Tax base erosion and profit shifting – part 2: a critique of some priority OECD action points from an African perspective – preventing excessive interest deductions and tax treaty abuse

Annet Wanyana Oguttu[*]

Abstract

This second part of the article on 'base erosion and profit shifting' (BEPS) in Africa', is a critical analysis of two of the OECD's BEPS action points that are of priority in most African countries. These are; Action 4: limit base erosion via interest deductions and Action 6: prevent treaty abuse. This analysis is premised on the view that Africa must come up with customised solutions to protect its own tax base in order to ensure domestic resource mobilisation. The paper stresses that international tax cooperation in addressing BEPS concerns should take into account the needs and capacities of all countries. In this African customised analysis on Actions 4 and 6, the author identifies the general concerns most African countries face with respect to base-eroding interest payments and abuse of tax treaties and provides examples on specific matters from an array of African countries. It provides recommendations as to how African countries can effectively adopt the OECD recommendations to prevent base-eroding interest payments and abuse of tax treaties in light of their economic development and tax administrative capacity constraints.

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[*] LLB (Makerere); LLM, LLD (Unisa); Dip Legal Practice (Law Development Centre Makerere); H Dip International Tax Law (University of Johannesburg). Professor: Department of Mercantile Law, University of South Africa.

INTRODUCTION

In Part 1[1] of this two-part paper on 'base erosion and profit shifting' (BEPS)[2] in Africa', the author dealt with the question: 'What should Africa's response be to the OECD BEPS Action Plan?' In answering this, part 2 describes what BEPS is, its causes and impact, and how African countries should respond to the OECD BEPS project. The article points out that although the OECD Project covers fifteen action points[3] to address BEPS, the G20 Development Working Group Domestic on Resource Mobilisation for Developing Countries has indicated that owing to the specific challenges faced by developing countries, the highest priority actions that have the greatest impact for developing economies are:[4]

- Action 4: limit base erosion via interest deductions and other financial payments.
- Action 6: prevent treaty abuse.
- Action 7: prevent the artificial avoidance of PE status.
- Action 10: assure that transfer pricing outcomes are in line with value creation with respect to other high-risk transactions.
- Action 12: require taxpayers to disclose their aggressive tax planning arrangements.
- Action 13: re-examine transfer pricing documentation.

The above are largely consistent with those identified by the United Nations (UN) Subcommittee on BEPS from the responses to its questionnaire on the priority BEPS concerns of developing countries.[5] It should be noted that the above action points may not necessarily be a top priority in all African

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1 Oguttu 'Tax base erosion and profit shifting in Africa – part 1: what should Africa's response be to the OECD BEPS Action Plan?' (2015) 48/3 *CILSA* 516–552.

2 BEPS refers to 'tax avoidance' by multinational enterprises (MNEs) that use gaps in the interaction between different tax systems to reduce taxable income artificially, or shift profits to low-tax jurisdictions in which little or no economic activity is performed. See OECD *Addressing base erosion and profit shifting* (2013) 5.

3 See OECD n 2 above.

4 G20 Development working group domestic resource mobilisation 'G20 response to 2014 reports on base erosion and profit shifting and automatic exchange of information for developing countries' (2014) at 8. Available at: https://g20.org/wp-content/uploads/2014/12/16%20G20%20response%20to%202014%20reports%20on%20BEPS%20and%20AEOI%20for%20developing%20economies.pdf (last accessed 4 March 2015).

5 UN Committee of experts on international cooperation in tax matters tenth session 'Responses to questionnaire for developing countries from the UN Subcommittee on base erosion and profit shifting' (31 September 2014); United Nations *Handbook on selected issues in protecting the tax base of developing countries* (2015) viii.

countries given the countries' differing levels of economic development and administrative capacity. Because of the broad nature of issues pertaining to each of these action points, they cannot all receive in-depth treatment in a journal article. Therefore, the main focus is on the first two priority Action Points – Actions 4 and 6 – from the African perspective. This choice is informed by Zambia's Tax Administration's response to the UN questionnaire on BEPS (the only African Tax Administration that responded to this questionnaire by the 2 May 2014 deadline).[6] In response to the question: 'If you are affected by base erosion and profit shifting, what are the most common practices or structures used in your country or region?', Zambia's Tax Administration[7] answered:

> The most common practices and structures include:
> Tax treaty abuse especially through treaty shopping;
> Profit shifting through high interest, royalty, management and consultancy fee deductions;
> The avoidance of permanent establishment creation by tailoring activities; and
> contracts in such a way that the activities cannot be deemed/create a permanent establishment.

These practices were also among those listed by the Economic Justice Network and Oxfam South Africa (a civil society organisation), the only other African body to respond to the UN questionnaire.[8] Although BEPS issues relating to permanent establishments were identified by the Zambian Revenue Authority, and although transfer pricing is also a priority for African countries, these issues are not covered in this article, which is a critical analysis of Africa's concerns over Actions 4 and 6 as well as recommendations on how African countries can effectively adopt the OECD recommendations in light of their economic development and tax administrative capacity constraints as they strive to prevent BEPS. The

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6 United Nations 'Questionnaire: base erosion and profit shifting issues for developing countries' (2013). Available at: http://www.un.org/esa/ffd/tax/Beps/BepsIssues.pdf (last accessed 25 February 2016).

7 UN 'Zambia's Tax Administration response to the BEPS questionnaire regarding country experiences with base erosion and profit shifting issues' available at: http://www.un.org/esa/ffd/tax/Beps/CommentsZambia_BEPS.pdf (last accessed 25 February 2016).

8 Economic Justice Network and Oxfam South Africa 'Countries' experience regarding base erosion and profit shifting issues – South Africa' available at: http://www.un.org/esa/ffd/tax/Beps/CommentsEJNandOxfamSA_BEPS.pdf (last accessed 25 February 2016).

premise of this analysis is the view that Africa must come up with customised solutions to protect its own tax base. This is affirmed by the Cross Border Taxation Technical Committee (CBTTC) created by the African Tax Administration Forum (ATAF)[9] in 2014 to define the African position on BEPS, to communicate the African response to the OECD/G20 BEPS project, and to present an African perspective on global tax matters. ATAF's CBTTC calls for a customised approach to addressing BEPS that will assist African countries and groups of countries in similar situations to ensure domestic resource mobilisation.[10] The UN has also stressed that efforts in international tax cooperation 'should fully take account of the different needs and capacities of all countries, in particular least developed countries, landlocked developing countries, small island developing states, and African countries'.[11] In this analysis of BEPS Actions 4 and 6, I identify the general concerns most African countries face and provide examples of specific matters from various African countries.

ACTION 4: LIMIT BASE EROSION VIA INTEREST DEDUCTIONS

Should a multinational enterprise (MNE) wish to finance its subsidiary companies as a group, it may do so by using loan capital, equity capital,[12] or a combination of debt and equity capital.[13] Internationally, the tax treatment of a company and that of its sponsors differ fundamentally depending on whether it is financed by loan or equity capital.[14] If capital is loaned by a parent company to its subsidiary, the latter will have to pay interest, which in most jurisdictions is a deductible expense when computing taxable income (unless there are special rules to the contrary).[15] Where the parent

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9 ATAF is an organisation that promotes and facilitates mutual cooperation among African tax administrators. For details on ATAF and its member countries visit: http://www.ataftax.org/en/Pages/default.aspx.

10 ATAF 'Outcomes document: consultative conference on new rules of the global tax agenda'.

11 United Nations ; 'Outcome document of the third international conference on financing for development: Addis Ababa action agenda' (13–16 July 2015) par 28. Available at: http://www.un.org/ga/search/view_doc.asp?symbol=A/CONF.227/L.1 (last accessed 17 August 2015).

12 Sommerhalder 'Approaches to thin capitalisation' 1996 *Bulletin for International Fiscal Documentation* 80.

13 Lawrence 'Government restrictions on international corporate finance (thin capitalization)' (1990) 44 *Bull Intl Fiscal Documentation* 3.

14 Sommerhalder 'Approaches to thin capitalisation' n 12 above at 82.

15 Oguttu 'Curbing thin capitalisation: a comparative overview with specific reference to South Africa's approach – challenges posed by the amended section 31 of the Income Tax Act' (2013) 67/6 *Bulletin for International Taxation* at 312; Huxham & Haupt *Notes on South African income tax* (2015) 80.

company invests in the shares of its subsidiary, dividends must be distributed by the subsidiary to the parent company. In most jurisdictions dividends are not deductible when calculating taxable income as they are classified as taxable profits.[16]

Clearly, financing a company with debt at a deductible interest rate, is more effective in reducing source country tax than doing so with equity financing, where dividend distribution is not deductible.[17] Indeed, debt financing has long been recognised as a strong tax planning tool for MNEs which often create 'thin capitalisation' schemes to ensure that their subsidiary companies are financed by debt rather than by equity capital.[18] Although the availability of debt is essential for business growth, the potential for excessive interest deductions can erode countries' tax bases. Where debt is granted among related entities, and one is located outside the country of the interest payer, the interest payments can present a major risk for base erosion. Debt can be loaded into companies operating in high-tax countries and arrangements made for deductible interest payments to be received by an entity in a low-tax jurisdiction where it may be taxed favourably or not at all.[19] The OECD notes that 'the use of interest, (in particular related party interest) is perhaps one of the simplest profit-shifting techniques available in international tax planning.'[20] This is because the fluidity and exchangeable nature of money lends itself to adjusting the mix of debt and equity capital in a controlled entity.[21] The BEPS risks with respect to excessive interest deductions often present in three basic scenarios. Firstly, subsidiary companies may be heavily debt-financed, bearing a disproportionate share of the group's total third party interest costs and incurring interest deductions which are used to shelter local profits from tax.[22] Second, parent companies can claim relief for their interest expense, while the return on equity holdings is taxed on a preferential basis – for example if it qualifies for a participation exemption[23]

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16 Sommerhalder n 12 above at 82.

