WORLD BANK

Somaliland PFM Education and Training Programme (phase 2)

DRM Module 5: – International Taxation

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Overview

- Learning Objectives;
- Taxation of foreign income;
- Double Taxation Treaties;
- Double Taxation Reliefs for Businesses and Individuals;
- International Agreements;
- Tax Avoidance Schemes;
- International Forums;
- Tax Administration Diagnostic Tools (TADAT)
- World Customs Organisations.

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Learning Objectives

- Understanding of the taxation of international transactions:
- Residence for individuals and companies
- Taxation of foreign income
- Double tax treaties
- Double tax relief for individuals and businesses
- International agreements
- Tax avoidance schemes
- Awareness of international forums
- Tax administration forums
- Customs/trade forums and customs unions
- Understanding of potential areas of revenue reform
- Tax Administration Diagnostic Tool (TADAT)
- World Customs Organization Diagnostic Framework
- Revenue reforms in Somaliland

Residence for individuals and companies

- International tax issues are of concern for both rich and low income countries, with evidence of aggressive tax planning by multinational companies. Given that the multinationals are able to exploit loopholes in the design of the international tax framework to reduce their tax liabilities., international tax has become a major issue. Various of the international tax reform initiatives have been designed by rich countries which may be too complex for less well resources countries.
- Generally speaking, countries' international tax systems broadly follow one of two models. The first, the "worldwide model", taxes its residents on all sources of income. That is, residents pay tax on both domestic income and foreign-sourced income. Under this model, non-residents of the country are subject to tax on local income derived from that country.

Models of International Taxation

- Generally speaking, countries' international tax systems broadly follow one of two models. The first, the "worldwide model", taxes its residents on all sources of income. That is, residents pay tax on both domestic income and foreign-sourced income. Under this model, non-residents of the country are subject to tax on local income derived from that country.
- The second model is the "territorial model". Under this system both residents and non-residents are only subject to tax on income from that country. This means that the country concerned does not tax residents on foreign-sourced income.

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Worldwide and territorial models of international taxation

Income source	Worldwide model	Territorial model
Tax Residents:		
- Domestic income	Taxable	Taxable
- Foreign-source income	Taxable	Not Taxable
Non-Residents:		
- Income from the country	Taxable	Taxable
- Other income	Not Taxable	Not Taxable

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Residency and Taxation System

- Residency taxation systems are typically linked with worldwide taxation, as opposed to territorial taxation. Therefore, it is particularly relevant when two countries simultaneously claim a individual or legal person to be resident within their jurisdiction.
- Many countries use a combination of both models, but most predominantly follow the "worldwide model". Similarly, Somaliland also follow the worldwide model. This means tax "residents" are taxed on their worldwide income and "non-residents" are taxed only on income that has a Somaliland source.
- In applying these models, an important first step is understanding who is a "resident" and who is a "non-resident" for tax purposes. It is particularly important to note the words "for tax purposes". Tax laws define "residents" and "non-residents" for the purpose of determining tax liability. Such definitions are generally very different than those used for immigration purposes and the term "non-resident" is not the same as the term "foreigner".

Resident individuals

- The criteria for residence for tax purposes vary considerably from jurisdiction to jurisdiction and residence can be different for other, non-tax purposes. For individuals, physical presence in a jurisdiction is the main test but for companies the test is where the central management and decision are based..
- The definitions of "resident" used in most countries, typically include three categories of individual, namely:
- a)Individuals whose primary residence or home is in the country. This is interpreted as where their principal place of abode is, where their family lives, where they have all their social and economic ties, etc.;

Resident individuals Cont…

- b)Individuals who have physically been in the country for more than 183 days (i.e. half of a year) in aggregate (i.e. includes those who have multiple visits) during a 12-month period (usually the tax year). Sometimes there will also be a similar additional test over a longer period of time (e.g. an average of over 122 days in country over the past 3 years);
- c)Officials of the government (usually diplomats and military) who are posted outside of the country.
- *Please note that has also been discussed in Module 1 refer to that.*

Resident companies

- The definitions of "resident" used in most countries, typically include three categories of company, namely:
- a) Companies that are incorporated/established within the country through whatever mechanisms are used in the country to register companies as separate legal entities from their owners;
- b) Companies whose management and control is exercised in the country i.e. their headquarters/head office or place of top decision-making is in country at any time during the tax year;
- c) Companies that undertake the majority of their operations in the country during the tax year.

African Countries Resident and Subsidiary Taxation

Country	Resident Company Rate	Branch Rate
Cameroon	30%	30%
Chad	35%	35%
Congo	30%	30%
Djibouti	25%	25%
Egypt	25%	40% for oil companies
Eswatini	27.5%	15%
Ghana	25%	25%, 8%
Kenya	35%	37.5%
Malawi	30%	35%
Morocco	31%	31%, 15%
Nigeria	30%	30%
Rwanda	30%	30%
South Africa	28%	28%
Sudan	0-35%	0-35%
Tanzania	30%	30%,10%
Uganda	30%	30%, 15%

Taxation of foreign income Methods

Branch

- is either an unincorporated division of a resident corporation, or a foreign partnership such as joint venture in which case, foreign income is considered earned directly by the resident corporation and then the state will tax foreign branch income.
- To avoid double taxation most countries, allow either deduction for the foreign tax or foreign tax credit

Foreign Subsidiary

- the subsidiary may not be taxed given that it is legal resident to the another country for instance, if Dell computers which is resident in US conducts foreign operations using a Kenyan subsidiary corporation, the US will not tax the earned foreign income.
- In Somaliland According to Revenue Act (2016) *Foreign-source employment income derived by a resident individual is exempt from tax if the individual has paid foreign income tax in respect of the income*

Taxation of foreign income Cont….

