TAX JUSTICE
NETWORK
AFRICA

Curbing Illicit Financial Flows and Tax Injustice in Africa

A toolkit for Members of Parliament

Become a Tax Justice Champion
in your Country and Region

Diakonia
People Change the World

Sweden
Sverige

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Word from the Executive Director (Foreword)

Word from the Coordinator of the African Parliamentary Network for Illicit Financial Flows and Taxation

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List of Abbreviations

AFDB	African Development Bank
AMV	African Mining Vision
APNIFFT	African Parliamentary Network on Illicit Financial Flows and Tax
AU	African Union
BEPS	Base Erosion and Profit Shifting
BO	Beneficial Ownership
CIT	Corporate Income Tax
CSOs	Civil Society Organizations
DRM	Domestic Resource Mobilization
DTA	Double Taxation Agreement
FDI	Foreign Domestic Investment
GCO	Grande Corte Operations
GDP	Gross Domestic Product
GFI	Global Financial Integrity
HLP	High Level Panel
IFFs	Illicit Financial Flows
IFI	International Financial Institution
IMF	International Monetary Fund
MNC	Multinational company
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PEPs	Politically-Exposed Persons
UBOs	Ultimate Beneficial Owners
UN	United Nations
UNECA	United Nations Economic Commission for Africa
USD	United States Dollars

Background

It is estimated that Africa has lost in excess of USD 1 trillion in illicit financial flows (IFFs) in the last 50 years alone.[1] This sum is roughly equivalent to half of the continent's nominal GDP of USD 2.6 trillion recorded in 2019 and all of the ODA received by Africa during the same timeframe.[2] The effect of these leakages are of a greater concern when set against the backdrop of the continent's poverty statistics across the same timeline. From 1990 to 2019 the number of people living on less than USD 1.25 a day in Africa is estimated to have increased from 290 million to 422 million.[3] As a result, one in three Africans are living in poverty. As the Covid-19 pandemic continues to ravage the continent this figure is only set to rise with some statistics indicating that another 40 million people have already been pushed into poverty.

These illicit financial flows affect the continent in many ways. For starters they dampen the prospects of realizing the Sustainable Development Goals which aim to end poverty by 2030. Estimates already put the annual funding gap for SDG for developing countries at USD 2.5 trillion.[4] In addition, these IFFs negatively impact Domestic Revenue Mobilization efforts by denying developing countries much needed revenue for funding public services and increasing reliance on ODA and unsustainable debt.

In the recent past there have been efforts by governments to curb these outflows at the national, regional and continental levels. One such initiative was the establishment of the High-Level Panel (HLP) report on Illicit Financial Flows from Africa by the African Union during its 4th Joint African Union Commission/United Nations Economic Commission for Africa (AUC/ECA) Conference of African Ministers of Finance, Planning and Economic Development, held in 2011.

The panel was tasked with developing a realistic and accurate assessment of the volumes and sources of the IFFs; gaining a concrete understanding of how these outflows occur in Africa based on case studies of a sample of African countries and ensuring that they make specific recommendations of practical, realistic, short- to medium-term actions for African governments and the rest of the World.

Finding 11 of the HLP report identified the weak national and regional capacities in Africa as the major impediments in the efforts to curb IFFs. This is propelled by ineffective or non-existent legislative support and frameworks on IFFs.[5]

A direct effect of these IFFs is that governments are forced into relying on regressive taxes such as VAT to finance their budgets. Although these taxes are easier to administer, they tend to negatively affect the poor. In addition, lack of funding often reduces financing of public services. This also has significant negative effects on the poor who are more heavily reliant on these services. In the meantime, wasteful tax incentives aimed at drawing Foreign Direct Incentives into African countries have continued to perpetuate unfair taxes.

Lawmakers have a critical role to play in the elimination of IFFs and the promotion of the tax justice agenda. The success or failure of such efforts depends on the active participation of the legislature. With most sub-Saharan countries maintaining the inceptive post-colonial governance systems that were invariably executive (presidential), the legislature has always tailed and evolved in the shadow of the much stronger executive arm of the government. One consequence of this imbalance in power is that the actions of the executive are often unchecked. However, over the last decade, the democratic space has drastically expanded across the continent and the legislature has increasingly taken up its strategic role of representation, law-making, fighting corruption and providing an oversight role over the executive. The most recent highlight of this legislative development is the success in stopping the scrapping of term limits in Zambia and Nigeria, which were being championed by the executive.[6]

It is against this background that the Tax Justice Network Africa (TJNA), with support from Diakonia, has developed this toolkit to provide Members of Parliament with concise yet comprehensive and practical information and resources needed to effectively legislate and provide oversight on IFF matters and tax justice at the national, regional and continental level. The toolkit will also guide the engagements of TJNA's flagship APNIFFT (African Parliamentary Network on Illicit Financial Flows and Tax) programme.

The toolkit summarizes and highlights key issues on IFFs and tax justice. It also recommends practical policy considerations that Members of Parliament can adopt to counter problems they may encounter in their two principal roles as legislators, namely providing oversight over the executive and making laws. The first half of the toolkit focuses on tax justice while the second half looks into IFFs.

[1] Kar & Brian LeBlanc, Illicit Financial Flows from Developing Countries: 2002-2013.
[2] OECD, Development Co-operation Report, 2012.
[3] UNDP, Global Multidimensional Poverty Index 2019.
[4] 'Developing Countries Face $2.5 Trillion Annual Investment Gap in Key Sustainable Development Sectors, UNCTAD Report Estimates | UNCTAD' (no date) <https://unctad.org/press-material/developing-countries-face-25-trillion-annual-investment-gap-key-sustainable> accessed 15 September 2021.
[5] High Level Panel (HLP) Report on Illicit Financial Flows, 2011.
[6] Ken Opalo, Legislative Development in Africa: Politics and Postcolonial Legacies, 2019.

USD 1 trillion

Lost in excess in illicit financial flows (IFFs) in the last 50 years alone.

Government

To curb these outflows at the national, regional and continental levels.

1/3

Of africans are living in poverty on less than USD 1.25 a day.

Regressive taxes

Such as VAT forced to be relied on by governments to finance budgets.

Lawmakers

To play role by eliminating IFFs and the promotion of the tax justice.

Lack of Funding

Often reduces financing of public services with negative effects on the poor.

Member of Parliament

To effectively legislate and provide oversight on IFFs matters and tax justice.

The Toolkit

summarizes and highlights key issues on IFFs and tax justice.

The First Half

Of the toolkit focuses on tax justice while the second half looks into IFFs.

Main Issues on Tax Justice and Illicit Financial Flows in Africa

Tax Justice: Vital Statistics

USD 23 billion

Amount of money Africa loses annually due to corporate tax losses

7/10

Of the ten most unequal countries in the world today, seven are in Africa

USD 148 billion

Average amount of money lost to corruption in Africa annually

USD 200 billion

Amount of Africa's cumulative debt-burden by end of 2020

USD 240 billion

Lost in tax revenue anually due to various forms of tax avoidance and evasion

53.7%

Percentage of government revenues that came from indirect taxes on goods and services in Africa in 2017

40 million

Number of Africans who will be pushed to extreme poverty due to COVID-19 by end of 2021

34%

Percentage of Africa's untaxed or under-taxed informal economy - compared to 9 in North America, and 15% in OECD countries

1.0 TAX JUSTICE

1.1 Overview

What is 'Tax Justice'?

