



AWAY FROM THE RACE TO THE BOTTOM

Effective governance and administration
of tax incentives in Africa



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EXECUTIVE STATEMENT

Tax incentives and aggressive tax planning (ATP) are significant taxation issues of concern within Africa's extractives industry and agribusiness sectors. This policy brief is based on the findings of four country case studies commissioned by Oxfam in Africa in 2023. The study analysed the costs and benefits of tax incentives and aggressive tax planning in Chad, Democratic Republic of Congo (DRC), Equatorial Guinea, and Nigeria to support evidence-based recommendations for policy reforms and advocacy for effective tax incentive frameworks in Africa. The unpublished report is entitled *Cost-Benefit Analysis of Tax Incentives and Aggressive Tax Planning in the Extractives Industry and Agribusiness Sectors: Making policy recommendations*.

The study finds that while tax incentives can attract foreign direct investment, stimulate economic growth in strategic sectors, promote technology transfer, job creation, and exports, they can have insignificant impacts on attracting Foreign Direct Investment (FDI) and other development indicators. Instead, harmful tax incentives have led to substantial revenue losses, economic inequality, and fiscal inefficiency in the four African countries. Multinationals engage in aggressive tax planning through strategies such as shifting income or profits to tax havens to take advantage of lower effective tax rates. Lack or limited transparency in the negotiation process for tax incentives due to strict privacy laws and inadequate monitoring mechanisms curtails public scrutiny and oversight thereby raising concerns about their effectiveness and fairness.

1. Chad
2. Democratic Republic of Congo
3. Equatorial Guinea
4. Nigeria

Such revenue losses and increased administrative costs for monitoring and auditing harmful tax incentives constrain the governments' capacity to finance essential social services and infrastructure.

To effectively regulate tax incentives, African governments, Regional Economic Communities (RECs), and the African Union must implement clear and transparent regulations, enhance monitoring and evaluation mechanisms, foster stakeholder engagement, strengthen institutional capacity, combat aggressive tax planning, and enhance transparency and accountability.

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This policy brief was written by Francis Omondi (PhD) and Perez Onono (PhD). The brief is informed by a research entitled Cost Benefit Analysis of Tax Incentives and Aggressive Tax Planning in the Extractive Industry and Agri-business sectors: Making policy recommendations conducted by Lyla Latiff and Learnmore Nyamadzunga for Oxfam Pan Africa Programme. Oxfam in Africa acknowledges the input and assistance of Gerald Byarugaba, Naomi Majale, Francis Agbere, Henry Ushie , Christian Hallum, Daniel Mule. This policy brief is written to inform public debate and offer recommendations towards effective governance and administration of tax incentives as a means towards increasing Domestic Revenue Mobilization amongst African countries.

For further information on the issues raised in this paper please email oxfaminafrica@oxfam.org.

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INTRODUCTION

Tax incentives are preferential treatments offered in the form of exemptions, tax holidays, credits, investment allowances, preferential tax rates and import tariffs, and deferral of tax liability.¹ They have been used extensively by governments, including in Africa, as tools to promote foreign direct investments (FDI) with the objective of stimulating the growth of strategic sectors, including manufacturing, agriculture, and extractive industries. They have also been used in promoting development, creating employment, transferring technology, and promoting export. Issuing tax incentives is attractive to governments because they seem to be costless and do not affect the current budget. However, tax incentives are often accompanied by various costs, such as economic inefficiency, revenue loss, as well as increased compliance and administrative costs. Tax incentives can be harmful, especially when their costs exceed benefits and when they erode the tax base.² The effectiveness of tax incentives in attracting foreign investment is often understated, as the risk of base erosion owing to tax competition is overstated.³



An assessment of
40
developing countries
found tax holidays
and lower corporate
income tax rates to be
effective in attracting
FDI in Latin America
and the Caribbean
countries, but
ineffective in Africa .



The efficacy,
transparency, and
potential adverse effects
of harmful tax incentives
on Africa's development
are of concern

The effectiveness of tax incentives depends on country-specific factors and priorities, defying 'one-size-fits-all' best practices.⁴ Effectiveness can be significant in countries with weak investment climates but strong rent potential, such as natural resources or locational advantages.⁵ An assessment of 40 developing countries found tax holidays and lower corporate income tax rates to be effective in attracting FDI in Latin America and the Caribbean countries, but ineffective in Africa.⁶ Another study using data for the period 2011 and 2014, established a positive but inelastic effect of tax incentives on industrial and economic growth in Ghana and Nigeria, indicating a less than proportional contribution to productivity growth.⁷ The positive relationship, however, suggests that granting tax incentives to priority sectors and close monitoring to generate data to regularly evaluate efficiency of the incentives can boost growth in Africa's gross domestic product (GDP) growth. Furthermore, other country case studies on the effects of tax incentives on revenue mobilization reveal mixed results, indicating a rise in investment levels in some countries following tax incentives, whereas other countries lost significant revenues⁸ pointing to the need for countries to offer cost-based incentives as opposed

to profit-based incentives and re-evaluating the governance and administration of tax incentives for enhanced efficacy.