- to eliminate double taxation for the companies that have subsidiaries in abroad, the US has deemed paid credit" which allows a foreign tax credit to the parent for the foreign tax paid by the subsidiary. The US has also Foreign Tax Credits (FTC) which is aimed is to eliminate double taxation on foreign source income.
- Section 127 of Revenue Act (2016) prescribes that "A resident taxpayer is entitled to a credit in this Section referred to as a "foreign tax credit", for any foreign income tax paid by the taxpayer in respect of foreign- source income included in the gross income of the taxpayer".
- However, the Act indicates that "the amount of the foreign tax credit of a taxpayer for a year of income shall not exceed the Somaliland income tax payable on the taxpayer's foreign-source income for that year, calculated by applying the average rate of Somaliland income tax of the taxpayer for that year to the taxpayer's net foreign-source income for that year

Taxation of foreign income Cont….

- Example
- The subsidiary earns $200 pays foreign taxes of $50 distributes a dividend of $150 to the US parent US parent is deemed to have paid the $50 foreign tax related to the $150 dividend However, the US parent must include $200 (= 150 + 50) in dividend income rather than just the $150 received This is known as the "dividend gross up"

Other Methods

Deduction Method

- The deduction method allows the tax paid in the source state to be deducted from the inland tax liability in the residence state.

Credit Method

- The credit method is complex from both a compliance and an enforcement perspective this is due to the fact that the foreign income requires to be recomputed according to domestic tax rules. This often discourages investments abroad or encourage the deferral options such as non-repatriation some kinds of foreign income, such as dividends, which are normally not assessed for tax in the country of residence until actually received.

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Credit method Cont…

- The credit method, the country of residence taxes the foreign income of its residents but allows the foreign tax as a credit against its own tax. Generally, it does not refund excess foreign tax over its own tax. The ultimate tax liability of the taxpayer would then be the higher of the domestic or foreign tax.

Example

- Jama & Jama is resident in country Sudan (corporate tax rate 40 %) and operates an affiliate in Somaliland (corporate tax rate 12.5 %). The affiliate derives $100.000 of income and pays $12500 tax in Somaliland. The remainder ($87500) is remitted to Sudan where it could be grossed up to $100.000 and taxed at 40 % resulting in a corporate tax liability of $40.000 However, since Jama & Jama is entitled to a credit for the tax paid in Somaliland, it only pays $12500 of tax in Sudan (i.e. 27.5%). Its ultimate tax liability therefore amounts to $40,000 (i.e. $27500 in Sudan and $ 12500 in Somaliland).
- Therefore, in both situations, the ultimate tax liability of jama & Jama is the higher of the domestic or foreign tax.Thus, Somaliland may get advantage from this scenario

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Tax on foreign income

- "Foreign income" is income that is regarded as having a "source" from outside the country. As referred to in Table 2, for tax "residents" this is their foreign-source income (as distinct from their domestic income), whereas for "non-residents" it is their income other than that which has a source from the country. "Source" is described in Section 2.2.5.
- For instance most of the common law countries including the United Kingdom impose taxation of the foreign income of the individual residents including; wages if you work abroad, foreign investment income, for example dividends and savings interest, rental income on overseas property and income from pensions held overseas

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Income Source rules

- The tax laws in most countries outline when different types of income are regarded as having a "source" in their country. A common rule is that income has a source in the country where the work that gave rise to that income was physically performed in that country. Thus, for example, an ex-patriate who was providing services within Somaliland could be subject to tax in Somaliland because the services were provided in country, even if the ex-patriate was physically paid from outside Somaliland and the funds were never banked into a Somaliland bank account.
- According to Somaliland Revenue Act (2016) *Foreign-source employment income derived by a resident individual is exempt from tax if the individual has paid foreign income tax in respect of the income. A resident individual is treated as having paid foreign income tax on foreign-source employment income if tax has been withheld and paid to the revenue authority of the foreign country by the employer of the individual*

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Withholding tax or other special provisions for non-residents

- Due to the difficulty in tax administrations being able to collect taxes from non-residents who are generally not in the country, it is common for some of the tax payable by non-residents to be collected as withholding taxes from the generally resident persons (meaning the payments have a country of payment source) who are paying income to those non-residents.
- The OECD is co-ordinating work on this issue and trying to get an international consensus on that issue. While consensus has not yet been achieved, some countries have taken temporary interim measures while most are waiting for some form of international agreement.
- In Somaliland, the Director may, by notice in writing, require any person who is in possession of an asset, including money, belonging to a non-resident taxpayer to pay tax on behalf of the non-resident, up to the market value of the asset but not exceeding the amount of tax due

Double Taxation Treaties

- Double taxation generally refers to the situation when two countries are trying to levy tax on the same income.
- This can easily arise where the tax laws in both countries follow the worldwide model and where a person who is a resident in one country (and pays tax on all of their worldwide income in that country) is also a non-resident in another country and earns income with a source in that other country (and thus is also subject to tax on that income in that second country).
- There are several other types of treaties that deal with tax issues. For Instance, countries that impose inheritance taxes may have treaties to eliminate double taxation with respect to them. On the other hand, many nations have previously signed the Multilateral Convention on Mutual Assistance in Tax Matters.