The term 'tax justice' has evolved over time to go beyond the stringent scope of tax issues[7]. It is broadly defined as the case for socially-just, accountable and progressive taxation policies and systems with pro-poor outcomes, with the ability to curb public resource leakages and enhance domestic resource mobilisation.

Tax justice is also synonymous with the term **'fair taxation'.** A tax policy or system is fair if it considers the following principles:

a) **Simplicity:** The more complex a tax system, the greater opportunities there are for avoidance, evasion and other forms of abuse and greater chance for exclusion for non-tax experts who are unable to understand the system.[8]

b) **Transparency:** This is the extent to which the tax system is designed to be easily understood and accessed. Transparency also relates to the extent to which the populace understands how much tax is collected, and how this tax funds government activities.

c) **Burden/Equity:** This refers to the higher taxation of those with the ability-to-pay. The tax 'burden' may also include the level of administration required in order to comply with the requirements of the tax regime.

d) **Sustainability:** This refers to the extent to which a tax system contributes to sustainability meeting its citizens' present needs without compromising the ability of future generations to meet their own.

Benefits of having a fair taxation system in your country

- **Domestic Revenue Mobilization:** Tax justice is necessary in order to broaden the tax base and increase the amount of revenue poor countries collect from tax.

- **Redistribution of wealth:** Fair tax policies promote equity by redistributing wealth so that rich individuals and large corporations bear the biggest burden of taxation.

- **Citizen ownership:** Transparent and accountable tax systems promote stronger and more accountable states, ownership and higher social involvement of citizens.

- **Economic growth:** Simple and equitable tax systems will boost entrepreneurial culture in a country, promote organic investments, eliminate bias against work and create decent jobs for locals.

- **Mitigation of corruption:** Bureaucratic and complex tax systems are generally susceptible to manipulation and abuse mainly by corrupt government officials and actors from the private sector. A fair tax system ensures that such tax leakages are kept in check.

- **Innovative initiatives:** Participation enables the citizens, as taxpayers to have an opportunity to hold their governments accountable on the quality of public goods and services and consequently increase their representation in decision-making processes. This has the overall effect of encouraging country-specific tax and spending policies.

- **Sustainable financing:** Adoption of fair tax systems also makes it easier to sustainably widen the tax base and improve domestic resource mobilization, to reduce external financing and to subsequently lead to predictable and sustainable financing of governments' development agenda.

- **Fiscal legitimacy and societal trust:** Fair tax systems create societal trust and increase tax compliance amongst citizens

1.2 Problem Outlook: Tax injustice in Africa

What is the extent of tax injustice in Africa?

A key measure of a just tax system is the correspondence between the tax burden and the taxpayers' ability-to-pay. A majority of Africa's tax systems today remain unjust given the fact that indirect taxes continue to dominate revenues collected. Given their narrow tax bases and the existence of a huge informal sector, International Financial Institutions have pushed for developing countries to levy higher indirect taxes given the fact that they are easier to administer.

This has contributed to increased inequality and the shifting of the burden of tax from the rich to the poor. This is evidenced by the fact that the average top rate of personal income tax remains lowest in the poorest regions of Africa.

[7] Martin Hearson (2018), 'The Challenges for Developing Countries in International Tax Justice', The Journal of Development Studies, 54:10, 1932-1938, DOI: 10.1080/00220388.2017.1309040.

[8] 10TACCA, Perspectives on Fair Tax, 2008.

This is despite the steep rise in the number of the 'super rich' on the continent.

According to the *Africa Wealth Report 2019*[9], the number of high-net-worth individuals (people with assets over USD 1 million) in Africa rose at twice the pace of the rest of the world in the past 15 years. Meanwhile, 'indirect' taxes on goods and services were on average the greatest source of tax revenue for African countries, at 53.7 percent of total tax revenues in 2017.

Such taxes account for a much larger proportion of the income of poor people, who spend more on goods and services than the rich.

Corporate tax rates have also been on a constant decline due to harmful tax competition, and which manifests in a race to the bottom on corporate tax. The tax base continues to be narrowed due to the use of harmful tax incentives such as tax holidays and special economic zones, which are believed to attract Foreign Direct Investment. As a result, Africa loses at least USD 23 billion annually due to corporate tax losses,[10] even though tax revenues have remained constant in the continent, mainly due to revenue increases from taxes on goods and services.[11]

In addition, Africa has consistently struggled to mobilize domestic revenues, which can be noted in its tax-to-GDP ratio. The continent has a tax-to-GDP ratio of about 17.2%, which is much lower than the OECD ratio of 34.2% and the Latin American and Caribbean ratio of 22.8%.[12] This is partially attributable to its huge informal sector economy which accounts for 70% of employment in Sub-Saharan Africa and 62% in North Africa.[13] Despite several attempt to bring these hard-to-tax individuals within the tax man's reach, these efforts have only resulted in marginal gains hence the reliance on indirect taxes. Inequality is further exacerbated by considerable losses of the already insufficient tax revenues, which occur through a variety of channels including tax avoidance, tax evasion, corruption, debt servicing, and illicit outflows.

Africa's debt burden is estimated to be more than **USD 770 billion.** According to the World Bank data[14], African governments spend almost **USD 14 billion** every year on debt servicing, shooting the debt-GDP ratio to upwards of 59%, which is way above the recommended 40%. This limits the capacity of governments to provide vital social services to their populations.

Main channels of tax leakages

The different forms of tax leakages can be defined as follows: [15]

- **Tax avoidance and tax evasion:** *Tax avoidance* can be defined as the practice of escaping tax by getting around (or avoiding) the spirit of the law, without breaking it. On the other hand, *tax evasion*, refers to the fraudulent under-declaration of tax liability. One estimate[16] indicates that **USD 240 billion** is lost in tax revenue every year globally due to various forms of tax avoidance and evasion alone, with most losses in low- and lower middle-income countries.

- **Corruption:** This incentivizes tax evasion through payment of bribes to facilitate under-payment and non-payment. This undermines public confidence in the integrity of rules, systems and institutions that are designed to promote public interest. According to the United Nations Economic Commission for Africa (UNECA), Africa loses **USD 148 billion** a year to the scourge.

