Tackling Illicit Financial Flows in Africa Arising from Taxation and Illegal Commercial Practices

This study has been drafted by Dr. Dan Ngabirano, Founder and Managing Partner of Development Law Group – Africa, and staff members of the UN Office of the Special Adviser on Africa (OSAA).

It has been produced within OSAA’s mandate to support analytical work in improving the coherence and coordination of the UN System support to Africa and to facilitate intergovernmental deliberations on Africa.

For more information, please visit www.un.org/osaa or contact osaa@un.org.

Designed by: SeproTec

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<tr>
<td>ACHPR</td>
<td>African Commission on Human and Peoples’ Rights</td>
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<td>AFCFTA</td>
<td>African Continental Free Trade Area</td>
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<td>AEOI</td>
<td>Automatic Exchange of Information on Financial Accounts</td>
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<td>AMDC</td>
<td>Africa Minerals Development Centre</td>
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<td>ATAF</td>
<td>African Tax Administration Forum</td>
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<td>AU</td>
<td>African Union</td>
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<td>BEPS</td>
<td>Base Erosion and Profit Shifting</td>
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<td>CNOOC</td>
<td>China National Offshore Oil Company</td>
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<td>DRC</td>
<td>Democratic Republic of Congo</td>
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<td>DTAs</td>
<td>Double Taxation Agreements</td>
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<td>ECA</td>
<td>Economic Commission for Africa</td>
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<td>EITI</td>
<td>Extractive Industries Transparency Initiative</td>
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<td>EOIR</td>
<td>Exchange of Information on Request</td>
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<td>FACTI</td>
<td>Financial Accountability, Transparency and Integrity</td>
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<td>FATF</td>
<td>Financial Action Task Force</td>
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<td>FD1</td>
<td>Foreign Direct Investment</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>HNWIs</td>
<td>High Net Worth Individuals</td>
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<td>HLP</td>
<td>High Level Panel</td>
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<td>HOGL</td>
<td>Heritage Oil and Gas</td>
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<td>IFFs</td>
<td>Illicit Financial Flows</td>
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<td>GFI</td>
<td>Global Financial Integrity</td>
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<td>MLI</td>
<td>Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting</td>
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<td>MNEs</td>
<td>Multinational Enterprises</td>
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<td>ODA</td>
<td>Official Development Assistance</td>
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<td>OECD</td>
<td>Organization for Economic Cooperation and Development</td>
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<td>OSAA</td>
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<td>PSA</td>
<td>Production Sharing Agreement</td>
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<td>SDGs</td>
<td>Sustainable Development Goals</td>
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<td>SME</td>
<td>Small and Medium Enterprises</td>
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<td>TJNA</td>
<td>Tax Justice Network Africa</td>
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<td>UN</td>
<td>United Nations</td>
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<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>UNDP</td>
<td>United Nations Development Program</td>
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<td>UNGA</td>
<td>United Nations General Assembly</td>
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<td>USD</td>
<td>United States Dollars</td>
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<td>WCO</td>
<td>World Customs Organization</td>
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<td>WGEI</td>
<td>Working Group on the Extractive Industries</td>
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Illicit Financial Flows (IFFs) are of increasing concern to governments, policy makers, civil society, regional and international bodies. However, there is presently no universally agreed definition for the term “illicit financial flows”. Current definitions of IFFs are not only diverse but are for the most part informed by the context. According to the African Union High Level on Illicit Financial Flows from Africa (HLP), which was established by the Economic Commission for Africa (ECA) in February 2012, IFFs constitute of “money that is illegally earned, transferred, or utilized.” The HLP concluded that Africa loses an estimated $50 billion annually in IFFs. More recent studies however show that Africa loses much more than this. The United Nations Conference on Trade and Development (UNCTAD) has for instance put the incidence of IFFs in Africa at $86.6 billion per year. This estimate is based on their definition and understanding of IFFs as “cross-border exchanges of value, monetary or otherwise, which are illegally earned, transferred, or used.”

In the various forms in which they are perpetrated, IFFs in particular deny developing countries the opportunity to generate the revenues required for them to meet their recurrent expenditure needs and to fund long term development plans. IFFs can drain foreign exchange reserves, affect asset prices, distort competition, undermining the capacity of countries to maintain economic and financial stability. Consequently, these countries become constrained in meeting commitments made under various regional and international frameworks, including the 2030 Agenda for Sustainable Development and Agenda 2063.

IFFs fundamentally limit the ability of developing countries to provide basic goods and services to their citizens. This has great implications for the enjoyment of fundamental rights and freedoms such as the right to health and education. If not addressed, IFFs may also be a cause of public dissatisfaction, social unrest, and conflict. Moreover, revenue deficits caused by IFFs are partly responsible for the increased tendency among countries - especially those in Africa - to resort to borrowing on often onerous and predatory terms as a coping mechanism. This situation has been aggravated by the outbreak of the global COVID-19 pandemic.

For all these reasons, there is a growing global movement towards the elimination of IFFs in the various forms in which they occur. In 2011, the Economic Commission for Africa (ECA) appointed a High-Level Panel (HLP) to study the incidences of IFFs out of Africa, offer guidance, and formulate policy recommendations for the African Union member states. Following the
commendable work of the HLP, numerous efforts have been made to stem the use of IFFs at the national, regional, and international levels.

In line with its mandate to facilitate discussions and promote cooperation on critical issues regarding Africa, and as a complement to existing knowledge and initiatives aimed at the elimination of IFFs in Africa, the UN Office of the Special Advisor on Africa (OSAA) commissioned three studies in 2021 on the impact of IFFs on Africa. The studies were in relation to IFFs in the context of a) taxation and illegal commercial practices; b) corruption and money laundering; and c) terrorism and conflict. Collectively, the studies are expected to amplify African voices raised against IFFs and to contribute to efforts towards a holistic approach in tackling IFFs and more importantly one that is aligned to African priorities and the nexus peace and development approach.

This report is focused on IFFs linked to aggressive tax planning and other illegal commercial practices in the context of Africa. The rest of the report is organized as follows: Section 2 provides a broad overview of IFFs in Africa; Section 3 looks at different forms of IFFs that arise from tax and illegal commercial practices; Section 4 explores the current initiatives for combating tax and commercial related IFFs in Africa; Section 5 provides the conclusion and policy recommendations towards combating tax and commercial IFFs in Africa.
2.0 Overview of IFFs in Africa

2.1 Background

The United Nations General Assembly (UNGA) has on various occasions identified IFFs as a global problem that requires international cooperation. In its resolution A/RES/71/213 of December 21st, 2016, the Assembly called for the “promotion of international cooperation to combat illicit financial flows in order to foster sustainable development”. The Assembly has also recommended that UN member countries “develop effective tools and create a policy environment for combating illicit financial flows, in accordance with the existing relevant international frameworks, including the United Nations Convention against Corruption.” More recently in December 2020, the UNGA called for “countries to work together to eliminate base erosion and profit shifting and to ensure that all companies, including multinationals, pay taxes to the Governments of countries where economic activity occurs and value is created, in accordance with national and international laws and policies.”

It is worth noting that before the UNGA Resolutions, African countries under the auspices of the African Union had already led the way in the endeavor to collectively combat the phenomenon of IFFs by establishing a High-Level Panel on Illicit Financial Flows from Africa. The establishment of the HLP arose out of a recommendation of the Joint ECA-AU Conference of African Ministers of Finance, Planning and Economic Development in 2011. The report of the findings of the HLP was formally adopted in 2015. One of its major findings is that Africa loses over $50 billion in IFFs annually with devastating economic, social, and political consequences for its countries. In light of this, the Panel offered numerous policy recommendations for African countries to adopt.

However, more than six years since these recommendations were made, IFFs remain a critical challenge for many African countries. A more recent study conducted by UNCTAD has put the magnitude of IFFs in Africa at an average of $88.6 billion per year. This represents about 3.7% of the continent’s total Gross Domestic Product (GDP). The size of IFFs also far outstrips the...
amount of Official Development Assistance (ODA) and Foreign Direct Investment (FDI) to Africa per year which stands at $48 billion and $54 billion respectively.\textsuperscript{12} Figure 1 provides the estimated capital flight as a share of GDP as well as revenue loss from tax avoidance in different subregions, according to UNCTAD estimates, for the period over 2013-2015.

Another recent study conducted by the Brookings Institute found that in a period of 38 years from 1980 to 2018, Africa lost close to $1.3 trillion in IFFs.\textsuperscript{13} Even then, it is critical to note that given the hidden nature of IFFs, these are only conservative estimates.\textsuperscript{14} It is highly probable that Africa loses far more revenue than this to IFFs annually. There is significant variation at the subregional level, with Western and Southern Africa reporting the highest levels of IFFs. Figure 2 below highlights the extent of capital flight from different subregions of Africa based on data from PERI.

The size of IFFs in Africa has severe implications on the region’s financing for development as IFFs take away critical resources of key development needs. UNCTAD estimates that SDG-related financing gap is greatest in Middle Africa.

