector. For policymakers to selectively choose among potential taxpayers, even with broadly defined criteria, can lead to adverse consequences. The specific eligibility rules in the DST proposals have been criticized as arbitrary from a policy standpoint.²¹³

4.4 The scope of Digital Advertising Taxes

Companies apply to digital platforms out of their jurisdiction for advertising services, especially where goods or the services rendered by such companies can be transnational. This has created the dichotomy of taxing the digital advertising revenue collected from players in the market.²¹⁴ The most recent innovation in this aspect especially at the sub-national level is at Maryland, USA. Maryland's tax is a levy on digital advertising services, which includes "advertisement services on a digital interface, including advertisements in the form of banner advertising, search engine advertising, interstitial advertising, and other comparable advertising services."²¹⁵ The future of sub-national DSTs is uncertain. Sub-national governments are being challenged in court on the constitutionality of their DST legislations. Maryland's proposed DST for instance was halted by the courts.²¹⁶ This is great decision from the court; allowing sub-national government taxing rights on DSTs will be chaotic especially in countries with a lot of states. The Digital Advertising Tax

²¹² George Kofler and Julia Sinnig, *Supra @ note 207*

²¹³ Congressional Research Service, *Digital Service Taxes (DSTs): Policy and Economic Analysis, Summary (2019)*.

²¹⁴ Ulrik Boesen and Jared Walczak, "Three Issues with Proposed Regulations for Maryland Digital Advertising Tax," (2021) Tax Foundation, online: [Maryland Digital Advertising Tax Regulations: 3 Issues with the Proposals \(taxfoundation.org\)](https://taxfoundation.org)

²¹⁵ Maryland General Assembly, "Digital Advertising Gross Revenues, Income, Sales and Use, and Tobacco Taxes— Alterations and Implementation," enacted May 30, 2021, online: <http://mgaleg.maryland.gov/mgawebsite/Legislation/Details/SB0787?ys=2021RS>.

²¹⁶ Michael Bernard and George L. Salis. "Court rulings stop Maryland digital ad taxes", (2023) online: [Court rulings stop Maryland digital ad taxes | Accounting Today](https://www.accountingtoday.com/news/court-rulings-stop-maryland-digital-ad-taxes/)

(“DAT”) law in Maryland was introduced by a law passed in 2021 and expected to be effective from January 2022 was imposed on annual gross revenue derived from digital advertising services in the state (referred to as the “assessable base”), and is limited to companies with over \$1 million in annual gross revenue from digital advertising services in the state and at least \$100 million in global gross revenues.²¹⁷ In a similar vein, Turkey has enacted legislation to tax income earned through digital advertising activities. This means advertising services provided on the internet within the scope of income/corporate tax withholding through Resolution No. 476 (“Resolution”), dated December 18, 2018. From January 1, 2019, it has been decided to apply withholding tax in relation to the payments made to those who provide digital advertising services or intermediaries providing the service.²¹⁸ This DAT on advertising services could mean additional liability on online companies whose business activities rely heavily on digital advertisement services and will still have to pay DST on gross revenue, depending on how the DST is implemented.

Recently, a First Amendment challenge was raised against Maryland's groundbreaking digital advertising tax, arguing that it constitutes a content-based regulation of speech in violation of the First Amendment. However, this challenge was unsuccessful, as a federal judge in Baltimore dismissed the First Amendment claim against the 2021 law that imposes a tax on internet ads in Maryland.²¹⁹ On the other hand, the Turkish Constitutional Court's has annulled paragraph 2 of Article 7 of the Digital Services Tax Law No. 7419 (DST Law) was published in the Turkish Official Gazette. The provision, which permitted the blocking of access to services provided by digital service providers failing to meet their tax obligations, was struck down on the grounds that it violated the Turkish Constitution. The Court found that this provision unjustifiably restricted the freedom of enterprise for digital service providers, deeming the restriction disproportionate and in violation of the principle of proportionality.²²⁰

²¹⁷ Joyce Beebe. “The Recent Debate Over Digital Advertising Taxes”, (2021). Issue brief no. 11.15.21. Rice University’s Baker Institute for Public Policy, online: <https://doi.org/10.25613/YTFK-0S86>

²¹⁸ Tutku Şen “Withholding Tax Issue in Digital Advertising Services” online: <https://www.erdem-erdem.av.tr/en/insights/withholding-tax-issue-in-digital-advertising-services>.

²¹⁹ Maryland Matters, “Federal Judge Dismisses First Amendment Challenge to Digital Ad Tax,” *Maryland Matters* (2024), online: <https://marylandmatters.org/2024/07/12/federal-judge-dismisses-first-amendment-challenge-to-digital-ad-tax/>.

²²⁰ EY Global Tax News, “Turkish Constitutional Court Annuls Paragraph 2 of Article 7 of the Digital Services Tax Law No. 7419,” *EY Global Tax News* (2023), online: <https://globaltaxnews.ey.com/Login/ViewNewsAttachment.aspx?AlertID=164330&AttachmentName=IM0q5qfDD%2FfdN2nr9Jp7Gz5xfE7F0EHZfWg5PCubSv5yvFxG8I7dBGNCgmgVOPgQ&ualertID=null>.

The DST and DAT do share similarities in that both seek to tax digital companies' top line revenue. Depending on how the DST is implemented, it ought not to lead to multiple taxation. Countries like Austria and Hungary have restricted their implementation to only advertising revenues.²²¹ The DST, in countries where it has been implemented is seen as an interim fix short-term to be reposed once a global consensus is reached.²²² The OECD/G20 reached this agreement on October 2021 and agreed on a preliminary framework regarding the digital tax rewrite; the mechanism for removing all unilateral DSTs will be revealed in a multilateral agreement.²²³ This has been further documented in the October 2023 Multilateral Convention to Implement Amount A of Pillar One. It will be more desirable to have a harmonized DST or DAT. Different tax rules on similar services will make compliance difficult.

4.5 Source-restricting provisions in Tax Treaties

As earlier discussed in the first chapter of this thesis, the objectives of tax treaties are to prevent double taxation, fiscal evasion and manage the allocation of taxing rights between the source and residence countries. However, one challenge arising from tax treaties is erosion of source tax revenue through provisions that restrict source taxing rights. By agreeing to these provisions, tax treaties facilitate transfer of revenue from capital importing countries (where revenues are much needed for socio-economic development) to capital exporting countries.²²⁴ For business income, source countries can only impose taxes if the income is linked to a PE within the country. Passive income, on the other hand, can only be taxed at a predetermined rate. If the tax treaty follows the OECD Model, the source country cannot tax any income not specifically covered by the treaty. Additionally, Articles 10, 11, and 12 of the OECD Model, which stipulate low withholding tax rates for dividends, interest, and royalties paid to affiliates by multinational enterprises in source

²²¹ Cassandra Knapman and Nakul Kohli "Taxing the digital economy – are we all on the same page?" accessed from <https://rsmcanada.com/insights/services/business-tax-insights/taxing-the-digital-economy-are-we-all-on-the-same-page.html#:~:text=As%20of%20January%202023%2C%20Austria,to%20implement%20such%20a%20tax.>

²²² Tax Foundation. "Digital Tax in Europe: 2024," Tax Foundation(2024), online: <https://taxfoundation.org/data/all/eu/digital-tax-europe-2024/>.

²²³ Joyce Beebe. "Recent Developments on the E.U.'s Digital Tax Proposal" (2019), Rice University's Baker Institute for Public Policy, online: <https://hdl.handle.net/1911/106087>

²²⁴ Kimberley Brooks & Richard Krever, "The Troubling Role of Tax Treaties" in Geerten M. M. Michielse & Victor Thuronyi, eds, Tax Design Issues Worldwide, Series on International Taxation, Volume 51 (Netherlands: Kluwer Law International, 2015) 159.

countries, are examples of provisions that restrict source taxation.²²⁵ Another example of source-restricting provisions in the OECD Model is the non-taxation of technical fees. According to the model, payments for administrative, technical, managerial, or consultancy services are not taxable in the source country if there is no permanent establishment present.²²⁶ The absence of a provision allowing source countries to tax non-residents' capital gains on indirect transfers of non-real estate assets, commonly referred to as offshore indirect transfers is another way tax treaties restrict source-based taxation.²²⁷ As discussed above, Article 7(1) of the OECD Model stipulates that only business profits attributable to a PE can be taxed in the source country. In contrast, Article 7(1) of the UN Model introduces a limited "force of attraction rule," which permits source countries to tax additional profits earned by the head office from the sale of goods similar to those sold through the PE, or from other business activities of a similar nature conducted in the source country. It would be worth noting that the number of tax treaties in force in the three jurisdictions under analysis is relatively small. Nigeria²²⁸ and Rwanda²²⁹ each have 15 tax treaties in force, whereas Kenya²³⁰ has 20 treaties, with 5 currently in force and the remainder either under consideration, negotiation, proposed, or not yet in effect. While it's true that the rules in the OECD's Model Treaty appear outdated in the context of the digital economy and that these treaty rules would make it difficult to effectively tax the income of a non-resident digital business (for example a social media business, a streaming service, or a cloud computing provider), the limited number of treaties take some of bite out of this challenge. For example, the United States doesn't have a tax treaty in force with Nigeria, Kenya, or Rwanda, so treaty rules are not stopping any of those countries from taxing the income earned by U.S.-resident corporations in their jurisdiction. (There may, of course, be political, administrative, or other challenges to taxing the likes of Apple, Alpha, Netflix, and Meta).

The incorporation of digital PE within the scope of the well-established text of Article 5 of the OECD Model means the amendment of the Article should be of utmost importance to

²²⁵ Ibid

²²⁶ See article 12A of the UN Model tax Convention; see also Kimberley Brooks, "Canada's Evolving Tax Treaty Policy toward Low-Income Countries" in Arthur J. Cockfield, ed, *Globalization and the Impact of Tax on International Investments*, (Toronto: University of Toronto Press, 2010)

²²⁷ Eric Zolt "Tax Treaties and Developing Countries" (2018) 72 *Tax L Rev* 1 at 4-10.

²²⁸ <https://www.firs.gov.ng/tax-treaties>

²²⁹ https://www.rra.gov.rw/en/details?tx_news_pi1%5Baction%5D=detail&tx_news_pi1%5Bcontroller%5D=News&tx_news_pi1%5Bnews%5D=1105&cHash=e8a3fb266e44e956a5c45ba989fc4b79

²³⁰ <https://www.treasury.go.ke/agreements/>

accommodate the redefinition of existing concepts.²³¹ In the existing rules, there is a requirement of a physical location to be categorized as permanent.²³² The fact that cloud and internet service providers are not captured in the source based taxation further strengthens the need to modify the convention to cater for digital PEs. While I share the opinion that the convention should be modified to accommodate for digital PEs,²³³ the introduction of the digital PE concept will have in consideration both qualitative and quantitative factors in order to consider threshold such as — (i) the number of active users; (ii) number of registered users; (iii) existence of a local domain; (iv) a specific local payment option.²³⁴ Measures for the introduction of a digital PE are overdue in the sense that online services have been an integral part of our modern life for a long time and their diversity determines the possibility of heterogenous tax treatment. Although there may not be a universal solution to this dilemma, the introduction of a new rule that would be amended in years to come is a good idea.²³⁵ There are however suggestions that a separate independent provision that examines this issue and is designed to tackle the challenge should be introduced.²³⁶ This concept may bear a semblance of the conventional PE in some aspects, it should however be independent in pursuing the actual goal of addressing the digital PE debacle. This approach should not affect the existing PE framework; it will rather be the beginning of the new concept, which will be updated and supplemented over the years.

Countries can also take a cue from the EU proposal in their conceptualization of digital PE. For instance, Art. 1 of the EU Proposal has its main subject as the extension of the PE concept while Art. 4, para 1 introduces the digital PE similar to Art. 5, para 1 of the OECD Model. Instead of the use of the term ‘place’, which is associated with objective geographical perception, the term ‘presence’ is used, emphasizing its diversity. Similarly, Art. 4, para 2 of the Proposal, the digital

²³¹ Dulevski, Stoycho, Digital Permanent Establishment (March 21, 2021). Economic Archive 4/2020, Available at SSRN: <https://ssrn.com/abstract=3809235>

²³² Art. 5, para 1 of the OECD-Model Convention 2017

²³³ Aleaxandra Bal. “The Sky’s the Limit – Cloud-Based Services in an International Perspective”, (2014), Bulletin for International Taxation, online: https://research.ibfd.org/#/doc?url=/document/bit_2014_09_int_2

²³⁴ Supra @ 102

²³⁵ Lisa Spinosa and Vikram Chand. “A Long-Term Solution for Taxing Digitalized Business Models: Should the Permanent Establishment Definition Be Modified to Resolve the Issue or Should the Focus Be on a Shared Taxing Rights Mechanism?” (2018) 46, Intertax, Issue 6, pp. 476-494, online: <https://kluwerlawonline.com/journalarticle/Intertax/46.6/TAXI2018052>

²³⁶ Ibid

PE develops the concept, without conflicting the traditional perception.²³⁷ There appears to be no divergence between this provision and the basic rule under OECD Model.

