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Fostering Implementation of The United Nations Sustainable Development Goals in Africa: Prospects of Revenue Generation Under the Tax Treaties Signed by Nigeria, Tanzania, And Botswana

Oladiwura Ayeyemi Eyitayo-Oyesode
Dalhousie University Schulich School of Law, oladiwura.eyitayo@dal.ca

FOSTERING IMPLEMENTATION OF THE UNITED NATIONS SUSTAINABLE DEVELOPMENT GOALS IN AFRICA: PROSPECTS OF REVENUE GENERATION UNDER THE TAX TREATIES SIGNED BY NIGERIA, TANZANIA, AND BOTSWANA

By

Oladiwura Ayeyemi Eyitayo-Oyesode

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Dedication

To God Almighty for giving me the grace and strength to complete this project.

To my dear late Father and my beloved Mother who taught me to never be afraid to dream big.

Table of Contents

Abstract

African countries are behind in social and economic development. The citizens of these countries experience high levels of poverty and hunger, unemployment, maternal and infant mortality, lack of access to quality education, gender inequality and other social, economic and environmental ills. To fix these development challenges, African countries have been encouraged to improve on domestic resource mobilization. This is regarded as a more viable and sustainable way of actualizing the UN Sustainable Development Goals (SDGs) against reliance on aids and grants. Also, emphasis is placed on taxation as the primary source of revenue for funding development because it ensures ownership of development projects by African countries.

This thesis shows how the tax treaties signed by African countries (using three African countries as case studies – Nigeria, Tanzania, and Botswana, herein referred to as the comparator countries) can be reformed to improve domestic resource mobilization in those countries for financing socio-economic development. The main objective of this thesis is to uncover provisions in the tax treaties signed by the comparator countries that limit tax revenue from economic activities carried out by non-resident companies in those countries. The analysis covers tax treaty provisions dealing with taxation of business profits, investment income, aircraft and shipping operations, technical services, digital services, capital gains, independent personal services, and other income not dealt with by the allocation rules in the treaties. The thesis identifies important findings for consideration by the comparator countries to drive reforms to their tax treaties to improve domestic resource mobilization to help finance socio-economic development.

Using the ideas of Third World Approaches to International Law (TWAIL) and the principle of "Common but Differentiated Responsibilities" (CbDR) to frame and explain my arguments for change, this thesis establishes the responsibility of developed countries to recraft the prescriptive rules of the international tax regime under which the bilateral tax treaties signed by African countries operate. It also argues for the individual African countries studied, and also for Africa as a regional bloc, to implement measures geared to foster increased tax revenue generation by reforming or cancelling their tax treaties with source-restrictive provisions.

List of Abbreviations Used

AEOI	Automatic Exchange of Financial Account Information
AMATM	Agreement on Mutual Assistance in Tax Matters
ATAF	African Tax Administration Forum
BEPS	Base Erosion and Profit Shifting
CbCR	Country-by-Country Reporting
CbDR	Common but Differentiated Responsibilities
CEN	Capital Export Neutrality
CFA	Committee on Fiscal Affairs
CIN	Capital Import Neutrality
CITA	Companies Income Tax Act
CON	Capital Ownership Neutrality
EOI	Exchange of Information
EU	European Union
FDI	Foreign Direct Investment
FIRS	Federal Inland Revenue Service
GDP	Gross Domestic Product
GHG	Greenhouse Gas
IATA	International Air Transport Association
IBFD	International Bureau of Fiscal Documentation
ICTD	International Centre for Tax and Development
ILO	International Labour Organization
IMF	International Monetary Fund
MCAA	Multilateral Competent Authority Agreement
MDGs	Millennium Development Goals
MLI	Multilateral Instrument
MNCs	Multinational Corporations
MNE	Multinational Enterprises

NEIL	New Approaches to International Law
NON	National Ownership Neutrality
OECD	Organization for Economic Co-operation and Development
OEEC	Organisation for European Economic Co-operation
OIT	Offshore Indirect Transfers
PCT	Platform for Collaboration on Tax
PE	Permanent Establishment
SDGs	Sustainable Development Goals
TIEA	Tax Information Exchange Agreement
TRA	Tanzania Revenue Authority
TWAIL	Third World Approaches to International Law
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNFCCC	United Nations Framework Convention on Climate Change
US	United States
VAT	Value Added Tax

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1. Chapter I: Introduction

> … the central challenge we face today is to ensure that globalization becomes a positive force for all the world's people, instead of leaving billions of them behind in squalor. Inclusive globalization must be built on the great enabling force of the market, but market forces alone will not achieve it. It requires a broader effort to create a shared future, based upon our common humanity in all its diversity.[1]

This first Chapter of the thesis provides the purpose, content outline and contribution of the thesis as well as the methodology of research used for its completion.

2. Purpose of Thesis

The reality of the world we live in today is that African countries are in dire need of development. Despite the abundant natural resources in Africa, the majority of the citizens of African countries live in deplorable conditions with limited access to food, security, healthcare, education and other socio-economic benefits.[2] The key challenge for most African countries has been how to transform the exploitation of the abundant resources within the continent by non-residents for the common good of the citizens. Source-restricting provisions in tax treaties signed by African countries lower overall tax revenue from economic activities carried out by non-residents. To this end I argue that the tax treaties signed by African countries (using three African countries as case studies – Nigeria, Tanzania, and Botswana, herein referred to as the comparator countries) can be improved to increase domestic resource mobilization in those countries for financing socio-economic development. Though research shows that corporate income is a significant source of tax revenue

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[1] Kofi A Annan, *We the Peoples: The Role of the United Nations in the 21st Century* (New York: UN, 2000) 6.

[2] World Bank, "The Number of Poor People Continues to Rise in Sub-Saharan Africa, Despite a Slow Decline in the Poverty Rate" (16 December 2020), *World Bank* (blog) online: < https://blogs.worldbank.org/opendata/number-poor-people-continues-rise-sub-saharan-africa-despite-slow-decline-poverty-rate> .

in African countries[3], statistics show that tax-to-GDP ratio for African countries is much lower than in other regions.[4] Tax treaty reform can be an effective tool to increase tax revenue collection in the comparator countries.

The main objective of this thesis is to uncover provisions in the tax treaties signed by the comparator countries that limit tax revenue from economic activities carried out by non-resident companies in those countries. The analysis covers tax treaty provisions dealing with taxation of business profits, investment income, aircraft and shipping operations, technical services, digital services, capital gains, independent personal services, and other income not dealt with by the allocation rules in the treaties. The analysis identifies important findings for consideration by the comparator countries to drive reforms to their tax treaties to improve domestic resource mobilization to help finance socio-economic development.

My proposal for tax treaty reform by the comparator countries is based on three fundamental premises. The first is that African countries deserve to be compensated by way of taxation of income derived by non-residents from the exploitation of resources in those countries. When foreign companies carry out economic activities in Africa and derive income from those activities, the income must be taxed by African governments. Structural changes must be made to the tax laws and policies of African countries to enable them to get their fair share of cross-border trade. Second, against the belief that tax treaties are necessary to prevent double taxation of international income, research shows there is a possibility for coordination of domestic tax rules without the need for tax treaties.[5] Tsilly Dagan, Professor of Tax Law at Oxford University, examines the

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[3] OECD/AUC/ATAF, *Revenue Statistics in Africa 2021* (Paris: OECD, 2021).

[4] *Ibid*. The percentage of tax-to-GDP ratio is 16.5% for the thirty African countries, 23.1% for Latin American Countries, 34.3% for OECD Countries.

[5] Tsilly Dagan, "The Tax Treaties Myth" (2000) 32 NUYJ Intl L & Pol 939.

implications of tax treaties for developing countries and concludes against the view that tax treaties are indispensable for alleviating double taxation of international income.[6] She argues that unilateral tax policies of the residence and host countries will give rise to an equilibrium necessary to prevent double taxation.[7] Lastly, tax treaties are said to increase foreign direct investment (FDI). There is, however, no clear-cut evidence that tax treaties indeed lead to increased FDI because there are other important factors that foreign investors consider in their investment decisions, such as abundant supply of raw materials, cheap labour, and large markets.[8]

Consistent with the three fundamental bases discussed above, I argue that the current tax treaty regime and the negative consequences it creates for African countries, together with the indifference at the international level to reform the rules governing allocation of taxing rights on cross-border income, make tax treaty reform by African countries crucial. A common thread that runs through my analysis of the tax treaties signed by the comparator countries is the proposal for domestic tax reform because of the principle that tax treaties cannot extend the obligations of a state.[9] No matter how expansive the provisions of a tax treaty, if there is no similar provision in the domestic law allowing such taxation, the contracting state cannot enforce such provision. Therefore, the comparator countries should reform their domestic laws to allow for expansive source taxation of income derived by non-resident companies. I further argue that the reforms at the domestic level should be used as a basis for tax treaty reform regionally to ensure consistency

[6] *Ibid*.
[7] *Ibid*.
[8] Paul L Baker, "An Analysis of Double Taxation Treaties and their Effect on Foreign Direct Investment" (2014) 21:3 International Journal of the Economics of Business 341. Also see B A Blonigen & R B Davies, "Do Bilateral Tax Treaties Promote Foreign Direct Investment" (2002) National Bureau of Economic Research Working Paper No 8834; B A Blonigen & R B Davies, "The Effects of Bilateral Tax Treaties on U.S. FDI Activity" (2004) 11:5 International Tax and Public Finance 601; and P Egger, M Larch, M Pfaffermayer, H Winner, "The Impact of Endogenous Tax Treaties on Foreign Tax Investment: Theory and Evidence" (2006) 39:3 The Canadian Journal of Economics 901.
[9] Peter Harris, *International Commercial Tax Law* (United Kingdom: Cambridge University Press, 2020).

and to present a unified regional approach to the rest of the world. Though there is no clear-cut evidence of the positive impact of tax treaties on FDI, and unilateral mechanisms can help prevent double taxation without the need for tax treaties, it would take the African governments some time to settle for a no-tax treaty situation. Therefore, I recommend that the comparator countries should start by adopting source-expanding provisions in tax treaties signed with fellow African countries, then build upon that to reform or cancel tax treaties signed with the rest of the world.

Though the emphasis in this thesis is for the comparator countries, and African countries in general, to quicken domestic resource mobilization efforts for socio-economic development, the background for my argument is the commitment by world leaders to take steps toward eliminating socio-economic challenges in all the nations of the world. In the next section, I discuss what this global partnership between developing countries looks like for African countries through the lens of tax treaties.

2.1 The UN SDG Agenda and Tax Treaty Reform in African Countries

At the adoption of the Sustainable Development Agenda (SDG Agenda) in 2015, world leaders pledged to foster cooperation and to take concrete steps to ensure that no one is left behind in achieving development. They reached a consensus to jointly tackle poverty in its most extreme forms in all the nations of the world. The SDG Agenda covers 17 development challenges, including poverty, health and well-being, gender equality, core issues of economic growth, the pervasive concerns of global warming, social justice, and peaceful and inclusive societies.[10] This thesis explains how there is a disconnect between the commitment of world leaders to help achieve the implementation of the Sustainable Development Goals (SDGs) globally, and provisions of the

[10] *Transforming Our World: The 2030 Agenda for Sustainable Development*, UNGAOR, 70th Sess, UN Doc A/RES/70/1 (2015), online: *United Nations Sustainable Development* <sustainabledevelopment.un.org/post2015/transformingourworld> (SDG Agenda).

tax treaties between high-income countries and low-income countries. Using the three African comparator countries, Nigeria, Tanzania, and Botswana as case studies, this thesis analyzes the nature, impact, and negative consequences of the tax treaties signed by these countries against the declaration to tackle their development challenges. The analysis shows that the tax treaties signed by the comparator countries greatly impede their domestic revenue mobilization efforts. Using the notion of shared responsibility in international law, this thesis makes two important arguments. First, high-income countries have the responsibility to align their tax treaty policies with their commitments to end poverty in all its forms in all the nations of the world. Second, low-income countries equally have a responsibility to design or change their tax treaty policies to stop giving up their legitimate taxation rights in the form of restrictive source tax provisions in the tax treaties they sign. Symmetrical relationships that will enhance tax revenue generation in low-income countries will be achieved if high-income countries do not insist on source-restrictive provisions, or pressure low-income countries to enter into tax treaties with source-restrictive provisions. In the same vein, the development of international tax policies by low-income countries with an understanding of the specific provisions of tax treaties, negative consequences of source restricting provisions of tax treaties, and a clear direction on the kinds of provisions to include in tax treaties (if necessary) in order to support revenue generation efforts, will enhance their development efforts. When all state actors join hands to assume this collective responsibility, inclusive globalization will truly be achieved.

The SDGs build and expand the UN Millennium Development Goals (MDGs), which lapsed in 2015. At the heart of the SDG Agenda is a recognition that development challenges are most prevalent in African countries, least developed countries, landlocked developing countries and small island developing States, and that these countries deserve special attention in their efforts to fulfil the SDGs.[11] World leaders highlighted the importance of global partnership to ensure the global implementation of the SDG Agenda, and committed to take concrete actions in that regard.[12] Also, the SDG Agenda emphasized the primary responsibility of countries to develop national policies and development strategies that are geared towards the actualization of the SDGs.[13] Against the background of the consensus by world leaders to build global partnerships to ensure the implementation of the SDGs in countries with the greatest development challenges, and the primary responsibility of developing countries to develop national policies and development strategies that are geared toward the actualization of the SDGs, this thesis pays attention to how this consensus can benefit the comparator countries through tax treaty reform.

2.2 The Concept of Development and the Nature of Development Challenges in African Countries

The concept of "Development" is broad. It has been used in different contexts over the years. Gustavo Esteva, the Mexican activist and prominent advocate for "post-development," points out that the word was first used in biology to explain the growth of plants and animals.[14] He further argues that the word entered into the social sphere toward the end of the eighteenth century where it was used to describe the gradual process of social change, describing the transformation of some political processes almost as natural processes.[15] The term was later adopted in the political sphere in 1949, when President Truman used it to describe the United States' plan to support "backward"

[11] *Ibid* at para 11.
[12] *Supra* note 10 at paras 39, 60, 62.
[13] Recurrent theme in the following Reports: *International Conference on Financing for Development* (New York: UN, 2002) (Monterrey Consensus); *Doha Declaration on Financing for Development* (New York: UN, 2009) (Doha Declaration); and the *Third International Conference on Financing for Development: Addis Ababa Action Agenda* (New York: UN, 2015) (Addis Agenda); SDG Agenda *supra* note 10 at para 63.
[14] Gustavo Esteva, "Development" in Wolfgang Sachs, *Development Dictionary, A Guide to Knowledge as Power* (United Kingdom: Zed Books, 2010); E B Poulton, *Charles Darwin and the Theory of Natural Selection* (London: Cassell and Co, 1896).
[15] *Ibid*.

or poor countries by providing industrial and scientific techniques, and fostering capital investment in those regions to alleviate poverty.[16] Similarly, neoliberal ideals were widely touted as the panacea for the development challenges faced by Latin American and African countries following the debt crises of the 1980s. The persistence of underdevelopment in developing countries later led to the adoption of the Millennium Development Goals in 2000 and the Sustainable Development Goals in 2015. While there have been some successes over the years under these global initiatives, dire levels of poverty still exist in African countries.[17]

The development challenges that affect the global community but are most prevalent in African countries, least developed countries, landlocked developing countries and small island developing States, are multidimensional. These challenges are not limited to low income, which is often cited as the threshold for determining development.[18] They include lack of access to basic infrastructure, such as safe drinking water, health services, sanitation, and education.[19] Developing countries have a lot in common in terms of large populations that lack access to basic amenities and weak institutions committed to redistributive functions for the benefit of the poor. Out of all these countries where poverty is most prevalent, African countries are the most affected.[20]

Poverty in Africa is accelerating at a faster pace than in other regions of the world.[21] The World Bank cites conflict, weak institutions, and failure to engage with redistribution of income for

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[16] Harry S Truman's Inaugural Address (January 20 1949), online *Inaugural Address*: < https://www.trumanlibrary.gov/library/public-papers/19/inaugural-address>.

[17] Makau Mutua, "Africa and the Rule of Law" (2016) 13:23 Sur Revista Internacional de Direitos Human 165.

[18] The World Bank sets the monetary threshold at intervals and is currently $1.90, see World Bank, "New Country Classifications by Income Level: 2018-2019" (1 July 2018), online (blog): World Bank < https://blogs.worldbank.org/opendata/new-country-classifications-income-level-2018-2019>.

[19] World Bank, *Poverty and Shared Prosperity 2018: Piecing Together the Poverty Puzzle* (Washington DC: World Bank, Washington, 2018).

[20] World Bank, "Poverty" (14 October 2021), online *Understanding Poverty*: <https://www.worldbank.org/en/topic/poverty/overview> .

[21] *Ibid*.

poverty reduction as the factors responsible for the level of poverty in sub-Saharan Africa.[22] In the World Bank's assessment, the poverty situation in Sub-Saharan Africa is worsening. The World Bank statistically describes it as follows:

> Sub-Saharan Africa now accounts for most of the world's poor, and—unlike most of the rest of the world—the total number of poor there is increasing. The number of people living in poverty in the region has grown from an estimated 278 million in 1990 to 413 million in 2015. Whereas the average poverty rate for other regions was below 13 percent as of 2015, it stood at about 41 percent in Sub-Saharan Africa. Of the world's 28 poorest countries, 27 are in Sub-Saharan Africa, all with poverty rates above 30 percent.[23]

The Report further states that:

> Of all regions, Sub-Saharan Africa has one of the worst performances in shared prosperity and the poor there suffer from multiple deprivations more than in any other region. Reaching the 3 percent target by 2030 will require more than business as usual: the region will need strong and sustained economic growth, significant improvements in the living standards of the bottom 40 throughout Sub-Saharan Africa at a scale not seen in recent history, and substantial investments in people.[24]

It must be understood that the concept of development that this thesis puts forward goes beyond economic growth; it is development that brings about a transformation of the quality of lives of citizens of low-income countries. The UN recognized the distinction between social development and economic development in the 1960s and addressed this in its 1962 Report[25] when it noted that: "…the problem of the underdeveloped countries is not just growth, but development. Development is growth plus change; change, in turn, is social and cultural as well as economic, and qualitative as well as quantitative". [26] The key objective of development efforts must be improved quality of people's lives. In this context, the expansive scope of the concept of "development" comes to light,

[22] *Supra* note 19.
[23] *Ibid* at 3.
[24] *Ibid* at 20. Here, the World bank is referencing its objective to reduce extreme poverty globally to less than 3 percent by 2030.
[25] *The UN Development Decade: Proposals for Action* (New York: United Nations, 1962).
[26] *Ibid* at 2-3.

and it shows that economic growth alone does not mean development.[27] Amartya Sen, a prominent development economist emphasized this fact. He notes that the level of "functionings attained"[28] by an individual is more than numbers. He also argues that the level of functionings attained by a person depends on the availability of the means to those functionings.[29] Sen argues that economic development goes beyond quantification through economic indicators. It involves an analysis of the nature of life that people succeed in living, which is measured by the ability to do certain things, such as being able to live a healthy life, eat good food, move about, etc.

Due to the open-endedness of the functioning of human beings, the International Labour Organization (ILO), in the 1970s, at the request of the UN General Assembly, introduced the "basic needs approach", noting that development programs should lead to the achievement of a certain specific minimum standard of living.[30] The ILO Report defines minimum standard of living as food, shelter, clothing, water, sanitation, transport, health, education, and participation by people in decisions affecting them.

2.3 The Concept of Sustainable Development in the UN SDG Agenda

The concept of sustainable development was introduced in the 1980s by the Brundtland Report.[31] The Report defines sustainable development as a progressive transformation of economy and society with a concern for social equity between generations. It requires that societies meet basic

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[27] Amartya Sen, "The Concept of Development" in H Chenery & T N Srinivasan eds, *Handbook of Development Economics*, Vol 1 (Amsterdam: Elsevier Science Publishers, 1988) at 12; W Arthur Lewis, *The Theory of Economic Growth* (London: Allen & Unwin, 1955), Paul N Baran, *The Political Economy of Growth* (New York: Monthly Review Press, 1957); Walter W Rostow, *The Stages of Economic Growth: A Non-Communist Manifesto* (Cambridge: Cambridge University Press, 1960).
[28] He defines this term as the ability to do certain things.
[29] Sen, *supra* note 27 at 16.
[30] *Employment, Growth and Basic Needs: A One-World Problem* (Geneva: ILO, 1978) at 31.
[31] *Report of the World Commission on Environment and Development: Our Common Future Our Common Future*, (4 August 1987), UN Doc A/42/251 (Brundtland Report). (The Report was released in 1987 following the call by the UN General Assembly to find sustainable development paths).

human needs both by increasing productive potential and by ensuring equitable opportunities for all without endangering the ecosystem.[32] The concept of sustainable development ensures that the needs of the present generation are met without compromising the ability of future generations to meet theirs. The Report makes it clear that the concept of "sustainability" covers all development policies and is not restricted to the environment. The core lesson from the Report is a caution to ensure that development policies are not implemented while causing ecological stress -degradation of soils, water regimes, atmosphere, and forests.[33] Sustainable socio-economic development should be the end goal of any development process. Hence the argument in this thesis is to generate a home-grown development agenda through the analysis of source-restricting provisions in the tax treaties signed by the comparator countries in their individual contexts towards the pursuit of increased public spending on infrastructure that would, ultimately, enhance the quality of life that citizens of those countries succeed in living.

The concept of sustainable development under the UN SDG Agenda also takes a multidimensional approach; it highlights core issues that limit the standard of life that a person succeeds in living.[34] Consequently, it covers such goals as lack of food, good health, clean water, education, gender inequality, environmental degradation, unemployment and lack of economic growth, weak and ineffective institutions etc.[35] This multidimensional concept of development must also be pursued

[32] *Ibid*.
[33] *Ibid* at 14.
[34] The World Bank World Development Report (2001) captures the multidimensional nature of development in detail. See World Bank, *World Development Report 2000/2001: Attacking Poverty. World Development Report* (New York: Oxford University Press, 2001).
[35] United Nations, "About the Sustainable Development Goals", online *Sustainable Development*: https://sdgs.un.org/goals.

in the implementation of the SDG Agenda. In measuring success, emphasis should be placed on the impact on peoples' lives rather than on numbers.[36]

To achieve this kind of multidimensional socio-economic development in the comparator countries, requires that, among others, they must have appropriate fiscal policies in place. A major proposition that this thesis makes is that the countries must catalyse their development process by identifying gaps in their fiscal systems and proposing solutions to them – this thesis focuses on tax treaties, a major component of the fiscal structures of the countries. The SDG Agenda also identifies the importance of effective national structures to foster domestic resource mobilization in developing countries to implement the SDGs.[37] The Addis Ababa Agenda on Financing for Development (Addis Agenda),[38] which establishes a strong foundation to support the implementation of the 2030 Agenda for Sustainable Development, provides a new global framework for financing sustainable development by aligning all financing flows and policies with economic, social, and environmental priorities.[39] For African countries, the Fiscal Policy for Financing Sustainable Development in Africa[40] identifies avenues by which they can increase revenue generation. Both reports highlight resource mobilization as a key tool for generating the revenue needed to fund development in African countries. Relevant to the focus of this thesis, it must be highlighted that the Addis Agenda emphasizes the need to fix structural barriers to

[36] Teodorescu Ana Maria, "Sustainable Development, A Multidimensional Concept" (2015) 0 Annals - Economy Series, Constantin Brancusi University, Faculty of Economics 82.
[37] Addis Agenda *supra* note 10 at paras 22-34 and para 43.
[38] Addis Agenda *supra* note 10.
[39] *Addis Ababa Action Agenda of the Third International Conference on Financing for Development* (New York: United Nations, 2015) (Addis Ababa Action Agenda).
[40] *Economic Report on Africa: Fiscal Policy for Financing Sustainable Development in Africa*, (Addis Ababa: UNECA, 2019) at 38.

increased tax revenue generation domestically, and a recognition of the importance of global cooperation to support national efforts.

2.4 The Importance of Local Context in Socio-Economic Development

The law and development literature highlights the importance of local context. The points of argument advanced in the literature and captured in this sub-section, fall into two complementary aspects: first, the inappropriateness of transplanting legal and institutional regimes on tax administration from the developed states for implementation in the developing ones. Second, the need to enable the developing states to create and/or modify appropriate institutions and laws to facilitate their own socio-economic development on a sustainable footing.

The premise here is that the globe is fundamentally polarized between the haves and the have-nots.[41] While developed countries have been largely successful in engaging law and institutions to ensure their socio-economic development, poor institutions and ineffective systems thrive in developing countries. This is why they are tagged "underdeveloped", "third world" and by other negative appellations that describe their socio-economic and political situations.

In a bid to change the socio-economic trajectory of these countries, universalism has become the trend.[42] International institutions prescribe development models for these countries to follow. Rather than designing local solutions that address the peculiar social, economic, and political challenges that these countries face, the approach has been to transplant foreign ideals for them to implement, essentially in a "copy and paste" format.[43] The danger of universalism lies in the assumption that generalized legal and economic models produced by the West would fit into the

[41] Niheer Dasandi, "International Inequality and World Poverty: A Quantitative Structural Analysis" (2014) 19:2 New Political Economy 201.
[42] Brian Z Tamanaha, "The Primacy of Society and the Failures of Law and Development" (2011) 44 Cornell Intl LJ 209 at 211.
[43] *Ibid*.

peculiar contexts of developing countries, and that they would produce positive results in those contexts too. Unsurprisingly, this has not always been the case because the process often ignores local circumstances and establishes structures that encourage inefficiencies and massive inequalities in the developing countries.[44]

For example, in the 1960s and 1970s, legal development was considered a significant aspect of the economic and political reform process being implemented in developing countries by international financial institutions. This involved copious transplantation of western legal codes and institutions. The effort failed because the advocates soon realized that the interconnectedness of everything in a society made it impossible to successfully implement legal reforms while ignoring local circumstances.[45] The same fate befell development economists who thought they had a formula for advancing economic growth in developing countries.[46] During this period, international financial institutions imposed conditionalities, including tax reform policies to loan, aid, and technical assistance provided to developing countries under structural adjustment programs.[47] The tax reform policies included the introduction of VAT with high rates, low corporate and personal income tax rates, trade liberalization, elimination of barriers to foreign direct investment, and provision of technical assistance on fiscal policies as a means to enhance efficiency, administrative effectiveness and economic growth.

The economic crises that followed the implementation of these policies led to criticisms of the Washington Consensus (a set of economic policy recommendations by the IMF, World Bank, and

[44] Miranda Stewart & Sunita Jogarajan, "The International Monetary Fund and Tax Reform" (2004) Brit Tax Rev 146 at 165.

[45] *Supra* note 42.

[46] David Landes, "Culture Makes Almost All the Difference" in Lawrence E Harrison & Samuel P Harrington eds, *Culture Matters: How Human Values Shape Human Progress* (New York: Basic Books, 2000).

[47] Miranda Stewart and Sunita Jogarajan, *supra* note 44 at 150.

US Treasury to developing countries) that codified the neoliberal ideals.[48] The policies were criticized for failing to respect and consider existing structures in the developing countries, making them unsuitable to promote economic growth in those countries. The neoliberal ideals were also critiqued for infringing on the fiscal sovereignty of the developing states.[49] These experiences did not, however, begin with the conditionalities attached to loans, aids, and technical assistance provided by international financial institutions under structural adjustment programs. They can be traced to the fiscal foundations laid during the colonial era in British colonies when colonial administrations established structures that only advanced their interests. On this point, Leigh Gardner, an economic historian, argues that the British Empire was intent on maintaining fiscal instabilities in its dependent colonies. Specifically, Gardner argues that British policy was to spend as little as possible on the socio-economic development of the colonies. She states this point in the following words:

> The political economy of the British Empire as a whole was designed not to generate widespread economic development in the dependent colonies, nor to extract resources from them, but rather to maintain order at the lowest possible cost to Britain. The policy of self-sufficiency was adopted to serve this purpose, but also created incentives which eventually led to the fiscal instability of post-independence governments.[50]

The abysmally low tax revenue to GDP ratio and incidental fiscal constraints in most British colonies in Africa generally traces back to the operation of the colonial fiscal systems that shaped and continue to influence the administration of the primary goods-oriented economies that they

[48] David Trubek & Alvaro Santos, "The Third Moment in Law and Development Theory and the Emergence of a New Critical Practice" in Alvaro Santos & David M. Trubek eds, *The New Law and Economic Development: A Critical Appraisal*, (New York: Cambridge University Press, 2006).

[49] M Martinez, *National Sovereignty and International Organisations* (The Hague/Boston: Kluwer Law International, 1996) 64; R Jefferey, *The Impact of State Sovereignty on Global Trade and International Taxation* (The Hague/ Boston: Kluwer Law International, 1999); I Seidl-Hohenveldern, *International Economic Law* (The Hague/Boston: Kluwer Law International, 1999) 22; M Tsai, "Globalization and Conditionality: Two Sides of the Sovereignty Coin" (2000) 31 Law & Pol'y Intl Bus 110.

[50] Leigh A Gardner, *Taxing Colonial Africa: The Political Economy of British Imperialism* (United Kingdom: Oxford University Press, 2012) at 242.

inherited at independence.[51] Fiscal structures were established to promote stability in the colonies rather than to ensure sustainable revenue streams for funding development programs. History shows that the cost of colonial administration in British colonies in Africa was larger than the total revenues collected[52], with heavy reliance on trade taxes rather than direct taxes, especially for West African colonies.[53] Local economic resources were insufficient to finance social spending on education, and the largest share of spending went into administration, law enforcement, defence, and building transport infrastructure which was necessary for increasing local revenue.[54] Although the structure of tax varied between British colonies in Africa, direct taxation turned out to be a steadier source of income to finance colonial administration, especially in light of the volatility in commodity prices that followed the outbreak of war and which lowered revenue from imports and exports.[55]

Tax collection practices also varied. While trade taxes were easy to administer, direct taxes required collection agents throughout the area in which the tax is to be collected. The measurement of incomes of African taxpayers[56] was hard, hence the resort to flat amounts in the nature of head/poll taxes. Even with this simplification, colonial administrators experienced a number of difficulties in tax collection and enforcement, including an inability to impose an equivalent tax on European and Asian settlers as on Africans, informal exemptions to avoid the cost of collecting

[51] *Ibid*.
[52] J A Hobson, *Imperialism: A Study* (New York: Cosimo Classics, 2005) at 39.
[53] Gardner, *supra* note 50 at 8. In west Africa, for example, where trade taxes constituted a large portion of revenues, there was less reliance on direct taxes. The reverse was, however, the case in East and central Africa – Gardener at 48.
[54] Gardener *supra* note 50 at 34.
[55] A G Hophins, *An Economic History of West Africa* (Routledge: London, 1973).
[56] Measurement of income of African taxpayers was difficult for colonial administrators because "African incomes were generally based on some combination of subsistence agriculture, the marketing of agricultural produce, or wages from labour on settler farms or in mines. The contribution of any or all of these varied widely between individuals and was well beyond the ability of the colonial government to measure…" Gardener *supra* note 50 at 53.

information from taxpayers, and regional differentiation of tax rates which did not take into account inequalities within the regions. Although colonial administrations recognised the need to reform direct taxation in order to distribute the tax burden more evenly, they were constrained by the influence of the immigrant settlers who were able to avoid tax based on their income and the need to raise revenue to sustain colonial governance. The international criticism of imperialistic governance and minimal expenditure devoted to social spending in African colonies led to the passage of the first British Colonial Development Act in 1929.[57] Notwithstanding this Act, social spending on Africans still did not improve because of decline in revenue.[58]

The colonial era experiences were carried over into the 1990s under structural adjustment programs, when developing countries in economic crises had to implement policies formulated by the West to promote economic growth. These policies included reduction of rates of tax on capital, and heavy reliance on revenue from the VAT which is a regressive tax.[59] These policies exist today, though they contradict even IMF statistics, which show that rising inequality is a threat to economic growth.[60] Unfortunately, the policies limit how governments engage in redistributive functions.

History has shown that to successfully promote a development agenda, policies must be country-specific, and designed to suit local circumstances.[61] An end must come to development programs that take a one-size fits all approach, like what happened in the 1990s when developing countries

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[57] *Colonial Development Act, 1929* (UK).
[58] S Bowden & P Mosley, "Politics, Public Expenditure and the Evolution of Poverty in Africa 1920-2007" (2008) Brooks World Poverty Institute Working Paper 125 at 13; P H Lindert, *Growing Public: Social Spending and Economic Growth since the Eighteenth Century*, 2 vols (Cambridge: Cambridge University Press, 2004) 171; D J Morgan, *The Official History of Colonial Development*, volumes 1-5 (London: Macmillan Press, 1980) 29.
[59] *Supra* note 44 at 152.
[60] Jonathan D. Ostry, Andrew Berg, Charalambos Tsangarides, "Redistribution, Inequality, and Growth" (2014) IMF Staff Discussion Note SDN/14/02; IMF, "Fiscal Policy and Income Inequality," (2014) IMF Policy Paper.
[61] *Economic Growth in the 1990s: Learning from a Decade of Reform*. (Washington DC: World Bank, 2005).

were made to transplant institutional arrangements designed by Western countries, such as liberalization of trade and foreign direct investment, privatization of nationalised industries, deregulation of currency, etc., before getting access to loan, aid, and technical assistance.[62] These policies were attached as loan conditions for developing countries, with no regard for the individual circumstances of each country. Unfortunately, they did little to promote development because they ignored the concept of endogenous development – internal factors that shape socio-economic development.[63] Though the concept of endogenous development gained currency in the 1970s[64], the neoliberal policies of the West in the 1990s failed to reflect the tenets of this principle. On this issue, Tamanaha emphasizes that every society's ethos is reflected in the rules by which they live. He emphasizes the importance of this inseparable nature of law and society as follows:

> No aspect of law or development operates in or can be understood in isolation from these surrounding factors. The qualities, character, and consequences of law are thoroughly and inescapably influenced by the surrounding society. There can be no standard formula for law because every legal context in every society involves a unique constellation of forces and factors. A good law in one location may have ill effects or be dysfunctional elsewhere.[65]

The international financial institutions, however, later learnt that economic growth can only be fostered effectively when attention is paid to institutional, social, and historic contexts.[66] Elaborating on the growth promoting neoliberal policies of the West, Stiglitz says they were known for non-involvement of stakeholders from the developing countries in the development agenda;

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[62] Isaac Igwe, "History of the International Economy: The Bretton Woods System and its Impact on the Economic Development of Developing Countries" (2018) 4:2 Athens Journal of Law 105 at 119.

[63] Laure-H´el`ene Piron, "Time to Learn, Time to Act in Africa" in Thomas Carothers ed, *Promoting the Rule of Law Abroad: In Search of Knowledge* (Washington DC: Carnegie Endowment for International Peace, 2006) 275.

[64] Esteva *supra* note 14 at 12.

[65] *Supra* note 42 at 219.

[66] *Supra* note 61.

prescription of one-size fit all policies; and failure to experiment and explore options that these countries feel are best for them.[67]

As indicated by Tamanaha through the "connectedness of law principle"[68], a consideration of how everything is connected in a society will largely determine the success of any development program. The success of the UN SDGs in the comparator countries must begin with an understanding of the issues that impede sustainable streams of revenue and outlining how to fix them. Moving from this premise, this thesis identifies means by which the comparator countries can maximize their domestic taxation opportunities, including through reform or cancelation of bilateral tax treaties. As seen above, the success of development programs hugely depends on their design and modes of implementation, rather than on their titles.

3. Contribution to the Current Literature

This thesis seeks to fill some of the gap in the literature by undertaking a detailed analysis of the provisions in the tax treaties of three African countries and, based on the findings, advancing proposals for tax treaty reform with the goal to increase domestic resource mobilization for socio-economic development in the three comparator states considered. The analysis highlights that the tax treaties signed by the comparator countries – Nigeria, Tanzania, and Botswana – are regressive; they set limits on the taxation rights of the three countries.

Tax treaties are entered into for various reasons, such as to prevent double taxation, tax evasion and avoidance, to provide certainty to foreign investors, to provide dispute resolution mechanisms for tax disputes, and to further diplomatic relations between countries.[69] However, critics have

[67] Joseph Stiglitz, "The Post-Washington Consensus" (Columbia, The Initiative for Policy Dialogue, 2015), online: http://policydialogue.org/files/events/Stiglitz_Post_Wahington_Consensus_Paper.pdf.
[68] Tamanaha, *supra* note 42 at 232.
[69] Eric Zolt "Tax Treaties and Developing Countries" (2018) 72 Tax L Rev at 4-10.

pointed out that the treaties do not bring benefits to developing countries. Rather, they promote revenue loss via their source restrictive provisions which allocate more taxing rights to the residence state. For this reason, some argue that the treaties should be amended to reverse inequities in the allocation of taxing rights. Others simply seek their abolition for the same reason, pointing out that amending them would not reverse the inequities that underlie their implementation.[70]

At the core of tax treaty negotiations is the benefit created for foreign investors, given that the treaties reduce taxes that are a direct cost to their businesses.[71] Martin Hearson, a research fellow at the Institute of Development Studies, and Programme Lead for the International Centre for Tax and Development, in his detailed analysis of the motivations behind tax treaty negotiations between high-income and low-income countries, using the United Kingdom as a case study, shows that it is often high-income countries that seek tax treaties with low-income countries to enhance the competition position of their own MNCs.[72]

The framework for the current tax treaties between developing and developed countries dates back to the Economists' Report produced by four experts from developed countries on ways to address the problem of double taxation which, at that time, posed a serious threat to international capital

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[70] Zolt, *ibid* ; Lee Sheppard, "How Can Vulnerable Countries Cope with Tax Avoidance" (2013) 69 Tax Notes Int'l 410; Kim Brooks & Richard Krever, "The Troubling Role of Tax Treaties" in Geerten M M Michielse & Victor Thuronyi eds, *Tax Design Issues Worldwide* (The Netherlands: Wolters Kluwer Law, 2015) 159; Tsilly Dagan, *International Tax Policy: Between Competition and Cooperation* (United Kingdom: Cambridge University Press, 2018) ; Dagan *supra* note 5 ; Michael J McIntyre, "Developing Countries and International Cooperation on Income Tax Matters: An Historical Review" (2005) [unpublished, archived at www.michielse.com/files/mcintyre_intl_cooperation.pdf ; Charles Irish, International Double Taxation Agreements and Income Taxation at Source" (1974) 23:2 ICLQ 292; Martin Hearson, "When Do Developing Countries Negotiate Away Their Corporate Tax Base" (2018) 30 Journal of International Development 233; Martin Hearson, "Tax Treaties in Sub-Saharan Africa: A Critical Review" (2015) Tax Justice Network.

[71] Martin Hearson, *Imposing Standards: The North-South Dimension to Global Tax Politics*, (Ithaca, NY: Cornell University Press, 2021) at 50-66.

[72] *Ibid*.

mobility after the First World War.[73] The experts established that the only way to prevent double taxation was to delimit the tax jurisdiction of nations.[74] To that end, they established the notion of economic allegiance as the basis for states to exercise taxing rights. The experts leaned toward residence-based taxation because they thought it was easier to establish the residence of taxpayers than the sources of their income. Current tax treaties have their foundations in the earlier drafts produced by Western countries which have a strong bias for residence taxation. Critics of tax treaties between developing and developed countries argue that because the treaties allocate more taxing rights to developed countries, they were designed to favour those countries and offer little or no economic benefit to developing countries.[75] To this end, they counsel developing states that tax treaties are of no use to them, considering the economic benefits foregone.[76] Because the developing countries entered into pre-existing regimes with high-income countries, and without the technical knowledge of the cost of tax treaty provisions, the tax treaties they sign continue to promote the interests of high income countries and their multinational corporations.

When colonialism ended, tax treaties were not considered a priority for change by several African countries. Rather, they concluded new tax treaties under the Organisation for Economic Co-operation and Development (OECD) Model. A recent study was conducted by Martin Hearson

[73] High Ault, "Corporate Integration, Tax Treaties and the Division of the International Tax Base: Principles and Practice" (1992) 47 Tax L Rev 565 at 567; Reuven S Avi-Yonah, "The Structure of International Taxation: A Proposal for Simplification" (1996) 74 Texas Law Review 1301 at 1305- 10.

[74] Sunita Jogarajan, *Double Taxation and the League of Nations (Cambridge Tax Law Series).* (Cambridge: Cambridge University Press, 2018).

[75] *Supra* note 70.

[76] Elizabeth A Owens, "United States Income Tax Treaties: Their Role in Relieving Double Taxation" (1963) 17 Rutgers L Rev 428; Alex A Easson, "Do We Still Need Tax Treaties?" (2000) 54 Bulletin for International Taxation 619; Dagan, The Tax Treaty Myth, *supra* note 5 at 939; Brooks & Krever "The Troubling Role of Tax Treaties" *supra* note 70 at 175; Michael Keen et al, "Spillovers in International Corporate Taxation" (2014) IMF Policy Paper at 25-31; Tsilly Dagan, *International Tax Policy: Between Competition and Cooperation* supra note 70 ; Michael Lang & Jeffrey Owens, "The Role of Tax Treaties in Facilitating Development and Protecting the Tax Base" (2014) WU International Taxation Research Paper Series, online: <http://ssrn.com/abstract=2398438> .

used archival documents relating to UK policy in tax treaty negotiations with developing countries to show that tax experts from the UK dictated the terms of the treaties by insisting on source-restricting provisions based on the OECD Model.[77] African countries accepted the source restricting provisions in the hope of attracting foreign investment.[78] However, in general, source-restrictive provisions (in treaties and national laws) have had no impact on investment in Africa, but have resulted in tax revenue losses.[79] Direct losses from Africa's tax treaties have been

[77] Martin Hearson, "Transnational Expertise and the Expansion of the International Tax Regime: Imposing 'Acceptable' Standards" (2018) 25:5 Review of International Political Economy 647.

[78] See Kim Brooks & Richard Krever, "The Troubling Role of Tax Treaties" *supra* note 70 at 166 for arguments against the justifications offered in favour of limiting source taxation - the difficulties attached to identifying the business income of non-residents with little physical presence is justification for excluding the business income of non-residents unless they are attributable to the income of permanent establishments; that limiting withholding tax on interest and royalty payments reduces the cost of doing business in source jurisdictions because the tax may be passed to borrowers; for dividends, that source countries are encouraged to limit their withholding tax rates in order to increase FDI in their jurisdictions, that higher tax rates are obstacles for attracting political benefits such as foreign aid. Brooks and Krever argue that these reasons are weak and are illogical for restricting source taxing rights. Also, these reasons are not persuasive and unfair based on the Inter-Nation Equity principle – see Peggy Musgrave, *United States Taxation of Foreign Investment Income: Issues and Arguments* (Cambridge: Harvard Law School, 1969) at 131. See also Alex J Easson, *International Tax Reform and the Inter-Nation Allocation of Tax Revenue* (Wellington, NZ: Victoria University Press, 1991) ; Jinyan Li, "Improving Inter-Nation Equity" in Arthur Cockfield eds, *Globalization and its Tax Discontents: Tax Policies and International Investments: Essays in Honour of Alex Easson* (Toronto: University of Toronto Press, 2010) 117-137; Nancy B Kaufman, "Fairness and the Taxation of International Income" (1998) 29:2 Law and Policy in International Business Journal 145, but see Kim Brooks, "Inter-Nation Equity: The Development of an Important but Underappreciated International Tax Value" in Richard Krever, John G Head, eds, *Tax Reform in the 21st Century*, (Netherlands: Kluwer Law International, 2009).