17 Arnold & McIntyre *International tax primer* (2002) 72–73; Olivier & Honiball *International tax: a South African perspective* (2011) 649.

18 Richardson, Hanlon & Nethercott 'Thin capitalization: an Anglo-American comparison' (1998) 24/2 *The International Tax Journal* 36.

19 United Nations *Protecting the tax base of developing countries* n 5 above at 11.

20 *Ibid*.

21 OECD/G20 BEPS Project 'Limiting base erosion involving interest deductions' (2015 Final Report) in par 1.

22 *Id* at 16.

23 A participation exemption can be defined as a tax regime under which dividends received from foreign companies by resident companies are exempt from resident country tax if the resident company owns at least some percentage of the shares of the foreign

or a preferential tax rate.[24] Thirdly, BEPS could result from the use of interest deductions to fund income that is exempt or deferred for tax purposes, or obtaining relief for interest deductions greater than the actual net interest expense of the group.[25] These scenarios can be utilised for various strategies. For example:

- by using intragroup loans to generate deductible interest expense in high tax jurisdictions and taxable interest income in low tax jurisdictions;
- by developing hybrid instruments which can give rise to deductible interest expense but no corresponding taxable income;[26] and
- by using dual resident hybrid entities to claim double interest deduction in both jurisdictions.[27]

From a policy perspective, failure to tackle excessive interest payments to associated enterprises gives MNE an advantage over domestic businesses that are unable to gain such tax advantages.[28] Research shows that debt shifting is a major BEPS risk for developing countries that are more prone to these risks that developed countries.[29] The IMF affirms that debt shifting through intra-group loans is a common method of profit-shifting in many developing countries and it is a cause for concern[30] that they often lack effective provisions to guard against the use of borrowing to shift profits to

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company. See Arnold & McIntyre n 17 above at 165.

24 OECD/G20 n 21 above at 15.

25 *Id* at 16.

26 A hybrid instrument can be defined as a financial instrument and may be treated as debt in one country and yet be regarded as equity in another country. Hybrid instruments can be used to achieve double non-taxation by for instance creating two interest deductions for one borrowing, generating deductions without corresponding income inclusions, or misusing foreign tax credit and participation exemption regimes. See Oguttu 'Challenges in taxing derivative financial instruments: international views and South Africa's approach' (2012) 24 *South African Mercantile law Journal* 388.

27 A 'hybrid entity' is a legal relationship that is treated as a corporation in one jurisdiction and as a transparent (non-taxable) entity in another. Where a hybrid entity is dual resident, in that it is treated as a taxable entity in two jurisdictions (for example if it is incorporated in jurisdiction and has its place of effective management in another), such an entity can be able to claim double interest deduction in both jurisdictions. See Arnold & Mclntyre n 17 above at 144; Olivier & Honiball n 17 above at 554; Oguttu 'The challenges of taxing investments in offshore hybrid entities: a South African perspective' (2009) 21/1 *SA Mercantile Law Journal* 51–73.

28 OECD 'Thin capitalisation legislation: a background paper for country tax administrators' (August 2012) 7.

29 Fuest, Hebous & Riedel 'International debt shifting and multinational firms in developing economies' (2011) 113 *Economic Letters* 135–138; UN 'Protecting tax base in developing countries' n 5 above at 12.

30 IMF *Spillovers in international corporate taxation* (2014) at 30.

lower tax jurisdictions.[31] ATAF asserts that cross-border interest and similar financial flows to tax havens have a long been a BEPS risk in Africa.[32] Many African countries are concerned about the high levels of interest deductions from their fiscus by domestic subsidiaries funded by foreign parent companies.[33] Although countries may have general anti-avoidance provisions and judicial doctrines that can be applied to prevent the ensuring tax avoidance, the sophisticated interest deduction schemes employed by MNE often necessitate that countries follow a more targeted approach, as discussed below.

Measures applied by countries to curb excessive interest deductions

The tax laws of countries cannot prohibit enterprises from accumulating excessive levels of debt but they can limit the amount of deductible interest. Various measures can be employed in this regard.[34]

The arm's length approach

The arm's length principle[35] (used to curb transfer pricing[36]) is utilised to determine whether the size of the loan would have been made in an arm's length transaction,[37] or whether the rate of the interest could be measured at an arm's length rate.[38] Thus, if the loan exceeds what would have been granted in an arm's length situation, the lender must be regarded to have an interest in the profitability of the enterprise and, therefore, the loan or interest rate that exceeds the arm's length amount is regarded as having been

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31 *Id* at 24.

32 ATAF 2nd Meeting: cross border taxation technical committee (3–4 March 2015) at 1.

33 *Ibid*.

34 OECD/G20 n 21 above in par 6.

35 The arm's length principle as set out in article 9(1) of the OECD MTC provides that when conditions are made or imposed between two associated enterprises in their commercial or financial relations which differ from those which would have been made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

36 Transfer pricing is a term that describes the process by which related entities set prices at which they transfer goods or services between each other. It entails the systematic manipulation of prices in order to reduce profits or increase profits artificially or cause losses and avoid taxes in a specific country. See Arnold & McIntyre n 17 above at 53.

37 In an arm's length transaction, each party strives to get the utmost possible benefit from the transaction. See art 9 of the OECD *Model tax convention on income and on capital* (2010 condensed version).

38 OECD *Issues in international taxation no 2: thin capitalisation: taxation of entertainers, artists and sportsmen* (1987) par 48.

deigned to procure a share in the profits.[39] Accordingly, a prima facie loan can be regarded as alternative form of payment. For example, interest on a loan can be regarded as a distribution of dividends for tax purposes.[40] In Ghana, for instance, section 31(5)(a) Income Tax Act 896 of 2015 permits the Commissioner-General to use the arm's length principle to re-characterise debt financing in a controlled relationship as equity financing. In South Africa, section 31 of the Income Tax Act 58 of 1962 as amended by the Taxation Laws Amendment Act 24 of 2011, clearly provides that the arm's length principle must be applied to financial assistance in cross-border transactions. Although the arm's length approach recognises that entities may have different levels of interest expense depending on their circumstances, it may not be effective in preventing BEPS in cases of intra-group debt with equity-like features justifying interest payments in excess of what the group actually incurs on its third party debt.[41] The OECD further notes that the arm's length test is not effective in preventing an entity from claiming a deduction for interest expense which is then used to fund investments in non-taxable assets or exempt income.[42] It should be noted that internationally, there are no clear guidelines for the parameters within which the arm's length principle is to apply in the context of thin capitalisation.[43] Consequently, countries tend not to rely solely on the arm's length principle to curb thin capitalisation, but they often apply this principle alongside fixed debt/equity ratios (discussed below).

The fixed ratio approach

This approach is based on a fixed debt/equity ratio, and normally used as a 'safe harbour' in setting the parameters of the arm's length principle with the interest relating to the debt above the fixed ratio being non-deductible.[44] Some countries apply fixed debt/equity ratios exclusively in that they are considered relatively easier for tax administrations to manage as the level of the interest expense can easily be linked to a measure of an entity's economic activity.[45] In Uganda, for instance, section 89 of the Income Tax

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39 OECD/G20 n 21 above in par12.
40 OECD n 38 above at 15 in par 25(i).
41 OECD/G20 n 21 above in par 12.
42 *Ibid.*
43 Oguttu 'Curbing thin capitalisation: a comparative overview with specific reference to South Africa's approach – challenges posed by the amended section 31 of the Income Tax Act' (2013) 67/6 *Bulletin for International Taxation* at 314.
44 ATAF 2nd Meeting 'Cross border taxation' n 32 above at 1.
45 OECD/G20 n 21 above in par 17.