- **Illicit outflows:** This refers to money that is illegally earned, illegally transferred or illegally utilized. Global Financial Integrity (GFI) has estimated that the cumulative stock of IFFs from Africa amounted to **USD 865 billion** between 1970 and 2008; and that the figure could be as high as USD 1.8 trillion. Annual outflows from Africa have been estimated by GFI at **USD 30 billion;** while the African Union (AU) estimates it to be **USD 148 billion.**

- **Tax incentives:** These are government measures that are intended to encourage individuals and businesses to spend money or to save money by reducing the amount of tax that they have to pay. These include tax exemptions and tax holidays, tax deferments, de facto control of national infrastructure such as railways, ultra-low royalty rates and excessively generous access to water, timber and land. Many of these concessions are negotiated exclusively between multinationals and government ministers with little or no consultation with citizens or the parliament. For instance, a deal concluded in the

[9] New World Wealth: The AfrAsia Bank Africa Wealth Report, 2019.

[10] TJN, State of Tax Justice, 2020.

[11] Keen and Mansour, Revenue Mobilisation in Sub-Saharan Africa: Challenges from Globalization II – Corporate Taxation, 2010.

[12] Elke Asen, 'OECD Report: Tax Revenue in African Countries' (Tax Foundation, 28 May 2020) <https://taxfoundation.org/oecd-report-africa-tax-revenue-in-african-countries/> accessed 15 September 2021.

[13] 'UNITED NATIONS ECONOMIC COMMISSION FOR AFRICA (ECA) Contribution to the 2015 United Nations Economic and Social Council (ECOSOC) Integration Segment' (2015).

[14] World Bank Global Economic Prospect, 2019.

[15] TJNA, Tax us if you can: Why Africa Should stand up for Tax Justice.

[16] Erik.S, https://www.theguardian.com/global-development-professionals-network/2016/may/10/were-losing-240 billion-a-year-to-tax-avoidance-who-really-ends-up-paying

Ethiopian Regional State of Benishangul Gumuz involved a five-year exemption from corporate income tax. Calculations, based on a USD20 per hectare of income tax levied from profits per hectare, show a 602,760-ha deal resulting in an annual tax loss of USD 12.1 million.

- **Informal economy:** Referred to as the part of any economy that is neither taxed nor monitored by any form of government. These Informal activities are often understood as low capacity and traditional exchange economies. Africa's untaxed or under-taxed informal economy was estimated by the International Monetary Fund (IMF) to represent 34 per cent of GDP in 2017/18, compared to 9 per cent in North America, and 15 per cent in OECD countries[17].

Main causes of tax injustice in Africa?

There are several causes of tax injustice that have led to Africa's impoverishment. Some of these include:[18]

- **Selective development or maldevelopment:** Africa's maldevelopment is reflected by the fact that despite most countries having abundant mineral and other resources they are still classified as least developed because of the type of development they have been subjected to. Since the colonial era, there has been no growth in Africa's exports, with its global share declining from 7.3 per cent in 1948 to 2 per cent in 2009. This maldevelopment is characterized by the following features:
  - Having a narrow and distorted tax-base vulnerable to the demands of large taxpayers; that is, 'legal' citizens and corporations benefitting from export-oriented economies.
  - Little or no development of an active taxpayer citizenry, leading to lack of political representation and lack of accountability by African governments.
  - Insufficient levels of transparency and failure to disclose information on investment projects as well as failure to redistribute revenue, income and wealth.
  - Over-valued currency, which makes the export sectors less competitive (the 'Dutch Disease'), thus distorting the economic base towards investment in extractive industries.
  - Over-dependence on rents from natural resource as a source of government revenue, resulting in rentier economies; failure to capture just portions of tax revenue due to hidden subsidies such as low or zero tax and royalty rates; falsified profits and tax-exemptions.
  - Failure to tax exploitation or extraction industries, degradation and loss of critical ecosystem services.

- **Regressive taxation:** African governments have been forced to adopt taxation systems that are regressive and dependent on taxes such as the VAT due to the ease in collecting them and sometimes as a conditionality for loans and grants by international financial institutions (IFIs), hence the unfair tax burden being largely borne by the poor.

- **Limited taxation undermining representation:** Dependence on revenues from the extractive industries has created a situation in which many African governments are largely sustained by resource rents extracted from a very small number of powerful companies, who in return for taxes paid have got a high degree of influence over the tax policy. As a result, the majority of citizens are excluded from the political process of tax policy formulation.

- **Under-resourced and ineffective tax and customs administration:** Tax administrations in most African countries have often been characterized as either corrupt or inefficient, hard to reach and unwelcoming places. One of the more efficient ones, the Kenyan Revenue Authority (KRA), employed approximately 3,000 tax and customs officers in 2009, to serve a population of 32 million. Meanwhile Nigeria, with its 5,000 tax officials, cannot engage in a meaningful tax dialogue with its 140 million citizens. On the other hand, the Netherlands, employs 30,000 tax and customs officials to serve a population of 10 million. Most of the time of the Dutch tax and customs officials is spent on managing tax credits, and responding to taxpayer queries rather than simply extracting revenue.

- **Treaty shopping:** This involves the abusive use of tax treaties to route investments through a jurisdiction purely to take advantage of treaty benefits. This causes significant revenue loss for developing countries.

Enablers of tax injustice in Africa

Tax injustice or unfair taxation is promoted by several actors that legally justify their actions under the guise of tax planning. Some of the actors include:

- **Accountants:** Often the global accounting firms reinforce the culture of tax avoidance by claiming to have a duty to minimize tax liabilities of clients, which is in conflict with their duty to the public.

- **Lawyers:** Lawyers play key roles in creating, interpreting and enforcing rules. Some lawyers act as conduits of secrecy to meet the wishes of their clients while others find it difficult to resist pressures to provide tax

[17] IMF, The Informal Economy in Sub-Saharan Africa : Size and Determinants, 2017.
[18]

evasion services. Lawyers also often lobby on behalf of their private clients to try to dilute draft public interest legislation and actively promote secrecy jurisdictions to their clients.

- **Bankers:** Banks play a major role in the world of secrecy jurisdictions, thus providing the weakest link in tackling global corruption. It is often difficult to find accounts in the name of specific individuals as corrupt individuals or companies try to evade tax by setting up charitable foundations, trusts and International Business Companies in whose name they open accounts.

- **Multinational Companies:** They do this by lobbying for extensive tax holidays and other exemptions. They also engage aggressively in tax avoidance, often by using transfer pricing techniques to shift profits away from the countries where they are generated into subsidiaries located in secrecy jurisdictions.

- **Secrecy Jurisdictions:** Africa loses a vast quantity of its wealth through deals structured in secrecy jurisdictions or places commonly known as tax havens that enable IFFs. Secrecy jurisdictions are defined as places that intentionally create regulation for the primary benefit and use of those not resident in their geographical domain. Such regulation is designed to undermine the legislation or regulation of another jurisdiction. To facilitate its use, secrecy jurisdictions also create a deliberate, legally backed veil of secrecy that ensures that those from outside the jurisdiction making use of its regulation cannot be identified to be doing so. Similarly, Free Zones, Special Economic Zones, or Export Processing Zones, are also clearly designed to confer advantages to those not resident in the countries hosting them.

CASE STUDY

Top 5 biggest losers to corporate tax abuse in Africa

The top five countries with highest tax leaks attributable to corporate tax abuse are Nigeria, South Africa, Egypt, Angola and Sudan.