[79] S M Ali Abbas et al, "A Partial Race to the Bottom: Corporate Tax Developments in Emerging and Developing Economies"(2012) IMF working Paper No WP/12/28; See also Douglas Zeng, "Global Experiences with special Economic Zones: Focus on China and Africa, (2015), online: *The World Bank Trade and Competitiveness Global Practice* https://www.worldbank.org/content/dam/Worldbank/Event/Africa/Investing%20in%20Africa%20Forum/2015/investing-in-africa-forum-global-experiences-with-special-economic-zones-with-a-focus-on-china-and-africa.pdf ; IMF, "Options for low-income Countries' Effective and Efficient Use of Tax Incentives for Investment", A Report to the G-20 Development Working Group By The IMF, OECD, UN And World Bank, online: https://www.imf.org/external/np/g20/pdf/101515.pdf; Felix Oppong & Sebastian James, Tax Expenditure Estimates in Ghana (September 20 2016), online: https://ssrn.com/abstract=2841302; See also the United Nations Economic Commission for Africa, *Economic Report on Africa supra* note 40 at 38.

estimated at 1% or more of tax revenue, along with much larger indirect losses.[80] Research confirms that for most African countries, the beneficial impact of tax on investment is minimal.[81]

Previous attempts to change the current residence bias in tax treaties have been met with stiff resistance. For instance, the Mexico Draft (1946) Model Bilateral Convention for the Prevention of the Double Taxation of Income and Property, which was developed by authors from developing countries with source expanding provisions,[82] was replaced with the London Draft (1946) Model Bilateral Convention for the Prevention of the Double Taxation of Income and Property, which contained source restricting provisions.[83] Tax treaty provisions that restrict source taxing rights under the OECD Model include:

- the provisions of Article 5 which prevent source countries from taxing profits derived from economic activities in their jurisdictions, other than profits derived through a permanent establishment as defined in the Model Treaty;
- Article 8 which allocates exclusive taxation rights derived from shipping and air transport operations to the residence state;
- Articles 10, 11 and 12, which prescribe low withholding tax rates for dividends, interest, and royalties paid to affiliates by multinational corporation (MNC) entities in source countries;
- Article 13 which allocates taxation rights over many types of capital gains derived in the host country to the residence country;
- Article 14 which allocates taxation rights over independent personal services derived from the source state to the residence state; and

[80] Mick Moore, Wilson Prichard & Odd-Helge Fjeldstad, *Taxing Africa Coercion, Reform and Development* (United Kingdom: Zed Books, 2018) at 85 interpreting the estimates presented by Martin Hearson, in his article "Tax Treaties in Sub-Saharan Africa: A Critical Review," (2015) London School of Economics Working Paper at 20.
[81] See the United Nations Economic Commission for Africa, Economic Report on Africa 2019 *supra* note 40.
[82] Charles Irish, "International Double Taxation Agreements and Income Taxation at Source" (1974) 23:2 ICLQ 292 at 298.
[83] Donald R Whittaker, "An Examination of the OECD and UN Model Tax Treaties: History, Provisions and Application to US Foreign Policy" (2016) 8 NCJ Intl L & Com Reg 39 at 43-4.

- Article 21 which allocates taxation rights over other forms of income not expressly dealt with by the other allocation rules to the residence state.[84]

Although the UN developed a slightly different Model to the OECD Model in 1980, most tax treaties are based on the OECD Model.[85] The recent 2014 International Bureau of Fiscal Documentation (IBFD) study that reviewed about 1800 treaties concluded between 1 April 1997 and January 2013, found that the adoption rates for 21 of the 30 UN provisions was lower than 40 percent, and for 12 of the UN provisions, the rate was 20 percent.[86] Unlike the OECD Model, the UN Model expands source taxing rights, for instance, by including more economic activities under the permanent establishment definition, such as general furnishing of services, including consultancy services by an enterprise through employees or other personnel where the activities continue for the same or a connected project within the country for more than six months, or a lesser period, within any twelve month period.[87]

There are striking differences between the OECD and the UN Model tax treaties, and some high-income countries agreed to the source-expanding provisions in the UN Model when negotiating tax treaties with low-income countries. Kim Brooks analysed Canada's position in this regard and found some variations in the standards agreed to in Canada's tax treaties.[88] She found that Canada has agreed to the extension of the concept of permanent establishment under the UN Model in six of the 21 tax treaties it negotiated with low-income countries since 1988, including Nigeria,

[84] Brooks & Krever *supra* note 70 at 166.
[85] Whittaker *supra* note 83; see also Lee-Ann Steenkamp, "An Analysis of the Applicability of the OECD Model Tax Convention to Non-OECD Member Countries: The South African Case" (2017) 10:1 Journal of Economic and Financial Sciences 83.
[86] WJG Wijnen & J de Goede, "The UN Model in Practice 1997–2013" (2014) 68 Bulletin for International Taxation 118; Eric Zolt, "Tax Treaties and Developing Countries" *supra* note 69 at 17-18.
[87] Kim Brooks, "Canada's Evolving Tax Treaty Policy toward Low-Income Countries", In Arthur J. Cockfield, ed., *Globalization and the Impact of Tax on International Investments*, (Toronto: University of Toronto Press, 2009).
[88] *Ibid*.

Senegal, Algeria and Zimbabwe.[89] For instance, delivery of goods does not constitute a permanent establishment under the OECD Model, but it does under the UN Model. Canada only agreed to this extension in tax treaties with 3 African countries – Algeria, Senegal, and Zimbabwe. The force of attraction rule which includes profits derived by a non-resident enterprise outside of the profits derived by the permanent establishment of such a non-resident from sales or similar activities in a source country as taxable by such source country based on the UN Model, is contained in Canada's tax treaties with 3 African countries, namely, Tanzania, Nigeria and Zimbabwe. Further, in contrast to the provisions of the OECD Model, the UN Model denies a deduction for head office expenses where those expenses are payments for royalties, fees, interest, and commissions for specific management services, thus increasing the amount of profits that source countries can tax. This provision is only present in Canada's tax treaties with 2 African countries – Algeria and Nigeria.

To find appropriate solutions to the problem of tax revenue loss in the comparator countries, this thesis discusses the negative impacts that restrictive source provisions in the tax treaties signed by the countries have on revenue generation. Economic activities by non-residents in those countries must be taxed there appropriately. Rather than bow to pressure from high-income countries to sign tax treaties citing foreign investment as the attraction, the countries must be aware of the negative consequences of tax treaties in terms of revenue losses and their limited impact on investment in African countries. While it is clear that African countries stepped into a pre-existing game of tax treaties with provisions that do not favour them, they must take the lead in changing the trajectory of their impacts by setting appropriate standards for taxing non-residents in a way that honours their contribution to global value chain. It is true that power plays an important role in tax treaty

[89] *Ibid*.

negotiations between high and low-income countries. [90] The asymmetrical relationships between these countries is, therefore, not to be glossed over in the design of tax policy reforms by the comparator countries. Armed with the appropriate technical knowledge of the nature, impact, and consequences of tax treaties, the comparator countries can set themselves free from deals that do not benefit them appropriately – not just tax treaties, but additional standards by the OECD that further restrict source taxation rights.

It must be pointed out that the OECD has dominated the development of international tax rules since the collapse of the League of Nations in 1946. [91] Set up as the Organisation for European Economic Co-operation (OEEC) in 1960, its original mandate was to promote market reforms in the European Community after World War II. One of its tasks was to prevent double taxation, with the goal to engender market reforms in the European Community. This led to the publication of its draft Double Taxation Convention on Income and Capital in 1963. That Convention has gone through 12 amendments since then.[92]

The OECD works through its subsidiary bodies to adjust international taxation rules to the ever-changing and sophisticated forms of transnational transactions carried out by multinational corporations. The 2013 Base Erosion and Profit Shifting (BEPS) Project is the OECD's current work on this subject. It consists of 15 Action Plans aimed at promoting transparency and ensuring value creation; that is, ensuring that the profits of MNCs are taxed in jurisdictions where the

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[90] Tarcisio Diniz Magalhães, "What Is Really Wrong with Global Tax Governance and How to Properly Fix It" (2018) 10:4 World Tax Journal 499.

[91] JFA Jones, "Are Tax Treaties Necessary?" (1999) 53 Tax L Rev 1 at 2: "the OECD has taken [the] place [of the League of Nations] and is becoming the world body overseeing tax treaties". See also S Jogarajan, "Prelude to the International Tax Treaty Network: 1845-1914 Early Tax Treaties and the Conditions for Action" (2011) 5:4 Oxford Journal of Legal Studies; S Jogarajan, "Stamp, Seligman and the Drafting of the 1923 Experts' Report on Double Taxation" (2013) 5:3 World Tax Journal 679.

[92] Oladiwura Ayeyemi Eyitayo-Oyesode, "Source-Based Taxing Rights from the OECD to the UN Model Conventions: Unavailing Efforts and an Argument for Reform" (2019) 13:1 Law and Development Review 193.

economic activities generating those profits occur.[93] Through the BEPS Project, the OECD proposed a multilateral approach to tackling profit shifting through its BEPS Inclusive Framework, and inviting non-OECD members to participate in the implementation of the BEPS' four Minimum Standards, though they were excluded from the norm-building process.[94] Non-OECD countries joined the implementation process, though it is not clear how the BEPS Project will help them.[95]

Although the BEPS phenomenon affects developing countries even more than it does developed countries because developing countries rely more on revenue from corporate income tax,[96] the BEPS Project was not designed to solve the problem of BEPS the way it is being experienced in developing countries. BEPS ignores the disparities between developed and developing countries in terms of the current taxing rules in tax treaties. The OECD made it clear at the start of the BEPS Project that its aim was not to change the rules governing the allocation of taxing rights on cross-border income in tax treaties which now favour developed countries more than developing countries.[97] It is therefore clear that the OECD is not concerned about the negative impact of tax treaties on low-income countries.

Similarly, there are challenges with the "two-pillar" solutions being proposed by the OECD to address the tax challenges arising from the digitalization of the economy in generating additional

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[93] *Action Plan on Base Erosion and Profit Shifting*, (Paris: OECD, 2013).
[94] The Global Forum on Transparency and Exchange of Information for Tax Purposes currently has over 150 members, see online: https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf, and the Inclusive Framework on BEPS has over 130 members, see online: https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf.
[95] Irma Mosquera et al, "Tax and Development: The Link between International Taxation, the Base Erosion and Profit Shifting Project and the 2030 Sustainable Development Agenda" (2018) United Nations University Institute on Comparative Regional Integration Studies Working Paper No W-2018/4.
[96] Ernesto Crivelli, Ruud De Mooij & Michael Keen, "Base Erosion, Profit Shifting and Developing Countries" (2015) IMF
Working Paper No WP/15/118 at 21. According to the IMF, non-OECD countries lose about $200 billion a year to base erosion and profit shifting.
[97] Eyitayo-Oyesode, *supra* note 92.

tax revenue for low-income countries. The OECD, through "pillar one" seeks to allocate taxation rights over 25 percent of profits in excess of 10 percent of profits of MNCs with greater than €20 billion in worldwide revenues and a profitability before tax margin of at least 10 percent, to market jurisdictions – jurisdictions where goods or services are used or consumed.[98] The allocation will only happen if the MNC recorded at least €1 million from the market jurisdiction. The value is reduced for market jurisdictions with GDP lower than €40 billion – the nexus is reduced to €250,000.[99] Pillar two seeks to establish a global minimum tax at 15 per cent to be paid in each jurisdiction in which they operate.[100] Where the effective tax paid in a jurisdiction is less than 15 per cent, the residence country has the right to charge a top-up tax for the difference.[101] Similar to the restrictions under "pillar one", pillar two does not apply to MNCs with less than €750 billion in consolidated revenues. Although the OECD's proposals are said to be a "historic global tax agreement,"[102] evidence from even the OECD shows that low-income countries have very little to gain from both proposals.[103] Kenya, Nigeria, Pakistan and Sri Lanka are abstaining from the "two-pillar" solutions because they understand that most of the extra income from the rules would go to high-income countries and the cost of signing up to implement the proposals far outweighs its benefits. At the root of OECD-led negotiations leading to the proposals is constant neglect of the concerns of non-OECD/low-income countries. According to Nigeria's Minister of Finance the

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[98] OECD/G20, "Base Erosion and Profit Shifting Project: Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy" (8 October, 2021), online: <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf>.
[99] *Ibid*.
[100] *Ibid*.
[101] OECD/G20, "Base Erosion and Profit Shifting Project: The Pillar Two Rule in a Nutshell" (20 December, 2021), online: <https://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf> .
[102] Baker McKenzie, "International: Historic Global Tax Agreement Reached" (1 November, 2021), online: <https://insightplus.bakermckenzie.com/bm/tax/international-historic-global-tax-agreement-reached>
[103] Abdul Muheet Chowdhary, "Developing Country Demands for an Equitable Digital Tax Solution" (2021) South Centre Tax Cooperation Policy Brief No 19 at 2.

country's clearly articulated concerns, which were duly communicated to the OECD, not taken into account at all:

> Nigeria participated in the discussions based on the expectation that the solution agreed would be fair to all members of the Inclusive Framework. As such, we committed enormous resources to participate in the discussions leading up to the deal. All Nigeria's concerns were clearly articulated and communicated at every stage of the discussion, but most of these were, unfortunately, ignored.[104]

If anything, it is clear that the OECD's "Pillar one" and "Pillar two" solutions further widen the inequality that currently exists between high-income and low-income countries in the international tax regime. Given that the OECD regime does not allow the reform of allocation of taxation rights, the comparator countries must act: Nigeria has taken the right step by refusing to sign up for the proposals because they fall short of Nigeria's legitimate expectation regarding fair re-allocation of Multinational Enterprises (MNEs) profit to market jurisdictions.[105] Tanzania is not a member of the OECD Inclusive Framework, but Botswana is. Botswana should also pull out of the proposal. Bearing in mind the extreme global economic inequality among high income and low-income countries, it is hard to imagine the OECD producing an agreement that identifies the concerns of the latter.

What is seen repeatedly in the international tax regime is high-income countries putting pressure on low-income countries to agree to standards that are greatly biased in favour of residence states at the expense of the tax revenue bases of the low-income countries. In a sophisticated way, the OECD Model treaty, with its numerous negative consequences for source countries, is presented

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[104] Statement by Mrs. (Dr.) Zainab Shamsuna Ahmed, Honourable Minister of Finance, Budget and National Planning, Federal Republic of Nigeria at a Virtual Meeting Organized by Coalition for Dialogue on Africa (CODA) and the South Center on the Two Pillar Solution of the OECD Inclusive Framework (December 16, 2021), online: https://taxinitiative.southcentre.int/wp-content/uploads/2021/12/Statement-by-Mrs.-Dr.-Zainab-Shamsuna-Ahmed-Honourable-Minister-of-Finance-Budget-National-Planning-Nigeria.pdf.

[105] *Ibid*.

as the perfect tool to facilitate cross-border trade by preventing double taxation. More recently, the OECD Two-Pillar solution is being touted as the ideal solution to address the tax challenges arising from the digitalization of the economy for the benefit of all countries. In reality, however, the rules were made by high-income countries while low-income countries were left on the sidelines.

Relying on the works of Pateman, Magalhães also queries the possibility of voluntary consent in international tax under circumstances of structural domination and subordination, as well as massive inequalities.[106] He argues thus: "In many cases, when weaker states are denied the chance to wield significant influence over the process of regime formation and its outcomes, they are left with little choice but to follow suit."[107] The argument here in this thesis is that African countries, especially the comparator countries, have the option to walk away from international tax agreements that result in the loss of revenues that they urgently need to promote their development.

Taxation is instrumental in national development,[108] and international organizations have reiterated the importance of increased tax revenue to Gross Domestic Product (GDP) and national growth. To this end, international institutions have emphasized the need for low-income countries to strengthen their tax systems[109] by implementing measures geared to foster increased tax revenue generation for socio-economic development. Scholars have identified tax treaty provisions that erode source taxation as a major impediment to increased tax revenue in low-income countries.

[106] Magalhães, *supra* note 90 at 507 citing DI O'Neill, ML Shanley & IM Young eds, *Illusion of Consent: Engaging with Carole Pateman* (Pennsylvania: Pennsylvania State University Press, 2008); and T Pogge, "The Role of International Law in Reproducing Massive Poverty" in S Besson & J Tasioulas eds, *The Philosophy of International Law* (United Kingdom: Oxford University Press, 2010) at 445: "in so far as very poor people do consent, through a meaningfully democratic process, to some global institutional arrangements, the justificatory force of such consent is weakened by their having no other tolerable option, and weakened even further by the fact that their calamitous circumstances are partly due to those whose conduct this consent is meant to justify".
[107] Magalhães, *supra* note 90 at 507.
[108] Michael Keen, "Taxation and Development – Again" (2012) IMF Working Paper No 12/220.
[109] United Nations, "Countries Urged to Strengthen Tax Systems to Promote Inclusive Economic Growth" (2018), online: https://www.un.org/development/desa/en/news/financing/tax4dev.html; Bernadin Akitoby, "Raising Revenue" (2018) 55:1 Finance & Development 18.

Other factors are regressive national taxes, large informal sectors, and ineffective tax administration.[110]

My contribution to these analytical efforts via this thesis is that, focusing on the tax treaty provisions of the comparator countries, namely Nigeria, Tanzania, and Botswana, I would illustrate the influence of the source-restricting provisions in those tax treaties on the capacity of the African states to generate sufficient tax revenue to finance their development activities. The detailed discussions on each comparator country demonstrate that there is clearly an urgent need for reform to the tax treaties signed by the three countries. The reforms must aim at improving the progressivity and fairness of taxes within the countries and eliminating gaps that promote tax revenue loss.

4. Research Theory and Methodology

4.1 Research Theory

This part outlines the theories that this thesis uses to ground its argument that the comparator countries must reform their tax treaties, and to urge the high-income countries to support the comparator countries in their development efforts by allowing source-expanding provisions in tax treaties. As argued above, this interconnected relationship is necessary to give some room to the comparator countries to generate greater taxation income to support their socio-economic development objectives. The theories utilized for my analysis are the Third World Approaches to International Law (TWAIL), and the principle of Common but Differentiated Responsibilities from international environmental law. These are set out in the next subsection, followed by an explanation of the research methodology that best utilizes their advantages to focus my discussion. Section 5 outlines the theme of the analysis and my arguments regarding the need for tax reform

[110] Michael Carnahan, "Taxation Challenges in Developing Countries" (2015) 2:1 Asia & the Pacific Policy Studies 169.

in the concrete taxation circumstances of the three comparator states studied in this thesis. Section 6 concludes by outlining the sequence of my analysis in the rest of the thesis.

4.1.1 Third World Approaches to International Law (TWAIL)

The Third World Approaches to International Law (TWAIL) perspective presents the most appropriate theory and methodological approach for unravelling how the OECD and UN Model treaties cannot foster sustainable home-grown development agendas in the comparator countries.

TWAIL scholarship rejects the contemporary account of international law for its failure to accommodate the interests of non-western groups in the interpretation and application of its principles and rules. TWAIL scholarship thus highlights the features of international law and politics that subsume the interests of developing countries to those of the developed states who are favoured by the application of the rules. In essence, TWAIL scholarship challenges the continuing legitimacy of existing treaties, customs and general principles of international law developed by the West.[111]

The conveners of the first TWAIL conference leveraged the New Approaches to International Law network (NAIL), and Critical Race and Critical Race Feminism Theory[112] to formulate their views on the inequities of the extant international legal order. But TWAIL scholarship is different from other approaches in international law to the extent that it does not assume that formal rules guarantee equality of states. Instead, it explores how international law legitimises the political and economic domination of developing countries by developed countries.[113]

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[111] Fred E Snyder& Surakirat Sathirathai, *Third World Attitudes Toward International Law: An Introduction* (Dordrecht: Boston, 1987).

[112] B S Chimni, *International Law and World Order: A Critique of Contemporary Approaches* (United Kingdom: Cambridge University Press, 2017).

[113]James Thuo Gathii, "The Agenda of Third World Approaches to International Law (TWAIL)" (December 20, 2018). Forthcoming in Jeffrey Dunoff and Mark Pollack, eds, *International Legal Theory: Foundations and Frontiers* (United Kingdom: Cambridge University Press, 2019).

Thompson defines domination as "when established relations of power are 'systematically asymmetrical', that is, when particular agents or groups of agents are endowed with power in a durable way which excludes, and to some significant degree, remains inaccessible to other agents or groups of agents, irrespective of the basis upon which such exclusion is carried out".[114] Political and economic domination of the developing countries is perpetuated when developed countries and international institutions dictate policies and laws for them to follow.[115] It is the account of imperialism, which TWAIL considers, that differentiates its critiques of international law from the views held of international law by mainstream scholars.[116] TWAIL scholars argue that unless there is an explicit engagement with how colonial realities shape international law, it cannot be a useful tool to promote the common good.[117] This is because, as they argue, colonialism shaped the development of international law doctrines and it is the underlying force behind the retention of unequal treaties.[118]

This critical approach is necessary to question the assumed neutrality of rules that have been prescribed by international institutions for developing countries as the means by which to achieve development. It also serves as a base for engendering participatory development; it is a tool needed to analyse structural problems that limit social spending in African countries. TWAIL scholarship is critical of the Eurocentric ideals that inform international law concepts and practice[119],

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[114] J Thompson, *Ideology and Modern Culture: Critical Social Theory in the Era of Mass Communication* (United States: Stanford University Press, 1991) 136.

[115] B S Chimni, "Third World Approaches to International Law: A Manifesto" (2006) 8 Inl Community L Rev at 3.

[116] B S Chimni, "Capitalism, Imperialism, and International Law in the Twenty-First Century" (2012) 14:17 Oregon Review of International Law 17 at 26.

[117] *Ibid*.

[118] *Supra* note 116 at 27.

[119] See Gathii, *supra* note 113; B S Chimni, "The Past, Present and Future of International Law: A Critical Third World Approach" (2007) 8 Melbourne Journal of International Law 499; Luis Eslava, Michael Fakhri & Vasuki Nesiah eds, *Bandung, Global History, and International Law: Critical Pasts and Pending Futures* (United Kingdom: Cambridge University Press, 2017).

especially how those ideals have legitimated global marginalization and domination of Third World countries.[120] It also offers a tool for use by Third World countries to overcome those challenges.

In terms of the focus of this thesis, the relevant takeoff offered by TWAIL scholarship is its argument that there is a new imperial social formation being created by the transnational capitalist class. This social group benefits from the gains produced by globalization in developed countries and emerging economies at the expense of the welfare of the people in developing countries. TWAIL argues that this is brought about by the application of the rules of international law that promote the interest of the transnational capitalist class, especially now under the guise of globalization and the acclaimed need to 'promote the common good'.[121]

In specific terms, TWAIL questions the prescription of deregulation and liberalization policies by international financial institutions to Third World countries as the means to achieve development.[122] TWAIL scholars argue that these neo-liberal policies promote the interest of developed countries and multinational corporations at the expense of developing countries.[123]

As a methodology in tax matters, thus far the only scholar who has applied it thinks it is a useful tool that can be used to probe the neoliberal policies prescribed by the West as a way to further development.[124] Those policies currently dominate the tax codes, tax treaties, and development

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[120] See for instance the concept of sovereign equality in international law which assumes the equality of states just by their status as states without considering unevenness in areas like military power, geographical and population size, levels of industrialisation and economic development. See Alex Ansong, "The Concept of Sovereign Equality of States in International Law" (2016) 2:1 GIMPA Law Review 14.
[121] Chimni, *supra* note 116 at 20.
[122] Antony Anghie, "Time Present and Time Past: Globalization, International Financial Institutions, and the Third World", (2000) 32 NYUJ Intl L & Pol 243.
[123] *Ibid*. see also Chimni, *supra* note 115.
[124] Jalia Kangave, "'Taxing' TWAIL: A Preliminary Inquiry into TWAIL's Application to the Taxation of Foreign

cooperation agreements of Third World countries.[125] These agreements grant concessions in favour of developed countries and foreign investors and limit the taxing rights of Third World countries, with the assumption that host countries would, in turn, benefit through increased FDI, infrastructural improvement, job creation, technology transfer, and increased capital flow.[126]

Research by non-TWAIL scholars also shows that Third World countries rarely benefit from tax incentives due to internal factors that determine investment location and systemic issues that distort efficient allocation of tax incentives.[127] Source-restricting provisions in tax treaties between African countries and developed countries are a major source of tax revenue loss to African countries. These countries try to make up for the loss by increasing tax rates or introducing new regressive taxes,[128] thereby shifting the burden of development on to the poor. The retention of these agreements must be questioned, considering the goal to improve domestic resource mobilization in African countries. On the importance of context in designing tax policy for developing countries, Richard Bird argues that, "[t]o be relevant, policy recommendations need to be geared specifically to the prevailing circumstances and objectives of that country."[129] Taking off from this premise, the point is that African countries must undertake an analysis of the

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Direct Investment" (2008) 10 Intl Community L Rev 389. See also Joel M Ngugi, "The World Bank and the Ideology of Reform and Development in International Economic Development Discourse" (2006) 14 Cardozo J Intl & Comp L 313.

[125] Kangave, *supra* note 124.

[126] *Ibid* at 394.

[127] Kevin Fletcher, "Tax Incentives in Cambodia, Lao PDR, and Vietnam" Prepared for the IMF Conference on Foreign Direct Investment: Opportunities and Challenges for Cambodia, Lao PDR and Vietnam Hanoi, Vietnam, (August 16-17, 2002), online: https://www.imf.org/external/pubs/ft/seminar/2002/fdi/eng/pdf/fletcher.pdf.

[128] As seen in the recent increase in VAT rate in Nigeria from 5% to 7.5%. see the FIRS, *Clarification on the Implementation of the Value Added Tax (Vat) Act Circular* (2021/08), online: < https://www.firs.gov.ng/wp-content/uploads/2021/06/CLARIFICATION-ON-THE-IMPLEMENTATION-OF-THE-VALUE-ADDED-TAX-VAT-ACT.pdf> .

[129] Richard M Bird, *Tax Policy and Economic Development* (Maryland: Johns Hopkins University Press, 1992) at 17.

provisions of foreign agreements and domestic laws that encourage base erosion and profit shifting.

History shows that tax in Africa is immersed in the influence of the West, including the imposition of tax policies and practices from the colonial era. African countries have retained these systems upon independence, and have since imported other types of taxes from abroad.[130] A recurrent theme in TWAIL scholarship is the possibility of reforming international law and practice with an alternative structure that would bring about a just global order.[131] TWAIL scholars are interested in interrogating how colonial legacies still frame present global governance, to the exclusion of Third World countries in policymaking, and under the assumed status of the universality of international rules. The influence of the West on tax structures of most African countries must, therefore, be assessed in light of the need to create systems that advance the socio-economic prosperity of the African people. The goal is to create structures to support taxation regimes to foster comprehensive development programs, and not to shift the burden of development on to the poor which is, otherwise, the trend in most African countries, with haphazard amendments to tax codes rather than a complete overhaul of tax structures.

Implicit in the foregoing explanation of the implications of TWAIL is that legal transplants are not suitable as normative bases on which to found developmental policies and objectives in developing countries. A legal transplant is simply the transfer and application of norms and rules created in one jurisdiction to a distinct socio-economic and cultural jurisdiction that has different

[130] See Mick Moore, Wilson Prichard, and Odd-Helge Fjeldstad, *supra* note 80 at 13-14.
[131] Karin Mickelson, "Rhetoric and Rage: Third World Voices in International Legal Discourse" (1998) 16 Wis Intl LJ 353; Obiora Chinedu Okafor, "Enacting TWAILian Praxis in Non-academic Habitats: Toward a Conceptual Framework" (2016) 110 AJIL Unbound 20.

institutional, administrative, and law enforcement traditions.[132] Thus, the transplantation of rules developed by the OECD to African countries without consideration of how the rules were developed, nor how they may operate in the receiving countries is, in the analysis of TWAIL, inappropriate and would not promote economic growth in accord with desirable norms and policies in developing countries. The OECD is seeking to create unified rules to update international tax rules for corporate taxation.[133] Although some African countries are part of the Inclusive Framework created by the OECD to drive the reform process[134], policymaking is done by the OECD countries, leaving little or no room to address how much African countries will gain from the OECD rules.[135]

It must be stressed that in a post-colonial era, international rules should not be transplanted to countries that did not participate in the policymaking process that generated them. To that end, every "sacred trust" still embedded in the international structure must be broken.[136] This is the ringing objective of TWAIL.[137] The implication of TWAIL in regard to tax policy development

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[132] Esin Örücü, "Law as Transposition" (2002) 51 ICLQ 205; M Langer, "From Legal Transplants to Legal Translations" (2004) 45 Harv Intl LJ 1; Zhangrun Xu, "Western Law in China: Transplantation or Transformation" (2004) 25 Social Sciences in China 3; and Mindy Chen-Wishart, "Legal Transplant and Undue Influence: Lost in Translation of a Working Misunderstanding" (2013) 62 ICLQ 1.

[133] Brin Rajathurai & Murray Clayson, "Unify and conquer: the OECD's 'Unified Approach' to Pillar One" (October 16, 2019) Tax Journal, online: < https://www.taxjournal.com/articles/unify-and-conquer-the-oecd-s-unified-approach-to-pillar-one#:~:text=The%20OECD%20Secretariat's%20proposals%20for,a%20way%20through%20competing%20proposals.>

[134] OECD, "Members of the OECD/G20 Inclusive Framework on BEPS", online: www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf

[135] Valderrama, *supra* note 95.

[136] CH Alexandrowicz, "The Juridical Expression of the Sacred Trust of Civilization." (1971) 65:1 AJIL 149; Anthony Anghie, "Colonialism and the Birth of International institutions: The Mandate System of the League of Nations" in *Imperialism, Sovereignty and the Making of International Law* (United Kingdom, Cambridge University Press, 2015) 115; B Bowden, Colonialism, Anti-Colonialism and the Idea of Progress in UNESCO-EOLSS Joint Committee ed, *History and Philosophy of Science and Technology, Encyclopedia of Life Support Systems*, online: < https://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.637.874&rep=rep1&type=pdf>.

[137] Brian Vincent-Ikejiaku, "International Law is Western Made Global Law: The Perception of Third-World Category" (2014) 2-3 African Journal of Legal Studies 337; M Mutua, "What is TWAIL?" (Lecture delivered to the American Society of International Law, 2000), Proceedings of the 94th Annual Meeting: International Law in Ferment: A New

and norm application is that the vestiges of colonialism under the trusteeship system of colonial administration must be done away with. Indeed, Article 22 of the League of Nations Covenant insists that the mandated provenance of the trusteeship system is that the trustee nations must help the newly independent nations to develop along the best lines that the trustee nations can map out for them, including, by implication, the trajectory of legal development:

> To those colonies and territories which as a consequence of the late war have ceased to be under the sovereignty of the States which formerly governed them and which are inhabited by peoples not yet able to stand by themselves under the strenuous conditions of the modern world, there should be applied the principle that the well-being and development of such peoples form a sacred trust of civilisation and that securities for the performance of this trust should be embodied in this Covenant. The best method of giving practical effect to this principle is that the tutelage of such peoples should be entrusted to advanced nations who by reason of their resources, their experience or their geographical position can best undertake this responsibility, and who are willing to accept it, and that this tutelage should be exercised by them as Mandatories on behalf of the League.[138]

The foregoing is the formalization of legal transplantation. The argument against this, within the framework of TWAIL, is that this institutionalization of legal transplant creates rules out of their socio-economic and cultural contexts. This mode of legal development offends the pragmatic idea that a rule is a construct of cultural context.[139] In other words, it is impossible to detach a rule from the prevailing circumstances within which it was made. Given that the formulation of rules is culture specific, is it then right for the OECD to formulate international tax rules for non-members to implement? The power imbalance between the OECD and developing states, and the context in which rules are formulated, will guide the discussion in this thesis about the incompetence of the

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Vision for Theory and Practice (April 5–8, 2000), Washington DC; A Anghie, *Imperialism, Sovereignty and the Making of International Law* (United Kingdom: Cambridge University Press, 2004); B S Chimni, "International Institutions Today: An Imperial Global State in the Making" (2004) 15 European Journal of International Law 1; and B Rajagopal, *International Law from Below: Development, Social Movements and Third World Resistance* (United Kingdom: Cambridge University Press, 2003); B S Chimni, "The Past, Present and Future of International Law: A Critical Third World Approach" (2007) 8 Melbourne Journal of International Law 499.

[138] Article 22, *The Covenant of the League of Nations,* June 28, 1919, (13 AJILs 128).

[139] Pierre Legrand, "The Impossibility of Legal Transplants" (1997) 4 MJECL 111.

OECD to formulate rules for non-members, in this case, African countries. This is because the effectiveness of the transplanted rules will greatly depend on how they were made, and how they fit into the underlying legal, social, and economic contexts of the receiving countries.[140]

This thesis analyzes the provisions of the tax treaties signed by the comparator countries and the need for their normative revamping to accommodate the need of these countries to derive greater benefit from their taxation arrangements in order to fund their sustainable development. In terms of theory, the thesis utilizes TWAIL to argue that transplanting rules and structures designed in the West is not appropriate for the comparator countries in their quest for relevant regimes of law within which to institutionalize the implementation of their sustainable development goals. This reasoning is reinforced by the practical implications of the second theory that informs my analysis in this thesis, namely, the Common but Differentiated Responsibilities concept. As far as I am aware, no scholarly work has infused the principle of Common but Differentiated Responsibilities into TWAIL for analysis of tax treaties, especially for developing countries.

4.1.2 The Principle of Common but Differentiated Responsibilities

This principle seeks to establish a common goal but different responsibilities of differentially able states in regard to tackling the varying forms of socio-economic development challenges around the world.[141] This principle is mainly used in multilateral environmental agreements where recognition is given to the capabilities of low-income countries to comply, within the limits of their abilities and resources, with the terms of the agreements to protect, among others, the climate system.[142] Due to the economic conditions of low-income countries, regarding the climate system,

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[140] Jinyan Li, "Tax Transplants and Local Culture: A Comparative Study of the Chinese and Canadian GAAR" (2010) 11:2 Theor Inq L 655; Assaf Likhovski, "Is Tax Law Culturally Specific? Lessons from the History of Income Tax Law in Mandatory Palestine" (2010) 11:2 Theor Inq L 725.

[141] Christopher Stone, "Common but Differentiated Responsibilities in International Law" (2004) 98:2 The American Journal of International Law 276.

[142] *Ibid*.

these multilateral environmental agreements impose more obligations on high-income countries. The 1992 Rio Declaration on Environment and Development contains the first direct articulation of the common but differentiated responsibilities principle in climate negotiations. The Agreement establishes the differential historical contributions of high-income countries to global environmental degradation and their differential obligation to protect the climate system. By Article 7, the Rio Declaration provides that in keeping with this principle, sustainable development must be a matter of co-operative and partnership undertaking between the developing and developed countries with each contributing the efforts and resources that they readily have:

> States shall cooperate in a spirit of global partnership to conserve, protect and restore the health and integrity of the Earth's ecosystem. In view of the different contributions to global environmental degradation, States have common but differentiated responsibilities. The developed countries acknowledge the responsibility that they bear in the international pursuit of sustainable development in view of the pressures their societies place on the global environment and of the technologies and financial resources they command.[143]

The late Professor Christopher Stone, former J. Thomas McCarthy Trustee Chair in Law, Emeritus at the University of South Carolina, gives some examples of the common but different degrees of responsibilities in multilateral environmental agreements: first, in the United Nations Law of the Sea Convention, it is provided that in giving effect to the duty of states to cooperate in the establishment of conservation and management measures for straddling fish stocks and highly migratory fish stocks, recognition shall be given to the vulnerability of developing States which are dependent on the exploitation of living marine resources, and developing countries in general.[144] Second, Principle 12 of the United Nations Conference on the Human Environment, Stockholm Declaration, also provides that resources should be made available to low-income

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[143] *Rio Declaration on Environment and Development*, June 14, 1992, 31 ILM 874.

[144] Article 24, *Agreement for the Implementation of the Provisions of the United Nations Convention of the Law of the Sea of December 10, 1982, Relating to the Conservation and Management of Straddling Fish Stocks, and Highly Migratory Fish Stocks, with Annexes (I and II),* August 4, 1995, UN Doc A/CONF 164/38.

countries towards preserving and improving the environment, including additional international technical and financial assistance.[145] Third, the 1987 Montreal Protocol to the Vienna Convention for the Protection of the Ozone Layer contains special provisions for low-income countries to eliminate the production and import of substances that deplete the ozone layer. These countries have additional 10-15 years to meet the targets. In addition, a Multilateral Fund has been established to help these countries with the cost of implementing the Protocol's provisions.[146]

In a more direct way, the United Nations Framework Convention on Climate Change (UNFCCC) enshrines the common but different responsibilities to protect the climate system. The Framework declares that the responsibilities of states to protect the climate system should be "on the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities".[147] A practical illustration of this concept is seen in the Kyoto Framework to the UNFCCC where state parties in Annex I to the Protocol (all high-income countries) are obligated to reduce their overall emissions of such gases by at least 5 per cent below 1990 levels in the commitment period 2008 to 2012.[148] There is no such obligation on low-income countries.

The 2015 Paris Agreement to UNFCCC also enshrines the common but differentiated responsibilities principle but in a different way. Unlike the Kyoto Protocol and other multilateral agreements which place the obligation to lower greenhouse gas (GHG) emissions on developed countries, the Paris Agreement creates binding obligations for each party – high-income countries and low-income countries.[149] Article 4(2) of the Agreement contains the obligation of all state

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[145] *Declaration of the United Nations Conference on the Environment*, June 16, 1972, 11 ILM 1416.
[146] See *Montreal Protocol on Substances that Deplete the Ozone Layer*, Sept 16, 1987, Doc 100-10.
[147] Article 3(1) of the *United Nations, Framework Convention on Climate Change*, May 7, 1992 BTS 67.
[148] Article 3(1) of the *Kyoto Protocol to the United Nations Framework Convention on Climate Change*, December 11, 1997, 37 ILM 32.
[149] Lavanya Rajamani, "Ambition and Differentiation in the 2015 Paris Agreement: Interpretive Possibilities and Underlying Politics" (2016) 65:2 Journal of International and Comparative Law Quarterly 1.

parties to combat global climate change: "Each Party shall prepare, communicate and maintain successive nationally determined contributions that it intends to achieve. Parties shall pursue domestic mitigation measures, with the aim of achieving the objectives of such contributions."[150] In a bid to accommodate the capacity needs of low-income countries, Article 2(2) of the Agreement provides that the Agreement will be implemented to reflect equity and the principle of common but differentiated responsibilities and respective capabilities, in the light of different national circumstances.[151]

Stone points to three variations in the common but differentiated responsibilities principle.[152] He traces them in terms of gains to high-income countries and low-income countries resulting from the negotiations that came up with them. First is rational/unrestricted bargaining – gains to countries pursuing their self interests in a rational way reflect their bargaining skills and leverage during negotiations. Here, a high-income country would obtain more gains than a low-income country based on its economic status. Second is the equitable variety. This imposes certain constraints on a high-income country to take a lower gain while allowing the low-income country to take the larger part of the gains. The third, the inequitable version, imposes additional constraints on a high-income state to not only take lesser gains but to give the low-income country more resources in addition to the gains it makes.

This thesis adopts the equitable version of the common but differentiated principle to make the argument that in the context of tax treaties between comparator countries and high-income countries, larger gains – in the form of source expansive taxing rights – should go to the

[150] Article 4(2) of the *Paris Agreement to the United Nations Framework Convention on Climate Change*, December 12, 2015, TIAS No 16-1104.
[151] *Ibid*.
[152] *Supra* note 141.

comparator countries not as a form of aid, but as a legitimate return for their contributions to the income derived within their jurisdictions. As said earlier, the common but differentiated responsibilities principle is not customary international law, but it is well recognized in international law as evident in several environmental multilateral agreements. The context in which the principle is used in this thesis is that the fulfillment of the SDG agenda, which high-income countries committed to, should be backed by the responsibility on them to ensure that low-income countries have the means to implement sustainable development within their jurisdictions. The responsibility of high-income countries is to match their commitment to help the poor countries to achieve development, including through the instrumentality of tax treaty policies which promote tax revenue generation in the developing countries. Low-income countries, and in this thesis, the comparator countries, have a different responsibility. This is to understand the nature and impact of tax treaty provisions and to gain a clear direction on what the provisions that would support their development efforts should look like. Working toward the goal to achieve development imposes responsibilities on both parties. This combined duty is not measured in terms of which party's duty is higher or lesser, but in terms of the separate roles each must play to reach the goal.

The common but differentiated responsibilities principle is contained in the SDG Agenda. Paragraph 12 of the Agenda states: "We reaffirm all the principles of the Rio Declaration on Environment and Development, including, inter alia, the principle of common but differentiated responsibilities, as set out in principle 7 thereof."[153] Within the framework of the responsibilities of all countries – high-income and low-income countries alike – world leaders pledged to take

[153] Para 12 of the SDG Agenda *supra* note 10.

common actions toward the actualization of the SDGs globally.[154] In particular, Paragraph 27 of the SDG Agenda obliges all states to adopt policies which will build the economic foundations of all countries. It is within this context that this thesis argues for differentiated responsibilities of the comparator countries and their treaty partners to ensure that strong economic foundations are built to secure the tax revenues needed to achieve the common goal of accomplishing development in the comparator countries. Simply put, the SDG Agenda is an opportunity to unravel underlying issues of inequity in the tax treaties signed by the comparator countries that impede development, and to institutionalize the measures that would reverse their continuing application and enforcement.

4.2 Research Methodology

The overarching methodological perspective in this thesis is historical. In short, the thesis traces international tax policy from the League of Nations era to today. Its analysis argues that the normative structure which low-income countries have inherited after decolonization has failed them, both historically and as a matter of their ongoing quest to promote and achieve socio-economic development. To pursue this theme, I draw on primary and secondary sources from international organizations, including the IMF, OECD, and the UN. The primary documents I use include tax treaties, policy documents, and legislation. I also utilize secondary sources, mainly books, journal articles and working papers on the matters relevant to the theme of this thesis.

The thesis demonstrates its arguments through specific study of the three African countries, namely, Nigeria, Tanzania, and Botswana. The source documents for these are their tax legislation, journal articles, books and policy documents.

[154] Para 18 of the SDG Agenda *supra* note 10.

Methodologically, the thesis is doctrinal with a policy objective. In other words, I argue that the current structure of international tax rules and their reflection in the tax regimes of the comparator countries creates one continuum of inequitable normativity. The policy objective of the analysis comes through recommendations: these urge reform of tax treaties signed by the comparator countries. The hope is that if the reforms are conscientiously carried out and implemented, the countries should generate greater taxation income from the exploitation of their resources and the other economic activities undertaken by non-residents within their jurisdictions to support their development efforts.