\textsuperscript{12} Ibid, pg.25
($289 per capita) and Western Africa ($274 per capita). Meanwhile, capital flight is estimated to be around the level of $78 per capita around all African countries, and curbing IFFs can reduce the region’s financing gap by 33%. In Southern Africa and Western Africa, where estimated capital flight per capita is the greatest ($159 and $107 per capita respectively), curbing capital flight could reduce their financing gap by as much as 75% and 40%.

The appointment of the HLP represents a very important step in this direction at the African regional level. Most importantly, the findings of the HLP have inspired more action from
individual African countries and from the AU. In 2013, African countries adopted Agenda 2063 - a master plan for the continent’s transformation into a global powerhouse. As part of the implementation of the plan, countries are enjoined to eliminate illicit capital outflows. Still in 2013, the African Commission on Human and Peoples Rights (ACHPR) – another body within the AU passed a Resolution complementing the work of the High-Level Panel and called upon state parties to take steps to prevent illicit capital flight from the continent.

The steps taken at the regional level are part of current efforts to combat IFFs at the global level. These include the Addis Ababa Action Agenda of 2015 which enjoins nations to work together to “redouble efforts to substantially reduce illicit financial flows by 2030, with a view to eventually eliminate them, including by combating tax evasion and corruption through strengthened national regulation and increased international cooperation.” African continental initiatives to combat IFFs are also in line with global commitments made by states under the UN SDGs – i.e., to take steps to reduce illicit financial flows by 2030.

In March 2020, the United Nations High-Level Panel on International Financial Accountability, Transparency, and Integrity for Achieving the 2030 Agenda (FACTI Panel) was convened by the Presidents of the UNGA and the Economic and Social Council (ECOSOC). In the report, which was released in February 2021, the FACTI Panel was unanimous in its recommendation for countries to act to promote financial accountability, transparency, and integrity for achieving the 2030 Agenda. This is to be achieved through reform, redesign, and revitalization of the global finance architecture to encourage financial integrity and sustainable development.

2.2 Sources of IFFs in Africa

The 2015 High-Level Panel Report found that in Africa, commercial practices constitute the largest source and are responsible for 65% of all IFFs in Africa. This is followed by crime, which accounts for 30% of IFFs, while the remaining 5% emanates from corruption. However, as stated above, IFFs by their nature are difficult to measure. The difficulty in measurement should nonetheless not be a reason for countries not to tackle them. Secondly, some activities giving rise to IFFs overlap with the three categories of sources.

Commercial activities giving rise to IFFs in the case of Africa mainly take the form of aggressive tax avoidance which occurs in the form of abusive transfer pricing, thin capitalization, exaggerated payments for use of intangible assets and inflated management fees. These practices are broadly categorized as Base Erosion and Profit Shifting (BEPS) strategies i.e., “tax planning strategies that exploit gaps and mismatches in tax rules to make profits ‘disappear’ for tax purposes or to shift profits to locations where there is little or no real activity, but the taxes are low, 

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17 Resolution on Illicit Capital Flight from Africa - ACHPR/Res.236(LIII)/2013
19 Goal 16, SDGs Target 16.4 Peace, Justice and Strong Institutions, UN Sustainable Development Goals, 2030.
21 Ibid.
resulting in little or no overall corporate tax being paid."  

The other form of commercial practice through which IFFs in Africa are perpetrated is trade misinvoicing/mispricing. This involves the falsification of prices, quality and quantity of traded goods and services. Treaty abuse or treaty shopping can also be used for tax avoidance practices. Lastly, inequitable resource contracts form another channel for IFFs.

Criminal activities that give rise to IFFs in Africa take the form of human and drug trafficking, smuggling, financial sector fraud, money laundering, stock market manipulation, and forgery. The HLP has observed that “the main purpose of such criminal activity might not be to generate IFFs, but criminality contributes substantially to such outflows because of the desire to hide the proceeds.”

Corruption-related IFFs mainly involve bribing of public officials in exchange for favorable terms and treatment. In this case, the IFF constitutes the amounts of the bribe paid to the public official as well as savings made by the person (natural or legal) giving the bribe. In all these cases, critical revenues are diverted for the benefit of individuals and multinationals involved. The table below indicates the sources of IFFs in Africa.

### 2.3 Factors driving IFFs in Africa

IFFs have diverse drivers and/or enablers. Globally, IFFs are mainly driven by the activities of powerful profit-driven multinational enterprises (MNEs). In the context of Africa, MNEs have taken advantage of their power and influence to perpetrate IFFs for their benefit and to the detriment of African governments. They

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25 Ibid, pg. 32.
26 Ibid.
manipulate current governance gaps, weak and often inadequate financial sector regulation, general institutional incapacity, and in some cases the lack of control of global commodity exports in the natural resource sector by governments in Africa.\footnote{Nikuman Leonce, Capital flight and tax havens: Impact on investment and growth in Africa. Revue d’économie du Développement, 22(2), 2014 pgs.113–141}

Other drivers of IFFs include information asymmetries which make it difficult for governments to detect tax schemes and other commercial practices specifically designed to place the income and profits of multinational enterprises out of reach of governments. Information asymmetries are very common in the extractive industries, and this is the reason why IFFs emanating from that sector are currently among the highest.


In particular, the liberalization of African economies gave MNEs an enhanced stake in business while substantially reducing the role of the state. The predominant role played by MNEs in African economies has turned them into one of the major drivers of IFFs.

More recently, the increased risk of IFFs for many African countries is attributable to the explosion of the digital revolution. The ability of multinational businesses to trade virtually across borders makes it very difficult for African governments to detect their activities and to trace their income. It is also very easy for these companies to evade payment of taxes on income sourced from Africa since they have no physical presence. More critically, there is no existing international framework for the regulation of the digital economy. This is a major gap that has been exploited by multinational enterprises active in the digital economy to perpetrate IFFs.

The difficulty of governments in dealing with the digital economy is aptly captured by the statement of the Vice Chair of the Africa Initiative of the Global Forum, as stated in the 2021 Tax Transparency Report - “Increasingly, as business models evolve to be more digital, non-local and virtual, and physical borders less relevant in the production and movement of goods and services, each of our individual national tax bases are under constant threat of erosion. Our taxing rights are constantly being compromised. The richer countries may appear to be short-term losers, and poorer, developing countries may continue to lose. In truth though, over the long term, we as Revenue Administrators, along with our governments, are all likely to be the biggest losers. It has never been more prudent than now for the adoption of tax transparency and exchange of information standards by all revenue authorities, specifically us as African revenue authorities.”\footnote{Tax Transparency in Africa 2021, Africa Initiative Progress Report, Global Forum on Transparency and Exchange of Information for Tax Purposes, African Union and African Tax Administrative Forum, 2021, pg. 38. Available at https://www.oecd.org/tax/transparency/documents/Tax-Transparency-in-Africa-2021.pdf}

2.4 Actors involved in IFFs in Africa

There are numerous actors (both local and global) involved where IFFs are concerned. They play different roles which may be seen as either competing or complementary depending on whether they are perpetrators or whether they are involved in the prevention of IFFs.

Perpetrators – In the context of tax and commercial IFFs in Africa, the main perpetrators are from the private sector. They include profit-driven large
Multinational Enterprises (MNEs) and High Net Worth Individuals (HNWIs) whose operations are deliberately structured to enable them to avoid and, in some cases, evade the payment of taxes. This is usually achieved through practices that encourage abusive transfer pricing, trade misinvoicing, thin capitalization and erosion of profits sourced from Africa. In this, they are aided by a network of mostly international financial institutions and professional groups of lawyers and accountants to hide their income and avoid the payment of taxes to African governments.

The efforts of African governments are complemented by initiatives from numerous other actors. These include civil society organizations from within and outside Africa. The work of civil society has been critical in building pressure on African governments to take steps to combat IFFs. They have also helped to create public awareness of the devastating effects of IFFs. This is critical given the complexity of the issue and the fact that they are not well understood by the public or by government officials.

**Actors involved in the prevention of IFFs** - African governments who are deprived of critical revenues because of illicit outflows are key actors in the prevention of IFFs. To stem these flows, the governments have in some cases gone ahead to establish institutions specializing in the detection and prevention of the perpetration of IFFs. The specialized institutions include financial intelligence authorities, anti-corruption agencies, supreme audit institutions, drug enforcement agencies, and revenue agencies. Some revenue agencies have a separate Large Taxpayers unit, transfer pricing unit and customs unit. These are usually established to complement the work of the existing traditional institutions such as the police, judiciary, ministries of finance, and the central bank.

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30 Ibid, pg.37
31 Ibid.
33 Ibid, pg. 37
3.0 IFFs Arising from Taxation and Illegal Commercial Practices in Africa

The commercial activities which are the focus of this study are responsible for the bulk of IFFs in Africa, accounting for 65%. The challenge is that, unlike all other sources of IFFs, determining the illegal/illicit nature of commercial activities is the most difficult form. 34 Secondly, by their very nature, commercial activities contribute the most to the payment of taxes, employment, and production of critical goods and services. For these reasons, there is a huge tendency to view them as a necessary evil notwithstanding the negative consequences they can have on economies. There is also a thin and rather blurred line between legitimate tax and commercial practices, and those considered to constitute illicit financial flows.