Country	Total annual tax loss (USD)	Annual tax loss due to corporate tax abuse (USD)	Annual tax loss due to offshore tax evasion (USD)	Total tax loss as a percent of public health expenditure
Nigeria	10, 825, 786, 952	10, 576, 472, 971	249, 313, 980	472.87%
South Africa	3, 391, 890, 587	2, 708, 824, 608	683, 065, 979	22.38%
Egypt	2, 320, 657, 159	2, 123, 341, 867	197, 315, 292	51.26%
Angola	2, 253, 340, 634	2, 050, 800, 000	202, 540, 634	146.52%
Sudan	645, 033, 468	643, 999, 989	1, 033, 479	121.11%

Key take-away

There is a direct relationship between a country's Gross Domestic Product (GDP) and the amount of annual tax losses. The higher your GDP the higher you stand to lose in corporate tax leakages.

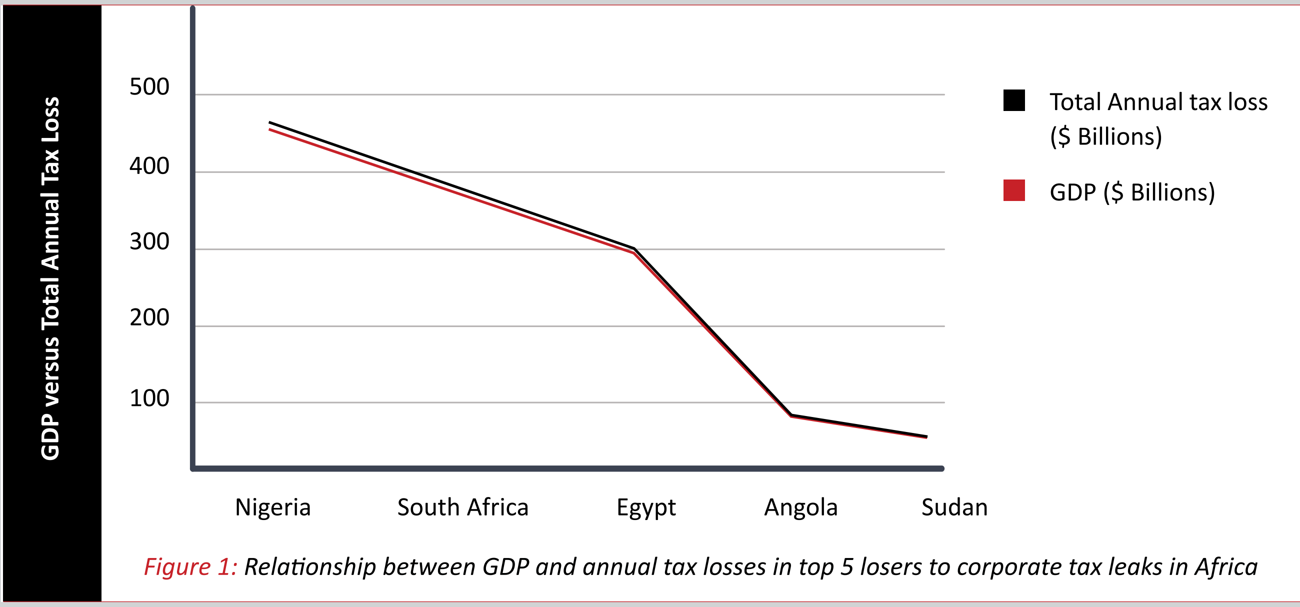


Figure 1: Relationship between GDP and annual tax losses in top 5 losers to corporate tax leaks in Africa

1.3 Legislative Considerations: What you can do?

1.3.1 Oversight role

As an individual MP and/or a member of a portfolio committee, with support from TJNA, you can do the following to keep the executive arm of government in check on matters tax justice.

1.3.2 Law-making role

Members of Parliament can do the following in their law-making role:

- Legislate a stand-alone and comprehensive access to information law.
- Legislate transparent, simple and comprehensible tax codes.
- Promote or develop a private member's bill on the formalization of the informal economy

Oversight role	Kind of support TJNA can offer you
• Question deals and treaties that are counter to the Constitution in delivering on political and social justice.	• Research, desktop reviews, share examples from other countries, provide policy briefs and cost-benefit analysis of the treaties.
• Fight regressive tax systems that charge people on lower incomes a higher proportional rate of tax than those on higher incomes.	• Provide policy briefs, desk reviews and country-specific researches on ideal tax systems • Coordinate symbiotic advocacy efforts with other local CSOs
• Request information on secretive extractive and other investment deals to uphold equality of all taxpayers	• Highlight the secretive deals through researches, desktop and literature reviews.
• Rebuff any oppressive tax systems which charge a source of income to more than one tax.	• Coordinate symbiotic advocacy efforts on the matter with other local CSOs and academia. • Share researches, policy briefs on tax systems and
• Question inconsistent tax systems which charge similar types of income in different ways or at substantially different rates.	
• Fight tax policy loopholes that diminish countries resources by eliminating arbitrary tax exemptions and tackling tax dodging of MNCs using strong regulatory framework.	• Provide timely data and researches on the existing tax policy gaps within and outside the country. • Coordinate meetings with local and international resource organizations and persons • Maintain dialogue with civil society and the academia on emerging local tax justice issues relating

1.4 Relevant Resources: Where you can find more information on tax justice?

Source	Links
Websites	TJNA: https://taxjusticeafrica.net/
Publications/Articles	• Tax Us If You Can: Why Africa Should Stand up for Tax Justice: https://www.taxjustice.net/cms/upload/pdf/tuiyc_africa_final.pdf • Tax Transparency in Africa 2020: Africa Initiative Progress Report: 2019: https://www.oecd.org/tax/transparency/documents/Tax-Transparency-in-Africa-2020.pdf
YouTube	• TJNA: https://www.youtube.com/channel/UCcYJuhBi0Nuq1-oFiBgmvQA • TJN: https://www.youtube.com/user/TackleTaxHavens
Organizations	TJNA, DIAKONIA, TJN, OXFAM, SEATINI

2.0 Illicit Financial Flows (IFFs)

2.1 Overview

Illicit financial flows

The United Nations[19] (UN) broadly defines IFFs as 'all cross-border financial transfers, which contravene national or international laws'. The definition emphasizes the illegal action of IFFs and requires the codified criminal nature of the flow for it to be classed as an IFF.