5. Approach of the Thesis

Applied to my argument for tax treaty reform in the comparator countries, this thesis advocates the generation of home-grown regimes for reform to enhance the prospect for increased tax revenue generation. To do this, two basic questions are confronted to generate justifications for the reforms I propose. First, I uncover the tax treaty provisions that limit tax revenue generation and social spending in the comparator countries. Second, I consider how the domestic laws of the comparator countries fail to maximize opportunities for increased tax revenue from activities carried on by non-residents in those countries. I consider these issues in order to provide policy direction for African leaders on viable ways to overcome the structural barriers that they face regarding how to increase tax revenue and enhance social spending. These questions and goals are discussed in five substantive chapters and brought together in the concluding chapter 7. Their projected contents are set out in substantive outline in the next section.

6. Thesis Outline

To answer the research questions set out above, this introductory chapter has examined the concept of development under the UN SDG Agenda, and the nature of development challenges that are most prevalent in African countries. Overcoming these challenges requires sustainable funding. Before I analyse the negative impact of tax treaties on tax revenue generation in the comparator countries in chapters 4 - 6, Chapter 2 sets the tone by tracing the historical origins of tax treaties and the gaps in the existing international tax structure that limit the tax revenue base of African countries. Chapter 3 challenges the assumed benefits of tax treaties and assesses the consequences for African states joining the ongoing global reform of international tax rules by the OECD. Given the concern over the negative consequences of tax treaties for African countries, this chapter concludes its discussion by recommending a cost and benefit analysis of existing tax treaties signed by the comparator countries.

Chapters 4-6 undertake this analysis. They examine the allocation rules in tax treaties signed by the comparator countries, pointing out provisions that limit expansive taxing rights over income derived from activities carried out by non-residents in those countries. The analysis in these chapters is not limited to the tax treaty provisions; it extends to provisions in the domestic tax laws of the comparator countries. This is because tax treaties only limit the taxes otherwise imposed by a country they cannot extend the country's taxing rights where none exists under the country's domestic law.[155] Without corresponding amendments to expand the taxing rights of the comparator countries through reforms to domestic tax laws, the effect of tax treaty reform will be lost.

Chapter 4 analyses and compares the restrictive source taxation rights over business profits in Articles 5 and 7 of the tax treaties signed by Nigeria, Tanzania, and Botswana. The analysis in this chapter shows the different elements that whittle down the taxing powers of these states, both in

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[155] S Leduc & G Michielse, " Are Tax Treaties Worth It for Developing Economies?" in Ruud A de Mooji, Alexande D Klemm & Victoria Perry, eds, *Corporate Income Taxes under Pressure (*USA: International Monetary Fund, 2022) 123 at 127.

brick-and-mortar businesses as well as in the digital economy. The analysis shows that some of the provisions in the tax treaties limit source taxation of business profits derived by residents of contracting states. Chapter 5 examines the limitations for source taxation of passive income (dividends, interest, royalties) and fees for technical services earned in source countries and how those limitations apply to the tax treaties signed by the comparator countries. The analysis highlights provisions that reduce the ability of these source countries to tax passive income earned by non-residents in their jurisdictions. Chapter 6 examines other allocation rules in the tax treaties signed by the three countries. The rules examined here relate to the taxation of income from shipping and aircraft operations, and as regards fees for digital service, capital gains, income from independent personal services, and other income not expressly dealt with by other allocation rules. The analysis reveals provisions that restrict the taxing rights of the comparator countries over those types of income earned by non-residents in their jurisdictions.

Through the discussion and analyses from chapter 4 – 6, reform recommendations are highlighted and explained to be adopted for implementation. In sum, these are that the comparator states should reform their tax treaties to include provisions that allow source-expansive taxing rights over income from economic activities undertaken by non-residents within their jurisdictions. Given the principle that tax treaties cannot extend the taxing rights of contracting states, I recommend that the comparator states should reform their domestic tax laws to ensure that income earned by non-residents in their jurisdictions are taxed there appropriately.

Concluding in chapter 7, I argue that if the concrete steps suggested through the analyses in chapters 4 – 6 are taken by the comparator countries, and by other African countries with similar tax treaty provisions, to address structural barriers that limit tax revenue collection in those countries, extreme poverty will be gradually reduced in African countries, as socio-economic activities to implement the objectives of the SDGs become better funded ongoing realities. Lastly, it is important to recognize the limitations of this thesis. This thesis does not cover other impediments to increased tax revenue in developing countries; namely, regressive national taxes, large informal sectors, and ineffective tax administration.[156] Future research on these other factors will illustrate their influence on the capacity of the African states to generate sufficient tax revenue to support their developmental efforts from those sources as well.

[156] Aqib Aslam et al, "Revenue Mobilization in Sub-Saharan Africa during the Pandemic" (2022) IMF Report, online: https://www.imf.org/-/media/Files/Publications/covid19-special-notes/en-covid-19-special-series-revenue-mobilization-in-ssa-during-the-covid-19-pandemic.ashx.

Chapter II - Resolving International Taxation Conflicts: The Fundamental Framework

1. Introduction

Increasing globalization has led to interactions of domestic tax rules. This has raised concerns of double taxation, which occurs when a stream of income is taxed by more than one country, and double non-taxation, when a stream of income is not taxed at all. Tax treaties are believed to offer solutions to these two problems, while also conferring an additional benefit of increased foreign direct investment (FDI) on developing countries, which are mostly capital importing countries. Though tax treaties emerged as outputs of deliberations by developed countries on bilateral cross-border transactions in the nineteenth century, the fundamental principles agreed to at the time remain the bedrock of modern tax treaties. The consequences of this arrangement include the inability to deal with triangular taxation issues due to the multilateral nature of cross-border transactions, the troubling creation of tax avoidance opportunities that result in no tax being paid anywhere, and the erosion of source taxation of international income.

To lay the foundations for the remainder of the thesis, this chapter offers some fundamental grounding. In an inevitably superficial way, it examines the principles and rules for taxing international income unilaterally, the development of tax treaties as supplements to unilateral mechanisms, the problems with tax treaties, and the Organisation for Economic Co-operation and Development (OECD's) attempt to reform tax treaty rules through the Base Erosion and Profit Shifting (BEPS) project. This background is, however, sufficient to support the chief argument of this thesis, namely, that the existing tax treaties signed by three African countries (Nigeria, Tanzania, and Botswana) are impediments to the fulfillment of the UN's Sustainable Development

Goals (SDGs) in those countries, and it is the same for other African countries with similar tax treaty provisions.

A more specific roadmap for this chapter follows. Section 2 discusses the challenge of applying domestic tax rules on international trade and mobile labour. This section discusses the possibility of double taxation of international income, arising from the interaction of domestic tax rules. Given the opportunities for double taxation of income from international trade and the negative consequences for investors, Section 3 gives an account of how conflicts in domestic tax rules are unilaterally resolved – through the grant of tax credits, deduction, or exemption mechanisms. Section 4 discusses the consequences of the adjustments that countries make to prevent double taxation for countries and for taxpayers. The key argument in this section is that unilateral rules adopted by residence countries to resolve conflicts over international income have consequences for source countries and taxpayers. The non-consideration of these consequences will affect the gains to source countries from international trade (a breach of inter-nation equity), increase the tax burden on taxpayers (inter-individual equity), and hinder the free flow of capital (a breach of the efficiency/neutrality principles). This section also argues for the inclusion of non-tax factors that influence the location decisions and allocation of international income by Multinational Corporations (MNCs) in the principles governing taxation of international income.

International tax rules are formulated based on certain key principles. Section 5 examines the objectives of two key principles of international tax (single tax and benefit principles) for the prevention of double taxation and double non-taxation of international income. The justifications for these principles are also discussed in this section. Section 6 offers a truncated history of the development of tax treaties as mechanisms to coordinate unilateral tax rules of developed countries for the prevention of double taxation. This section offers an account of the emergence of tax treaties in the nineteenth century; the context in which tax treaties emerged; foundational principles of tax treaties established in the nineteenth century; and how those foundational principles continue to shape existing bilateral tax treaties. Gaps in tax treaty rules continue to create opportunities for tax avoidance by MNCs and restrictive taxation base for developing countries. Given this background, Section 7 discusses the problems with tax treaties and the OECD's failure to address those problems in the BEPS project. Although there is a pervasive narrative by the OECD that its BEPS Project will put an end to international tax avoidance, the discussion in Section 7 reveals that the Project leaves out the key factor that allows for base erosion and profit shifting by MNCs – the separate entity principle in international tax. Section 7 also discusses a fundamental problem with tax treaties, which is the focus of this thesis – source-restricting provisions in tax treaties. This chapter concludes by recommending a cost-benefit analysis of provisions of existing tax treaties signed by the comparator countries as the foundation for designing effective and efficient structures for taxing the incomes of non-residents. The cost-benefit analysis is a standard of evaluation that enables African countries to get into the position where their tax treaties recognize their rights to derive more tax revenue from non-residents. The specifics of my argument are shown in Chapters 3-6 of this thesis in relation to the tax treaties signed by the comparator countries.

2. The Challenge of Applying Conflicting Domestic Tax Rules to International Trade and Mobile Labour

The movement of persons and trade across borders raises challenges of double taxation of international income. Double taxation arises when countries exert their full taxing powers over income of residents or non-residents; taxing residents both on the basis that the income was derived from activities carried out within their jurisdictions (source) and on all of the income earned by taxpayers who are residents of a country, no matter where that income is earned (residence).[1]

In addition to the potential for double tax that results from taxing on the basis of both source and residence, the interaction of different countries' domestic tax rules can create other conflicts. Source taxation is justified based on the location of assets and activities that generated the income in the source state, while residence taxation is justified based on the relationship of the taxpayer to the residence country.[2] The problem is that an item of income from cross-border trade can be sourced in more than one country. Domestic tax rules can create conflicts in those source rules. Those conflicts result when more than one country lays claim to the same income on the basis that part or all the assets or activities that generated the income is located in their jurisdiction. Similarly, conflicts in claims to residence can arise due to the different residency rules applied by countries. Some countries use 183 days' presence in the country to determine residence, while others may use tests of close economic and personal ties or nationality.[3] For corporations, countries adopt different tests to determine residence – some use place of incorporation, others use place of management, or both.[4] The different tests used to determine corporate residence by countries also open opportunities for double taxation.

3. How Conflicts in Domestic Tax Rules are Unilaterally Resolved

Taxation of the same stream of international income by both the source and residence country might result in juridical double taxation if left uncoordinated. However, there are unilateral

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[1] *Manual for the Negotiation of Tax Treaties Between Developed and Developing Countries*, UN Doc ST/ESA/94 11-21.

[2] Richard Vann, "International Aspects of Income Tax" in Victor Thuronyi, ed, *Tax Law Design and Drafting* Vol 2 (Washington DC: International Monetary Fund, 1998) at 15.

[3] *Ibid*.

[4] *Ibid*.

solutions to this problem. The source country can maintain its primary right to tax income arising from activities carried out within its jurisdiction, and the residence state can redress the potential for double taxation. There are four options open to a residence country that wishes to alleviate double taxation. The residence country could levy its own tax on foreign income gross of foreign tax; apply residence tax on foreign income net of foreign tax, treat the foreign tax as a deduction from taxable income; allow full or limited crediting of the foreign tax, treat the foreign tax as its own; surrender its tax sovereignty over the foreign income of its residents by exempting the foreign income from its own tax.[5] To prevent double taxation, generally countries adopt either the foreign tax credit or exemption mechanisms. The maximum deduction under the credit method is the portion of tax in the residence country – this method is named the "ordinary credit method" in the OECD and UN Model tax conventions.[6] Some countries also allow taxpayers to choose the deduction method for foreign taxes paid even though deductions result in double taxation, especially when foreign source tax is low.[7] In some tax treaties between developed and developing countries, a tax-sparing credit is introduced to protect the effectiveness of the tax incentive measures adopted by developing countries.[8] A tax-sparing credit allows the residence country to grant a tax credit not only for taxes paid in source countries but also for the tax spared by incentive investment measures in source countries. The benefit of such tax incentive measures is preserved if the residence country grants a tax-sparing credit; without that tax sparing credit, any tax benefit

[5] Peggy Musgrave, "Combining Fiscal Sovereignty and Coordination: National Taxation in a Globalizing World," in Inge Kaul and Pedro Conceicao, eds, *The New Public Finance Responding to Global Challenges* (United Kingdom: Oxford University Press, 2006) 167 at 168-9.
[6] See commentary on Article 23, *Model Tax Convention on Income and on Capital*, (Paris: OECD Publishing, 2017), and *Model Tax Conventions between Developed and Developing Countries*, (United Nations: New York, 2017).
[7] See *US Internal Revenue Code* (1986), §901(a); *Einkommensteuergesetz (Income Tax Act) – Germany (2002)*, §34c (2); and *Besluit ter voorkoming van dubbele belasting (Decree on the Prevention of Double Taxation)* (2001) – Netherlands § 18, 21 and 38.
[8] Commentary on Article 23, UN Model Tax Convention *supra* note 6.

granted by the source state is simply transferred to the residence country (and does not benefit taxpayers). Tax exemption is pre-eminently beneficial to taxpayers because, under this method, foreign source income is not taken into consideration at all by the residence country. Developed countries are, however, wary of including the exemption mechanism in tax treaties signed with developing countries.[9]

An illustration of these different mechanisms may assist. Tax credit by the residence country works this way – assuming A, a resident company in the US has a foreign subsidiary, B, in Nigeria. The US tax rate is 35 per cent. Let us assume Nigeria's tax rate is 20 percent. B's foreign source income is $100. A would pay the difference in tax rates over the foreign source income, that is, 15 percent of $100 which is $15. A's total tax liabilities would be $35 ($20 paid to source country, $15 paid to the residence/home country). Deduction, on the other hand, works this way – A would pay 35 percent of the after foreign tax amount. The foreign tax amount would be 20 percent of $100, which is $20. The after foreign tax amount would be $80 (100-20). A would pay 35 percent of $80 to the residence country, which is $28. A's total tax liabilities under the deduction mechanism is $20+$28 =48.

4. Evaluation of the Design of Domestic Tax Rules when Applied to International Activity

This section discusses the consequences of the adjustments that countries make to prevent double taxation for countries and for taxpayers. The key argument in this section is that unilateral rules adopted by residence countries to resolve conflicts over international income have consequences for source countries and taxpayers. The non-consideration of these consequences will affect the gains to source countries from international trade (a breach of inter-nation equity), increase the tax

[9] Commentary on Article 23, OECD Model Tax Convention, *supra* note 6 at para 8.

burden on taxpayers (inter-individual equity), and hinder the free flow of capital (a breach of the efficiency/neutrality principles). This section also argues for the inclusion of non-tax factors that influence the location-decisions and allocation of international income by MNCs in the principles governing taxation of international income.

A. Inter-nation Equity and Inter-individual Equity Principles

Domestic tax rules used in resolving conflicts over international income by the residence country have consequences for source countries and taxpayers. One of those consequences is on the fairness of how the rules adjust the tax consequences for countries (compared to each other – inter-nation equity) or individuals (inter-individual equity). The residence country, as explained above, has taxing authority over the total income of its residents and can choose to exercise certain policy choices over taxation of its taxpayers' foreign income. The right to tax the foreign income of residents by their country of residence is recognized in international law.[10] If the residence country decides not to recognize the foreign tax imposed by the source country and taxes the gross foreign income of residents, it will serve as a strong deterrent to capital outflow, resulting in a revenue loss to the source country (breach of inter-nation equity). If the residence country adopts the second option by treating foreign tax as a cost to the taxpayer by allowing a deduction of foreign tax from taxable foreign income, the same result under the first option is achieved, but to a lesser extent.[11] Deduction increases the tax burden of the taxpayer compared to other taxpayers who choose to invest domestically because it only entails a deduction of foreign tax from taxable foreign income and residence tax is then levied on the net foreign income. These first two options advance the welfare of the residence country at the expense of gains to source countries and hinder free flow

[10] Nancy Kaufman, "Fairness and the Taxation of International Income" (1998) 29: 2 Law and Policy in International Business 145-203.
[11] Michael Devereux, "Some Optimal Tax Rules for International Portfolio and Direct Investment" (2004) 60:1 FinanzArchiv: Public Finance Analysis.

of capital because of the increased tax burden on taxpayers. This breaches the inter-nation equity, and inter-individual equity principles.

The third option – the credit method -- is the most efficient choice that fulfills inter-nation equity and inter-individual equity. Given that there will be inequities when one country is required to sacrifice revenue in an international tax system (especially when the residence country is more economically advanced and the source country is a low-income country), the residence country can best bear the sacrifice because they are more economically advanced. The residence country sacrifices revenue by treating foreign tax as its own, thus ensuring that source countries receive full revenue transfer from them by imposing maximum tax rates possible to the level of the residence country without jeopardizing capital outflows.[12] The fourth option – exemption method -- distorts capital outflows and leads source countries to engage in tax competition to attract foreign investment because the residence country exempts foreign income from tax. Source countries lower their tax rates on non-residents, and they end up not sharing in the gains of factors of production operating within their borders, which ultimately limits redistributive functions within the countries. The most efficient option that advances the welfare gain of the source country without distorting the benefits to the residence country nor imposing a higher cost on taxpayers is the credit method, especially when the tax paid at source is lower than the residence country tax. Tax paid at source is considered by the residence country as tax paid to itself.[13] If the tax paid at source is lower than the residence tax, the difference is paid by the taxpayer.[14] If the tax paid at

[12] Lorraine Eden, "Equity and Neutrality in the International Taxation of Capital." (1988) 26:2 Osgoode Hall LJ 367 at 375; Joel Slemrod, “Free Trade Taxation and Protectionist Taxation” (1995) 2:3 International Tax and Public Finance 471.
[13] *Supra* note 1.
[14] *Ibid*.

source is higher than the residence tax, the residence country does not collect any tax.[15] The adoption of the credit method by the residence state is therefore a win-win situation for all the parties – the residence country (especially when is a developed country), the source country, and the taxpayer.

B. Efficiency/Neutrality Principles

Efficiency principles assume that allocation of factors of production by market mechanisms without public interference will result into the highest productivity.[16] The economic principle of capital import neutrality (CIN) aims to foster equal treatment of foreign investors and local investors in host countries by subjecting them to equal tax treatment. Under the CIN principle, the residence country is to exempt foreign-sourced income from tax to avoid double taxation. The economic principle of capital export neutrality (CEN) is also aimed at achieving efficiency by requiring the residence country to treat the income of residents, whether derived locally or abroad, to the same tax rates by granting tax credit for foreign taxes.[17] National neutrality seeks to promote national welfare by promoting investment at home rather than abroad. For this principle, net outbound investment returns must be equal to or exceed the gross return on an alternative domestic investment.[18] The argument for national neutrality is that it is optimal to tax foreign source income but allow a deduction for foreign taxes.[19] National neutrality is a breach of global economic

[15] *Ibid*.
[16] Klaus Vogel, "Worldwide vs. Source Taxation of Income – A Review and Re-evaluation of Arguments Part II" (1988) 16:8/9 Intertax 310.
[17] *Ibid*.
[18] Peggy B Musgrave, *United States Taxation of Foreign Investment Income: Issues and Arguments* (Cambridge: International tax Program, Harvard law School, 1969) 171; Peggy B. Richman, *Taxation of Foreign Investment Income, An Economic Analysis* (Baltimore: Johns Hopkins Press, 1963); Fadi Shaheen, "International Tax Neutrality: Reconsiderations" (2007) 27:1 Va Tax Rev 203 at 234.
[19] David Weisbach, "The Use of Neutralities in International Tax Policy" (2014) Coase-Sandor Institute for Law and Economics Working Paper No 697 at 3-4.

efficiency because it encourages double taxation, which impedes cross-border investment.[20] There is also the market neutrality principle, and the argument is that if two firms compete with each other in the same market, they should face the same overall effective tax rates. This is to ensure that taxation does not distort the competition between both firms.[21]

Besides the CEN, CIN, national neutrality, and market neutrality principles, Mihir Desai, Professor of Law and Finance at Harvard University, and James Hines, Economics Professor at the University of Michigan and research associate of the National Bureau of Economic Research, have advanced two additional efficiency principles to promote the efficiency of the allocation of capital – capital ownership neutrality (CON) and national ownership neutrality (NON).[22] These two principles place emphasis on capital ownership rather than location of capital. They ensure that the potential gain of reallocating capital ownership equals the cost of such reallocation to avoid ownership distortions. Desai and Hines argue that mixed systems of worldwide taxation and territorial taxation, alongside the types of double tax relief mechanisms provided, distort ownership decisions because the potential gain of reallocating ownership between related parties is not equal to the cost of such reallocation. They claim that universal exemption or territoriality will remove tax-induced distortions to ownership.

Mitchell Kane, Professor of Taxation at New York University, agrees that mixed systems distort ownership efficiencies because of the differential taxes. However, he disputes the conclusion that

[20] Eden *supra* note 12.
[21] Alan J Auerbach, Michael P Devereux & Helen Simpson, "Taxing Corporate Income" (2008) National Bureau of Economic Research Working Paper No 14494.
[22] Mihir A Desai, "New Foundations for Taxing Multinational Corporations Taxes" (2004) 82:3 The Tax Magazine; Mihir A Desai & James R Hines Jr, "Evaluating International Tax Reform" (2003) 56:3 National Tax Journal 409; Mihir A Desai & James Rodger Hines, "Old Rules and New Realities: Corporate Tax Policy in a Global Setting" (2004). Ross School of Business Paper No 920.

a mixed system implies ownership distortions.[23] Kane critiques Desai and Hines' argument on the ground that the empirical evidence they rely upon does not distinguish between locational and ownership distortions.[24] Kane argues that the empirical evidence at best shows that MNCs make decisions relating to location of investment with sensitivity to tax burden, but the evidence fails to show a direct link between tax differences and ownership distortions.[25] Kane's argument is that CON and NON are inadequate benchmarks for setting international tax policy. Consistent with Kane's argument, the interplay of other factors that influence ownership and location decisions of MNCs (for example, abundant supply of raw materials, cheap labour, and large markets) makes it impossible to conclude that the absence of tax differences will establish ownership neutrality. It is upon this premise that the argument in this thesis for source-expansive taxing rights for the comparator countries is based. MNCs operate in African countries for reasons other than tax. Therefore, African countries deserve to be compensated for their contributions to income derived by those MNCs.

Economic efficiency principles were developed in the 1920s when the concern was double taxation and removal of tax distortions to cross-border trade. Considering the many distortions to the global economy now caused by MNCs, it is time for a reconsideration of the principles upon which the international tax regime was built. Neutrality principles do not consider other factors that influence location decisions and allocation of international income by MNCs, such as abundant supply of raw materials, cheap labour, and large markets.[26] The principles only consider how tax systems

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[23] Mitchell Kane, "Ownership Neutrality, Ownership Distortions, and International Tax Welfare Benchmarks" (2006) 26 Va Tax Rev 54.
[24] *Ibid* at 60.
[25] *Ibid* at 61.
[26] Michael Lang and Jeffrey Owens, "The Role of Tax Treaties in Facilitating Development and Protecting the Tax Base" (2014) WU International Taxation Research Paper Series No 2014-03.

encourage distortions to location and ownership decisions. However, empirical studies show that location decisions are based on a number of factors and tax is only one of them.[27] There are other factors that distort the decision-making process of MNCs, and good tax policy should be able to balance them.

Scholars have argued against basing international tax policies solely upon neutrality principles. Michael Graetz, a leading expert on national and international tax and Professor of Tax Law at Columbia University, argues that "an effort to take seriously each of the relevant norms frees us to think anew about policy alternatives, to consider U.S. international tax policy proposals quite differently from the confinements of a commitment to CEN or CIN or to a compromise between them."[28] David Weisbach, Professor of Law at the University of Chicago, posits that good international tax policy should be derived from the reasons countries tax mobile capital income, taking into consideration welfare gains under the different types of tax systems.[29] The reasons should also include other factors that influence the cross-border businesses of MNCs. There are other factors that distort the decision-making of MNCs on where to locate entities or transfer assets. Therefore, focus on particular tax systems should not be the only basis for designing international policies as means to achieve economic efficiency. Clearly, domestic tax rules do not only raise conflicts in terms of categorization, and which country should tax what share of income from cross-border trade. They also have consequences on capital flows and the behaviour of taxpayers on where to invest. These shortcomings offend inter-nation equity, inter-individual equity, and efficiency principles. An effective international tax policy should consider all these factors not just

[27] Alex Knauer, *Impact of International Taxation on FDI Location Choice* (Germany: GRIN Verlag, 2008).
[28] Michael J Graetz, "Taxing International Income – Inadequate Principles, Outdated Concepts, and Unsatisfactory Policy" (2001) 54 Tax L Rev 261.
[29] Weisbach, *supra* note 19.

for the benefit of MNCs but also for source states. In the context of this thesis, the argument is that the provisions of the tax treaties signed by the comparator countries should reflect all other factors that contribute to income generated by non-residents in those countries. Those factors include abundant supply of raw materials, cheap labour, and large markets. These factors contribute significantly to the businesses of multinational corporations and serve as valid reasons why the comparator countries, and indeed all African countries, should tax income derived by MNCs operating in those countries. The focus of international tax rules should shift from a one-sided approach of protecting MNCs at the expense of the gains to countries where economic activities are carried out.

5. The Application of the Single Tax and Benefits Principles to Taxation of International Income

Two key principles of international tax seek to address concerns of double taxation of cross-border income identified above.[30] The first is the single tax principle, which means that income from cross-border activities should only be taxed once.[31] Commentary to the first model treaty drafted by tax experts in 1927 clearly explains that the objective of the single tax principle is, among others, to prevent double taxation by international cooperation:

> From the very outset, [the drafters of the model convention] realized that the necessity of dealing with the questions of tax evasion and double taxation [is] in co-ordination with each other. It is highly desirable that states should come to an agreement with a view to ensuring that a taxpayer shall not be taxed on the same income by a number of different countries, and it seems equally desirable that such international cooperation should prevent certain incomes from escaping taxation altogether. The most elementary and undisputed

[30] Reuven S Avi-Yonah, "Who Invented the Single Tax Principle?: An Essay on the History of US Treaty Policy" (2015) 59:2 NYL Sch L Rev 305 at 309.

[31] Thomas S Adams, "Interstate and International Double Taxation" in *Lectures on Taxation 101* (Roswell Magill ed., 1932) cited in Reuven S Avi-Yonah, "International Taxation of Electronic Commerce" (1997) 52 Tax L Rev 507 at 517.

> principles of fiscal justice, therefore, required that the experts should devise a scheme whereby all incomes would be taxed once and only once.[32]

Reuven Avi-Yonah, a tax professor at the University of Michigan, argues that the single tax principle also means that income from cross-border trade should not be undertaxed or subject to no tax at all.[33] When a country with the primary right to tax cross-border income does not tax the income, the other country with residual taxing right is required to tax it.[34] The non-taxation of cross-border income by either the source or residence country is a breach of the single tax principle. The organization structure of multinational corporations and their ability to allocate profits to affiliates in response to different tax rates in countries undermine the validity of the single tax principle in modern times.

The second principle is the benefits principle: states should get to tax people or activities that benefit from the state's support and protection. The benefits principle is justified on the basis that source countries provide the infrastructure used in the production of income; as such, they deserve the "first bite at the apple".[35] For residence taxation, the justification is the need for corporations to contribute to their home countries for economic and social benefits provided to them.[36]

The benefits principle is often marshalled to support the view that business income from cross-border transactions should be taxed primarily by source countries (because the source state

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[32] League of Nations, *Report prepared by the Committee of Experts on Double Taxation and Tax Evasion* April 12, 1927, C216 M85 at 23.
[33] *Ibid*.
[34] Reuven S Avi-Yonah, "Full Circle? The Single Tax Principle, BEPS, and the New US Model" (2015) University of Michigan Public Law Research Paper No 480.
[35] Avi-Yonah *supra* note 31 at 521 citing T.S. Adams, "Taxation of Business", (1917) 11 The National Tax Association 186. "A large part of the cost of government is traceable to the necessity of maintaining a suitable business environment." See also Michael J Graetz & Michael M O'Hear, "The "Original Intent" of US International Taxation" (1997) 46 Duke LJ 1021 at 1102-03.
[36] Kaufman, *supra* note 10; Richard Vann, "'Liable to Tax' and Company Residence Under Tax Treaties," in Guglielmo Maisto, ed, *Residence of Companies Under Tax Treaties and EC Law* (Amsterdam: IBFD, 2009), 197 at 198-203.

provides the primary benefits to business) while passive income from cross-border transactions should be taxed primarily by the residence country (because the residence state is thought to primarily provide the benefits required to produce passive income). The benefits principle also means that when the country with the primary right to tax fails to do so, the residual country (source or residence as the case may be) may do so.[37] Rules are developed based on these two principles, defining source and residence countries and assigning primary and residual taxing rights over income from cross-border trade to them.[38] Analysis of the OECD and UN Model tax treaties and the tax treaties signed by the comparator countries in this thesis reveal that the benefits principle is not adequately reflected in those instruments. The provisions of those treaties allocate more taxing rights to the residence country ignoring the contributions of the source country and their right to tax income derived from economic activities carried out within their jurisdictions.

The challenges to the single tax principle and the benefits principle in tax treaties are discussed in detail in section 7. The next section discusses the history of tax treaties.

6. The Rise of the "Double Tax Treaty" Solution

This section offers an account of the emergence of tax treaties in the nineteenth century; the context in which tax treaties emerged; foundational principles of tax treaties established in the nineteenth century; and how those foundational principles continue to shape existing bilateral tax treaties.

A. Early History of Tax Treaties

Tax treaties were developed to address concerns of double taxation on cross-border economic activities. Sunita Jogarajan, Professor at Melbourne Law School, relying on archival documents, observes that the first international tax treaty that addressed the concerns of double taxation with

[37] Avi-Yonah, *supra* note 31 at 517.
[38] Vann, *supra* note 2 at 4.

respect to free movement of capital and persons was concluded by the Austro-Hungarian Empire and Prussia (Germany) government in 1899.[39] Specific concerns raised were that double taxation could arise due to dual nationality or residence, that is, residence in one country but nationality in another. Another concern raised was the possibility of double taxation from taxpayers working in one country but living in the other.[40] Tax treaties sought to address these concerns by allocating taxing rights between the two countries – personal taxes were allocated to the country of domicile, while business taxes were allocated to the country of source.[41]

The origin of modern tax treaties can be traced to the 1923 Report of the league of Nations prepared by four economists: Prof. Bruins of the Commercial University, Rotterdam; Prof. Senator Einaudi of Turin University; Prof. Seligman of Columbia University, New York; and Sir Josiah Stamp, K.B.E., of London University. These four economists considered the economic consequences of double taxation through overlapping tax claims by taxpayers' country of residence and country of source.[42] They recommended the method of classification and assignment of sources of income based on the test of "economic allegiance".[43] This test was an answer to one of the key questions raised by the economists: "which Exchequer ought to bear the burden of paying for any relief given for double taxation?". It was felt that the taxpayer's liability should be divided between source and residence countries according to his relative interests. It was also felt that the residence country

[39] Sunita Jogarajan, "Prelude to the International Tax Treaty Network: 1815 – 1914 Early Tax Treaties and the Conditions for Action" (2011) 31:4 Oxford J Leg Stud 679 at 690.
[40] *Ibid*.
[41] *Ibid*.
[42] W H Coates, "League of Nations Report on Double Taxation Submitted to the Financial Committee by Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp" (1924) 87:1 Journal of the Royal Statistical Society 99.
[43] League of Nations*, Report on Double Taxation, Submitted to the Financial Committee by Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp*, April 5, 1923, EFS 73 F19, 40 at 42.

should get a larger share of taxpayer's income because it was the main place where his economic interests were.[44]

Draft bilateral conventions and reports by the League largely followed the foundations laid by the report of 1923.[45] As a matter of fact, some scholars argue that the economic principles formulated in the 1923 report, to this day, are the foundational principles for the taxation of cross-border transactions.[46] Model tax conventions were developed to create a degree of uniformity between tax treaties.[47] For items of income assigned to source countries, the residence country has residual taxing rights with the duty to give tax credit for foreign taxes paid to source countries. For items that are exclusively assigned to the residence country, source countries have no taxing rights.[48] The economic principles upon which tax treaties are built fail to take cognizance of the value of benefits provided by source countries.

Principles were also developed to solve theoretical problems arising from the allocation of taxing rights, such as the challenge in determining country of residence and source. Where residence has been maintained in more than one country, the taxpayer's place of main residence/fiscal domicile will be considered as the taxpayer's country of residence.[49] The following factors will be considered in determining the taxpayer's place of main residence – duration, regularity, frequency

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[44] Coates, *supra* note 42 at 101.
[45] Ke Chin Wang, "International Double Taxation of Income: Relief Through International Agreement 1921-1945" (1945) 59:1 Harvard Law Review 73.
[46] Elliott Ash & Omri Marian, "The Making of International Tax Law: Empirical Evidence from Natural Language Processing" (2019) University of Irvine Legal Studies Research Paper Series No 2019-02 at 9 citing Hugh J Ault, "Corporate Integration, Tax Treaties, and the Division of the International Tax Base: Principles and Practices" (1992) 47 Tax Law Review 565; Reuven S Avi-Yonah, "The Structure of International Taxation: A Proposal for Simplification" (1996) 74 Tex L Rev 1301.
[47] Michael Kobetsky, *International Taxation of Permanent Establishments: Principles and Policy* (United Kingdom: Cambridge University Press, 2011).
[48] Hugh J Ault, "Corporate Integration, Tax Treaties, and the Division of the International Tax Base: Principles and Practices" (1992) 47 Tax Law Review 565 at 568.
[49] Wang, *supra* note 45 at 76.

of stays, the place where the family of the taxpayer is usually present, and proximity to the place where the taxpayer carries out his occupation.[50] For overlapping claims as source countries, states can only tax income where there is a permanent establishment in their jurisdictions and only the income produced in its territory.[51]

Additional principles governing allocation of international income between associated enterprises were considered in the 1933 report by Mitchell B. Carroll, an American tax lawyer, to the Fiscal Committee of the League of Nations. Due to the unique way in which enterprises conduct their businesses, it was difficult for national taxing authorities to ascertain the true share of the income of permanent establishments within their jurisdictions. As such, there was a tendency for each country with a permanent establishment to insist on a larger share of income than what is stated in the separate accounts of such establishments, which would result in double taxation. This was the problem that Carroll attempted to solve. He highlighted three methods used in combination by national taxing authorities in allocating international income between states, to wit: separate accounting (takes the account of permanent establishment as the basis for assessment, might involve a comparison and verification of accounts of Permanent Establishment (PE), and other affiliates); empirical method (the taxing authority attempts to estimate an income by comparing the given enterprise with similar enterprises, or taking into account turnover, assets and other readily ascertainable factors[52]); fractional apportionment (the determination of the income of one establishment of an enterprise by dividing total net income in the ratio of certain factors — for

[50] *Ibid*.
[51] Wang, *supra* note 45 at 77-8.
[52] *Taxation of Foreign and National Enterprises* (Geneva: League of Nations, 1932-1933) at 46.

example, assets, turnover, pay-roll or a fixed percentage[53]). The separate accounting approach was preferred to the other two approaches.

A key principle formulated by Carroll is the treatment of subsidiaries of parent enterprises as separate legal entities and that parent enterprises must deal with subsidiaries as if they were separate legal entities.[54] These principles assume that inter-company transactions between subsidiaries and associated entities can be conducted in the same manner as similar transactions between independent legal persons. The separate accounting method and treatment of inter-company transactions as between independent entities dealing at arm's length were included in the 1935 Draft Convention for the Allocation of business Income between States for the Purposes of Taxation. They form the crux of the arm's length principle in Article 7 of the OECD and UN Model Tax Conventions.[55]

Regional conferences were held in Mexico in 1940 and 1943 under the auspices of the Fiscal Committee and capital importing countries from Latin America were invited to participate. The participants argued for primacy of source taxation and the outcome of the meetings led to the publication of the Draft Model bilateral Convention for the prevention of the Double Taxation of Income (1943) (the "Mexico Draft").[56] The provisions of the draft favoured source taxation, and provide that taxation of income from any industrial, commercial, or agricultural business, and from any other gainful activity, shall be taxable only in the state where the business or activity is carried out, provided that activities did not merely take the form of isolated or occasional transactions.[57]

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[53] *Ibid*.
[54] *Ibid* at 109.
[55] Sol Picciotto, *International Business Taxation: A Study in the Internationalization of Business Regulation* (United Kingdom: Cambridge University Press, 1992).
[56] *London and Mexico Model Tax Conventions Commentary and Text*, November 1946, C88 M88 1946 II A.
[57] *Ibid*.

The draft also states that income from royalties, and income from movable capital (interests and dividends) should be taxed at source.[58] Although the residence country had the power to tax the worldwide income of residents, they have the duty to grant tax credit for source taxes paid.[59]

Another meeting was held in London in 1946 and the outcome was the London Draft (1946) Model Bilateral Convention for the Prevention of the Double Taxation of Income and Property. Provisions of the favoured London Draft contrasted with the Mexico Draft. The London model greatly favoured residence taxation and it reintroduced the permanent establishment threshold, which only allowed source taxation of income from any industrial, commercial, or agricultural business and from any other gainful activity once that income was derived through a permanent establishment.[60] Under the London draft, dividends are taxed where the distributing entity has its fiscal domicile or its real centre of management.[61] Interests are taxed exclusively in the state where the creditor has his fiscal domicile.[62] Royalties for the use of patent or similar rights are taxed in the grantor's country of residence.[63]

B. The OECD and UN Model Tax Conventions

The League of Nations became defunct in 1946 and the OECD (formerly OEEC) continued the work of international tax coordination. The OEEC was established to help reconstruct Europe after World War II. The United States and Canada joined in 1960 and the OECD came into being in 1961. The OEEC established its fiscal committee in 1956 to consider obstacles to international investment among member countries.[64] It was clear from the onset that the OEEC, now OECD,

[58] Article X and IX, Mexico Draft, *supra* note 56.
[59] *Ibid* at 49-50.
[60] Article IV, London Draft, *supra* note 56.
[61] Article VIII, London Draft, *supra* note 56.
[62] Article IX, London Draft, *supra* note 56.
[63] Article X, London Draft, *supra* note 56.
[64] Picciotto, *supra* note 55 at 52-54.

was established, in part, to harmonize existing bilateral treaties between member countries to address the problem of double taxation.[65] The OECD published its first Model Tax Convention in 1963 with provisions mirroring those of the London Draft which, as noted above, had favoured exclusive residence taxation.[66] Latin American countries produced the ANDEAN Model in 1971. It favoured source taxation, but had minimal impact on bilateral tax treaties.[67]

The UN established a committee of experts on international cooperation in tax matters in 1968 and their work led to the publication of the first UN Model Tax Convention in 1980.[68] The UN Model Tax Convention emerged from the recognition by the UN that the OECD Model Tax Convention, upon which the relatively small number of tax treaties signed between developed and developing countries were based, create inequitable consequences for the latter. [69] The UN sought to create a model that was more sympathetic to the interests of developed countries by balancing the need to encourage investment in developing countries, with the preservation of source country taxation rights over economic activities in source countries.[70] This resolve led to the establishment of an Ad Hoc Group of Experts on Tax Treaties between developed and developing countries, with a mandate to formulate guidelines for the negotiation of bilateral treaties between developed and developing countries.[71] The Group of Experts comprised tax experts and tax officials appointed in

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[65] Ash & Marian *supra* note 46.

[66] Michael Lennard, "The Purpose and Current Status of the United Nations Tax Work" (2008) 23:20 Asia-Pacific Tax Bulletin 23.

[67] Thomas Rixen, *The Political Economy of International Tax Governance* (New York: Palgrave MacMillan, 2008).

[68] Ash & Marian *supra* note 46 at 13.

[69] Origin of the UN Model Tax Convention, *supra* note 6 at p. vii. The OECD highlights this fact as well, by noting that "existing treaties between industrialized countries sometimes require the country of residence to give up revenue. More often, however, it is the country of source, which gives up revenue. Such a pattern may not be equally appropriate in treaties between developing and industrialized countries because income flows are largely from developing to industrialized countries and the revenue sacrifice would be one-sided". See *Fiscal Incentives for Private Investment in Developing Countries: Report of the OECD Fiscal Committee* (Paris, OECD Publishing, 1965), para. 164.

[70] Lennard, *supra* note 66.

[71] ECOSOC, *Group of Experts on Tax Treaties between Developed and Developing Countries*, 1967, 43rd Mtg, UN Doc E/4429.

their personal capacity from the following countries: Argentina, Chile, France, Federal Republic of Germany, Ghana, India, Israel, Japan, the Netherlands, Norway, Pakistan, the Philippines, the Sudan, Switzerland, Tunisia, Turkey, the United Kingdom of Great Britain and Northern Ireland and the United States of America. Two experts from Sri Lanka and Brazil were added in 1972 and 1973 respectively at the request of the Economic and Social Council of the UN.[72]

The Group of Experts concluded the formulation of the guidelines in 1977 in the course of seven meetings, and published the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries in 1979.[73] The Group subsequently produced a draft Model Bilateral Convention between Developed and Developing Countries in 1980 using the 1977 OECD Model Tax Convention as their main reference text.[74] The UN Model Tax Convention was based on the guidelines published in the manual and upon the recommendation of a Group of Eminent Persons that was set up by the UN to study the impact of MNCs on development and international relations.[75] Six members of the Group and one member of the UN Secretariat served as members of the drafting committee: Maurice Hugh Collins (United Kingdom of Great Britain and Northern Ireland); Jean-François Court (France); Jose Daniel Diniz (Brazil); N.M. Qureshi (Pakistan); Avtar Singh (India); Max Widmer (Switzerland) and J. Pierre V. Benoit, Head, Fiscal and Financial Branch, Department of International Economic and Social Affairs, United Nations Secretariat.[76]

[72] *Model Double Taxation Convention between Developed and Developing Countries* (New York: United Nations, 1980) at 2-3.
[73] *Manual for the Negotiation of Bilateral Tax Treaties Between Developed and Developing Countries* (New York: United Nations Publications, 1979).
[74] *supra* note 72 at 4.
[75] *The Impact of Multinational Corporations on Development and on International Relations* (New York, United Nations, 1974).
[76] *Supra* note 72 at 5.

The UN Model Tax Convention was amended in 2001, 2011, and 2017, reflecting developments in the area of international tax policies.