4.6 The challenges of African countries

In many African countries, political motives and limited capacity inhibit the development of good laws and policies which will consider tax principles.²³⁸ In addition, there is a lack of compliance by taxpayers because of poor governance.²³⁹ The poorly designed DSTs being enacted by African countries may not generate the desired revenue and could reduce access to the internet.²⁴⁰ In an effort to address various irregularities and declining government revenue, many administrations introduce a range of arbitrary taxes, often labeled as sin taxes. The challenge of internet usage is exacerbated in countries where high customs duties on mobile devices and excise taxes on over-the-top (OTT) services and other digital mediums, such as mobile money, further drive-up costs. These sin taxes and poorly designed DSTs can undermine affordable and meaningful access to the internet. Many African countries have concentrated on imposing indirect taxes on digital businesses, often paying less attention to MNEs.²⁴¹

The BEPS debates have primarily focused on how advanced business models coupled with existing legal structures have been used to avoid tax classification as a PE, which favors digital MNEs as explained in chapters 2 and 3. For African countries which are still muddled and struggling with the process of digitalizing their tax base, the income generated from legal structures created under the existing rules is not captured by these rules.²⁴² These concerns make pan-African tax organizations like the ATAF postulate that the OECD/G20 BEPS project alone may not be

²³⁷ Petruzzi Raffaele, Vasiliki Koukoulioti. “The European Commission’s Proposal on Corporate Taxation and Significant Digital Presence: A Preliminary Assessment”, (2018), European Taxation, 2018 (Volume 58), No. 9 online: <https://doi.org/10.59403/gp3qf7>

²³⁸ Sanjeev Gupta, Carlos Mulas-Granados, Jianhong Liu, Danial Salman, and Kelsey Ross. “Institutional and Political Determinants of Statutory Tax Rates: Empirical Evidence from Sub-Saharan Africa.”, (2020), CGD Policy Paper 191. Washington, DC: Centre for Global Development, online: <https://www.cgdev.org/publication/institutional-and-political-determinants-statutory-taxrates-empirical-evidenc>

²³⁹ Ibid

²⁴⁰ Shamira Ahmed and Alison Gillwald “Multifaceted challenges of digital taxation in Africa” (2020) (Policy Brief 2020, No. 7). Research ICT Africa, online: <https://researchictafrica.net/publication/multifaceted-challenges-of-digital-taxation-in-africa/>

²⁴¹ Celia Becker, “Taxing the Digital Economy in Sub-Saharan Africa”, (2021) International Bar Association, online: <https://www.ibanet.org/Taxing-the-digital-economy-sub-Saharan-Africa>.

²⁴² IMF. “Corporate Taxation in the Global Economy”, (2019) IMF Policy Paper No. 19/007, Washington D.C.

sufficient to solve the tax challenges plaguing African countries.²⁴³ There is therefore a need beyond BEPS for African countries to look towards solving their tax issues while taking advantage of the international community's concerns, rather than attempting to fit the digital economy into the existing inadequate system.

4.7 Unilateral approach to taxation of the digital economy

Notwithstanding the recent efforts of the G20/OECD Inclusive Framework (IF) to develop a uniform and consensus-based solution for taxing the digital economy, tax administrations around the world continue to propose and enact several uncoordinated DSTs and other unilateral digital tax measures adding to the existing disconnection in the international tax space. A major challenge deep-rooted in this system is that MNEs may find it difficult to keep up with the tax compliance systems of each unilateral system. To put this in context, Israel in April 2016 developed its SEP which is a slight variation from the OECD and EU proposal. Israel released a government regulation declaring that if an MNE offers online services to Israeli clients that qualify as SEPs, this could result in a taxable presence.²⁴⁴ This is only applicable if the online service provider resides in a nation that does not have a double taxation agreement (DTA) with Israel.²⁴⁵ Similarly, in a bid to accommodate the SEP concept, India amended its tax rules. An SEP is established under Section 4 of the Finance Act No. 13 of 2018 to modify the Indian Income Tax Act, with two thresholds being used: if the total amount of money received from digital transactions surpasses a predetermined threshold; and if there is "systematic and continuous" digital solicitation to reach out to and converse with a defined number of Indian users. Regardless of the taxpayer's location or place of residence, these criteria will result in a direct tax obligation in India.²⁴⁶ The primary impediment to the SEP method is its incompatibility with the majority of DTAs, which frequently require an MNE to be physically present for it to be considered a PE. For MNEs based in nations that have a DTA with the market jurisdiction, any revision to domestic laws establishing the SEP provision would not be invalid, rather the lower SEP threshold would be overridden by the higher

²⁴³ ATAF. "The Tax Challenges Arising in Africa from the Digitalisation of the Economy", (2019a), ATAF 1st Technical Note, CBT/TN/01/19

²⁴⁴ Israel Tax Authority. "The Israeli Tax Authority Published Guidelines Regarding Taxation of Foreign Corporation Activity in Israel Via the Internet" (2016), Announcement, 14 April, online: https://taxes.gov.il/English/About/SpokesmanAnnouncements/Pages/Ann_11042016.a.spx

²⁴⁵ Ibid

²⁴⁶ Section 4 of the Indian Finance Act No. 13 of 2018.

treaty threshold of a PE. Conversely, the European SEP proposal notes that it would only apply to MNEs based in the EU and in non-EU countries which have no DTA with an EU member state.²⁴⁷

Several sub-Saharan African countries have tread the heels of the UK and France by expanding the scope of their indirect taxes to cover digital services, while a few others have been able to enact some form of DST to apply to non-residents.²⁴⁸ Kenya is imposing a 1.5% tax on income derived from "digital marketplaces," which are described as online marketplaces that facilitate electronic transactions between buyers and sellers of goods and services. This tax took effect on January 1, 2021.²⁴⁹ With effect from January 1, 2019, there is a 5% tax on the yearly gross income from satellite broadcasting services related to the provision or delivery of television or radio programs, as well as e-commerce operators that provide or deliver goods or services to individuals residing in Zimbabwe, that exceeds \$500,000.²⁵⁰ The issue however with many of these African countries' digital taxes is that they are just extra tax on digital/internet activities within the country, it does not exactly address the incursion of digital MNEs into the country's market.

In contrast to the European approach to digital taxation, African countries often pass the costs of these taxes directly onto users. While European governments can levy taxes on the revenues of large companies, African governments face significant challenges in doing so. In nations where revenue collection is already difficult, implementing taxes at the user level, in collaboration with internet service providers, is viewed as a more practical method for generating revenue.²⁵¹ The subsequent paragraph examines some of the improvements that are being made to existing laws to capture digital economy taxation.

²⁴⁷ European Commission. "A Proposal for a Council Directive Laying Down Rules Relating to the Corporate Taxation of a Significant Digital Presence", online: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018PC0147>

²⁴⁸ Lyla Latif. "The Challenges in Imposing the Digital Tax in Developing African countries" (2019). Journal of Legal Studies and Research Vol 5, Issue 3, online: <https://ssrn.com/abstract=3901955>

²⁴⁹ Victor Otieno. "What Kenya's Tax Policy means for SMES businesses?" (2022) American International Journal of Social Science Research, 12(1), 30-38, online: <https://doi.org/10.46281/aijssr.v12i1.1783>

²⁵⁰ Ibid @ 234

²⁵¹ Merriden Varrall, "Digital Taxation in Africa: What Are the Causes and Consequences?" (2024), online: <https://www.linkedin.com/pulse/digital-taxation-africa-what-causes-consequences-merriden-varrall/>.

4.7.1 Withholding tax on digital goods and services

A withholding tax on digital transactions was one of the OECD's other recommendations for unilateral taxation.²⁵² The OECD direction is that the tax may be applied as a principal collection method and enforcement instrument to support the application of the SEP option as net-basis taxation, or it could be applied as a stand-alone gross-basis final withholding tax on specific payments to digital MNEs. Withholding tax in practice can either be withheld by individuals or by companies and it is afterwards remitted to the revenue authority on behalf of the other party.²⁵³ The withholding tax can be used as a form of tax credit to offset future taxes. Developing states that are more consumer-based have the potential to benefit from the withholding tax strategy because it gives them a way to "own" a portion of the consumer market for products and services or digital infrastructure, thereby increasing their capacity to collect taxes.²⁵⁴

Although the withholding tax is like the SEP strategy, it would be restricted because the majority of DTAs either completely remove or set a cap on withholding tax rates.²⁵⁵ In business-to-business interactions (B2B), a withholding tax would be simple to implement if resident businesses were reasonably anticipated to fulfill the withholding duty. When calculating revenue, a business that makes online purchases is likely to deduct the payment, which lowers its CIT liability. However, it is challenging to implement in B2C interactions, as individual customers would have minimal incentive to withhold taxes for the government.²⁵⁶ In the B2C setting, the issue of withholding can be resolved by using third-party payment processing intermediaries. However, this can be challenging for the intermediaries who may not have access to transaction-identifying information. Data privacy concerns may arise from accessing such information and using it for extraneous

²⁵² Supra @ OECD (2015a) Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report, Paris: OECD Publishing

²⁵³ Ibid

²⁵⁴ UN Committee of Experts on International Cooperation in Tax Matters. "Tax Challenges in the Digitalized Economy: Selected Issues for Possible Committee Consideration", (2017) E/C.18/2017/CRP.22, United Nations, online: https://www.un.org/esa/ffd/wp-content/uploads/2017/10/15STM_CRP22_-_Digital-Economy.pdf

²⁵⁵ KPMG, "Digitalized Economy Taxation Developments Summary". KPMG International, (2023), online: <https://kpmg.com/kpmg-us/content/dam/kpmg/pdf/2023/digitalized-economy-taxation-developments-summary.pdf>

²⁵⁶ Supra @ OECD (2015a) Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report, Paris: OECD Publishing

purposes in a world where protecting personal data is a fundamental human right that can only be violated in rare circumstances—which does not include taxation.²⁵⁷

4.7.2 Profit Shifting Tax (PST)

MNEs can pay less or no tax in the country where they produce or sell goods and services by legally shifting payments into affiliates based in tax havens. The profit that is moved into a tax haven is subsequently subject to taxation, either at zero percent or at a very low rate, depending on whether the tax haven has no corporate tax rate at all or a very low one.²⁵⁸ Research shows profit shifting has an impact on both high- and low-income nations; nonetheless, it causes lower-income nations to lose a larger percentage of their tax revenue. Overall, MNEs use globalization and national sovereignty—including tax havens—to avoid paying taxes at the expense of all nations, regardless of economic status.²⁵⁹

The UK, for example, has taken action to guarantee that profit shifting is minimized with the introduction of diverted profits tax in 2015 by the UK Finance Act 2015. The PST provisions target two main types of avoidance schemes: first, where profits accrued in the UK are diverted away by an MNE taking advantage of PE rules; and second, where tax advantages are created by employing transactions using foreign entities lacking economic substance.²⁶⁰ The tax is only applicable if in a 12-month accounting period, UK sales exceed £10 million or if UK-related expenses exceed £1 million.²⁶¹ Similar PST regulations have also been introduced by Australia, which targets MNEs with annual global incomes of one billion Australian dollars (AUD) (USD 750 million) through the Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015.²⁶² PST has been

²⁵⁷ Zyl, SP van, and WG Schulze. “The Collection of Value Added Tax on Cross-Border Digital Trade - Part 2: VAT Collection by Banks.” *The Comparative and International Law Journal of Southern Africa* 47, no. 3 (2014): 316–49, online: <http://www.jstor.org/stable/43894813>.

²⁵⁸ Normah Omar and Salwa Zolkafilil “Profit Shifting and Earnings Management through Tax Haven Subsidiaries: An Exploratory Analysis of Multinational Companies”, (2015) *Procedia Economics and Finance*, Volume 28, P 53-58, online: [https://doi.org/10.1016/S2212-5671\(15\)01081-3](https://doi.org/10.1016/S2212-5671(15)01081-3).

²⁵⁹ Javier Garcia-Bernardo and Petr Jansky. “Profit Shifting of Multinational Corporations Worldwide”, online: <http://dx.doi.org/10.2139/ssrn.4435224>

²⁶⁰ Rego Cunha. “Britain Open for Business”, (2017) in K.B. Brown (ed.) *Taxation and Development – A Comparative Study*, Springer: 285-308

²⁶¹ Sections 89, 90 and 91 of the UK Finance Act 2015 Cap 11.

²⁶² Combating multinational tax avoidance – a targeted anti-avoidance law accessed from <https://www.ato.gov.au/businesses-and-organisations/international-tax-for-business/in-detail/doing-business-in-australia-or-overseas/combating-multinational-tax-avoidance-a-targeted-anti-avoidance-law>

challenged in the UK for contradicting DTAs by holding that business profits should be taxed in the resident jurisdiction in the absence of a PE.²⁶³ With PST, taxpayers find it challenging to estimate their tax payments due to the PST's intricate legislative framework. If implemented in every country, it would confuse and hinder international trade.²⁶⁴ any African countries are yet to adopt a direct approach towards profit shifting by MNEs; however, some African countries like Morocco have introduced anti-abuse rules, country-by-country reporting requirements to see the economic activities of MNEs in each country of operation and TP rules.²⁶⁵ These are indirect means to strengthen tax transparency and reduce profit-shifting activities.