The High Level Panel Report on Illicit Financial Flows from Africa[20] takes a different approach where it defines IFFs as '*money that is illegally earned, transferred or used*' but includes tax avoidance, as opposed to just evasion, as a type of IFF. This moves the debate around IFFs from the illegality of IFFs to include a moral dimension. **This is the operative definition for this toolkit.**

Main sources of IFFs in Africa

There are three main sources of IFFs in Africa, each contributing to a differing level of the totality of IFFs.*They include those attributable to:

I. Commercial activities;
II. Criminal activities; and
III. Corruption.

> * *Commercial activities constitute the bulk at 65%, criminal activities 30% and corruption makes up the remaining 5%.*

I. Commercial activities

These arise from business-related activities deliberately planned with a goal to, among others, hide wealth, evade or aggressively avoid tax, and dodging customs duties and domestic levies.[21] The various channels through which these goals are achieved include the following:

- **Tax Base Erosion and Profit Shifting (BEPS):** These are the tax avoidance strategies that exploit the gaps in tax regimes to shift profits to low or no tax locations. Whereas BEPs are not entirely illegal, they make a substantive part of IFFs. To address them requires efforts from both developed and developing countries.

- **Abuse of Transfer Pricing:** This occurs when a Multinational Corporation (MNC) takes advantage of its multiple structures to shift profit across different jurisdictions. While it is not generally illegal for trade to take place between a company and its subsidiaries, they would have to comply with the 'arm's-length principle' *for them not to be engaging in base erosion and profit shifting.

> * *arm's-length principle is an international standard that compares the transfer prices charged between related entities with the price in similar transactions carried out between independent entities at arm's length.*

- **Trade mispricing:** This is the manipulation of trade invoicing of imports and exports to deceive tax authorities or manipulate markets. These could range from the desire to evade customs duties and domestic levies on traded goods to the intent to export foreign exchange abroad.

- **Abusive Tax Exemptions:** This refers to the offering of tax incentives and exceptions for MNCs in a race to the bottom with the promise of increased Foreign Domestic Investment (FDI). This has resulted in a situation where the MNCs make billions in profits but pay almost zero corporate taxes.

- **Mis-invoicing of services and intangibles:** This include mis-invoicing of services and intangibles such as intra-group loans, intellectual property and management fees. This is partly due to the increasing share of services in global trade, changing technology, transactions that lack substance and a lack of comparative price information.

- **Thin capitalization:** This is a situation where the MNCs borrow from their low taxed affiliates, rather than raising capital through shares.

II. Criminal activities

Criminal activities generate money illegally and then use and often transfer it illegally. This practice constitutes an IFF. These include human trafficking, poaching, drugs, arm dealing, oil and mineral theft, and money laundering. The proceeds from these activities often use the same mechanisms that are used in the commercial sector to evade taxes and customs duties to move the money abroad.

[19] UN, Coherent Policies for Combatting IFFs, UNODC and OECD, Issue Brief Series from the Inter-Agency Task Force on Financing for Development, July 2016.
[20] AU/ECA, Track it! Stop it! Get it!: Report of the High Level Panel on Illicit Financial Flows from Africa, 2013.
[21] AU/ECA, Track it! Stop it! Get it!: Report of the High Level Panel on Illicit Financial Flows from Africa, 2013

Illicit Financial Flows (IFFs): Vital Statistics

USD 278 billion

IFFs linked to the export of primary extractive resources in Africa between 2010- 2020.

USD 88.6 billion

Capital flight from Africa, which captured trade mis-invoicing and other balance-of-payment transactions between 2013-2015.

USD 770 billion

Africa's total external debt stock by end of 2018 which translates to USD 74 liability per person.

USD 54 billion

Total foreign direct investments received by African countries in 2018.

16%

Percentage of extractive export under-invoicing in relation to merchandise exports.

77%

Percentage attributable to gold's contribution to total African extractive export under-invoicing.

TAX FRAUD

65%

Mining and extractive companies in Africa are responsible for 65% of tax fraud in the continent.

III. Corruption

Corruption refers to the paying of public officials and their misuse of public funds through embezzlement. Non-transparent government procedures and supply chains perpetuate opportunities for these practices and thus facilitate the commercial and criminal aspects of IFFs. With its cross-cutting contribution to IFFs and enablement of duty-holders, corruption is better understood as simply the abuse of entrusted power.

2.2 Problem Outlook

What is the magnitude of IFFs in Africa?

Africa loses at least USD88.6 billion annually, which is equivalent to 3.7% of its GDP, through various forms of IFFs.[22] These outflows are nearly as much as the combined total annual inflows of ODA, valued at USD48 billion, and yearly foreign direct investment, pegged at USD54 billion, received by African countries – which represents the average investment between 2013 and 2015.

From 2000 to 2015 alone, the total illicit capital flight from Africa amounted to USD836 billion, translating to a loss of USD74 per person in Africa, a figure that could alleviate hunger and guarantee decent meals per-household for over three months, consecutively. Further, if compared to Africa's total external debt stock of USD770 billion in 2018, the amount makes Africa a "net creditor to the world". These IFFs have also been found to have a strong and negative effect on investment rates, notably private investment, and are presently curtailing the overall Africa's savings rate.[23]

IFFs related to the export of extractive commodities valued at USD 40 billion in 2015, are the largest component of illicit capital flight from Africa. Additionally, the European commission recognizes that mining and extractive companies in Africa are responsible for 65% of tax fraud in the continent.[24]

Why is the extractive sector most vulnerable to IFFs in Africa?

The extractive sector, which includes mining, oil and gas production, is a major source of investment and revenue in Africa. It contributes as high as 60% to GDP in some countries. The African Development Bank (AFDB) estimates that 30% of the world's mineral reserves are in Africa.[25] The continent has 8% of the world's natural gas reserves, 12% of its oil reserves, 40% of its gold and between 80 and 90% of its chromium and platinum. Africa's fish exports are valued at USD3 billion annually; while, cumulatively, forests contribute an average of 6% of GDP in Africa.

The sector is most vulnerable to IFFs for several reasons:

- **Over-reliance on the sector for revenue and export earnings:** The extractives sector is marred by a high degree of discretionary power and political influence. Consequently, this influence has become a source of the secret and unequal contracts that African countries sometimes enter with MNCs. These contracts in turn undermine efforts to promote transparency and accountability in the extractives industry. This phenomenon is best explained by the IFFs in the petroleum and gold mining sub-sectors.

- **Complexity of value chains associated with the sector:**[26] These chains are normally complex and transcend national borders. As such, this gives MNCs undue advantage in contracts negotiations.

Country	Amounts lost to IFFs
Algeria	USD 25.7 billion in oil revenues between 1970 -2008
Egypt	USD 31.3 billion in oil revenues from 1970 – 2015
Nigeria	USD 217 billion in oil revenues from 1970 – 2008
Angola	USD 4 billion in oil revenues was not reported in national accounts in 2002
Tanzania	USD 84 billion in gold mining between 1998 - 2017
South Africa	USD 78 billion in under-declared gold exports

[22] UNCTAD, Economic Development in Africa Report, 2020.

[23] Nkurunziza, J.D, Illicit Financial Flows: A Constraint on Poverty Reduction in Africa. 2012.

[24] European Commission DEVCO, Collect more Spend better, https://op.europa.eu/en/publication-detail/-/publication/7914c998-ecd6-11e5-8a81-01aa75ed71a1/language-en

[25] AFDB, Governance of the Extractive Industries in Africa: Survey of Donor-funded Assistance, 2017.