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This Agreement deals with administrative tax issues, including sharing the information, cooperating with taxes collections and dispute resolution in certain cases

Double Taxation Treaties Cont…

- ***The role of a double tax treaty includes:***
- Providing greater certainty of tax treatment for taxpayers by defining and allocating taxing rights, permitting tax credits, and establishing mutual agreement procedures (which enable tax administrations to discuss and resolve cross-border tax disputes);
- Defining the basis for sharing the cost of relieving double taxation by identifying types of income where the country of source of that income has no, limited, or full taxing rights;
- Improving the return for international investors by reducing the possibility of double taxation and providing greater certainty for such foreign investors due to the more enduring nature of a concluded double tax treaty;
- Providing a basis for international co-operation between tax administrations enabling the exchange of information, assisting in the prevention of tax avoidance and tax evasion, and even assisting in the collection of outstanding taxes.

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Double Taxation Treaties Cont…

- It should be noted that the preparation and finalisation of double tax treaties typically spans several years and can involve multiple negotiation meetings between officials of the respective countries and then lengthy approval procedures in each country.
- For example, some East African countries and Turkey double tax treaty was signed in the last couple of years, some are not yet ratified by the Turkish Parliament until 2020. It is often a complex technical process and as a consequence many countries have only concluded a small number of double tax treaties.
- As both countries need to agree to commit the resources to develop and negotiate such agreements, priority is usually given to the establishment of double tax treaties with a country's major trading partners.
- The Somaliland Tax law states that "Where an international agreement provides for reciprocal assistance in the collection of taxes and the Director has received a request from the competent authority of another country pursuant to that agreement for the collection from any person in Somaliland of an amount due by that person under the income tax laws of that country, the Director may, by notice in writing, require the person to pay the amount to the Director by the date specified in the notice for transmission to the competent authority of that other country

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Double Taxation Treaty Models

- Treaties are agreements between countries as guided by Article 2 of the Vienna Convention on the Law of Treaties which applies to all treaties, indicates that "A treaty is an international agreement (in one or more instruments, whatever called) concluded between States and governed by international law.
- Tax treaties are often called either "agreements" or "conventions"
- There are two influential model tax conventions that most of the countries comply with; the United Nations and OECD Model Conventions. However, nations have also their own model tax treaties between them, which are often not published but are provided to other countries for the purpose of negotiating tax treaties.
- It should be noted that the United Nations Model Convention draws heavily on the OECD Model Convention.

Double Taxation Treaty Models Cont…

- The content of most double tax treaty agreements is based on two similar but differing models, the UN model or the OECD model. The UN model generally favours retention of greater so called "source country" taxing rights (the taxation rights of the host country of investment) as compared to those of the "residence country" of the investor which is given more prominence in the OECD model. Given this, the UN model has long been regarded as being of more usefulness to developing countries and thus is likely to be more applicable for future use in Somaliland.
- The UN Model Double Taxation Convention between Developed and Developing Countries has 31 Articles spanning 50 pages with an associated commentary on each of the Articles spanning 750 pages. Those topics covered in that UN Model Convention are detailed in Table 5 below. As shown in the contents, it should be noted that double tax treaties only deal with the taxation of income and capital. They do not deal with taxes on sales such as sales tax and VAT (value added tax).

UN Model Convention

Immovable property, agriculture, industry, Income from self-employed or employment	Full taxation	Exemption method or credit method
Dividends and interest payments	Limited taxation	Exemption method
Licence fees etc.	Exemption method	Full taxation

Treaty Shopping

- Treaty shopping is process where corporations may involve a premeditated effort to take advantage of the international tax treaty loophole by conducting a careful selection of the most favourable tax treaty for a specific purpose.
- There are possible motives where the corporations engage in treaty shopping such as obtaining otherwise unavailable reduction or exemption of (withholding) taxes in the country of the source of the income, claiming an otherwise unavailable tax exemption in the residence State or claiming taxation in the source country at a lower tax rate than the one applicable in the residence one.
- Mostly, the taxpayers purpose is the avoidance or reduction of withholding taxes in the source country and the tax advantage occurs to the detriment of the source country of the dividends

Treaty Shopping Cont…

- For example, a building constructor resident of Djibouti who will carry on a construction activity in Somaliland that is expected to last for 11 months may set up a subsidiary in the Ethiopia to do the job because under the Somaliland/Djibouti treaty he will have a permanent establishment and become taxable in Belgium, while under the Somaliland/Ethiopia treaty he will not.
- A Belgian company wishing to set up an office in Ivory Coast solely for purchasing goods or merchandise there, will have a permanent establishment there, while it can avoid this effect if it sets up a subsidiary in another State that opens the purchase office in Kenya if that State has a treaty with Kenya that follows the OECD Model Please clarify this treaty?
- This is example not actual treaty Somaliland has not signed treaty with international community. So this example will be here