4.7.3 Value Added Tax (VAT)

VAT is a broad-based consumption tax that is levied on the value added at every stage of manufacturing and distribution along the supply chain. VAT is imposed at every level of the production process to the final consumer. When digital MNEs make supplies, suppliers, customers, or intermediaries are required to collect VAT.

Digital MNEs are now required to charge and remit VAT. Several African countries have attempted to apply this tax to the supply of electronic services by digital MNEs. If a non-resident entity provides electronic services to a recipient in South Africa for more than 50,000 South African Rand (ZAR) (about USD 4000) every month, the Taxation Laws Amendment Act, Act No. 31 of 2013, mandates that the entity register for and account for VAT.²⁶⁶ Similarly, the Kenya Revenue Authority (KRA) declared in August 2019 that the Kenyan Value Added Tax (VAT) Act 2013 applies to online platforms that are made available for third parties to use. To gather transaction data from local and foreign app developers operating in Kenya, the KRA declared that it will concentrate on payments made for app downloads and collaborate with the Communications

²⁶³Parliamentary Committees, Tax avoidance and profit shifting – the scale of the problem, (2021), online: <https://committees.parliament.uk/writtenevidence/11855/pdf/#:~:text=The%20main%20form%20of%20tax,disappearing%20from%20national%20accounts%20altogether>

²⁶⁴ Ibid

²⁶⁵ PCNS. “Policy Brief - Fiscal Space in African Economies and Base Erosion”, (2023) Policy Center for the New South. Morocco, online: <https://policycommons.net/artifacts/4777284/policy-brief/5613580/>

²⁶⁶Ruddy Kabwe and SP Van Zyl. “Value-added tax in the digital economy: a fresh look at the South African dispensation”, (2021). *Obiter*, 42(3), 499-528, online: http://www.scielo.org.za/scielo.php?script=sci_arttext&pid=S1682-58532021000300004&lng=en&tlng=en.

Authority of Kenya.²⁶⁷ In December 2018 and October 2019, the Uganda Revenue Authority (URA) released two public notices informing non-resident providers of electronic services of their need to register for and pay VAT.²⁶⁸ Facebook also in Nigeria now charges 7.5% VAT on ads from 1 January 2022.²⁶⁹

Customer collection, which is not common in Africa, is when a resident customer is liable to account for any tax due on a supply by a non-resident digital MNE. Usually, the customer is expected to include the VAT self-assessed on the supply from the overseas merchant.²⁷⁰ This approach to VAT remittance may not be effective in African countries where tax compliance and tax remittance is a major issue for governments and tax authorities. This was why the South African government was said to have introduced VAT on non-resident companies as there was a low compliance level from residents.²⁷¹ The new laws effectively transfer the compliance burden to the NRCs.²⁷²

Traditionally, suppliers have the responsibility of charging, collecting, and remitting VAT in addition to the related reporting requirements. This is functional only if the provider is located within the tax administration's jurisdiction, where the supplier is subject to collection and related obligations. Although some authors argue in favor of VAT because it could be a low-hanging fruit for African countries to immediately start collecting taxes on transactions because of the administrative ease and existing framework²⁷³, it is only a matter of time before tax administrators

²⁶⁷ The East African. “KRA to Tax Income from Apps Downloaded in Kenya”, (2019) online: <https://www.theeastafrican.co.ke/business/Kenya-plan-to-taxyoutube-netflix-in-final-stage/2560-5237506-13fhv1yz/index.html>

²⁶⁸ URA. “What is Value Added Tax (VAT)?”, (2019), online: https://www.ura.go.ug/openFile.do?path=/webupload/upload/download/staticContent/RGTMENU/306/398_What_is_VAT.pdf

²⁶⁹ DataPhyte, “Explainer: Nigeria's 7.5% VAT for Social Media Ads.”, online: <https://www.dataphyte.com/latest-reports/economy/explainer-nigerias-7-5-vat-for-social-media-ads-may-not-equate-gagging-voices-but-it-scores-high-on-the-insensitivity-scale/#:~:text=Nigerians%20will%20now%20pay%207.5,a%207.5%25%20Value%20Added%20Tax>

²⁷⁰ OECD “Mechanisms for the Effective Collection of VAT/GST When the Supplier Is Not Located in the Jurisdiction of Taxation”, (2017) online: <https://www.oecd.org/tax/taxpolicy/mechanisms-for-the-effective-collection-of-VAT-GST.pdf>

²⁷¹ Heinrich Louw and Danielle Botha “Value-added Tax on electronic services supplied by persons outside South Africa” online: <https://www.thesait.org.za/news/168149/Value-added-Tax-on-electronic-services-supplied-by-persons-outside-South-Africa.htm>

²⁷² Ibid

²⁷³ Mustapha Ndajiwo, *Supra* @ note 60

realize it is not sustainable as traditional follow-up actions, such as accessing books and records and creating auditing and collection procedures for outstanding taxes, become a challenge.²⁷⁴ Conversely, enacting DST or a new SEP threshold may not solve this because accessing books and records could be just as hard and an administrative problem as what has been plaguing the VAT mechanism. This is another reason why a multilateral solution is more desirable.

4.7.4 Social media and mobile application taxes

A few African nations have enacted taxes aimed at social media and smartphone app users. The principal justification for these levies is that, as more people turn to mobile applications, revenue from taxes on their traditional voice and message services has decreased.²⁷⁵

As the name suggests, social media taxes are a more modern idea that imposes an extra charge on users of social media. Africa is seeing an increase in this trend, with Uganda setting the standard with the adoption of the Excise Duty (Amendment) Act 2018.²⁷⁶ The daily excise duty price for using mobile applications and social media sites in Uganda, such as Facebook and WhatsApp, was 200 Ugandan Shillings (UGX) (USD 0.05). The main defense offered was that a lot of the tariffs on phone calls had been ineffective due to the widespread usage of mobile communication applications. In its first year, the tax only brought in the equivalent of USD 14 million, far less than the USD 80 million that was anticipated. This was mostly because many social media users avoided paying tax by using virtual private networks.²⁷⁷ An application usage tax of 5 CFA Francs (XOF) (USD 0.008) per megabyte was introduced by the Benin Republic government on social media platforms like Facebook, Instagram, Skype, and Twitter. The charge was removed in just five days after receiving strong criticism and protests.²⁷⁸ Similarly in Nigeria, the government proposed a 5% levy on telecommunications in 2022. This was halted after the Communications

²⁷⁴ ALP Company, “Tax Challenges Facing Digital Enterprises” (2022), online:

<http://www.alp.company/sites/default/files/Tax%20Challenges%20Facing%20Digital%20Enterprises.pdf>.

²⁷⁵ Christoph Stork and Steve Esselaar “OTT and Other ICT Sector Taxes, Research ICT Solutions.”, (2018), online: https://researchictsolutions.com/home/wpcontent/uploads/2019/01/ITU_PP_2018_Dubai_ICT_Taxes.pdf

²⁷⁶ <https://ulii.org/ug/legislation/act/2018/12>

²⁷⁷ Kayiwa, E. (2019) ‘Social Media Tax Performs Dismally in 2018/19’, New Vision, 16 January, https://www.newvision.co.ug/new_vision/news/1504744/social-media-tax-performsdismally-2018-19

²⁷⁸ Christoph Stork and Steve Esselaar, “When the People Talk: Understanding the Impact of Taxation in the ICT Sector in Benin”, (2019) Washington D.C.: Alliance for Affordable Internet

and Digital Economy Minister argued²⁷⁹ that the sector was already over-taxed in the face of rising costs.²⁸⁰

While these levies are reasonable and simple to implement, they have a detrimental effect on the capacity of internet users in these nations to obtain inexpensive internet connections, unnecessarily restricting their right to free speech. Social media and mobile applications are examples of communication tools that promote the right to information access and freedom of speech. Taxes that would seek to restrict their usage are therefore seen as violations of these rights.²⁸¹

4.8 Nexus and Profit Attribution

Even though local affiliates and some sort of physical presence exist in the jurisdictions in many digitalization scenarios, profit-shifting issues still exist. For example, Google has a significant presence in Nigeria, where it has created local companies with real offices. Although these subsidiaries are not the owners of any intellectual property and do not get any money from Google application users, they are put up to offer administrative services. Equivalently, Amazon has no physical or taxable presence in many African countries. It is contradictory for a country like Nigeria because the provisions of the Companies and Allied Matters Act (CAMA) require foreign companies to register to carry on business but that doesn't mean they have to establish a physical presence.²⁸² Likewise, Nigeria in 2019 introduced the concept of significant economic presence as a basis for taxable nexus, but there are no details yet on how it would be implemented.

In addition to the main problem of finding a taxable nexus, the attribution of profits also constitutes another challenge. Attribution of profit has been extensively discussed in the earlier chapters but as it relates to African countries, it looks more achievable if there are country-specific thresholds adjusted to the relative size of the economy to ensure that smaller economies are not excluded in

²⁷⁹Premium Times. "Why I oppose new 5% tax on phone calls, data – Pantami.", online: <https://www.premiumtimesng.com/business/business-news/546715-why-i-oppose-new-5-tax-on-phone-calls-data-pantami.html?tztc=1>.

²⁸⁰ Moneyweb. "Nigeria halts plan for new telecoms tax.", *Moneyweb*. online: <https://www.moneyweb.co.za/news/africa/nigeria-halts-plans-for-new-telecoms-tax/>.

²⁸¹ Kakungulu-Mayambala and Solomon Rukundo. "Implications of Uganda's New Social Media Tax." (2018), *East African Journal of Peace & Human Rights* 24.2: 146-181

²⁸²Section 78 of the Companies and Allied Matters Act, 2020

profit allocation rules and the need to have a fixed minimum return rule should be a high priority for African countries.

4.9 The efforts of African countries

In taxing the profits arising from the digitalized economy, some African countries have introduced DSTs and SEP while others are focused on indirect taxation. Some other governments have imposed excise taxes on mobile transactions, internet data, mobile transactions, and money transfers²⁸³ which do not address the issue at stake but rather seem like an effort to tax the development of internet-related activities in the country.

MNEs such as Uber, Google, and Amazon should theoretically be the focus of African nations. However, achieving this would likely require international collaboration. This cooperation is crucial because many of these MNEs lack books and records in the jurisdictions where they operate and do not possess assets that could be seized in the event of enforcement actions. African nations should not be pressured into making decisions that could harm them, especially when taxing the profits of highly digitalized companies is already challenging. For example, the Independent Commission for the Reform of International Corporate Taxation (ICRICT) has condemned the IMF for exploiting its role in debt renegotiations to coerce countries into adopting OECD tax rules. According to the IMF's own research, these rules would further restrict the revenue-raising potential of financially struggling nations and are increasingly unlikely to be implemented even by OECD member countries.²⁸⁴

Notwithstanding the progress towards consensus-based digital taxes globally, unilateral digital taxes are still being implemented. Disintegrated legislation is of no benefit to tax policy which is why considering the issues expressed about the BEPS/G20 inclusive consensus-based digital taxation plans when considered in the African context is of greater benefit to Africa in the long

²⁸³ Silue Tarna. 2021. E-Money, Financial Inclusion and Mobile Money Tax in Sub-Saharan African Mobile Networks. Available online: <https://hal.uca.fr/hal-03281898/document>

²⁸⁴ Tax Justice Network “Top Economists Condemn IMF Arm-Twisting Countries to Adopt Harmful OECD Tax Deal”, (2023), online: <https://taxjustice.net/press/top-economists-condemn-imf-arm-twisting-countries-to-adopt-harmful-oecd-tax-deal/>.

run. African nations must work together to develop a tax policy to address its concerns.²⁸⁵ ATAF has emphasized how the current OECD plans are not inclusive and are unlikely to curb MNEs profit shifting activities as the OECD plan fails to consider factors such as user data and user participation in determining value streams. The African Forum further recommended that, given the poor tax administration capabilities of African nations and the ongoing abuse of TP regulation by MNEs, cooperative African efforts be made to devise African solutions to the challenges of taxing the digital economy.²⁸⁶ African Union (AU) or ATAF might serve as a platform for coordinating and unifying the cooperative efforts of African nations.

Evaluating obstacles by the interests of government, tax authorities, and consumers can help to reduce the issues and shortcomings associated with DST and tax policies in African countries. Consultation and cooperative efforts between tax authorities, taxpayers, and tax bodies like ATAF are essential to developing an ideal tax policy. Even though stakeholders in African economies are already consulting to build a framework for taxing the digital economy, African nations should also learn from industrialized nations and one another to comprehend the various component models that operate the DSTs.²⁸⁷ Creating a new form of tax and later passing legislation to abolish it could lead to tax uncertainty i.e., instances where taxes on social media and other communication means were proposed (Nigeria, Uganda and Benin) and later removed should provide vital lessons on why policies and legislation should be carefully considered.

Beyond the critical analysis of the wrongdoings of some African countries in their effort to tax the digital economy, the table below gives a general overview of some proposed and implemented Digital Services Taxes in some African countries. In my view, these are efforts in the right direction towards taxing the digital economy that, if properly coordinated, could lead to a concerted effort in negotiating a favorable deal with the G20/OECD.