The UN Model favours source taxation, although not as much as the provisions of the Mexico Draft.[77] There are two important factors that account for the UN's reactionary role in the international tax regime and its inability to secure radical amendments to tax treaty rules. First, the UN is not an intergovernmental organization like the OECD, and thus, unable to foster consensus on fundamental changes to tax treaty rules.[78] Second, unlike the OECD, the UN lacks skilled resources and adequate funding to undertake projects.[79] In spite of these shortcomings, the UN Model introduced some source-expanding provisions. These provisions are discussed below:

i. Article 5 – Permanent Establishment

The UN Model has a broader definition and a smaller time threshold for the establishment of a permanent establishment (PE) in a source country. Article 5 of the OECD Model defines a PE as "a fixed place of business through which the business of an enterprise is wholly or partly carried on, including a building site, a construction or installation project that lasts more than twelve months".[80] The UN Model adds supervisory activities to this list and the threshold for a building site, a construction or installation project is six months as against twelve months in the OECD Model.[81] Also, the provision of services in the source country would constitute a PE in that country

[77] See Edwin van der Bruggen, "A Preliminary Look at the New UN Model Tax Convention" (2002) 2 Brit Tax Rev 119. Bruggen argues that the 2001 amendments to the UN 1980 Model Tax Convention does not contain substantial changes to tax treaty provisions that would benefit developing countries.
[78] Sudarshan Kasturirangan, "The United Nations Tax Committee as a Player in the International Tax Policy Discussion" in Anna Binder and Viktoria Wöhrer eds, *Special Features of the UN Model Convention* (Linde: Vienna, 2019) at 14-15.
[79] *Ibid*.
[80] Article 5 (1) & (3) of the OECD Model, *supra* note 6.
[81] Article 5(1) & (3) (a) of the UN Model, *supra* note 6.

under the UN Model.[82] This provision is absent in the OECD Model. The use of facilities solely for the purpose of delivery constitutes a PE under The UN Model.[83] The OECD does not have this provision. Business activities conducted by dependent agents without a fixed place of business in the source country for the delivery of goods or merchandise on behalf of the enterprise constitutes a PE in the source country under the UN Model.[84] This provision does not exist in the OECD Model.

ii. Article 7 – Business Profits

The rule under Article 7(1) of the OECD Model is that only the business profits attributable to the permanent establishment will be taxed in the source country.[85] Article 7(1) of the UN Model, however, introduces a limited "force of attraction rule".[86] Business profits from "(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment" shall also be taxable in the source country.[87] In addition, Article 7(3) of the UN Model explicitly lists allowable deductions in the determination of the profits of a permanent establishment as "expenses which are incurred for the purposes of the business of the permanent establishment".[88] This provision is absent in the OECD Model. The limited force of attraction rule in the UN Model expands source taxation of business profits of a non-resident. In addition to business profits derived directly from the

[82] Article 5(3)(b) of the UN Model, *supra* note 6.
[83] Article 5(4)(a) of the UN Model, *supra* note 6.
[84] Article 5(5)(b) of the UN Model, *supra* note 6.
[85] Article 7(1) of the OECD Model, *supra* note 6.
[86] Article 7(1) of the UN Model, *supra* note 6.
[87] *Ibid*.
[88] Article 7(3) of the UN Model, *supra* note 6.

permanent establishment, profits derived in the source state from goods or merchandise that are the same or similar to those sold through the permanent establishment are taxable at source.

iii. Article 8 – International Shipping and Air Traffic

Article 8 (Alternative B) in the UN Model allows source taxation of profits of an enterprise of a Contracting State from shipping activities in international traffic in that state if such activities are more than casual.[89] The OECD Model, however, provides that profits of an enterprise of a Contracting State from shipping activities in international traffic can only be taxed in the residence country.[90]

iv. Articles 10 & 11 – Dividends and Interest

The UN Model also leaves the withholding tax rates for dividends and interests paid by a company resident in a source country to a resident of the other contracting state to bilateral negotiations.[91] Leaving the rates to states to decide gives room for source countries to insist on higher withholding tax rates during bilateral treaty negotiations. The rule under both the OECD and UN Models is that dividends and interests paid by a resident of a contracting state to a resident of the other contracting state may be taxed in that other state (residence state of the receiver).[92] Both Models, however, allow source taxation of such dividends and interests if the beneficial owner of such payments is a resident of the other contracting state.[93] The OECD set the limit to five percent of the gross dividends if the receiving company is a resident of the other contracting state and holds directly at least twenty-five percent of the capital of the company paying the dividends, or 15 percent in all

[89] Article 8 (Alternative B) of the UN Model, *supra* note 6.
[90] Article 8(1) of the OECD Model, *supra* note 6.
[91] Articles 10(2) & 11(2) of the UN Model, *supra* note 6.
[92] Articles 10(2) & 11(2) of the OECD and UN Models, *supra* note 6.
[93] *Ibid*.

other cases.[94] The withholding tax rate for interest is 10 percent of the gross amount of the interest under the OECD Model.[95]

v. Article 12 - Royalties

Article 12 of the UN Model allows greater taxing rights for source countries. Under the OECD Model, royalties arising in source countries and beneficially owned by a resident of the other contracting state (residence country) can only be taxed in the residence country unless the royalties arise through a permanent establishment situated in the source country.[96] The UN Model, however, allows source taxation of royalties arising in a source country (whether through a permanent establishment or otherwise).[97] Also, Article 12 of the UN Model introduces an expansive definition of the term "royalties' to include the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.[98] Another key provision under Article 12 of the UN Model is Article 12A, which allows source taxation of fees for technical services arising in source countries.[99] Fees for technical services arising in a source country can be taxed by the source country unless it arises through a permanent establishment situated in the source country or independent personal services from a fixed base situated in that other State.[100] In that case, taxation of such technical fees would be governed by Articles 7 and 14 of the UN Model, respectively.[101] Article 12A is a laudable initiative; it opens more opportunities for source taxation.

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[94] Article 10(2) of the OECD Model, *supra* note 6.
[95] Article 11(2) of the OECD Model, *supra* note 6.
[96] Articles 12(1) & (3) of the OECD Model, *supra* note 6.
[97] Article 12(1) of the UN Model, *supra* note 6.
[98] Article 12(3) of the UN Model, *supra* note 6.
[99] Article 12(A) of the UN Model, *supra* note 6.
[100] *Ibid*.
[101] Article 12(4) of the UN Model, *supra* note 6.

vi. Article 13 – Capital Gains

Article 13 of the UN Model also expands source taxation. Both the OECD and the UN Models allow source taxation of capital gains from movable and immovable property forming part of the business property of a permanent establishment.[102] Article 13(2) of the UN Model, however, also allows source taxation of gains from the alienation of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State (source country) for the purpose of performing independent personal services.[103] Article 13(5) of the UN Model also allows source taxation of gains derived by a resident of a Contracting State (residence country) from the alienation of shares of a company, or comparable interests, (such as interests in a partnership or trust), which is a resident of the other Contracting State (source country). Article 13(5) does not specify the rate for source taxation of capital gains and leaves it to be established through bilateral negotiations. .[104]

vii. Article 14 – Independent Personal Services

Prior to 2000, the OECD Model included rules for taxation of income from independent personal services in Article 14. The OECD deleted Article 14 from the OECD Model following concerns about the scope and purpose of the article.[105] Under the current version of the OECD Model, the taxation of independent personal services is assimilated with the taxation of business profits in article 7.[106] The UN Model provides for source taxation of income from independent personal services in a separate provision. Article 14 of the UN Model allows source taxation of income from independent personal services if either of these two conditions are met: if the non-resident

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[102] Articles 13(1) & (2) of the OECD and UN Models, *supra* note 6.
[103] Article 13(2) of the UN Model, *supra* note 6.
[104] Article 13(5) of the UN Model, *supra* note 6.
[105] *Issues Related to Article 14 of the OECD Model Tax Convention,* (OECD Publishing: Paris, 2000).
[106] Keefe Han, "The Mistaken Removal of Article 14 from the OECD Model Tax Convention" (2010) 16 Auckland UL Rev 192.

has a fixed base regularly available to him in the source State for the purpose of performing his activities, or if his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days within a twelve-month period.[107]

viii. Article 21 – Other Income

Under both the OECD and UN Models, income of a resident of a residence country, wherever arising, not dealt with in the articles of the conventions can only be taxed in the residence country.[108] The UN introduces an exception to that rule in Article 21(2) by allowing source taxation of income derived from business in a source country through a permanent establishment situated therein, or independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base.[109]

Even with the minimal source taxing rights promoted by the UN Model, scholars argue that it has minimal impact on bilateral tax treaties.[110] Elliot Ash, an Assistant Professor of Law, Economics, and Data Science, at ETH Zurich and Omri Marian, a Professor of Law and Academic Director of the Graduate Tax Program, University of California, Irvine, School of Law conducted an empirical analysis of 4,052 bilateral income tax treaties and 23 model treaties. They found that there was clear convergence in the language of tax treaties in the 1970s and the OECD Model is the current dominant source of influence in tax treaties.[111]

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[107] Article14(1)(a) &(b) of the UN Model, *supra* note 6.
[108] Article 21(2) of the UN Model, *supra* note 6.
[109] Article 12(2) of the UN Model, *supra* note 6.
[110] Thomas Rixen, *The Political Economy of International Tax Governance* (New York: Palgrave MacMillan, 2008); Pasquale Pistone, "General Report" in Lang, Michael and Pasquale Pistone eds, *The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties* (United Kingdom: Cambridge University Press, 2012).
[111] Ash & Marian *supra* note 46 at 18-24.

7. The Problems with Tax Treaties and Proposals to Address Them

This section discusses two major problems with bilateral tax treaties, namely, gaps in tax treaty rules, which give rise to tax avoidance by MNCs; and source-restricting provisions in tax treaties, which limit the taxing rights of source countries. The OECD's attempt to reform tax treaty rules is also discussed in this section.

A. The Problem of Tax Avoidance

The more than 3,000 bilateral tax treaties in existence pose great challenges because of the opportunities they afford MNCs to engage in tax planning. Globalization, combined with lax domestic tax laws and permissive tax treaties, allows MNCs to artificially shift profits to affiliates in response to tax differentials in countries. MNCs adopt the following strategies for corporate tax avoidance

- transfer mispricing (prices are set for intra-firm trade in response to different tax rates in countries – higher amounts are paid to affiliates in low tax jurisdictions and lower amounts are paid to affiliates in high tax jurisdictions);
- strategic location of intellectual property rights (intellectual property rights are strategically located in low tax jurisdictions, and affiliates in high tax jurisdictions pay royalties to licensees to reduce taxable profits);
- international debt shifting (intercompany loans - entities in high tax jurisdictions borrow from entities in low tax jurisdictions, so taxable profits are reduced through interests paid to borrower);
- and treaty shopping (the company sets up a conduit in a third country by a non-resident company to take advantage of low withholding tax rates in the third country due to tax treaty between source country and the third country).[112]

[112] Sebastian Beer, Ruud de Mooij & Li Liu, "International Corporate Tax Avoidance: A Review of the Channels, Magnitudes and Blind Spots" (2018) IMF Working Paper No 18/168 at 661.

Intra-firm trade plays a significant role in the global economy.[113] In 2015, it was estimated that intra-firm trade accounts for about one-third of global trade.[114] Apart from the artificial allocation of profits from source countries to low or no tax jurisdictions through the strategies highlighted above, tax treaties also allow artificial characterization of income by MNCs in source countries. Due to the fact that withholding tax rates in tax treaties over passive income varies, and there are no rules governing characterization of income in tax treaties, MNCs characterize income in a way that responds to tax rates to maximize their profits. There is empirical evidence that allocation of international income by MNCs respond to tax differentials in countries.[115] Data from Country-by-Country Reports filed by MNCs show misalignment between where profit is declared by MNCs and location of economic activities.[116] Tax avoidance prevails because the separate entity principle governs allocation of international income between countries. The separate entity principle allows national tax authorities of countries to only consider the accounts of entities of MNCs within their jurisdictions. Put simply, the national activities of MNC entities rather than the integrated businesses of MNCs are considered by tax authorities while assessing their tax liabilities. This separate entity treatment allows MNCs to get away with artificial allocation of profits because of limited information about their global businesses.

Another major flaw of tax treaties and inability to prevent tax avoidance is the arm's length principle, which tax authorities apply in determining prices fixed for transactions by related entities. The arm's length principle requires tax authorities to find comparables to determine the

[113] R Lanz, R & S Miroudot, "Intra-Firm Trade: Patterns, Determinants and Policy Implications" (2011) OECD Trade Policy Paper No 114.
[114] UNCTAD, "Investor Nationality: Policy Challenges" (2016) 23:3 Transnational Corporations Journal 1.
[115] *Ibid*.
[116] OECD, "OECD Tax Talks" (July 2020), online: < https://www.oecd.org/tax/oecd-tax-talks-presentation-july-2020.pdf>.

prices that contracting parties would have fixed for similar transactions between related entities. The arm's length principle is based upon the assumption that comparables can be found for transactions between related entities. It ignores the synergistic nature of transactions between related entities, the unique advantages they confer on MNCs, and difficulty in finding comparables for most goods and services supplied by associated entities[117], especially intangibles.[118] Due to the challenges inherent in the application of the arm's length principle to transactions between related entities, some authors argue that the formulary apportionment approach, which allocates international income of MNCs to countries based on substantial economic activities, should replace the arm's length principle.[119]

B. Source-restricting Provisions in Tax Treaties

The second challenge arising from tax treaties is erosion of source tax revenue through provisions that restrict source taxing rights. Though the objectives of tax treaties are to prevent double taxation and fiscal evasion, the majority of tax treaty provisions allocate taxing rights between the source and residence countries. By agreeing to these provisions, tax treaties facilitate transfer of revenue from capital importing countries (where revenues are much needed for socio-economic

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[117] Reuven S Avi-Yonah, "The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation" (2006) 9 Finance and Tax Law Review 310; Lorraine Eden, "The Arm's Length Standard: Making it Work in a 21st Century World of Multinationals and Nation States" in Thomas Pogge & Krishen Metha ed, *Global Tax Fairness* (United Kingdom: Oxford University Press, 2016) 155; Kerrie Sadiq, "The Fundamental Failing of the Traditional Transfer Pricing Regime – Applying the Arm's Length Standard to Multinational Banks based on a Comparability Analysis" (2004) 58:2 Bulletin for International Taxation 67; Piccotio, *supra* note 55.

[118] Yariv Brauner, "Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes" (2008) 28 Va Tax Rev 79; Richard Vann, "Reflections on Business Profits and the Arm's-Length Principle" in B.J. Arnold, J. Sasseville, E.M. Zolt, eds, *The Taxation of Business Profits Under Tax Treaties*, Sydney Law School Research Paper No 10/127.

[119] Reuven S Avi-Yonah, Kimberly Clausing & Michael C Durst, "Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split" (2009) 9:5 Fla Tax Rev 497; Reuven S Avi-Yonah & I Benshalom, "Formulary Apportionment – Myths and Prospects: Promoting Better International Tax Policies by Utilizing the Misunderstood and Under-Theorized Formulary Alternative" (2011) 3 World Tax Journal 376; Sol Picciotto, "Towards Unitary Taxation: Combined Reporting and Formulary Apportionment" in Thomas Pogge & Krishen Metha ed, *Global Tax Fairness* (United Kingdom: Oxford University Press, 2016) 221.

development) to capital exporting countries.[120] For business income, source countries can only tax the income if it is attributable to a permanent establishment in the country, while passive income can only be taxed at a set rate. If the tax treaty is based on the OECD Model, the source country cannot tax any other income not listed in the tax treaty. Also, Articles 10, 11 and 12, which prescribe low withholding tax rates for dividends, interest, and royalties paid to affiliates by multinational corporation (MNC) entities in source countries are examples of source-restricting provisions in the OECD Model.[121] Another example of source-restricting provisions in the OECD Model is the non-taxation of technical fees where there is a payment of any kind to any person in consideration for any service of an administrative, technical, managerial or consultancy nature in the absence of a permanent establishment.[122] Lastly, lack of provision for source countries to tax non-residents' capital gains on the indirect transfers of non-real estate assets, also known as offshore indirect transfers (OITs) is another example of source-restricting provisions in the OECD Model.[123]

Some developed countries, when negotiating with developing countries, give certain concessions on treaty provisions favouring source taxation. They use the UN Model which favours source countries to negotiate with developing countries. However, on the global scale, there is resistance to substantive reallocation of treaty provisions in favour of source taxation. Even the expansion to

[120] Kimberley Brooks & Richard Krever, "The Troubling Role of Tax Treaties" in Geerten M. M. Michielse & Victor Thuronyi, eds, *Tax Design Issues Worldwide, Series on International Taxation*, Volume 51 (Netherlands: Kluwer Law International, 2015) 159.

[121] *Ibid* at 166.

[122] See article 12A of the UN Model tax Convention, *supra* note 6; see also Kimberley Brooks, "Canada's Evolving Tax Treaty Policy toward Low-Income Countries" in Arthur J. Cockfield, ed, *Globalization and the Impact of Tax on International Investments*, (Toronto: University of Toronto Press, 2010).

[123] Eric Zolt "Tax Treaties and Developing Countries" (2018) 72 Tax L Rev 1 at 4-10.

the UN Model does not eliminate all the source-restricting provisions.[124] It is important to note the policy behind source-restricting provisions in tax treaties. The solution to the problem of double taxation formulated by the four economists in 1923 was that a source country should give up its taxing rights over non-residents except for income from permanent establishments based on the doctrine of "economic allegiance".[125] This policy was justifiable at the time it was adopted because income flows among treaty countries were balanced.[126] As between capital exporting countries and capital importing countries, source restricting provisions create huge revenue loss in the latter because capital flows are uneven. The main purpose of tax treaties is allocation of taxing rights between the source and residence countries.[127] This is reflected in the number of articles in tax treaties allocating taxing rights to countries. Ironically, tax treaties remain ineffective in achieving their stated objective of preventing double taxation, because of lack of characterization rules for source taxation.[128]

C. Tax Treaties and the OECD BEPS Project

The role that tax treaties play in facilitating aggressive tax planning by MNCs is discussed above. If tax treaties continue to be used as a device for integrating domestic tax systems, then solutions to that problem are urgently needed. Empirical studies of the revenue impact of base erosion and profit shifting (BEPS) reveal the magnitude of BEPS and attendant consequences on the economy

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[124] Piccotto, *supra* note 49; Michael S Kirsch, "Tax Treaties and the Taxation of Services in the Absence of Physical Presence" (2016) 41 Brook Journal of International Law 1143.
[125] Oladiwura Ayeyemi Eyitayo-Oyesode, "Source-Based Taxing Rights from the OECD to the UN Model Conventions: Unavailing Efforts and an Argument for Reform" (2019) 13:1 Law and Development Review 193 at 204 citing Report on Double Taxation submitted to the Financial Committee – Economic and Financial Commission Report by the Experts on Double Taxation – Document E.F.S.73. F.19 (April 5, 1923) – Volume 4 Section 1: League of Nations, available at: <https://adc.library.usyd.edu.au/view?docId=split/law/xml-main-texts/brulegi-source-bibl-1.xml> at 49.
[126] *Ibid*.
[127] *Ibid*; see also Brooks & Krever, *supra* note 120 at 166.
[128] Brooks & Krever, *supra* note 120 at 168.

of nations, especially developing countries, which rely more on capital income tax.[129] Just as double taxation was the scourge of the nineteenth century in international tax, double non-taxation is the danger of the twenty-first century. MNCs save billons of dollars in taxes by shifting their profits to tax havens. The OECD in 2013 estimated that about $100-$240 billion representing 4%-10% of global corporate income tax is annually lost to BEPS.[130]

The financial crisis of 2008 and the increased media attention to base erosion and profit shifting activities of MNCs informed policies by the G20 on how governments can protect their tax base.[131] Prior to the crisis, global economic policies were addressed by G7 countries. The G7 countries, however, felt the need to include developing countries in issues of economic management in dealing with the crisis, hence the shift of economic policy-making power to the G20. In 2009, the G20 pledged to reform the global architecture to meet the needs of the 21st century by implementing reforms to tackle the root causes of the crisis.[132] The G20 acknowledged the role of tax havens and misuse of corporate vehicles in eroding the tax base of countries.[133] At a meeting in Los Cabos in 2012, the G20 leaders requested the OECD to examine the issue of BEPS.[134] In 2013, the OECD published the BEPS Action Plan, which consists of fifteen actions needed to address BEPS.[135] The then Secretary General of the OECD, Angel Gurria, said that the mission of

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[129] Clemens Fuest et al, "Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform" (2013) 5 World Tax Journal 307 at 314-16.
[130] OECD, *Measuring and Monitoring BEPS, Action 11- 2015 Final Report*, (Paris: OECD Publishing, Paris, 2015) at 102.
[131] Allison Christians, "Taxation in a Time of Crisis: Policy Leadership from the OECD to the G20" (2010) 5 North Western Journal of Law and Social Policy at 1.
[132] G20, "G20 Leaders Statement: The Pittsburgh Summit", online: <http://www.g20.utoronto.ca/2009/2009communique0925.html>.
[133] G20, "Cannes Summit Final Declaration – Building Our Common Future: Renewed Collective Action for the Benefit of All", online: <http://www.g20.utoronto.ca/2011/2011-cannes-declaration-111104-en.html>
[134] *Ibid*.
[135] *Action Plan on Base Erosion and Profit Shifting*, (Paris: OECD Publishing, 2013).

the BEPS Project is, among others, to put an end to double non-taxation and immobilize BEPS-inspired tax structures:

> …The measures we are presenting today represent the most fundamental changes to international tax rules in almost a century: they will put an end to double non-taxation, facilitate a better alignment of taxation with economic activity and value creation, and when fully implemented, these measures will render BEPS-inspired tax planning structures ineffective.[136]

The above aspirations, however, are not reflected in the BEPS outputs. The BEPS project is silent on the fundamental restructuring of the international tax regime. The outputs have been analysed and described as a patch-up of the current rules.[137] As discussed above, the root cause of BEPS is the artificial allocation of profits made possible by the separate entity concept and the arm's length principle in international tax. These assume that constituent entities of MNCs are independent of each other and conduct transactions with each other at arm's length.[138] The separate entity concept and the arm's length principle are unable to solve the problem of profit misallocation by MNCs because of the integrated form of MNC transactions.[139] The integrated nature of MNC businesses is what creates opportunities for them to leverage economies of scale to maximize global profits. Thus, an assumption that MNC entities can deal with each other at arm's length is a myth.[140]

Though the G20 had suggested a replacement of the arm's length principle with unitary taxation, which would ensure that global profits of MNCs are assigned to jurisdictions where economic

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[136] OECD, "OECD Presents Outputs of OECD/G20 BEPS Project for Discussion at G20 Finance Ministers Meeting", online: https://www.oecd.org/tax/oecd-presents-outputs-of-oecd-g20-beps-project-for-discussion-at-g20-finance-ministers-meeting.htm.

[137] Reuven S Avi-Yonah & Haiyan Xu, "Evaluating BEPS" (2017) 10:1 Erasmus Law Review 3 at 7; Yariv Brauner, "What the BEPS" (2014) 16 Fla Tax Rev 55.

[138] Avi-Yonah and Xu *ibid*; OECD, *Action Plan on Base Erosion and Profit Shifting- Report, supra* note 135 at 14.

[139] Avi-Yonah *supra* note 117.

[140] S I Langbein, ''The Unitary Method and the Myth of Arm's Length'' (1986) 30 Tax Notes 625; Avi-Yonah, *ibid*.

activities take place and value is created[141], the OECD emphasized the separate entity and arm's length principles and built the BEPS outputs on the very principles that keep creating BEPS opportunities.[142] The BEPS project is also silent about the reform of the rules governing where profits are earned. This is reflected in the concept of "residence" and "source" in tax treaties. These rules also create opportunities for allocation of profits from jurisdictions where economic activities occur to low or no-tax jurisdictions. Addressing these BEPS problems has become a major focus of attention at the OECD, but the retention of the existing rules leaves much to be desired of the OECD BEPS project.

The project also ignores the disparities between developed countries and developing countries in terms of the current taxing rules in tax treaties. The OECD made it clear at the start of the BEPS Project that its aim was not to change the rules governing the allocation of taxing rights on cross-border income in tax treaties, which now favour developed countries over developing countries.[143] Through the BEPS Project, the OECD proposed a multilateral approach to tackle profit shifting through its BEPS Inclusive Framework, inviting non-OECD members to participate in the implementation of the BEPS' four Minimum Standards, though they were excluded from the norm-building process.[144] Non-OECD countries joined the implementation process, though it is not clear how the BEPS Project will help them.[145]

[141] The BEPS Monitoring Group (BMG), "Overall Evaluation of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project", online: < https://www.bepsmonitoringgroup.org/>.
[142] Avi-Yonah and Xu, *supra* note 137 at 7.
[143] Eyitayo-Oyesode, *supra* note 125.
[144] The Inclusive Framework on BEPS has over 130 members. See the OECD, BEPS Inclusive Framework, Online: https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf.
[145] Irma Mosquera et al, "Tax and Development: The Link between International Taxation, the Base Erosion and Profit Shifting Project and the 2030 Sustainable Development Agenda" (2018) UNU Working Paper at 14.

The OECD-invited members of the Inclusive Framework on BEPS decided to focus on the prevention of double non-taxation as an important objective of tax treaties. Action Plan 6 in the OECD BEPS project seeks to prevent double non-taxation.[146] The OECD's work led to amendments to the purpose of the treaty models. The preamble to the OECD Model Tax Conventions now reads as follows:

> Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States.[147]

The retention of the separate entity approach and the arm's length principle indicate that the OECD only proposes cosmetic changes to ineffective tax treaty rules. Mismatches in the different tax rules give opportunities to MNCs to use hybrid instruments and entities to obtain undue benefits under the treaties and domestic tax laws. This situation is exacerbated by the evolution of e-commerce and the multibillion-dollar industry of ingenious experts committed to helping corporations to avoid taxes. As corporations continue to exploit gaps and mismatches in tax rules to shift profits to low or no-tax jurisdictions where low or no tax activity occurs, there is the need for fundamental changes to the existing tax treaty rules.

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[146] *BEPS Action 6 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Peer Review Documents*, (Paris: OECD, 2017).

[147] See amendments to the preamble to the OECD Model Tax Convention, *supra* note 6 at M-5; and amendments to the preamble to the UN Model Tax Convention, *supra* note 6 at 5.

8. Conclusion

From the beginning, tax treaties were designed to facilitate cross-border investment based on bargains between two countries. The interconnectedness of countries and triangular forms of transactions in a global world, however, makes bilateral tax treaties unworkable. The BEPS project, which was designed to reform tax treaty provisions, only adds another layer of complexity to existing tax treaty provisions. The retention of the separate entity treatment/ arm's length principle, and preservation of rules guiding source and residence rules and where profits are considered to be earned, are indications of the non-revolutionary nature of the BEPS project. These rules allow distortions to taxation of international income and make tax treaties inadequate to prevent double taxation, fiscal avoidance/evasion. Allocation rules, which impose restrictions on the taxing rights of source countries, also impact the tax base of African countries significantly. An efficient international tax regime should be based on rules that address the modern and integrated nature of MNC transactions. Also, tax treaty provisions should eliminate allocation rules which prevent source taxation. Countries should be able to tax economic activities carried out within their jurisdictions in line with their domestic tax rules, while unilateral mechanisms are used to prevent double taxation. In the absence of such considerations at the international level, it might benefit African countries to assess their tax treaty networks, especially because of the costs of negotiating and implementing tax treaties and other multilateral instruments.

The next chapter examines specific issues arising from the international tax regime namely: the OECD BEPS Project, the OECD Exchange of Tax Information Initiatives, and their implications for African countries.

Chapter III - Implications of the International Tax Regime for African Countries

1. Introduction

The failure of tax treaty rules to protect the tax base of African countries casts doubt on the usefulness of tax treaties in African countries. Also, the marginalization of African countries in the attempt by the OECD to reform international tax rules, and the lack of consideration of specific issues that engender BEPS in African countries, are fundamental reasons why African countries should do a proper cost-benefit analysis of remaining in the OECD-driven international tax regime.

The previous chapter discussed the different challenges arising from tax treaties in terms of namely the opportunities they present to facilitate tax avoidance, and the prescription of source-restricting provisions. This chapter queries the belief that the international tax regime is a construct for international tax cooperation for the benefit of African countries. Given the role of the developed countries in the establishment of international tax rules, and the OECD's central role in the reform of the rules, this chapter argues that the cost of staying in the international tax regime for African countries far outweighs its benefits. The chapter challenges the assumed benefits that tax treaties may offer and assesses the consequences for African countries of joining the ongoing global reform of the international tax rules by the OECD.

Section 2 queries the argument that international cooperation through tax treaties is necessary to prevent double taxation. This section expands the discussion in Chapter 2 on how unilateral mechanisms by the residence state can prevent double taxation without the need for tax treaties. Section 3 debunks the belief that tax treaties are necessary for African countries to attract foreign direct investment (FDI) due to the lack of clear-cut evidence that tax treaties attract investment. This alludes to my argument regarding the need for a cost-benefit assessment of tax treaties signed by African countries, in particular, those signed by the comparator countries. The argument in this section is that if there is no established positive impact of tax treaties on investment, the negative consequences of tax treaties are compelling enough for African countries to consider reforming or cancelling their tax treaties. Next, I discuss the OECD BEPS project which aims to end domestic tax base erosion and profit shifting by MNCs. Section 4 examines the implications of the attempt by the OECD to reform international tax rules for African countries. This section criticizes the idea that the BEPS Project is an initiative that would benefit of African countries, seeing that they are not included in setting the agenda for the BEPS project, and that the BEPS issues that affect them are not considered in the BEPS Action Plans. Section 5 discusses some unilateral measures for the prevention of BEPS in African countries as alternatives to joining the OECD-led multilateral measures. To address the inadequacy of unilateral measures to combat BEPS, I argue that African countries should design a regional framework to tackle artificial profit shifting by MNCs.

A dominant narrative in the international tax regime is that joining the regime, either in the form of tax treaties or other multilateral instruments, will afford the participants the benefit of accessing the tax information necessary to prevent fiscal evasion. Against this background, Section 6 examines the OECD's exchange of tax information initiatives in its Model tax treaty, Convention on Mutual Administrative Assistance in Tax Matters, Tax Information Exchange Agreement, and the Country-by-Country Reporting Rules, and their implications for African countries. I point out that although exchange of information will benefit African countries, there are constraining factors that limit their ability to collect, supply, use, and benefit from exchanging information under those mechanisms. This section therefore argues for an African-led regional framework for exchange of information.

Given the concern over the negative consequences of tax treaties and related multilateral tax agreements developed by the OECD, this chapter concludes by recommending a cost and benefit analysis of existing tax treaties and other multilateral tax agreements signed by African countries.

2. Implications of Tax Treaties on Double Taxation

One of the primary purposes of tax treaties is to coordinate domestic tax rules in order to eliminate double taxation of international income. The argument in this section is that there is a possibility for coordination of domestic tax rules without the need for tax treaties. Tsilly Dagan, Professor of Tax Law at Oxford University, examines the implications of tax treaties for developing countries and concludes against the view that tax treaties are indispensable for alleviating double taxation of international income.[1] Dagan puts it succinctly: "developing countries stepped into a pre-existing game. At first, tax treaties were presented as a mechanism that would encourage investments into developing countries. If only developing countries would be willing to give up some tax revenues, double taxation would be eliminated, and foreign investments would flow across their borders."[2] The truth is that developing countries do not have to sacrifice tax revenues for the prevention of double taxation because there are unilateral mechanisms that can do the same.

Using the game theory methodology, Dagan examines the effect of the unilateral tax policies of countries.[3] She argues that unilateral tax policies of the residence and host countries will give rise to an equilibrium necessary to prevent double taxation.[4] For the host country that is willing to create a high level of incentive for cross-border investment, she examines the optimal policy that will best serve its political, social, and economic interests if the residence country adopts the credit,

[1] Tsilly Dagan, "The Tax Treaties Myth" (2000) 32 NYUJ Intl L & Pol 939.
[2] *Ibid* at 990-91.
[3] *Supra* note 1 at 947-77.
[4] *Ibid*.

exemption, or deduction mechanisms to prevent double taxation.[5] Under the credit mechanism, the host country will benefit the most by imposing the highest possible tax rate on foreign investment that the residence country is willing to credit.[6] If the residence country exempts the foreign source income of its residents from tax, the best option for the host country is to also exempt the source income of non-residents from tax, since doing otherwise will create a tax wedge – the efficiency loss due to the imposition of taxes.[7] A similar result will be achieved if the residence country uses the deduction mechanism, because deductions do not fully offset the total amount of foreign taxes paid; it only reduces the taxable income by that amount.[8]

Adoption of the credit mechanism by the residence country will benefit African countries the most, because they will be able to impose the highest possible tax rate on non-residents without creating a tax wedge. This opportunity will not exist if the residence country decides to adopt the deduction or exemption mechanisms, since African countries would be better off if they would refrain from taxing foreign investment to eliminate the tax wedge. Developed countries should take the distributive element of international tax into consideration when they design their domestic tax rules.[9] The unilateral policies of residence countries should not frustrate developing countries into giving up tax revenue in a bid to relieve the tax burdens of MNCs. Moreover, taxation of foreign-source income by residence countries does not only affect the gains to source countries but also worldwide efficiency and distortions to international trade. Therefore, developed countries should not implement policies that obstruct global free trade. Ultimately, as discussed in the preceding chapter, most countries adopt the tax credit or exemption mechanisms to resolve conflicts in

[5] *Ibid*.
[6] *Ibid*.
[7] *Ibid*.
[8] *Ibid*.
[9] Allison Christians, "Taxing According to Value Creation" (2018) 90 Tax Notes International.

domestic tax rules. Therefore, unilateral policies will prevent double taxation without the need for tax treaties.

One danger of preferring unilateral mechanisms to bilateral tax treaties is possible conflicts over the categorization of income, which is bound to occur between states if tax treaties are cancelled. Since there would be no rules assigning income to countries, it might be a bit difficult for MNCs to avoid the risk of double taxation if more than one country claims taxing right over their income. For example, two countries could claim source taxing rights over the same stream of income – the first country on the basis of economic activity having occurred in its jurisdiction, and the other country on the basis that transfer of possession of goods sold occurred in its jurisdiction. Alternatively, two countries could claim taxing rights over income earned by a taxpayer – the first on the basis of residence and the second on the basis that economic activity occurred in its jurisdiction (source). The possibility of conflicts over categorization of income will happen less with tax treaties because of the rules defining the taxing rights of countries.[10] This arrangement is, however, at the expense of the taxing rights and revenue of source countries, which are mostly developing countries. Since there are unilateral mechanisms that can achieve the same objective of preventing international double taxation, developing countries ought not to accept any arrangements that delimit their taxing rights.

The next section discusses another reason why capital-importing countries sign tax treaties – to attract Foreign Direct Investment. If it is true that tax treaties lead to increased FDI, perhaps one could argue that the cost of revenue foregone in tax treaties would be mitigated by the benefits of

[10] Double taxation will still happen with tax treaties because it is impossible to include every possible type of income in tax treaty rules. See Article 3(2) of the *Model Tax Convention on Income and on Capital*, (Paris: OECD Publishing, 2017), which states that undefined terms under the Model Treaty should be defined in accordance with the domestic tax laws of the taxing state. This same position is what will apply if unilateral strategies are preferred - States taxing the business income of residents and non-residents based on their domestic tax laws.

increased FDI from the contracting state. Research on the influence of tax treaties on FDI inflows to developing countries, however, show lack of clear impact of tax treaties on FDI. Even if tax treaties lead to increased FDI in African countries, my argument is that there is still the need to analyse the cost of tax treaties vis-à-vis the benefit of FDI attraction.

3. Lack of Clear Impact of Tax Treaties on Foreign Direct Investment (FDI)

Tax treaties are said to increase FDI; help provide certainty and predictability for foreign investors; encourage non-discrimination of nationals of the other contracting state; provide assistance in tax collection; serve as a framework for fostering harmonious international relations; and create a framework within which the tax authorities of contracting states can minimize disputes and resolve them when they arise.[11] A prominent collection of scholars, however, argue that tax treaties either have no effect, or have negative effect on FDI in developing countries.[12] In terms of the advantages that tax treaties confer on non-residents, which include low withholding tax rates, source-restrictive provisions in tax treaties can be considered as tax incentives. More directly, a study conducted by Stefan Van Parys and Sebastian James, officials at the IMF and World Bank Group respectively, show no relationship between tax incentives and FDI in Sub-Saharan Africa.[13] Also, the investor motivation survey by the World Bank highlights the irrelevance of tax incentives to investment in African countries.[14] Jacques Morisset and Nede Pirnia, officials at the Foreign

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[11] Michael Lang and Jeffrey Owens, "The Role of Tax Treaties in Facilitating Development and Protecting the Tax Base" (2014) WU International Taxation Research Paper Series No 2014-03 at 6-7.

[12] Paul L Baker, "An Analysis of Double Taxation Treaties and their Effect on Foreign Direct Investment" (2014) 21:3 International Journal of the Economics of Business 341. Also see B A Blonigen & R B Davies, "Do Bilateral Tax Treaties Promote Foreign Direct Investment" (2002) National Bureau of Economic Research Working Paper No 8834; B A Blonigen & R B Davies, "The Effects of Bilateral Tax Treaties on U.S. FDI Activity" (2004) 11:5 International Tax and Public Finance 601; and P Egger, M Larch, M Pfaffermayer, H Winner, "The Impact of Endogenous Tax Treaties on Foreign Tax Investment: Theory and Evidence" (2006) 39:3 The Canadian Journal of Economics 901.

[13] S Van Parys & S James, "The Effectiveness of Tax Incentives in Attracting Investment: Panel Data Evidence from the CFA Franc zone" (2010) 17 Int Tax Public Finance 400.

[14] Maria R Andersen, Benjamin R Kett & Erik von Uexkull, "Corporate Tax Incentives and FDI in Developing Countries" (2017) World Bank, online: < https://elibrary.worldbank.org/doi/10.1596/978-1-4648-1175-3_ch3>.

Investment Advisory Services at the World Bank argue that tax incentives do not compensate for other important factors that foreign investors consider, such as infrastructure, and political and economic stability.[15] The argument that source-restricting provisions in tax treaties are necessary in order to increase FDI in African countries is untenable in light of the outcomes of these empirical studies. Source-restricting provisions in tax treaties as a means to attract FDI in African countries are nothing but an unnecessary revenue sacrifice.[16] Besides, investment treaties have provisions designed to remove barriers to cross-border trade and investment, so they can be applied to attract FDI.[17] Overall, the presence of abundant natural resources and thriving non-commodities sectors position Africa as a hub for investment.[18] Although some fundamental structures that determine location decisions for foreign investment (political stability, good infrastructure, good tax administration)[19] are still works in progress in most African countries, the right place to begin is by securing tax revenue to put those structures in place to increase Africa's competitiveness.

Céline Azémara and Dhammika Dharmapala, professors at Adam Smith Business School, University of Glasgow, United Kingdom and University of Chicago Law School, United States of America respectively, contradict the empirical studies that tax incentives are not necessary to attract FDI.[20] Azémara and Dharmapala analysed the impact of tax sparing provisions using panel

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[15] Jacques P Morisset & Nede Pirnia, "How Tax Policy and Incentives Affect Foreign Direct Investment: A Review" (1999) World Bank Working Paper No 2509.
[16] Kim Brooks, "Tax Sparing: A Needed Incentive for Foreign Investment in Low-Income Countries or an Unnecessary Revenue Sacrifice?" (2009) 34:2 Queens LJ 505.
[17] Reuven S Avi-Yonah "Double Tax Treaties: An Introduction." in K P Sauvant and L E Sachs, eds, *the Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows*, (United Kingdom: Oxford: Oxford Univ. Press, 2009) 99.
[18] World Bank, "Africa Still Poised to Become the Next Great Investment Destination" (20 June 2015), blog, online: < https://www.worldbank.org/en/news/opinion/2015/06/30/africa-still-poised-to-become-the-next-great-investment-destination>.
[19] Lang & Owens *supra* note 11 at 4.
[20] Céline Azémara & Dhammika Dharmapala, "Tax Sparing Agreements, Territorial Tax Reforms, and Foreign Direct Investment" (2019) 169 Journal of Public Economics 89.

data on bilateral FDI stocks from 23 OECD countries in 113 developing and transition economies over the period 2002–2012.[21] They found that tax sparing agreements are associated with up to 97% higher FDI in developing countries.[22] However, their study does not account for other factors that investors consider when making their investment decisions, such as infrastructure, and political and economic stability. Consequently, their study must have assumed that tax incentives compensate for these other important factors. Second, even if their argument that tax sparing agreements account for up to 97% higher FDI in developing countries is valid, there is still the need for African countries to analyse the cost of those incentives vis-à-vis the benefit of FDI attraction. FDI should not be an end but a means to ensure that African countries really benefit from foreign investment within their borders. A cost-benefit analysis by individual African countries will show if tax sparing agreements are necessary to attract FDI. Tax incentives are distortions to FDI inflows, and the absence of these incentives does not imply a decline of FDI inflows.

Moving on from the false belief that tax treaties are indispensable for the prevention of double taxation of international income and necessary to attract FDI, subsequent sections of this paper discuss other implications of tax treaty provisions and the OECD's effort to reform international tax rules for the prevention of double non-taxation for African countries. Given the gaps in tax treaties and the OECD's failed attempt to foster an inclusive and fundamental restructuring of the international tax regime, the next section examines the role of African countries in the reform of international tax rules by the OECD.

[21] *Ibid*.
[22] *Ibid*.

4. Implications of the OECD BEPS Project for African countries

As discussed in the preceding chapter, in 2012, the G20 leaders requested the OECD to develop solutions to BEPS. In 2013, the OECD released 15 Action Plans to ensure the effective and efficient taxation of MNCs.[23] Agenda setting and the formulation of the action plans in respect to BEPS was by OECD countries.[24] An inclusive framework was later designed to involve interested non-G20 countries and jurisdictions, particularly developing countries, 'on an equal footing' to support the implementation of the recommended changes and setting of future standards relating to BEPS issues.[25] Given this background, two questions come to mind. First, do African countries possess the capacity to effectively influence the BEPS measures to fit their preferences and economic realities? If the answer to this question is in the negative, what are the consequences of not joining the BEPS (pre-determined) agenda for African countries?

A. Lack of Consideration of Specific BEPS Issues in African Countries

The non-inclusion of African countries in the agenda setting for the BEPS project weakens the OECD's claim that the project will help non-OECD countries to tackle BEPS. As Carmel Peters, Policy Manager at the New Zealand Inland Revenue, argues, the fact that BEPS has the potential to affect all countries does not mean that its effect is uniform, or that countries at different stages of development would agree on how best to address the issue.[26] Even the OECD acknowledges

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[23] *Action Plan on Base Erosion and Profit Shifting*, (Paris: OECD Publishing, 2013).
[24] *Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project*, (Paris: OECD, 2015).
[25] OECD, "G20 and Low-Income Developing Countries Framework" (2015), online: < http://www.g20.utoronto.ca/2015/G20-and-Low-Income-Developing-Countries-Framework.pdf>.
[26] Carmel Peters, "Developing Countries' Reactions to the G20/ OECD Action Plan on Base Erosion and Profit Shifting" (2015) Bulletin for International Taxation 375.

that BEPS affects developing countries differently, and that there is the need to include the specificities of the risks faced by developing countries from BEPS in the action plans.[27]

Some of the unique BEPS issues that affect developing countries are: allocation of taxing rights between source and residence countries; base eroding payments by residents for management, consulting, technical services provided by related non-resident companies[28]; wasteful incentives in tax treaties; lack of comparable data for transfer pricing purposes; lack of capacity to assess and prevent BEPS risks.[29] None of these issues, however, gained priority in the BEPS action plans, unsurprisingly. On this issue, Zolt writes, "The BEPS project also did not address two areas of importance to developing countries: the tax treatment of technical services and the right of source countries to tax non-residents' capital gains on the indirect transfers of non-real estate assets".[30] These challenges require a reconstruction of the current international tax regime to suit the realities of developing countries; and the BEPS project does not provide for this. Botswana and Nigeria are part of the BEPS project, but it is not certain that they will benefit from it.