Nevertheless, in the context of Africa, the HLP has provided guidance on which tax and commercial practices/activities may be categorized as forms of IFFs. They include “abusive transfer pricing, trade mispricing, misinvoicing of services and intangibles and using inequitable contracts, all for purposes of tax evasion, aggressive tax avoidance and illegal export of foreign exchange.” 35 For its part, UNCTAD has defined tax and commerce-related IFFs in Africa to include “tax-avoidance practices, including transfer mispricing, debt shifting, relocation of intellectual property, tax treaty shopping, tax deferral, changes in corporate structure or economic residence, and other profit-shifting schemes.” 36 The other forms of tax and commerce-related IFFs listed include “tax evasion, tariff, duty and revenue offenses, competition offenses, import/export offenses, acts against trade regulations, restrictions or embargoes and investment or stock/shares offenses.” 37 All these activities generate IFFs when they contribute to flows across borders.

Although the cost of IFFs is difficult to quantify, over the past few years, efforts have been made to measure the financial loss from different sources of IFFs. Table 2 summarizes the range of estimates for IFFs related to taxation and commercial activities.

Unlike OECD countries, which are able to receive a more significant amount of payroll taxes, African governments face a multitude of challenges in collecting this form of tax mainly because of the prevalence of a huge and dominant informal sector that is hard to reach. For this reason, they depend heavily on corporate...
Consequently, for most African countries, corporate taxes contribute between 6%-13% of the total tax revenues. This is significantly high when compared to OECD countries where corporate taxes contribute between 2%-3% of the total taxes.\textsuperscript{39}

In 2015 alone, the total corporate taxes collected by African governments was estimated at $67 billion.\textsuperscript{40} In 2014, the taxation of MNEs amounted to 88% of Nigeria’s tax base. Rwanda similarly reported that up to 70% of its tax revenue was raised from the taxation of multinational enterprises.\textsuperscript{41} In Burundi, one multinational enterprise alone is responsible for close to 20% of the country’s tax revenue.\textsuperscript{42} All this shows the significance of corporate taxes for African countries. Given this reality, IFFs through tax avoidance and other commercial activities are extremely harmful for countries, since they have the effect of denying governments critical corporate income taxes.

Sections 3.1-3.4 below explain the different forms of tax and commercial IFFs, ranging from Base Erosion and Profit Shifting strategies, treaty abuse, inequitable contracts, and trade mispricing. Country examples from Africa are provided to illustrate how the illicit activities are carried out and the impacts they have on African economies.

**3.1 Base Erosion and Profit Shifting Strategies**

In the context of taxation, some of the above commercial practices are collectively referred to as Base Erosion and Profit Shifting (BEPS) strategies.\textsuperscript{43} These practices are carried out in particular with the aim of enabling companies and individuals to avoid paying taxes. They include the use of profit shifting strategies that facilitate abusive transfer pricing, inflation of management and other forms of fees, thin capitalization, and the routing of business activities through tax havens and high financial secrecy jurisdictions.

\begin{table}[h]
\centering
\caption{Estimated Costs of Tax and Commercial IFFs in Africa}
\begin{tabular}{|l|c|c|}
\hline
\textbf{IFF Categories} & \textbf{Loss Estimate} & \textbf{Years of Estimation} \\
\hline
Trade misinvoicing & $30-52$ billion & 2008-2015 \\
Transfer pricing manipulation & $4.8-55.4$ billion & 2015 \\
Treaty shopping & $3.4$ billion & 2015 \\
Income tax evasion by high net worth individuals & $9.6$ billion & 2014 \\
\hline
\end{tabular}
\footnotesize{Source: Tackling Illicit Financial Flows for Sustainable Development in Africa, UNCTAD 2020, page 37.}
\end{table}
3.1.1 ABUSIVE TRANSFER PRICING/TRANSFER MISPRICING

Transfer pricing generally refers to the price of transactions between two related entities.\(^{44}\) It usually arises from trade between companies with common ownership or management. In these circumstances, international and domestic tax rules usually require that the transactions are carried out at arm’s length – an international standard for comparison of prices charged between related entities with prices in similar transactions involving unrelated/independent entities. The arm’s length principle thus makes it a requirement for related entities to transact at prices analogous to those between unrelated entities i.e., the prevailing market prices.

There is a tendency among entities comprising of largely MNEs to violate this standard, and to instead trade at prices other than those prevailing in the market. This is done as a strategy of shifting their profits to another country/jurisdiction where there is either no tax or a lower tax rate. This is referred to as abusive transfer pricing/transfer mispricing and is a form of tax avoidance which is a source of IFFs. Tax avoidance has been broadly defined as the “legal practice of seeking to minimize a tax bill by taking advantage of a loophole or exception to tax regulations or adopting an unintended interpretation of the tax code”.\(^{45}\)

Transfer mispricing/abusive transfer pricing takes place when one entity charges another related entity either a higher or lower price than that prevailing in the market.\(^{46}\) Transfer mispricing as a tax avoidance strategy is effected through the payment of inflated management fees, intangibles and unusually high interest loans to subsidiary companies of MNEs, many of which are domiciled in tax havens, i.e. countries with tax regimes that either completely exempt companies from payments of taxes or impose exceptionally low tax rates. These practices are discussed in more detail and with reference to examples from African countries below.

3.1.2 INFLATED MANAGEMENT FEES

BOX 1. SABMILLER REDUCES TAX PAYABLE IN GHANA BY PAYING MANAGEMENT FEES TO SWISS SUBSIDIARY

SABMiller, one of the biggest beer manufacturing multinational companies in Africa, paid an equivalent of £0.93 million to a subsidiary company registered in the Swiss town of Zug for the purpose of reducing its pre-tax income and consequently the CIT payable to the Ghanaian government. Whereas the payment stated that it constituted management fees in respect to the company’s operations in Ghana, it is not very clear whether any management services indeed had been provided by the subsidiary.

The investigations revealed that the Ghanaian operations received most of their support from the company’s South Africa office. Nonetheless, the payment of management fees helped reduce the multinational company’s taxable income occasioning the Ghanaian government an estimated tax loss of £160,000. The company was able to achieve this by shifting a large amount of their income (in form of payment of management fees) to Zug where the corporate tax rate was lower at 7.8% compared to Ghana’s 25%. The study revealed further that in a period of four years spanning 2007-2010, the company had paid corporate taxes only once.

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\(^{44}\) Report of the HLP on Illicit Financial Flows from Africa.

\(^{45}\) Ibid

\(^{46}\) Ibid
In the context of Africa, one common form of transfer pricing is the payment of exorbitant management fees and other forms of fees like paying headquarter fees to subsidiaries. This takes place when multinational enterprises located in and deriving income in an African country charge unusually high management and headquarter fees only for these to be paid to their sister companies registered in tax haven countries where there is either no tax or significantly low tax rates on such income. This practice significantly reduces the corporate income and the tax payable by MNEs resulting in a significant loss of tax revenue for African governments.  

Box 1 below summarizes a study by Action Aid in respect to the activities of one of the biggest beer manufacturing multinational companies in Africa and their impact on revenue generation for African governments.

3.1.3 THIN CAPITALIZATION AND HIGH INTEREST GROUP LOANS

The other common form of profit shifting is thin capitalization which refers to the practice of subsidiary companies substantially funding their operations through the use of loans (as compared to equity) sourced from their parent company or other related entities. In the context of MNEs operating in Africa, thin capitalization results in profits sourced from African countries being used to offset the loan obligations incurred by the parent company. This leaves countries with little or no income to tax, since a significant amount of it is utilized for loan repayments.

Also usually related to thin capitalization is the practice by MNEs of contracting high interest loans from their subsidiaries which are often registered in tax haven countries. Consequently, such interest payments, despite constituting income for the subsidiary, are either untaxed or taxed at very low rates. While the African country where the income is sourced may tax the interest payments, this is usually at a much lower tax rate secured through an inequitable investment treaty. At the same time, interest payments are deducted from the income of the MNE substantially reducing the amount of corporate taxes. This is highly detrimental since as indicated above, African countries are highly dependent on corporate income taxes.

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47 Report of the HLP on Illicit Financial Flows from Africa, at pg.28
49 Ibid.
3.1.4 PAYMENT FOR INTANGIBLES

The payment of fees for intangibles such as intellectual property rights like trademarks, royalties and others is another profit shifting strategy deployed by MNEs. As is the case with management and other forms of fees, MNEs in Africa will pay their subsidiaries (most of which are incorporated in tax havens) unusually high and unjustifiable fees for the use of intangibles. The challenge for many African countries where these MNEs operate and source their income is that in the absence of standard prices they are often unable to determine whether the prices for such intangibles are warranted/justified. MNEs use this gap to abuse the tax system by exaggerating the amount of the fees payable with the result that much less income will be available for taxation by African governments, as shown in the example of SABMiller through royalty payments to their Dutch subsidiary as a strategy to lower taxation in its country of operation (Box 2).