²⁸⁵ Favourate Mpofo and Moloi Tankiso. “Direct Digital Services Taxes in Africa and the Canons of Taxation”, (2022) *Laws* 11, no. 4: 57, online: <https://doi.org/10.3390/laws11040057>

²⁸⁶ ATAF. “ATAF Publishes an Approach to Taxing the Digital Economy” (2020), online: <https://www.atafatax.org/atafapublishes-an-approach-to-taxing-the-digital-economy>

²⁸⁷ James Anyanzwa. “Kenya joins Tanzania and Uganda in Taxing Digital Transactions.”, (2021) online: <https://www.theeastafrican.co.ke/tea/business/kenya-joins-tanzania-and-uganda-digital-tax-3264326>

Country	Provision	Threshold	Effective date
Nigeria	The SEP Order designs the prerequisites that NRCs offering digital services to Nigerians must meet to be deemed to have a taxable nexus, and therefore be subject to tax. ²⁸⁸ Nigeria's Finance Act 2023, provides that non-residents that operate an online store or digital platform now have the compliance burden on them and were appointed VAT collection agents are now required to charge and collect VAT on the purchase of goods by Nigerian customers. ²⁸⁹	The SEP threshold in Nigeria is if the company derives gross turnover or income of more than ₦ 25 million (about US\$65k) each year from any or a combination of the activities listed in the SEP Order. ²⁹⁰	The SEP was passed and signed on 3 February 2020 while the Finance Act 2023 was signed and passed on 28 May 2023.
Kenya	For non-residents, the VAT regulations released in 2021 offer a simplified form of registration that requires NRCs to register for VAT in Kenya. Kenya's Finance Act 2021 requires non-resident persons dealing in the digital economy to register for Digital Service Tax in Kenya. The Finance Act 2021 requires non-resident persons dealing in the digital economy to register for Digital Service Tax in Kenya. This is applicable at the rate of 1.5% of		7 November 2019

²⁸⁸ A non-resident digital service provider will meet the SEP threshold in Nigeria if: 1) it derives gross turnover or income over ₦ 25 million (about US\$65k) each year from any or a combination of the activities listed in the SEP Order. The ₦ 25 million threshold will also take into account activities carried on by the NRC's connected persons during the accounting year, or 2) it uses a Nigerian domain name (.ng) or registers a website in Nigeria; or 3) it has a purposeful and sustained interaction with persons in Nigeria by customizing its platform to target persons in Nigeria (e.g. by reflecting prices of products/services in Naira, providing options for billing or payment in Naira etc.).

²⁸⁹ While the SEP order does not have an exact percentage for taxing NRCs, the application of VAT as stated in the Finance Act 2023 means NRCs in Nigeria will be taxed at 7.5%

²⁹⁰ There was no threshold stated in the Finance Act 2023.

	the gross transaction.		
Egypt	<p>Although nothing has been introduced to tax the digital economy. In 2020, the finance minister mentioned the need to introduce digital taxes to strengthen revenue mobilization from the digital economy.²⁹¹</p> <p>Similarly in 2022, Assistant Minister of Finance for Tax Policies and Development stated Egypt would be adopting the multilateral approach and they are fully prepared to implement the two-pillar agreement.²⁹²</p>		

African countries have varying thoughts on their digital tax policy, and this may likely lead to differing approaches if cooperation is not adopted. This further emphasizes the difficulty of obtaining tax revenue from the digital economy and suggests that there may be ramifications for the potential tax revenues that may be obtained through direct DSTs.²⁹³ How African governments will strike the best balance to create an encompassing DST policy that promotes digital investment and business expansion while enhancing revenue generation from the industry to fund development is one anticipated tax policy challenge.²⁹⁴

²⁹¹ Bloomberg. “Egypt MOF Announces Budget Proposal.”, online: <https://news.bloombergtax.com/daily-tax-reportinternational/egypt-mof-announces-2020-budget-proposal>

²⁹² Premium Times. “Nigeria, Egypt test different approaches to tax digital economy” online: <https://www.premiumtimesng.com/news/headlines/545116-nigeria-egypt-test-different-approaches-to-tax-digital-economy.html>

²⁹³ Simbarashe, H. 2020. Digitalization and the Challenges for African Administrations. *Financing for Development* 1: 177–203

²⁹⁴ Favourate Mpfu. “Taxation of the digital economy and direct digital service taxes: Opportunities, challenges, and implications for African countries.” (2022) *Economies* 10, no. 9: 219, online: <https://doi.org/10.3390/economies10090219>

4.10 Efforts of the African Union

Africa must develop a framework for taxing the digital economy that can serve as the cornerstone of a continental strategy. There doesn't seem to be any at the AU level right now. The AU started making efforts and initiating conversations towards taxing the digital economy in 2020. In the 2020 tax policy dialogue the AU discussed how to further the development of an African proposal for changes to the international tax laws to meet those difficulties and strengthen the cooperation between African Ministries of Finance and tax authorities.

A joint release of country-level revenue estimates from Amount A compared with Article 12B of the UN Model Tax Convention was made in June 2022 by the Coalition for Dialogue on Africa (CODA), a Special Initiative of the AU, for the 84 Member States of the African Union Combined. A series of proposals on the taxes of the digital economy has also been given to developing nations by CODA.²⁹⁵ The estimated revenue indicated that the UN Model Tax Convention's Article 12B, if applied on a gross basis at a 4% rate to a wide range of Automated Digital Services (ADS), would yield the highest revenue for most of the 84 Member States, all of which are developing countries. While delivering two to five times less cash than Article 12B, Amount A has little advantage for the majority of developing nations.²⁹⁶

Developing countries find the suggested solution less and less attractive with every new set of regulations. For each of the 141 jurisdictions that make up the IF, the OECD must, at the very least, publish revenue forecasts so that each can make an educated decision that serves the interests of the country.²⁹⁷

Africa is looking to actively participate in the global tax debate at the UN on International tax cooperation and the opportunities it presents for increased domestic revenue mobilization as part of its effort to ensure that the continent protects its interests in the global tax rules to increase revenues.²⁹⁸ Additionally, the AU has acknowledged that the new global tax regulations will affect

²⁹⁵ The South Centre. "South Centre comments on progress report on Amount A of pillar one" online: <https://www.southcentre.int/south-centre-comments-on-progress-report-on-amount-a-of-pillar-one-18-august-2022/#more-20442>

²⁹⁶ Ibid

²⁹⁷ Ibid

²⁹⁸ <https://au.int/en/pressreleases/20230602/africa-moves-protect-its-interests-global-tax-rules-increase-revenues-and>

current national tax policies and offer African nations a way to safeguard themselves against losing their taxation rights to nations where MNEs reside.²⁹⁹

A central tenet of the movement spearheaded by activist organizations such as the Tax Justice Network (TJN) is that MNEs operate in developing nations with minimal contribution to public coffers while reaping enormous profits. The AU believes that the UN is the better platform to achieve its agenda because of the OECD's resistance to the focus on illicit money flows, its push for tax transparency, and the fact that its main policy organs are closed to the public.³⁰⁰

African nations should optimize the advantages of the new international taxation system by pursuing equitable taxation policies that consider the reality of the continent and enhance the continent's financial inclusion.³⁰¹

4.11 Selected countries analysis

Because the adoption of digital taxes is still in its infancy and only a few nations have imposed these taxes, there is a dearth of literature examining the advantages, difficulties, and ramifications of doing so in developing countries, particularly in Africa.³⁰² For African countries, the digitization of the tax base is inherently difficult since revenue agencies lack the necessary technological capabilities.³⁰³ The following paragraphs review the digital taxation propositions that have been implemented in selected African countries. A few of the issues that will be discussed are from the criticism that ATAF and other writers levelled against the OECD's two-pillar structure. ATAF expressed several concerns regarding the suitability and application of the OECD's digital taxation recommendations and guidelines for African nations.

²⁹⁹ Ibid

³⁰⁰ Gathii James Thuo. "Recharacterizing Corruption to Encompass Illicit Financial Flows", (2019), AJIL Unbound. Cambridge University Press;113: 336–340, doi:10.1017/aju.2019.60

³⁰¹ Amaglo Kokou Essegebe, Kouevi Tsotso and Adjeyi Kodzo Senyo. "Taxation of Digital Services: What hope for the African States?"(2023) Tax Cooperation Policy Brief, No. 33, online: https://www.southcentre.int/wp-content/uploads/2023/06/TCPB33_Taxation-of-Digital-Services-what-hope-for-the-African-States_EN.pdf

³⁰² Kelbesa Mergesa. "Digital service taxes and their application.", (2020), 12413:16968, online: <https://opendocs.ids.ac.uk/opendocs/bitstream/handle/20.500>

³⁰³ Solomon Rukundo, Supra @ 90

4.11.1 Nigeria

Nigeria, located in West Africa, has a population exceeding 220 million people³⁰⁴ and a current GDP of \$472.62billion.³⁰⁵ As of 2021, Nigeria's tax-to-GDP ratio was 6.7%.³⁰⁶

Before the Finance Act, of 2019, most of the relevant tax laws in Nigeria were obsolete as they were not effective in catching up with the trends and changes in a constantly evolving world.³⁰⁷

The lack of provisions in the relevant tax laws to impose taxes on companies without a relevant PE in Nigeria was an issue. NRCs and companies operating in the digital space had no reason to pay taxes since there was no scope within the bounds of the tax laws to tax the digital MNEs in Nigeria. The coming into play of the Finance Act, 2019 paved the way for the taxation of the digital economy.³⁰⁸ Before the Finance Act 2019, S.9 of the Nigerian Companies Income Tax Act (CITA) applied to “the profits of any company accruing in, derived from, brought into, or received in Nigeria”. Non-Nigerian companies were expected to maintain a physical presence and their profit taxable if they maintained a physical presence. Section 4 of the Finance Act 2019 has amended the provision of S.13(2) CITA.³⁰⁹ This amendment jettisoned the physical presence requirement, a change that was antithetical to most treaties that require either a fixed base in Nigeria, habitual operation through a person authorized to conclude contracts on its behalf, or activities involving a single contract for surveys, deliveries, installation, or construction.

³⁰⁴ <https://www.unfpa.org/data/world-population/NG>

³⁰⁵ <https://data.worldbank.org/country/nigeria?display=gra>

³⁰⁶ <https://www.oecd.org/ctp/tax-policy/revenue-statistics-africa-nigeria.pdf>

³⁰⁷ James Odia and Sarah Akonoafua. “Digital Taxation In Nigeria: Issues, Challenges And The Way Forward” *Journal of Taxation and Economic Development*, Chartered Institute of Taxation of Nigeria, vol. 21(1), pages 75-92 online: *Digital Taxation In Nigeria: Issues, Challenges And The Way Forward*

³⁰⁸ Fiyinfoluwa Adeosun, “Taxation of the Digital Economy: An Evaluation of the Nigerian Approach in the Global Context”, online: <http://dx.doi.org/10.2139/ssrn.4504730>

³⁰⁹ A non-resident company became taxable in Nigeria if any of the following conditions is met: i) the non-resident company has a fixed base (i.e. a place of business) in Nigeria to the extent that the profit is attributable to the fixed base; ii) the non-resident company habitually operates a trade or business through a person in Nigeria or maintains a stock of goods or merchandise in Nigeria from which deliveries are regularly made by a person on behalf of the company; iii) the non-resident company does not have physical presence in Nigeria but derives income from Nigeria through digital activities to the extent that it has a “significant economic presence” in Nigeria; iv) the trade or business or activities of the non-resident involves a single contract for surveys, deliveries, installations or construction; v) the trade or business of the non-resident involves the remote provision of technical, management, consultancy or professional services to a Nigerian resident; vi) the trade or business or activities is between the company and a related party, which is considered not to be at arm’s length.

Before now, a non-Nigerian company was not subject to this provision. This is because the S.54 of the CAMA 2004³¹⁰ requires any foreign company intending to carry on business in Nigeria to incorporate a separate entity in Nigeria for that purpose, failing which its acts would be void.³¹¹ MNEs planning to conduct business in Nigeria typically incorporate a local affiliate to comply with this legislation. They also use non-resident partners for related services, and they do not consider the income to be taxable in Nigeria under s.13 of CITA. The Federal Inland Revenue Service (FIRS) was displeased with this arrangement, and it was contested in court. In *Saipem Contracting Nigeria Ltd, Saipem (Portugal) Comercio Maritimo, SU, LDA (Saipem Portugal) and Saipem S.A. (Saipem France) vs. FIRS*,³¹² Saipem contracted to supply services to Shell Nigeria through three of its affiliates: Saipem Contracting Nigeria, Saipem Portugal and Saipem SA (resident in France). The Federal High Court held that payments made to Saipem Portugal and Saipem SA for services under this contract constituted income ‘derived from Nigeria and is taxable under CITA, because it was a single contract. The Court also ruled in favor of FIRS that Saipem’s Nigerian associate constituted the fixed base for the other affiliates. Hence, all the payments on the contract should be treated as income derived from Nigeria, and subject to both VAT and CITA. This, to me, marked a turning point because many MNEs require a local affiliate to carry out activities in the market country. For instance, in Nigeria, AliExpress makes use of a local courier company called Speedaf for many of its deliveries.