To the substance of the OECD BEPS measures, there are fundamental problems in the international tax regime. The solutions entail a fundamental restructuring of the whole system (which genuinely accommodates the interests of developing states as participants in the international tax regime), not an amendment as the OECD recommends. There are inherent gaps in the rules governing the characterization of income, allocation rules, and principles governing the taxation of related entities. For residence, most countries adopt the control/management rule in defining corporate

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[27] OECD, "Two-Part Report to G20 Developing Working Group on the Impact of BEPS in Low-Income Countries", (2014), online: < http://www.oecd.org/tax/tax-global/report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf>.
[28] *Handbook on Selected Issues in Protecting the Tax Base of Developing Countries*, (New York: United Nations, 2017) at 63.
[29] *Ibid*.
[30] Eric Zolt "Tax Treaties and Developing Countries" (2018) 72 Tax L Rev 5 at 35.

residence. This is, however, easy to avoid. For instance, a corporation may be incorporated in a high tax jurisdiction, but its board meets in a low-tax jurisdiction. The U.S. adopts the incorporation rule. This is also very easy to avoid, since a corporation can be incorporated in a low or no tax jurisdiction but controlled in the U.S. Problems with source rules arise because of lack of rules for some categories of income, given the sophisticated means by which MNCs transact, and source-restricting provisions that prevent source countries from taxing income arising from activities carried out within their jurisdictions. There are challenges in establishing that a business has a permanent establishment in source countries, and how much income can be attributed to the permanent establishment if it does exist. Permanent establishment is even harder to establish for digital multinational corporations with only a web presence. Data traffic in Africa is growing at the rate of 41 percent per year.[31] This signals greater access to digital MNE services on the continent.[32] MNCs exploit these gaps in tax treaties, making it difficult for countries to determine where value is created, especially for the digital economy.

The arm's length principle is the method by which tax authorities determine the taxable income of permanent establishments in source countries. This principle requires tax authorities to compare the prices fixed by associated parties with prices fixed by unrelated parties under similar circumstances. There are challenges with finding comparables due to the economic benefits attached to transactions between independent entities. According to Avi-Yonah, "economists have argued that comparables cannot be found because of the economic circumstances which cause multinationals to form".[33] The consequence of this is double non-taxation, despite specific transfer

[31] *Digital Economy Report 2019: Value Creation and Capture: Implications for Developing Countries* (New York: UNCTAD, 2019) at 11.
[32] Solomon Rukondo, "Addressing the challenges of Taxation of the Digital Economy: Lessons for African Countries" (2020) ICTD Working Paper 105 at 6.
[33] Reuven S Avi-Yonah, *Advanced Introduction to International Tax Law,* Second Edition (United Kingdom: Elgar Publishing, 2019) at 32-33.

pricing guidelines on the application of the arm's length principle.[34] These gaps allow ineffective taxation of MNCs and provide opportunities for stateless income.[35] Amendment of international tax rules cannot resolve these fundamental issues. Joining the BEPS train will not solve all the existing challenges of the international tax regime in African countries; hence, the need for African countries to evaluate their role in the BEPS project, especially given the nature of the issues considered in the project.

B. Legitimacy Concerns

Apart from the OECD's failure to consider specific BEPS issues in African countries in the BEPS project, there are also concerns about the legitimacy of international institutions, like the OECD, reforming tax treaty rules for both developed and developing countries through the BEPS Project.[36] African countries were not involved in the design of the BEPS project. According to a report by the African Tax Administration Forum (ATAF), ATAF was approved as an observer to the Committee on Fiscal Affairs (CFA) (the decision-making body for the OECD's tax work) in 2014, after the agenda and action plans had been determined by the OECD.[37] Though five African countries (Kenya, Morocco, Nigeria, Senegal, and Tunisia) were invited to participate in the BEPS project, they were only invited to play consultative roles.[38] Even for these African countries that were invited to play consultative roles, they had no impact on the BEPS outcomes. They did not

[34] To solve the problem of transfer 'mispricing' by related parties, countries adopt the following methods – comparable uncontrolled price (CUP), cost plus, resale price, comparable profits method (CPM), and transactional net margin method (TNMM).

[35] Edward D Kleinbard, "Stateless Income" (2011) 11 Fla Tax Rev 699.

[36] Irene Burgers & Irma Mosquera, "Corporate Taxation and BEPS: A Fair Slice for Developing Countries?" (2017) 1 Erasmus Law Review 1 at 29-47.

[37] ATAF, "The Place of Africa in the Shift Towards Global Tax Governance: Can the Taxation of the Digitalized Economy be an Opportunity for More Inclusiveness?" (2019), online: < https://www.ataftax.org/ataf-high-level-tax-policy-dialogue-ensuring-africas-place-in-the-taxation-of-the-digital-economy>.

[38] *Ibid*.

actively participate in the design of the action plans because the agenda was predetermined by the OECD members.[39]

The exclusion of African countries from the process of policymaking under the BEPS Agenda leaves much to be desired of the OECD's role in reforming the governance structure of international tax for their benefit. Its role in international taxation governance has been described as international fiscal imperialism.[40] Reflecting on the OECD's agenda, Horner, who worked with the OECD on its tax competition project and transfer pricing guidelines, argues very plainly that the OECD develops the rules, but only in the interest of the developed countries:

> The OECD making development issues a priority? The rich countries club? Perhaps not. The OECD has evolved to become, principally, a policy forum to discuss, agree on, and promote the interests of the rich countries. There is some development work undertaken at the OECD, but it operates within rather fixed boundaries. The OECD likes to claim that it develops the "rules of the game," but unfortunately not all the players are at the table.[41]

Following the marginalization of non-OECD members in the BEPS policy-making process, the G20 leaders gave a new task to the OECD – to develop an inclusive framework to ensure uniform implementation of the BEPS package by non-G20/OECD countries.[42] The BEPS inclusive framework was created by the OECD in 2016.[43] It was designed to develop future norms and monitor the implementation of the BEPS measures.[44] Members of the framework participate as "Associates", and are required to implement the BEPS four minimum standards: Actions 5

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[39] *Ibid*.
[40] S A Rocha, "International Fiscal Imperialism and the "Principle" of the Permanent Establishment", (2014) 68:2 Bulletin for International Taxation 1.
[41] F M Horner, "Do We Need an International Tax Organization?" (2001) Tax Notes International.
[42] OECD, "All Interested Countries and Jurisdictions to be Invited to Join Global Efforts led by the OECD and G20 to Close International Tax Loopholes" (2016), online: < http://www.oecd.org/tax/all-interested-countries-and-jurisdictions-to-be-invited-to-join-global-efforts-led-by-the-oecd-and-g20-to-close-international-tax-loopholes.htm>.
[43] OECD, "International Collaboration to End Tax Avoidance", online: https://www.oecd.org/tax/beps/about/#:~:text=The%20OECD%2FG20%20Inclusive%20Framework,needed%20to%20tackle%20tax%20avoidance.
[44] *Ibid.*

(harmful tax practices), 6 (tax treaty abuse), 13 (Country-by-country Reporting (CbCR)), and 14 (dispute resolution).

The fundamental flaw of the BEPS inclusive framework lies in the requirement to commit to the implementation of the BEPS minimum standards, which were handpicked by developed countries as priority areas for all jurisdictions to implement.[45] Though the OECD noted that BEPS concerns differ for developed and developing countries,[46] the OECD still chose to decide which issues should take priority for all countries. The OECD's role should not come as a surprise to African countries. The OECD is not an international organization in the legal sense and is not committed to fostering the growth of non-members.[47] Although the OECD seeks to address multi-dimensional problems existing globally and issue policy recommendations directed at national governments, its decision-making process is driven by member states. Since African countries are, therefore, not at the table (non-members of the OECD), they cannot complain about the outcomes.

The competence of the OECD in designing policy changes for all countries is questionable. As regards the competence of the OECD in international tax reform, Avi-Yonah argues: "I believe that the UN will be more qualified, impartial, transparent, credible, and influential than the OECD/G20 in rewriting and renovating the international tax rules including the BEPS counter-measures".[48] He cites the following reasons: OECD countries dominated the agenda setting process; the inclusive framework does not include all non-OECD countries; the project does not

[45] See Michael Lennard, Chief of International Tax Cooperation and Trade at the United Nations' argument that the OECD BEPS project was not designed to solve BEPS challenges in developing countries, Michael Lennard, "Base Erosion and Profit Shifting and Developing Country Tax Administrations" (2016) 44:10 Intertax 745.

[46] OECD, "Two-Part Report to G20 Developing Working Group on the Impact of BEPS in Low Income Countries" (2014), online: http://www.oecd.org/tax/tax-global/report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf

[47] One of the OECD's primary objectives is to foster economic and social growth in member countries, see the "OECD: What is it?", online: < https://www.oecd.org/newsroom/34011915.pdf>.

[48] Avi-Yonah, *supra* note 33 at 81.

reflect proposals from developing countries; limited resources will hamper the effective implementation of the action plans in some countries.[49]

Although the OECD is not the best institution to reform international tax rules for the benefit of all countries, the UN is not a better option. The UN's history of silence over salient issues in international tax and its lack of capacity to cause revolutionary changes to the rules has robbed it of the opportunity to be the norm-setter.[50] History shows that the OECD's organization, consistency and capacity has helped its member states to use tax as a tool for development.[51] The UN, on the other hand, lacks the capacity and a clearly defined process to help developing countries to use taxation as a tool to foster sustainable development. Africa must take its destiny into its own hands and step up to the challenge of designing effective and efficient rules for taxing international income.

The limitations of the BEPS agenda informed the argument by various scholars against the legitimacy of the OECD in developing what appears to be multilateral solutions to BEPS.[52] They also argue that the consultations with non-OECD countries do not equate to participative decision-making.[53] Indeed, the argument by scholars against the legitimacy of the OECD is defensible both in theory and in practice. The development of 'global' norms by the OECD for non-OECD members is an arbitrary exercise of power. Also, jettisoning the unique BEPS issues identified by non-OECD members, including African counties during the consultations, further evidences the

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[49] *Ibid*.

[50] Nana Ama Sarfo, "How the OECD Became the World's Tax Leader" (2020) Tax Notes International.

[51] *Ibid*.

[52] Sissie Fung, "The Questionable Legitimacy of the OECD/G20 BEPS Project" (2017) 10:2 Erasmus Law Review 76; C A T Peters, "The Faltering Legitimacy of International Tax Law (2013) Centre for Economic Research; I J Mosquera Valderrama, "Legitimacy and the Making of International Tax Law: The Challenges of Multilateralism" (2015) 7 World Tax Journal 344.

[53] P Essers, "International Tax Justice between Machiavelli and Habermas" (2014) Bulletin for International Taxation 54 at 57.

deliberate attempt by the OECD to ignore the interests of non-members in its effort to reform international tax rules.[54]

African countries should reconsider their stance on joining the BEPS agenda. The uniqueness of BEPS issues in the different countries being affected by it requires a case-by-case analysis, and the development of solutions that reflect the peculiar realities of each country. This factor alone casts doubt on the viability of the BEPS project to deliver solutions to BEPS issues in African countries.

The danger of not joining the OECD BEPS project for African countries is their fear of being blacklisted by OECD countries as being unwilling to join in the reform of international tax rules. Namibia was blacklisted by the EU in 2017 for not joining the OECD BEPS inclusive framework.[55] Namibia was forced to join the inclusive framework and to commit to the implementation of BEPS minimum standards by the end of 2019 due to EU's imposition of defensive measures in both tax and non-tax areas against it.[56] First, blacklisting of non-OECD countries by the OECD is illegitimate. Non-OECD countries have the right to abstain from the endorsement of the BEPS package because they had little or no influence in its development.[57] Moving towards an effective international tax regime that can demand accountability from all countries will entail the creation of an ideal forum that fosters active and inclusive participation by all. Until then, the only option for African countries is to carve a niche for themselves for the design of viable BEPS solutions.

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[54] The OECD organised a regional conference in 2014 for African countries to discuss BEPS issues. The outcome of that meeting was included in the OECD's report to the G20 Development Working Group on the impact of BEPS issues in developing countries, see the ATAF report, *supra* note 37.
[55] ATAF report, *supra* note 37.
[56] *Ibid*.
[57] Fung, *supra* note 52 at 78.

C. Capacity Concerns

The OECD BEPS measures are illegitimate because African states' interests are not reflected in their formulation. As well, Namibia's experience shows the OECD is ready to impose its will on the African states to adopt its BEPS measures. Beyond their illegitimacy, African states are also hampered by concerns that would prevent their effective implementation of BEPS even if they adopt them. These concerns relate to their capacities: they include the cost of attending meetings, peer review process for the minimum standards, and required changes to domestic legislation and tax treaties.

French-speaking African countries that participated in the regional meeting on BEPS for francophone countries have discussed these the need for capacity building and training in implementing the BEPS measures.[58] These concerns must inform serious policy discussions by the African countries, instead of their wasting precious time and resources on what will not deliver effective BEPS solutions for the continent. African countries should devise BEPS solutions that are in tune with their realities. Annett Oguttu, professor of tax law at the University of Pretoria, also analysing the implications of the BEPS project, highlights that African countries must adopt rules suitable to their peculiar realities rather than accept the one-size-fits-all approach that the OECD BEPS project provides.[59]

Though an increasing number of African countries have signed the OECD Multilateral Convention on Mutual Assistance in Tax Matters (the MLI), they are still in dire need of capacity and resources

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[58] Irene Burgers & Irma Mosquera, "Corporate Taxation and BEPS: A Fair Slice for Developing Countries?" (2017) 10 Erasmus Law Review Journal at 32 citing, "OECD, CREDAF, and UNDP hold Regional Meeting of the Inclusive Framework on BEPS for Francophone Countries" (2017), online: <http://www.oecd.org/ctp/oecd-holds-regional-meeting-of-the-inclusive-framework-on-beps-for-francophone-countries.htm>.

[59] Annet Wanyana Oguttu, "Tax Base Erosion and Profit Shifting in Africa – Part 2: A Critique of Some Priority OECD Actions from an African Perspective" (2017) ICTD Working Paper 64.

to effectively implement the OECD BEPS measures.[60] Although the OECD has promised to help developing countries to implement the BEPS action plans, there is no motivation for African countries to implement measures designed to favour only OECD countries. These three factors – lack of consideration of specific BEPS issues in African countries, legitimacy concerns, and capacity concerns – impinge on the potential effectiveness of implementing the OECD BEPS agenda in African countries.

5. Unilateral Mechanisms to Prevent BEPS in African Countries

African countries have unilateral mechanisms that seek to prevent base erosion. These unilateral rules can be used as a basis for creating unified anti-BEPS standards for the continent. For example, Nigeria has domestic tax rules on transfer pricing and thin capitalization rules that seek to limit interest deductions among related parties. An example is the joint provisions of Section 10(b) of Nigeria's Finance Act[61], which amends section 24(a) of Nigeria's Companies Income Tax Act[62] (CITA) (the expense deductibility section); and the Seventh Schedule of CITA[63], which limits the percentage of the income of a permanent establishment of a foreign company in Nigeria that is deductible as an expense on loan servicing while computing the company's taxable income.[64] The limit is 30% of earnings before interest, taxes, depreciation, and amortization.[65] Any amount that

[60] Annet Wanyana Oguttu, "Should Developing Countries Sign the OECD Multilateral Instrument to Address Treaty Related Base Erosion and Profit Shifting Measures?" (2018) Centre for Global Development Policy Paper 132.
[61] *Finance Act (Nigeria)* 2019, s 10(b).
[62] *Companies Income Tax Act (Nigeria)*, 2004, s 24.
[63] Seventh Schedule, *Companies Income Tax Act* (Nigeria) *ibid*.
[64] *Ibid*.
[65] *Ibid*.

exceeds the 30% threshold will not be deductible by the Nigerian company.[66] Similar provisions regarding payments for transfer of rights in an intangible exist in the transfer pricing regulations.[67]

In addition, section 27 of CITA, as amended by Section 11 of the Finance Act, disallows certain deductions for the purpose of ascertaining the profits of any company. Listed disallowable expenses include any expense whatsoever incurred within or outside Nigeria involving related parties as defined under the Transfer Pricing Regulations, except to the extent that it is inconsistent with the Transfer Pricing Regulations; expense incurred in deriving tax exempt income, and losses of a capital nature; any expense allowable as a deduction under the Capital Gains Tax Act; and any compensating payment made by a borrower, which qualifies as dividends under Section 9(1)(c) of this Act, to its approved agent or to a lender in a "Regulated Securities Exchange Transaction".[68]

African countries can rely on domestic rules on thin capitalization and transfer pricing to prevent artificial deductions among related entities without the need for tax treaties. Although there are fundamental issues with the arm's length principle, the argument here is that a collective design of BEPS measures by African countries is a better option to start crafting viable solutions to BEPS for African countries, than joining a predetermined agenda created by the OECD. Though a multilateral approach is necessary to defeat BEPS, I argue against the claim that the OECD can deliver effective BEPS solutions for African countries. To address the inadequacy of unilateral

[66] *Ibid*.
[67] *Federal Inland Revenue Service, Transfer Pricing Regulations, (Nigeria), 2018,* Reg. 7(5), which provides as follows: "Notwithstanding any other provision of this Regulations, where a person engages in any transaction with a related person that involves the transfer of rights in an intangible, other than the alienation of an intangible, the consideration payable in that transaction that is allowable for deduction for tax purposes shall not exceed 5% of the earnings before interest, tax, depreciation, amortization, and that consideration, derived from the commercial activity conducted by the person in which the rights transferred are exploited.
[68] Section 27(1) of Companies Income Tax, Nigeria *supra* note 62; Section 11 of Finance Act, Nigeria *supra* note 61.

measures to combat BEPS, African countries should design a regional framework to tackle artificial profit shifting by MNCs. The regional framework should contain provisions that address the base erosion and profit shifting concerns of African countries.

To further illustrate how the OECD-led international tax regime fails to take cognisance of the specificities of the unique capacity constraints of African countries, the next section examines the exchange of tax information initiatives by the OECD and their implications for African countries. The argument in the next section is that although exchange of information will benefit African countries, there are constraining factors that limit their ability to collect, supply, use, and benefit from exchange of information initiatives launched by the OECD. I recommend an African-led regional framework for exchange of information.

6. The OECD's Exchange of Tax Information Initiatives: Implications for African countries

There has been an increased attention to transparency and disclosure in recent years as one of the ways to prevent BEPS. There is consensus that international cooperation is necessary to obtain information about the activities of MNCs. International cooperation is necessary to deter, detect, and disrupt international tax evasion and avoidance.[69] Exchange of information is necessary to foster international cooperation, and different frameworks have been developed to achieve this objective. This section reviews the non-comprehensive-tax-treaty instruments that support exchange of information and then discusses some of the challenges and opportunities of those information exchange tools for African countries. I argue that by not deploying those tools, African

[69] OECD, "Global Forum on Transparency and Exchange of Information for Tax Purposes", online: <https://www.oecd.org/tax/beps/tax-transparency/>.

countries would place themselves in the position to more effectively deal with their BEPS concerns individually and by cooperation among themselves.

A) The OECD Convention on Mutual Administrative Assistance in Tax Matters

The OECD's work on international cooperation to prevent fiscal evasion and avoidance began in 1971 with the establishment of the OECD working party on tax avoidance and evasion.[70] The Convention on Mutual Administrative Assistance in Tax Matters was developed by the Council of Europe and OECD in 1988.[71] The Convention came into force in 1995 and was amended in 2010 in accordance with the OECD's international standard on exchange of information on request.[72] The Convention provides a standardised and efficient mechanism to facilitate the automatic exchange of information on a multilateral basis. It asks parties to exchange any information that is foreseeably relevant for the administration or enforcement of domestic laws concerning the taxes covered by the Convention. It extends coverage to non-members of the Council of Europe and OECD; includes other forms of administrative assistance which the Parties may provide to each other, namely: simultaneous tax examinations and tax examinations abroad, assistance in recovery, including measures of conservancy and service of documents. To date, 136 countries are parties to the Convention on Mutual Administrative Assistance in Tax Matters.[73] Fourteen African countries have also signed it.[74]

The new global model of automatic exchange of information (Automatic Exchange of Financial Account Information Standard (the AEOI Standard)) was developed by the OECD in 2013 to

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[70] *Ibid*.
[71] *Ibid*.
[72] *Ibid*.
[73] *Ibid*.
[74] Benin, Burkina Faso, Cameroon, Gabon, Ghana, Kenya, Liberia, Morocco, Nigeria, Senegal, South Africa, Togo, Tunisia, and Uganda, see OECD, "Jurisdictions Participating in the Convention on Mutual Administrative Assistance in Tax Matters" , online: < https://www.oecd.org/tax/exchange-of-tax-information/Status_of_convention.pdf>.

ensure greater tax transparency and to complement the exchange of information upon request under the multilateral convention.[75]

B) The OECD Model Tax Information Exchange Agreement

The AEOI standard was published in the OECD Model Tax Information Exchange Agreement (TIEA) in 2002.[76] The objective of the TIEA is to provide for exchange of information that is foreseeably relevant to the administration and enforcement of the domestic laws of the Contracting Parties concerning taxes covered by the Agreement. The Model contains specific provisions on exchange of information between countries where there are no double tax treaties in place. Article 5 of the Model TIEA provides for exchange of information upon request. A model protocol was approved in 2015 to extend the scope of existing TIEAs to also cover automatic and/or spontaneous (discretionary) exchange of information. TIEAs seek to break bank secrecy laws and reveal questionable cross-border transactions. Countries can enter into bilateral competent authority agreements under existing TIEAs to implement exchange of information in accordance with the common reporting standard. Thirteen bilateral TIEAs have been signed with African countries.[77]

C) Article 26 of the OECD Model Tax Convention

Article 26 of the OECD Model Tax Convention also provides for exchange of tax information upon request.[78] Exchange of information under the OECD Model Tax Convention is not limited to taxpayer-specific information. It includes exchange of other sensitive information related to tax administration and compliance improvement, such as risk analysis techniques, or tax avoidance or

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[75] *Ibid.* The Global Forum on Transparency and Exchange of Information for Tax Purposes has a peer review set up to carry out an in-depth monitoring and peer review of the implementation of the OECD's standards of transparency and exchange of information for tax purposes.

[76] OECD, "Tax Information Exchange Agreements (TIEAs)", online: < https://www.oecd.org/ctp/exchange-of-tax-information/taxinformationexchangeagreementstieas.htm>.

[77] *Ibid*.

[78] Article 26 of the OECD Model Tax Convention, *supra* note 10.

evasion schemes. Bilateral competent authority agreements can be negotiated for information exchange between parties upon request, automatically, or spontaneously.[79] This provision is replicated in the tax treaties signed by African countries.

D) The OECD Country-by-Country Reporting Rules

A key tactical concern identified in the BEPS project is lack of sufficient information about the value creation process of MNC entities without which it is difficult for tax administrators to neutralize mismatch arrangements by MNCs. Although there are provisions on mutual exchange of information and tax enforcement in tax treaties, they are hard to enforce.[80] The BEPS initiative seeks to overcome the challenge of double non-taxation by creating a mechanism for information exchange on the global allocation of the income of MNCs, their economic activities and taxes paid among countries according to a common template – CbCR.[81] CbCR seeks to give tax administrations a better understanding of the global allocation of income, profit, taxes paid and economic activity among tax jurisdictions in which an MNC operates. The CbCR package consists of a model legislation to require the ultimate parent entity of an MNE group to file the CbC Report in its jurisdiction of residence; 3 model competent authority agreements that countries can use to facilitate implementation of the exchange of CbC reports under the multilateral convention developed by the OECD, bilateral tax conventions, and tax information exchange agreements (TIEAs). CbCR is one of the minimum standards implemented under the OECD BEPS inclusive framework.[82]

[79] See Commentary on Article 26 of the OECD Model Tax Convention, *supra* note 10.
[80] Dagan, *supra* note 1 at 42-43.
[81] OECD, *Action Plan on Base Erosion and Profit Shifting supra* note 23 at 23.
[82] OECD, *Action 13 Country-by-Country Reporting,* online: < https://www.oecd.org/tax/beps/beps-actions/action13/>.

E) Implications of the OECD's Exchange of Tax Information Measures for African Countries

Exchange of information is important to prevent fiscal avoidance, aggressive tax planning, and base erosion and profit shifting from African countries to tax havens. The challenges that come with global trade make it difficult to access information about international transactions of taxpayers without information exchange agreements. Exchange of information is important for African countries to generate additional tax revenue, but there are constraining factors that may limit their ability to collect, supply, use, and benefit from exchanges under the existing mechanisms. There are certain obligations for states under the exchange of information initiatives. First, interested states must review their domestic law and make necessary changes to facilitate the exchanges. Second, states must commit to automatic exchange of information.[83]

Some authors disprove the claim by the OECD that exchange of information will benefit all parties.[84] They argue that though exchange of information is beneficial to developing countries, capacity limitations that constrain their ability to participate and implement the disclosure mechanisms may limit reciprocity between developed and developing countries.[85] For example, exchange of information under the Multilateral Competent Authority Agreement (MCAA) pursuant to the OECD Convention on Mutual Administrative Assistance in Tax Matters is not automatic, even after signing the agreement. A signatory will have to enter into a bilateral

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[83] See the European Commission, "Proposal for a Council Directive Amending Directive 2011/16/EU as regards Mandatory Automatic Exchange of Information in the Field of Taxation", online: <http://eur-lex.europa.eu/resource.html>; See also the automatic reporting obligations under the FATCA, IRS, online: < https://www.irs.gov/businesses/corporations/frequently-asked-questions-faqs-fatca-compliance-legal>. There are other regional and industry-specific agreements on exchange of information, See Ring, "Developing Countries in an Age of Transparency and Disclosure" (2016) Brigham Young University Law Review 1784.

[84] Ring *ibid*; Vokhid Urinov, "Developing Country Perspectives on Automatic Exchange of Tax Information" (2015) 1 Law, Social Justice & Global Development Journal, Warwick School of Law Research Paper; Kerrie Sadiq & A Sawyer, "Developing countries and the Automatic Exchange of Information Standard - A "One-Size-Fits-All" Solution?" (2016) 31:1 Australian Tax Forum 99.

[85] *Ibid*.

agreement with another signatory after both countries have met the preconditions for exchange of information (enactment of domestic legislation and administrative resources on data confidentiality and proper use of exchanged information).

Also, the MCAA allows a country to choose the states among the signatories with which it intends to exchange information.[86] The opportunity for discretion regarding which country to choose to exchange information with among signatories, the need for bilateral agreements, and the preconditions for exchange of information might mean that African countries will be unable to have meaningful agreements with suitable countries.

There are also cost and time implications in respect of the bilateral agreements that African countries must sign and the resources to put in place to implement the agreements. African countries that cannot meet the domestic legislation obligation regarding confidentiality and data protection, as well as the administrative burden of collecting, organizing and sharing information will ultimately be excluded from the exchange process because the required capacity building is beyond their reach.[87] These are great implications that should be considered in assessing the usefulness of tax information agreements that seek to prevent double non-taxation through exchange of tax information in African countries.

As seen above, tax treaties are just one of the methods for exchange of tax information. It is, therefore, clear that African countries can initiate exchange of tax information without tax treaties. Though the OECD has developed alternative mechanisms for exchange of tax information, they contain fundamental gaps that cast doubt on their benefits for African countries. An analysis of

[86] Section 7(1)(f) of the OECD *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*, online: https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm.
[87] Ring, *supra* note 83 at 1828.

how the agreements work in practice will determine their efficacy. It is important to consider the fact that African countries will have an increased burden to supply information to developed countries since they are mostly capital importing countries. To that end, it will be necessary to assess the benefit of the existing framework to African countries.

Resource, capacity (human, information, and data handling infrastructure), legal and administrative infrastructure, political will also pose great challenges. Capacity issues under tax treaties, multilateral competent authority agreements also exist under TIEAs. They are also stand-alone agreements that require funding, time, and necessary infrastructure to negotiate and implement. In addition, there is no empirical data showing that TIEAs will help mobilize revenue from MNCs in African countries.[88] The IMF, however, advocates that a combination of domestic law and tax information exchange agreement may be a more appropriate alternative to tax treaties for capital importing countries.[89] Diane Ring, Professor of Law at Boston University, agrees with the IMF's position because these types of agreements will not lead to source-restricting provisions that exist in tax treaties. However, she noted that developing countries do not have universal TIEAs. She further noted that even if such universal TIEAs exist, there is a possibility that they may contain built-in assumptions and may fail to reflect the best interests of developing countries.[90]

It is not just about signing alternative agreements to replace tax treaties. African countries must evaluate how they got to where they are and assess if TIEAs or any such instruments will benefit them. A TIEA model can be designed to suit the realities and current capacities of African

[88] Benedict Clements et al, *International Corporate Tax Spillovers and Redistributive Policies in Developing Countries* (Washington: IMF, 2015) 177.
[89] IMF, "Spillovers in International Corporate Taxation" (2014) IMF Policy Paper 1 at 27.
[90] Ring, *supra* note 83 at 1799-1802.

countries, but each country is expected to evaluate its situation and design solutions in line with its realities. There must be cost-benefit analysis of joining any of the existing frameworks. The greater obstacle that African countries must overcome is willingness and ability to invest in necessary infrastructure, and capacity to evaluate the costs and benefits of implementing information exchange requirements.[91] These are unique challenges that must be dealt with before African countries can fully enjoy the benefit of international cooperation through exchange of information.

The Report by the OECD on the relevance of information exchange agreements in African countries reveals some challenges that limit the potential of exchange of information in African countries. These challenges include setting up an exchange of information unit, technical assistance for implementation of standards, training for auditors, confidentiality and data safeguards framework.[92] The Report by the OECD on the impact of exchange of tax information agreements in Africa reveals that African countries are net receivers of requests and are yet to maximize their potential of EOI.[93] The African Tax Administration Forum (ATAF) launched a practical guide on exchange of information to assist ATAF members to improve the effective use of exchange of information – the Agreement on Mutual Assistance in Tax Matters (AMATM). The Agreement has been signed by nine African countries.[94] It is aimed at increasing the participation of African countries in the OECD's exchange of tax information initiatives. This is a misstep. A useful framework for exchange of tax information for African countries must be free

[91] OECD, "The Global Forum's Plan of Action for Developing Countries Participation in AEOI", online: < https://www.oecd.org/tax/transparency/plan-of-action-AEOI-and-developing-countries.pdf>.

[92] OECD, "Tax Transparency in Africa 2020: Africa Initiative Progress Report 2019" online: https://www.oecd.org/tax/transparency/documents/Tax-Transparency-in-Africa-2020.pdf at 61-66.

[93] *Ibid* at 34.

[94] ATAF, "Capacity Building on Tax Treaty Administration", online: <https://www.un.org/esa/ffd//wp-content/uploads/2014/10/20130128_Presentation_Storbeck.pdf>.

of external influence and reflect the concerns and capacities of African countries. Some authors suggest that developed countries should extend help to developing countries for capacity building not just at the initial phase (to ensure participation), but continued capacity building to ensure their continuing participation, and to enhance their ability to use the information they obtain in a meaningful way.[95]

There are several capacity building efforts by developed countries for their developing counterparts to strengthen tax systems and boost tax collection, but none is yet to deliver significant results. They include the OECD's Tax Inspectors Without Borders[96]; United Nations' Capacity Development Programme on International Tax Cooperation[97]; Platform for Collaboration on Tax (a joint initiative between the OECD, UN, IMF, and World Bank)[98]; and Africa Initiative.[99] These initiatives tend to focus on transfer of expertise and pay little or no attention to local context. They tend to apply 'best practices' to each country rather than a pragmatic approach grounded in the peculiar realities of recipient countries. Most capacity building efforts also do not focus on long-term structural reforms that can generate the fundamental changes that are needed in most African countries.[100] Capacity building initiatives should be assessed to ensure that they produce the effective changes necessary to stem the tide of fiscal evasion and aggressive tax planning in Africa.

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[95] Ring, *supra* note 83 at 1830.
[96] OECD, "Tax Inspectors Without Borders", online: <http://www.oecd.org/tax/taxinspectors.htm>.
[97] United Nations, "United Nations Capacity Development Programme on International Tax Cooperation: Progress Report", online: https://www.un.org/esa/ffd/wp-content/uploads/2014/08/2013_2CD_Newsletter.pdf.
[98] See IMF Managing Director, Christine Lagarde's observation that the platform will "not produce miracles." in Stephanie Soong Johnston, "International Organizations to Reveal Tax Cooperation Platform" (2016) Worldwide Tax Daily.
[99] OECD, "Africa Initiative", online: < http://www.oecd.org/tax/transparency/what-we-do/technical-assistance/africa-initiative.htm>.
[100] World Bank, *Capacity Building in Africa: An OECD Evaluation of World Bank Support* (Washington DC: World Bank, 2005).

Assessment of information exchange agreements will be beneficial for African countries not just based on capacity building initiatives by developed countries, but also based on the usefulness of the information exchange agreements. Existing information exchange initiatives were launched by OECD countries, and this important factor determines how much benefit African countries can derive from these agreements. Developed countries have played the dominant role not only in setting the agenda, but also in designing the specifics of the various mechanisms. On this point, Vokhid Urinov, professor of Law at the University of New Brunswick, argues even the information exchange scheme excludes developing countries' participation:

> [T]he initiative on automatic exchange of information [is] intended to establish a platform for regular flow of information mainly between tax havens and some developed countries. It, by and large, ignores the developing countries' participation in the new regime. In fact, some strict requirements of the standard would prevent most developing countries from joining the regime anytime soon.[101]

The transparency initiatives were set by developed countries. Developing countries were subsequently invited to participate. This is seen in the most recent initiative on information exchange – CbCR. CbCR has the following benefits: provides access to uniform information directly from multinationals; provides an opportunity to improve domestic tax rules on transparency; useful information might produce improved capacity to enforce tax rules.[102] Commitment to CbCR might, however, mean increased devotion of resources to multinational taxation which might reduce resources for domestic enforcement. African countries might not be able to use the information obtained in a meaningful way (capacity issues).[103] The CbCR framework has a high threshold. It does not reflect the revenue of MNCs operating in Africa.[104]

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[101] Urinov, *supra* note 84 at 3–4, 9.
[102] Ring, *supra* note 83 at 1814.
[103] *Ibid*.
[104] See for instance the "Joint Statement of The Commissioners General and Heads of Delegation of South Africa, Botswana, Lesotho, Mozambique, Namibia, Swaziland And Zambia" (2015), online: <https://www.iitf.net/joint-

Also, lack of capacity to process and use exchanged information is another unique challenge arising from joining international agreements on exchange of information. In addition, jurisdictions that African countries might want to obtain information from, such as tax havens, may not have joined as signatories to these initiatives, or if they joined, they may rely on techniques to avoid exchanging information with participating jurisdictions.

Overall, there are challenges associated with joining and implementing existing information exchange initiatives.[105] An effective mechanism for exchange of information that would benefit African countries must be one that is designed to align with their reality. My argument is that African countries are in the best position to design an information exchange agreement that serves this purpose. Previous initiatives on the global front have been at the instance of the developed countries, and they are unsuitable to the needs of African countries. To make it uniform, it is recommended that African countries should come together to publish a draft model containing details on practicable ways to secure the necessary infrastructure that will aid the collection, supply, and use of exchanged information.

7. Conclusion

Taxation of MNCs is important to increase corporate income tax revenues in African countries. Gaps in international tax rules, however, inhibit effective taxation of the increased revenues of MNCs. The OECD BEPS Project seeks to close gaps in international tax rules to ensure that profits are taxed where economic activities generating the profits are performed, and where value is

statement-of-the-commissioners-general-and-heads-of-delegation-of-south-africa-botswana-lesotho-mozambique-namibia-swaziland-and-zambia-tshwane-south-africa-16-july-2015/ that the 750 million euros threshold in the CBCR framework was too high for their region. "[T]he [Euro] threshold for CbCR may be too high for multinational enterprises headquartered in the sub-region. We agree to explore the possibility of a lower threshold for these enterprises in our subregion".

[105] Ring, *supra* note 83 at 1824.

created. ATAF's regional consultation highlights specific challenges faced by African countries if the BEPS project would yield positive results in those countries. Also, African leaders have noted the need to contribute to the design and application of the BEPS project. The OECD, however, failed to include African countries in its agenda setting process. As well, it did not take the peculiar challenges that African countries face into consideration in its BEPS outputs. The BEPS project is a replication of a cycle of exclusion in international tax policymaking.[106] African countries must, therefore, prioritize their interests and produce rules that are in tune with their realities.

Some authors suggest that the only way developing countries can refuse to sign tax treaties is if they act as a group, or if that is impossible, they should, at least, create their own treaty network in order to become attractive for foreign investment.[107] A model African tax convention exists, but its provisions are not significantly different from the OECD and UN Models.[108] The appropriate place to begin is when each African country evaluates its tax treaty networks and identifies its needs and interests that the tax treaties it concludes must accommodate. Given this, a model can then be created (if necessary) based on the aggregate analysis done by individual countries.

Victor Thuronyi, who worked on tax reforms in numerous countries at the IMF, posits a three-pronged approach to determine whether a tax treaty should be negotiated by developing countries: (1). are there problems of double taxation in relation to the potential treaty partner; (2) is there a substantial concern for trade, investment and other transactions; and (3) are the costs for

[106] Allison Christians, "What Should a 'New Deal' on International Tax Look Like for Developing Countries?" ICTD Blogpost, (May 28, 2020), online: < https://www.ictd.ac/blog-author/allison-christians/>.
[107] Eduardo A Baistrocchi, "The Use and Interpretation of Tax Treaties in the Emerging World: Theory and Implications" (2008) 4 Brit Tax Rev 352.
[108] See the *ATAF Model Tax Agreement*, online: < https://irp-cdn.multiscreensite.com/a521d626/files/uploaded/ATAF Model Tax Agreement_Highres.pdf>.

negotiating a treaty justified.[109] If Thuronyi's approach is used to evaluate the tax treaty networks of African countries, the answer will be that unilateral rules can solve the problem of double taxation, bilateral investment treaties can prevent hindrances to cross-border trade, and, overall, the costs of negotiating tax treaties far outweigh their benefits.

Chapters 4 - 6 of this thesis examine the specifics of this argument. They discuss source-restricting provisions of tax treaties signed by three African countries (Nigeria, Tanzania, and Botswana). Together, the chapters demonstrate that the tax treaties signed by the comparator countries result in the loss of considerable revenue that is otherwise needed for socio-economic development in these states.

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[109] Victor Thuronyi, "Tax Treaties and Developing Countries," in Michael Lang et al, eds, *Tax Treaties: Building Bridges between Law and Economics* (Amsterdam: IBFD, 2010) 441 at 444.

Chapter IV - Tax Treaty Provisions on Source Taxation of Business Profits in Nigeria, Tanzania, And Botswana: An Analysis

1. Introduction

The optimal functioning of governments requires public finance sustainability. One of the ways to foster sustainable public finance in African countries is through the effective implementation of international tax policies that capture in the tax net, profits from business activities carried on by non-residents. The taxation of business income of non-residents is important to African countries for raising revenue and making the tax system fairer and more progressive. Although tax treaties preserve the taxing rights of the source (host) country over business income arising within its jurisdiction, there are provisions that limit the power of the source country as to maximizing the potential of business profits for tax revenue.

The threshold for source taxation of business profits of non-resident taxpayers is the existence of a permanent establishment (PE) through which the business of the non-resident taxpayer is carried on.[1] Tax treaties define PE as "a fixed place of business" and lists activities that constitute a PE.[2] In the absence of a PE in the source country, tax treaties give exclusive taxing rights to the residence state. The higher the PE threshold in a tax treaty, the more restrictive source taxing rights over business income. In addition to the PE threshold, tax treaties contain rules for determining the profits of a PE.[3] The broader the allowable deductions and the narrower the base of PE taxation generally, the less the taxable income in the source state. The implication of the PE threshold and

[1] Jinyan Li, "Taxation of Non-residents on Business Profits" (2013) United Nations International Trade Centre Paper No 5-A.
[2] Article 5(1) of the *Model Tax Convention on Income and Capital: Condensed Version 2017* (Paris: OECD Publishing, 2017), and Article 5(1) of the *Model Double Taxation Convention between Developed and Developing Countries* (New York: United Nations, 2017).
[3] Article 7(3) of the OECD and UN Model Treaties, *ibid*.

rules for determining the profits of a PE is that business profits arising from significant economic activities carried out in source countries may escape being taxed there.

Apart from the revenue implications, source-restrictive allocation rules over business income also violate the inter-nation equity and inter-individual equity principles. The equitable distribution of tax ensures that countries are able to claim tax revenue in proportion to the budgetary services and intermediate goods which they provide to foreign investment.[4] The inability of source countries to share in the gains of foreign-owned factors of production operating within their borders is, therefore, an infraction of the inter-nation equity principle.[5] The principle of "inter-individual equity" also suggests that individuals who also benefit from government, including non-residents, should contribute to the host country's cost of governance.[6] The non-taxation of business profits of non-residents, therefore, creates inequality between taxpayers.

Consistent with the inter-nation equity principle, tax treaty provisions should preserve the taxing rights of African countries over income derived by non-residents from activities carried out in their jurisdictions. Also, domestic tax policies in African countries should advance inter-individual equity through income tax imposed on non-residents relative to the benefit derived by those non-residents from African states. The synergistic relationship between tax treaty provisions that advance inter-nation equity, and domestic tax laws and policies that enhance inter-individual

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[4] Peggy B Richman, *Taxation of Foreign Investment Income: An Economic Analysis* (Baltimore: John Hopkins Press, 1963) at 15.

[5] Peggy Musgrave, "Combining Fiscal Sovereignty and Coordination: National Taxation in a Globalizing World," in Inge Kaul and Pedro Conceicao, eds, *The New Public Finance Responding to Global Challenges* (United Kingdom: Oxford University Press, 2006) 167 at 192.

[6] Nancy Kaufman, "Fairness and the Taxation of International Income" (1997-1998) 29:2 Law & Pol'y Int'l Bus 145 at 153. Kaufman challenges the traditional thinking equating inter-individual equity (which is based on a country's decision on distribution of tax burden among taxpayers, involving questions of economic justice among individuals – purely a domestic issue) with inter-nation equity (equitable international distribution of tax base among countries, involving questions of economic justice among nations – purely an international issue).

equity, is what this thesis argues for as an essential basis for the implementation of sustainable development projects in the comparator countries.

This chapter analyses and compares the restrictive source taxation rights over business profits in Articles 5 and 7 of the tax treaties signed by Nigeria, Tanzania, and Botswana. These countries could raise more tax revenue to support their socio-economic development if they truly reckon with the consequences of the provisions that limit tax revenue from business profits derived by non-resident enterprises, and also responsively design concrete international tax policies based on the lessons from the analysis. A concrete international tax policy that would benefit Nigeria, Tanzania, and Botswana should be one that emphasizes the inequity of the uneven income flows between them and the negotiating countries, and therefore, highlights their need to insist on expansive source taxation rights over business profits of non-residents. Regarding signatory countries with lesser or even income flow, the argument is the same, namely, the need to prevent opportunities for treaty abuse by MNCs.