Transfer Pricing

- Transfer pricing is the pricing method of the intermediate goods or services supplied by one or more related companies to other companies within the same group. Multi-National Companies (MNCs) have normally various subsidiaries, joint ventures or branches across various countries where each unit being a profit centre.
- The prices can be set in three ways in such a situation: the headquarters sets the price, subsidiaries or branches negotiate with the parent company and set the price or alternatively the market price is used for the inter-trading goods and services supplied within the group
- According to OECD (2008) states that the transaction value of a good or service between related enterprises may not always reflect market values. Transfer pricing refers to the distortion between transaction values and market values.
- The motives for transfer pricing manipulation can be broadly categorised into four categories: managerial, market, government policy and taxation

Transfer Pricing Cont…

Example

- Consider Delta Holding , a U.S. based pen company manufacturing pens at a cost of 10 cents each in the U.S. Delta Holding's subsidiary in Canada, Jelta Co., sells the pens to Canadian customers at $1 per pen and spends 10 cents per pen on marketing and distribution. The group's total profit amounts to 80 cents per pen. Now, Delta Holding. will charge a transfer price of between 20 cents and 80 cents per pen to its subsidiary.
- In the absence of transfer price regulations, Delta Holding. will see where the tax rates are lower and seek to put more profit in that country. Thus, if U.S tax rates are higher than Canadian tax rates, the company is likely to assign the lowest possible transfer price to the sale of pens to Jelta Co.

Arm's length principle

- Arm's length principle sets the rules for the Arm's Length Principle, which is important in transfer pricing, this rule states that transfer prices between two commonly controlled entities must be treated as if they are two independent entities.
- The Arm's Length Principle is based on market fair value where it enables using a single international standard of tax computation. Thus, the governments can receive their share of taxes but also provides sufficient provisions for MNCs to avoid double taxation.
- 15.The Arm's length principle has been hot topic in the recent years for both governments and tax professionals.

Google Case Study

- Google runs a regional headquarters in Singapore and a subsidiary in Australia. The Australian subsidiary provides sales and marketing support services to users and Australian companies. The Australian subsidiary also provides research services to Google worldwide. In FY 2012-13, Google Australia earned around $46 million as profit on revenues of $358 million. The corporate tax payment was estimated at AU$7.1 million, after claiming a tax credit of $4.5 million.
- When asked about why Google did not pay more taxes in Australia, Ms. Maile Carnegie, the former chief of Google Australia, replied that Singapore's share in taxes was already paid in the country where they were headquartered. Google reported total tax payments of US $3.3 billion against revenues of $66 billion. The effective tax rates come to 19%, which is less than the statutory corporate tax rate of 35% in the US

Group Discussion : Double tax treaties and Somaliland

- Somaliland has not yet entered a double taxation treaty, However there were discussion on this issue with some countries in the region.
- Discuss the benefits of double taxation treaties that Somaliland may have get it

Double tax relief for individuals and businesses

- While one of the main purposes of double tax treaties is to clarify taxing rights so as to avoid double taxation by two countries on the same income, as noted above, there are not a large number of double tax treaties particularly in small low-income countries. While double tax treaties will assist by clarifying taxing rights in respect of cross-border transactions where such treaties exist, consideration needs to be given to what other double tax relief provisions exist where there is no double tax treaty in place.
- Where there is no double tax treaty in place, then consideration needs to be given to the provisions of the tax laws of both countries involved in cross-border transactions. In some cases, tax laws provide an exemption from income tax where tax has been paid on the same income in a foreign country and proof of such foreign tax payment is provided. This operates on a similar basis to the "exemption method" for relief from double taxation within double tax treaties. However, such exemption provisions are often limited in tax laws and thus do not fully cover double taxation on the same income that may arise.

Exemptions and foreign tax credits

- The more common international practice is for double taxation relief to be provided through "foreign tax credits". In such cases foreign income is included as taxable income of resident taxpayers but a credit is allowed for foreign tax paid on that income. Common features of such foreign tax credit provisions are:

1. Taxpayers claiming foreign tax credits are required to provide evidence of their foreign tax payment
2. The credit allowable to the taxpayer is limited to the amount of tax that would have been paid on that income if it had been taxed in the country providing the credit

- The latter of these points deals with the issue of such income being subject to different tax rates in the two countries involved in cross-border transactions, but also ensures that countries do not give more credit than they should if the income had been taxed in those countries.
- As an example of foreign tax credits, a Somaliland-based taxpayer paying tax at a marginal rate of 12.5% on their income who also earned income during the year from work physically conducted in the United Kingdom (taxed at a rate of 45% there), would include their UK income in their worldwide income in Somaliland and will receive a foreign tax credit in Somaliland but this will be limited to the 18% rate on that income in Somaliland.

