Action plan to stem tax avoidance is a good start

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The brunt of tax avoidance by big corporations falls heavily on poor countries, with long-term effects on growth and social stability. African countries are the poorer for it. The recent Organisation for Economic Co-operation and Development (OECD) action plan on base erosion and profit shifting, adopted by Group of 20 (G-20) finance ministers in Peru a week ago, has been hailed as groundbreaking. The measures it proposes create an important basis for evolution of new norms on international tax treaties and to curb aggressive tax planning by companies.

One area the OECD has highlighted is that of transfer pricing, a practice in which divisions of a company set terms at which they sell intangible goods, products and services to one another. When this practice is used for tax avoidance, intracompany transactions are structured to minimise tax exposure by boosting profits of the divisions that are located in low-tax jurisdictions, while lowering the profits of those divisions based in high-tax jurisdictions.

Other ways companies avoid tax include claiming interest deductions for payments made to their own subsidiaries. High-profile cases involving western companies such as Google, Starbucks and Apple have led to intensified calls for overhauling international tax treaties to bring an end to these practices.

Just as G-20 finance ministers were about to agree on the OECD action plan, MTN, which has a strong African presence, was implicated in a profit-shifting scam in a report compiled by Amabhungane and Finance Uncovered. The report suggested that MTN moved billions of rand earned in African countries to offshore tax havens, when Deputy President Cyril Ramaphosa was its chairman from 2001 to 2013.

A report of an African Union high-level panel chaired by former president Thabo Mbeki has pointed out that African countries lose $50bn every year in illicit financial flows, largely as a result of tax avoidance. The report cites trade mispricing, misinvoicing of services and intangibles, transfer pricing and other profit-shifting mechanisms as being responsible. It warns of grave implications for governance in Africa.

The OECD estimates that the cost of forgone revenue globally as a result of tax avoidance is about $240bn a year. Profit shifting drains the fiscus and erodes the economic sovereignty of states. It undermines the principle of fairness, as the burden for paying tax falls on individuals. Tax avoidance not only cripples public investment in infrastructure — which is crucial for stimulating growth and creating jobs — but it is also an assault on the provision of public services such as education and health.

It will take time for the OECD measures to be diffused across the globe. They will have most effect when they are adopted on a multilateral basis, especially because of uneven tax regulations internationally. There will therefore need to be strong global co-ordination. Not all countries have the same ability to undertake regulatory reforms.

SA has solid institutional capacity on tax issues. For example, since 2012, SA has put in place transfer-pricing legislation, with a transfer-pricing unit located at the South African Revenue Service to undertake risk assessment on

companies. This does not mean SA is not affected.

Significant resources should be dedicated to building institutional capacity in African countries to modernise their revenue authorities, to improve legislative capabilities on tax issues, and to enable their full participation in international standard-setting bodies. Development assistance in future should factor in this vitally important aspect of institution-building. There is also a need to enhance co-operation between international intergovernmental bodies and business groups to improve the global tax architecture and strengthen dispute-resolution mechanisms.

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