To provide some context for these conclusions, section 2 offers an overview of the development of the rules for source taxation of business profits of non-residents. I examine the development of the permanent establishment (PE) concept in the 1869 Prussia–Saxony tax treaty, and the retention of the PE concept in the League of Nations' 1928 Draft Model Bilateral Convention[7] as a limitation on source taxation. Section 3 examines the PE concept in the first OECD Model Tax Convention, which was adopted in 1963[8], as well as subsequent models. While the OECD Model[9], following the previous Models crafted by the League of Nations, greatly limits the scope of activities that

[7] League of Nations, *General Meeting of Government Experts on Double Taxation and Tax Evasion*, 1928, Doc II 49.
[8] *Draft Double Taxation Convention on Income and Capital* (Paris: OECD, 1963).
[9] OECD Model, *supra* note 2.

would constitute a PE, the UN Model[10] broadens the scope of activities that will be deemed sufficient to constitute a PE. I also discuss the reforms by the OECD to the PE concept in the BEPS Project which leaves out the distributional consequences of the concept for source countries. Section 4 explores the expansion of the PE concept under the UN Model as well as the extended circumstances under which profits associated with a PE will be subject to tax in the source country. The analysis of the provisions on source taxation of business profits in the OECD and UN Models guide the analysis of the provisions in the tax treaties signed by Nigeria, Tanzania, and Botswana in sections 5, 6, and 7. The analysis shows that some of the provisions in the tax treaties fall short of the source-expanding provisions in the UN Model, which has greater source taxing rights.

Though this chapter uses the UN Model as the criteria against which to assess the treaty provisions of the comparator countries, it still queries the suitability of the provisions of both the OECD and the UN Model on taxation of business profits for the comparator countries in terms of their potential to enhance tax revenue generation from taxation of non-residents' business income. This chapter concludes by recommending the reform of source-restricting provisions for taxation of business profits in the tax treaties as one of the effective ways to improve upon domestic resource mobilization for socio-economic development.

2. The Development of the PE Concept

Generally, the objectives of most tax treaties, as expressed in their preambles, are to prevent double taxation and double non-taxation. Most tax treaty provisions achieve the avoidance of double taxation by limiting the rights of the source state to tax and preserve residual taxing rights for the state of residence. Only occasionally will a tax treaty allocate the taxing rights entirely to one

[10] UN Model, *supra* note 2.

state.[11] However, the rules restrict source taxation of business income through the PE concept.[12] The implication of the PE concept is that the source state is only able to tax business income once the level of activity in the country reaches a relatively substantial level ("permanent establishment"). This is an infraction of inter-nation equity, which presupposes that source countries are entitled to tax income arising within their borders, including that accruing to foreign investors.[13]

The PE requirement is a basic principle in international taxation and it seeks to ensure that activities which do not possess significant basis of operation in the source country are excluded from source taxation on the basis of convenience.[14] Surrey aptly captures the essence of the PE concept as follows: "[t]he basic premise is one of convenience, in that some presence should exist before a foreigner is put to the task of filing returns and computing and paying a tax at source".[15] The PE concept fulfills this notion of convenience by allowing source taxation of business profits of non-resident enterprises only if there is a substantial economic interest or engagement in the source state.[16] The real challenge, however, is that with the PE threshold as defined in the OECD and UN model tax treaties as well as in bilateral tax treaties, the source state's right to tax significant economic business activity carried out in its jurisdiction is whittled away to achieve either

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[11] Lorraine Eden, "Equity and Neutrality in the International Taxation of Capital" (1988) 26.2 Osgoode Hall Law Journal 367.
[12] *Ibid*.
[13] Jinyan Li, "Improving Inter-nation Equity through Territorial Taxation and Tax Sparing" in Arthur J. Cockfield, ed, *Globalization and its Tax Discontents: Tax Policy and International Investments* (Toronto: University of Toronto Press, 2010); Oladiwura Eyitayo-Oyesode, "Source-Based Taxing Rights from the OECD to the UN Model Conventions: Unavailing Efforts and an Argument for Reform" (2020) 13:1 Law and Development Review 193-227.
[14] Stanley S Surrey, "United Nations Group of Experts and the Guidelines for Tax Treaties Between Developed and Developing Countries" (1978) 19:1 Harvard International Law Journal 12.
[15] *Ibid*.
[16] Leonardo F M Castro, "Problems Involving Permanent Establishments: Overview of Relevant Issues in Today's International Economy" (2012) 2:3 Global Bus L Rev 125 at 129.

administrative or political objectives. The PE threshold is not suitable for source states, not just because of its high threshold for engaging source state taxation right, but because its use as a basis for allowing the source state to tax business income earned by non-residents deprives the source state of a substantial portion of the revenue it could gain. In the absence of the PE provision, such economic activities by non-residents would be taxed under the domestic laws of the source state in a way that ensures inter-individual equity.

The PE concept can be traced to the 1869 Prussia–Saxony tax treaty, where it was used as a limitation on source-state taxation.[17] The source state could only tax the business income of non-residents where two conditions were fulfilled: the presence of a fixed location in the source state; and the intention of the enterprise to continue performing business activities at that location.[18] The 1925 Report of the Technical Experts on Double Taxation and Tax Evasion to the League of Nations affirms the requirement of a fixed location for source taxation of business income arising from activities carried out by residents of the other contracting state.[19] The Report grants source taxing rights over impersonal or schedular taxes, which are income from immovable property (land/buildings); agricultural undertakings; and industrial and commercial establishments.[20] Although the report allows source taxation of income from activities carried out in the source state, the report further clarifies that the source state is entitled to impose impersonal/schedular taxes on a non-resident enterprise only if the enterprise has a branch, an agency, an establishment, a stable commercial or industrial organisation, or a permanent representative in the source state.[21]

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[17] Benjamin Walker, *The evolution of the Agency Permanent Establishment Concept* (2018) [unpublished, archived at the University of New South Wales].
[18] *Ibid*.
[19] League of Nations, *Double Taxation and Tax Evasion Report and Resolutions submitted by the Technical Experts to the Financial Committee, 1925,* Doc F 212.
[20] *Ibid*.
[21] *Ibid*.

The experts justified the strict limitation of source taxation on the basis that it was the best way to avoid double taxation that would otherwise hinder international trade.[22] Article 5 of the Draft Bilateral Convention included in the 1927 Report by the Technical Experts on Double Taxation and Tax Evasion to the League of Nations also recommends source taxation of business income of non-resident enterprises only when the enterprises possess PEs in the source state.[23] The Convention offers a list of establishments which are considered as PEs: the real centres of management, affiliated companies, branches, factories, agencies, warehouses, offices, depots.[24]

Following the 1925 and 1927 reports by the Technical Experts to the League of Nations on limitation of source taxation of business profits of non-resident enterprises, the 1928 Draft Model Bilateral Convention of the League of Nations upholds the requirement of a fixed place of business for source taxation of business income of non-resident enterprises. The 1928 Model also gives an expanded definition of PEs - the real centres of management, branches, mining and oilfields, factories, workshops, agencies, warehouses, offices, and depots constitute permanent establishments under the convention.[25]

The PE concept was sustained by the League of Nations in the revised text of the model draft convention for the allocation of business income between states issued in 1935.[26] Article I of the 1935 revised text provides that "an enterprise having its fiscal domicile in one of the contracting states shall not be taxable in another contracting state except in respect of income directly derived from sources within its territory and, as such, allocable in accordance with the articles of this

[22] *Supra* note 14 at 9.
[23] League of Nations, *Report and Resolutions submitted by the Technical Experts to the Financial Committee*, 1927, Doc C216 M85.
[24] *Ibid*.
[25] Article 5, League of Nations Model Tax Convention, *supra* note 7.
[26] Article I of the *League of Nations Double Taxation Convention*, June 7, 1935, Doc C 252 M 124.

convention to a permanent establishment situate in that state".[27] The League of Nations released model tax conventions after 1935 and the PE concept, which was established in the 1928 Model Tax Convention and revised in 1935, was maintained in subsequent models.

Recounting the history re-emphasizes how much the UN and OECD conceptions have remained true to their European origins. Consequently, nothing has changed in terms of their use of the same concept, defined according to the same parameters, that they include in their tax treaties with African states. Though the businesses of foreign investors routinely meet the definition to be taxed by African states, the latter cannot because of the restrictions in the tax treaties they signed and the business practices of the non-residents to keep them out of the taxation loop. Consequently, the African states must review the use of the PE concept even if they continue to accept it as a basis for exercising taxation right over foreign investment activities. Section 5 of this chapter examines the PE threshold in the tax treaties signed by the comparator countries. I make proposals to the three African states to reform their tax treaties to broaden the tax base of non-resident companies carrying out business activities within their respective jurisdictions in order to ensure expansive source-taxation rights over income earned from such activities.

3. Source Taxation of Business Profits Under the OECD Model

The OECD stepped into the role of harmonizing international taxation rules after the League of Nations became defunct in 1954.[28] The OEEC was formed in 1947 to administer American and Canadian aid under the Marshall Plan for the reconstruction of Europe after World War II.[29] The

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[27] *Ibid*.
[28] See Eyitayo-Oyesode, supra note 13 at 199 citing OECD, *Explorations in OEEC History* (Paris: OECD Publishing, 2009); see also *Draft Double Taxation Convention on Income and Capital* (Paris: OECD Publishing, 1963); Warren Christopher, *In the Stream of History: Shaping Foreign Policy for a New Era* (California: Stanford University Press, 1998).
[29] *Ibid*.

OEEC later became OECD in 1961 when Canada and the United States joined, and the OECD gained an extensive mandate to develop policies that would enhance the economic development of member states, which, at this time, included non-European states.[30] The first OECD Model Tax Convention, which was adopted in draft in 1963, as well as the subsequent models[31] adopt the PE concept established by the League of Nations.

3.1 The PE Concept in the OECD Model

In the OECD Model, a PE is defined as "a fixed place of business through which the business of an enterprise is wholly or partly carried on".[32] A PE under the OECD Model includes a place of management; a branch; an office; a factory; a workshop; a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.[33] A building site or construction or installation project constitutes a PE only if it lasts more than twelve months.[34] The OECD Model removes from the scope of source taxation facilities solely used for the purpose of storage, display or delivery; the maintenance of a stock of goods without more; the maintenance of a fixed place solely for the purpose of purchasing goods or merchandise or of collecting information; and the maintenance of a fixed place of business solely for a preparatory or auxiliary reason.[35] Essentially, business activities of a casual or temporary nature are removed from source taxation.[36]

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[30] *Ibid*.
[31] The OECD Model has gone through series of amendments beginning in 1977, 1992, 1994, 1995, 1997, 2000, 2002, 2005, 2008, 2010, 2014, and in 2017, see the OECD Model, *supra* note 2.
[32] Article 5(1) of the OECD Model, *supra* note 2.
[33] Article 5(2) of the OECD Model, *supra* note 2.
[34] *Ibid*.
[35] Article 5(4) of the OECD Model, *supra* note 2; see also Kim Brooks, "Canada's Evolving Tax Treaty Policy in Arthur J. Cockfield ed, *Globalization and Its Tax Discontents: Tax Policy and International Investments* (Toronto: London: University of Toronto Press, 2010) at 7.
[36] *Ibid*.

The PE concept under the OECD Model emphasizes the existence of a place of business with a certain degree of permanence. The list of places of business listed in Article 5(2) would only constitute PEs if they meet the definition in Article 5(1), that is, a fixed place of business through which the business of an enterprise is wholly or partly carried on.[37] Also, Article 5(4) excludes a number of activities carried on through fixed places of business but are of a preparatory or auxiliary character.[38] Though these activities may well contribute to the overall productivity of the enterprise, they are not treated as PEs under the OECD Model.[39] It is often difficult to distinguish between activities that are of a preparatory or auxiliary nature and those that are not.[40] In this case, the decisive criterion, according to the OECD, will require a case-by-case analysis to determine whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole.[41]

While the OECD Model greatly limits the scope of activities that will constitute a PE, the UN Model broadens the scope of activities that will be deemed sufficient to constitute a PE. The UN Model also includes the force of attraction rule, which grants taxing rights to source states over profits derived outside the PE. The next section examines the PE concept under the UN Model.[42]

4. Expanded Source Taxing Rights over Business Profits under the UN Model

The UN Model was developed as an alternative to the OECD Model, where the allocation rules gave more taxing rights to residence/developed countries.[43] The Economic and Social Council

[37] OECD Commentary on Article 5(2), *supra* note 2 at para. 45.
[38] Article 5(4) of the OECD Model, *supra* note 2.
[39] OECD Commentary on Article 5(4), *supra* note 2 at paras. 58-59.
[40] *Ibid*.
[41] *Ibid*.
[42] See Brooks, *supra* note 35 for a similar review.
[43] Eyitayo-Oyesode, *supra* note 13 at 214-215.

(ECOSOC) of the United Nations set up in 1968 the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries to develop an alternative template to the OECD Model.[44] The Group of Experts were given the task to produce a model that would be used for the conclusion of bilateral tax treaties between developed and developing countries with a view to improve the flow of international trade and investment, transfer of technology, and source taxing rights.[45] From the Ad Hoc Group of Experts' deliberations, in 1979, the UN published the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries[46] and in 1980, the United Nations Model Double Taxation Convention between Developed and Developing Countries.[47] Though the UN Model is based on the 1963 OECD Model, it expands source taxing rights in some aspects, one of which is business income.

4.1 Expansion of the PE Concept under the UN Model

First, the UN Model broadens the scope of source taxation of construction activities in two major ways. It includes assembly and supervisory activities in the list of activities that will constitute a PE in addition to a building site, construction, or installation project listed under the OECD Model.[48] The significance of these additional activities in the UN Model is to prevent tax avoidance possibilities by MNCs and to broaden the tax base of source countries to include assembling of equipment and supervisory activities by non-resident enterprises. Also, the UN Model reduces the time threshold for a building site, a construction, assembly or installation project or supervisory activities in connection therewith to be considered a PE to more than six

[44] Origin of the United Nations Model Convention, *supra* note 2 at v.
[45] *Ibid*.
[46] *Manual for the Negotiation of Bilateral Tax Treaties Between Developed and Developing Countries* (New York: United Nations, 1979).
[47] *Model Double Taxation Convention between Developed and Developing Countries* (New York: United Nations, 1980).
[48] Article 5(3)(a) of the UN Model, *supra* note 2.

months.[49] The UN Model further recommends that in special cases, this six-month period could be reduced in bilateral negotiations to not less than three months.[50] Under the OECD Model, such project/activities must last for more than twelve months to constitute PEs.[51] Reduction in time threshold for economic activities is significant for source countries because it captures business profits that would otherwise have escaped source taxation.

Second, the UN Model includes the provision of services in the definition of activities that constitute a PE.[52] Under the UN Model, the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose for a period or periods aggregating more than 183 days in any 12-month period will constitute a PE.[53] There is no equivalent provision in the OECD Model. Management and consultancy services can generate large profits in source countries.[54]

The 2011 UN Model Draft Convention included these words "for the same or a connected project" to qualify source taxation of profits from provision of services.[55] Some scholars also argue that the limitation is an anti-abuse rule that seeks to prevent artificial division of projects so as to avoid the time threshold required for source taxation.[56] These words were, however, removed from the 2017 Draft because it was felt that the limitation was easy to manipulate and created difficult interpretive issues for tax authorities in developing countries.[57]

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[49] *Ibid*.
[50] See the Commentary on Article 5(3) of the UN Model, *supra* note 2, para. 7.
[51] Article 5(3) of the OECD Model, *supra* note 2.
[52] Article 5(3)(b) of the UN Model, *supra* note 2.
[53] *Ibid*.
[54] Commentary on Article 5(3)(b) of the UN Model, supra note 2, para. 9.
[55] *Ibid*.
[56] Joel Nitikman, "More on Services PEs—What Is a Connected Project?" (2014) 62:2 Canadian Tax Journal 317 at 350.
[57] *Ibid*.

The limitation in the 2011 UN Model is an important anti-tax avoidance rule that would benefit African countries because non-resident taxpayers can structure their affairs intentionally to fall outside the scope of the treaty provision. The inclusion of the anti-avoidance rule is an opportunity for tax authorities to build capacity in this area; so, there is value in including the anti-avoidance rule. Thus, the comparator countries should reform their tax treaties to include the anti-avoidance rule in the 2011 UN Model. They should also take steps to build implementation capacity to counter avoidance transactions by MNCs seeking to take advantage of treaty provisions on provision of services. Also, the comparator countries should negotiate a shorter time threshold to capture more profits from provision of services. As against the 183 days prescribed by the UN Model, three months would be more appropriate to increase tax revenue from services provided by non-residents following the three-month period for construction projects. However, the comparator countries should weigh the equity concerns and their administrative capacity in prescribing a time limit.

Third, the UN Model allows delivery of goods as one of the activities that will constitute a PE.[58] This is contrary to the provision in the OECD Model, which includes delivery in the list of activities that are not sufficient to constitute PEs, though carried on through fixed places of business.[59] The exclusion of the word "delivery" from the list of activities that are not sufficient to constitute a PE under the UN Model is a good strategy because it follows the decisive criterion stated in both the OECD and UN Models, which is that the activity of the fixed place of business must form an essential and significant part of the activity of the enterprise as a whole to constitute

[58] Article 5(4)(a) of the UN Model, *supra* note 2 omits 'delivery' from the list of activities that will be deemed not to constitute a PE.
[59] See Article 5(4)(a) of the OECD Model, *supra* note 2.

a PE.[60] The use of facilities by an enterprise for the purpose of delivery of goods belonging to that enterprise is, indeed, an essential and significant part of its activity as a whole. A stock of goods for prompt delivery facilitates sales of the product and ultimately the profit earned in the source country.[61] Therefore, the exclusion of "delivery" from the list in Article 5(4)(a) and (b) in the UN Model is appropriate.

In a global world, it is possible to have significant activities carried out in source countries that are of a preparatory or auxiliary character. These activities may even be carried on for a long period of time in source states.[62] It is, therefore, important for the allocation rules to grant source taxing rights on activities that are of a preparatory or auxiliary nature but form an essential and significant part of the activity of the enterprise as a whole; otherwise, the inclusion of a general restraint threatens the tax base of source countries. It is also important to note that paragraph 4.1 of both the OECD and UN Models contain an anti-fragmentation rule. This prevents an enterprise from fragmenting its activities in order to qualify for the specific activity exemptions in Article 5(4).[63]

Fourth, in addition to habitual conclusion of contracts by dependent agents on behalf of an enterprise as part of the activities that constitute a PE, the UN Model includes a dependent agent who habitually maintains in the source state a stock of goods or merchandise from which he/she regularly delivers goods or merchandise on behalf of the enterprise.[64] The OECD only lists habitual conclusion of contracts by dependent agents and agents who habitually play the principal role leading to the conclusion of contracts that are routinely concluded on behalf of an enterprise as

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[60] See the commentary on Articles 5(4) of the OECD and UN Models, *supra* note 2, paras. 59 and 18, respectively.
[61] See the commentary on Article 5(4) of the UN Model, *supra* note 2, para. 20.
[62] OECD commentary on Article 5(4) of the OECD Model, *supra* note 2, para. 60.
[63] Article 5(4.1) of the OECD and UN Models, *supra* note 2.
[64] Article 5(5)(b) of the UN Model, *supra* note 2.

activities that will be deemed sufficient to constitute a PE.[65] What is concerning, however, with the expansion in the UN Model is the interpretation given to it by the Group of Experts in the 1999 version of the UN Model, which is also contained in the 2017 Model.[66] The Group of Experts noted that only delivery by a dependent agent on behalf of an enterprise would not constitute a PE in the source state.[67] However, if other sales-related activities are carried on by the dependent agents on behalf of the enterprise, e.g. advertising/promotion, and have contributed to the sale of such goods or merchandise, a permanent establishment may exist.[68] The application of this interpretation will greatly reduce source taxation of profits from online sales effected through delivery agents. The rationale for the Group of Experts' viewpoint is not clear because delivery in itself constitutes a PE under the UN Model.[69] If the underlying principle of source taxation rules is to tie up economic activities conducted by non-resident enterprises in source states with the economic life of that State, delivery by dependent agents ought also to constitute a PE in the source state.[70]

Fifth, under the UN Model, non-resident insurance enterprises will be deemed to have a PE if they collect premiums in the source state or insure risks situated therein through a person.[71] The UN Model further clarifies the conditions under which such persons would be deemed to be acting on behalf of the insurance enterprise. A person who devotes his activities wholly or almost wholly to one or more enterprises to which it is closely related is regarded as a dependent agent, and

[65] Article 5(5) of the OECD Model, *supra* note 2.
[66] UN Commentary on Article 5(5)(b) of the 2017 UN Model, *supra* note 2, para. 26.
[67] *Ibid*.
[68] *Ibid*.
[69] Article 5(4) of the UN Model, *supra* note 2.
[70] Josef Schuch & Eline Husman "The Dependent Agent PE" in Michael Lang et al eds, *Dependent Agents as Permanent Establishments* (Linde: Vienna, 2014) at 274.
[71] Article 5(6) of the UN Model, *supra* note 2.

therefore, constitutes a PE for the insurance enterprise.[72] The OECD Model does not contain a similar provision.

Lastly, independent agents acting exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related will constitute a PE.[73] There is no equivalent provision in the OECD Model.

Before I move to discuss the implications of Article 7 of the UN Model, which further expands the taxing rights of source countries over business income derived by non-resident enterprises, it is important to note that the validity of the PE concept is being challenged owing to the paradigm shift in global trade where multinational corporations engage in cross-border trade without physical presence in host countries.[74] Action 7 of the OECD BEPS Project introduces changes to the definition of PE in the OECD Model to address strategies used to avoid having a taxable presence in a jurisdiction under tax treaties.[75] The proposed changes take three different forms.

First, the OECD expands the circumstances under which a foreign enterprise would be deemed to have a taxable presence in the source country. Currently, Article 5(5) of the OECD Model provides that where an agent other than an agent of an independent status acts on behalf of a foreign enterprise in a source state, and habitually exercises an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in the source state. The OECD widens the scope of source taxation of foreign enterprise by adding situations

[72] Article 5(7) of the UN Model, *supra* note 2; Michael Lang, *Introduction to the Law of Double Taxation Conventions* (Linde: Vienna, 2013) at 96.
[73] Article 5(7) of the UN Model, *ibid*.
[74] Arvind Skaar, *Permanent Establishment* (Netherlands: Kluwer Law and Taxation Publishers, 1991).
[75] OECD, "Article 7: Permanent Establishment Status", online: <https://www.oecd.org/tax/beps/beps-actions/action7/>.

where the dependent agent habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise.[76]

Second, the OECD reduces the scope of the exclusion of activities that are auxiliary or preparatory in nature from the PE definition in the OECD Model. The OECD now considers such activities excluded from the PE definition only when the overall activity resulting from the combination of the activities still results in activities that are preparatory or auxiliary in relation to the business as a whole.[77]

Third, the OECD includes an anti-avoidance provision to prevent splitting up of contracts into shorter periods of time to avoid the PE threshold (twelve months) for building site, construction project, installation project or other specific project in Article 5(3) of the OECD Model.[78] Article 14 of the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) provides that where connected activities are carried on in relation to the project by one or more enterprises closely related to the foreign enterprise during different periods of time, each exceeding 30 days, these different periods of time shall be combined in determining if the threshold was met.

Clearly, the OECD is leading reforms to the PE concept to tackle international tax avoidance by multinational corporations in brick-and-mortar businesses. One question that has been left out from the reforms is the distributional consequences of the PE concept. The PE concept was adopted in the 19th century by countries with relatively similar income and capital flows. Considering the

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[76] Article 12 of the OECD, "Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI)" (2016), online: < https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>.
[77] Article 13 of the OECD MLI, *ibid.*
[78] Article 14 of the OECD MLI, *supra* note 76.

asymmetry between developed and developing countries, there are significant negative consequences for the latter because they can only tax the income of non-residents where the PE threshold under the tax treaties have been met.

African countries need to understand and assess the implications of the PE concept and propose reforms to it based on the restrictions it imposes on their taxing rights. Their proposals must offer alternatives that would accommodate their taxing rights in an effective way. Section 5 of this chapter outlines my reform proposals to the three African countries, and to African countries with similar tax treaty provisions, to expand their taxing rights over business income earned by non-residents from activities carried out in their respective jurisdictions.

4.2 The Force of Attraction Rule under Article 7 of the UN Model

Article 7 of both the OECD and UN Models allow for source taxation of business profits derived by an enterprise in a source state through a PE situated therein.[79] In addition to this general rule, Article 7 provides the circumstances under which profits associated with a PE will be subject to tax.[80] While Article 7 of the OECD Model proposes that only profits attributable to the PE may be taxed by the source state,[81] Article 7 of the UN Model includes a limited force of attraction rule, which allows the source state to tax not only the profits attributable to that PE but other profits of the enterprise from sales of similar goods or merchandise in the source country, as well as other business activities of the same or similar kind carried on by the enterprise in the source country.[82] The limited force of attraction rule is also significant because it obviates the need for tax authorities

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[79] Article 7 of the OECD and UN Models, *supra* note 2.
[80] Brooks, *supra* note 35 at 10.
[81] Article 7(1) of the OECD Model, *supra* note 2.
[82] Article 7(1) of the UN Model, *supra* note 2; Michael Lennard, "The UN Model Tax Convention as Compared with the OECD Model Tax Convention – Current Points of Difference and Recent Developments" (2009) IBFD Asia-Pacific Tax Bulletin 1 at 9.

to absolutely determine whether particular activities are related to the PE or the income involved is attributable to it.[83] This will be beneficial to African countries with tax administration challenges because of the lower administrative costs involved when the force of attraction is applied to determine the taxable income of a PE.

Another distinction between Article 7 in the OECD Model and UN Model is with regard to the deductions allowable from the profits and gains of an enterprise carrying on business in a source state through a PE situated therein. In determining the profits attributable to a PE, the UN Model allows deductions of expenses that are incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses, whether they are incurred in the source state or elsewhere.[84] The UN Model also denies a deduction by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees, commissions for specific management services.[85] In essence, under the UN Model, deductions shall only be allowed for actual expenses incurred for the purpose of the business of the PE. A similar provision was present in the OECD Model until 2010 when it was deleted. Article 7(2) of the OECD Model leaves the issue of deductibility of expenses to the consideration of what unrelated entities would do in similar circumstances, that is, the arm's length principle which is a myth for controlled transactions between related entities.

There is no similar provision in the OECD Model. Therefore, the UN model provides for a significant expansion of the taxation of business profits earned at source.[86]

[83] Lennard, *ibid*.
[84] Article 7(3) of the OECD and UN Model, *supra* note 2.
[85] Article 7(3) of the UN Model, *supra* note 2.
[86] Brooks, *supra* note 75.

I turn next to analyse the rules on source taxation of business profits in the tax treaties signed by Nigeria, Tanzania, and Botswana. The analysis is guided by the discussion above and the differences in the rules under the OECD and UN Models. Though I use the UN Model as the criteria against which to assess the treaty provisions of the comparator countries, I still query the provisions of both the OECD and the UN Model on taxation of business profits as suitable models for the comparator countries.

The next section examines the rules for source taxation of business profits in Nigeria's tax treaties.

5. Source Taxation of Business Profits in Nigeria's Tax Treaties: Key Findings

Nigeria has thirteen tax treaties in operation.[87] They were signed between 1976 and 2017 with the following countries: Canada, the United Kingdom, France, the Netherlands, Belgium, Romania, Singapore, the Philippines, Czech Republic, South Africa, Pakistan, China, and Italy.[88] In terms of its relationship with these countries, Nigeria is a capital-importing country. Therefore, Nigeria should advocate for expansive source-taxing rights in its tax treaties.

Limiting source-taxing rights over business income derived by non-residents is one of the factors that accounts for Nigeria's low tax revenue, hence the need for a cost-benefit analysis of the provisions of existing tax treaties that Nigeria has signed. The argument under this heading is that if the analysis for a particular tax treaty turns out to be negative, Nigeria should renegotiate the tax treaty, or if it is impossible to do so, to terminate it. The reform of source-restricting provisions in Nigeria's tax treaties is an effective way to improve domestic resource mobilization for socio-

[87] Nigeria, Federal Inland Revenue Service: Tax Treaties, online: https://www.firs.gov.ng/TaxResources/TaxTreatiesNew. Nigeria's tax treaty with Italy covers only air and shipping operations. Nigeria has signed other tax treaties with Korea, Mauritius, Qatar, Spain, Sweden, and United Arab Emirates; however, these treaties are not yet in force.

[88] *Ibid*.

economic development. The analysis below shows that some of the provisions in Nigeria's tax treaties even fall short of the source-expanding provisions in the UN Model for taxation of business profits which, as established above, is the take off point for the analysis of source-restricting provisions in the tax treaties signed by the comparator countries. A detailed analysis of the provisions of these tax treaties is presented below. The analysis argues that Nigeria's taxation rules should at least reflect the UN Model provisions that expand source-taxing rights over business profits earned by non-residents in the country and include provisions that allow source-taxation of profits derived by non-residents from digital services performed in Nigeria.

5.1 How broad is the Permanent Establishment (PE) Concept under Article 5?

The PE threshold "sets the level of presence that is required for the source state to tax business profits generated by non-residents".[89] The PE provision is an important provision in Nigeria's tax treaties because it creates the nexus/threshold for taxing the business income of non-residents. Under paragraph 5(1) of the UN Model, a PE is defined as "a fixed place of business through which the business of an enterprise is wholly or partly carried on".[90] The OECD Model has similar definition[91], but the distinguishing factor between the substance of the PE threshold in both Models is that the UN Model has a broader definition and a smaller time threshold for the establishment of a permanent establishment in a source country.[92] There is no uniformity with regard to the PE provision in Nigeria's tax treaties; some align with the provisions in the UN Model while some

[89] Siddhesh Rao, "The PE Definition: A Threshold for Source State Taxation' in Anna Binder and Viktoria Wöhrer eds, *Special Features of the UN Model Convention* (Linde: Vienna, 2019) 47 at 56.
[90] Article 5(1) of the UN Model, *supra* note 2.
[91] Article 5(1) of the OECD Model, *supra* note 2.
[92] Paragraphs 2–9 of Article 5 of the UN Model, *supra* note 2 define what constitutes a fixed place of business in view of the broad definition of a PE.

lean towards the restrictive PE threshold in the OECD Model. The details of the analysis of the PE provision in Nigeria's tax treaties are as follows:

A. Low Time Threshold

Time threshold for a building site or construction or assembly project or supervisory activities to constitute a PE is three months in all the tax treaties[93], except in the tax treaties with Singapore, South Africa, and China where it is six months.[94] A lower threshold is beneficial to Nigeria, and it is recommended that all of Nigeria's tax treaties adopt the lower time threshold. A lower threshold will trigger taxation of significant activities that are conducted within a short period of time.

B. Supervisory Activities

Supervisory activities constitute a PE in all the tax treaties in line with the provisions of the UN Model.[95]

C. Use of Facilities Solely for Delivery

The use of facilities solely for delivery qualifies as a PE under the UN Model.[96] Delivery activities are not considered auxiliary or preparatory under the UN Model; they are part of the list of activities that constitute PEs.[97] This provision, however, exists in only Nigeria's tax treaties with Singapore and China.[98] The lack of provision for taxing facilities solely for the purpose of delivery in most of Nigeria's tax treaties is a missed opportunity to broaden Nigeria's taxing power,

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[93] See Article 5(2)(g) of Nigeria's tax treaties with Belgium, Canada, Czech Republic, France, Pakistan, the Philippines, Romania, the United Kingdom; and Article 5(3)(a) of Nigeria's tax treaty with the Netherlands, *supra* note 87.
[94] See Article 5(3)(b) of Nigeria's tax treaty with Singapore, Article 5(3)(a) of Nigeria's tax treaty with South Africa, and Article 5(3) of Nigeria's tax treaty with China, *supra* note 87.
[95] See Article 5(2)(h) of Nigeria's tax treaty with Belgium, Canada, Czech Republic, France, Pakistan, the Philippines, and the United Kingdom, *supra* note 87. See also Article 5(3) of Nigeria's tax treaty with China, Article 5(3)(a) of Nigeria's tax treaty with the Netherlands, Article 5(2)(g) of Nigeria's tax treaty with Romania, Article 5(3)(b) of Nigeria's tax treaty with Singapore, Article 5(3)(a) of Nigeria's tax treaty with South Africa, *supra* note 87.
[96] Article 5(4) of the UN Model, *supra* note 2.
[97] *Ibid*.
[98] See Article 5(4)(a) of Nigeria's tax treaties with Singapore and China, *supra* note 87.

especially over online retailers who would usually only maintain warehouses for delivering physical goods in source countries.[99] In view of this, Nigeria should amend its tax treaties with other treaty partners in order to increase tax revenue from this activity.

D. Service PE

The inclusion of provision of services under the PE concept in the UN Model is a contribution that expands source-taxation in a significant way because it dispenses with the need for a "fixed base" in the source country.[100] It introduces a new category of PE through the provision of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose.[101]

Service PE provision is present in Nigeria's tax treaties with the Netherlands, Romania, Singapore, and South Africa.[102] Provision of services by a non-resident enterprise or through employees or other personnel engaged by the enterprise constitute a PE based on the service PE provisions.[103] The time threshold, however, varies in the tax treaties. The time threshold for services by non-resident enterprises in the tax treaty with the Netherlands is for a period of more than three months.[104] It is for a period or periods aggregating more than three months within any 12 month period in the tax treaty with Romania.[105] It is for a period or periods aggregating more than 183 days in any 12 month period in the tax treaty with Singapore.[106] It is for a period or periods

[99] Rao, *supra* note 89 at 62.
[100] Article 5(3)(b) of the UN Model, *supra* note 2.
[101] *Ibid*.
[102] See Article 5(3)(a) of Nigeria's tax treaty with the Netherlands, Article 5(2)(h) of Nigeria's tax treaty with Romania, Article 5(3)(c) of Nigeria's tax treaty with Singapore, and Article 5(3)(b) of Nigeria's tax treaty with South Africa, *supra* note 87.
[103] *Ibid.*
[104] *Ibid.*
[105] *Ibid*.
[106] *Ibid*.

exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned in the tax treaty with South Africa.[107] These thresholds have revenue implications for Nigeria. It is recommended that the time threshold for service PE in Nigeria's tax treaties should be removed to include services provided by non-resident enterprises in Nigeria that fall below the prescribed thresholds. The provision of services by a PE is enough nexus to trigger source taxation of income derived from the activity.

Section 4 of the Finance Act inserts a new taxing provision into the Companies Income Tax Act, which allows the Federal Inland Revenue Service (FIRS) to impose a withholding tax on income derived from furnishing of technical, management, consultancy, or professional services outside of Nigeria to a person resident in Nigeria if the non-resident enterprise has a significant economic presence in Nigeria.[108] The Ministry of Finance released an Order in 2020, clarifying that a non-resident company providing technical, professional, management or consultancy services shall have a significant economic presence in Nigeria in any accounting year where it earns any income, or receives any payment from a person resident in Nigeria, or a fixed base or agent of a foreign company in Nigeria.[109]

This new tax on non-resident enterprises providing services to persons resident in Nigeria is likely to create conflict, especially with tax treaties without the service PE provisions. The best way to avoid such conflicts is for Nigeria to amend its tax treaties to include the service PE provision.

The service PE provisions in Nigeria's tax treaties with Romania, Singapore, and South Africa contain the words "connected projects".[110] As discussed above, the conditions created by the non-

[107] *Ibid*.
[108] *Finance Act (Nigeria)* 2019, s4(e).
[109] *Companies Income Tax (Significant Economic Presence) Order (Nigeria)* 2020.
[110] *Supra* note 102.

inclusion of these words in the service PE provision create opportunities for enterprises to avoid source taxation. In 2017, the UN Committee of Tax Experts removed the words "for the same or a connected project" from Article 5(3)(b) and left to countries the decision to include the words.[111] Nigeria should, therefore, reform the service PE provision in its other tax treaties in light of the opportunities for tax avoidance created by the non-inclusion of the words "connected projects". The inclusion of the words in Nigeria's tax treaties will prevent artificial division of projects by non-residents companies so as to avoid the time threshold required for source taxation.

Generally, the lack of service PE provision in the other tax treaties greatly restrict the scope for source taxation of economic activities of non-residents in Nigeria, especially because the services sector contributes significantly to Nigeria's GDP (53.64% in the fourth quarter of 2019[112]) and can generate large tax revenues.

Nigeria's tax treaty with Romania has the service PE provision in paragraph 2.[113] It is argued that this might create interpretation issues while determining whether the service provided by a non-resident enterprise constitutes a fixed place of business in accordance with Article 5(1) of the tax treaty.[114] The link to Article 5(1) is because the UN commentary on Article 5(2) states that the provisions of Article 5(2) are not self standing; in other words, the activities listed in Article 5(2) will constitute permanent establishments only if they meet the requirements of paragraph 1.[115] The

[111] See the UN Commentary on Article 5 of the UN Model, *supra* note 2 at 161.
[112] Nigeria, "National Bureau of Statistics: Nigerian Gross Domestic Product Report" (Q4 & Full Year 2019), online: https://nigerianstat.gov.ng/elibrary.
[113] *Supra* note 102.
[114] Aaron Gerwig, "The Service PE (Article 5) in Anna Binder and Viktoria Wöhrer eds, *Special Features of the UN Model Convention* (Linde: Vienna, 2019) 73 at 79-81.
[115] UN Commentary on Article 5(2) of the UN Model, *supra* note 2 at 153.

argument is that the best place to insert a service PE provision is in paragraph 3 following the UN Model to avoid an argument against the stand-alone character of the service PE provision.[116]

The service PE provision is present in paragraph 2 of Article 5 of India's tax treaties with Canada[117] and the Swiss Confederation.[118] It is also present in Article 5(2) of South Africa's tax treaty with the US.[119] Although the service PE provision in India and South Africa's tax treaties fall under paragraph 2, which means that the requirement of a fixed place must still be met according to the UN commentary[120], the courts in India and South Africa have held that service PE is independent of the need for a fixed place under paragraph 1 of Article 5.[121] Nigeria can rely on these decisions if there are issues arising from determining the existence of service PEs under its tax treaty with Romania. Alternatively, Nigeria can amend its tax treaty with Romania to include the service PE provision in paragraph 3 of Article 5 to avoid any conflict that may arise in this regard.

In 2015, India gave a unique interpretation to the service PE provision. In an Indian Tax Tribunal Case[122], provision of services outside of India by a UAE resident was held to constitute a service PE in India based on Article 5(2)(i) of the India–UAE Tax Treaty.[123] The Tribunal held that the

[116] Gerwig, *supra* note 114.
[117] *Agreement Between the Government of Canada and the Government of the Republic of India for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital*, online: https://www.treaty-accord.gc.ca/text-texte.aspx?lang=eng&id=102409.
[118] *Agreement Between the Republic of India and the Swiss Confederation for the Avoidance of Double Taxation with Respect to Taxes on Income*, online: <https://www.incometaxindia.gov.in/pages/international-taxation/dtaa.aspx>.
[119] *Convention Between the United States of America and the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains*, online: https://www.irs.gov/pub/irs-trty/safrica.pdf.
[120] *Supra* note 115.
[121] Gerwig *supra* note 114 at 81 citing *DIT* v. *Morgan Stanley ad Co. Inc* (SC) (2007) 292 ITR 416; *Cal Dive Marine Construction (Mauritius) Ltd* (315 ITR 334) (AAR); *AB LLC and BD Holdings LLC* v. *Commissioner of the South African Revenue Services* (13276) [2015] ZATC 2 (15 May 2015).
[122] *ABB FZ-LLC*, v. *Deputy Commissioner of Income tax (International Taxation)*, Circle - 1(l), Bengaluru IT(TP)A.l103/Bang/2013 & 304/Bang/2015, online: http://www.kluwertaxblog.com/wp-content/uploads/sites/59/2017/08/Bangalore-Tribunal-Ruling.pdf. see page 50-51 of the ruling.
[123] *Ibid*.

services provided by the non-resident (consultancy services) can be provided virtually without physical presence. Therefore, it was held that the non-resident fulfilled the prerequisite of service PE.[124] This is a landmark case and would be useful for Nigeria for interpreting existing service PE provisions in its tax treaties, and in considering reforms to other tax treaties to include similar provisions. To buttress India's position, the UN Tax Committee decided in 2015 that physical presence in the source state is not required for the service PE provision in the UN Model.[125]

E. Anti-fragmentation Rule

There is an anti-fragmentation rule in paragraphs 4.1 of Article 5 of the OECD and UN Models.[126] The paragraphs provide that the exemptions listed in paragraph 4 of article 5 (activities that do not constitute PE) will not apply where activities are broken into smaller units and performed by closely related entities to qualify as preparatory/auxiliary activities, thereby falling under the exemptions in Article 5(3). The anti-fragmentation rule provides that the activities, if divided artificially, will be combined provided they are carried on by closely related entities and constitute complementary functions that are part of a cohesive business operation.[127] The implication of this provision is that any ingenious strategy by MNCs to fragment cohesive business operations into small operations in order to avoid the PE threshold will be caught by the anti-fragmentation rule. Although there is no clear definition of the term "cohesive business operation" in the UN and OECD commentary, this provision seeks to prevent the avoidance of PEs. The provision is, however, absent in Nigeria's tax treaty network. It is argued that Nigeria should amend all its tax

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[124] *Ibid*.

[125] *United Nations, Committee of Experts on International Cooperation in Tax Matters, Report on the Eleventh Session*, UN Doc E/2015/45-E/C.18/2015/6.

[126] Paragraphs 4.1 of Article 5 of the UN and OECD Model Tax Conventions, *supra* note 2.

[127] *Ibid*.

treaties to include this anti-avoidance rule to counter tax-avoidance transactions by MNCs seeking to take advantage of the treaty provisions.

F. Non-resident Insurance Enterprises

Paragraph 6 of Article 5 is another major provision in the UN Model.[128] It creates a nexus between a non-resident insurance enterprise (except with regards to reinsurance) that collects premium or insures risks in a source state either directly or through a dependent agent. There is no need for a fixed base of business or any time threshold to trigger source taxation.[129] This provision is present in only Nigeria's tax treaty with Singapore.[130] This is an important provision that expands source taxing rights by automatically creating a nexus for source taxation of non-resident insurance enterprises and should be replicated in all of Nigeria's tax treaties.