International agreements

- In addition to tax laws, there are typically a range of international agreements that countries sign up to, or enter into, that have impacts that supersede the domestic tax laws. These include:
- a)Double taxation treaties. These were covered in Section 2.3 above.
- b)The UN Charter of 1945. This is the founding document of the United Nations and contains provisions relating to all countries that are members of the United Nations. Somaliland is not yet a member of the United Nations.
- Articles 104 and 105 provide for privileges and immunities of the UN and its officials and representatives.
- It should be noted that United Nations employees receive “assessed contributions”. While these are set amounts with no tax withheld, a notional 25% tax is calculated in respect of ex-patriate employees and offset against country contributions to the UN.

International agreements Cont….

a) The Vienna Convention on Diplomatic Relations of 1961 and the Vienna Convention on Consular Relations of 1963. These are international treaties that define a framework for diplomatic and consular relations between independent countries. Somaliland did not sign these treaties.

- The Conventions include articles that provide that the diplomatic and consular employees and members of their families are exempt from taxes.

a) n international agreement entered into between the Government of Somaliland and the government of a foreign country or foreign countries shall have effect as if the agreement was contained in the Revenue Act Bilateral international assistance agreements. Where countries provide financial or technical assistance to other countries, it is normal practice for the such countries to enter into agreements with recipient countries to outline the rules that will apply to staff from such countries based in the recipient country and sometimes to technical assistance contractors and their staff providing such assistance while in the recipient country.

b) Agreements with international investors. It is common for countries to enter into agreements with foreign investors for large public or private sector investments which outline the terms of their investments. Such agreements will usually contain provisions relating to the taxes applicable to the investment including exemptions. These may differ from and supersede not only tax laws but also any laws providing tax exemptions and incentives for investment

VAT concepts, principles and application

- A value-added tax (VAT) is a consumption tax levied on products at every point of sale where value has been added, starting from raw materials and going all the way to the final retail purchase. Ultimately, the consumer pays the VAT; buyers at earlier stages of production receive reimbursements for the previous VAT they've paid.
- VAT is commonly expressed as a percentage of the total cost. For example, if a product costs $100 and there is a 15% VAT, the consumer pays $115 to the merchant. The merchant keeps $100 and remits $15 to the government.
- A VAT system is invoice-based and collected at several points throughout an item's production, each time value is added and a sale is made. Sales transactions are taxed, with the customer informed of and charged for the VAT on the transaction and remitting that amount to the government, and businesses receiving a credit for VAT paid on input materials and services. The amount of tax levied at each sale along the chain is based on the value added by the latest seller.
- The main disadvantage of VAT is the extra accounting required by those in the middle of the supply chain; this is balanced by the simplicity of not requiring a set of rules to determine who is and is not considered an end use.

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VAT On Cross-Border Transaction

- VAT on cross border transactions requires understanding on who levies the VAT to the consumers. There are different principles that is basis for this VAT Under the destination principle, tax is ultimately levied only on the final consumption that occurs within the taxing jurisdiction.
- No VAT is levied on exports and the associated input tax is refunded to the exporting company under the destination principle, this referred as zero-rated, while imports are taxed on the same basis and at the same rates as domestic supplies.
- While introducing tax at the various rates applicable in the jurisdictions where value is added, the origin principle could influence the economic or geographical structure of the value chain and undermine neutrality in international trade.
- The application of the destination principle in VAT achieves neutrality in international trade, as there is no advantage in buying from a low or no-tax jurisdiction . However, under the origin principle, the tax is levied in the various jurisdictions where the value was added

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Class Discussion : How is the newly imposed VAT/GST will affect goods and services

- As we know the Ministry of Finance has recently extended the GST or How do you think that will have impact on government revenue and cross trading between Somaliland and neighbouring countries particularly Ethiopia?

Tax avoidance schemes

- Tax evasion is the illegal practice of not paying taxes by not reporting income, overstating expenses or by not paying outstanding taxes owed to the Government. This may also be referred to as tax fraud i.e. the practice of deceiving or misrepresenting the business tax position to the revenue authorities.
- Tax avoidance is legal actions to minimise tax payable by individuals and corporations simply by using all the allowed deductions, deferrals and exemptions given by law. Businesses may hire accountants and other tax practitioners who are able to provide insights on how to “shelter income” i.e. provide the business with legal means to lower its taxes. Similarly, in areas where the tax code is complex, savvy accountants may find “loopholes” or “a technicality” that allows a business to avoid the scope of a tax law.
- Thus, tax avoidance is the legal usage of the tax regime in a single territory to one's own advantage to reduce the amount of tax that is payable by means that are within the law. While forms of tax avoidance which use tax laws in ways not intended by governments may be considered legal, it is almost never considered moral in the court of public opinion. Many corporations and businesses which take part in the practice experience a backlash, either from their active customers or online. Conversely, benefiting from tax laws in ways which were intended by governments is sometimes referred to as "tax planning".