Act, Cap 340, restricts the deduction of interest by a foreign-controlled resident company if fifty per cent or more of the resident company is held by a non-resident, where foreign debt to foreign equity ratio exceeds two to one.[46] Ghana's thin capitalisation rules in section 33 of the Income Tax Act 896 of 2015 provide that where a non-resident holds more than fifty per cent of a resident company, interest deduction in excess of a debt to equity ratio of three to one will be disallowed. Despite the presence of fixed ratio rules in some African countries, these revenue administrations still find it difficult to deal with excessive interest deductions, as tax legislation in general, does not clearly define the difference between 'interest' and 'equity'.[47] Over the years the OECD has supported the fixed ratio approach and is willing to assist African countries in introducing rules that would be in line with international best practice.[48] However, it warns that fixed ratios can be relatively inflexible if the same ratio is applied in all sectors. The other concern is that in some countries the rates at which these ratios are set are either too high to be an effective tool in addressing BEPS, or too low leading to the risk of double taxation.[49] A rule which can limit an entity's amount of debt can still allow significant flexibility in terms of the its interest rate. This makes it relatively easy for an MNE to manipulate the outcome of a ratio by increasing the level of equity in a particular entity. Because of these disadvantages, the OECD advises that although the fixed ratio approach can play a role in limiting interest deductions ,within the overall tax policy, it is generally not a best practice when dealing with BEPS.[50]

Withholding taxes

Some countries levy withholding taxes on interest as a means of preventing erosion of their tax bases. A withholding tax is used as a mechanism to enable the tax collection from non-residents by appointing a resident as agent for the non-resident thereby imposing an obligation on the resident agent to withhold a certain percentage of tax from payments made to the non-resident. Should the resident not comply with this duty or if he/she withholds an incorrect amount of tax, he/she will be personally liable.[51] Many African countries levy withholding taxes on interest as it is considered

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[46] KPMG *Uganda Fiscal Guide* (2012/2013) at 13.
[47] ATAF 2nd Meeting 'Cross border taxation' n 32 above at 2.
[48] *Ibid*.
[49] *Ibid*.
[50] OECD/G20 n 21 above in par 17.
[51] Olivier & Honiball n 17 above at 362–363.

a relatively simple tool to apply and administer.[52] In Uganda, for example, section 83(1) of Uganda's Income Tax Act, Cap 340 (subject to certain exemptions) levies a withholding tax of fifteen per cent on gross interest payments to non-residents from sources in Uganda. In Ghana's section 116 of the Income Tax Act 896 of 2015, a withholding tax of eight per cent is levied on interest paid to non-residents. In South Africa, (subject to certain exemptions) a withholding tax on interest is levied under sections 371 to 37M of the Income Tax Act 58 of 1962, at a rate of fifteen per cent on interest received by or accrued to a non-resident from a South African source.[53] Where there is a double-tax treaty in place, withholding tax rates on interest are normally reduced to ten per cent for double taxation agreements based on article 11 of the OECD MTC. Should double taxation occur, it is usually addressed in terms of article 23A of the OECD MTC by extending credit in the country where the interest payment have been received. In practice, however, interest-withholding tax in most African countries' tax treaties is often reduced to below ten per cent (sometimes to nil) – which exposes such treaties to abuse.[54] One would imagine that perhaps the best way to prevent base-eroding excessive interest deductions is to set the withholding tax at the same rate as corporate tax; however, this may hamper foreign investment.[55] It should also be noted that lenders often minimise the impact of withholding taxes by 'grossing up' such payments in order that the domestic company that raised the loan bears the cost of the withholding tax in the form of a higher interest charge.[56] Since the high interest rate is a tax deductible expense in calculating taxable income, this further reduces the borrower country's tax base. Therefore, the OECD advises countries to apply withholding taxes alongside other best practices as discussed below.[57]

Debt / EBITDA ratios

Some countries apply debt/EBITDA ratios to prevent excessive interest deductions.[58] A debt/EBITDA ratio is a metric measure of a company's ability to pay off its short term debt by giving an investor the approximate

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52 OECD/G20 n 21 above in par 13.

53 De Koker *Silke on South African income tax: being an exposition of the law, practice and incidence of income tax in South Africa vol 1* (2016) par 14.4.

54 OECD/G20 n 21 above in par 13.

55 UN 'Protecting the tax base of developing countries' n 5 above at 180.

56 *Ibid*.

57 OECD/G20 n 21 above in par 13.

58 *Id* at 18.

amount of time needed to settle all debt. The metric ratio is calculated as debt divided by earnings, before factors such as interest, taxes, depreciation and amortisation (EBITDA) are taken into account. A high debt/EBITDA ratio suggests that if a company may be unable to service its debt, this could result in a lowered credit rating. Conversely, a low ratio would suggest that the company may wish to incur additional debt if needed and often warrants a relatively high credit rating.[59] Although debt/EBITDA ratios may be useful, the fact that they do not reflect the effects of the company's expenditure on its finances, requires that they should be used with caution when evaluating a company as not all of the company's risk is factored into the ratio.[60] For example, in 2013 the South African Revenue Service (SARS) issued a draft Interpretation note on thin capitalisation[61] in which it indicated that it had adopted a risk-based audit approach in selecting potential thin capitalisation cases for audit. In selecting cases, the SARS will consider transactions in which the debt/EBITDA ratio of the South African taxpayer exceeds three to one as a greater risk. The SARS explains that the ratio is not a safe harbour and does not preclude it from auditing a taxpayer who is within the range of the above ratio. [62]

Rules which compare the level of debt in an entity by reference to the corporate groups' overall position

These group ratio tests typically operate by reference to debt/equity ratios. However, in many cases the amount of equity in an entity can at best only be an indirect measure of its level of activity and is subject to manipulation.[63]

Targeted anti-avoidance rules

These rules disallow interest expense on specific transactions. Unlike other African countries, South Africa's developed financial services sector has

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[59] Investopedia. Available at: http://www.investopedia.com/terms/d/debt edbitda.asp#axzz2AxUfUVka accessed 31 October 2012; see also Novinson 'Explanation of Debt to EBITDA Ratio' eHow.com http://www.ehow.com/info 7856136 explanation-debt-ebitda-ratio.html#ixzz2AxWymT1e (last accessed 31 October 2015).

[60] The Free Dictionary 'Debt/EBITDA ratio'. Available at: http://financial-dictionary.thefreedictionary.com/Debt%2FEBITDA+ratio (last accessed 31 October 2015).

[61] SARS Draft Interpretation Note 'Determination of the taxable income of certain persons from international transactions: thin capitalisation' (2013) at 3.

[62] *Ibid*.

[63] OECD/G20 n 21 above at 19.

prompted the country to enact various targeted provisions in its Income Tax Act 58 of 1962 to prevent sophisticated interest deduction tax avoidance schemes:

- section 24J regulates the incurring and accrual of interest in respect of financial instruments;
- section 45 deals with excessive debt transactions using debt pushdown structures in intra-group transactions;
- section 23N limits the deduction of an interest expense incurred by a company on a loan or debt raised to acquire assets or shares in reorganisations and acquisition transactions;
- section 23M imposes a limitation on the deductibility of interest in debt owed to persons in a controlling relationship;
- section 24O limits the deduction of interest in respect of share acquisitions;
- section 10B deals with round-tripping;
- section 8E and 8EA deem a dividend declared by a company on a hybrid equity instrument as interest; and
- section 8F and 8FA deem interest on a hybrid debt instrument to be a dividend *in specie* such that no deduction is allowed on the interest paid by the issuer of the instrument.

However, various provisions have complicated the rules relating to cross-border debt and could discourage foreign investment, especially for investors who are not involved in such sophisticated schemes. The downside of such provisions is that as new BEPS schemes are exploited, further targeted rules may be required and there will be a tendency in time for more rules to be introduced resulting in a complex system and increased administration and compliance costs.[64]

OECD Recommendations to curb BEPS from excessive interest deductions

When the OECD issued its BEPS Action Plan in 2013, Action Plan 4 called on countries to come up with effective provisions to limit base erosion via interest deductions and other payments. In particular, they were asked to develop rules that prevent the use of related-party and third-party debt to achieve excessive interest deductions, as well as rules that prevent financing the production of exempt or deferred income.[65] The OECD evaluated the

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[64] *Id* at 20.

[65] OECD *Action plan on base erosion and profit shifting* (2013) at 17.

effectiveness of measures that countries apply to prevent base-eroding excessive interest deductions and concluded that the use of arm's length tests, withholding taxes and rules to disallow a percentage of interest are not effective.[66] The OECD recommended that countries should adopt a consistent approach of utilising international best practices if concerns regarding BEPS on interest deductions are to be addressed. Such a consistent approach would remove distortion opportunities for BEPS, and reduce the risk of unintended double taxation and thus increase fairness and equality between groups.[67] In its 2015 final BEPS Report on Action 4, the OECD recommends that the effective approach for countries to address BEPS would be to apply a fixed ratio rule which limits an entity's net deductions for interest and payments, the economic equivalent of which would be interest of a percentage of its (EBITDA), and that this should apply to entities in multinational groups.[68] To ensure that countries apply a fixed ratio that is low enough to address BEPS, while recognising that not all countries are in the same position, the OECD recommended an approach that includes a corridor of possible ratios of between ten and thirty per cent.[69] Although the fixed ratio rule may provide a country with a level of protection against BEPS, it is a blunt tool that does not take into account the fact that groups operating in different sectors may require different levels of leverage, and even groups within some sectors can be more highly leveraged for non-tax reasons (which could result in double taxation for groups which are leveraged above the level). Therefore, the OECD recommends that the use of a fixed ration rule can be supplemented by a worldwide group ratio rule which allows an entity to exceed this limit in certain circumstances.[70] This would allow an entity with net interest expense above its country's fixed ratio to deduct interest up to a level of the net interest/EBITDA ratio of its worldwide group. Countries may also apply an uplift of up to ten per cent of the group's net third party interest expense to prevent double taxation. The earnings-based worldwide group ratio rule can also be replaced by different group ratio rules, such as the 'equity escape' rule (which compares an entity's level of equity and assets with those held by its group). A country may also choose not to introduce any group ratio rule. In that case it should apply the fixed ratio rule to entities in multinational and domestic groups

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66 OECD Discussion draft *BEPS Action 4: interest deductions and other financial payments* (18 December 2014) par 21.

67 *Id* at par 5.