G. Dependent Agent

Another important provision that expands source taxation is contained in paragraphs 5 and 7 of Article 5 of the UN and OECD Models.[131] These provisions provide for a possibility in which a PE exists in respect of activities undertaken by a person on behalf of an enterprise, thus enabling source countries to tax the profits of an enterprise derived from activities performed on its behalf by dependent agents. The UN Model contains additional source expanding provisions by including habitual maintenance of a stock of goods or merchandise from which that person regularly delivers goods or merchandise on behalf of the enterprise to the list of activities of dependent agents taxable in a source country.[132] This expanded provision is not contained in Nigeria's tax treaty with China

[128] Article 5(6) of the UN Model, *supra* note 2.
[129] *Ibid*. see also Jinyan Li, *supra* note 1.
[130] Article 5(6) of Nigeria's tax treaty with Singapore, *supra* note 87.
[131] Article 5(5) and 5(7) of the UN and OECD Model Tax Conventions, *supra* note 2.
[132] Article 5(5)(b) of the UN Model Tax Convention, *supra* note 2.

and Singapore but it is in others.[133] It is argued that Nigeria should amend its tax treaties with China and Singapore to include this expanded provision because of the opportunities that the lack of the provision creates for non-taxation of income from sales of products of a non-resident enterprise by another person.

H. Taxation of the Digital Economy

Increasing digitalization of the economy raises some concerns about the non-suitability of the rules for taxing profits of MNCs. Article 5 of Nigeria's tax treaties emphasizes physical presence. This means that the non-existence of physical presence will lead to a shift of the profits of non-residents derived in Nigeria to residence countries. This approach makes profits derived from digital services in Nigeria exempt from tax. The OECD is crafting unified solutions to the tax challenges arising from the digitalization of the economy, as expressed through Pillar 1 and Pillar 2.[134] Nigeria is part of the OECD inclusive framework.[135] African countries are also working on a common African position on the challenges arising from the digitalization of economy as well as on ways to champion that common position at the OECD.[136]

In the meantime, Nigeria has enacted its unilateral digital services tax.[137] To capture profits from the digital economy in Nigeria's tax net, Nigeria introduced the "significance economic test" in its Finance Act to broaden the nexus required to tax the income of non-residents that operate on a

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[133] See Article 5(5) of Nigeria's tax treaties with China and Singapore, *supra* note 87.

[134] *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, (Paris: OECD Publishing, 2020); *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, (Paris: OECD Publishing, 2020).

[135] OECD, "Members of the OECD/G20 Inclusive Framework on BEPS", online: https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf.

[136] African Union, "Africa Calls for International Taxation Systems Reforms as it Forges a Common Position on Digital Taxation", online: <https://www.africa-newsroom.com/press/africa-calls-for-international-taxation-systems-reforms-as-it-forges-a-common-position-on-digital-taxation>.

[137] Section 4 of *Finance Act*, *(Nigeria), supra* note 108.

digital platform.[138] A non-resident enterprise will be deemed to have a significant economic presence in Nigeria, where it...

a. derives N25 million annual gross turnover or its equivalent in other currencies from any or

combination of the following digital activities:

i. streaming or downloading services of digital contents, including but not limited to movies, videos, music, applications, games and e-books to any person in Nigeria; or

ii. transmission of data collected about Nigerian users which has been generated from such users' activities on a digital interface including website or mobile applications; or

iii. provision of goods or services other than those under sub-paragraph 5 of the Order, directly or indirectly through a digital platform to Nigeria;

or

iv. provision of intermediation services through a digital platform, website or other online applications that link suppliers and customers in Nigeria;

b. uses a Nigerian domain name (i.e., .ng) or registers a website address in Nigeria; or

c. has a purposeful and sustained interaction with persons in Nigeria by customizing its digital page or platform to target persons in Nigeria, including reflecting the prices of its products or services in Nigerian currency or providing options for billing or payment in Nigerian currency.[139]

From the above, Nigeria has taxing rights over non-resident enterprises that derive income in Nigeria from digital or related activities, such as streaming or download services, data transmission, and provision of goods and services through a digital platform, if these enterprises meet the prescribed threshold of more than N25 million in any accounting year.[140]

[138] *Ibid*.
[139] *Supra* note 109.
[140] *Ibid*.

It is thought that unilateral digital service tax is at variance with the PE provision in Article 5 of the OECD and UN Models, which requires physical presence for the exercise of taxing rights by source countries.[141] Increasing digitalization makes it difficult to apply the current rules to the sophisticated business models being used by multinational corporations to transfer intangible assets, which usually dispense with physical presence. This situation makes it challenging for countries to tax profits derived from digital services. The OECD noted these challenges in its final report on BEPS Action 1[142], and has begun to devise unified solutions for them. In light of this, Nigeria's unilateral digital services tax is a significant piece of legislation. Chowdhary argues that the significant economic presence legislation is the most important requirement for effective taxation of the digitalized economy.[143] Christians and Towfigh draw on the rationale of significant economic presence legislation, which is to draw non-resident enterprises operating in the digital services sector into source countries' income tax net in order for states to justify their adoption of unilateral digital services taxes.[144]

The amendment to Nigeria's Companies Income Tax Act, introducing the significant economic presence test, is significant and has the potential to increase Nigeria's domestic resource mobilization. However, to avoid conflicts with the application of the significant economic test to

[141] A M Jiménez, "BEPS, the Digitalized Economy and the Taxation of Services and Royalties" (2018) 46 8:9 Intertax 620 at 624. See Allison Christians & Kimia Towfigh, "Significant Economic Presence (SEP): Threshold To Taxing Digital Profits" (21 August 2020), Canadian Tax Foundation Digital Tax Log (blog), Online: < https://www.ctf.ca/CTFWEB/EN/Newsletters/Blogs_and_Reports/Digital_Services_Updates/Entries/Entry04.aspx> for a rebuttal of the argument.
[142] *Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report* (Paris: OECD Publishing, 2015).
[143] Abdul Muheet Chowdhary, "Significant Economic Presence Laws: Key to Fulfilling the Post Pandemic Social Contract" (July 2020), Afronomics (blog), online: https://www.afronomicslaw.org/2020/07/23/significant-economic-presence-laws-key-to-fulfilling-the-post-pandemic-social-contract/.
[144] *Supra* note 141.

residents of countries with whom Nigeria has signed a tax treaty, it is recommended that Nigeria should amend its tax treaties to include the significance economic test provision.

5.2 How Broad are the Items of Income which could be Included in Article 7?

As discussed above, the rule in Article 7(1) of the OECD Model is that only the business profits attributable to the permanent establishment will be taxed in the source country.[145] Article 7(1) of the UN Model, however, introduces a limited "force of attraction rule'.[146] This rule allows source countries to tax other profits earned outside of the PE by the head office from sale of the same or similar kind of goods as those sold through the PE, or profits from other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment.[147] The "force of attraction" rule is limited because it does not cover passive income nor profits from sales through independent commission agents and purchasing activities.[148]

The "limited force of attraction rule" is absent in Nigeria's tax treaties with the United Kingdom[149], France[150], the Netherlands[151], Singapore[152], and China.[153] Therefore, activities similar in nature to those conducted by the PE by residents of those countries will not be taxed in Nigeria. I argue that Nigeria should reform these treaties to include the limited force of attraction rule to capture profits derived from similar activities outside of PEs by non-resident enterprises. The rule is, however, present in Nigeria's tax treaty with South Africa[154], but Nigeria must show that such sales or

[145] Article 7(1) of the OECD Model, *supra* note 2.
[146] Article 7(1) of the UN Model, *supra* note 2.
[147] Article 7(1) of the UN Model, *supra* note 2.
[148] Commentary on Article 7(1) of the UN Model, *supra* note 2 at 215.
[149] Article 7(1) of Nigeria's tax treaty with the United Kingdom, *supra* note 87.
[150] Article 7(1) of Nigeria's tax treaty with France, *supra* note 87.
[151] Article 7(1) of Nigeria's tax treaty with the Netherlands, *supra* note 87.
[152] Article 7(1) of Nigeria's tax treaty with Singapore, *supra* note 87.
[153] Article 7(1) of Nigeria's tax treaty with China, *supra* note 87.
[154] Article 7(1) of Nigeria's tax treaty with South Africa, *supra* note 87.

activities were structured with the intent to avoid taxation in Nigeria.[155] This provision might be hard for the FIRS to enforce, especially because of the ingenious ways that MNCs structure their businesses to avoid tax. Therefore, Nigeria should reform its tax treaty with South Africa to remove the conditions listed in Article 7(1).

Also, as discussed above, Article 7(3) of the UN Model explicitly lists allowable deductions in the determination of the profits of a permanent establishment as "expenses which are incurred for the purposes of the business of the permanent establishment".[156] This provision is absent in the OECD Model. Allowable deductions in Nigeria's tax treaties are only those incurred for the purposes of the business of the PE in line with the UN Model.[157] Also, in all the treaties, deduction by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees, commissions for specific management services are disallowed except if they are reimbursement for actual expenses.[158]

5.3 Overall Assessment

Largely, Nigeria's tax treaties have source-expanding provisions for taxation of business profits. Out of 13 treaties signed by Nigeria, 10 have low threshold (three months) for building projects; 13 list supervisory activities as part of the activities that constitute a PE; two include delivery in the list of activities that constitute a PE; four have service PE provisions; none has the anti-fragmentation rule; one allows taxation of non-resident insurance enterprises; 11 include habitual maintenance of a stock of goods by dependent agents as activities that constitute a PE. Nigeria has also enacted a digital services tax to capture profits derived by non-residents from the digital

[155] *Ibid*.
[156] Article 7(3) of the UN Model, *supra* note 2.
[157] Article 7(3) of Nigeria's tax treaties with Belgium, Canada, China, Czech Republic, France, the Netherlands, Pakistan, the Philippines, Romania, Singapore, South Africa, and the United Kingdom, *supra* note 87.
[158] *Ibid*.

economy in its tax net. To further strengthen domestic resource mobilization in Nigeria, I propose that Nigeria should reform its tax treaties to ensure that they are all aligned to ensure source-expansive taxing rights for business profits earned by non-residents.

6. Source Taxation of Business Profits in Tanzania's Tax Treaties: Key Findings

Tanzania has nine tax treaties in operation.[159] These tax treaties were signed between 1968 and 2005 with the following countries: Canada, Denmark, Finland, India, Norway, South Africa, Sweden, and Zambia.[160] Unlike Nigeria, Tanzania's tax treaties cut across high-income, middle-income, and low-income countries. The argument under this section is that for the tax treaties with high-income countries and middle-income countries, Tanzania should be allowed to tax business profits derived by residents of these countries from economic activities conducted in Tanzania. This argument is based on the uneven inflows of trade and investment between Tanzania and most of its tax treaty partners. For Zambia, which is also a low-income country, the same argument applies. As much as it would be fair to keep source restrictive provisions in tax treaties signed between African countries, it is important to keep in mind that there is a possibility for foreign enterprises doing business in these countries to take advantage of the provisions which ultimately would lead to erosion of profits derived from African countries.

Statistics show that Tanzania's tax-to-GDP ratio is low in comparison with peers and with respect to its level of development.[161] To raise tax revenue to finance development programs, Tanzania needs to address inefficient tax policies that fail to capture potential revenues from business

[159] Tanzania Revenue Authority, Tax Treaties, online: < https://www.tra.go.tz/index.php/double-taxation-agreements>.
[160] *Ibid*.
[161] Thomas Baunsgaard et al, "United Republic of Tanzania: Selected Issues" (2013) IMF Country Report No 16/254.

activities carried on by non-residents.[162] There is the need for a cost-benefit analysis of the provisions of existing tax treaties and if the analysis for a particular tax treaty turns out to be negative, Tanzania should renegotiate the tax treaty, or if it is impossible to renegotiate, Tanzania should terminate it. The analysis below shows that some of the provisions in Tanzania's tax treaties even fall short of the source-expanding provisions in the UN Model for taxation of business profits. A detailed analysis of the provisions of these tax treaties is presented below.

6.1 How broad is the Permanent Establishment (PE) Concept under Article 5?

There is no uniformity with regard to the PE provision in Tanzania's tax treaties; some align with the provisions in the UN Model while some lean towards the restrictive PE threshold in the OECD Model. The details of the analysis of the PE provision in Tanzania's tax treaties are as follows:

A. Low Time Threshold

Time threshold for a building site or construction or assembly project or supervisory activities to constitute a PE is six months in all the tax treaties[163], except in the tax treaty with Canada where it is six months or more[164], and Italy where it is more than twelve months.[165] Tanzania should negotiate lower time thresholds (especially the tax treaties with Sweden, Norway, Finland, Denmark, India, and South Africa).[166] A lower threshold will trigger taxation of significant activities that are conducted within a short period of time. A cue can be taken from the time threshold in Nigeria's tax treaties where it is three months in all the tax treaties, except in the tax treaties with Singapore, South Africa, and China where it is six months.

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[162] SIDA, "Taxation in Tanzania – Revenue Performance and Incidence, Country Economic Report" (2005), online: < https://publikationer.sida.se/contentassets/5d939d3268f2481797372783b87f03ce/14722.pdf.

[163] See Article 5(2)(g) of Tanzania's Tax treaties with Sweden, Norway, Finland, Denmark; Articles 5(2)(h) of Tanzania's tax treaty with India; Article 5(3)(a) of Tanzania's tax treaty with South Africa, *supra* note 159.

[164] Article 5(3)(a) of Tanzania's tax treaty with Canada, *supra* note 159.

[165] Article 5(2)(g) of Tanzania's tax treaty with Italy, *supra* note 159.

[166] These are higher and middle-income countries with higher GDP per Capita.

B. Supervisory Activities

Supervisory activities constitute a PE in Tanzania's the tax treaties with only Canada, Italy, India, and South Africa.[167] The UN Model extends source taxation to cover supervisory activities in connection with building sites and construction, assembly or installation projects.[168] The absence of this provision in the majority of Tanzania's tax treaties is a missed opportunity to expand Tanzania's taxing rights over business profits derived by non-resident enterprises involved in supervisory activities in connection with construction projects in the country. Unlike Tanzania, supervisory activities constitute a PE in all of Nigeria's tax treaties. It is therefore argued that Tanzania should amend its tax treaties with its other treaty partners to include the provision.

C. Use of Facilities Solely for Delivery

The use of facilities solely for delivery qualifies as a PE under the UN Model.[169] This provision exists in Tanzania's tax treaty with only India.[170] The lack of provision for taxing facilities solely for the purpose of delivery in most of Tanzania's tax treaties is a missed opportunity to broaden Tanzania's taxing power, especially over online retailers who would usually only maintain warehouses for delivering physical goods in source countries.[171]

D. Service PE

A service PE provision is present in Tanzania's tax treaties with only Canada[172] and South Africa.[173] Time threshold for services by non-resident enterprises in the tax treaty with Canada is

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[167] See Article 5(3)(a) of Tanzania's tax treaties with Canada, South Africa; Article 5(2)(h) of Tanzania's tax treaty with India; Article 5(2)(i) of Tanzania's tax treaty with Italy, *supra* note 159.
[168] Article 5(3)(a) of the UN Model, *supra* note 2.
[169] Article 5(4) of the UN Model, *supra* note 2.
[170] Article 5(3)(a) of Tanzania's tax treaty with India, *supra* note 159.
[171] Siddhesh Rao, "The PE Definition: A Threshold for Source State Taxation" *supra* note 89.
[172] Article 5(3)(b) of Tanzania's tax treaty with Canada, *supra* note 159.
[173] Article 5(3)© of Tanzania's tax treaty with South Africa, *supra* not 159.

for a period or periods aggregating to more than six months within any twelve-month period.[174] It is for a period or periods exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned in the tax treaty with South Africa.[175] These thresholds have revenue implications for Tanzania. It is recommended that the time threshold for service PE in Tanzania's tax treaties should be removed to include services provided by non-resident enterprises in Tanzania that fall below the prescribed thresholds. The provision of services by a PE is enough nexus to trigger source taxation of income derived from the activity.

Only one of Tanzania's tax treaties (treaty with Canada) contains the words "connected projects" in the service PE provision. As discussed above, the conditions created by the non-inclusion of these words in the service PE provision create opportunities for enterprises to avoid source taxation. Tanzania should, therefore, reform its tax treaty with other signatory partners to include the anti-avoidance provision.

The lack of service PE provision in most of Tanzania's tax treaties greatly restricts the scope for source taxation of economic activities of non-residents in Tanzania, especially because services contribute almost 50% of Tanzania's GDP[176] and can generate large tax revenues. Tanzania should reform its tax treaties to include the service PE provision in the UN Model subject to the changes to the conditions proposed above.

E. Anti-fragmentation Rule

The anti-fragmentation rule provides that the activities if divided artificially will be combined, provided they are carried on by closely related entities and constitute complementary functions

[174] *Supra* note 172.
[175] *Supra* note 173.
[176] Deloitte, "Tanzania Economic Outlook 2016: The Story Behind the Numbers", online: < https://www2.deloitte.com/content/dam/Deloitte/tz/Documents/tax/Economic%20Outlook%202016%20TZ.pdf> See also https://www.nordeatrade.com/en/explore-new-market/tanzania/economical-context.

that are part of a cohesive business operation.[177] The implication of this provision is that any ingenious strategy by MNCs to fragment cohesive business operations into small operations in order to avoid the PE threshold will be caught by the anti-fragmentation rule. This provision is, however, absent in Tanzania's tax treaty network.

F. Non-resident Insurance Enterprises

The UN Model allows source taxation of non-resident insurance enterprises (except with regards to reinsurance) that act in a source state directly or through dependent agents.[178] There is no need for a fixed base of business or any time threshold to trigger source taxation.[179] This provision is present in Tanzania's tax treaty with only Canada[180] and South Africa.[181] This is an important provision that expands source taxing rights by automatically creating a nexus for source taxation of non-resident insurance enterprises and should be replicated in all of Tanzania's tax treaties.

G. Dependent Agent

Another important provision that expands source taxation is contained in paragraphs 5 and 7 of Article 5 of the UN and OECD Models.[182] These provide for a possibility in which a PE exists in respect of activities undertaken by a person on behalf of an enterprise, thus enabling source countries to tax the profits of an enterprise derived from activities performed on its behalf by dependent agents. The UN Model contains additional source expanding provisions by including habitual maintenance of a stock of goods or merchandise from which that person regularly delivers goods or merchandise on behalf of the enterprise to the list of activities of dependent agents taxable

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[177] Paragraphs 4.1 of Article 5 of the UN and OECD Model Tax Conventions, *supra* note 2.
[178] Article 5(6) of the UN Model, *supra* note 2.
[179] *Ibid*.
[180] Article 5(6) of Tanzania's tax treaty with Canada, *supra* note 159.
[181] Article 5(6) of Tanzania's tax treaty with South Africa, *supra* note 159.
[182] Article 5(5) and 5(7) of the UN and OECD Model Tax Conventions, *supra* note 2.

in a source country.[183] This expanded provision is contained in Tanzania's tax treaties with only India[184] and Zambia.[185] It is recommended that Tanzania should reform other tax treaties by including this provision to expand source taxation of profits derived by residents of the other contracting states.

H. Taxation of the Digital Economy

Under Tanzania's tax statute, business profits are taxable only to the extent that a non-resident enterprise has in the country a PE to which the profits are attributable.[186] As is the case under international tax rules, PE under Tanzania's Income Tax Act is measured by some degree of tangible presence.[187] The Income Tax Act lists the following examples of a PE: a place where a person is carrying on business; a place where a person has used or installed, or is using or installing substantial equipment or substantial machinery; a place where a person is engaged in a construction, assembly or installation project.[188]

The insistence on physical presence creates gaps for taxation of income from online business activities where tangible properties may not be located in Tanzania but in other jurisdictions. This means that profits from online businesses carried on in Tanzania will be left untaxed. The OECD acknowledges the opportunities for base erosion and profiting shifting in the digital economy,[189] and is developing a consensus solution to the tax challenges raised by the digitalisation of the

[183] Article 5(5)(b) of the UN Model Tax Convention, *supra* note 2.
[184] Article 5(4) of Tanzania's tax treaty with India, *supra* note 159.
[185] Article III(5)(b) of Tanzania's tax treaty with Zambia, *supra* note 159.
[186] *Income Tax Act Tanzania* (2019), s 4 & 8.
[187] Section 3 of Tanzania's Income Tax Act, *ibid*.
[188] *Ibid*.
[189] *Addressing the Tax Challenges of the Digital Economy* (Paris: OECD Publishing, 2014).

economy through the Inclusive Framework.[190] Tanzania is not a member of the OECD Inclusive Framework.[191] Thus it is not committed to the implementation of the proposed uniform rules by the OECD. Tanzania's non-involvement in the OECD digital tax architecture may be because of its cost implications, lack of clarity on revenue impact, lack of administrative capacity to participate, and power imbalances within the Inclusive Framework.[192] Some counties, even some members of the Inclusive Framework, have introduced their own initiatives for national taxes on digital companies.[193] To capture profits from online businesses, Tanzania should consider enacting a digital service tax law with provisions designed to balance the need to raise revenue and also to promote investment and growth in its digital economy.[194] Tanzania can refer to the Suggested Approach to drafting legislation on Digital Sales Tax Services published by the African Tax Administration Forum (ATAF) and the digital service tax laws enacted by Nigeria and a fellow East African country, Kenya.[195]

6.2 How Broad are the Items of Income which could be Included in Article 7?

As discussed above, Article 7(1) of the UN Model introduces a limited 'force of attraction rule'.[196] The limited force of attraction rule allows source countries to tax other business profits earned

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[190] OECD, "Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy", Online: < https://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf>.

[191] OECD, "Members of the OECD/G20 Inclusive Framework on BEPS", online: < https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf>.

[192] Joy Ndubai, "If Developing Countries are not Listened to at the OECD, They Will Vote with Their Feet" (28 November 2019) ICTD (blog), online: < https://www.ictd.ac/blog/developing-countries-oecd-inclusive-framework-consensus/>.

[193] Jason Osborn, Michael Lebovitz & Astrid Pieron, "Unilateral Taxation of the Digital Economy: The Fight is Not Over Yet—It's Only Beginning" (2020) Tax Executive Journal, online: < https://taxexecutive.org/unilateral-taxation-of-the-digital-economy/.

[194] ATAF, "ATAF Publishes an Approach to Taxing the Digital Economy", online: < https://www.ataftax.org/ataf-publishes-an-approach-to-taxing-the-digital-economy>.

[195] *Ibid*.

[196] Article 7(1) of the UN Model, *supra* note 2.

outside of the PE from sale of the same or similar kind as those sold through the PE. The limited force of attraction rule is present in Tanzania's tax treaty with only Canada.[197] Therefore, activities similar in nature to those conducted by the PE by residents of other contracting states will not be taxed in Tanzania. I argue that Tanzania should reform these treaties to include the limited force of attraction rule to capture profits derived from similar activities outside of PEs by non-resident enterprises.

Also, as discussed above, Article 7(3) of the OECD and UN Model explicitly lists allowable deductions in the determination of the profits of a permanent establishment as "expenses which are incurred for the purposes of the business of the permanent establishment".[198] The UN Model also denies a deduction by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees, commissions for specific management services. Only one of Tanzania's tax treaties (treaty with South Africa) has the expanded restrictions on allowable deductions in the UN Model.[199] The provision in Tanzania's treaty with Zambia is particularly egregious. Article IV (4) of the treaty allows as deductions "all expenses, including administrative and executive expenses, which would be deductible if the permanent establishment were an independent enterprise in so far as they are reasonably allocable to the permanent establishment, whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere".[200]

Zambia is a low-income country. Although it has abundant natural resources, it derives little tax revenue from their extraction due to fiscal incentives granted to non-resident enterprises and other

[197] Article 7(1) of Tanzania's tax treaty with Canada, *supra* note 159.
[198] Article 7(3) of the UN Model *supra* note 2.
[199] Article 7(3) of Tanzania's tax treaty with South Africa, *supra* note 159.
[200] Article IV (4) of Tanzania's tax treaty with Zambia, *supra* note 159.

opportunities for corporate tax avoidance.[201] In essence, it is possible for non-resident enterprises to exploit this treaty provision to erode profits from Tanzania to low or no tax jurisdictions.[202] It is recommended that this provision be amended to conform to the provision in the UN Model, which only allows as deductions expenses which are incurred for the purposes of the business of the permanent establishment.

6.3 Overall Assessment

The analysis reveals that most of Tanzania's tax treaties contain source-restrictive provisions for taxing business income earned by non-residents. Out of the nine tax treaties signed by Tanzania, none has a low threshold (three months) for building projects; none lists supervisory activities as part of the activities that constitute a PE; only one includes delivery in the list of activities that constitute a PE; two have service PE provisions; none has the anti-fragmentation rule; two allow taxation of non-resident insurance enterprises; and two include habitual maintenance of a stock of goods by dependent agents as activities that constitute a PE. Unlike Nigeria, Tanzania does not have a digital service tax law. I argue that Tanzania should reform its tax treaties to allow for expansive source taxation of business income derived by non-resident companies. I further argue that Tanzania should enact a digital service tax law to capture income derived by non-residents from digital services performed in the country.

[201] War on Want, "Extracting Minerals, Extracting Wealth: How Zambia is Losing $3 billion a Year from Corporate Tax Dodging", (1 October 2015), online: < https://www.waronwant.org/sites/default/files/WarOnWant_ZambiaTaxReport_web.pdf>.

[202] See the ICIJ Report on how multinational corporations exploit tax treaties signed by African countries to divert revenue to low or no-tax jurisdictions - ICIJ, "Treasure Island: Leak Reveals How Mauritius Siphons Tax From Poor Nations to Benefit Elites", (23 July 2019), online: https://www.icij.org/investigations/mauritius-leaks/treasure-island-leak-reveals-how-mauritius-siphons-tax-from-poor-nations-to-benefit-elites/?utm_content=buffer8297e&utm_medium=social&utm_source=twitter.com&utm_campaign=Buffer+-+Twitter.

7. Source Taxation of Business Profits in Botswana's Tax Treaties: Key Findings

Botswana has sixteen tax treaties in operation.[1] These were signed between 1977 and 2019 with the following countries: Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, United Kingdom, Zambia, and Zimbabwe.[2] Compared to Nigeria and Tanzania, Botswana has the most tax treaties. Its contracting states are spread between high-income countries, middle-income countries, and low-income countries. Botswana also has the most tax treaties with other African countries compared to Nigeria and Tanzania.

Botswana is blessed with abundant natural resources and is heavily dependent on mineral revenue.[3] Over-reliance on mineral revenue has, however, impacted Botswana's ability to maximize other sources of fiscal revenue and, in turn, its tax-to-GDP ratio.[4] According to the OECD, Botswana's tax-to-GDP ratio in 2018 (12.1%) was lower than the average of 30 African countries (16.5%) by 4.4 percentage points and also lower than the average in Latin America and the Caribbean (23.1%).[5] The implementation of sustainable fiscal policies is necessary to foster a stable environment for socio-economic development in Botswana. The reform of Botswana's tax treaty network to include expansive source-taxing rights over business profits will increase domestic resource mobilization necessary for socio-economic development in the country.

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[1] International Bureau of Fiscal Documentation, "Tax Treaties Database", online: https://www.ibfd.org/IBFD-Products/Tax-Treaties-Database.

[2] *Ibid*.

[3] Hany Besada & Ben O'Bright, "Policy Impacts on Africa's Extractive Sector: Botswana, Diamond Dependence, and Diversification in the Post-Diamond Period" (2018) 15:2 Revue Gouvernance Journal 86.

[4] *Ibid*. See also OECD, "Revenue Statistics in Africa 2020 – Botswana", online: < https://www.oecd.org/countries/botswana/revenue-statistics-africa-botswana.pdf>.

[5] OECD *ibid*.

7.1 How broad is the Permanent Establishment (PE) Concept under Article 5?

There is no uniformity with regard to the PE provision in Botswana's tax treaties; some align with the provisions in the UN Model while some lean towards the restrictive PE threshold in the OECD Model. The details of the analysis of the PE provision in Botswana's tax treaties are as follows:

A. Low Time Threshold

Time threshold for a building site or construction or assembly project or supervisory activities to constitute a PE is more than six months in all the treaties[6], except in the treaty with China where it is more than twelve months[7], Lesotho and Seychelles where it is not less than 183 days[8], and Zambia where it is more than 183 days.[9]

Overall, a lower threshold will be beneficial to Botswana, and it is recommended that Botswana's tax treaties (especially the tax treaty with China) adopt a lower time threshold. A lower threshold will trigger taxation of significant activities that are conducted within a short period of time. A cue can be taken from the time threshold in Nigeria's tax treaties where it is three months in all the tax treaties, except in the tax treaties with Singapore, South Africa, and China where it is six months.

B. Supervisory Activities

Supervisory activities constitute a PE in all the treaties[10], except in the treaty with Ireland.[11] The absence of this provision in the treaty limits Botswana's taxing rights over business profits from supervisory activities. It is recommended that Botswana should reform its treaty with Ireland to

[6] Article 5(3)(a) of Botswana's tax treaties with Barbados, Czech Republic, France, India, Ireland, Malta, Mauritius, Russia, South Africa, United Kingdom, Zimbabwe; and Article 5(3) of Botswana's tax treaty with Sweden, *supra* note 203.
[7] Article 5(3)(a) of Botswana's tax treaty with China, *supra* note 203.
[8] Article 5(3)(a) of Botswana's tax treaties with Lesotho and Seychelles, *supra* note 203.
[9] Article 5(3)(a) of Botswana's tax treaty with Zambia, *supra* note 203.
[10] Article 5(3)(a) of Botswana's tax treaties with Barbados, China, Czech Republic, France, India, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, United Kingdom, Zambia, Zimbabwe, *supra* note 203.
[11] Article 5(3)(a) of Botswana's tax treaty with Ireland, *supra* note 203.

include supervisory activities in connection with building activities in line with the provisions of the UN Model.[12]

C. Use of Facilities Solely for Delivery

The use of facilities solely for delivery qualifies as a PE under the UN Model.[13] Delivery activities are not considered auxiliary or preparatory under the UN Model; they are part of the list of activities that constitute PEs.[14] This provision is present in all the tax treaties, except in the treaty with China, France, Ireland, and Malta.[15] It is interesting to see the distinctiveness of the tax treaties signed by Nigeria, Tanzania, and Botswana because this provision is present in Nigeria's tax treaty with China. It is argued that Botswana should reform its tax treaties with China, France, Ireland, and Malta to include the provision. If China could agree to this provision with Nigeria, Botswana should be able to advocate for similar treatment.

D. Service PE

A service PE provision is present in Botswana's tax treaties[16], except the treaty with Sweden. The time threshold, however, varies in the tax treaties. The time threshold for services by non-resident enterprises in the tax treaties with Lesotho and Seychelles is for a period or periods aggregating not less than 183 days in any twelve-month period commencing or ending in the fiscal year concerned.[17] It is for a period or periods aggregating more than 183 days in any 12 month period in the tax treaties with China, United Kingdom, South Africa, and Barbados.[18] It is for a period of more than six months in the tax treaties with Czech Republic, France, Ireland, Malta, Mauritius,

[12] Article 5(3)(a) of the UN Model, *supra* note 2.
[13] Article 5(4) of the UN Model, *supra* note 2.
[14] *Ibid*.
[15] Article 5(4)(a) of Botswana's tax treaties with China, France, Ireland, and Malta, *supra* note 203.
[16] Article 5(3)(b) of Botswana's tax treaties with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, United Kingdom, Zambia, and Zimbabwe, *supra* note 203.
[17] *Ibid*.
[18] *Ibid*.

Russia, and Zimbabwe.[19] As discussed in the previous sections, these thresholds have revenue implications for the comparator states. It is therefore recommended that the time threshold for service PE in Botswana's tax treaties should be removed to include services provided by non-resident enterprises in Botswana that fall below the prescribed thresholds. The provision of services by a PE is enough nexus to trigger source taxation of income derived from the activity.

The service PE provision in Botswana's tax treaties, except the treaty with Czech Republic[20] and Sweden contain the words "connected projects". As discussed in the previous sections, the conditions created by the non-inclusion of these words in the service PE provision create opportunities for enterprises to avoid source taxation. Botswana should, therefore, reform its tax treaties to include these words in the service PE provisions in its tax treaties with Czech Republic and Sweden.

E. Anti-fragmentation Rule

The anti-fragmentation rule provides that the activities if divided artificially will be combined, provided they are carried on by closely related entities and constitute complementary functions that are part of a cohesive business operation.[21] The implication of this provision is that any ingenious strategy by MNCs to fragment cohesive business operations into small operations to avoid the PE threshold will be caught by the anti-fragmentation rule. This provision is, however, absent in Botswana's tax treaty network. It is therefore argued that Botswana should reform its tax treaties to include this anti-avoidance provision against tax planning by MNCs seeking to take advantage of the gaps in the treaty provisions.

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[19] *Ibid*.
[20] *Ibid*.
[21] Paragraphs 4.1 of Article 5 of the UN and OECD Model Tax Conventions, *supra* note 2.

F. Non-resident Insurance Enterprises

Paragraph 6 of Article 5 of the UN Model is another provision that expands source taxation.[22] It creates a nexus between a non-resident insurance enterprise (except with regards to reinsurance) that acts in a source state directly or through a dependent agent. There is no need for a fixed base of business or any time threshold to trigger source taxation.[23] This provision is absent in Botswana's tax treaties with China, France, Ireland, Mauritius, Russia, South Africa, Sweden, United Kingdom. This is an important provision that expands source taxing rights by automatically creating a nexus for source taxation of non-resident insurance enterprises and should be replicated in all of Botswana's tax treaties. Obviously, Botswana should reform its tax treaties with these countries to include this provision.

G. Dependent Agent

Another important provision that expands source taxation is contained in paragraphs 5 and 7 of Article 5 of the UN and OECD Models.[24] These provide for a possibility in which a PE exists in respect of activities undertaken by a person on behalf of an enterprise, thus enabling source countries to tax the profits of an enterprise derived from activities performed on its behalf by dependent agents. The UN Model contains additional source expanding provisions by including habitual maintenance of a stock of goods or merchandise from which that person regularly delivers goods or merchandise on behalf of the enterprise to the list of activities of dependent agents taxable in a source country.[25] This provision is absent in Botswana's tax treaties with China, France, Ireland, Malta, and United Kingdom. These are top economies in the world, leading in terms of export trade. It is therefore recommended that Botswana should reform its tax treaties with these

[22] Article 5(6) of the UN Model, *supra* note 2.
[23] *Ibid*. see also Jinyan Li, *supra* note 1.
[24] Article 5(5) and 5(7) of the UN and OECD Model Tax Conventions, *supra* note 2.
[25] Article 5(5)(b) of the UN Model Tax Convention, *supra* note 2.

countries to include habitual maintenance of a stock of goods by dependent agents on behalf of an enterprise to the list of activities of dependent agents taxable in a source country.

H. Taxation of the Digital Economy

Taxation of digital activities is another area where Botswana can expand its taxing rights to increase domestic revenue. As argued in the previous sections, the PE concept is outdated in view of the sophisticated forms of cross-border economic activities without the need for physical presence in host countries, hence the need to realign international tax rules to suit the realties of the twenty-first century.

The OECD is developing new allocation rules to ensure that the allocation of taxing rights with respect to business profits is no longer exclusively circumscribed by reference to physical presence.[26] Botswana is part of the OECD Inclusive Framework, thus committed to implementing measures on taxation of the digital economy.[27] In addition to the OECD's multilateral proposal, countries have also enacted unilateral measures for taxing the digital economy. Botswana's domestic law, however, does not capture digital activities.[28] To respond to this gap, it is recommended that Botswana should analyse the impact of the digital economy, enact a unilateral digital services tax, and assess the cost vis-à-vis the benefits of its involvement in the OECD global framework. The asymmetry between the participants in the Inclusive Framework and the way decisions are being made threaten the possibility of a truly inclusive solution that can be adopted by Botswana. To capture profits from online businesses, Botswana should consider enacting a

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[26] *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, (Paris: OECD Publishing,2020); *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, (Paris: OECD Publishing, 2020).

[27] OECD, "Members of the OECD/G20 Inclusive Framework on BEPS", online: < http://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf>.

[28] *Income Tax Act (Botswana)*, 2021.

digital service tax law with provisions designed to balance the need to raise revenue and to promote investment and growth in the digital economy. Botswana can refer to the Suggested Approach to drafting legislation on Digital Sales Tax Services published by the African Tax Administration Forum (ATAF)[29] and the digital service tax laws enacted by Nigeria and Kenya.[30]

7.2 How Broad are the Items of Income which could be Included in Article 7?

As discussed above, Article 7(1) of the UN Model introduces a limited "force of attraction rule'.[31] The rule allows source countries to tax other profits earned outside of the PE by the head office from the sale of goods of the same or similar kind as those sold through the PE or profits from other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment. A limited force of attraction rule is absent in all Botswana's tax treaties. This means that Botswana is not allowed to tax business profits earned by non-resident enterprises from the sale of goods or other business activities of the same or similar kind as those effected through a PE. The absence of this provision in all Botswana's tax treaties significantly reduces source taxation of non-residents in Botswana. Therefore, it is recommended that Botswana reform its tax treaties to include a limited force of attraction rule in accordance with the UN Model.

Also, as discussed above, Article 7(3) of the UN Model explicitly lists allowable deductions in the determination of the profits of a permanent establishment as "expenses which are incurred for the purposes of the business of the permanent establishment".[32] Allowable deductions in all Botswana's tax treaties are only those incurred for the purposes of the business of the PE in line

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[29] ATAF, "ATAF Publishes an Approach to Taxing the Digital Economy", online: < https://www.atafax.org/ataf-publishes-an-approach-to-taxing-the-digital-economy>.
[30] *Ibid*.
[31] Article 7(1) of the UN Model, *supra* note 2.
[32] Article 7(3) of the UN Model, *supra* note 2.

with the UN Model.[33] Also, payments by the PE to the head office of the enterprise or any of its other offices, such as royalties, fees, commissions for specific services are disallowed, except if they are reimbursement for actual expenses incurred by the PE, in all the treaties[34], except the treaty with China.[35] It is recommended that Botswana should amend its tax treaty with China to disallow deduction of payments by the PE to the head office of the enterprise or any of its other offices except they are reimbursement for actual expenses incurred for the purposes of the business of the PE. The amendment of the tax treaty with China will be a measure to counter base-eroding payments.

7.3 Overall Assessment

The analysis indicates that most of Botswana's tax treaties have source-expansive provisions for taxing business profits earned by non-residents. Out of the 16 treaties signed by Botswana, 15 list supervisory activities as part of the activities that constitute a PE; two include delivery in the list of activities that constitute a PE; 15 have service PE provisions; 13 allow taxation of non-resident insurance enterprises; 11 include habitual maintenance of a stock of goods by dependent agents as activities that constitute a PE. However, none has a low threshold (three months) for building projects nor the anti-fragmentation rule. Botswana does not have any provision, either in its tax treaties or its domestic tax laws, for taxing income earned by non-residents from digital services carried out in the country. To promote domestic resource mobilization in Botswana, I recommend that Botswana reform its tax treaties to ensure that they all aligned to ensure source-expansive taxing rights for business profits earned by non-residents. I further argue that Botswana should

[33] Article 7(4) of Botswana's tax treaty with Barbados; Article 7(3) of Botswana's tax treaties with China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, Sweden, United Kingdom, Zambia, and Zimbabwe, *supra* note 203.
[34] *Ibid*.
[35] Article 7(3) of Botswana's tax treaty with China, *supra* note 203.

enact a digital service tax law to capture income derived by non-residents from digital services performed in the country. The implementation of these reforms will ensure increased tax revenue from economic activities carried out by non-residents in the country.

8. Conclusion

The analysis in this chapter raises important findings for consideration by Nigeria, Tanzania, and Botswana to drive reforms to tax treaties as a way to improve domestic resource mobilization to help finance socio-economic development. This chapter focuses on Articles 5 and 7 of the treaties, which deal with taxation of business profits by non-residents in host countries. Below is a summary of the results of the analysis.

First, the analysis shows that there are no unique provisions in the treaties signed by these countries with fellow African countries. Nigeria has only one tax treaty with a fellow African country – South Africa. Tanzania has tax treaties with two African countries – South Africa and Zambia. Botswana has the most tax treaties with African countries – Seychelles, South Africa, Zambia, Zimbabwe, Lesotho, and Mauritius. All these treaties, however, contain the OECD and UN Model provisions. Adopting tax treaty provisions that allow source-expansive taxing rights for business profits in tax treaties with fellow African countries might be a great step towards creating source-expanding provisions in all the treaties. The rationale for this argument is that even though there is no clear-cut evidence on the positive impact of tax treaties on FDI, it would take the African governments some time to settle for a no-tax treaty situation. Adopting tax provisions that allow source-expanding provisions for business profits in tax treaties signed with fellow African countries would indicate to the rest of the world a common African position on cross-border tax rules. African governments can then build upon that basis for reform or cancellation of tax treaties signed with the rest of the world. It may be difficult to challenge the status quo without providing a different alternative. Nigeria, Tanzania, Botswana, and other African countries should design an alternative to the OECD and UN Models and adopt the same, first, with each other, and then with the rest of the world.

Closely linked to the observation above is the fact that the tax treaties signed by Nigeria, Tanzania, and Botswana do not reflect the economic status of these countries compared to their treaty partners. In other words, the fact that most of the treaties signed by the countries are with countries that are more economically developed does not translate into source-expanding provisions in the treaties. This situation is inappropriate and should constitute a basis for tax treaty reform.

Third, the analysis shows the distinctiveness of each tax treaty. Even in cases where the countries have the same contracting state partners, the provisions in the tax treaties are not the same. For example, while the use of facilities for delivery constitutes a PE in Nigeria's tax treaty with China, delivery is included in the list of activities that do not constitute a PE in Botswana's tax treaty with China. An insurance enterprise that acts in a source state directly or through a dependent agent does not constitute a PE in Nigeria's tax treaty with Canada but does in Tanzania's tax treaty with Canada. Habitual maintenance of a stock of goods or merchandise by dependent agents constitutes a PE in Botswana's tax treaty with India but does not in Tanzania's tax treaty with India.

Fourth, compared to Nigeria and Botswana, Tanzania has the most source-restrictive treaty provisions for taxing business profits. Out of the nine tax treaties signed by Tanzania, none has a low threshold (three months) for building projects; none lists supervisory activities as part of the activities that constitute a PE; only one includes delivery in the list of activities that constitute a PE; two have service PE provisions; none has the anti-fragmentation rule; two allow taxation of non-resident insurance enterprises; and two include habitual maintenance of a stock of goods by dependent agents as activities that constitute a PE.

Botswana has the most source-expansive treaty provisions for taxing business profits. Out of the 16 treaties signed by Botswana, 15 list supervisory activities as part of the activities that constitute a PE; two include delivery in the list of activities that constitute a PE; 15 have service PE provisions; 13 allow taxation of non-resident insurance enterprises; 11 include habitual maintenance of a stock of goods by dependent agents as activities that constitute a PE. However, none has a low threshold (three months) for building projects nor the anti-fragmentation rule.

Nigeria is also progressive in terms of the number of treaties with source-expanding provisions for taxing business profits. Out of 13 treaties signed by Nigeria, 10 have low threshold (three months) for building projects; 13 list supervisory activities as part of the activities that constitute a PE; two include delivery in the list of activities that constitute a PE; four have service PE provisions; none has the anti-fragmentation rule; one allows taxation of non-resident insurance enterprises; 11 include habitual maintenance of a stock of goods by dependent agents as activities that constitute a PE.