3.1.5 TAX HAVENS, FINANCIAL SECRECY JURISDICTIONS & TAX EVASION

Tax havens are “jurisdictions whose legal regime is exploited by non-residents to avoid or evade taxes.” Secrecy jurisdictions on the other hand are “cities, states or countries whose laws allow banking or financial information to be kept private under all or all but a few circumstances.”

It is a practice for MNEs to register subsidiaries in tax haven countries for the sole purpose of undertaking a strategy of profit shifting. As explained above, MNEs pay exorbitant amounts of fees to their subsidiaries in tax haven countries. This is done in order to benefit from taxation regimes that allow for the payment of either very low taxes or that help avoid payment of any taxes whatsoever. The fees paid are recorded as business expenses in the country of origin (usually a developing country) and are offset from the taxable amount. Moreover, the subsidiary companies to which these payments are made

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51 Ibid.

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BOX 2. UNJUSTIFIED ROYALTY PAYMENTS TO JURISDICTIONS WITH LOW TAX RATES

In addition to tax avoidance through the payment of management fees, the ActionAid study found that in the period 2007 to 2010, SABMiller Accra Brewery in Ghana paid SABMiller International BV in Rotterdam a total of £1.33 million (Gh¢2.69 million) as royalties for the use of the Castle Milk Malt and Stone Larger brands. Whereas both brands were manufactured and consumed in Africa, their names were owned by the Dutch company. This is shown to constitute a deliberate strategy for the MNE to benefit from the extremely low tax rates on royalties in the Netherlands, and to reduce their income before tax to the detriment of the Ghanaian government and its people.

In addition, payment of unjustified fees for intangibles as a strategy for tax avoidance by SABMiller is further shown to reflect a pattern. The company is also reported to have made royalty payments of £110 million (R3.06 billion) to its Dutch subsidiary from its South African operations. From this payment the company made a saving of £5.1 million (R77 million) which would have ordinarily gone to the South African government in tax payment. Similar royalty payments amounting to £11 million were made from the company’s Zambia operations to its Dutch subsidiary.
are in most cases shell/mailbox companies with no substantial business operations, and whose major purpose of incorporation is to facilitate tax avoidance. This often results in substantial loss of revenue for many African countries, as seen in Box 3 below.

Since in most cases, tax havens also double as high financial secrecy jurisdictions, it makes it very difficult for African countries to scrutinize the transactions of MNEs and HNWIs. In this way, high secrecy jurisdictions make it relatively easy for these categories of taxpayers to evade the payment of taxes on income realized through their commercial business activities in Africa.⁵²

Given that corporate taxes constitute the largest source of tax revenue for many African countries, due to large informal sectors that are difficult to tax, the BEPS strategies mentioned above that are undertaken by corporations deny African governments a critical source of tax revenue, which if received would be utilized to finance development programs and to provide goods and services in particular to the vulnerable populations in Africa. An example of this result exists in Tanzania, where the Court of Appeal recently found that African Barrick Gold had managed to send net profits and pay its shareholders dividends despite consistently declaring losses for taxation purposes in Tanzania.⁵³

Furthermore, tax avoidance by MNEs shifts the tax burden to SMEs and the informal sector. They are the ones to shoulder the biggest tax burden while MNEs enjoy a free ride. This adversely impacts business development and long-term sustainable economic growth in African countries.

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**BOX 3. AGGRESSIVE TAX AVOIDANCE BY MULTINATIONAL CORPORATIONS IN SOUTH AFRICA**

The Report of the High-Level Panel on Illicit Financial Flows from Africa (2015) discussed a case in South Africa in which a multinational corporation was found to have avoided taxes worth $2 billion by claiming that a large part of its business was conducted in the low tax jurisdictions of Switzerland and the United Kingdom, and moving the legal site of their business to these jurisdictions. Yet their substantial activity and majority of its customers were domiciled in the African country.

Investigation by South African authorities revealed that the Swiss and UK branches had only a few low-paid personnel and these offices did not handle any of the commodities in which the company dealt. The company was able to evade tax by routing business transactions through the Swiss or UK offices. The South African authorities were able to reclaim the tax because it was clear that the substance of the company’s activities was conducted in South Africa.

### 3.2 Treaty Abuse

It is a common practice for capital importing countries (which many African countries are) to sign tax and other investment-related treaties with developed countries. Such treaties are referred to as Double Taxation Agreements (DTAs) or Double Taxation Treaties (DTTs). According to the HLP, DTAs/DTTs constitute “Agreements between states (usually in the form of bilateral treaties) that are designed to prevent an individual from being taxed on the same income (or other forms

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⁵³ African Barrick Gold PLC v. Commissioner General Tanzania Revenue Authority Civil Appeal No. 144 of 2018 at pg.40.
of wealth, e.g., an estate or a gift) by two different countries.\(^{54}\) DTAs/DTTs have also been defined as “agreements through which state parties voluntarily agree to restrictions on their ability to tax economic activity that spans both countries.”\(^{55}\)

While the primary objective of signing these DTAs/DTTs is to prevent double taxation of income, the major consideration for most African countries is to attract Foreign Direct Investment (FDI). Consequently, DTAs/DTTs have increasingly become an important vehicle for channeling various forms of tax incentives for MNEs domiciled in developed countries.\(^{56}\) For this reason, they tend to benefit large MNEs more than the companies in African countries. Even more concerning, for the various incentives that they offer such as reduced tax rates, DTAs/DTTs have become a source of treaty abuse and IFFs.

This happens through a practice known as treaty shopping whereby an MNE from a country without a DTA/DTT with the African country from which it sources substantial income incorporates a shell/mailbox company in another developed country with an existing DTA/DTT for the sole purpose of benefiting from the incentives under such a treaty. In the end, the treaty is abused to benefit MNEs from countries that are not party to the DTA to the detriment of African countries.\(^{57}\)

Box 4 provides examples of tax evasion practices by major international oil companies in Uganda. The abuse of DTAs by companies involved in the oil industry is not new. In 2010, Heritage Oil and Gas (HOGL) Company made a last-minute decision to redomicile its operations to Mauritius (a renowned tax haven) for purposes of avoiding payment of over $400 million in capital gains taxes to the Ugandan government. Although this scheme was foiled by the Ugandan government, it goes to show the risks posed by treaty abuse for African countries. In Ghana, the reduction of royalty tax rates from 10% to 8% under a new tax treaty signed with the Netherlands in January 2009 is estimated to cost the country BP 52,000 annually.\(^{58}\)

For all these reasons, some African countries have taken the decision to renegotiate and, in some cases, to terminate existing agreements that facilitate abuse by MNEs. In June 2020, the government of Zambia announced its decision to terminate the DTA with Mauritius effective the next year 2021. The Treaty was deemed unfavourable given its terms that gave MNEs and individuals resident in Mauritius benefits in the form of exemption from payment of taxes on management fees and significantly reduced rates of withholding taxes on dividends (5%), interest (10%) and royalties (5%).\(^{59}\) Other countries that have recently renegotiated their DTAs with Mauritius include South Africa and Rwanda.

While this is great progress, several African countries are still burdened in particular by unfair DTAs signed with tax haven countries. As of 2015 there were over three hundred (300) DTAs signed between African countries and capital exporting developed countries.\(^{60}\) All these have damaging consequences and facilitate IFFs by means of aggressive tax avoidance and treaty shopping. Secondly, it has been shown that DTAs do not necessarily promote FDI and that there may be other better ways in which African countries can attract investment.

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\(^{54}\) Report of the HLP on Illicit Financial Flows from Africa.


\(^{56}\) Ibid

\(^{57}\) Ibid

\(^{58}\) Martin Hearson & Richard Brooks, Calling Time, Action Aid, 2010 at pg 21


Moreover, capital exporting countries recognize that MNEs resident in other countries are subject to taxes in those countries. For this reason, the majority of developed countries have better ways in place of ensuring that the revenues of such companies are not subject to double taxation. One such approach by which this can be achieved is through offering foreign tax credits. Unfortunately, due to information asymmetries, most African countries are not in a position to know where such credits are given and, on this basis, they have gone ahead to extend further tax reductions all in the name of avoiding double taxation. In the end, MNEs enjoy tax benefits from both the capital-exporting countries and capital-importing African countries. This means DTAs/DTTs facilitate double non-taxation instead of their intended purpose i.e., avoidance of double taxation.\(^{61}\)

3.3 Inequitable Contracts

Inequitable contracts signed by African governments constitute another source of IFFs. They include bi-lateral and multi-lateral investment agreements that seek to restrict the power of developing countries to tax (such as the DTAs and resource contracts) and to collect other forms of revenues from multinational enterprises and individuals from countries with which they are signed.

The challenge posed by such agreements is that they are usually negotiated on an uneven footing whereby the developed country wields a lot of power and leverage over the developing country. As a result, large powerful MNEs rely on these agreements to get a free ride while domestic Small and Medium Enterprises (SMEs) and individual tax payers bear the biggest burden of taxes and other forms of payments to the state. Secondly, these agreements deny African governments a critical opportunity to collect any form of revenue from large multinational enterprises even when such enterprises utilize public infrastructure to generate income, which in this case is remitted to their countries of origin.