68 OECD/G20 n 21 above at pars 23, 78 & 99.

69 *Ibid.*

70 *Id* at pars 24 & 116.

without improper discrimination.[71] The recommended approach also allows countries to supplement the fixed ratio rule and the group ratio rule with other provisions that reduce the impact of the rules on entities or situations which pose lower BEPS risk, such as:

- a *de minimis* threshold which carves-out entities which have a low level of net interest expense;[72]
- an exclusion for interest paid to third party lenders on loans used to fund public-benefit projects, subject to conditions. In these circumstances, an entity may be highly leveraged but, due to the nature of the projects and the close link to the public sector, the BEPS risk is reduced;[73] and
- provisions to permit carrying forward of disallowed interest expense for future use. This will be of help to entities that have incurred interest expenses on long-term investments and are expected to generate taxable income only in subsequent years. It will also allow entities with losses to claim interest deductions when they return to profit.[74]

Nevertheless, concerns have been raised that the recommendation for an interest rate cap within the scope of ten and thirty per cent, with the option of using apportioned consolidated interest costs if they are higher, seems self-defeating in view of the fact that debt ratios vary widely both between economic sectors and firms.[75] It has been suggested that a firm rule is needed whereby interest deductions should not be greater in aggregate than the corporate group's consolidated interest costs to third parties. It is also suggested that countries that insist on using a fixed cap on deductions should use the lowest limit.[76]

General recommendations on curbing excessive interest deductions

African countries adopting appropriate measures to prevent base-eroding excessive interest deductions, are required to balance the need to attract foreign investment against the necessity of protecting their tax bases. Numerous and complex targeted anti-avoidance provisions (as is the case with South Africa) may not be advantageous in this regard as they pose

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71 *Id* at par 119.
72 *Id* at 1 and 26.
73 *Id* at 12.
74 *Ibid*.
75 See the study by PwC included in the comments submitted by the Business and Industry Advisory Committee (BIAC) on Action 4, February 2015.
76 BEPS Monitoring Group *Overall evaluation of the G20/OECD base erosion and profit shifting (BEPS) project* (2015) 5.

overwhelming administrative burdens and regulatory uncertainty. On the flipside, although the use of withholding taxes on interest may be considered easy to administer, high rates could discourage foreign investment as they are generally levied on a gross basis.

ACTION 6: PREVENT TREATY ABUSE

Before discussing issues pertaining to treaty abuse, it is important to provide some background as to how double taxation agreements (DTAs) work. DTAs are usually drafted on the basis of certain models. The two main models employed internationally are: the OECD Model Tax Convention (OECD MTC), and the UN Model Tax Convention between Developed and Developing Countries (UN MTC). The OECD MTC embodies rules and proposals by developed capital-exporting countries thus favouring these over capital-importing countries,[77] while the UN MTC favours the opposite. One of the main reasons for countries entering into DTAs[78] (as is found in the preamble of most DTAs) is to prevent double taxation.[79] Some DTAs state in their preambles that the purpose of the treaty is to prevent double taxation and fiscal evasion.[80] Currently the preambles to DTAs do not specify that they are not intended to be used for abusive tax avoidance practices.[81] Nevertheless, although the network of DTAs that countries have entered into encourages international trade and investment, it also opens up opportunities for abusing treaties for tax avoidance purposes.[82] Taxpayers may for instance get involved in 'treaty shopping', a term which refers to the use of DTAs by

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77 Arnold & McIntyre n 17 above at 109.

78 Reinhold 'What is tax treaty abuse? (is treaty shopping an out dated concept?)' (2000) 53 *The Taxpayer* 673.

79 For the meaning of double taxation see generally Oguttu 'Resolving double taxation: the concept 'place of effective management' analysed from a South African perspective' (2008) 41/1 *CILSA* 80–104

80 Fiscal evasion can be defined as defined as the non-compliance with the tax laws and includes activities (like the falsification of tax returns and books of account) that are deliberately undertaken by a taxpayer to illegally free himself from the tax, which the law charges upon his income. Tax authorities normally resort to criminal prosecution to prevent tax evasion. See Oguttu *International tax law: offshore tax avoidance in South Africa* (2015) 2.

81 The term tax avoidance refers to the use of legal methods of arranging one's affairs, so as to pay less tax. This is done by utilising loopholes in tax laws and exploiting them within legal parameters. See Oguttu 'Curbing treaty shopping: the beneficial ownership provision analysed from a South African perspective' (2007) 40/2 *CILSA* 242; Oguttu n 80 above at 2.

82 The term tax avoidance refers to the use of legal methods of arranging one's affairs, so as to pay less tax. This is done by utilising loopholes in tax laws and exploiting them within legal parameters. See Oguttu 'Curbing treaty shopping' n 81 above 242.

the residents of a non-treaty country in order to obtain treaty benefits that are not supposed to be available to them.[83] This is mainly done by interposing a 'conduit company' in one of the contracting states so as to shift profits out of those states.[84] A conduit company is an intermediary company with very narrow powers, which is used for holding assets or rights as an agent or nominee on behalf of another company.[85] Treaty shopping is, however, undesirable because it frustrates the spirit of a treaty.[86] The anticipated capital flows are distorted if the treaty is used by third country residents.[87]

Factors that encourage treaty abuse in Africa

DTAs signed with low tax jurisdictions

As is the case with other countries, the DTAs that African countries have signed with low tax countries can be abused in the form of sophisticated tax planning to frustrate the tax claims of African countries. Most treaty shopping schemes in Africa involve companies registered in Mauritius under the Global Business Licenses 1 regime,[88] which encourages nil or minimum tax on active business in Mauritius while taking advantage of other countries' treaty benefits. Historically, Mauritius has been an established treaty haven for offshore activities of African countries. Its extensive tax treaty network with African countries, and its membership of regional bodies such as the Southern African Development Community,[89] offers residents and foreign nationals in African countries the opportunity to direct their investments via Mauritius.[90] Apart from Mauritius, treaties have also been

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83 Van Weeghel *The improper use of tax treaties with particular reference to the Netherlands and The United States* (1998) 119.

84 Wurm 'Treaty shopping in the 1992 OECD Model Convention' (1992) *Intertax* 658; Tomsett *Tax planning for multinational companies* (1989) at 149.

85 OECD Committee on Fiscal Affairs *Double taxation conventions and the use of conduit companies* (1987) at pars 4(2) and 5(d); see also Oguttu n 81 above at 238.

86 OECD n 85 above at par 4(2).

87 Haug 'The United States policy of stringent anti-treaty shopping provisions: a comparative analysis' (1996) 29 *Vanderbilt Journal of Trans-national Law* 216.

88 Rohatgi *Basic international taxation* (2002) 284; Oleynic *Mauritius tax guide* (2006) at 43.

89 The SADC consists of fifteen member states: Angola, Botswana, the Democratic Republic of Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, the United Republic of Tanzania, Zambia, and Zimbabwe. SADC's mission is to promote sustainable and equitable growth and to be a competitive and effective player in the world economy. For details on SADC Member states visit: http://www.sadc.int/member-states/ (last accessed 30 May 2013).

90 Mauritius Offshore Business Activities Authority (MOBAA) 'Mauritius: a sound base for the new millennium' (5 July 1999). Available at: http://www.mondaq.com/article.asp?articleid=7371&searchresults=1 (last accessed 2 June 2014). See also Schulze *International tax-free trade zones and free ports: a*

signed with other low tax jurisdictions such as the Netherlands and Switzerland, which have raised treaty abuse concerns. The IMF estimates that treaties with the Netherlands led to lost revenue for developing countries of at least €770 million in 2011.[91] Treaties signed with low tax jurisdictions encourage treaty abuse for the following reasons:

Low withholding tax taxes

Since DTA negotiators from African countries are not always as skilled as their developed country counterparts in negotiating DTAs,[92] they often sign DTAs containing provisions that are not in their favour but rather reflect the position of the other contracting state.[93] Of particular concern is the low or zero treaty withholding tax rates for dividends, interest or management fees payable by MNEs, which are also often used for treaty shopping purposes. This was one of the main reasons why in 2013 Rwanda negotiated its 2001 DTA with Mauritius, stipulating withholding taxes at a zero rate, relinquishing all taxation rights to Mauritius. The new DTA which was ratified on 4 August 2014, provides a ten per cent withholding tax on dividends, royalty and interest and twelve percent for management fees.[94] The Rwandan Revenue Authority notes that the new DTA is intended to stop treaty shopping where investors would opt to register their companies in Mauritius while doing business in Rwanda, with repatriation of all profits without paying taxes.[95] In order to combat this, South Africa renegotiated its 1997 DTA with Mauritius in 1915.[96] South African residents wishing to invest in India often took advantage of the old DTA by routing investments via Mauritius in order to gain tax advantages. South African companies also often route investments into other African countries via Mauritius because

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comparative study of their principles and practices (1997) 185–186.

91 IMF n 30 above at 22.

92 PWC, EuropeAID *Implementing the tax and development policy agenda: final report on transfer pricing and developing countries* (2011) at 21.

93 Akunobela 'The relevance of the OECD and UN Model Conventions and their commentaries for the interpretation of Ugandan tax treaties' in Lang, Pistone, Schuch & Staringer *The impact of the OECD and UN Model tax conventions on bilateral tax treaties* (2012) 1089.

94 The East African 'Rwanda-Mauritius tax treaty renegotiated'. Available at: http://africamoney.info/rwanda-mauritius-tax-treaty-renegotiated-loopholes-closed/ (last accessed 22 February 2016).

95 The DTAA has retroactive application as from 1 January 2013 for Rwanda and as from 1 July 2013 for Mauritius. The East African 'Rwanda-Mauritius tax treaty renegotiated' n 94.