[26] S.A. Igbatayo, Combating Illicit Financial Flows from Africa's Extractive Industries and Implications for Good Governance, 2019.

What are the main drivers of IFFs in Africa?

The drivers of IFFs are diverse and cut across multiple sections of society. These can be characterized as three interconnected categories, namely macroeconomic drivers, structural characteristics and overall governance.[27]

I. Macroeconomic drivers

These are the economic characteristics that cause companies and people to want to move their money across borders. They may include high and variable inflation, overvalued real effective exchange rate, negative real rates of return and external debts.

II. Structural characteristics

This refers to the structured economy, which includes fiscal and monetary architecture as well as the composition of the economy. Inequality is measured by the Gini coefficient. A high Gini coefficient means an unequal society. This will result in higher savings among higher income earners. When combined with macroeconomic drivers such as negative real rates of return, this will incentivize savers to move their money abroad.

Double Taxation Agreements (DTAs) can be used to shift earnings away from the source country to one where they pay little or no tax.

III. Poor Governance

The informal economy can be characterized as a governance driver of IFFs, as most of the informal sector pays little to no tax, which reduces the ability of a government to fund the countries development.

What are Double Taxation Agreements (DTAs) and why are they quickly becoming a facilitator for IFFs?

A DTA, also known as a double taxation treaty, is a bilateral (two-party) agreement made by two countries to allocate taxing rights between them over different sources of income and capital.[28] Such treaties generally determine the amount of tax that a country can apply to a taxpayer's income, capital, estate, or wealth.

DTAs are a subject of interest because of the rising degree of globalization, which has resulted in increased tax competition.

Whereas DTAs have been hailed as enablers of international trade and investment by equitably and efficiently sharing the taxing rights between the participating countries and avoiding double taxation, studies have indicated that DTAs have been used by developed countries for the benefit of their MNCs in exploiting developing countries.[29] Some of the concerns raised regarding tax treaties are as follows:

- **Treaty Shopping -** This refers to a situation where a party that is not a resident of either of the contracting states will route its investment through one of the contracting states with a view of enjoying the treaty benefits. In such situations the primary driver of the transactions will be the obtaining of the tax benefits provided under the DTA such as lower withholding tax rates, among others. Such treaty shopping denies source countries their duly owed tax revenues because DTAs rely on reciprocity between two jurisdictions for them to be effective. Where an entity is based in a country that does not have a tax treaty with the source state and engages in treaty shopping, revenue leakages result.

- **Round Tripping -** This arises where a resident of one country routes his investments through another country back to his own country as FDI. The main aim of such transactions is to ensure that such companies pose as foreign investors and benefit from preferential tax treatment. These schemes have often contributed to instances of tax avoidance and subsequently led to the review of many DTAs, such as in India which revised its three-decades-old DTA with Mauritius.

- **Source versus Residence Based Principle -** Over a period of time, economies have evolved two principles for determination of taxability of an income in a particular jurisdiction. Of them is the residence-based taxation, where income is taxed by virtue of an entity's (taxpayer's) domicile in a particular country. The other is the concept of source-based taxation, where an entity (foreigner) is taxed in a country on the income sourced from that country.[30] There has been a big challenge in balancing the equation between source and residence principles in the development of DTAs.

- **Principle of Tax Neutrality -** It provides that different parties in similar circumstances ought to be taxed using the same rates on similar incomes. The principle of neutrality emphasizes that generally the tax system should strive to be neutral so that decisions are made on their economic merits and not for tax reasons. However, it is worth noting that in some cases neutrality may be subject to distortions. As such, there is need to measure the extent to which any tax system departs from this principle. Even with acceptable cases of distortions tax

[27] UNCTAD, Economic Development in Africa Report, 2020.
[28] Nkurunziza, J.D, Illicit Financial Flows: A Constraint on Poverty Reduction in Africa. 2012.
[29] European Commission DEVCO, Collect more Spend better, https://op.europa.eu/en/publication-detail/-/publication/7914c998-ecd6-11e5-8a81-01aa75ed71a1/language-en
[30] AFDB, Governance of the Extractive Industries in Africa: Survey of Donor-funded Assistance, 2017.

neutrality is often violated in DTA negotiations through tax concessions that are often reached between the contracting states.

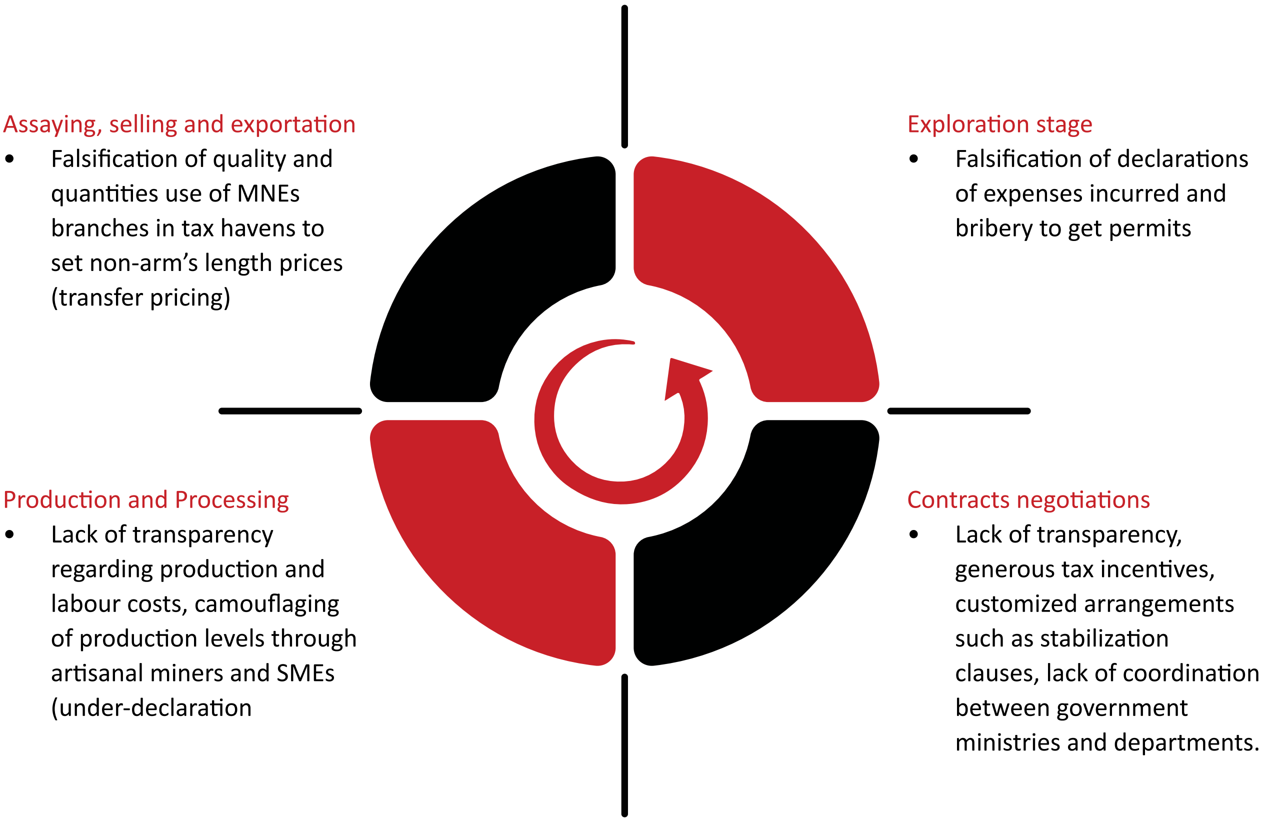
- **Limitation of Treaty Benefits** - This stipulates that reduced withholding rates and other treaty provisions apply only to companies that meet specific tests of having some genuine presence in the treaty country[31] (such as a minimum share of ownership by its residents or a minimum level of income from conducting an active trade or business there). Treaties which have no anti-abuse provisions often result in the granting of treaty benefits in instances that were not intended. This has raised concern, especially where MNCs have set up box offices in given jurisdictions primarily to take advantage of the treaty benefits.

