

Tax directors must rise to the challenge in Africa

By Mark Stevens, The Cragus Group

First published: www.internationaltaxreview.com

22nd October 2018

Tax has certainly become more challenging in Africa, but understanding the current situation requires context. Taxation is only part of a bigger picture, which must also include the broader opportunities and risks involved in operating on the continent.

Contrary to the traditional view of investing to achieve cost saving, the over-riding strategic objective for most businesses investing in Africa is growth and market potential (there are far more potential consumers in Africa than in many wealthier jurisdictions); the favoured route for achieving growth by most investors being organically (as opposed to growth through acquisition or strategic partnerships). Tax directors should bear in mind that:

1. Governance is a perennial issue – the capacity of the states, with fewer economic resources, have less to devote to the tasks of government.
2. Policy predictability – this varies widely from country to country, but changes to fiscal policy can occur frequently and rapidly, often with minimal consultation or warning.
3. The rule of law is a substantial governance challenge – a brief glance at a global map showing the results of Transparency International’s Corruption Perceptions Index presents a pessimistic view of Africa in this regard.

Despite the drive for increased transparency and accountability in the business world in recent years, in navigating the risks, trust remains the most essential component of the relationship between a company and its stakeholders. In so far as tax risk is concerned, the key stakeholders that requires management are, of course, host governments and tax authorities in Africa.

Practically, unexpected tax cost in Africa is created through a combination of:

1. Sudden changes to tax policy and legislation, driven primarily by budgetary pressure.
2. The propensity of African governments to take the path of least resistance in policy matters, developing tax systems that allow them to exploit whatever options are available rather than establishing rational, modern, and efficient tax systems. This is best exemplified in the excise systems prevalent throughout Africa, which target a wide range of products (most commonly banking and insurance services, mobile telephone services, soft drinks including water manufacturing) purely for revenue reasons. The economic rationale for imposing duties is very different from that for imposing a general consumption tax such as VAT. While the latter should be broadly based to maximise revenue with minimum distortion, the former should be highly selective, narrowly targeting a few price inelastic goods mainly on the grounds that their consumption entails

negative externalities on society (tobacco, fuel and alcohol typically). Excise policies in Africa result in tax discrimination, and market distortion, as consumers search for substitute products that are not subject to excise (in the soft drink context, for example, consumers drift towards products not subject to excise such as tea, coffee, milk and juice).

3. The inherent suspicion by many governments that larger companies manipulate their local tax contributions through tax avoidance arrangements, particularly in a transfer pricing context.
4. Motivated tax authorities tasked with raising additional tax to ease budgetary pressure on governments. Regardless of the legitimacy of the conclusions drawn by tax officials following detailed audits of a companies' tax affairs, so-called 'pay now, argue later' principles are enshrined within the tax laws of many African countries, including South Africa, Zimbabwe, Tanzania, Ethiopia. This means that any additional assessments raised will realise immediate tax collections, as most laws provide that a deposit (typically 50% of the additional taxes assessed) must be settled as a precondition for entering an appeal. As a result of these immediate tax collections that result, taxpayers sometimes struggle to have their appeals heard in a timely manner since the tax authority, perhaps satisfied with the deposit paid on the appeal, becomes less incentivised to conclude appeals.
5. An often (or at least perceived) partial judiciary system, which means that disputing a tax claim from a tax authority before the courts carries unacceptable levels of uncertainty – almost regardless of the strength of the defence. Alternative remedies, such as alternative dispute resolution mechanisms, are not widely implemented on the African continent.

So how best then to engender the trust between taxpayer and tax authority and become alert to and manage policy developments?

The approach to engaging with African tax authorities

Matters that lead to tax exposures listed above, in the absence of strong rule of law principles, can only be managed through continuous engagement. A recurring engagement process as outlined in the table overleaf can, for example, be considered.

The table outlined supports multi-tier engagement with personnel employed within government, from relatively junior personnel employed within a local large taxpayer office up through the local governmental hierarchy. While engagement with government senior hierarchy is critical, it is equally important that junior personnel within a tax authority are also continuously engaged. As many countries within Africa, such as Mozambique or Ethiopia, display a 'bottom-up' emphasis within their hierarchical structure.