All these are no longer issues as section 4 of the Finance Act, 2019, amended section 13 (2) of CITA, which brings the operation of these companies and digital companies within the tax net, which was not achievable before due to the provision relating to the absence of a fixed base, registration requirements or recognized agents.

In determining the taxable profits attributable to a Nigerian company, the starting point is its accounts, adjusted for tax purposes as required by the CITA. In the case of a company that is part of a corporate group, S.22 CITA allows appropriate adjustments to be made by FIRS to counteract ‘artificial or fictitious’ transactions between related persons. To implement S.22, Nigeria

³¹⁰ This has now been amended to the Companies and Allied Matters Act 2020 and is now S.78.

³¹¹ Martins Arogie, Titilope Ajetunmobi and Ordera Iyizoba. “Developments in Nigeria’s Taxation of Non-resident Companies”, (2014) Tax Notes International 76: 623-626

³¹² Tax Law Reports of Nigeria 15: 76-99,

introduced TP regulations which are based on the arm's-length principle which is in line with the OECD TP guidelines. The CITA also includes an important provision which is relevant to the taxation of the digitalized economy. Section 30 of the CITA provides power for FIRS to assess tax on a 'fair and reasonable percentage' of turnover. This applies where it appears that 'the trade or business produces either no assessable profits or assessable profits which in the opinion of the Board is less than what is expected from that trade or business or, as the case may be, the true amount of the assessable profits of the company cannot be ascertained'.³¹³ This provision seems unfair as the only way to ascertain the profit of a company is by the books, and not by presumption. In the Saipem case, the Federal Court ruled that all the income under its contract with Shell was taxable in Nigeria under CITA s.13(2) and s.30. This case was upheld by the Court of Appeal³¹⁴ and it confirms that the CITA gives the FIRS power to tax income derived from delivering services in Nigeria by digital means that could be considered taxable in Nigeria and taxed under CITA S.30.1.b.(i) on 'such a fair and reasonable percentage of that part of the turnover attributable to the fixed base', perhaps at the effective rate of 6% of the turnover.³¹⁵

Nigeria is restricted by an agreement to prevent double taxation; this is validated by the provisions of the s. 45 of CITA.³¹⁶ A basic provision of most tax treaties is that taxation of business profits is limited to the profits attributable to a PE and it restricts Nigeria's ability to tax MNEs that are resident in countries with which Nigeria has a tax treaty. Most of Nigeria's 15 tax treaties³¹⁷ are based on the OECD model in this respect (those with Belgium, Canada, China, France, Pakistan, and the United Kingdom). Only three of the treaties include a provision for the services PE based on the United Nations Model Double Taxation Convention between Developed and Developing Countries (those with the Netherlands, Romania, and South Africa).

³¹³ S. Odimma. "Nigeria – Corporate Taxation", (2018), Country Surveys, IBFD

³¹⁴ (2018) Lawpavilion Electronic Law Report -45118(CA)

³¹⁵ Okanga Ogbu Okanga, "The Single Contract Basis of International Corporate Taxation: A Review of Saipem v Firs" (2018) 9:4 *Gravitas Rev Bus & Property L* 33.

³¹⁶ If the Minister by order declares that arrangements specified in the order have been made with the Government of any country outside Nigeria to afford relief from double taxation about tax imposed on profits charged by this Act and any tax of a similar character imposed by the laws of that country and that it is expedient that those arrangements should have effect, the arrangements shall have effect notwithstanding anything in this Act.

³¹⁷ See <https://www.firs.gov.ng/tax-treaties/> for list of treaties.

Lastly, Nigeria has in place a VAT system that is destination based. This means VAT is paid when the consumption of a good or service takes place. Section 10(2) of the VAT Act 1993 provides that foreign suppliers are required to register with the FIRS using the address of the person with whom they have a subsisting contract. The client that receives the supply of goods or services in Nigeria is to remit the VAT in the currency of the transaction. This is known as ‘the reverse charge’, one of the models recommended by the OECD³¹⁸. Nigeria has always adopted this model for the taxation of NRCs through the activities of affiliate companies within Nigeria’s jurisdiction.³¹⁹ However the VAT Act was amended by the Finance Act 2020 and section (10)(3) of the VAT Act, as amended by Finance Act, 2020, provides that, for supplies made by an NRC, “the taxable person to whom the supply of taxable goods or services are made in Nigeria, or such other person as may be appointed by the Service shall withhold and remit the tax to the Service in the currency of the transaction”.

Based on the Circular,³²⁰ the FIRS notes that the "NRC shall have a prior obligation to collect VAT" on the cross-border supply of goods and services. However, where the NRC fails to collect VAT, the Nigerian customer shall withhold or self-account for the tax in line with sections 10(3) and 14(4) of the Act. Therefore, an NRC will be deemed to have failed to collect VAT on taxable supplies where it does not include the transaction in its return, or from the facts of the transaction, it can be demonstrated that the NRC has not charged or collected VAT on the transaction. Consequently, the Circular notes that the FIRS is empowered to do all such things as may be necessary for it to

³¹⁸OECD (2017a) OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, Paris: OECD Publishing

³¹⁹ Section 49 of the CITA provides that the FIRS has the authority to appoint an agent to enforce income tax liability. This provision states that the FIRS may appoint any person to be the agent of any company and such person may be required to pay any tax that is or will be payable by the company from any money that may be held by him for, or due by, or to become due by him to the company whose agent he has been declared to be, and that if there is a default in such payment, the tax shall be recovered from him. See also Section 31 of the Federal Inland Revenue Service Establishment Act, Cap. F36 LFN 2004. This provision implies that if a Nigerian Company is indebted to an NRC and the NRC has outstanding tax liabilities, the FIRS may by this provision appoint the Nigerian Company as an agent of the NRC to settle such outstanding tax liabilities. This appointment as an agent can be made directly to the company or a Nigerian bank that has custody of the money of the said company.

³²⁰ The Federal Inland Revenue Service (FIRS) has issued Information Circular No.: 2021/19 (“the Circular”) on Guidelines on Simplified Compliance Regime for Value Added Tax (VAT) for Non-Resident Suppliers (NRSs) of goods, services, or intangibles to persons in Nigeria through electronic, digital, or similar platforms. The Circular was issued under the provisions of Section 10(5) of the VAT Act Cap.V1 LFN 2004 (as amended) and replaces other notices and publications issued by the FIRS in this regard. The Guidelines will take effect from 1 January 2022 concerning the supply of services and intangibles, and 1 January 2024 for goods.

enforce the tax laws and collect the amount due. This may lead to a Best of Judgment from the FIRS.³²¹ The designation of NRCs as agents for VAT collection for B2B transactions further to Section 10(3) of the VAT Act shifts the compliance burden on NRCs from which Section 14(3) (as amended by Finance Act, 2019) has absolved them by transferring the responsibility for VAT collection and remittance to "the person to whom the goods or services are supplied in Nigeria".

Nigeria, however, does not have a simplified registration and compliance system for cross-border suppliers, as suggested by the international VAT/GST guidelines.³²² NRCs without a physical presence in Nigeria may be reluctant to register in all the countries in which they operate, and for transactions with individual consumers, it would be difficult to apply the reverse charge.

4.11.2 Rwanda

Rwanda is an East African country with a population of over 12 million people and a current GDP of \$13.31 billion.³²³ The tax-to-GDP ratio of Rwanda for the year 2021 was 16.9%.³²⁴ In comparison, the average for 31 African countries was 16.0% in 2020.³²⁵ Rwanda had no unilateral plans to effect the taxing of the digital economy until recently when the Rwanda Revenue Authority (RRA) announced its plans to start taxing digital services such as Netflix and Amazon as the country looks to expand its tax base. This announcement is coming as the country has said as the market for digital services in Rwanda grows, it is only fair that the country gains from it.³²⁶ While the details about which platforms will be taxed and the modes of taxing are still unclear,

³²¹ The BOJ Assessment is a tax appraisal method done by a tax authority based on information about a company's accounts. This is usually the practice when a taxpayer fails to remit taxes when due or refuses to provide an audited account. Where a NRC does not comply with the applicable provisions, based on the provision of Section 65(3) of CITA, the FIRS may assess such companies with the BOJ method. This will also reflect the opinion of the FIRS that such an entity should remit taxes which are due based on its operation in Nigeria. This provision of the CITA simply empowers the FIRS to use the BOJ method to determine the overall turnover and profit of a company and thereby determine its profit accordingly if a company does not file its returns. The BOJ assessment must be made available to the company within a reasonable time, and it should also include interest and penalties for non-compliance.

³²² Ibid @ 300

³²³ World Bank. "Inclusiveness of Foreign Direct Investment in Rwanda". (2023) Rwanda Economic Update, June 2023: Edition No.21. © Washington, DC: World Bank, online: <http://hdl.handle.net/10986/39975>

³²⁴ OECD/ATAF/AUC (2020) Revenue Statistics in Africa 2020: 2000-2020, Paris: OECD Publishing See <https://www.oecd.org/tax/tax-policy/revenue-statistics-africa-rwanda.pdf>.

³²⁵ Ibid

³²⁶The East African. "EA economies bank on digital tax to shore up budget funding.",

<https://www.theeastafrican.co.ke/tea/business/ea-economies-bank-on-digital-tax-to-shore-up-budget-funding-3753606>.

since the proposal is still being reviewed by the Ministry of Finance and Economic Planning, we look at some of the existing laws in Rwanda that could make the taxing of the digital economy possible as well as some of the plans being put in place to harness taxes in the digital space.

Article 5 of the Income Tax Law No 027/2022 defines PE as “*a fixed place of business which gives rise to a taxable presence in Rwanda.*” The PE threshold as stated in their income tax is (i) that of an entity with third parties acting on its behalf and the third parties usually exercise the power to negotiate or enter into contracts on behalf of the non-resident entity or play the main role leading to the conclusion of such contracts in Rwanda and; (ii) A non-resident entity, except in regards to re-insurance, is deemed to have a PE if it collects insurance premiums or insures risks in Rwanda except through an independent agent. With this requirement, most digital MNEs with no physical dealing in Rwanda have no tax liability, as they do not meet the PE. There are, however, other provisions of the Income Tax Act that capture non-resident persons. Under the current income tax law, income from digital services is a source of taxable income. Digital services have been defined in the law to include online advertising services, the supply of user data, online search engines, online intermediation platforms, social media platforms, online media, digital content services, online gaming, cloud computing services or standardized online teaching services. Income from gaming activities is now within the scope of withholding tax, making it a source of taxable income.³²⁷

In addition to the Income Tax Act and in a bid to reduce tax avoidance, Rwanda had a ministerial order in 2020 to regulate TP³²⁸ in line with the OECD 2017 guidelines. The order establishes rules on TP in Rwanda. It lists the transactions that could have their TP adjusted. These consist of the free sale, purchase, or transfer of products; leasing of tangible assets; granting or receiving the right to use intangible assets; offering services; lending or borrowing money; and any other transaction that could have an impact on the individual's profit or loss. According to Article 33 of the order, documents demonstrating that prices are set following the arm's length principle must be provided for transfers between related parties engaged in controlled activities. It is anticipated

³²⁷ Article 6, Income Tax Law No 027/2022 (ITL 2022)

³²⁸ Ministerial Order No 003/20/10/TC of 11/12/2020

that the regulations would cover MNEs' dealings with related parties for digital services (software purchases, online subscriptions, hosting contracts, etc.).

The RRA has signed the Convention on Mutual Administrative Assistance in Tax Matters (MAAC)³²⁹. The MAAC is a multilateral treaty used by countries to exchange information for tax purposes to better enforce their domestic laws. The signing and implementation of this will be important in providing wide access to the exchange of information with other jurisdictions, which will be extremely important in increasing transparency of taxpayer operations and better-informing authorities on the gaps in tax law.

The current outlook did not foresee the need for digital PE to bring digital MNEs into the tax net. Rwanda may consider initiating changes to the income tax law and all existing DTAs in the interim by expanding the conditions required to establish a PE in Rwanda to include non-resident entities with no physical presence but a customer, user, or other base above a specified threshold. Rwanda may also renegotiate its DTAs to include a digital PE. This will place the onus on companies operating in Rwanda without a physical presence to declare any income earned concerning customers or users based in Rwanda.

Although it appears the Rwandan government was initially waiting for the OECD proposals, the Government has started the process of reviewing and updating its tax laws to catch up with the digital economy. The VAT and Income Tax are under continuous review and will target digital supplies and services where income or sale has been made in Rwanda. These measures are set to widen the tax base, generate additional revenues from the digital economy, and establish fair competition for both digital and non-digital businesses.³³⁰

Article 3 of the VAT Law 2023 introduced a new provision to capture "online supplies" as taxable. This is to ensure uniformity with the current ITL 2022, which added digital services as part of the

³²⁹<https://www.oecd.org/tax/exchange-of-tax-information/maldives-papua-new-guinea-and-rwanda-join-multilateral-convention-to-tackle-tax-evasion-and-avoidance.htm> or <https://www.rwandainsingapore.gov.rw/info/info-details/rwanda-signs-international-convention-on-tax-matters>

³³⁰ John Karangwa, Naomi Alexander and Joy Waruguru Ndubai. "Taxing Rwanda's Digital Economy: A Reflection Paper", (2021) Joint paper between RRA and ICTD online: https://www.rra.gov.rw/fileadmin/user_upload/13_taxing_rwandas_digital_economy_a_reflection_paper.pdf

taxable sources of income. The modalities of subjecting digital services to VAT are to be provided under an Order of the Minister³³¹ but this is yet to be released. Article 6 of the VAT Law 2023 further affirmed that imported services are subject to VAT.