More predominantly, inequitable contracts are very common in the extractive industries sector. This is common in richly endowed African countries that seek to exploit their natural resources but are at the same time unable to do so by themselves due to technical and capital limitations (Box 5). In most cases they need to rely on international companies for geological and other information on the occurrence and extent of the resources to be developed. On the other hand, multinational enterprises that eventually assist these countries to develop their resources come with a lot of expertise and a wealth of experience in the negotiation of resource agreements. Secondly, they are in a better position to invest for the long term in what are often capital-intensive and risky projects. They also have access to modern and sophisticated technology. This is not only necessary to undertake the projects but also ensures that these companies obtain a lot of information in relation to the quality and quantity of the resource to be developed. As most African governments do not have the capital and technical capacity required to exploit their resources on their own, they are therefore forced to turn to international companies even where the terms are unfavorable.

MNEs in the extractives sector also often utilize their financial leverage to attract the best lawyers and accountants to represent them in contract negotiations. In other cases, they have been accused of bribing public officials in the host countries in exchange for favorable terms including provisions for payment of less revenues than ought to be paid. For all these reasons, international companies enjoy a high leverage in the negotiation and signing of resource contracts with African countries. The result is that most of these resource contracts are inequitable and favor multinational enterprises in various ways. The revenue payments saved by relying on inequitable contracts as well as bribes paid to public officials in return for favors also constitute a major source of IFFs.

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63 Ibid, pg.52.
64 Ibid, pg.35.
**BOX 5. INEQUITABLE CONTRACTS IN AFRICA’S EXTRACTIVES INDUSTRY LED TO UNELECTED TAXES**

**Guinea** – the government granted a multinational mining company a concession at a cost of $165 million in respect to a mine whose revenue potential was later determined to be worth $140 billion. The company which had been originally granted the concession sold half of its rights in the mine to another company for $2.5 billion. Although the government later revoked the concession and issued another one on revised terms, this experience goes to show the IFFs risk faced by African countries in negotiating resource agreements with powerful international companies in the absence of their own geological data and information.

**Uganda** – Under Article 23.5 of the Production Sharing Agreement (PSA) signed between the government of Uganda and Tullow Oil in respect to Exploration Area 2, the company was exempted from having to pay capital gains taxes on transfers of its assets. At the time of signing the PSA, Uganda had not confirmed the existence of commercially viable oil. Fast forward to 2006, the country struck commercial oil following upon which Tullow sought to transfer part of its interests to two other international oil companies: Total E & P and China National Offshore Oil Company (CNOOC). The Uganda Revenue Authority (URA) assessed the transaction at $472 million in capital gains taxes. Although this was subsequently revised to $462 million, the tax was contested by Tullow Oil in the local courts and before an international arbitration tribunal.

The local tax tribunal found in favor of the government of Uganda on the basis that under the Ugandan Constitution tax is a creature of statute and that on this basis the exemption ought to have been authorized by Parliament and not the Minister of Finance as was the case. Eventually Tullow agreed with the government of Uganda to pay $256 million in full settlement of the tax. Although this was a slightly better deal than the company receiving a full exemption, the government of Uganda still lost more than $200 million on the transaction. This would not have been lost if it was not for the unequal negotiating powers that resulted into inclusion of a grossly unjustified exemption in the PSA.

**Mozambique** – The most common examples of provisions included in inequitable contracts at the insistence of international companies relate to stabilization. Such stabilization clauses restrict the ability of host governments to alter their tax regimes to the “detriment” of the companies. The effect of these provisions is that countries are inhibited from pursuing tax and other related reforms that are necessary for them to maximize revenues from their extractive industries. While it may be tolerable for companies to insist on these provisions to protect their investment especially in the initial stages, it is grossly unfair for them to insist on enforcement of these clauses even where there are changed circumstances.

Tax reforms undertaken by the government of Mozambique to maximize returns from the booming gas industry do not apply to the Rovuma basin contracts due to the stabilization clauses therein. As a result, the progressive tax reforms of 2014 and 2017 do not apply, and irrespective of the change in circumstances, international oil companies involved in the Rovuma basin projects continue to pay a discounted corporate tax rate of 24% instead of the standard 32%. This represents an 8% loss of revenue from the taxation of corporate income.

Inequitable resource agreements are the main reason why the extractives sector in Africa is one of the most prone to IFFs. According to recent studies, nine out of the ten countries with the highest IFFs in Africa are dependent on the extractive industries (table 3). The 2020 UNCTAD report shows that over the last decade, Africa lost an estimated $278 billion in illicit financial flows arising from the export of extractive sector commodities. Similar past studies have shown that 50% of all IFFs in Africa arise from trade mispricing of which more than half of this is from the extractives sector.

### 3.4 Trade Misinvoicing/Trade Mispricing

Trade misinvoicing is also referred to as trade mispricing. The HLP has defined this practice as “the falsification of the price, quality, and quantity values of traded goods.” Global Financial Integrity (GFI) offers an even more detailed definition. According to their 2020 report of a study on trade related IFFs, trade misinvoicing is defined as “the act of the deliberate manipulation of the value of a trade transaction by falsifying, among others, the price, quantity, quality and/or country of origin of a good or service by at least one party to the transaction.”

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65 Landry Signe, Marianna Sow & Payce Madden, Illicit Financial Flows in Africa: Drivers, Destinations and Policy Options.
68 Report of the HLP on Illicit Financial Flows from Africa, pg.27. See also definition of the Tax Justice Network Africa. Trade Mispricing, Do Countries Fetch the Rightful Value from Exports, Tax Justice Network Africa
usually done to achieve different objectives that include tax avoidance and evasion, laundering of proceeds of crime, export of foreign exchange, smuggling and hiding profits offshore.

Trade misinvoicing constitutes a major form of IFFs from African countries. In fact, trade misinvoicing alone is responsible for more than 50% of Africa’s total IFFs. According to UNCTAD, the size of trade mispricing in Africa ranges from $30 billion to $52 billion annually based on different estimates. The 2020 Global Financial Integrity report found that three out of the top five countries with the largest average percentage value gaps in respect to trade between 135 developing countries and all trading partners over the period 2008-2017 were all in Africa. These are Gambia (46.8%), Seychelles (38.3%) and Ghana (26.8%).

An earlier study involving Ghana, Kenya, Mozambique, Tanzania, and Uganda found that total amount of IFFs from trade misinvoicing in these countries was in the range of $60 billion over a period of ten years over 2002-2011. Tanzania had the largest volume of IFFs at $1.87 billion followed by Kenya at $1.51 billion. Ghana was third at $1.44 billion. Uganda and Mozambique had the least volume of IFFs from misinvoicing at $884 million and $585 million respectively. The report observes further that a significant portion of these IFFs was lost in the form of missed tax and tariff revenues. Ghana lost $386 million, Kenya lost $435 million, Tanzania lost $248 million, and Uganda lost $243 million to missed tax and tariff revenues. Table 3 below shows a summary of figures for the five countries.

The prevalence of trade misinvoicing as a form of IFFs in Africa has been attributed to several factors. First and foremost, many African countries do not have the capacity to effectively scrutinize the transactions of multinational enterprises. Secondly, there is not much data especially as regards intra-African trade. Most of the available data relates to trade between Africa and the developed world. Even then, this information is more often availed by the developed countries involved in trade with Africa. Trade data recorded by African countries is often limited and, in most cases, inconsistent. According to UNCTAD, 45 out of the 54 African countries were somewhat consistent in reporting their trade data as of 2020.

Differences in data recording and trade reporting systems also make it difficult to harmonize cross-border commodity trade reports provided by multinational enterprises. For instance, some countries consider insurance as part of the cost while others do not. Other countries disregard commodities stored in warehouses and free trade zones in their reporting. All of these create discrepancies and make it difficult for countries to verify the records provided by multinational enterprises.

Zambia provides a good example of this difficulty. The country is reported to have exported more than 50% of its copper to Switzerland but there were no corresponding imports recorded (by Switzerland). Whereas this creates an impression of export over-invoicing, the copper, while acquired by a Swiss company, seems

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70 Tackling Illicit Financial Flows for Sustainable Development in Africa, UNCTAD 2020, pg. 45
71 Ibid, pg. 72
73 Tackling Illicit Financial Flows for Sustainable Development in Africa, UNCTAD 2020, pg.73
74 Tackling Illicit Financial Flows for Sustainable Development in Africa, UNCTAD 2020, at pg. 72
Trade misinvoicing involves the illicit movement of the value of the traded commodities across countries through practices that encourage outflows and inflows. Table 4 below shows the four main types and common purposes of trade misinvoicing.

### 3.4.1 OVER-INVOICING IMPORTS AND/OR UNDERVERVALUING EXPORTS

These practices are responsible for outflows of value from African countries. Over-invoicing imports involves falsification of invoices to reflect a higher price than the one paid for imports. In doing this, the company is able to transfer the difference between the amount paid and the inflated invoice price to a tax haven country with low to no taxes.