Tax avoidance schemes Cont…

- There are a wide range of types of tax avoidance including arrangements that gain tax advantages through:

1. Income splitting – shifting income from taxpayers with higher tax rates to those facing lower tax rates e.g. an individual subject to tax at the highest personal income tax rate transfers money to his/her spouse who have a lower personal income tax rate
2. Conversion – converting income that would otherwise have been taxable into non-taxable capital gains or other non-taxable sources
3. Deferral – postponing the derivation of income or accelerating the deductibility of expenditure
4. Transfer pricing where taxpayers intend to minimise the tax liability by shifting income to lower tax rate jurisdictions

- While some forms of tax avoidance may be broadly accepted by the public at large, there are other forms that would be regarded as more aggressive and unfair. The more aggressive tax avoidance involves schemes that fall into the grey area between commonplace and well-accepted tax avoidance and evasion, but that are widely viewed as unethical.

Tax avoidance schemes

- ***Example of Tax Avoidance scheme***
- One type of tax avoidance using tax havens is transfer pricing manipulation, which refers to trade between related parties at prices meant to manipulate markets or to deceive tax authorities. For example, if company A, a food grower in Africa, processes its produce through three subsidiaries: X (in Africa), Y (in a tax haven, usually offshore financial centres) and Z (in the United States). Now, Company X sells its product to Company Y at an artificially low price, resulting in a low profit and a low tax for Company X based in Africa.
- Company Y then sells the product to Company Z at an artificially high price, almost as high as the retail price at which Company Z would sell the final product in USA.
- Company Z, as a result, would report a low profit and, therefore, a low tax. About 60% of capital flight from Africa is from improper transfer pricing. Such capital flight from the developing world is estimated at ten times the size of aid it receives and twice the debt service it pays.

Government responses on Tax Avoidance

- Governments responded to the tax avoidance with the following;
- Anti-avoidance rules are measures that prevent the reduction of tax by legal arrangements, where those arrangements are put in place purely to reduce tax, and would not otherwise be regarded as a reasonable course of action.
- These legislative rules can be divided into two categories: specific anti-avoidance provisions and the general anti-avoidance provisions.
- Specific anti-avoidance provisions are directed to particular defined situations. Owing to the complexity of tax laws and the variety of business entity structures that can exist, it is practically impossible to include specific provisions covering every possible avenue of tax avoidance and evasion in tax laws.
- Governments have thus also included general anti-avoidance provisions in their tax laws which have been used as yardsticks by which the line between legitimate tax planning and improper tax avoidance can be drawn

Government responses on Tax Avoidance Cont…

- According to the Article 48 of the Revenue Act (2016), the Somaliland Tax Authority is provided a power to recharacterize of tax avoidance transaction or schemes For the purposes of determining liability to tax under this Act, the Director may “recharacterize a transaction or an element of a transaction that was entered into as part of a tax avoidance scheme”
- Some governments have gone further by including legal provisions requiring promoters of tax avoidance schemes to disclose details of those schemes to the tax authorities so their details and revenue impacts can be examined.
- Some countries have defined tax avoidance as occurring where the main object (or purpose), or one of the main objects (or purposes) of a transaction, is to enable tax advantages to be obtained. In such cases, the tax administration may adjust the accounts of the taxpayer to counteract the tax advantage obtainable, i.e. treating those tax avoidance transactions as not having occurred.

International forums

Tax administration forums

- In addition to tax administration assistance available through the IMF, World Bank and from donor assistance under bilateral aid programmes, there are also a range of international forums that provide tax administration advice and provide networking opportunities between tax administrations. These include the OECD and CATA (the Commonwealth Association of Tax Administrators). Of more relevance in Africa is ATAF (the African Tax Administration Forum).
- ATAF is an international organisation which provides a platform for cooperation among African tax authorities and was launched in November 2009 in Uganda. Through mutual cooperation between member states, ATAF works towards increasing the level of voluntary tax compliance whilst combating tax evasion and avoidance.
- ATAF is supported by a range of organisations including the OECD, the African Development Bank and country support from Austria, Denmark, Finland, Germany, Ireland, Netherlands, Norway, Switzerland and the United Kingdom. It collaborates with African regional economic organisations, the Commonwealth Association of Tax Administrators, the Inter-American Center of Tax Administrations, the Centre de Rencontres et d'Etudes des Dirigeants des Administrations Fiscales, the Intra-European Organisation of Tax Administrations, and the International Centre for Tax and Development

Customs forums and customs unions

- There are several customs forums and customs unions such as international customs and trade forums and World Customs Organization (WCO).

International customs and trade forums

- The main international forum in relation to customs matters is the World Customs Organization (WCO). The WCO was established in 1952 as an independent intergovernmental body whose mission is to enhance the effectiveness and efficiency of Customs administrations.
- Today, the WCO represents 183 Customs administrations across the globe that collectively process approximately 98% of world trade. As the global centre of Customs expertise, the WCO is the only international organisation with competence in Customs matters and can rightly call itself the voice of the international Customs community.
- Somaliland is not a member of the WCO due to its recognition status.
- Another important international forum is the World Trade Organization (WTO). The WTO is an intergovernmental organisation that is concerned with the regulation of international trade between nations. It is the only international organisation dealing with global rules of trade and its main function is to ensure that trade flows as smoothly, predictably and freely as possible.
- The WTO was established in January 1995. It was a successor to the General Agreement on Tariffs and Trade (GATT).