Ultimately, Rwanda has a Medium-Term Revenue Strategy for 2021 - 2024 prepared by the Ministry of Finance and Economic Planning.³³² The country has plans to replace the existing PE concept with a “significant presence” meant to respond to the dynamic nature of customer relationships in the digital economy. In addition to this, the country plans to impose a withholding tax on certain payments made by residents of a country for digital goods or services provided by a foreign provider.

4.11.3 Kenya

Kenya, situated in East Africa, is home to a population of over 55 million people³³³ and boasts a current GDP of 113.42 billion³³⁴ and a tax-to-GDP ratio of 15.2% as at 2021.³³⁵ Kenya has seen tremendous growth in Information and Communication Technology (“ICT”) in the last few years. According to the Communication Authority of Kenya, mobile data subscriptions stood at 46.63 million users; the number of mobile commerce transactions was 526.991 million; the value of mobile commerce transactions was KSh 15.3 trillion; broadband subscriptions were 28.5 million; and data/ internet subscriptions stood 46.4 million.³³⁶ Over time, pressure to meet KRAs performance targets has increased due to the institution's need for additional revenue to fund Kenya's development initiatives, forcing KRA to turn to new sources of income. To increase revenue and broaden its tax base, KRA has thus over the years invested in technology innovations and data-driven initiatives. To close budget shortfalls by expanding the tax base, the KRA has already unilaterally begun taxing the digital economy. This section looks at the Kenyan government's strategy.

³³¹ Ibid

³³² Available at

<https://www.minecofin.gov.rw/index.php?eID=dumpFile&t=f&f=47839&token=8a225ec327ea93e24ca2ad06633abd4e3f5836e8>

³³³ <https://population.un.org/wpp/>

³³⁴ <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=KE>

³³⁵ <https://www.oecd.org/tax/tax-policy/revenue-statistics-africa-kenya.pdf>

³³⁶ Economic Survey 2022, Kenya National Bureau of Statistics, online: <https://www.knbs.or.ke/wp-content/uploads/2022/05/2022-Economic-Survey1.pdf>

Kenya's income tax applies to all the income of any person, resident, or non-resident, 'which accrued in or was derived from Kenya.'³³⁷ PE in Kenya is defined to mean a fixed place of business in which that person carries on business and for this definition, a building site, or a construction or assembly project, which has existed for six months or more shall be deemed to be a fixed place of business.³³⁸ The definition of the PE also includes the provision of services, by a person through employees or other personnel engaged for that purpose, but only where the services or connected business in Kenya, continue for a period of, or periods exceeding in the aggregate, ninety-one days in any twelve months commencing or ending in the year of income concerned.

The ITA definition makes it difficult for Kenya to tax digital MNEs unilaterally because of taxation of non-residents requires a PE. The Act is however subject to the DTAs which Kenya has with other countries. This is because S.41 of the ITA provides that tax treaties override all other provisions except for the anti-avoidance rule. Hence, any entity resident in one of these treaty partner countries would only be taxable on profits derived from Kenya that are attributable to a PE, as defined in that treaty. Taxing non-resident digital businesses is equally challenging, regardless of whether a DTA is in place.

The ITA includes an interesting provision in S.18(3) "Where a non-resident person carries on business with a related resident person and the course of such business is such that it produces to the resident person or through its PE either no profits or less than the ordinary profits which might be expected to accrue from that business if there had been no such relationship, then the gains or profits of such resident person or through its PE from such business shall be deemed to be of such an amount as might have been expected to accrue if the course of that business had been conducted by independent persons dealing at arm's length." There has however been an attempt to apply this provision of the ITA which was not successful.³³⁹ This was why Kenya enhanced its TP

³³⁷ S.3(1) Kenya's Income Tax Act 2022 (ITA)

³³⁸ S. 2 ITA 2022

³³⁹ Atiya Waris. "How Kenya Has Implemented and Adjusted to the Changes in Transfer Pricing Regulations", (2017), 1920-2016, ICTD Working Paper 69, Brighton: IDS

regulations in 2006, by introducing detailed regulations which is similar to the OECD's TP guidelines.³⁴⁰

Kenya also operates a destination-based VAT system, and it applies a reverse charge mechanism to imported goods and services.³⁴¹ Nonresident individuals/companies that are subject to VAT but have no fixed place of business in Kenya are required to appoint a representative.³⁴² This is a provision that offers no means for remote registration of foreign suppliers even if they are willing to voluntarily comply. However, the Value Added Tax (Electronic, Internet and Digital Marketplace Supply) Regulations, 2023 may be explored because S. 5(1) and (a) of the regulation provides that “a person supplying a taxable electronic, internet or digital marketplace supply specified in regulation 3 shall register for tax in Kenya within thirty days after the date of making taxable supply per section 34 if — (a) the supplies are made by a person from an export country to a recipient in Kenya;” Although the provision for the registration for VAT is still not made easy for NRCs, this provision creates an opportunity for Kenya to tax digital businesses and MNEs.

Beyond the existing legislation and framework, Kenya has made several attempts to tax the digital economy adopting the method of indirect taxation. For instance, the country introduced an excise tax on mobile phone-based financial transactions in 2013 at 10%, which was increased to 12% in 2018. Due to the widespread adoption of cash-only transactions to evade incurring an extra fee on mobile phone transactions, this legislation has become redundant.³⁴³ With the introduction of the Kenyan Finance Act of 2019, the nation expanded the definition of "income accruing through a digital marketplace" under Section 3 of the ITA.³⁴⁴ The term 'digital marketplace' was defined as a platform that enables the direct interaction between buyers and sellers of goods and services through electronic means. Section 18 of the Finance Act 2019 further clarified that VAT applies to 'supplies made through a digital marketplace', also to be implemented by regulations.

³⁴⁰ Ibid

³⁴¹ S.10 Value Added Tax (VAT) Act 2013

³⁴² S. 9 VAT Act 2013

³⁴³ Njuguna Ndung'u Ndung'u. “Taxing Mobile Phone Transactions in Africa: Lessons from Kenya” , (2019) Africa Growth Initiative, Washington: Brookings Institute, online: <https://www.brookings.edu/articles/taxing-mobile-phone-transactions-in-africa-lessons-from-kenya/>

³⁴⁴ S. 3 Kenyan Finance Act 2019

Kenya introduced a DST³⁴⁵ payable at the time of the transfer of the payment for the service to the service provider at the rate of 1.5% of the gross transaction value. The tax is assessed on income from digital services accrued in or derived from Kenya through a digital marketplace.³⁴⁶ Businesses that generate more than Ksh5 million (\$50,000) in annual sales are now required to register for VAT obligations for supplies, in addition to corporate tax at 30% for resident companies and 37.5% for foreign entities.³⁴⁷ This digital services tax was increased to 3% in 2022.³⁴⁸ It, however, appears that the DST in Kenya was introduced as an interim measure since the IF is yet to conclude on a solution to tax the profits of digitalized businesses. The Kenyan president announced in 2023 its plan to scrap the DST so Kenya can fall in line with the OECD's proposed global tax reforms.³⁴⁹ Although, this move could be as a result of pressure from the USA because Kenya has been blocked from signing a free trade deal with the US partially because of its DST.³⁵⁰ In a recent but not so-related development, Kenya introduced DST on income derived from the transfer or exchange of digital assets (such as cryptocurrency transactions and non-fungible tokens) at a rate of 3%.³⁵¹

4.12 Conclusion

It is obvious that the selected African countries have taken steps or are evaluating their steps in taxing the digital economy. One strength unique to all the countries examined is the advantage African countries have with their VAT to immediately ensure the collection of taxes from digitized transactions. Another advantage of VAT is that it is easier to administer compared to corporate taxes, since most countries have an existing legal framework, and those frameworks will only need to be adjusted to make it possible to tax these digital businesses.

³⁴⁵ It was initially introduced by the Finance Act 2019 amendment to the ITA. The provision for the DST is currently in section 12(E) of the ITA 2023

³⁴⁶ Kenya Revenue Authority. "Taxing the Digital Economy in Kenya", (2020), Policy Brief, online: <https://www.kra.go.ke/images/publications/Policy-Brief--Taxing-the-Digital-Economy-in-Kenya.pdf>

³⁴⁷ Ibid.

³⁴⁸ TechCrunch. "Tech firms face higher levies as Kenya plans to double digital service tax." *TechCrunch*, online: <https://techcrunch.com/2022/04/13/tech-firms-face-higher-levies-as-kenya-plans-to-double-digital-service-tax/>.

³⁴⁹ VATCalc. "Kenya to Scrap 1.5% Digital Services Tax.", online: <https://www.vatcalc.com/kenya/kenya-to-scrap-1-5-digital-services-tax/>.

³⁵⁰ Ibid

³⁵¹ Introduced by S.10 of the Finance Act 2023 by inserting a new section 12(F) in the current ITA. The provision is to take effect from January 1, 2024.

However, in administering these taxes, African countries are at a disadvantage because of their limited technology capacity. Technology is required for enforcement as there will be a need for tax authorities to collect and collate data to determine the global revenue of these entities and what percentage is attributable to their presence in the various countries.

The preferability to expand the current tax systems to tax the digital economy, as opposed to creating brand-new ones by African countries, should not hinder or discourage African countries from participating in dialogue towards international cooperation. While the negotiation is ongoing, it is reasonable for African countries to adopt the interim method of taxing the digital economy. This should however not be legislated in such a way as to stunt the growth and development of trade in African countries, because many of the unilateral provisions conflict with the OECD/G20 multilateral measures being proposed. African countries should be open to the idea of adopting the multilateral measures when passed. Relying on the unilateral measures alone could exclude the countries from other beneficial provisions of the multilateral deal, like the exchange of information, and could lead to isolation from trading partners who are embracing the two-pillar solution.

CHAPTER FIVE: CONCLUSION AND RECOMMENDATION

5.1 Introduction

The difficulty of taxing services is an issue that many African nations have long recognized. The tax rules in place in these countries, including those that were earlier examined, include mechanisms to impose a tax on the activities of non-resident companies providing services to people within the nation. Such mechanisms are not perfect and are still being developed, but at least they are in place and can therefore facilitate tax reform. However, there are other barriers to tax reform, specifically tax treaties, which typically restrict source taxation to profits attributable to a PE, limiting many of these taxing privileges. Even with these barriers in place, some countries have developed ways to assert source taxation rights. Nigeria's introduction of SEP rules is one good example. Further action needs to be taken, and effective MNE taxation, which is a pressing issue for African nations, requires a more comprehensive approach. Indeed, digitalization has exacerbated existing problems with the current system and exposed other problems, such as the fact that appropriate laws are not in place, or enforcement is weak in countries where laws have been introduced, and / or penalties for non-compliance are an inadequate deterrent. Further, as has been shown in previous chapters, while progress on developing proposals for taxing digital MNEs has taken place, such work and resulting proposals have not thoroughly considered the viewpoint or experiences of African countries. From the perspective of many African countries, tax reform is needed, but the needs go beyond technical reforms of the taxation system to the broader socio-economic concern of generating the revenue required for development. These are some of the core issues that this thesis has engaged with.

This final chapter returns to the broad research questions outlined in the introduction, while also outlining some of the lessons that can be learnt from the various efforts discussed above. As part of this discussion, the chapter will provide some recommendations for African countries towards tax reform, particularly with respect to taxing the digital economy. This final chapter will begin by reviewing the unique nature of taxing the digital economy as it relates to African countries as well as the effect of the adoption of either the unilateral or multilateral approach. The chapter analyses the possibility of having a new international tax organisation to supplant the OECD and take over

the coordination of international tax cooperation but concludes that this proposal may never make headway.

The chapter also examines the twist of events in the world of international tax cooperation with the UN resolution of November 2023. The resolution was passed with 125 votes (comprising majorly of LMICs) in favor of the Tax Convention, with 48 votes against (majorly developed nations), and 9 abstentions. These twists have led to an expectation of significant reforms which will be in the interest of developing nations. In my view, the resolution may not provide a consensus solution to global tax problems as it appears we may end up with two proposals for cooperation: one led by the OECD and one led by the broader UN, rejected by all OECD members. In short, I contend that there is a long way to go before we achieve real international tax cooperation.

Beyond the policy steps required to achieve a shift in the international tax cooperation dynamics, I advocated the need for an improved tax administration from African countries as this will be required to achieve a coordinated global effort. Finally, I discuss the need for a more inclusive OECD agenda, and I also endorse the possibility of imbibing some of the UN proposals in the OECD proposals to avoid a loop of negotiations in international tax cooperation.