The efficacy, transparency, and potential adverse effects of harmful tax incentives on Africa's development are of concern due to the following reasons:

- i) Potential erosion of tax base that makes it difficult for governments to spend on development needs.
- ii) Reduced transparency, efficiency, and equity of the fiscal system when negotiated as part of tax and investment treaties or executive decrees that are not subjected to public participation.
- iii) Possible exclusion and inequality amongst local stakeholders from reaching regional value chains and South-South trade when the incentives are not applied equally across foreign investors, regional agents and local traders.

Harmful tax incentives can foster an enabling environment for aggressive tax planning (ATP)⁹ in the form of transfer pricing, interest payments, and/or royalty payments. These are possible where the Multinational Corporations (MNCs) structure themselves in a way that allows them to place subsidiaries as target entities consequently reducing the tax base; or as lower tax entities, where the tax base increases but the units are taxed at a lower rate; or as conduit entities.¹⁰ The MNCs use these classifications in Africa depending on the domestic tax laws, regulations, policies and directives. The ATP activities amplify illicit financial flows (IFFs) and undermine fiscal activism. In the long term, the harmful tax incentives and their use in ATP slows down the transitioning of the tax system of the domestic state from to a progressive tax system that is inclusive and fair in line with the financing and resource mobilization Strategy of the African Union Agenda 2063.¹¹ They also go against states' need to honour the commitments of the 2022 African Union Commission (AUC) Tax Strategy for Africa for a harmonized continental tax policy to collectively address harmful tax incentives and curb IFFs.¹² Harmful tax incentives and ATPs also distort south-south establishment of fair for all regional value chains to support intra-regional trade between local farmers, artisanal and small-scale miners, and local businesses. Additionally, they impede and delay the domestic state's ability to mobilize sufficient revenues to progressively spend on human development programs that contribute to enjoyment of human rights, especially economic and social rights (ESR), and avoid implementing austerity measures.

KEY FINDINGS FROM THE COST-BENEFIT ANALYSIS OF TAX INCENTIVES AND AGGRESSIVE TAX PLANNING IN THE EXTRACTIVES INDUSTRY AND AGRIBUSINESS SECTORS IN FOUR AFRICAN COUNTRIES


i) Reduced government revenue

While tax incentives in Chad, DRC, Equatorial Guinea, and Nigeria aim to boost economic development and attract foreign investment, harmful tax incentives have resulted in increased administrative costs, substantial loss of government revenue due to illicit financial flows, and forgone revenues due to

exemptions, reduced rates, and low royalty rates (see table 1). The revenue loss constrains the ability of governments to finance essential social services and infrastructure. The findings suggest the need for a balanced approach to optimize the benefits of tax incentives and minimize their adverse effects on government revenue and public spending.

Table 1: Impact of tax incentives on government revenue

	Chad	DRC	Equatorial Guinea	Nigeria
IFFs	US\$1.95bn (2021)	US\$638.7m (2021)	US\$43.9m (2021)	US\$2.02bn (2021)
Revenue foregone	XAF140bn (2016)	\$254.8m (2018)	\$33.79m (2019)	\$16.29bn (2020)
Revenue foregone as % of Tax Revenue	13% (2015)	7.64% (2018)	3.2% (2019)	-



Source: Cost-Benefit Analysis of Tax Incentives and Aggressive Tax Planning in the Extractives Industry and Agribusiness Sectors: Making policy recommendations.¹²

ii) Aggressive Tax Planning

Profit-based tax incentives offered by governments were found to have generally reduced the applicable tax rate on taxable income. The tax holidays, exemptions, and credits that reduce the effective tax rates for businesses have facilitated MNCs who take advantage of lower rates to minimize their tax liabilities. Lack of clear regulations, weak enforcement, and the absence of global cooperation were found to have exacerbated ATP, leading to base erosion and profit shifting across the four countries.