96 *South African Government Gazette* 18111. Date of Entry into Force 20 June 1997. The re-negotiated DTA between South Africa and Mauritius is set out in *Government Gazette* 38862 – entry into force 28 May 2015.

it has negotiated better benefits than South Africa (such as lower withholding tax rates).Because of similar concerns, the Tax Justice Network instituted a case in the Kenya High Court (still undecided at the writing of this article and so unreported) against the Kenyan government and the Kenyan Revenue Authority[97] for signing a DTA with Mauritius. The accusation is that it is riddled with tax abuse loopholes such as low withholding tax rates.[98] The Tax Justice Network argues that the DTA contravenes the principle of good governance, sustainability, and accountability, in that it is a violation of articles 10 and 201 of the Kenyan Constitution. The DTA was signed on 7 May 2012 and ratified by Kenya through a legal notice published in the *Kenya Gazette* of 23 May 2014, but is not yet in force. DTA low withholding tax rates have also been a concern for other African countries that have signed treaties with low tax countries like the Netherlands, Switzerland and Luxembourg. In June 2013 Malawi terminated its 1969 colonial treaty with the United Kingdom, Northern Ireland and the Netherlands for this very reason.[99] In 2014 Malawi re-signed a treaty with the Netherlands,[100] in terms of which dividends will be subject to five per cent withholding tax in the case of shareholdings of at least ten per cent and the standard rates in both countries will apply to other dividends. Interest will be taxed at ten and royalties at five per cent. The low withholding tax rates in Netherlands' DTAs with other African treaties may still give rise to treaty shopping. For example, South Africa's treaty with the

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97 Martin 'TJN Africa's challenge to "loophole-ridden" Kenya-Mauritius tax agreement to be heard in Kenya High Court' *MNE Tax* (12 November 2015). Available at: http://mnetax.com/tjn-africas-court-challenge-to-loophole-ridden-kenya-mauritius-tax-agreement-moves-forward-11832 accessed 29 February 2016 (last accessed 22 February 2016). TJN *Tax Drainage: Kenya/Mauritius DTA and its potential impact on tax base erosion in Kenya* (Tax Justice Network-Africa, 2015).

98 Note that the treaty sets the rate for interest at ten per cent (the domestic tax rate is between fifteen to twenty-five per cent) but art 11 of treaties based on the OECD MTC also limit the interest rate to ten per cent; for royalties the treaty rate is ten per cent (the domestic rate is twenty per cent) however art 12 of treaties based on the OECD MTC does not permit source countries to tax royalties; for dividends the treaty rate is five or ten per cent, depending on the shareholding (the domestic rate is ten per cent). Article 10 of treaties based on the OECD MTC limits the rate to five or twenty-five per cent depending on the shareholding. See Axis 'Kenya – Mauritius DTA ratified by the Republic of Kenya'. Available at: http://www.axis.mu/uploads/DTA-%20Mauritius%20&%20Kenya.pdf (last accessed 4 March 2016).

99 Multinational tax and transfer pricing news 'Netherlands renegotiates tax treaties with developing nations to add anti-abuse clause'. Available at: http://mnetax.com/netherlands-renegotiates-tax-treaties-ethiopia-ghana-kenya-zambia-to-add-antiabuse-clause-hopes-add-clause-23-treaties-9530 (last accessed 4 March 2016).

100 IMF n 30 above at 28.

Netherlands can be subjected to treaty shopping by third country residents in order to circumvent South Africa's dividends withholding tax which is imposed at a statutory rate of fifteen per cent on dividend distributions by the subsidiary to its parent company.[101] To circumvent this withholding tax rate, investments can be channelled through an intermediate holding company established in the Netherlands, to take advantage of the Netherlands/South African DTA which limits the dividend withholding tax to five per cent, provided the Dutch holding company holds at least twenty-five per cent, either directly or indirectly, of the voting power in the company paying the dividends.[102] The dividends could also qualify for the Dutch participation exemption[103] for foreign dividends. The Netherlands/South African DTA can further be used to reduce the South African withholding tax on royalties[104] levied at a rate of fifteen per cent and reduced to nil in the treaty. Investors from a third country can license the supply of intellectual property (IP) to the Dutch holding company, which can sub-license the use of the IP to the South African subsidiary, thus avoiding the royalty withholding tax. The Dutch holding company may not be subject to tax in the Netherlands which imposes no withholding tax on royalties paid to a non-resident and merely requires a small margin for the Dutch holding company.[105]

Avoiding Capital Gains Tax (CGT

Most African countries levy CGT. In a treaty context, article 13(1) of treaties based on either the OECD or the UN MTC provides that income from the alienation of immovable property located in a country shall be taxable in that state. Article 13(2) gives the source country the right to tax capital gains derived from a PE located in that country. Article 13(3) is a special rule for gains from the alienation of ships or aircraft operated in international territory, which are taxable in the place where effective

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[101] Dividends withholding tax in South Africa is levied in terms of section of 64D to 64N of the Income Tax 58 of 1962.

[102] Article 10(2) of the Netherlands/South Africa DTA.

[103] A participation exemption can be defined as a tax regime under which dividends received from foreign companies by resident companies are exempt from resident country tax if the resident company owns at least some percentage of the shares of the foreign company. See Arnold & McIntyre n 17 above at 165; Deloitte 'Taxation and investment in Netherlands' (2015) at 10. Available at: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-netherlandsguide-2015.pdf (last accessed 22 February 2016).

[104] Interest withholding tax in South Africa is levied in terms of section of 37I to 37M of the Income Tax 58 of 1962.

[105] Deloitte n 103 above.

management of the enterprise is situated. In all other cases, (except the anti-avoidance rule of article 13(4)), article 13(5) allocates tax proceeds from the alienation of any property to the resident state of the alienator. Article 13(5) presents BEPS concerns especially in treaties with low tax jurisdictions like Mauritius, which does not impose CGT to its companies, with the result that companies investing through Mauritius avoid paying CGT altogether, enabling them to generate large profits from their investments. In such situations, it would be advisable for African countries to negotiate a provision in their DTAs to the effect that when the investor's resident country does not levy tax on a particular type of income, the source country would not give away its taxing right, so to speak. As mentioned above, article 13(4) is an anti-avoidance measure, which provides that gains from the alienation of shares deriving more than fifty per cent of their value directly or indirectly from immovable property situated in a contracting state, may be taxed in that state. However, many African countries do not have this anti-avoidance rule in their DTAs. Thus MNEs often incorporate conduit companies in low tax jurisdictions which are used to dispose of their shares and re-invest the funds in assets located in African countries to make the proceeds appear to be derived from such jurisdictions, thereby avoiding CGT in the relevant African countries. This is exemplified by the Ugandan case, *Zain International BV v Commissioner General of Uganda Revenue Authority*.[106] In this case, Zain International BV (Zain) disposed of its shares in Zain Africa BV to Bharti Airtel International BV on 30 March 2010. All three companies are incorporated and resident in the Netherlands. Zain Africa BV had equity interest in 26 Dutch BV Companies, among which was Celtel Uganda Holding BV which owned 99,99 per cent of Celtel Uganda Ltd. The Uganda Revenue Authority (URA) issued a tax assessment on Zain on the ground that the transaction was one of gain arising from the disposal of an interest in immovable property located in Uganda in terms of article 13 of the DTA between Uganda and the Netherlands. Zain contended that the income was not sourced from Uganda as it had sold its shares in the Netherlands to a Netherlands entity and so its income was sourced in the Netherlands and not in Uganda. The court *a quo* which did not consider the substantive tax treaty issues in the case, ruled that the URA had no jurisdiction to tax Zain International BV. The URA took this decision to the Court of Appeal, which ruled that Uganda had jurisdiction over tax proceeds on the sale of shares between two foreign companies involving the sale of

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[106] High Court of Uganda at Kampala (Civil Division) Miscellaneous Cause No 96 of 2011.

assets in Uganda. The Court of Appeal gave the URA an opportunity to study the transaction again and determine what taxes to claim. By the time the URA reassessed Zain, the company had liquidated all its assets in Uganda. The URA has requested the Dutch authorities to assist in the recovery of the taxes due in terms of article 27 of the DTA. However, Zain has applied for Mutual Agreement Procedure in the Netherlands to resolve the case.[107] If Uganda had secured the article 13(4) anti-abuse provision in its treaty with the Netherlands, it would have been in a more secure position in its claim against Zain.[108] This matter is one of the concerns that the Tax Justice Network raises in the above case against the Kenyan government with regard to the loopholes in the Kenyan/Mauritius treaty. Despite the anti-avoidance rule in article 13(4) the OECD MTC which allows the right to tax shares to the source state, the Kenya/Mauritius DTA provides that capital gains on the disposal of shares by a Mauritius resident are only taxed in the residence state (Mauritius). In effect, Kenya has relinquished the right to tax capital gains from stock sales of Kenyan companies to Mauritius, which does not levy CGT.[109]

Abuse of tax sparing provisions in tax treaties

Treaty shopping is encouraged by the tax sparing provisions that many African countries often insist on DTAs with developed countries in an effort to encourage foreign investment.[110] The argument is that when a developing country grants a tax incentive to an investor from a developed country treaty partner, it may be eliminated or reduced where the investor's country applies the credit method to prevent double taxation of income.[111] To preserve the benefit of tax incentives granted to the foreign investor, a 'tax sparing' provision is included in the DTA in terms of which the developed country amends its taxation of foreign source income to allow its residents who invest in developing countries to retain the tax incentives provided by those

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107 Kalinaki 'Court gives URA nod to seek taxes on sale of Zain assets in Uganda' *The East* African available at: http://www.theeastafrican.co.ke/news/URA-taxes-on-sale-of-Zain-assets-in-Uganda/-/2558/2451578/-/item/0/-/6hm2he/-/index.html (last accessed 4 March 2016).