5.2 The challenges related to taxing the African digital economy: The unique nature of the challenge

The taxation mechanisms most at risk from the digital economy are CIT, Withholding Tax, and VAT, which account for a far higher share of total tax collections in developing nations than in wealthy nations. Because of the heavy reliance on consumption taxes and the continued weakness of their income tax, developing nations will find it extremely difficult to offset any decrease in their VAT.³⁵² Furthermore, developing countries are net importers of digital goods and services, therefore any loss of tax revenue is urgent for them, and has long term consequences. The BEPS issues and challenges faced by African countries differ from those faced by developed countries.

³⁵² IMF. “Corporate Taxation in the Global Economy”, (2019) IMF Policy Paper No. 19/007, Washington D.C.: IMF

Developing countries continue to face these problems in global tax governance because the majority of the international tax rules were developed by the OECD and other advanced countries, and these rules were developed largely without input from developing countries.³⁵³ The reason for this lack of input is that many developing countries were still under colonial rule when the foundations for international tax coordination were laid and thus western countries have enjoyed their first-mover advantage.

In addition to the colonial history that resulted in advanced countries dominating the process of setting rules for global tax governance, the G20 and the OECD states still dominate agenda-setting at the global level. The agenda-setting power — which encapsulates the order in which issues were and still are brought up for discussion and decisions made in the international community — has enabled the OECD countries to retain their dominance in the international tax arena.³⁵⁴ A review of OECD/G20 tax initiatives (the latest being the BEPS project) — which often birth international tax policies— reveals that the OECD/G20 target issues that are most important to developed countries and adopt solutions that are tilted in their favor³⁵⁵ Finally, ongoing economic power imbalances in the global arena continue to limit developing countries' ability to make the most of opportunities available to them to negotiate tax reforms.³⁵⁶

5.3 Effect of unilateral and multilateral measures

Tax arrangements that have been created unilaterally are tagged as temporary while countries await the outcome of the multilateral procedure coordinated by the OECD. Whether they are permanent or not, the provisional plans make it more difficult to reach a consensus. It could also be argued

³⁵³ Martin Hearson, Joy Ndubai and Tovony Randriamanalina. “The Appropriateness of International Tax Norms to Developing Country Contexts” (2020) Facti Background Paper 3, online: <https://www.ictd.ac/publication/facti-appropriateness-international-tax-norms-developing-countries/>

³⁵⁴ Tsilly Dagan. “International Tax Policy: Between Corporation and Competition”, (2018), Cambridge University Press 2018, p. 177.

³⁵⁵ Joy Ndubai “If developing countries are not listened to at the OECD, they will vote with their feet” online: <https://www.ictd.ac/blog/developing-countries-oecd-inclusive-framework-consensus/>

³⁵⁶ Allison Christians and Lauren Van Apeldoorn. “The OECD Inclusive Framework” (April/May 2018) Bulletin for International Taxation; https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3393140 > African Tax Administration Forum, ‘The Place of African in the Shift Towards Global Tax Governance: Can the Taxation of the Digitalised Economy be an Opportunity for More Inclusiveness?’ (2019) African Tax Administration Forum Paper < <https://irp-cdn.multiscreensite.com/a521d626/files/uploaded/ATAF%20PAPER%5B1%5D.pdf> >

that these unilateral actions will increase urgency, providing the motivation for the international community to reach a consensus.

Digital service taxes (DSTs) and other unilateral measures run the risk of inciting trade disputes in the absence of international harmonization. However, addressing them with the same unilateral action jeopardizes the multilateral economic system, which is already in a precarious state because of various one-sided taxes. The adverse effect of sabotaging Pillar One and Two of multilateral cooperation should be on the minds of governments. Countries ought to favor multilateral coordination because it provides relative uniformity and consistency, even though they have the flexibility to unilaterally develop regulations to apply market-based income taxes on MNEs that enter their territory. Multilateral coordination will also help minimize the possibility of double taxation. It is noteworthy that lower-income countries find it challenging to forecast and decide which approach will be favorable in the long run, particularly in a world economy where high-income nations predominate.³⁵⁷

Unjust deals can be the trigger for divisive unilateral tax policies. There is a risk that lower-income nations, including those willing to ratify the multilateral convention of Pillars One or Two in principle, would keep rejecting a clause that prevents them from passing future digital tax laws.³⁵⁸ Policymakers must endeavor to make international bargains like the OECD multilateral convention fair and truly inclusive to avert such discontent in future.

The OECD's digital tax ideas acknowledge the new tax nexus while attempting to do away with unilateral DSTs. The plan calls for MNEs to pay some corporate taxes in the country where sales revenue is produced, with the amount modified to account for the relative profitability of the businesses that fall under the initiative's purview. With DSTs intended to guarantee that "market" nations have more taxing authority over the earnings of tech-based MNEs that sell into and gather

³⁵⁷ Tarcísio Diniz Magalhães, "International Tax Law Between Loyalty, Exit, and Voice" (2021) 44 Dal LJ 49;

³⁵⁸ FE Bureau, "India, others oppose OECD plan on future digital taxes", (August 19, 2022) Financial Express online: <https://www.financialexpress.com/economy/india-others-oppose-oecd-plan-on-future-digital-taxes/2635574/>.

data from local markets,³⁵⁹ the OECD should be more concerned about ensuring that market countries earn their fair portion of tax, especially with the STTR.

With the OECD currently unable to reach a consensus and several countries under the OECD multilateral convention launching DSTs, it appears the OECD won't enjoy the goodwill of several countries if its proposals are not implemented as early as possible. The OECD's decision on 11 July 2023 to impose a one-year standstill on imposing any DST legislation³⁶⁰ made it clear that Pillar One of the IF may not be fully implemented by the end of 2023. Although 138 member countries approved of the statement, Canada did not. Canada instead appears ready to move ahead with its implementation of the DSTA.³⁶¹ Although one can only speculate, Canada appears to have passed the DSTA to trigger other countries to promptly accept the OECD proposals, especially the US, because it appears the US has more to lose in terms of tax revenue should Pillar One be implemented. The Senate Committee on Finance stated the likelihood of the country losing up to 120 million dollars should Pillar One be implemented.³⁶² There is, however, no concrete reason to say the OECD is stalling on the implementation of these frameworks because of the US.

5.4 An evolutionary approach?

Although there is a lot of promise for improved trade in Africa with the introduction of digitalized company models, the two main issues with international tax have been made much worse: first, what constitutes taxable presence has been further complicated and is largely based on physical and geographical connection; and second, how MNEs divide their business profits among the several jurisdictions in which they do business is still based on separate entity accounting and the

³⁵⁹ William Morris and Pat Brown "Digital service taxes: Are they here to stay?" online:

<https://www.pwc.com/us/en/services/tax/library/digital-service-taxes.html>

³⁶⁰ Outcome Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy — 11 July 2023 - OECD

³⁶¹ The proposed DST would apply to large domestic and foreign businesses where:

Total revenue from all sources (or the total revenue of a consolidated group of which they are a constituent entity at any time in the calendar year or the preceding calendar year) is at least €750 million during a fiscal year that ends in the preceding calendar year; and

Canadian digital services revenue (or the total of all Canadian digital services revenue for all entities in a consolidated group if they are a constituent entity of a consolidated group at any time in the calendar year) is greater than CA\$20 million in the calendar year.

³⁶² Senate Finance Committee. "JCT: U.S. stands to lose revenue under OECD tax deal." *Senate Finance Committee*, online: <https://www.finance.senate.gov/ranking-members-news/jct-us-stands-to-lose-revenue-under-oecd-tax-deal>.

arm's length principle. As a note of caution, rather than isolating the digital economy for special treatment which would be somewhat absurd given how permeating digital technologies are and their unpredictable future development, an evolutionary approach that considers the foundational tax principles is necessary. Isolating the digital economy will go against the tax neutrality principle, which states that taxes should apply to similar activities equally and should not distort commercial decision-making.³⁶³

It is vital to have an approach that considers the various digital MNEs' business models and how these might change over time. It is also important to consider the potential rise of new technologies. For instance, cryptocurrency payments can be made in an uncontrolled and hard-to-trace manner, undermining laws and regulations that target certain transactions. Another possible challenge may be the use of VPNs, which can change users' apparent location and may present a challenge in determining the origin of a transaction. There is a potential for double taxation because many of the existing tax policy plans, which are most appropriate in African countries, tax digital enterprises uniformly based on their gross revenue. To distribute the worldwide tax base equitably among nations, a thoughtful, methodical, and creative strategy aimed at reforming / changing the basic structure of the current rules is required.

5.5 Towards a strategic cooperation approach to resolving the deficiency in global tax governance as it relates to the digital economy for African countries

The current structure of the OECD-dominated global tax governance is antithetical to the principles of institutional design — “the instrumental view which maintains that one should design institutions to realize the most plausible conception of justice, and the democratic view, which maintains that one should design institutions to enable persons to participate in the decisions that impact their lives.”³⁶⁴ As a result, two approaches have been suggested to solve the deficiency in

³⁶³ Douglas Kahn. “The Two Faces of Tax Neutrality: Do They Interact or Are They Mutually Exclusive?” (1990) N. Ky. L. Rev. 18 (1990): 1-19.

³⁶⁴ Simon Caney. “Cosmopolitan Justice and Institutional Design: An Egalitarian Liberal Conception of Global Governance” (October 2006) 32 (4) Social Theory and Practice, online: <https://www.jstor.org/stable/23558730?seq=1&cid=pdf-reference>>

global tax governance; the restructuring option³⁶⁵ and the International Tax Organization (ITO) option.³⁶⁶

The restructuring option suggests actions to reform the deficiency in global tax governance should happen from within the existing institutional framework of tax cooperation and coordination.³⁶⁷ This approach however suffers some inherent problems. First, it would be led by the OECD, which seems not to be genuinely interested in reforming global tax governance in the interest of developing countries. Secondly, attempting this sort of internal restructuring is akin to clothing the OECD with the garb of a global tax forum which it is not — the OECD does not have global scope and was not created solely for tax purposes. Indeed, the OECD is active in many social and economic policy areas and has not focused on tax reform as its priority.³⁶⁸

Yet another approach calls for the creation of an entirely new organization — to be known as an ITO — to supplant the OECD.³⁶⁹ The ITO, it is said, would be a global tax body with an assembly in which the principles and rules of international taxation can be negotiated and defined by the representatives of member-states and every member-state would be allowed to propose agenda items.³⁷⁰ In advocating for the establishment of an ITO, Horner argues that “a new global institution in taxation policy will make a significant, non-redundant contribution to global governance if – and only if – it gives a full and true voice to the fiscal concerns and needs of developing countries.”³⁷¹ According to Horner, five conditions are essential for an international tax arrangement to be valuable: (1) “no gag rules: all issues must be eligible for discussion at the forum”; (2) “fair share: attention should be given to profit allocation rules”; (3) “link to official development assistance: development issues should be relevant in formulating tax policy”; (4) “tax administration efficiency: developed countries should assist developing countries in improving tax

³⁶⁵ Sieb Kingma. “Inclusive Global Tax Governance in the Post-BEPS Era’ Kluwer International Blog”, (11 October 2019), online: <http://kluwertaxblog.com/2019/10/11/inclusive-global-tax-governance-in-the-post-beps-era/?print=print>>;

³⁶⁶ Thomas Rixen. “Institutional Reform of Global Tax Governance: A Proposal”, (2016) Peter Dietsch and Thomas Rixen (eds), *Global Tax Governance: What is Wrong With it and How to Fix it* (ECPR Press 2016)

³⁶⁷ *Supra* @ 186

³⁶⁸ *Supra* @ 186

³⁶⁹ *Ibid*

³⁷⁰ *Ibid*

³⁷¹ Frances Horner, “Do We Need an International Tax Organization?” (2001) 24 TAX NOTES INT’L 179.

administration”; and (5) “governance: developing countries should have a meaningful voice in any world tax”.³⁷² Unfortunately, the idea of an ITO is dead on arrival having been vehemently opposed by the International Monetary Fund, the World Bank and most first-world countries.³⁷³ The discussion and several agitations on reforming the deficiency in global tax governance have centered more on the need for the OECD to ensure greater inclusivity.

With the emergence of ATAF and organizations like TJN, Africa has begun to play its part within the international tax scene but now faces distinct kinds of vulnerabilities due to most countries’ dependency on foreign aid and countries’ political fixation with a race to the bottom in the tax competition. Favorably, the UN resolution on global cooperation recognized the work of the “AU, in collaboration with other pan-African institutions, in promoting international cooperation to fight illicit financial flows, including the decision by the Assembly of the AU at its thirty-sixth ordinary session, held in Addis Ababa on 18 and 19 February 2023, to curb illicit financial flows that drain from the continent of Africa substantial financial resources paramount for economic and social development.” Given these issues, no surprise that the UN seems to be preferred in the negotiations, especially for African countries.