Transfer pricing is the most significant form of ATP in Chad, DRC, Equatorial Guinea, and Nigeria. Chad lacks country-by-country reporting requirements and has not joined the OECD's Inclusive Framework on Base Erosion and Profit Shifting (BEPS), and documentation insufficiencies have provided businesses with opportunities for manipulation. In DRC, there are limited thin capitalization rules and a general anti-avoidance rule does not exist. In Nigeria, related parties are defined based on management,

control, or capital, but the rules concerning comparable parties are not clear. Strengthening regulatory oversight, enhancing transparency, and participating in global frameworks are crucial steps to mitigate ATP risks and protect national tax bases for sustainable economic development.

iii) Lack of Transparency in Negotiations for Tax Incentives

The report shows that tax incentive negotiations in the four countries lacked transparency due to the strict privacy laws and inadequate monitoring mechanisms that have hindered public scrutiny and oversight around them, yet they are offered as part of domestic tax laws. The negotiations are opaque and lack public oversight and are therefore not easy to monitor for compliance with tax incentive agreements. Chad specifically struggles with addressing tax avoidance effectively, which also worsen the challenges associated with tax incentives. In Equatorial Guinea, the control of tax incentives is held by elite interests, and public scrutiny and oversight are constrained by non-membership in any transparency initiatives, such as the Extractive Industries Transparency Initiative (EITI). In Nigeria, there is limited civil society engagement in tax incentive negotiation processes, yet the regulatory frameworks governing tax incentives are perceived to be highly complex. The fairness and effectiveness of these incentives are therefore questionable. The lack of transparency increases the risks associated with potential abuse of tax incentives, which could lead to favouritism towards corporate interests and undermine public welfare.



In Equatorial Guinea, the control of tax incentives is held by elite interests

iv) Effectiveness and impact on development

The impact of tax incentives was found to vary by sector. In the case of extractive industries, it was reported that harmful tax incentives had not improved FDI and growth outside the petroleum sector, with Chad experiencing significant revenue losses due to preferential tax regimes in the oil sector. The agriculture sector was found to have varying forms of tax incentives, some of which may be beneficial. In DRC, the Agriculture Act provides exemptions from property tax for land used exclusively for agriculture to promote food security and rural development and encourages firms to produce water and energy in exchange for tax exemptions. Furthermore, FDI in agriculture is tied to joint ventures with the government or local partners to promote sustainable agriculture and involve small-scale producers. Such provisions allow for the elimination of harmful incentives and limit ATP because they encourage private sector participation, investment in economically disadvantaged areas, research and development, job creation, and local businesses.



The agriculture sector was found to have varying forms of tax incentives, some of which may be beneficial.

Overall, the analysis of the benefits of tax incentives in the four countries found no significant impacts on FDI and other economic indicators, including GDP and the Human Development Index (HDI). Rather, harmful tax incentives were found to have constrained fiscal space, limiting governments' capacity

to spend on essential social sectors hence resulting in increased social inequality. For example, the corruption and tax evasion case involving Glencore in DRC serves to illustrate the ineffectiveness of these incentives in promoting genuine investment and revenue generation.¹³ The finding that there is no significant impacts on FDI and other economic indicators suggests the need for governments in Chad, DRC, Equatorial Guinea, and Nigeria to reevaluate the use of tax incentives to ensure they align with broader development goals and are only granted in sectors that yield benefits to the economies. This may involve implementing stricter regulations, enhancing transparency and accountability mechanisms, and prioritizing investments in sectors that have the potential to generate long-term developmental impact.

RECOMMENDATIONS FOR EFFICIENT AND EFFECTIVE TAX INCENTIVES IN AFRICA

To governments:

i) Reform regulatory frameworks

- Address loopholes in regulatory frameworks that allow for aggressive tax planning, by improving transfer pricing regulations, thin capitalization rules, and anti-avoidance measures.
- Enact legislation to ensure greater disclosure of tax incentive terms and conditions, and measures to prevent BEPS.

ii) Implement clear and transparent regulations

- Establish guidelines specifying the eligibility criteria, duration, and conditions for tax incentives in alignment with broader development goals.
- Publish clear and transparent regulations governing the granting and monitoring of tax incentives.

iii) Enhance monitoring and evaluation mechanisms

- Tax authorities and independent bodies to strengthen monitoring and evaluation mechanisms to track the effectiveness of tax incentives.
- Tax authorities and independent bodies to define indicators for measuring the performance of the tax exemption and timelines for target outcomes.
- Tax authorities and independent bodies to conduct regular audits and evaluations to assess the impact of tax incentives on government revenue, economic growth, and social development outcomes.

iv) Promote stakeholder engagement

- Ministries of finance, Civil Society Organizations, business associations, and academics to foster stakeholder engagement in the design, implementation, and review of tax incentive policies to enhance transparency in decision-making processes regarding tax incentives.
- Ministries of finance, Civil Society Organizations, business associations, and academics to organize regular public consultations and forums to gather feedback.

