Departing from the OECD's Conversation: Post-Pandemic Tax Policy Options for African Countries

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The pandemic has changed the landscape

The effect of the COVID-19 pandemic, which necessitated the global economic lockdowns is negatively affecting the operations of major businesses. From the World Bank projections, "businesses could struggle to service debts, increased risk aversion could lead to climbing borrowing costs, and bankruptcies and defaults" could result in a financial crisis. In the tax world, this is significant because businesses react to tax policy. Tax policy, in turn, stimulates the interest of both local and international investors who are the key drivers of economic growth. Therefore, the challenges of the economic downturn will be more glaring and significant for African countries, who have a greater reliance on tax revenue from large taxpayers than more advanced economies. Clearly, it is very challenging for African governments to use tax measures to counter the economic consequences of the pandemic, and even more challenging to use tax measures to shield the poor. This makes it imperative for tax administrations in Africa to rethink ways in which they can fuel their various economies, as lower tax receipts will present fiscal and budgetary challenges.

Pre-pandemic global tax conversations

Before now, the Organization for Economic Cooperation and Development ("OECD") had been having conversations around the best ways to allocate taxing rights between (cross-border) jurisdictions especially considering the growth of digital trade. The OECD, through its Inclusive Framework, hopes to produce solutions that mirror the right balance between accuracy and administrability, as well as ensure a level playing field, underpinned by sound economic principles between trading partners. Prior to the pandemic, they had made remarkable progress in the efforts to reach a global consensus on this issue. However, there are now new concerns about how the health crisis impacts the global discourse. For instance, the pandemic could pose a setback to the adoption and implementation of the proposals by the Inclusive Framework due to the fact that fiscal planning in many countries has been disrupted, as well as disruption to the efforts by the OECD to coordinate the response(s) and obtain the buy-in of different countries. With these, it is clear that progress in this regard could be severely inhibited.

African tax considerations It is fairly accepted that the pandemic will bring economies across borders into a time of negative growth. Thus, more than ever, there is a strong bid by African governments to drive up revenue to cushion the effects of the predicted global recession. For some time, African countries have engaged in discussions that focus on how the global tax regime should take cognizance of their peculiar needs in reaching a consensus on the treatment of international income. As participants in international trade, this is an issue of concern for African governments and businesses, because, with digital trade (for instance), it is difficult for many African countries to establish nexus, and even where they do establish nexus, they face capacity and legal constraints in ensuring that they are allocated an appropriate amount of the relevant profits.

In light of these, questions remain as to what approaches African countries need to adopt in view of the aforementioned global discussions and the pandemic-imposed new normal. Do African countries aggressively pursue a regional or global convergence on tax rules as a post-pandemic recovery plan, should they be keen to tighten tax measures to meet their fiscal needs, or could they allow for a more incentivizing tax regime in a bid to stimulate growth in their economies?

Tax policy options for African countries

It is suggested that African countries now need to look inwards – it is time for greater thinking and creativity. There needs to be a discussion within Africa on how it can reposition itself to further build on specific rules and policies which puts it in a better situation. The question then is, what tax options and policies do African countries need to explore in fulfilment of their social contract to their citizens?

a. Incentives: to give or not to give?

As of now, African governments can look at broader tax policies to cushion the impact of the pandemic on their economies. The focus should be on carefully designed tax incentives which aim to stimulate investment within their borders. These incentives are usually in the form of special tax provisions. Generally, they take numerous forms: tax holidays, preferential tax rates or targeted allowances. Tax holidays usually provide targeted exemptions (partial/complete) from tax for a limited duration and could be industry-specific, corporate structure-specific, or for activities taking place in special economic zones. The target of post-pandemic tax holidays by African governments should be given to job-creating SMEs, companies engaged in export-related manufacturing, companies operating in the health sector, private-sector engaged in essential services, and businesses who provide support to governments and health centers in the fight against the pandemic. Beyond short term tax holidays, African countries should, in the long-term, also apply lower income tax rates to companies in the sectors above to stimulate investment, recovery, and job creation.