What are the general red flags of IFFs that you should be on the lookout for?

There are certain tell-tale signs that IFFs are present and can be used as a basis for further analysis in your respective countries:[32]

- The involvement of shell companies in the award process of licenses and contracts.
- Involvement of blacklisted and sanctioned individuals and companies in the award process.
- Abuse of office and conflict of interests by Politically Exposed Persons (PEPs) in the awards process.
- Failure to ascertain and verify the ultimate beneficial owners (UBOs) in the awards process.
- Weak enforcement of anti-bribery and corruption laws.
- Encouragement of a monopolistic market to favor certain individuals or companies.
- Diversion of revenue from government coffers to individuals and companies.
- Non-enforcement of uniform standards.
- Rent-seeking by authorities within an industry or sector
- Transactions with bank secrecy jurisdictions

Typically, with respect to the above stated red flags, IFFs will manifest in the following stages in the extractive sector.



Assaying, selling and exportation

- Falsification of quality and quantities use of MNEs branches in tax havens to set non-arm's length prices (transfer pricing)

Exploration stage

- Falsification of declarations of expenses incurred and bribery to get permits

Production and Processing

- Lack of transparency regarding production and labour costs, camouflaging of production levels through artisanal miners and SMEs (under-declaration

Contracts negotiations

- Lack of transparency, generous tax incentives, customized arrangements such as stabilization clauses, lack of coordination between government ministries and departments.

Figure 2: Stages of IFFs in the extractive sector

[31] IMF: Spillovers in International Corporate Taxation, 2014

[32] TJNA: Illicit Financial Flows – Factsheet.

CASE STUDY

Some notable actions/initiatives taken by Members of Parliament in Africa to curb IFFs in their countries

Inclusive Framework on BEPs: Mauritius

The OECD/G20 Inclusive Framework on BEPS was established with the purpose of having different jurisdictions come together to set standards on various issues of BEPS. Any states or jurisdictions that would join this process would have to adhere to certain minimum standards, namely:

- Countering harmful tax practices;
- Countering tax treaty abuse;
- Enhancing country by country reporting;
- Enhancing dispute resolution systems.

Mauritius joined the Inclusive Framework on BEPS in 2016 and as part of adhering to the minimum standards on BEPS, specifically BEPS Action 5 on 'Countering Harmful Tax Practices More Effectively by Taking into Account Transparency and Substance', Mauritius made some changes to its well-known global business sector.

These changes made in 2018 were spearheaded by its Parliament so as to mitigate the bad reputation of the Mauritius Financial Centre.

Parliamentary Action: Introducing major amendments to the Financial Services Act 2007 through the Financial Services (Miscellaneous Provisions) Act 2018 to make changes to the Mauritian global business sector.

Result: Mauritius abolished both global business license 1 and global business license 2 that had easily allowed foreigners to set up companies in Mauritius while carrying out their businesses elsewhere. These licenses previously enabled these companies to enjoy the treaty benefits of Mauritius' wide DTA network.

Hence, companies would transfer their registration to Mauritius for the sole purpose of enjoying lower taxes and escaping the high taxes of their home countries in Africa. These licenses were replaced with the new global business licenses that require a certain threshold of economic activity, a number of employees and management and control within Mauritius before the holders of the license could gain any treaty benefits. These regulations were expected to make it more difficult for companies to set up in Mauritius for the sole purpose of carrying out aggressive tax avoidance.

Beneficial Ownership: Kenya

In the wake of multiple prosecuted cases in Kenya, it was acknowledged that persons who facilitate the flow of illicit capital make use of legal vehicles such as companies and trusts to hide their activities.

Requirements on beneficial ownership transparency counter this by providing that the living natural person behind these legal vehicles be disclosed. In 2015, the National Assembly of Kenya took some definitive steps towards the realization of beneficial ownership transparency by formulating legislation that provided for BO laws.

Parliamentary Action: Introducing an amendment to the Companies Act 2015 through section 93A that requires companies to disclose the beneficial owners of their shares in their registry of members. This has further led to the enactment of the Beneficial Ownership Regulations 2020 that require an ownership threshold of 10% before it can be necessary for beneficial owners to be declared.

Result: As from October 2020, the Beneficial Ownership e-registrar has been operationalized. The register is however not yet accessible to the general public.

Tax and Natural Resource Governance: Lesotho

In 2009, the Africa Mining Vision (AMV) was adopted by the African Union as a framework to foster the utilization of transparent and equitable mineral exploitation to ensure sustainable development for Africans. Member States were to implement the AMV through domesticating it by formulating a Country Mining Vision based on the key tenets of the AMV and implementing it. One of the key tenets of the AMV is improving mineral sector governance, which includes improving the fiscal governance of the mineral sector. To date, Lesotho is the only Member State that has fully domesticated the AMV and the role of Parliament was central to this fact. In 2014, the Parliament passed the Mines and Minerals Act (Amendment) 2014 (Legal Notice No. 7 of 2014), which introduced some key changes to the mining laws especially within mineral sector governance.

Parliamentary Action: The enactment of the Mines and Minerals Act (Amendment) 2014, which introduced transparency and accountability mechanisms in mining governance.

Result: A legal framework that aligns with the AMV and enhances the utilisation of minerals for development.

Double Taxation Agreements: Senegal

Senegal cancelled its DTA with Mauritius on the basis of the treaty causing Senegal significant revenue leakages. This came in the wake of the West Africa Leaks in which the mining company Grande Corte Operations (GCO) obtained engineering, construction and management services from SNC-Lavalin, a Canadian based company. However, the service agreement signed was between GCO and SNC-Lavalin's subsidiary company that was registered in Mauritius.

The West African Leaks exposed how SNC-Lavalin used its Mauritius subsidiary to grossly avoid taxes due to the existence of the DTA between Senegal and Mauritius. Due to this arrangement, it is estimated that Senegal lost up to USD 8.8 million by SNC-Lavalin taking advantage of the DTA.