108 Hearson *Tax treaties in Sub-Saharan Africa: a critical review* (2015) 24.

109 Martin n 97 above; TJN *Tax drainage: Kenya/Mauritius DTA* n 95 above.

110 Easson *Tax incentives for foreign direct investment* (2004) 1–2; Hines 'Tax sparing and direct investment in developing countries' in Hines *International taxation and multinational activity* (2001) 40; Holland & Vann 'Income tax incentives for investment' in Thuronyi *Tax law design and drafting* (1989) 986.

111 Hines n 110 above at 40.

countries.[112] The developed country is thus required to extend a tax credit to the investor for the taxes that would have been paid to the developing country if the incentive had not been granted.[113] Tax sparing has, however, become rather unpopular and several developed countries have imposed restrictions on including tax sparing provisions in their tax treaties.[114] It is reasoned that tax sparing may not be that instrumental in promoting foreign investment and that it encourages abusive tax practices[115] such as treaty shopping. Generous tax sparing credits in a particular treaty can encourage residents of third countries to establish conduit entities in the country granting the tax incentive.[116] Treaty shopping as a result of the tax sparing provision in 1997 South Africa/Mauritius DTA was one of the reasons why it was renegotiated in 2015.[117] The DTA no longer includes a tax sparing clause; rather, it allows for relief in the form of a foreign tax credit.[118]

To sum up with regard to the factors that encourage treaty abuse in Africa, it should be noted that in many African countries the issue of curbing treaty shopping has not received much attention, even though African tax officials often deal with multinational companies involved in treaty shopping. Most African tax officials acknowledge that DTA negotiations have not fully taken into account the way DTAs could allow certain jurisdictions to act as conduits for tax avoidance.[119] However, over the last couple of years there have been measures by some African countries to address issues of treaty abuse. In Ghana, an effort is being made to strengthen the way DTAs are negotiated by increasing research into the potential treaty partner beforehand and bringing more diverse expertise into the negotiating team.[120] In 2014, the Government of Uganda announced that it had suspended all its ongoing

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[112] Rohatgi n 88 above at 213.

[113] Oguttu 'The challenges of tax sparing: a call to reconsider the policy in South Africa' (2011) 65/1 *Bulletin for International Taxation* par 2; Brooks 'Tax sparing: a needed incentive for foreign investment in low-income countries or an unnecessary revenue sacrifice?' (2008–2009) 34 *Queen's Law Journal* 508.

[114] Thuronyi 'Recent treaty practice on tax sparing' (2003) 29 *Tax Notes International* 301.

[115] Arnold & McIntyre n 17 above at 52–53.

[116] *Ibid*.

[117] The re-negotiated DTA between South Africa and Mauritius is set out in *Government Gazette* 38862 – entry into force 28 May 2015.

[118] See art 22(2) of the DTA between South Africa and Mauritius. *South African Government Gazette* 38862 – entry into force 28 May 2015.

[119] Hearson n 108 above at 6.

[120] ActionAid 'Calling time: why SAB Miller should stop dodging taxes in Africa' (2012) 22. Available at: https://www.actionaid.org.uk/sites/default/files/doc_lib/calling_time_on_tax_avoidance.pdf (last accessed 22 June 2015).

DTA negotiations pending a review into the treaty terms that the nation should seek in such negotiations.[121] Several African countries have renegotiated certain of their DTAs that encouraged tax abuse. As stated above, in 2014 Malawi re-negotiated its DTA with the Netherlands, in 2015 South Africa re-negotiated its treaty with Mauritius,[122] and Zambia is re-negotiating several of its old colonial era treaties that were negotiated on poor terms.[123]

Current measures to prevent treaty shopping

In order to prevent treaty shopping, paragraph 7.1 of the Commentary on article 1 of the 2014 version of the OECD MTC provides that where taxpayers are tempted to abuse the tax laws of a state by exploiting the differences between various countries' laws, such attempts may be countered by jurisprudential rules in the domestic law of the state concerned (for example general anti-abuse rules and judicial anti-abuse doctrines like the substance over form doctrine[124]) as well the use of specific treaty anti-avoidance provisions.[125] For example, Ghana has a general anti-avoidance provision in section 34 of Income Tax Act 896 of 2015 to curb, *inter alia*, fictitious schemes where form does not reflect substance. South Africa also has general anti-avoidance provisions in section 80A-80L of Income Tax 58 of 1962 and it also applies the substance over form common-law doctrine to prevent tax avoidance.

Although the commentaries of both the OECD and the UN MTC contend that there is no conflict between DTA provisions and domestic anti-avoidance rules, as the latter merely establish the facts to which DTAs apply,[126] while DTA provisions are generally considered to prevail over domestic law since a DTA is a contract between the contracting states. To

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121 Ladu 'Govt suspends double taxation pacts' *Daily Monitor* (6 June 2014); Hearson 'Tax treaties in Sub-Saharan Africa' n 108 above at 1; TreatyPro.com 'Latest Treaty Updates: Uganda' (10 June 2014). Available at: http://www.treatypro.com/treaties_by_country/uganda.asp (last accessed 18 February 2016).

122 IMF n 30 above at 28.

123 Hearson 'Tax treaties in Sub-Saharan Africa' n 108 above at 1.

124 Roper & Ware *Offshore pitfalls* (2000) at 77, where the 'substance over form' doctrine is described as a doctrine which permits the tax authorities to ignore the legal form of a tax arrangement and look at the actual substance of the relevant transaction.

125 OECD n 85 above in par 4(2).

126 Paragraph 22 of the Commentary on article 1 of the OECD MTC; Arnold 'Tax treaties and tax avoidance: the 2003 revisions to the Commentary to the OECD Model' (2004) 58 *Bulletin for International Fiscal Documentation at 245.*

prevent arguments about treaty override, it is necessary that countries enact domestic anti-abuse rules that mirror the anti-abuse rules in their own DTAs.

Currently the OECD and UN Commentary on article 1 also set out various examples of specific provisions that may be included in tax treaties to curtail treaty shopping.[127] The main provision applied in most tax DTAs (including those signed by African countries) is the 'beneficial ownership' provision normally in articles 10, 11 and 12 of both the OECD and UN MTCs, which deal with the taxation of interest, dividends and royalties respectively.[128] Although the meaning of 'beneficial ownership' is not clear internationally,[129] the provision is intended to deny treaty benefits (in particular, reduced withholding tax on interest, dividends and royalties) to a conduit company unless the beneficial owner is a resident of one of the contracting states.[130] However, the efficacy of the beneficial ownership provision in curbing treaty shopping is now questionable in light of decisions such those in the Canadian cases of *Velcro Canada Inc v The Queen*[131] and *Prevost Car Inc v Her Majesty the Queen,* which ruled that the relevant taxpayers were beneficial owners and entitled to treaty benefits.[132] The OECD acknowledges the limits of using the beneficial ownership provision as a tool to address various treaty-shopping situations.[133] Consequently, in paragraph 12.5 of the 2014 version of the Commentary on Article 10, the OECD explains that 'whilst the concept of "beneficial ownership" deals with some forms of tax avoidance (*ie* those involving the interposition of a recipient who is obliged to pass on the dividend to someone else), it does not deal with other cases of treaty shopping and must not be considered as restricting in any way the application of other approaches addressing such cases'.

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127 For example, the look through approach; subject to tax provisions; limitation of benefits provision and the beneficial ownership provision. See par 12–20 of the Commentary on article 1 of the OECD MTC. The provisions are explained in Oguttu 'Curbing treaty shopping' n 81 above 237–258

128 Article 10(2) of the OECD MTC.

129 For example par 4.1 of the OECD MTC Commentary on article 12, only indicates that a nominee or agent cannot be a beneficial owner; so is the case with a conduit company which has very narrow powers. See also International Fiscal Association *The OECD Model Convention – 1998 and beyond: the concept of beneficial wwnership in tax treaties* (2000) at 22.

130 Paragraph 12.2 of the Commentary on article 10 of the OECD MTC.

131 2012 TCC 57.

132 2008 TCC 231.

133 OECD 'Tax conventions and related questions: preventing the granting of treaty benefits in inappropriate circumstances' (17–18 September 2013) in par 8.

OECD BEPS recommendations on preventing treaty abuse

The OECD BEPS report on Action Plan 6 notes that although current rules to prevent treaty abuse work well in many cases, they need to be adapted to prevent BEPS resulting from interaction in more than two countries so as fully to account for global value chains.[134] In its 2015 Final Report on Action 6,[135] the OECD came up with recommendations regarding the design to domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. In this regard, the OECD noted that a distinction has to be made between:

a) Cases where a person tries to circumvent the provisions of domestic tax law to gain treaty benefits. In these cases, treaty shopping must be addressed through domestic anti-abuse rules (as discussed above).[136]

b) For cases where a person tries to circumvent limitations provided by the treaty itself. The OECD recommends that should be addressed through treaty anti-abuse rules; using a three-pronged approach:

   i The title and preamble of treaties should clearly state that the treaty is not intended to create opportunities for non-taxation or reduced taxation through treaty shopping.[137] Such a provision augments the treaty interpretation approach of preventing treaty abuse in article 31 of the Vienna Convention on the Law of Treaties which provides that treaties are to be interpreted in good faith and in the light of the object and purpose of the treaty.[138]

   ii The inclusion of a specific limitation-of-benefits provisions (LOB rule), which is normally included in treaties concluded by the United States and a few other countries: The OECD is of the view that such a specific rule will address a large number of treaty shopping situations based on the legal nature, ownership in, and general activities of, residents of a Contracting State. [139]

   iii To address other forms of treaty abuse, not be covered by the LOB rule (such as certain conduit financing arrangements), tax treaties should include a more general anti-abuse rule based the principal purposes (PTT) rule. This rule is intended to provide a clear statement that the Contracting States intend to deny the application of the provisions of their treaties when transactions or arrangements

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134 OECD n 65 above at 19.