In this regard, targeted allowances and incentives for certain investment expenditure are encouraged but must be used circumspectly. For effectiveness and efficiency, tax incentives should be targeted at mobile capital and other industries that will inevitably lead to a massive reduction of imports and increase in exports because the productive capacity of the national economy will have been developed in the process and multiple jobs created. In addition, governments can generate more income as a result of improved economic activities.

The International Monetary Fund (IMF) has recommended that for African countries to effectively benefit from the use of tax incentives. They need to apply "cost-based allowance (such as tax credits) more aggressively than profit-based incentives, such as tax holidays and income exemptions because of the former yields more investment". But where profit-based incentives are utilized, it is suggested that in the post-pandemic era, these should be limited to SMEs, the health and essential services sector, and export-oriented manufacturing companies. According to a World Bank report, applying tax incentives towards highly productive sectors of African economies, as seen in South Africa, would increase economic growth, provide additional jobs, and assist in alleviating poverty.

It is noteworthy that beyond tax concessions, African governments will need to provide development/growth funds for SMEs – this could be in the form of concessionary facilities at a single-digit interest rate aimed at sustainable businesses. Furthermore, there needs to be in place conditions that facilitate a positive impact of these tax concessions on the economy. Some of which are: good infrastructure, macroeconomic stability, and the rule of law.

Apart from tax incentives, to stimulate growth, African countries should also focus on strengthening their tax systems in a way that it is free from avoidance and possible evasion. They can achieve this by the increased imposition of withholding taxes on every income derived within their jurisdiction. Withholding taxes need to be applied in their cross-border trade dealings by carefully analyzing particular facts and circumstances of each transaction. This will be an effective policy tool by African governments that will result in revenue generation.

b. Tax administration and governance reforms

Another key factor that will ensure the success of post-pandemic tax policies will be a consideration of important governance reforms aimed at improving transparency, accountability and a proper tax administration that keeps the general public well-informed. This can be achieved through tax expenditure reporting being published frequently, along with monitoring and evaluation reports on the effectiveness of these actions. In addition, African governments should utilize intergovernmental forums and peer-review systems to reduce the incidences of corruption, double taxation, and eliminate administrative bottlenecks that short-circuit the running of an efficient and transparent tax regime.

c. Tax and incentive administration

Furthermore, to ensure the proper administration of tax incentives in Africa, they should be granted based on rules rather than individual discretion. The tax concessions should go through legislative procedure and scrutiny to become regulations if there will be any significant success. The approval processes for tax incentives should be consolidated under a single tax administration authority to provide for consistency in its administration. There also needs to be a regular review of these incentives to re-assess their cost-implication and effectiveness - with special provisions of the law in place to limit them to a specific number of years.

These policy options are important because pre-pandemic, most African countries such as Nigeria and Angola had their economy and public finances dealt a heavy blow by the fall in oil prices and depleted foreign exchange reserves. With the decline in oil revenue, there had been a heavy reliance on taxation as a source of government revenue. Most African countries (like Nigeria) need to rethink aspects of their tax regime to improve their appeal to foreign investors and skilled expatriates. This is so they can meet up with their fiscal responsibility and development aspirations in the post-pandemic era.

In conclusion, there are different tax options for African countries in view of COVID-19. Right now, it is pertinent to capitalize on the beneficial aspects of incorporating carefully designed tax incentives to boost African economies and imposing withholding taxes. Individual African countries need to figure out the best approach to develop a robust tax regime that aids revenue generation within their economic landscape without hampering growth. Broader tax policy measures seem to be the way to go to cushion the impact of the pandemic within African countries. The continent needs to adopt these measures to alleviate the heavy financial, economic and social costs of the pandemic for their individual economies to recover post-pandemic. Undisputedly, Africa needs urgent policies to address the health crisis and its aftermath because it seems that a global convergence may not be an attainable objective due to the recession, impending financial crisis and uncertainty occasioned by the global economic shutdowns.

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