Parliamentary Action: The Senegalese Parliament exercised oversight over GCO, inquiring into its operations and fiscal arrangements. In the wake of the West African Leaks, it was revealed that major mining companies carrying out large scale mining operations in Senegal had their majority shareholders registered in Mauritius, thus placing Senegal at a great risk of further leakages due to the DTA. Parliamentarians decried these arrangements, consequently inducing political pressure on the need for action against the Senegal-Mauritius DTA, with one parliamentarian, who was a former revenue authority, official saying, "A tax haven might be heaven for multinational companies to avoid taxes, but, for the country, it's hell.''

Result: Review of the DTA between Senegal and Mauritius and its eventual cancellation in 2020.

Increased Focus on Transparency and Exchange of Information - Kenya

The OECD's Global forum has done a lot of work to enhance transparency through both the Exchange of Information on Request (EOIR) and the Automatic Exchange of Information (AEOI). EOIR has historically relied on bilateral relationships under a double tax treaty (DTT) or a tax information exchange agreement (TIEA) as the legal basis for undertaking the exchange while AEOI is based on the Common Reporting Standard (CRS), which provides for multilateral exchange of financial account information in tax matters. Transparency in tax matters plays a significant role on curbing IFFs. Many African countries have joined the Global Forum, and by so doing have committed to implementing the EOIR standard at the minimum. An increasing number have adopted the CRS and are planning to enact laws for operationalizing it. Kenya, for instance, joined the Global Forum in 2010 and introduced laws allowing for Exchange of Information through the Finance Act, 2012, which saw the introduction of s41A of the Income Tax Act, Cap 470. In 2016, Kenya signed the Convention on Mutual Administrative Assistance in Tax Matters (the Convention) and ratified it in 2019. As it lays the groundwork for AEOI through the passing of requisite legislation, Kenya continues to benefit from EOIR.

Parliamentary Action: The amendment of the Income Tax Act, Cap 470 to allow for exchange of information in 2012

Result: Kenya has continued to increasingly make information requests that have increased visibility over tax evaders' affairs.

2.3 Legislative Considerations: What you can do to curb IFFs in your country and/region

2.3.1 Oversight Role

Members of Parliament can do the following to keep the executive arm of government in check on matters related to IFFs:

Oversight Role	Kind of support TJNA can offer you
• **On DTAs:** o Demand that the executive balances the concerns between source and residence issues in taxation while negotiating for a treaty. o Question any tax system that prioritizes taxes over the real economic merit of the decision o Ensure that there is an inclusion of a provision on limitation of benefits in a double taxation treaty that will contribute towards mitigation of treaty abuses where investments are routed through given jurisdictions to benefit from the existing treaty.	- Provide documents on how certain DTAs can be regressive in Africa - Make available on request, research papers, policy briefs and case studies from other countries in Africa
• **Collaborative work:** Compel the Executive to collaborate with their counterparts in the regional economic communities, namely the African Union, and at the global level, the G20, the OECD, the World Bank, the IMF and the United Nations to ensure consistency in their legal framework.	- Facilitate MP participation in meetings with CSOs, RECs
• **Access to information:** Put pressure the Executive to make available all contracts in digital formats, develop the capacity of the citizens to request, process and use the information that they obtain.	- Provide information on international best practices
• **Transfer pricing:** Push the executive to establish transfer pricing units or strengthen necessary institutions by building its capacity for effective functioning and providing necessary resources.	- Provide information on international best practices
• **On the extractive sector:** o Pay more attention to the whole value-chain of the sector o Advocate for investment in capacities and technology to monitor extraction of their natural resources better o Ensure the Executive promotes transparency especially in negotiating contracts o Make greater use of the information and support provided by voluntary existing mechanisms promoting transparency in the natural resource sector o Push the Executive to adopt mandatory global reporting requirements o Pressurize the Executive to develop a plan on diversifying the economy away from dependence on natural resources into higher value activities.	- Provide documents that speak to how countries can mitigate IFFs in the extractive sectors - Facilitate the participation of MPs in meetings on IFFs in the extractive sector - Make available, on request, research papers, policy briefs and case studies from other countries in Africa
• **On taxing the emerging digital economy:** Encourage the Executive to invest more in further research of the new trends and their connections to IFFs.	- Provide information on international best practices

Oversight Role	Kind of support TJNA can offer you
• **On tax incentives:** o Demand that the Executive undertakes and publishes the cost-benefit analysis in granting tax incentives, especially tax holidays intended to attract foreign direct investment o Call for the executive to coordinate issuance of such incentives with members of regional economic communities in order to develop common standards and prevent a "race to the bottom".	- Provide data on the regressive nature of particular tax incentives
• **On corruption:** o Call for the Executive to domesticate the provisions of the United Nations Convention against Corruption (UNCAC) and The African Union Convention on Preventing and Combating Corruption (AUCPCC) at the national level.	- Provide information on corruption statistics and the impact on national development
• **On money laundering** o Stress the urgency to address the dichotomy between revenue and law enforcement agencies on the sharing of information about money laundering discovered in the process of tax audits.	- Provide learning information on international best practices
• **On national and regional efforts** o Encourage the Executive to strengthen existing institutions fighting IFFs by giving them the necessary autonomy and tools with which to carry out their duties. o Forster better relations with the regional partners by participating in forums such as the African Tax Administration Forum and related mutual assistance programmes.	- Facilitate MP participation in regional meetings with fellow MPs from other African countries

2.3.2 Law-making role

- Develop or amend the current laws on tax holidays to prevent the same entity or beneficial owner from continuing to benefit after there is an apparently substantial change in ownership.

- Develop or amend an existing law to strengthen the anti-corruption body that brings them together for regional cooperation and providing them with autonomy, resources and capacities to prevent and prosecute corruption cases.

- Develop laws, regulations and mechanisms that ensures that financial establishments and banks identify and refuse to accept IFFs, rather than relying on self-regulation by banks.

- During the budgeting process, ensure that there is an allocation of money to create relevant agencies, such as revenue authorities, transfer pricing units, customs services, anti-corruption agencies, financial intelligence units and the like where these do not exist.

- Review any existing laws on the registration of companies and operations of the banking sector to curtail any haven for financial secrecy.

2.4 Relevant resources: Where you can find more information on IFFs

Source	Links
Websites	TJNA: https://taxjusticeafrica.net/
Publications/Articles	• HLP Report: Track it! Stop it! Get it!: https://www.uneca.org/sites/default/files/PublicationFiles/iff_main_report_26feb_en.pdf • TJNA Factsheet on IFFs: https://taxjusticeafrica.net/wp-content/uploads/2020/06/Tax-Justice-Fact-Sheet.pdf
YouTube	• TJNA: https://www.youtube.com/channel/UCcYJuhBi0Nuq1-oFiBgmvQA • TJN: https://www.youtube.com/user/TackleTaxHavens
Organizations	TJNA, DIAKONIA, TJN, OXFAM, SEATINI

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