International customs and trade forums Cont…

- GATT is a legal agreement between many countries, whose overall purpose was to promote international trade by reducing or eliminating trade barriers such as customs tariffs or quotas. According to its preamble, its purpose was the "substantial reduction of tariffs and other trade barriers and the elimination of preferences, on a reciprocal and mutually advantageous basis."
- The GATT was signed by 23 nations in Geneva on 30 October 1947, and took effect on 1 January 1948. It remained in effect until the signature by 123 nations in Marrakesh on 14 April 1994, of the Uruguay Round Agreements which established the WTO. The original GATT text (GATT 1947) is still in effect under the WTO framework, subject to the modifications of GATT 1994. Nations that were not party in 1995 to the GATT need to meet the minimum conditions spelled out in specific documents before they can accede; in September 2019, the list contained 36 nations.

Customs unions

- Another potential forum for customs support is a “customs union”. A customs union under GATT Article XXIV is an agreement under which partners commit to removing all duties on products originating in each other’s territory and having a common external tariff. This means that there is a common tariff border across the countries represented by the customs union. It also means the ability to set those tariffs is transferred from member states to customs union institutions.
- Examples of customs unions are the African Continental Free Trade Area (AfCFTA), the Common Market for Eastern and Southern Africa (COMESA) and the Southern African Customs Union (SACU).

Sub-Saharan Africa and International Taxation

- Although progress has been made international taxation in the past two decades and Sub-Saharan countries in Africa, international tax issues still remains a significant concern for these governments given that aggressive tax planning is often used by multinational enterprises (MNEs).
- Revenues from corporate income taxes have remained resilient at about one-fifth of the average tax take. However, the income tax is the least collected tax in Somaliland But, MNEs are able to exploit weaknesses in the current international tax framework in SSA to reduce their tax liabilities. These strategies usually aim to shift income to low tax jurisdictions and away from higher tax jurisdictions or to shift tax deductions so they can be claimed in higher taxed jurisdictions rather than in low tax jurisdictions.
- Nevertheless, both developed and developing countries are challenged by MNE activities that have impact on tax revenues. Certainly SSA countries have weak capacity to administer international tax rules which can have implications of governments ambition to provide expected services to citizens

African Continental Free Trade Area (AfCFTA)

- African Continental Free Trade Area (AfCFTA) is a free trade area which, as of 2018, includes 28 African countries. It was created by the African Continental Free Trade Agreement among 54 of the 55 African Union nations. The free-trade area is the largest in the world in terms of the number of participating countries since the formation of the WTO.
- The agreement was brokered by the African Union (AU) and was signed on by 44 of its 55 member states in Kigali, Rwanda on March 21, 2018. The agreement initially requires members to remove customs tariffs from 90% of goods, allowing free access to commodities, goods, and services across the continent.
- The United Nations Economic Commission for Africa estimates that the agreement will boost intra-African trade by 52 percent by 2022. While, Somaliland is not part of this agreement yet. The agreement went into force on May 30, 2019 and entered its operational phase in July 2019.

Common Market for Eastern and Southern Africa (COMESA)

- COMESA is a regional trade bloc aimed that has established a free trade area in Africa. Its vision is to “be a fully integrated, internationally competitive regional economic community with high standards of living for all its people ready to merge into an African Economic Community”
- While its mission is to “endeavour to achieve sustainable economic and social progress in all Member States through increased co-operation and integration in all fields of development particularly in trade, customs and monetary affairs, transport, communication and information, technology, industry and energy, gender, agriculture, environment and natural resources”.
- COMESA was formed in December 1994, replacing a Preferential Trade Area which had existed since 1981. It now has 21 member states which joined in July 2018. Somaliland does not yet joined the Preferential trade Agreement as separate state.

Southern African Customs Union (SACU)

- Another regional example of a customs union is SACU. The Southern African Customs Union (SACU) is a customs union among five countries of Southern Africa: Botswana, Lesotho, Namibia, South Africa and Eswatini (formerly Swaziland). Its headquarters are in the Namibian capital, Windhoek. It was established in 1910. SACU is the oldest existing customs union in the world.
- All customs, excise and additional duties (trade taxes) collected in the SACU Common Customs Area are paid into the Common Revenue Pool and shared among member states. Member states' share of the pool is disbursed or determined in accordance with the SACU Agreement's revenue sharing formula.
- For Botswana, Lesotho, Namibia and Eswatini (BLNE), the SACU revenue share makes up a significant component of total government revenue – even more than half in some years for Lesotho and Eswatini. BLNE get a significant share of their revenue from the Customs Component, whilst South Africa gets more that 90% of its share from the Excise Component. The Development Component is meant to compensate the least developed countries but is distributed more or less equal among all member states.
- For 2018/19 revenue shares, South Africa has received the highest share with 47%, followed by Botswana (21%), Namibia (19%), Eswatini (7%) and Lesotho (6%).