In general, African countries seem to be in favor of the process of moving global tax decision-making from the OECD. This preference was demonstrated in a vote on the floor of the UN to create a global tax convention.³⁷⁴ The outcome of the vote will lead to the development of a new global tax framework, coordinated by the UN (UN tax convention). Such an outcome will result because negotiators from developing countries have accused representatives of the EU and the UK of trying to “kill” proposals that do not favor the richer economies that make up its membership.³⁷⁵ Organizations like the TJN have also said “...Tax havens and corporate lobbyists have had too much influence on global tax policy at the OECD for too long...”³⁷⁶ The UN has the view that

³⁷² Ibid

³⁷³ Sissie Fung. “The Questionable Legitimacy of the OECD/G20 BEPS Project” (2017) 2 *Erasmus Law Review*, online: http://www.erasmuslawreview.nl/tijdschrift/ELR/2017/2/ELR_2017_010_002.pdf>

³⁷⁴ A/C.2/78/L.18/REV.1 accessed from UN Tax Convention | Financing for Sustainable Development Office

³⁷⁵ <https://www.ft.com/content/e05b0767-cab5-44de-9fbf-af5ce841a026>

³⁷⁶ Tax Justice Network. “UN adopts plans for historic tax reform.”, online: <https://taxjustice.net/press/un-adopts-plans-for-historic-tax-reform/>.

many of the OECD's policy prescriptions disregard developing economies, saying it was often "beyond" poorer countries' tax administration capacities to implement such measures.³⁷⁷ In reaction to UN effort to take over international tax cooperation, the EU and its Member States released a statement on September 22, 2023 on tax cooperation at the United Nations, stating they "could consider... working at the UN on a non-binding multilateral agenda for coordinated actions."³⁷⁸

Some scholars have held the view that although the OECD is mandated, funded, and has its agenda set by the G20, a selective political grouping of some countries, these factors do not mean that the UN is necessarily a good or better representative of developing countries. However, given the inclusion of developing countries in the UN, many believe that its views can better convey the views of all countries.³⁷⁹ While there is a need for equity to ensure views from all countries have been properly considered in tax reform proposals currently in place, there is also a need to agree on a model in the cooperation process as the never-ending negotiations are likely to diminish countries' enthusiasm. The OECD as a body has invested so much in research and development and should not just be put aside in pursuit of new rounds of negotiation. As it stands, the UN negotiation process may not be as expedited as the OECD negotiations. For instance, any negotiation agreement reached by the committee on international tax cooperation of the UN, which meets twice a year,³⁸⁰ must be sanctioned by the UN General Assembly, which meets only once a year.³⁸¹ This time frame of UN committee meetings makes it difficult for a quick resolution and will likely lead to an unending round of negotiation for the next few years. Consequently, it is more desirable to have a resolution mandating the OECD to incorporate some of the UN proposals as discussed earlier.

³⁷⁷ <https://www.ft.com/content/e05b0767-cab5-44de-9fbf-af5ce841a026>

³⁷⁸ Position on behalf of the European Union and its Member States on tax cooperation at the United Nations accessed from <https://data.consilium.europa.eu/doc/document/ST-12967-2023-INIT/en/pdf>

³⁷⁹ Tatiana Falcao. "A UN Tax Body made for you and Me" (2023). Tax Notes International, August 7, 2023, p. 723, online: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4641539

³⁸⁰ <https://www.un.org/esa/ffd/tax-committee/about-committee-tax-experts.html#:~:text=At%20the%20Third%20International%20Conference,Assembly%20resolution%2069%2F313>

³⁸¹ <https://www.un.org/en/model-united-nations/general-assembly#:~:text=All%20UN%20Member%20States%20are,are%20decided%20by%20simple%20majority>.

5.6 Recommendations

I. The need to improve tax administration

The administrative difficulties associated with taxing digital MNEs are often not addressed by the numerous international proposals that exist to solve the legal issues. The SEP and DST approaches, for instance, would require registration and filing of returns by MNEs. As discussed in earlier chapters, some African countries, previously gave notices to MNEs to register for taxes such as VAT, but such notices were disregarded. In designing these proposals, administrative safeguards to guarantee adherence to any imposed digital tax should be considered.

While developing reform ideas, it is important to consider the resource-constrained conditions faced by many of Africa's revenue administration organizations. The revenue authorities and other pertinent government agencies would probably need to establish new infrastructure and engage in capacity building to effectively implement the tax measures aimed at the digital economy. Such administrative reforms at the state level would include high costs for personnel skill development, administrative system maintenance, and MNE monitoring. For tax administrations with limited resources and staff members with limited experience to apply the new laws with ease, they must be simple in their implementation.

In addition to the recent UN resolution providing an opportunity for new insights about the structure of multilateral cooperation, the resolution submitted includes arrangements on tax administration for the digital economy for African countries which OECD failed to include in its proposals. Resolution 6(B) provides that "...sufficient flexibility and resilience in the international tax system to continuously ensure equitable results as technology and business models and the international tax cooperation landscape evolve."

II. A more inclusive OECD agenda

It would be preferable to have an umbrella approach that permits the meaningful participation of African nations in the formulation of the international tax laws that affect them. An umbrella approach will guarantee that the global tax governance framework

intentionally addresses matters that are particular and significant to African nations. Treating countries on the continent as an equal partner to the developed countries will encourage African nations to negotiate a global fiscal relationship that ensures inequalities are in check. This will guarantee that the global tax governance framework intentionally addresses matters that are particular and significant to African nations.

As noted earlier, the OECD is accountable only to its members, who are mostly developed countries. Despite the fact that the OECD tends to be viewed as an organization that primarily looks out for the interests of the Global North, it appears it has displaced the UN in a central role in global tax policymaking³⁸². And the expansion of the BEPS project from its narrow membership to an IF that comprises over 135 countries (including African countries), the BEPS project continues to attract skepticism and criticism about its inclusivity. African nations run the risk of experiencing trade deal withdrawals when they deviate from the route established by the powerful nations.³⁸³ Further, the UN resolution on global tax cooperation recognizes the respect for tax sovereignty which is that international tax cooperation allows all countries to effectively participate in developing the rules, by right and without preconditions. Ultimately, what will authenticate the claims of true inclusivity is the extent to which the IF is prepared to go in addressing African challenges. While the negotiations are ongoing, it is the responsibility of African nations to form coalitions with willing parties to achieve the shared objective of creating international tax cooperation in which all opinions are valued.

III. ATAF and the AU should push for Africanized reforms.

Presently, it appears the OECD global reforms in the international tax world will be further delayed and may even be jettisoned because of the new rounds of negotiation that will be coordinated by the UN. Given the commonalities between African countries and ongoing

³⁸² A resolution proposed by African countries was passed on November 23, 2023, for the UN to start the coordination of Government negotiations on international tax cooperation. The passing of this resolution is regarded as the most significant development in international taxation in recent years because it may shift the responsibility of global tax policy to the UN in the coming years.

³⁸³ Pedro Goncalves. "EU to Roll out Sanctions against Blacklisted Jurisdictions, International Investment" (Sept. 17, 2019), online: <https://www.internationalinvestment.net/news/4008313/eu-roll-sanctions-blacklisted-jurisdictions#:~:text=The%20EU%20has%20approved%20a.by%20the%20end%20of%202020>

discussion about the OECD proposals, this could be the best time to input into and influence the global tax agenda to ensure changes to the global tax rules are fit for purpose in Africa. Conventionally, all African countries are involved in the AU, and it would be better if an organ of the AU is dedicated to global tax reform for African countries. Perhaps this could be designated to the ATAF, but all AU members should be allowed to vote upon this. With that, ATAF would have a cloak of legitimacy and every African country could see ATAF as advocating for them in the global tax field. And there should be a push for a global or continental consensus towards a legal requirement for all companies with a digital presence to provide a database showing the source of its revenue generation.

5.7 Conclusion

In this chapter, the argument is made for African nations' right to impose taxes on MNEs' income in the digital economy. The current OECD work and the rise of digitalization are more recent than this normative entitlement to tax as a market state. Nonetheless, the current Pillar One and Two agreement recognizes that circumstances are changing, namely, our growing comprehension of what adds value to firms and our ability to properly enforce tax laws. The OECD Agreement is a compromise that restricts nations' taxing powers to achieve efficiency goals, that is, more effectively taxing MNEs without undermining or discouraging their participation in international trade. The limitations that have been suggested mirror well-known issues: the capacity of wealthy nations to enforce norms that, when mediated by the OECD, might not be effective considering a more "inclusive" perspective for global affairs. In lower-income nations, this issue has contributed to a portion of the revenue deficits and, consequently, the development deficits.

High-income countries need to do better to address these concerns. They cannot claim to be interested in advancing international tax cooperation while at the same time exercising their tax sovereignty by introducing DSTs and adopting a unilateral approach.

It is true that there is no effective global tax framework to prevent countries from reclaiming their tax sovereignty through unilateral measures. Although the multilateral approach is important, the agreement has to be domesticated by countries in their local laws to take effect. As such, it is still within the power of countries to make the unilateral decision to comply with the global tax system.

This highlights once again the authority that states have at the discretion to exercise their fiscal sovereignty.

Beyond deliberating on the challenges being faced by the OECD, embracing the multilateral approach seems more viable as it allows for a more coordinated international tax system, an easy international trade system, and an automated exchange of tax information. The proliferation of unilateral methods may lead to distortion within the international tax system.

African nations must guarantee that the tax policies they implement do not impede the advancement of the digital economy. For many MSMEs, the digital MNEs platforms offer low-cost tools that make doing business easier i.e., social media platforms offer MSMEs a broad reach for a relatively low advertisement cost, something that was previously only available to major companies with the financial means to purchase costly broadcast advertising space. With improved market access for suppliers, rivals, and customers, as well as reduced trade costs, MSMEs in developing nations can effectively compete in both local and international trade by utilizing digital platforms. Although there is no conclusive evidence on the effect of this taxation on trade, in a recent study within the EU, investors perceive the introduction of digital tax as a threat to digital firms' future profitability and it negatively affects their investment perspective.³⁸⁴

The main goal of the worldwide discussion on digital economy taxes is to provide a just and equal framework for all businesses, including local MSMEs. In a reality where local MSMEs are needed to fulfill their tax responsibilities and MNEs bypass this obligation, it creates an uneven balance and portrays MNEs as having an unfair advantage over domestic companies. Therefore, a fair strategy that targets digital MNEs without impeding the expansion of local firms is required.

5.8 Where to go from here?

The thesis has examined the limitations of the current tax system regarding the digital economy. The digital economy is rooted in value creation models adopted by many companies that are challenging the traditional framework for distributing taxable income between source and resident

³⁸⁴ Daniel Klein, Christopher A. Ludwig, and Christoph Spengel, *Supra @* note 201

states. In essence, these models increasingly obscure the identification of where value is created in an activity, thereby complicating the allocation of taxing rights among relevant states. MNEs like Facebook and Google serve as prominent examples of such challenges – hence becoming symbolic of practices, and even abuses, that may not entirely be their own.

The predominant impact of this global tax system is the unjust distribution of tax revenue that it fosters. It falls short of attaining equity between nations and taxpayers alike. Most significantly, the current global tax system exacerbates the depletion of limited revenue crucial for African countries to achieve the Sustainable Development Goals (SDGs).

Two core proposals have been advanced to address the shortcomings of the global tax system, referred to as OECD BEPS initiative and UN Tax Committee project. The OECD and UN proposals, discussed in chapter three provide a promising foundation for tackling tax issues in the digital economy. But the effectiveness of these proposals will depend on how well they are tailored to each country's situation and how committed governments are to putting them into action. One of my core points advanced in this thesis is that countries can and should benefit in form of taxes from sales and transaction within their jurisdiction so they can raise the necessary revenue for development.

As it seems, the OECD is not making so much progress in the implementation of the Pillar One or two proposals. Consequently, many countries including African countries have gone ahead to introduce several unilateral means to tax and have the digital economy in its tax net. Chapter four examined how some African countries have expanded the scope of VAT and introduced various type of taxes to capture e-commerce taxation in the gap created by the slow pace of the OECD's implementation of Pillar One or two. In doing this, the current efforts towards international tax cooperation either by the UN or OECD is being watered down because in the absence of a multilateral resolution, the proliferation of DSTs, leading to ambiguity and the risk of double taxation.

At the core of my argument is that the OECD proposal is more superior in details than the UN proposal because the OECD proposal exhibits greater sophistication and ambition, whereas the

UN recommendation is characterized by its simplicity, practicality, and ease of administration. However, the UN proposal falls short of addressing the entirety of the issue. For instance, the UN proposal does not delve into the differentiation between residual income and routine income, a complexity which was addressed in the OECD proposal. Also, the UN proposal does not extend to all consumer-oriented digital businesses but rather applies to a specific category of businesses. While the response of African countries to the OECD/UN proposals will vary depending on several factors, including their level of development, economic priorities, and capacity to implement international tax standards, African countries seem to have favoured the UN for further negotiations describing the OECD negotiation process as not inclusive. This response does not necessarily mean the OECD proposal is not beneficial to African countries, but they want to participate and not be marginalised in the process of forming OECD the proposal.

This thesis does not purport to offer all-encompassing solutions or present a fail-safe remedy to income allocation issues in the digital economy. Rather, the goal of this dissertation is to contribute fresh insights and perspectives to the ongoing dialogue surrounding global tax system reform. It seeks to amplify a voice often marginalized in global discussions—the African perspective.

Ultimately, any departure from the current global tax system will encounter challenges in both acceptance and implementation at least for the first few years. What matters most is that countries advocate for alternatives that align with their economic conditions and developmental stages. The discourse surrounding the future global tax system must be comprehensive and inclusive. African nations must actively participate in global discussions and engage domestically on the continent.

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