v) Strengthen institutional capacity

- Ministries of finance and tax authorities to invest in building institutional capacity within tax authorities to effectively administer, monitor, and enforce compliance with tax incentive regulations.
- Ministries of finance and tax authorities to provide training and resources to tax officials to enhance their understanding of tax laws, regulations, and international best practices.

vi) Address corruption and rent-seeking behavior

- Ministries of finance, parliamentary oversight committees, and independent audit bodies to strengthen anti-corruption laws and enforcement mechanisms to combat corruption and rent-seeking behavior that undermine the effectiveness of tax incentives.
- Ministries of finance, parliamentary oversight committees, and independent audit bodies to enhance governance frameworks to promote transparency, accountability, and integrity in the administration of tax incentives.

vii) Enhance transparency and accountability

- Ministries of finance, parliamentary oversight committees, and independent audit bodies to publish relevant information and incentive agreements to enhance transparency around the negotiation and implementation of tax incentives.
- Ministries of finance, parliamentary oversight committees, and independent audit bodies to establish mechanisms for public oversight and accountability, including the use of parliamentary oversight committees or independent audit bodies, to scrutinize the use of tax incentives and address potential abuses.

viii) Prioritize essential social spending

- Government ministries to allocate resources efficiently to address critical social needs and reduce inequality, even in the presence of tax incentives.
- Government ministries to ensure that revenue foregone due to tax incentives does not undermine essential social spending, such as health, education, and infrastructure.

To the African Union, Regional Economic Communities (RECs), and Member States:**i) Enhance transparency and public participation**

- The AU and RECs to enforce mandatory disclosure of all tax incentives and agreements, including their terms and conditions, to promote transparency and accountability among member states.
- The AU and RECs to develop a uniform public consultation framework to be adopted by member states in the negotiation and implementation of tax incentives and the promotion of public consultations.

ii) Harmonize and strengthen tax policies

- The AU and RECs to facilitate regional tax policy harmonization by developing a unified regional tax policy framework to minimize harmful tax competition, including setting minimum standards for tax incentives.
- The AU and RECs to establish anti-ATP measures and regulations across member states, including robust transfer pricing rules, thin capitalization rules, and country-by-country reporting requirements.

iii) Conduct regular cost-benefit analyses

- The AU and member states to establish independent review bodies to conduct regular cost-benefit analyses of tax incentives to assess their effectiveness and use the findings in reviews of tax incentive policies to ensure they contribute positively to economic and social development goals.

iv) Combat IFFs and strengthen enforcement

- The AU, RECs and member states to develop and implement regional strategies to combat IFFs, including enhanced cross-border cooperation and information exchange between tax authorities on the continent.
- The AU, RECs and member states to invest in capacity-building initiatives to enhance the ability of tax authorities in member states to effectively monitor and enforce tax regulations.

v) Promote fair and equitable tax incentives

- AU and RECs to develop guidelines to ensure tax incentives are targeted, temporary, and transparent, focusing on sectors aligned with national development goals to promote social welfare and economic equality.
- AU and RECs to spearhead regular evaluation of the fairness and impacts of tax incentives offered on the continent on inequality and poverty.

NOTES

¹ A. Trepelkov, M. Verdi. (2018). Design and Assessment of Tax Incentives in Developing Countries. World Bank. Accessed 7 July 2024.

https://www.un.org/esa/ffd/wp-content/uploads/2018/02/tax-incentives_eng.pdf

² Ibid.

³ https://www.unescap.org/sites/default/files/S3_Tax-Incentives-and-Tax-Protection-Base.pdf .

⁴ Ibid.

⁵ Ibid.

⁶ A, Klemma. (2010). *Causes, benefits, and risks of business tax incentives. International Tax and Public Finance*, 17(3), 315–336.

⁷ T. Siyanbola et al. (2017). Tax incentives and industrial/economic growth of subSaharan African States. *Journal of Advanced Research in Business and Management Studies*, 7(2), 78–90.

⁸ L. Abramovsky et al (2018). *Are Corporate Tax Incentives for Investment Fit for Purpose? Revisiting economic principles and evidence from low-and middle-income countries*: IFS Report.

⁹ Multinational corporations (MNCs) exploiting mismatches and loopholes in the international tax framework to reduce their overall tax burden or avoid tax liability.

¹⁰ A group with ATP activities but with no clear observable effect on the tax base in their audits.

¹¹ African Union. Agenda 2063. Accessed 7 July 2024.

https://au.int/sites/default/files/documents/36204-doc-agenda2063_popular_version_en.pdf

¹² Press release. 19 April 2022. The African Union.

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¹² Brier, G. (2022, June 27). *A fault confessed is half redressed: Glencore pleads guilty*. (P. Danssaert, Ed.) doi:<https://ipisresearch.be/tag/dr-congo/>



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