Revenue reforms

- TADAT (Tax Administration Diagnostic Assessment Tool) is a measurement tool that provides an objective and standardised performance assessment of a country's system of tax administration.
- TADAT focuses on the performance of the major national taxes: Corporate Income Tax (CIT), Personal Income Tax (PIT), Value Added Tax (VAT) (or its indirect tax equivalent such as sales tax), and Pay As You Earn (PAYE) amounts withheld by employers (which, strictly speaking, are remittances of PIT). Social Security Contributions (SSCs) may also be included in assessments where SSCs are a major source of government revenue and are collected by the tax administration.
- TADAT is a collaborative effort supported by the International Monetary Fund, the World Bank, the European Union, and the governments of France, Germany, Japan, Netherlands, Norway, Switzerland, and the United Kingdom. A TADAT Secretariat is hosted by the International Monetary Fund.

TADAT assessments

- 100. The TADAT tool is used as the measurement tool during TADAT "assessments" of national tax administrations. The process for conducting such assessments has four phases:

Phase 1. Assessment initiation

- The client country sends a formal request either to a sponsor or the TADAT secretariat directly.

Phase 2. Pre-assessment

- This is the assessment team's planning and preparation phase that begins 6 to 8 weeks prior to the in-country assessment phase.

Phase 3. In-country assessment

- The assessment team, together with the country's officials, uses the TADAT methodology to assess the health status of the country's system of tax administration using concrete evidence and field office visits, and document the results in a Performance Assessment Report (PAR).

Phase 4. Post-assessment

- The PAR is finalised during this phase in which the team leader incorporates the authorities' comments and sends, for final review and certification, the revised PAR to the TADAT Secretariat

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Benefits of TADAT assessments

Benefits of TADAT assessment include;

- Identify the relative strengths and weaknesses in systems, processes, and institutions.
- Create a shared view on the condition of the system among all stakeholders (e.g., country authorities, international organisations, donor countries, and technical assistance providers).
- Set the reform agenda, including reform objectives, priorities, initiatives, and implementation sequencing.
- Facilitate coordination of external support for reforms and achieving more efficient implementation.
- Monitor and Evaluate reform progress by way of subsequent repeat assessments.

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TADAT performance outcome areas and indicators

- The tool is used to assess performance in 9 key performance outcome areas (summarised in Figure 1 and detailed below) covering the most critical tax administration functions, processes and institutions.
- They are assessed on 32 high-level indicators, each built on 1 to 5 dimensions adding up to 55 measurement dimensions, making TADAT a comprehensive but administrable diagnostic tool.

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World Customs Organization Diagnostic Framework

- The Customs Capacity Building Diagnostic Framework has been prepared by the WCO to:
- provide a standardised diagnostic tool and project design and implementation guide to improve the quality of capacity building initiatives in the customs administrations of developing countries;
- promote the effective implementation of WCO, WTO and other trade and customs-related conventions, instruments, best practice approaches and useful reference materials that can assist in the development of capacity building solutions that are appropriate to the individual needs and operating environments of customs administrations; and
- equip senior customs officials with the detailed information necessary to more fully engage and lead discussions/negotiations with donor agencies and other government officials.

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World Customs Organization Diagnostic Framework Cont…

- Part A of the Framework outlines the critically important role that an efficient and effective customs administration can play in the economic and social development of countries and makes a sound case for increased investment in the reform and modernisation of customs administrations.
- Part B of the Framework describes the core elements of modern customs administration and outlines the internationally agreed principles that should underpin all reform and modernisation initiatives. It also describes a number of pre-requisite conditions that need to be met before comprehensive capacity building activities should be contemplated.
- Part C of the Framework introduces the diagnostic tool and explains how it can be used to identify key developmental needs. Practical guidelines are provided to assist officials to identify any gaps between existing systems, procedures and practices and those outlined in Part B of the Framework.
- Part D of the framework provides practical guidelines and a reference model on how to undertake effective capacity building initiatives in the customs administrations of developing countries. It covers the identification of needs, the development of project documentation, the implementation of capacity building activities and how such activities can be reviewed and evaluated

Arusha Declaration

- Declaration was adapted in 1993 in Tanzania and it has been revised in 2003. This declaration is aimed to be a effective focal tool for the global customs to increase the integrity and prevent the corruption in Customs.

The declaration indicates that;

- Customs legislation should be clear and precise. Import tariffs should be moderated where possible. The number of rates should be limited. Administrative regulation of trade should be reduced to the absolute minimum. There should be as few exemptions to the standard rules as possible.
- 2. Customs procedures should be simple, consistent, and easily accessible, and should include a procedure for appealing against decisions of the Customs, with the possibility of recourse to independent adjudication in the final instance. They could be based on the Kyoto Convention and should be so framed as to reduce to a minimum the inappropriate exercise of discretion

Revenue reforms in Somaliland

- There are various tax reform projects that are under way in Somalia, Puntland and Somaliland. They include:
- The Domestic Revenue Mobilisation and Public Financial Management Phase II project which is managed by the World Bank – the project provides assistance to Somaliland and is the project funding this course
- The Prosperity for Reform (PROFR) project which is specific to Somaliland and is funded by DFID and implemented by Oxford Policy Management – the PROFR project supports the implementation of tax and customs reforms in Somaliland.
- The Revenue reforms in Somaliland are speled out National Development Plan (NDP II) and supported by the Revenue legislations (Please refer to Module 1)