Undervaluation of exports involves falsification of invoices to reflect a low price for exports than the one received by the company. In this way, the company is able to transfer the price difference to another country with low or no taxes. Most significantly, by under-declaring the value, companies pay lower taxes on the exports. They are also able to pay lower corporate taxes. The total effect of export misinvoicing is that commodities leave countries without a corresponding value. This is a loss to the exporting country and in the context of Africa denies countries their right to earn from their commodities. Undervaluation of exports is very common with natural resources, as seen in examples from Mozambique and Ghana in Box 6.

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75 Ibid at pg.62
76 Ibid at pg.43
3.4.2 OVER-INVOICING EXPORTS AND/OR UNDER-INVOICING IMPORTS

The overpricing of exports involves the declaration of higher prices for exports than the ones realized. This is usually done to benefit from government incentives on exports such as tax cuts and rebates. An example of this is a Tunisian company which purported to be in the business of exporting services to a European company in order to benefit from tax incentives and exemptions from duties and indirect taxes. However, upon obtaining further information from the European country, the Tunisian tax authorities found that the company was in fact managing local suppliers of the European company. This did not qualify as an export but by reporting it as such, the company unjustly gained from the incentives provided by the government. For this, the company was required to pay €1.5 million to the Tunisian tax authorities in fines and penalties.\(^7\)

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\(^7\) Africa Tax Transparency Report at pg.46.
The undervaluation of exports is very common with natural resources. In one case of export under-declaration, the High-Level Panel found that in one incident involving Mozambique, the total value of exports of logs and timber was recorded at 260,385 cubic meters. However, a record obtained by the panel showed that close to double this amount i.e., 450,000 cubic meters was imported from Mozambique by China alone. Earlier studies have shown that close to 100,000 barrels are looted in Nigeria each day.

Studies conducted in Ghana also show that there was gross undervaluation of commodity exports. In the period 2011-2012, the amount of undervalued gold leaving the country in exports was reported to be $3.8 billion. This was the equivalent of 11% of the total export value of commodities i.e., $35.6 billion. Similarly, 2.7% of cocoa beans exports worth a total of $12.6 billion, and 7.5% of the cocoa paste worth $1.8 billion in total exports were found to be undervalued. All this was attributed to the presence of several multinational enterprises in Ghana’s gold and cocoa industries.

4.0 Current Initiatives to Combat Tax & Commercial IFFs

Given the devastating effects of IFFs, there have emerged several initiatives to combat them at the global, regional, and country levels. These are discussed in further detail below.

4.1 OECD Base Erosion and Profit Shifting (BEPS) Initiative

The Base Erosion and Profit Shifting (BEPS) is a framework for international collaboration to end tax avoidance. An initiative of the Organization for Economic Cooperation and Development (OECD), BEPS was born out of concern over the increased manipulation of current gaps and mismatches in tax systems by multinational enterprises to deny countries tax revenues.\(^78\)

The BEPS framework is implemented through an Action Plan for implementation by member countries. The Action Plan which was launched in 2013 contains 15 Actions for countries to consider as part of efforts to address tax avoidance and to ensure that profits are taxed in jurisdictions where economic activities from which they are generated are carried out. In relation to tax and related IFFs, the Action Plan provides for taxation of the digital economy, elimination of harmful tax practices, prevention of treaty abuse, transfer pricing, mandatory disclosure, mutual agreement procedure and adoption of a multilateral instrument on BEPS.

Currently, 141 countries subscribe to and are implementing the BEPS framework.\(^79\) A total of 96 countries are also signatories to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (“Multilateral Instrument” or “MLI”). Although 26 African countries are presently part of the BEPs inclusive framework, and 14 have gone ahead to sign the MLI, there is concern that the initiative is not helping much in stemming IFFs from the continent.\(^80\) Secondly there has generally been very limited and in some cases no participation by African countries in BEPS processes. This has created an atmosphere of distrust and a belief that only developed countries benefit from BEPS initiatives.\(^81\)

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\(^78\) Inclusive Framework on Base Erosion and Profit Shifting, OECD. Available on https://www.oecd.org/tax/beps/


4.2 Global Taxation Rules

In October 2021, 136 countries out of 140 agreed to new rules for the taxation of multinational enterprises and the digital economy. The deal initiated by the OECD is a culmination of several years of intense negotiation and lobbying for reform of international tax rules that have for long favored multinational enterprises.

The deal which is expected to unlock more than $125 billion of profits of multinational enterprises is anchored on two main pillars. The first Pillar seeks to reallocate the taxing rights over multinational enterprises from their countries of origin to countries where they earn profits. However, this does not include companies in the extractives sector or those involved in the provision of financial services. Secondly, it applies to multinational enterprises with revenues of more than €20 billion. This threshold is expected to be lowered further to €10 billion after a review period of seven years. Pillar Two introduces a global minimum corporate tax rate of 15% for all companies whose revenue is over €750 million. Pillar One is expected to concretize into a multilateral convention to be signed by countries in 2022. Pillar Two will be implemented through domestic regulations to be guided by rules developed by the OECD in 2022.

Some developing countries including those from Africa have expressed some reservations about the deal. Kenya and Nigeria declined to sign the deal. They were joined by Pakistan and Sri Lanka. Kenya's decision was informed by the risk that the international deal poses for taxation of especially digital services. Secondly, since most MNEs are headquartered in wealthy countries, they stand to benefit the most from the increase in revenue income. Moreover since these wealthy countries are equally affected by IFFs perpetrated by MNEs, their domineering role towards a global tax treaty is largely designed to benefit them and not to necessarily address the IFF-related challenges faced by developing countries.

In light of this, there is a need for a reconsideration of the proposals contained in the tax deal in order to accommodate the interests of the global south. The voice of Africa and other developing countries must be heard even as the multilateral treaty designated to operationalize the deal is developed. Short of this, there will be less cooperation in the endeavor to ensure that multinational enterprises pay their fair share of taxes in countries where they derive their revenues.

4.3 EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE (EITI)

The Extractive Industries Transparency Initiative (EITI) is a global standard for the good governance of oil, gas, and minerals resources. The EITI requires the full disclosure of revenues earned throughout the whole extractive industry value chain and how they benefit the public. This is intended to achieve open, accountable, and transparent management of oil, gas, and mineral resources. The implementation of the EITI is overseen by an International Board which African countries charge in corporate taxes i.e., 25-35%. Consequently, there is less incentive for MNEs to reduce their tendency to shift profits from African countries to tax havens. Secondly, since most MNEs are headquartered in wealthy countries, they stand to benefit the most from the increase in revenue income. Moreover since these wealthy countries are equally affected by IFFs perpetrated by MNEs, their domineering role towards a global tax treaty is largely designed to benefit them and not to necessarily address the IFF-related challenges faced by developing countries.

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assesses the progress of countries with the requirements of the standard. Countries that are interested in joining the EITI are required to apply to the International Board. To be admitted, there must be a demonstration of commitment to government, company and civil society engagement, establishment of a stakeholder group and development of an EITI workplan. Post admission, countries are expected to take steps to comply with the EITI standard and to file regular progress reports.

Presently, the EITI has a total of 52 member countries of which 26 are from the African continent. EITI membership comes with numerous benefits that are critical in combating IFFs which are known to be highly prevalent in the extractive industries. The EITI process enhances transparency in natural resources revenue collection since it requires governments to disclose all payments received from the companies. Similarly, the companies are also required to disclose how much they have paid to the government in the form of taxes and royalties. The amounts provided by both the government and the companies are then reconciled by an independent party appointed by the Multi-Stakeholder Group (MSG) – a body responsible for implementation of the EITI at the national level and is constituted by representatives from government, companies, and civil society.

The revenue reconciliation process is key in combating IFFs since it makes it possible to identify any tax and other payment irregularities as well as revenue leakages. In 2012/2013 for instance, oil and gas revenue reconciliations in Ghana discovered a $55 million discrepancy in payments made by Anadarko WCTP Ltd. According to its 2016 EITI report, Nigeria was also able to recover $2.4 billion in tax payments following reconciliation of its oil and gas payments in 2016. In the Democratic Republic of Congo (DRC), $88 million was found missing while one of the companies involved in tax collection was unable to account for royalties in the amount of $26 million.

It would have been extremely difficult to discover all these leakages and to recover the lost revenues if it was not for all these countries being members of the EITI. For this reason, it is very highly recommended for all countries in Africa where the extractive industries play a role to join the EITI. Upon admission, these countries should continuously strive to implement EITI principles and to remain compliant through undertaking regular reconciliations and filing progress reports, among other things.