Engagement outside of the government community, among peers within other large taxpayers, local industry and other trade bodies, are also key components to the annual engagement cycle as, on many occasions, policy and commonly regarded administrative deficiencies may most effectively be tackled through a collective voice. An example of success through concerted and persistent engagement by the business community is the postponement of the introduction of the EGMS (excise goods management scheme) in Kenya. The proposed regulations required manufacturers and importers of bottled water, juices, soda and other non-alcoholic beverages, as well as cosmetics, to affix excise stamps on such goods. Following legal action in March 2018, the Kenyan court issued an order that, on the basis that the

Relationships					
	Tax auditors	Tax authority leadership (commissioners)	Tax policy makers	The wider taxpayer community	African Tax Administration Forum and private sector industry bodies
Objective	Garner trust with local tax auditors, respect and feeling of mutual co-operation	Annual meetings to discuss relationships and policy	Annual meetings with country tax policy makers to understand / influence policy change	Bi-annual meetings to identify and present policy improvements	Influence tax policy at an African trans national level
Taxpayer interface	- Local finance team members	- Local finance director - Group tax director - Local head of public affairs	- Local finance director - Group tax director - Local head of public affairs	Group tax director	Group tax director
Other parties	None	None	External advisors (optional)	- Tax directors of other larger taxpayers; - Independent chairperson (for example, a well-regarded lawyer, who may be tasked with representing the taxpayer group before government)	None

regulations were enacted without adequate public participation in an unconstitutional manner, manufacturers and importers of the affected goods were no longer required to affix excise stamps.

Finally, developing interfaces with influential international organisations, such as the African Tax Administration Forum (ATAF), which promotes and facilitate mutual cooperation among various individual African tax administrations, is recommended in order to obtain a more holistic and continental view on the 'direction of travel', particularly in terms of transfer pricing and exchange of information matters.

The key success factors in delivering a sound engagement strategy are:

1. Agreeing with local subsidiaries, in particular local public affairs staff (be they in-house or outsourced) and general managers, as well as peer groups, an annual engagement cycle for each territory in which operations are carried on.
2. Determining the focus of the engagements for each cycle, typically no more than three initiatives per country, comprising, for example, a policy matter, an administrative matter and a transparency-related.
3. Ensuring the in-house group tax function attends relevant meetings locally, in-country, on a regular basis. Engagement in Africa is only effective on a face-to-face basis, and the importance of having a senior tax strategy decision maker visiting regularly and maintaining relationships cannot be underestimated.

The skill sets required

Some seasoned tax professionals can view Embarking upon such an engagement strategy with trepidation, as the core skills required for engagement (e.g. confidence, assertiveness, creativity, personability, stakeholder relationships and spontaneity), may not be well tested relative to other activities generally carried on within the tax function. The link into the public affairs function, which is well populated with these kinds of skill sets, is therefore an important partnership, but also, of course, from being able to leverage off their wider responsibilities for corporate communications, government relations, public affairs, stakeholder engagement and community relations.

Strengthening relationships and communication, between the tax and public affairs functions is essential. These functions are easily misaligned as they typically have separate reporting lines, into finance and human resources respectively, and different business objectives. Internal cross-function secondments, resource permitting, are a practical way of increasing fluidity.

Summary

From the perspectives of both taxpayers and tax administrations, there is an increasing uncertainty in African tax matters.

On the one hand, taxpayers have legitimate concerns over the inconsistent approaches of different tax authorities towards the application of international tax standards and the way in which disputes can be resolved. On the other hand, tax administrations identify taxpayer behaviour as an important source of uncertainty, in particular as a result of perceived aggressive tax planning and a lack of cooperation.

While government budgetary pressure will continue to drive tax policy and collection, countries should prioritise the more important and greater policy of attracting and maintaining foreign investment. The over-riding objective of a tax engagement strategy is to alleviate the tax authority of their concerns, and to engender the requisite levels of trust, so that taxpayers are better positioned to influence change to the concerns that they have.

This article was prepared by Mark Stevens, a senior tax advisor at The Cragus Group. He has previously worked for PwC, EY and Andersen and was the tax director of an African multinational corporation for a decade.