135 OECD/G20 BEPS Project 'Preventing the granting of treaty benefits in inappropriate circumstances Action 6' (September 2014).

136 OECD/G20 '2015 Final Report on Action Plan' 6 n 135 above in par 15.

137 *Id* at 9.

138 Vienna Convention on the Law of Treaties of 23 May 1969

139 OECD/G20 '2015 Final Report on Action Plan 6' n 135 above in par 19.

> are entered into in order to obtain the benefits of these provisions in inappropriate circumstances. [140]

The OECD acknowledges that each rule has strengths and weaknesses and may not be appropriate for all countries.[141] It therefore advises that the rules be adapted to the specifics of individual states and the circumstances of the negotiation of DTAs. For example, some countries may have constitutional or other legal restrictions that prevent them from adopting the recommendation. Some countries may have domestic anti-abuse rules or interpretative tools developed by their courts that prevent some treaty abuse. In other cases, the administrative capacity of some countries (a major issue in African countries) may prevent them from applying certain detailed anti-abuse rules and require them to adopt more general anti-abuse provisions (for example the PPT rule).[142] Nevertheless, the OECD recommends that, as a minimum measure to protect against treaty abuse, countries should include in their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.[143] This intention should be implemented through either:

- using the combined LOB and PPT approach described above; or
- the inclusion of the PPT rule or;
- the inclusion of LOB rule supplemented by a mechanism (such as a restricted PPT rule applicable to conduit financing arrangements or domestic anti-abuse rules or judicial doctrines that would achieve a similar result) that would deal with conduit arrangements not already dealt with in tax treaties. [144]

To ensure that African countries can effectively curtail treaty shopping, it is important that provisions suited to their specific circumstances are put in place. In principle, African countries should ensure that the preamble to all future or older re-negotiated DTAs should refer to the fact that the purpose of the treaty is not to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

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140 *Ibid.*
141 *Id* at par 20.
142 *Id* at par 21.
143 *Id* at par 22.
144 *Id* at par 21.

Regarding the feasibility of applying the LOB provision in preventing treaty shopping in Africa, it is important to understand the details of this provision (which was adopted from the USA). Essentially, the provision restricts entitlement to treaty benefits for a person who is technically a treaty resident but lack substantial connection with the residence jurisdiction. To qualify for treaty benefits, such a resident has to pass the tests of a 'qualified person'.[145] In a nutshell, the terms of the provision as set out in the 2014 discussion draft on Action 6 provided that:

> A resident of a Contracting State shall not be entitled to treaty benefits unless it constitutes a 'qualified person', which term is defined by reference to the nature or attributes of various categories of persons.
>
> A person is however entitled to the benefits of the treaty even if it does not constitute a "qualified person" where (subject to certain exceptions) the relevant income is derived in connection with the active conduct of a trade or business in that person's State of residence. This "derivative benefits" test allows certain entities owned by residents of other States to obtain treaty benefits that these residents would have obtained if they had invested directly.
>
> The LOB provision however provides for discretionary relief in that even if a taxpayer does not qualify for tax benefits, he may request to be treated as a qualified person. In that case, the competent authority of a Contracting State may grant treaty benefits where the other provisions of the LOB rule would otherwise deny these benefits.[146]

Essentially, this version of the LOB provision required that treaty benefits (such as reduced withholding rates) are available only to companies that meet specific tests of having some genuine presence in the treaty country. However, such an LOB provision has not been applied in many DTAs other than those signed by the USA, and even then, the provisions vary from treaty to treaty. South Africa, for instance (one of the few African countries that has a DTA with the USA – others are Egypt, Morocco and Tunisia)[147] has an LOB provision in article 22 of its 1997 DTA with the USA.[148] Although

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[145] *Ibid*.

[146] *Ibid*.

[147] IRS 'United States income tax treaties – A to Z'. Available at: https://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties---A-to-Z (last accessed 18 February 2016).

[148] Published in *Government Gazette* 185553 of 15/12/1997.

the LOB provision may be an effective anti-abuse provision, and although it offers some flexibility that allows for competent authority discretion, concerns have been raised that a complex LOB may hamper African countries with limited administrative capacity as it requires access to information to verify the pre-requisites of qualifying for treaty benefits.[149] It should also be noted that in most cases complex LOB provisions are intended to cover a number of sophisticated financing transactions that typically would not be an issue in developing African countries.[150] In its 2015 Final Report, the OECD considered some simplified versions of LOB provisions to be finalised in 2016.[151] It is interesting to note that some African countries such as Uganda provide for a limited form of LOB in their domestic tax laws. Section 88(5) of the Ugandan Income Tax Act (Cap. 340, as amended), provides that the benefits of any bilateral treaty are not available to a partner state-resident enterprise if fifty per cent or more of the underlying ownership of that enterprise of a partner state is controlled by individuals who are not resident in the partner state. Application of this domestic provision in a treaty, where there is no such provision in the treaty itself, may create disputes as section 88(2) of Uganda's Income Tax Act clearly provides that an international agreement entered into by the government of Uganda with any foreign country prevails over the provisions of the Income Tax Act. The IMF advises that if developing countries adopt the LOB provision in their domestic law, they should also adopt the provision in their DTAs to prevent treaty override concerns.[152]

With regard to the use of a PPT test as a general measure to prevent treaty shopping, this could be a feasible approach for African countries, especially those that do not have general anti-avoidance provisions that could serve a similar purpose. In this regard, Ghana could be emulated as it has a general anti-avoidance rule in section 34 of Income Tax Act 896 of 2015, that clearly defines tax avoidance to include any arrangement whose main purpose is to reduce or avoid tax liability. A similar main purpose provision exists in South Africa's general anti-avoidance provisions in section 80A-80L of Income Tax 58 of 1962. The treaty PPT test, which is mostly influenced by the United Kingdom, requires that treaty benefits are denied if one of the principle purposes of the transaction is to avoid taxation by

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[149] IMF n 30 above at 27.
[150] UN 'Protecting tax base erosion in developing countries' n 5 above at 33.
[151] OECD/G20 '2015 Final Report on Action Plan 6' n 135 above in par 25.
[152] IMF n 30 above at 28.

taking advantage of treaty benefits.[153] Over the last two years, the Netherlands appears to have changed its tax treaty policy with regard to developing countries. It shows a proactive approach in the use of the PPT to prevent treaty abuse. The re-signed 2014 Netherlands/Malawi DTA contains an anti-treaty abuse provision[154] in articles 10, 11 and 12 (which deal with interest, dividends and royalties respectively) to the effect that no relief shall be granted if the main purpose, or one of the main purposes is to take advantage of the treaty. The provision requires the competent authority of the contracting state which has to grant the benefits to consult with the competent authority of the other state before denying the benefits. The Netherlands has also renegotiated tax treaties with twenty-three other developing countries, among which are Ethiopia, Ghana, Kenya and Zambia each of which contains a PPT anti- abuse provision.[155] The re-negotiated treaties also cover a provision on assistance in collection of taxes and exchange of information on tax matters – instrumental factors in uncovering BEPS practices. It is worth noting that for DTAs based on the UN MTC, paragraph 23 of the Commentary on article 1 provides the following guiding principle in dealing with situations relating to abuse or improper use of a treaty:

> A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable tax treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.

It should, however, be noted that tests such as the PPT which rely upon notions of 'purpose' or 'intention' are normally difficult to administer and for taxpayers to comply with as they require proof of intent. It would be advisable that in addition to such tests, African countries also rely on other more mechanical tests like the LOB provision to control the abuse of treaties.[156]

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153 OECD/G20 September 2014 Report on Action Plan 6 at 13.

154 IMF n 30 above at 28.

155 Multinational tax and transfer pricing news 'Netherlands renegotiates tax treaties with developing nations to add anti-abuse clause'. Available at: http://mnetax.com/netherlands-renegotiates-tax-treaties-ethiopia-ghana-kenya-zambia-to-add-antiabuse-clause-hopes-add-clause-23-treaties-9530 (last accessed 18 February 2016).

