SUGGESTED APPROACH

to Drafting Digital Services Tax Legislation

An ATAF Publication

AFRICAN TAX ADMINISTRATION FORUM

FORUM SUR L'ADMINISTRATION FISCALE AFRICAINE

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INTRODUCTION

Many ATAF members have reported difficulties in taxing highly digitalised businesses operating in their countries. Their economies are rapidly becoming more and more digitalised and that digitalisation often enables multinational enterprises (MNEs) to carry out business in African countries with no or very limited physical presence in those countries. This trend has increased due to the use of digitalised process necessitated by the COVID-19 pandemic that has seen some MNEs with physical presence in a country close their premises and move to online trading. This makes it difficult for countries to establish taxing rights over the profits the MNE is making from those business activities.

This is due to the current international tax rules which only allocate taxing rights to a country where a non-resident enterprise creates sufficient physical presence in that country i.e. creating a "nexus" in that country. Business models that enable an MNE to carry out business in an African country with no or very limited physical presence in that country, therefore, represent a significant tax risk. The examples cited by commentators of such business models include social media platforms, search engines and online marketplaces.

The OECD Inclusive Framework has for some time been discussing and trying to find a global consensus-based solution to the tax challenges arising from the digitalisation of the economy. ATAF has been providing technical analysis and support to its members who are also Inclusive Framework members to ensure that if there is a global solution it is fit for purpose in Africa (see the series of ATAF Technical Notes).

However, there is a significant risk for African countries in simply waiting to see whether the OECD Inclusive Framework can achieve an international solution. Doing so could significantly delay enacting and implementing legislation to ensure countries obtain the appropriate taxing rights on the profits of highly digitalised businesses. Such delays may cost African countries millions of dollars of tax with many such business seeing significant increases in their profits during the COVID 19 pandemic. Meanwhile that pandemic has decimated many African economies and the need to ensure that tax revenues bolster national budgets has become critical to sustain even the most essential national requirements in the pandemic.

To assist members in their consideration of whether to introduce new rules for the taxation of highly digitalised businesses, ATAF has developed this Suggested Approach to Drafting Digital Services Tax Legislation that sets out a proposed drafting for such legislation.

This paper, which has been prepared by the ATAF Cross Border Taxation Technical Committee and ATAF Secretariat, contains a suggested approach to the drafting of Digital Services Tax (DST) legislation. It is intended to provide African countries that are considering introducing a DST with a suggested structure and content for their legislation. It provides a framework that draws from the various DST legislation enacted in other jurisdictions but adapted to meet the specific challenges faced by African countries.

DST is a way of collecting tax from those types of businesses that present the greatest challenge to the current international tax framework, and which have been paying little or no tax in Africa. In addition, the size of the digital economy is rapidly growing as a proportion of the total economy of African states. Consequently, it will become increasingly important for African countries to ensure that the digital economy is taxed appropriately.

While the revenue raised may not be large for some African countries, a DST could have other benefits. Much of the recent public concern about the under-taxation of multinationals has focussed on high-profile digital companies that do not have a physical presence in countries so are not subject to income tax. By taxing these companies, a DST could improve public confidence in the fairness of the tax system, which is an important factor for the enhancement of voluntary compliance.

Members should however note that the DST is a tax on gross turnover, and therefore would apply to firms in loss, or with low profit margins. This is something that can be partially mitigated with high de minimis

thresholds, as the larger firms tend to be more profitable. Setting a lower DST rate could also help to mitigate this issue. However, these features cannot eliminate the issue altogether.

It is important that DSTs does not reduce the growth of the digital sector in African countries, particularly start-ups and SMEs. For this reason, Members should consider whether there is a need for a robust de minimis threshold, to ensure the DST only targets established and profitable digital businesses.

Many countries that have introduced DSTs have stated that they will repeal them if and when a consensus based international solution is achieved. ATAF members will need to consider whether they will make a similar commitment.

The explanatory notes at the end of the document describe in greater detail some of the reasoning underlying the draft legislation.