85 How to Become an Implementing Country, EITI. Available on https://eiti.org/join-EITI
86 Countries, EITI. Available on https://eiti.org/countries
87 Tackling Illicit Financial Flows for Sustainable Development in Africa, UNCTAD 2020, pg. 181
90 Ibid
91 Ibid. See also Generating ‘Ripple Effects’ in DR Congo, EITI, 2014. Available on https://eiti.org/node/4276
### BOX 7. EXCHANGE OF INFORMATION GREATLY ENABLED AFRICAN COUNTRIES TO RAISE ADDITIONAL REVENUE

In Tunisia, the Directorate General of Information was able to raise an additional €1.5 million following successful submission of a request for information to a European country. The request was made in respect to the affairs of a local company that had irregularly benefited from tax incentives and other rebates on exports offered by the government. The response provided revealed that while the said company had benefited on the basis that it was exporting services to a client in Europe, it was in fact managing local suppliers and therefore its services did not qualify for the claimed incentives. Uganda is also reported to have identified a total of $43.2 million (€34.7 million) from requests sent and answered by other jurisdictions. In total, African countries have been able to identify over €1.2 billion in additional tax revenues through offshore tax investigations, exchange of information requests and voluntary disclosure programs. The additional revenues raised are in the form of taxes, interest, and penalties. In addition to this, it is estimated that between 2014 and 2020 a group of countries including Burkina Faso, Cameroon, Kenya, Senegal, South Africa, Togo, Tunisia, and Uganda benefited over $244 million (€196 million) in additional taxes as a result of automatic information exchanges.


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### 4.4 Africa Initiative of the Global Forum on Transparency & Exchange of Information

The Africa Initiative was established in October 2014 and currently its membership consists of 33 African countries. The initiative is an Africa-focused program of the Global Forum on Transparency and Exchange of Information for Tax Purposes- a 163-member organization working on global transparency to end tax evasion and bank secrecy. The forum is specifically responsible for promoting and monitoring two major standards i.e., Exchange of Information upon Request (EOIR) and the Automatic Exchange of Information on Financial Accounts (AEOI). Together, the two standards facilitate the exchange of information among countries while at the same time ensuring deeper access to information held by financial institutions.

While facilitating the realization of the broader objectives of the Global Forum, the African Initiative is specifically focused on promoting transparency and information exchange by and among African countries as part of the efforts to prevent tax evasion and avoidance and to stem IFFs from Africa. In light of this, the current focus of the Africa Initiative is to raise political awareness around transparency and EOIR as a tool for combating tax evasion, enrolling countries into the AEOI and building the capacity of African countries to utilize tax information.

In terms of stemming IFFs, the Global Forum and the Africa Initiative have availed African governments of opportunities to access legal and beneficial ownership information, banking information and to understand the affairs of their taxpayers. Box 7 summarizes a few cases where
African countries have been able to raise substantial revenue through the exchange of information requests.

**4.5 Regional Initiatives – African Tax Administrative Forum (ATAF) and the African Commission Working Group on the Extractive Industries (WGEI)**

The African Tax Administration Forum (ATAF) was formed in 2009. Its membership constitutes of African tax/revenue authorities. ATAF’s mandate is to strengthen their capacity in revenue mobilization and administration and to ensure that they are accountable to citizens.\(^5\)

In relation to IFFs, ATAF’s work has involved the promotion of transparency and intergovernmental cooperation in information exchange. ATAF is also playing a capacity-building role by offering training to officers from African tax authorities in diverse areas of taxation including transfer pricing, treaty abuse and other harmful tax prices, and customs management. Also, as part of this role, ATAF has supported the establishment of transfer pricing units in several African countries. ATAF also regularly releases regular studies on these subjects. All of this is critical in stemming tax and commercial illicit financial flows.

ATAF’s work on IFFs has also involved engagement with parliamentarians at the continental level. In October 2018, ATAF signed a Memorandum of Understanding with the Pan African Parliament to strengthen tax legislation in Africa to combat IFFs.\(^6\)

At the global level, ATAF is a partner and one of the organizations behind the establishment of the African Initiative. To date, the ATAF has managed to mobilize up to 33 African countries to join the Africa Initiative.

Still at the regional level, there exists the State Reporting Guidelines on Articles 21 and 24 of the African Charter on Human and People’s Rights Relating to the Extractive Industries, Human Rights, and the Environment. The Guidelines which were developed by the Working Group on Extractive Industries (WGEI) were adopted by the African Commission in May 2017. Importantly, the Guidelines among others provide guidance on steps that ought to be taken by state parties to the Charter to combat IFFs.\(^7\) In this regard, the Guidelines enjoin states to adopt fiscal regulations that address IFFs through amendment of tax laws and policies, rules on related party transactions, banking laws and policies, and those governing the financial sector. The Guidelines also show it is important for African states to develop and implement robust and efficient tax collection systems to address the challenge of IFFs. It should also be noted that the State Reporting Guidelines are legally binding on state parties to the Charter.

**4.6 Individual Country Initiatives**

In view of the devastating risks of tax and commercial IFFs, and the associated losses incurred by African countries, some governments have taken decisive steps to tackle this challenge. In some cases, these efforts have been motivated by and supported by the work of civil society and other groups of citizens committed to ensure

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that their countries obtain a fair share of revenues from the activities of multinational enterprises and other high net worth individuals.

**Renegotiation of Double Taxation Agreements** – Some of the country initiatives to stem the risks arising from IFFs have involved attempts and, in some cases, successful renegotiation of existing DTAs. As seen above, DTAs provide a huge avenue for multinational enterprises to avoid the payment of corporate taxes to the detriment of African countries. They are also subject to abuse where multinational enterprises exploit current loopholes in international tax rules to benefit from treaty provisions that were intended to prevent double taxation of companies and individuals carrying on substantial business activities in the signatory countries.

In view of these challenges, and to close current gaps, South Africa and Rwanda successfully renegotiated their DTAs with Mauritius in 2013.98 Zambia has also successfully renegotiated their DTAs with Ireland and the Netherlands.99 Most recently, the Zambian government took the decision to terminate the DTA with Mauritius effective January 2021.100 Earlier on in May 2020, Senegal took the same decision after realizing that it had lost over $257 million in tax revenue over a period of 17 years when the treaty with Mauritius was in place.101

**Strengthening legal and institutional frameworks** – Furthermore, some African countries have taken the approach of amending their domestic tax laws to include anti-avoidance and anti-treaty abuse provisions. Other countries have taken a further step to establish transfer pricing and international tax units in their revenue administration authorities. Some of the examples of countries that have taken these steps include South Africa, Kenya, Uganda, and Egypt.

Most recently, Tanzania has in view of past revenue losses and challenges in its mining industry taken a radical step to fundamentally overhaul its sector laws. This spate of reforms started with the amendment of the Mining Act in 2010. Some of the key provisions amended relate to the increase in royalty rates paid by mining companies and increment of state participation in mining projects of up to a minimum of 16% on a free carry basis. These provisions are all intended to turn around and increase the revenue yield from the country's longstanding mining sector. More critically, under the leadership of the late President John Pombe Magufuli, Tanzania enacted critical laws for the review and renegotiation of existing mining agreements.102 The pressure on mining companies has yielded some encouraging results. In 2019, Acacia Mining, which had for long been accused of tax avoidance and in some cases tax evasion paid the Tanzania government $300 million in settlement of a long-standing tax dispute with the government.103

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99 Ibid.


103 Ibid, pg.36.
Participation of civil society to help prevent IFFs – Moreover, the efforts of individual governments to stem IFFs at the country level have also been complimented by the acts of civil society and other spirited groups of individuals. In 2019, the Tax Justice Network Africa challenged the DTA between Kenya and Mauritius in the High Court. In its ruling issued in April 2019, the court agreed with the petitioner’s contention to the effect that the treaty was unconstitutional and accordingly nullified it.\textsuperscript{104} In reaching this conclusion, the court considered the fact that the Kenyan government had not followed the necessary constitutional steps required for ratification of the DTA.

5.0 Conclusion and Recommendations

IFFs remain a critical global challenge with devastating impact on the socioeconomic development of Africa. IFFs have robbed African governments and people of the opportunity to utilize their demographic dividend, natural resources, and investment opportunities to generate revenues critical for the transformation of lives and economies. As a result, Africa lags in the pursuit of its own aspirations and commitments such as those contained in the UN Sustainable Development Goals (SDGs).

This study confirms earlier findings to the effect that commercial and tax related activities account for the largest source of IFFs in Africa. MNEs and HNWIs continue to exploit loopholes in tax rules to deploy strategies for profit shifting and base erosion of income sourced in and from Africa. This is achieved through transfer mispricing, and inflated payments to subsidiaries which are often shell/mailbox companies registered in tax haven jurisdictions, and trade mispricing. More still, MNEs continue to use their power, leverage, and information asymmetries to exploit African countries through inequitable contracts. They also exploit current gaps in global tax rules and financial secrecy to hide their incomes in tax haven countries where they are out of the reach of African governments.

Despite the multitude of challenges, African countries have taken action to prevent and reduce IFFs from the continent. The HLP including eminent people from throughout Africa led the way by flagging the extent of the damage caused by IFFs in Africa. The panel also offered a set of policy recommendations for African governments that are continuously challenged by IFFs. Their efforts have been complemented by other actors including the UN and AU and their respective agencies. African countries have also initiated country-level and regional programs for combating IFFs.

While all these efforts are positive steps in the right direction, there is a need for renewed momentum considering the increasing sophistication, frequency, and intensity with which IFFs are perpetrated in Africa. This is a shared obligation involving a diverse range of actors that include individual African countries, the African Union, civil society, UN, and other multinational bodies. Considering this, the study makes the following recommendations.