156 UN 'Protecting the tax base of developing countries' n 5 above at 284.

Apart from the above provisions, the OECD also suggests that countries have specific anti-abuse provisions regarding certain types of income in place. I shall deal with two that are pertinent to African countries. The OECD recommends that countries should ensure their DTAs contain article 17(2) which is in both the OECD and the UN MTC, and is aimed at personal services companies used by entertainers and athletes to avoid source-country tax. The OECD also recommends that article 13(4) (discussed above) is included in DTAs, which allows countries to tax gains from the sale of shares of real estate holding companies in order to prevent the use of such companies to avoid taxation on gains on the underlying real estate. As discussed above, had Uganda included this provision in its DTA with the Netherlands, it would have had a clear-cut claim in its case against Zain International.[157] Currently, paragraph 28.5 of the Commentary on article 13(4) provides that states may wish to consider extending the provision to cover not only gains from shares, but also those from the alienation of interests in other entities such as partnerships or trusts, which would address one form of abuse. Under the BEPS project the OECD has agreed that article 13(4) will be amended to include such wording.[158] This development is most welcome for African countries concerned about investors circumventing CGT on the alienation of assets situated in their jurisdictions. The OECD has also noted that there might be cases where assets are contributed to an entity shortly before the sale of the shares or other interests in that entity in order to dilute the proportion of the value of these shares or interests derived from immovable property situated in one contracting state. In order to address such cases, it was agreed that article 13(4) should be amended to refer to situations where shares or similar interest derive their value primarily from immovable property at any time during a certain period, as opposed to only at the time of alienation.[159]

Although the OECD has recommended that countries include a provision in their DTA against treaty shopping, it is noteworthy that in general, African countries are sceptical about extending their limited treaty network because of concerns about treaty abuse resulting from a general lack of treaty negotiating capacity. Indeed the IMF's 2014 'Spill over report' recommends that developing countries should sign DTAs with considerable caution so as

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157 *Zain International BV v Commissioner General of Uganda Revenue Authority* High court of Uganda at Kampala (Civil Division) Miscellaneous Cause No. 96 of 2011.

158 OECD 2015 final report on Action 6 n 135 above in par 42.

159 *Id* at par 43.

to guard against treaty shopping.[160] And, because of the risks involved in signing tax treaties, 'countries should be well-advised before signing the treaties and that they should not enter treaties lightly', which is the case for many African tax treaties with DTAs signed mainly as political gestures.[161] The IMF also notes that although one of the perceived advantages of a DTA is that it signals a strong commitment to tax assurance for foreign investors.[162] Before signing a DTA with any country, the IMF recommends that capital-importing countries (which is what most African countries are) should first consider whether they could achieve more by signing a treaty or by simply providing for key aspects (for example, the permanent establishment definition discussed below and withholding tax rates) in their own domestic law to protect the tax base, as the envisaged benefits that a DTA could provide may actually be of relatively little value. Other important administrative aspects of DTAs such as those relating to exchange of information in tax matters could be achieved through signing Tax Information Exchange Agreements[163] which provide a forum for exchanging information, even where a double tax treaty is not in place. For example, Kenya has initiated the process of signing TIEAs with Guernsey, Seychelles, Singapore and Bermuda; and negotiations are under way with Jersey, Cayman Islands, Isle of Man and Malta.[164] South Africa has signed TIEAs with the Bahamas, Bermuda, Cayman Islands, Guernsey, Jersey and San Marino.[165] The IMF also notes that treaty administrative aspects like assistance in the collection of taxes, can also be achieved by signing the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters.[166] African countries that have signed but not yet ratified this

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160 IMF n 30 above at 22.

161 *Id* at 28.

162 *Ibid*.

163 In 2002 the OECD's Global Forum developed a Model Agreement on Exchange of Information on Tax Matters. The TIEAs provide a forum to exchange information even where a double tax treaty is not in place. See Oguttu 'A critique on the effectiveness of 'exchange of information on tax matters' in preventing tax avoidance and evasion: a South African perspective' (2014) 68/1 *Bulletin for International Taxation*.

164 Taxwise 'Double Tax Agreements and Tax Information Exchange Agreements' (2014) 1 *Tax Alert* Issue 1 (2014)

165 SARS 'International Tax Treaties – Tax Information Exchange Agreements'. Available at: http://www.sars.gov.za/home.asp?pid=5307 (last accessed 10 August 2010).

166 IMF n 30 above at 28. The Multilateral Convention on Mutual Assistance in Tax Matters was developed by the Council of Europe and the OECD; for member states in 1988. In 2010, the Convention was amended by a Protocol and opened to all countries. See OECD 'Convention on mutual administrative assistance in tax matters'. Available at: http://www.oecd.org/tax/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm (last accessed

Multilateral instrument are: Cameroon, Gabon, Ghana, Kenya, Mauritius, Morocco, Nigeria, Senegal, Seychelles, South Africa, Tunisia and Uganda.[167] ATAF also has a multilateral convention (which is not yet in force), which will be useful to African member countries since low tax jurisdictions like Mauritius are party to the Convention. It is thus important that African countries who do not belong to ATAF strive to do so.

For African countries keen to expand their existing DTA network,[168] but are not sure whether to enter into a DTA or to terminate punishing ones already in place, the OECD under its BEPS project has identified tax policy considerations, which countries should consider before deciding to enter into a DTA with a specific country (or to terminate one if changes to the domestic law of a treaty partner raise BEPS concerns).[169] In this regard, the OECD has proposed to amend the Introduction to its MTC so that it includes these factors:

- Where a state levies no or low income taxes, other states should consider whether there are risks of double taxation that would justify a tax treaty.
- States should consider whether there are elements of another state's tax system that could increase the risk of non-taxation – these may include tax advantages that are ring-fenced from the domestic economy.

States should evaluate the extent to which the risk of double taxation actually exists in cross-border situations involving their residents; and they should note that many cases of residence/source juridical double taxation can be eliminated through domestic provisions for the relief of double taxation (ordinarily in the form of either the exemption or credit method) which can operate without the need for tax treaties.

Since one of the objectives of tax treaties is the prevention of tax avoidance and evasion, states should consider whether their prospective treaty partner is willing and able to implement effectively the DTA administrative assistance provisions, such as the ability to exchange tax information and the willingness to provide assistance in the collection of taxes. In this regard, the OECD reiterates the IMF's recommendation (above) that these

9 May 2013).

167 OECD 'Jurisdictions participating in the convention on mutual administrative assistance in tax matters status – 8 February 2016'. Available at: http://www.oecd.org/tax/exchange-of-tax-information/Status_of_convention.pdf (last accessed 25 February 2016).

168 UN 'Protecting the tax base of developing countries' n 5 above at 275.

169 OECD/G20 n 135 above in par 75.

administrative assistance provisions could still be achieved signing Tax Information Exchange Agreements (TIEAs),[170] or by signing the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.[171]

Where a state has concerns that certain features of the domestic law of the other State may raise BEPS concerns or that it might effect changes after the conclusion of a DTA, that may poses BEPS risks, the OECD has come up with proposals to be included in the MTC to restrict treaty benefits if taxpayers benefit from 'special tax regimes' with preferential tax rules or where certain drastic changes are made to a country's domestic law after the conclusion of a treaty. These proposals will be finalised in 2016.[172]

The OECD, however, recognises, that there may be non-tax factors that could lead to the conclusion of a DTA and that each country has a sovereign right to decide to enter into a DTA with any jurisdiction it wishes.[173]

GENERAL RECOMMENDATIONS TO PREVENT ABUSE OF TAX TREATIES IN AFRICA

With respect to the OECD recommendations to curb treaty shopping, it can be concluded that there is no 'one size fits all' in addressing treaty abuse issues. For African countries, the most appropriate method or combination of methods will depend on the basic legal structure of the country involved and the nature of the transaction. For African countries, the first line of defence against treaty abuse is to ensure that they have domestic general anti-avoidance rules in place. To ensure that the application of such domestic provisions is not considered as treaty override, an effort should be made to ensure such general anti-avoidance provisions are aligned with the recommended treaty PPT rule in order to avoid conflict.

Clearly Action 6 will result in changes to the OECD MTC which implies that like other countries, African countries may have to renegotiate all their existing DTAs or to sign a protocol to include changes to the text proposed in the recommendations. Such renegotiations could be costly in light of the number of treaties involved. African counties will have to consider joining

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170 In 2002 the OECD's Global Forum developed a model agreement on exchange of information on tax matters. Oguttu 'A critique on the effectiveness of exchange of information on tax matters' n 163 above.

171 OECD/G20 '2015 Final Report on Action Plan 6' n 135 above in par 75.

172 *Id* at pars 79–80.

173 *Id* at par 75; OECD n 65 above at 19.

the multilateral instrument proposed by the OECD in its BEPS Action 15 to implement measures developed in the course of the work on BEPS with respect to tax treaties.

To benefit from the OECD tax policy considerations that countries should consider before deciding to enter into a DTA or terminate one, it is important for African countries to take pro-active measures in reviewing their DTA policies. They could model themselves on Uganda, which in 2014 announced that it had suspended all of its extant double-tax treaty negotiations pending a review into the treaty terms that it should seek in such negotiations.[174] It is important that such a review should evaluate all the countries' tax treaties in order to determine which ones pose BEPS risks; especially those that lack anti-abuse provisions; those with zero or low withholding tax rates; or those with open ended tax-sparing provisions. Such DTAs should be negotiated to ensure an improved re-distribution of taxing rights.[175] The decision to cancel a DTA should, however, not be taken lightly due to its possible impact on international relations between countries.[176] Effective prevention of treaty abuse by African countries, requires not only a review of tax treaties, but also of domestic tax laws to ensure that they have the right to tax relevant income. A treaty cannot impose tax where the income is not subject to tax under domestic legislation.[177] In a situation where a DTA gives the right to tax a specific type of income to a resident state, but then that state's domestic law does not levy tax on that income, African countries should negotiate a provision in their DTAs which would not compel them to relinquish their source taxing right.

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[174] Ladu 'Govt Suspends Double Taxation Pacts' n 121 above at 1.
[175] *Ibid*.
[176] IMF n 30 above at 22.
[177] *Ibid*.