African Union (AU)

> Establish a permanent highly specialized and dedicated African regional mechanism for the detection and prevention of IFFs at the continental level. The mechanism once

established should offer support to African countries to detect, prevent, and counter IFFs. It should also offer dedicated support to resource-rich African countries given the intensity and frequency with which IFFs take place in the extractive sector.

> To complement the permanent mechanism suggested above, the AU should urgently establish an intergovernmental working group on taxation i.e., African Union Tax Working Group. The working group should not only be responsible for advising African countries on their peculiar tax systems but should also solicit for and present a common African position on the evolving global tax rules.

> As part of its role, the African Union Tax Working Group should initiate the process for consultation, drafting, and adoption of a model multilateral African investment treaty that among others makes provision for the prevention and elimination of BEPS strategies for tax avoidance and tax evasion. Importantly, the multilateral investment treaty if adopted would provide a good template for African countries in the negotiation of bilateral investment treaties like DTAs/DTTs.

> Support the Africa Minerals Development Centre (AMDC) and the African Commission Working Group on the Extractive Industries (WGEI) to develop model resource contracts. This will augment the bargaining power of African resource-rich countries when negotiating with powerful Oil and Mining MNEs with respect to the exploration, development, and production of their resources.

African Countries

> Enact specific legislation for transfer pricing, anti-tax avoidance, anti-treaty abuse, and disclosure of beneficial ownership information. Criminalize financial crimes such as aggressive tax evasion and money laundering.

> Establish specialized, efficient, and effective transfer pricing, international tax units, and Large Taxpayers units within their revenue administrations/authorities. These are extremely critical in stemming IFFs arising from base erosion and profit shifting strategies such as transfer mispricing.

> African countries must themselves act to avoid tax competition amongst themselves. Current efforts by some African countries to become international financial services centers need to be rethought and, if possible, dropped, as there is a high chance that these will worsen the current challenges arising from IFFs, with the result that Africa will be the party to lose. The decision made by Ghana to drop its bid to become an international financial service center in 2004 is a good lesson for other African countries that are currently considering taking this step.

> Utilize the opportunities provided by African Continental Free Trade Area (AfCFTA) to combat IFFs. This provides a foundation for harmonization of investment laws and practices, information exchange, enhancement of institutional capacities and transparency and accountability in the public and private realms, all of which are critical for stemming IFFs.

> Through the Africa Initiative, embrace the automatic exchange of information on customs values and prices of commodities and invest in training of their customs officials on general and reasonable benchmarks for valuation of commodity prices. These interventions are key in tackling the challenge of trade mis invoicing that is responsible for over 50% of current IFFs from Africa.
In addition to the above, African countries should utilize the avenues available under the Agreement establishing the AfCFTA to urgently review and harmonize current commodity descriptions and coding systems between countries. In undertaking this critical initiative, reference may also be made to the World Customs Organizations systems and codes.

Follow the examples of Zambia, Rwanda, South Africa, Malawi, Kenya, and Senegal to urgently renegotiate existing DTAs/DTTs that seek to limit the power of African governments to tax multinational enterprises domiciled in countries with which these treaties have been concluded. Similarly, DTAs concluded with tax haven countries should be either terminated or renegotiated as they deny African governments a sizeable amount of corporate taxes.

African resource-rich countries that are not yet members should join the Extractive Industries Transparency Initiative (EITI) - a global standard for open and accountable management of oil, gas and mineral resources and for the disclosure of resource payments. This will not only build accountability but also diminish the secrecy that comes with non-disclosure of contracts.

Establish publicly accessible beneficial ownership registries where the names of natural persons and/or groups of individuals with ownership and controlling stake in companies are disclosed. This is critical for stemming current tax evasion, especially by high net worth individuals.

Publish past, present, and all future resource contracts concluded with multinational oil and mining companies without any further delays. This is critical for transparency and accountability in the highly IFFs-prone extractive industries.

Take steps to urgently renegotiate current resource contracts that limit the ability of countries to revise tax and other revenue terms even when there are changed circumstances. Such provisions also referred to as stabilization clauses create an inequitable arrangement where multinational companies benefit to the detriment of countries. Tanzania’s efforts and success in the renegotiation of existing mining contracts provides a good case study and an inspiration for African countries looking to pursue this critical step.

Empower and build the capacity of staff of state institutions involved in the detection and combating of IFFs. These include the staff members of revenue authorities (especially those employed in transfer pricing, customs, and Large Taxpayers units), supreme audit institutions, financial intelligence and other state institutions involved in combating IFFs. African governments must enhance the capacity of their officials to negotiate investment agreements, Double Taxation Agreements, and resource agreements. This can be achieved through providing officials with continuous specialized training in this area.

**Multinational Enterprises (MNEs)**

MNEs should urgently embrace responsible business practices. These include payment of their fair share of taxes in Africa and in other developing countries from where they derive a substantial part of their profits.

Company management should institute employee training programs, conduct diligent employee monitoring, and ensure that individuals do not become facilitators or enablers of IFFs. Company officials and employees who
engage in irresponsible business practices and perpetrate illegal practices that lead to IFFs should be held accountable and/or reported to state authorities.

> Declare and disclose all financial information including profits earned from each African country that they operate in. Additionally, MNEs must fully disclose beneficial ownership information including the natural persons that own them, shareholders, and local partners.

> Embrace the principles contained in the 2019 Business Roundtable Statement on the purpose of a corporation. The Declaration enjoins corporations to practice ethics, fairness, and transparency in all their business dealings, embrace sustainable business practices, and support the communities in which they operate.

Civil Society

> Play a more active role in enlightening members of the public and African governments on the dangers of IFFs and how these affect the achievement of sustainable development.

> Compliment current efforts by African governments to combat IFFs. This can be achieved through offering active support to government initiatives and capacity building of officials working in institutions involved in the detection and combating of IFFs.

> Undertake frequent studies and research the nature, size, and impact of IFFs in countries where they operate. The studies may upon completion provide a good reference point for governments in combating IFFs that arise from tax and illegal commercial practices.

UN and Other International Bodies

> The UN should expedite the implementation of recommendations made by the UN FACTI Panel in its 2021 report. These include among others the formation of a Global Pact for Financial Integrity for Sustainable Development and the need to urgently reform, redesign, and revitalize the global finance system in order to make it more fair, transparent, and accountable. The other FACTI panel recommendations related to the overhauling of tax rules and norms to treat corporations as single entities in taxation, unitary taxation and adopt a minimum tax rate of 20-30%, among others.

> The UN and in particular the Tax Committee should advocate more for the interests of Africa and other developing countries. This is necessary when we consider the vulnerability of these countries and the fact that they suffer the most devastating consequences of IFFs.

> The UN should strive for appropriate global tax rules that among others ensure that MNEs pay their fair share of taxes in countries where their economic activities occur and where value is created. Importantly the process leading to the formulation of such rules should be more inclusive and sensitive to the challenges of developing countries including those in Africa.

> The UN Tax Committee should initiate and support global action towards the formulation and adoption of an international framework for regulating the digital economy.

> OSAA and other UN bodies should aim to provide technical assistance and other forms of capacity-building such as training programs in African countries. Such assistance should
be provided upon request and/or in collaboration with the African Tax Administration Forum (ATAF).

> OSAA and other UN bodies should similarly extend technical assistance and other forms of support such as training programs for civil society organizations involved in advocacy against IFFs in Africa. Although some civil society organizations are currently active in combating IFFs, many still lack expertise in this rather complex area.

> OSAA should utilize the recently formed Knowledge Network to undertake country-by-country studies in order to understand the nature, size, and impact of IFFs in Africa. This is necessary to fill the current data gap on IFFs in Africa and to facilitate country-specific engagements.

> Collaborate with ATAF to urge African governments to establish frameworks and mechanisms for collaboration, information exchange and tax transparency. These are critical in the detection and stemming of IFFs in Africa since many are attributed to information asymmetries.

> The World Customs Organization (WCO) should scale up its current efforts to empower and capacitate African countries to embrace and implement a uniform and harmonized system convention. This can be achieved through providing support in the form of capacity-building, technical assistance, and other critical resources.

> The OECD should involve and engage with more African countries in the BEPS and other similar initiatives. Given that similar past initiatives by the OECD have not been very successful largely because of legitimacy concerns expressed by developing countries, the participation and inclusion of African countries are critical to generate the support needed for the BEPs and other related initiatives to succeed.

> Given that a majority of MNEs are headquartered in rich countries, many of which are members of the OECD, this organization should provide more active support to current initiatives for global tax cooperation and asset recovery. Some of this support may be in the form of financial and technical assistance to developing countries.

> OECD member countries should also endeavor to hold accountable any individuals and/or companies found responsible for perpetrating IFFs in Africa and in other developing countries.

> Similarly, current efforts to develop a global tax treaty should be sensitive to the needs and wishes of African countries. Some of the proposals should be reconsidered to accommodate the interests of the global south.
Reference