The solution to the problem of double taxation formulated in the 1920s was that a source country should give up its taxing rights over non-residents except for income from permanent establishments. This policy was justifiable when it was adopted – as a matter of administrative convenience – because income flows among treaty countries were balanced. As between capital exporting countries and capital importing countries, source restricting provisions create huge revenue loss to the latter because capital flows are uneven. The three African countries studied in this chapter are capital importing countries. For this reason, source-restricting provisions lead to significant revenue losses for them. It is, therefore, recommended that they reform their tax treaties to ensure that business profits derived from significant economic activities carried on in their jurisdictions are taxed therein.

Overall, the analysis in this chapter shows the different elements that whittle down the taxing powers of the three African states, both in brick-and-mortar businesses, and in the digital economy. Since corporate income taxes are important for these countries, reforms to source-restrictive provisions in their tax treaties can be the foundation for creating sustainable tax systems necessary for fostering socio-economic development.

Chapter V - Taxing Passive/Investment Income in Nigeria, Tanzania, And Botswana

1. Introduction

The preceding chapter examined the limitations for source taxation of business income and how those limitations applied to the tax treaties signed by three African countries (Nigeria, Tanzania, and Botswana). This chapter examines the limitations for source taxation of passive income earned in source countries, and how those limitations apply to the tax treaties signed by the three African countries. The key conclusion from the previous chapter is that the tax treaties signed by the comparator countries contain various source-restrictive provisions for taxation of business profits of non-residents. This is why I recommended that the countries should reform their tax treaties to ensure that business profits derived from significant economic activities carried on in their states are taxed therein. I recommend as well, that the comparator countries should start by adopting tax treaty provisions that allow source-expanding provisions for business profits in tax treaties with fellow African countries, and build upon this to reform or cancel tax treaties signed with the rest of the world.

One of the objectives of tax treaties is to facilitate international trade and investment by providing for the prevention of double taxation.[1] This objective is achieved by restricting the tax base and the taxing rights of source countries.[2] The threshold for taxing business income is increased to restrict the tax base of non-resident enterprises carrying on economic activities in source states. For passive/investment income, low or no withholding tax rates are prescribed for source taxation,

[1] Kim Brooks, "Canada's Evolving Tax Treaty Policy Toward Low-Income Countries" in Arthur Cockfield, ed, *Globalization and its Tax Discontents: Tax Policy and International Investments: Essays in Honour of Alex Easson* (Toronto: University of Toronto Press, 2010) 189 at 190-191.
[2] *Ibid*.

thus limiting the tax revenue accruing to source states from investment earned by non-residents in their jurisdictions.[3]

The overarching argument that this chapter makes is that the tax treaties of Nigeria, Tanzania, and Botswana can and should be reformed to increase their abilities as source countries to tax passive income. To come to this conclusion, section 2 discusses the provisions on taxation of dividends in the OECD Model, UN Model, and the comparator countries. A similar analysis is done on taxation of interest, royalties, and technical services in sections 3, 4, and 5. This chapter concludes by proposing reforms to the tax treaty provisions signed by the comparator countries to ensure that they derive maximum benefits (in terms of tax revenue) from activities carried on within their jurisdictions yielding investment income.

2. Taxation of Dividends

Dividends are income distributed by a company to its shareholders out of its profits.[4] When a foreign person conducts business in the source state through a corporate entity, the remuneration from the investment may be in the form of dividends (or as discussed below, royalties or interest, depending on the arrangements) and the foreign person is taxable on the profits distributed (dividends) by the company.[5]

2.1 Allocation of Taxing Rights

Article 10 of the OECD Model allows concurrent taxation of dividends by the source and residence states.[6]

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[3] *Ibid*.
[4] Commentary on Article 10 of the OECD, *Model Tax Convention on Income and Capital* (Paris: OECD, 2017) at 230.
[5] Carlo Garbarino, *Taxation of Bilateral Investments: Tax Treaties After BEPS* (United Kingdom: Elgar Publishing, 2019) at 113.
[6] Article 10 (1) & (2) of the OECD Model, *supra* note 4.

Similar to the provision of Article 10 of the OECD Model, Article 10 of the UN Model allows concurrent taxation of dividends by the source and residence states.[7]

All of Nigeria's tax treaties allow source taxation of dividends.[8] All of Tanzania's tax treaties, except the treaty with Zambia, allow source taxation of dividends.[9] All of Botswana's tax treaties allow source taxation of dividends.[10] Tanzania should amend its treaty with Zambia to allow for source taxation of dividends. Low tax rates or outright exemption of investment income earned in Tanzania holds no benefit for Tanzania. It only creates opportunities for treaty shopping where residents of developed countries enjoy the benefits of tax treaties not intended for them, to the detriment of the source state.[11] Investors can easily set up a conduit company in Zambia and route investment income earned in Tanzania through that conduit company, thereby paying little or no tax to the Tanzanian government. The income, in turn, is transferred to the residence state or tax havens which translate to no tax revenue for both the Tanzanian and Zambian governments.[12]

2.2 Maximum Rates

Article 10(2) of the OECD Model prescribes a low withholding tax rate of five percent for source taxation of direct investment dividends and fifteen percent for portfolio dividends.[13]

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[7] Article 10 (1) & (2) of the UN, *Model Tax Convention on Income and Capital* (New York: UN, 2017).

[8] Article 9(1) of Nigeria's tax treaty with Czech Republic; Article 10(1) of Nigeria's tax treaties with Canada, the United Kingdom, France, the Netherlands, Belgium, Romania, Singapore, the Philippines, South Africa, Pakistan, and China.

[9] Article 11(1) of Tanzania's tax treaty with India; Article 10(1) of Tanzania's tax treaties with Canada, Denmark, Finland, Norway, South Africa, and Sweden.

[10] Article 10(1) of Botswana's tax treaties with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, United Kingdom, Zambia, and Zimbabwe.

[11] Luc De Broe, *International Tax Planning and Prevention of Abuse* (Amsterdam: IBFD, 2008).

[12] Action Aid, "How Tax Havens Plunder the Poor", (May 2013), online: < http://www.gfintegrity.org/wp-content/uploads/2014/05/ActionAid-Tax-Havens-May-2013.pdf>.

[13] Article 10(2) of the OECD Model, *supra* note 4.

Article 10(2) of the UN Model leaves the withholding tax rates for source taxation of dividends to be established through bilateral negotiations.[14]

There are differences in the prescribed rates for source taxation of dividends in Nigeria's tax treaties. All the treaties, except the treaties with China, Singapore, South Africa, and Romania provide for maximum withholding tax rates of 12.5% of the gross amount of the dividends if the recipient is a company which controls directly or indirectly, at least 10% of the voting power in the company paying the dividends; and 15% in all other cases.[15] Nigeria's tax treaties with China and Singapore prescribe 7.5% rate for source taxation of dividends in all cases.[16] Nigeria's tax treaty with South Africa prescribes 7.5% rate if the beneficial owner is a company which holds at least 10 per cent of the capital of the company paying the dividends; and 10 per cent of the gross amount of the dividends in all other cases.[17] For the treaty with Romania, the rate prescribed is 12.5% of the gross amount of the dividends in all cases.[18] It is interesting to note that Nigeria's domestic withholding tax rate for dividends paid by non-resident companies is 10%.[19] The implication is that for treaties with higher withholding tax rates than the domestic rates, Nigeria cannot collect more than 10% of dividends paid to residents of those signatory states because tax treaties cannot extend a country's taxing rights.[20] However, for tax treaties with lower rates, the treaty rate is what applies. It is therefore recommended that the treaties with rates lower than the

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[14] Article 10(2) of the UN Model, *supra* note 7.

[15] Article 10(2) of Nigeria's tax treaties with Belgium, Canada, France, Netherlands, Pakistan, Philippines, and the United Kingdom; Article 9(2) of Nigeria's tax treaty with Czech Republic.

[16] Article 10(2) of Nigeria's tax treaties with China and Singapore.

[17] Article 10(2) of Nigeria's tax treaty with South Africa.

[18] Article 10(2) of Nigeria's tax treaty with Romania.

[19] FIRS, "Public Notice to Federal And State Ministries, Departments and Agencies, Local Government Councils, Corporate Organizations and other Collecting Agents on Withholding Tax Monthly Remittances and Returns", online: < https://www.firs.gov.ng/wp-content/uploads/2021/06/PUBLIC-NOTICE-ON-WHT-3.pdf>.

[20] S Leduc & G Michielse, " Are Tax Treaties Worth It for Developing Economies?" in *Corporate Income Taxes under Pressure: Why Reform Is Needed and How It Could Be Designed* (Washington DC: IMF, 2021).

domestic rates (China, Singapore, South Africa) be amended to increase the rates to 10%. Given that the non-resident companies will already be subject to income tax[21], the 10% withholding tax rate on outbound dividend payments sounds reasonable to avoid excessive taxation.

The withholding tax rates in Tanzania's treaties for source taxation of dividends varies. Tanzania's treaty with Canada provides for maximum withholding tax rates of 20% of the gross amount of the dividends if the recipient is a company that controls, directly or indirectly, at least 15% of the voting power in the company paying the dividends; and 25% in all other cases.[22] The treaty with Denmark prescribes a maximum withholding tax rate of 15% in all cases.[23] The treaty with Finland and Norway prescribe a maximum withholding tax rate of 20% in all cases.[24] The treaty with India prescribes a maximum withholding tax rate of 10% of the gross amount of the dividends if the recipient is a company which controls, directly or indirectly, at least 10% of the voting power in the company paying the dividends; and 15% in all other cases.[25] The treaty with Italy prescribes withholding tax rate of 10% in all cases.[26] Tanzania's treaty with South Africa prescribes maximum withholding tax rates of 10% of the gross amount of the dividends if the recipient is a company which controls, directly or indirectly, at least 15% of the voting power in the company paying the dividends; and 20% in all other cases.[27] The treaty with Sweden prescribes maximum withholding tax rates of 15% of the gross amount of the dividends if the recipient is a company which controls, directly or indirectly, at least 25% of the voting power in the company paying the

[21] *Companies Income Tax Act (Nigeria)* 2004, s9.
[22] Article 10(2) of Tanzania's tax treaty with Canada.
[23] Article 10(2) of Tanzania's tax treaty with Denmark.
[24] Article 10(2) of Tanzania's tax treaties with Finland and Norway.
[25] Article 11(2) of Tanzania's tax treaty with India.
[26] Article 10(2) of Tanzania's tax treaty with Italy.
[27] Article 10(2) of Tanzania's tax with South Africa.

dividends; and 25% in all other cases.[28] The treaty with Zambia exempts dividends earned in Tanzania from source taxation.[29]

Similar to Nigeria's domestic withholding tax rate for dividend payments by non-resident payments, Tanzania's domestic withholding tax rate is also 10%.[30] The implication is that though the withholding tax rates for outbound dividend payments in Tanzania's tax treaties are high, Tanzania cannot collect more than 10% of the payments because tax treaties cannot extend a country's taxing rights. As argued above, 10% withholding tax rate on outbound dividend payments is reasonable since the non-resident company will also pay companies income tax in the source country.

The withholding tax rates in Botswana's treaties for source taxation of dividends also varies, but are lower than the rates in Nigeria and Tanzania's tax treaties. Botswana's tax treaties with Mauritius, Russia, Seychelles, and Zimbabwe prescribe maximum withholding tax rates of 5% of the gross amount of the dividends if the recipient is a company which controls directly or indirectly at least 25% of the voting power in the company paying the dividends; and 10% in all other cases.[31] The treaties with Barbados, France, and the United Kingdom prescribe maximum withholding tax rates of 5% of the gross amount of the dividends if the recipient is a company which controls directly or indirectly at least 25% of the voting power in the company paying the dividends; and 12% in all other cases.[32]

[28] Article 10(2) of Tanzania's tax treaty with Sweden.
[29] Article VI of Tanzania's tax treaty with Zambia.
[30] Tanzania Revenue Authority, Withholding Tax, online: https://www.tra.go.tz/index.php/withholding-tax.
[31] Article 10(2) of Botswana's tax treaties with Mauritius, Russia, Seychelles, and Zimbabwe.
[32] Article 10(2) of Botswana's tax treaties with Barbados, France, and the United Kingdom.

Botswana's treaty with India prescribes maximum withholding tax rates of 7.5% of the gross amount of the dividends if the recipient is a company which controls directly or indirectly at least 25% of the voting power in the company paying the dividends; and 10% in all other cases.[33] Botswana's treaty with Zambia prescribes maximum withholding tax rates of 5% of the gross amount of the dividends if the recipient is a company which controls directly or indirectly at least 25% of the voting power in the company paying the dividends; and 7.5% in all other cases.[34] Botswana's treaties with Lesotho and South Africa prescribe maximum withholding tax rates of 10% of the gross amount of the dividends if the recipient is a company which controls directly or indirectly at least 25% of the voting power in the company paying the dividends; and 15% in all other cases.[35] Botswana's treaties with China, Czech Republic, and Ireland prescribe maximum withholding tax rates of 5% of the gross amount of dividends. Botswana's treaty with Malta prescribes maximum withholding tax rates of 5% of the gross amount of the dividends if the recipient is a company which controls directly or indirectly at least 25% of the voting power in the company paying the dividends; and 6% in all other cases.[36] Lastly, Botswana's treaty with Sweden prescribes a withholding tax rate of 15% of the gross amount of dividends.[37]

Botswana's domestic withholding tax rates for outbound dividend payments by non-resident companies is 7.5%[38] and that could be why the withholding tax rates in Botswana's tax treaties are low. In any case, it is proposed that Botswana's tax treaties with withholding tax rates for dividend payments lower than 7.5% be amended to increase the rate to the domestic rate (all of Botswana's

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[33] Article 10(2) of Botswana's tax treaty with India.
[34] Article 10(2) of Botswana's tax treaty with Zambia.
[35] Article 10(2) of Botswana's tax treaties with Lesotho and South Africa.
[36] Article 10(2) of Botswana's tax treaties with China, Czech Republic, and Ireland.
[37] Article 10(2) of Botswana's tax treaty with Sweden.
[38] Botswana Unified Revenue Service, Withholding Tax, online: http://www.burs.org.bw/phocadownload/2011%20withholding%20tax%20rates.pdf.

tax treaties, except the treaties with India, Lesotho, South Africa, and Sweden). Also, it is recommended that Botswana should amend its domestic law and tax treaties to increase the withholding tax rate for dividend payments to 10% in line with Nigeria and Tanzania's domestic rate to boost domestic tax revenue needed to finance socio-economic development.

2.3 Ordering and Force of Attraction Rules

Article 10(4) of the OECD Model makes paragraphs 1 and 2 of Article 10 inapplicable to dividends on shares that are effectively connected with a permanent establishment of the recipient in the source country.[39] In such a case, Article 10(4) of the OECD Model provides that Article 7 governing taxation of business profits will apply.[40] This provision allows source countries to tax outbound dividend payments as business profits, thus obviating the low withholding tax rates in Article 10.

Article 10(4) of the UN Model reproduces the provisions of Article 10(4) of the OECD Model, but also refers to dividends on shares effectively connected to a company performing independent personal services from a fixed base of the recipient in the source state.[41] In this case, Article 10(4) of the UN Model provides that Article 7 or Article 14 (governing taxation of business income or independent personal services) shall apply.[42] The extended restrictions in the UN Model will increase revenue from taxation of outbound dividend payments.

All of Nigeria's tax treaties copy the provisions of Article 10(4) of the UN Model.[43] All of Tanzania's tax treaties, except the treaties with South Africa and Zambia, mirror the provisions of

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[39] Article 10(4) of the OECD Model, *supra* note 4.
[40] *Ibid*.
[41] Article 10(4) of the UN Model, *supra* note 7.
[42] *Ibid*.
[43] Article 9(3) of Nigeria's treaty with Czech Republic; Article 10(3) of Nigeria's treaties with Belgium, France, Pakistan, Romania; Article 10(4) of Nigeria's treaty with Canada, China, Netherlands, Philippines, South Africa, United Kingdom; Article 10(5) of Nigeria's treaty with Singapore.

the UN Model.[44] It is proposed that Tanzania's treaties with South Africa and Zambia be amended to reflect the UN provisions. All of Botswana's tax treaties, except the treaties with the Czech Republic, Ireland, Lesotho, Malta, South Africa, Zambia, and Zimbabwe, mirror the provisions of Article 10(4) of the UN Model.[45] It is similarly proposed that Botswana's treaties with these countries be amended to reflect Article 10(4) of the UN Model to limit the benefits of reduced tax rate over dividend payments to non-residents.

2.4 Income Definition and Geographic Source Rules

Article 10(3) of the OECD Model defines the term "dividends" as income from shares according to the laws of the source state.[46] Article 10(3) of the UN Model copies the definition of dividends in Article 10(3) of the OECD Model.[47] All of Nigeria's tax treaties copy the definition of dividends in the OECD and UN Model.[48] All of Tanzania's tax treaties, except the treaty with Zambia, copy the definition of dividends in the OECD and UN Model. [49] All of Botswana's tax treaties copy the definition of dividends in the OECD and UN Model.[50]

Article 10(5) of the OECD Model clarifies that the provision applies only to dividends paid by a company that is a resident of the source state to a resident of the residence state, and not to

[44] Article 10(4) of Tanzania's tax treaties with Canada, Denmark, Finland, Italy, Norway, Sweden. Article 11(4) of Tanzania's tax treaty with India.
[45] Article 10(4) of Botswana's treaties with Barbados, China, India, Mauritius, Russia, Seychelles, Sweden, United Kingdom; Article 5 of Botswana's treaty with France.
[46] Article 10(3) of the OECD Model, *supra* note 4.
[47] Article 10(3) of the UN Model, *supra* note 7.
[48] Article 9(5) of Nigeria's treaty with Czech Republic; Article 10(3) of Nigeria's treaty with Canada, China, Netherlands, Philippines, South Africa, United Kingdom; Article 10(4) of Nigeria's treaty with Singapore; Article 10(6) of Nigeria's tax treaties with Belgium, France, Pakistan, and Romania.
[49] Article 10(3) of Tanzania's treaties with Canada, Denmark, Finland, Italy, Norway, South Africa, Sweden; Article 11(3) of Tanzania's treaty with India.
[50] Article 10(3) of Botswana's treaties with Barbados, China, Czech Republic, France, India, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, Zambia, Zimbabwe; Article 10(4) of Botswana's tax treaties with Ireland and South Africa.

dividends paid by a company to a resident of a third state.[51] Article 10(5) of the OECD Model also prevents source taxation of the company's undistributed profits, (even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State) or dividends effectively connected with a permanent establishment in a third state.[52] Article 10(5) of the UN Model reproduces the provisions of Article 10(5) of the OECD Model. [53]

Nigeria's tax treaties include the rules in the OECD and UN Model which exclude source taxation of undistributed profits and dividends derived from third states.[54] Tanzania's tax treaties include the rules in the OECD and UN Model which exclude source taxation of undistributed profits and dividends derived from third states.[55] Botswana's treaties include the source rules in the OECD and UN Model which exclude source taxation of undistributed profits and dividends derived from third states.[56] These provisions seek to prevent double taxation. They ensure that only the country where the payer is resident has the primary right to tax the income.

2.5 Anti-avoidance Provisions

The OECD Model includes an anti-abuse provision in Article 10(2), by including a minimum holding period to access the five per cent rate applicable to dividends.[57] The anti-abuse rule restricts the application of the five percent rate to situations where the company that receives the

[51] See the Commentary on Article 10(5) of the OECD Model, *supra* note 4 at 242.
[52] *Ibid*.
[53] Article 10(5) of the UN Model, *supra* note 7.
[54] Article 9(4) of Nigeria's tax treaty with Czech Republic; Article 10(4) of Nigeria's tax treaties with Belgium, France, Pakistan, Romania; Article 10(5) of Nigeria's tax treaties with Canada, Netherlands, Philippines, South Africa, United Kingdom; Article 10(6) of Nigeria's tax treaties with China and Singapore.
[55] Article 10(5) of Tanzania's treaties with Canada, Denmark, Finland, Italy, Norway, South Africa; Article 10(6) of Tanzania's treaty with Sweden; Article 11(5) of Tanzania's tax treaty with India.
[56] Article 10(5) of Botswana's tax treaties with Barbados, China, Czech Republic, India, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, United Kingdom, Zambia, Zimbabwe; Article 10(6) of Botswana's treaties with France and Ireland.
[57] Article 10(2) of the OECD Model, *supra* note 4. This modification is as a result of the 2017 update to the OECD Model *supra* note 4 at 237-239. See also Article 8 of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (MLI) (Paris: OECD, 2016) for a similar provision.

dividend holds directly, at least twenty-five per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend to avoid artificial corporate reorganizations set up by the company to abuse the provision.[58] The 2010 OECD Model did not include the minimum holding period, making it possible for a company with a holding of less than twenty-five percent, shortly before the dividend, to become payable by increasing its holding primarily for the purpose of obtaining the reduction.[59] This anti-abuse rule was included in the 2017 OECD Model as a result of the 2015 OECD Report on preventing the grant of treaty benefits in inappropriate circumstances.[60]

The OECD Model includes another anti-abuse rule in Article 10(2), by restricting the application of the provision to 'beneficial owners' of dividends paid by a company resident in the source country to residents of the other contracting state.[61] In other words, the provision on source taxation of dividends will not apply to income received by a resident of a contracting state who is acting as an agent, nominee, or conduit for another person who in fact receives the benefit of the income concerned.[62]

The UN Model reproduces the anti-abuse provisions of the minimum holding period and the term 'beneficial owner' introduced to Article 10(2) of the OECD Model to restrict the operation of Article 10 to avoid artificial corporate reorganizations set up by companies to abuse the provision.[63]

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[58] *Ibid*.
[59] See the *Base Erosion and Profit Shifting Project Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report* (Paris: OECD, 2015).
[60] *Supra* note 51.
[61] Article 10(2) of the OECD Model, *supra* note 4.
[62] *Ibid*. see also the OECD Commentary on Article 10(2), *supra* note 4 at page 234.
[63] UN Commentary on Article 10(2), *supra* note 7 at 259.

None of Nigeria's tax treaties include the anti-abuse rule of "a minimum holding period" in Article 10(2) of the OECD and UN Model to deny artificial reorganizations set up to exploit the provision. Although the minimum holding rule is present in the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI)[64] and Nigeria is a signatory to the MLI[65], Nigeria has not ratified nor deposited its instrument of ratification with the OECD.[66] This signals no intention to apply the provisions of the MLI to Nigeria's tax treaties.

None of Tanzania's treaties includes the anti-abuse provisions of the minimum holding period introduced to Article 10(2) of the OECD and UN Model to restrict the operation of Article 10 to avoid artificial corporate reorganizations set up by companies to abuse the provision. None of Botswana's treaties include the anti-abuse provisions of the minimum holding period included in Article 10(2) of the OECD and UN Model to restrict the operation of Article 10 to avoid artificial corporate reorganizations set up by companies to abuse the provision.

It is, therefore, proposed that the three countries amend their tax treaties to include the minimum holding provision as an anti-abuse rule to deny corporate reorganizations set up to take advantage of the treaty provision. This provision will have the effect of denying the benefit of the reduced rate for taxation of dividends for transactions entered into for the purpose of securing the benefit of the provision.

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[64] OECD, MLI *supra* note 57.

[65] OECD, "Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting", online: < https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf>.

[66] *Ibid*.

Three of Nigeria's tax treaties (Pakistan, Romania, and the United Kingdom) do not contain the anti-abuse rule in paragraph 2 of Article 10 of the OECD and UN Model, which restricts the provision on taxation of dividends to 'beneficial owners' of dividends paid by a company resident in the source country to residents of the other contracting state.[67] In other words, the benefit of the provision in those treaties will apply to income received by a resident of a contracting state who is acting as an agent, nominee, or conduit for another person who in fact receives the benefit of the income concerned.

Only two of Tanzania's tax treaties (Canada and South Africa) contain the anti-abuse rule in paragraph 2 of Article 10 of the OECD and UN Model, which restricts the provision on taxation of dividends to 'beneficial owners' of dividends paid by a company resident in the source country to residents of the other contracting state.[68]

All of Botswana's tax treaties include the anti-abuse rule in paragraph 2 of Article 10 in both the OECD and UN Models[69], which restricts the application of the provision on taxation of dividends to 'beneficial owners' of dividends paid by a company resident in the source country to residents of the other contracting state.[70]

It is therefore recommended that Nigeria and Tanzania amend their tax treaties to include this anti-abuse rule. This provision will deny the benefit of the reduced tax rate in their tax treaties for dividends paid to residents of their treaty partners acting in the capacity of agent or nominee and not the legal owner.

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[67] Article 10(2) of Nigeria's tax treaties with Pakistan, Romania, and the United Kingdom.
[68] Article 10(2) of Tanzania's tax treaties with Canada and South Africa.
[69] *Ibid*.
[70] Article 10(2) of Botswana's tax treaties with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, United Kingdom, Zambia, and Zimbabwe.

All Nigeria's tax treaties, except the treaties with the Czech Republic, the Netherlands, Philippines, Singapore, and the United Kingdom contain special anti-abuse provisions, limiting the operation of the provision on source taxation of dividends if the right giving rise to the dividends was created or assigned mainly for the purpose of taking advantage of the Article and not for bona fide commercial reasons.[71] This provision is not present in either the OECD or the UN Model. In other words, the provision on taxation of dividends in Nigeria's tax treaties, except the treaties with the Czech Republic, the Netherlands, the Philippines, Singapore, and the United Kingdom, will not apply to dividend transfer transactions created mainly for the purpose of exploiting the reduced withholding tax rates in Nigeria's tax treaties.

None of Tanzania's tax treaties contain the special anti-abuse provision present in Nigeria's tax treaties with Belgium, Canada, China, France, Pakistan, Romania, South Africa, and the United Kingdom. It is also recommended that Tanzania should amend its tax treaties to include this anti-abuse provision to deny the benefit of reduced withholding tax rates in Tanzania's tax treaties regarding dividend transfer transactions created mainly for the purpose of exploiting the reduced withholding tax rates in its tax treaties. Only three of Botswana's tax treaties (treaties with China, Lesotho, and the United Kingdom) contain the special anti-abuse provision present in Nigeria's tax treaties.[72]

It is therefore recommended that the three countries amend their treaties to include this anti-abuse rule to further strengthen their efforts to prevent transactions entered into for the purpose of obtaining a more favourable tax treatment. Strong anti-avoidance provisions are needed to prevent

[71] Article 10(5) of Nigeria's tax treaties with Belgium, China, France, Pakistan, Romania, Article 10(6) of Nigeria's tax treaties with South Africa, United Kingdom; Article 10(7) of Nigeria's tax treaty with Canada.

[72] Article 10(6) of Botswana's tax treaties with China, United Kingdom; Article 10(7) of Botswana's tax treaty with Lesotho.

tax benefits from transactions that lack economic substance, which in turn will increase source taxation in their respective countries.

My rationale for the reform recommendations proposed in regard to the various aspect of taxation of outbound dividend payments by the three comparator states are that: First, they include provisions of the OECD and UN Models allowing source taxation of dividends in their tax treaties in order to increase their tax revenue from income derived by non-residents within their respective jurisdictions. Second, they reform their tax treaties to align the rates prescribed for source taxation of dividends with the rates specified in their domestic tax laws in order to maximize the opportunities for increased tax revenue from outbound dividend payments. I propose that Botswana amend its domestic law and tax treaties to increase the withholding tax rate for dividend payments to 10% in line with Nigeria and Tanzania's domestic rate to boost domestic tax revenue needed to finance socio-economic development. Given that the non-resident companies will already be subject to income tax[73], the 10% withholding tax rate on outbound dividend payments sounds reasonable to avoid excessive taxation. Third, I recommend that they include the force of attraction rule present in the UN Model in all their tax treaties to limit the benefit of the reduced rate for residents of their treaty partners. Lastly, I advance an argument for the inclusion of the anti-avoidance provisions in the OECD and the UN Models (minimum holding period, beneficial ownership rule), and the additional anti-avoidance rule in some of Nigeria's tax treaties in all their treaties to deny treaty benefits to non-residents for transactions created for the purpose of obtaining a more favourable tax treatment. The implementation of these proposals by the three states will

[73] *Companies Income Tax Act (Nigeria), supra* note 21, s9.

lead to effective taxation of dividends paid to non-residents and eventually increased tax revenue generation.

3. Taxation of Interest

It is also possible that a resident of a contracting state receives remuneration of investment (interest) on money lent to a company resident in the source state.[74] Tax treaties allocate taxing rights over interest paid by a company which is a resident of a contracting state to a resident of the other contracting state. Interest is generally a deductible expense; therefore, a total exemption of interest payment from source taxation or reduced withholding tax rate would be a great loss for the source country. This is especially so where the interest payment is to a related entity and in excess of the amount of debt or the interest rate of parties dealing at arm's length.[75]

3.1 Allocation of Taxing Rights

Article 11 of the OECD Model allows concurrent taxation of dividends by the source and residence states.[76] Similar to the provisions of the OECD Model, Article 11(1) and (2) of the UN Model allows both the residence and source state to tax interest arising from the source state.[77]

All of Nigeria's tax treaties allow source taxation of interest payments.[78] All of Tanzania's tax treaties, except the treaty with Zambia, allow source taxation of interest payments.[79] Tanzania

[74] Garbarino, *supra* note 5 at 122.
[75] *Practical Portfolio: Interest, Protecting the Tax Base of Developing Countries Against Base-eroding Payments: Interest and other Financing Expenses* (United Nations: New York, 2017).
[76] Article 11 (1) & (2) of the OECD Model, *supra* note 4.
[77] Article 11(1) & (2) of the UN Model, *supra* note 7.
[78] Article 11(2) of Nigeria's treaty with Czech Republic; Article 11(2) of Nigeria's treaty with Belgium, Canada, China, France, Netherlands, Pakistan, Philippines, Romania, Singapore, South Africa, United Kingdom.
[79] Article 12(2) of Tanzania's treaty with India; Article 11(2) of Tanzania's treaties with Canada, Denmark, Finland, Italy, Norway, South Africa, Sweden.

should amend its tax treaty with Zambia to allow source taxation of interest. All of Botswana's tax treaties allow source taxation of interest payments.[80]

3.2 Maximum Rates

Article 11(2) of the OECD Model allows source taxation of interest at a reduced rate of ten percent.[81] Article 11(2) of the UN Model leaves the rate to be applied by the source state on taxation of interest to bilateral negotiations.[82]

The rates in Nigeria's treaties for source taxation of interest vary. Nigeria's tax treaties with Belgium, Canada, France, the Netherlands, and Romania prescribe a maximum rate of 12.5% for source taxation of interest.[83] Nigeria's tax treaty with the United Kingdom prescribes a rate of 12%.[84] The treaties with China, Singapore, and South Africa prescribe a maximum rate of 7.5%.[85] Nigeria's treaties with the Czech Republic, Pakistan, and the Philippines prescribe a rate of 15%.[86] As established earlier in this chapter, tax treaties cannot extend the taxing rights of contracting states.[87] The prevailing domestic withholding tax rate for non-resident companies for interest payments is 10%.[88] Therefore, for treaties with rates higher than 10%, Nigeria cannot collect more than 10%. For tax treaties with lower rates, however, the treaty rate will apply. Given that interest payments are deductible against the source country's tax base, I make two recommendations. First, Nigeria should increase its domestic withholding tax rate for interest payments to 15% to increase

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[80] Article 11(2) of Botswana's treaties with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, United Kingdom, Zambia, Zimbabwe.
[81] Article 11(2) of the OECD Model, *supra* note 4.
[82] Article 11(2) of the UN Model, *supra* note 7.
[83]Article 11(2) of Nigeria's tax treaties with Belgium, Canada, France, Netherlands, and Romania.
[84] Article 11(2) of Nigeria's tax treaty with the United Kingdom.
[85] Article 11(2) of Nigeria's tax treaties with China, Singapore, and South Africa.
[86] Article 10(2) of Nigeria's tax treaty with Czech Republic; Article 11(2) of Nigeria's tax treaties with Pakistan and the Philippines.
[87] *Supra* note 20.
[88] *Supra* note 19.

tax revenue generation. Second, Nigeria should amend its tax treaties by increasing the withholding tax rates to the domestic tax rate. Nigeria's tax treaties with China, Singapore, and South Africa are greatly restrictive, prescribing a maximum rate of 7.5%. In the interim, these treaties should be amended to increase the rate to the domestic tax rate of 10%.

The rate prescribed for source taxation of interest in Tanzania's tax treaties with Canada, Finland, Italy, Norway, and Sweden is 15%.[89] Tanzania's treaties with Denmark and India prescribe a maximum withholding tax rate of 12.5%.[90] Tanzania's treaty with South Africa prescribes a rate of 10%.[91] Tanzania's domestic withholding tax rate for interest payment is 10% similar to Nigeria.[92] Similar to the recommendation provided to the Nigerian government, the Tanzanian government should consider reforms to its law to increase the domestic withholding tax rate to 15% to boost domestic revenue generation. Also, the tax treaties signed by Tanzania should be amended to include the maximum withholding tax rate of 15% for interest payments. Low tax rates for taxation of interest increases the opportunities for outflow of interest payments without giving Tanzania adequate opportunity to maximize revenue from capital outflows. It is, therefore, proposed that the rates for source taxation of interest in Tanzania's tax treaties be raised to enable it increase revenue from outflow of income earned by investors from capital investment activities in the country.

The rate prescribed for source taxation of interest in Botswana's tax treaties with China, the Czech Republic, Ireland, and Seychelles is 7.5%.[93] The rate for the treaties with Malta is 8.5%.[94]

[89] Article 11(2) of Tanzania's tax treaties with Canada, Finland, Italy, Norway, and Sweden.
[90] Article 12(2) of Tanzania's tax treaties with Denmark and India.
[91] Article 11(2) of Tanzania's tax treaty with South Africa.
[92] *Supra* note 30.
[93] Article 11(2) of Botswana's tax treaties with China, Czech Republic, Ireland, Seychelles.
[94] Article 11(2) of Botswana's tax treaty with Malta.

Botswana's tax treaties with Barbados, France, India, Lesotho, Russia, South Africa, the United Kingdom, Zambia, and Zimbabwe prescribe a maximum withholding tax rate of 10%.[95] The treaty with Mauritius prescribes a maximum withholding tax rate of 12%.[96] Botswana's treaty with Sweden prescribes a maximum withholding tax rate of 15% for source taxation of interest.[97] Unlike Nigeria and Tanzania, Botswana's domestic withholding tax rate for interest payment by non-resident companies is 15%.[98] Even though Botswana's domestic withholding tax rate for interest payments is higher than Nigeria, and only one of its tax treaties (with Sweden) allows maximum revenue collection of withholding taxes from non-residents in line with its domestic law. Other tax treaties restrict Botswana's taxing rights by prescribing lower withholding tax rates. This situation is unreasonable and should be changed. It is proposed that Botswana's tax treaties with these other contracting states be amended by increasing the rate for source taxation of interest payments to non-residents to 15%, following Botswana's domestic withholding tax rate for source taxation of interest.

3.3 Ordering and Force of Attraction Rules

Article 11(4) of the OECD Model excludes the application of Article 11(1) and (2) if the interest is paid in respect of debt-claims of the assets of a permanent establishment or is effectively connected with the permanent establishment situated in the source state.[99] In such cases, Article 11(4) provides that Article 7 will apply to tax such interest at source.[100]

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[95] Article 11(2) of Botswana's tax treaties with Barbados, France, India, Lesotho, Russia, South Africa, the United Kingdom, Zambia, and Zimbabwe.
[96] Article 11(2) of Botswana's tax treaty with Mauritius.
[97] Article 11(2) of Botswana's tax treaty with Sweden.
[98] *Supra* note 38.
[99] Article 11(4) of the OECD Model, *supra* note 4.
[100] *Ibid*.

Article 11(4) of the UN Model makes two important changes to the provisions of the OECD Model. First, while the OECD Model provides that Articles 11(1) and (2) will not apply if the recipient of the interest has a permanent establishment in the source state, the UN Model refers to a permanent establishment as well as a fixed base.[101] Second, since the UN Model adopts a limited force of attraction rule in Article 7, paragraph 4 of the UN Model makes paragraphs 1 and 2 inapplicable if the debt claim is effectively connected with business activities in the source country of the same or similar kind as those effected through the permanent establishment.[102]

All of Nigeria's tax treaties copy the UN provision excluding the operation of the provision on source taxation of interest payments for interest derived from business carried on in the source state through a permanent establishment, or independent personal services through a fixed base situated in the source state.[103]

All of Tanzania's treaties, except the treaties with Italy and South Africa copy the provisions of the UN Model,[104] which excludes the provision on source taxation of interest in Article 11 if the recipient of the interest has a permanent establishment as well as a fixed base in the source state.[105] The treaties with Italy and South Africa exempt the provisions on source taxation of interest if the recipient has a permanent establishment in the source state, copying the provision in the OECD Model.[106] Only the treaty with Canada copies the limited force of attraction rule in the UN Model, which excludes the operation of Article 11 if the debt claim is effectively connected with business

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[101] UN Commentary on Article 11(4), *supra* note 7 at 288-9.
[102] UN Commentary on Article 11(4) of the UN Model, *supra* note 7 at 289.
[103] Article 10(4) of Nigeria's tax treaty with Czech Republic; Article 11(3) of Nigeria's tax treaty with Belgium; Article 11(4) of Nigeria's tax treaties with France, Pakistan, Romania, United Kingdom; Article 11(5) of Nigeria's tax treaties with Canada, China, Netherlands, Philippines, Singapore, and South Africa.
[104] Article 11(4) of the UN Model, *supra* note 7.
[105] Article 11(4) of Tanzania's tax treaties with Denmark, Norway, Sweden; Article 11(5) of Tanzania's tax treaties with Canada, Finland; Article 12(5) of Tanzania's tax treaty with India.
[106] Article 11(4) of Tanzania's tax treaty with Italy; Article 11(5) of Tanzania's tax treaty with South Africa.

activities in the source country of the same or similar kind as those effected through the permanent establishment.[107]

All of Botswana's treaties, except the treaties with the Czech Republic, Ireland, Lesotho, Malta, South Africa, Zambia, and Zimbabwe, copy the provisions of the UN Model,[108] which excludes the provision on source taxation of interest in Article 11 if the recipient of the interest has a permanent establishment as well as a fixed base in the source state.[109] The treaties with the Czech Republic, Ireland, Lesotho, Malta, South Africa, Zambia, and Zimbabwe exempt the provisions on source taxation of interest if the recipient has a permanent establishment in the source state, copying the provision in the OECD Model.[110] None of the treaties include the limited force of attraction rule in the UN Model, which excludes the operation of Article 11 if the debt claim is effectively connected with business activities in the source country of the same or similar kind as those effected through the permanent establishment.

It is proposed that the three countries reform their tax treaties to include the full exclusion under the UN Model to limit the benefits of reduced tax rate over outbound interest payments.

3.4 Income Definition and Geographic Source Rules

Article 11(3) of the OECD Model gives an expansive definition of 'interest' as income from debt-claims of every kind, whether or not secured by mortgage or whether or not carrying a right to

[107] Article 11(5) of Tanzania's tax treaty with Canada, *supra* note 106.
[108] Article 11(4) of the UN Model, *supra* note 7.
[109] Article 11(4) of Botswana's tax treaty with United Kingdom; Article 11(5) of Botswana's tax treaties with Barbados, China, France, India, Mauritius, Russia, Seychelles, Sweden.
[110] Article 11(4) of Botswana's tax treaties with Zambia, Zimbabwe; Article 11(5) of Botswana's tax treaties with Czech Republic, Ireland, Lesotho, Malta, South Africa.

participate in profits.[111] Article 11(3) of the UN Model reproduces the OECD provision by setting out the definition of interest as income from debt claims of every kind.[112] All of Nigeria's tax treaties copy the definition of interest in the OECD and UN Models.[113] All of Tanzania's tax treaties, except the treaty with Zambia, copy the definition of interest as income from debt claims of every kind similar to the definition in the OECD and UN Model.[114] All of Botswana's treaties copy the definition of interest as income from debt claims of every kind under the OECD and UN Model. [115]

Article 11(5) of the OECD Model prescribes the source rule for interest – the state of source for the interest is the state of which the payer of the interest is a resident.[116] An exception is provided for interest which arose from a permanent establishment in the other contracting state and the interest is borne by such permanent establishment.[117] In such cases, the source of the interest shall be the contracting state in which the permanent establishment is situated.[118]

Article 11(5) of the UN Model copies the source rule for interest under the OECD Model.[119] The source state is defined as the State of which the payer of the interest is a resident.[120] The UN Model also copies the exception to this rule under the OECD Model, which excludes interest with an

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[111] Article 11(3) of the OECD Model, *supra* note 4.
[112] Article 11(3) of the UN Model, *supra* note 7.
[113] Article 11(4) of Nigeria's tax treaties with Canada, China, Netherlands, Philippines, Singapore, South Africa; Article 11(7) of Nigeria's tax treaties with Belgium, Czech Republic, United Kingdom; Article 11(8) of Nigeria's tax treaty with Romania.
[114] Article 11(3) of Tanzania's tax treaties with Canada, Denmark, Italy, Norway, Sweden; Article 11(4) of Tanzania's tax treaties with Finland, South Africa; Article 12(4) of Tanzania's tax treaty with India; Article VIII of Tanzania's tax treaty with Zambia.
[115] Article 11(3) of Botswana's tax treaty with United Kingdom; Article 11(4) of Botswana's tax treaties with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, Zambia, and Zimbabwe.
[116] Article 11(5) of the OECD Model, *supra* note 4.
[117] *Ibid*. see also the OECD Commentary on Article 11(5), *supra* note 4 at 266.
[118] *Ibid*.
[119] Article 11(5) of the UN Model, *supra* note 7.
[120] *Ibid*.

economic link with a permanent establishment in the other contracting state from the definition of the source state. The UN Model, however, refers to a fixed base as well as a permanent establishment.[121] All of Nigeria's tax treaties copy the source rules for interest in the UN Model – all the treaties exclude the operation of the provision if the interest is derived from a permanent establishment, or a fixed base situated in a third state.[122]Tanzania's treaties, except the treaty with Canada, include the source rule in the OECD Model.[123] Tanzania's treaty with Canada reproduces the source rule in the UN Model.[124]Botswana's treaties with the Czech Republic, Ireland, Lesotho, Malta, South Africa, Zambia, and Zimbabwe include the source rule in the OECD Model.[125] Botswana's treaties with Barbados, China, France, India, Mauritius, Russia, Seychelles, Sweden, and the United Kingdom copy the source rule in the UN Model excluding source taxation of interest derived from third states.[126] These provisions seek to prevent double taxation. They ensure that only the country where the payer is resident has the primary right to tax the income.

3.5 Anti-avoidance Provisions

The requirement of 'beneficial owner' was introduced in Article 11(2) of the OECD Model as an anti-abuse rule to deny the benefit of the provision to residents of the other contracting state acting in the capacity of agent or nominee for another person who in fact receives the benefit of the

[121] *Ibid.*
[122] Article 10(5) of Nigeria's tax treaty with Czech Republic; Article 11(4) of Nigeria's tax treaty with Belgium; Article 11(5) of Nigeria's tax treaties with France, Pakistan, Romania, United Kingdom; Article 11(6) of Nigeria's tax treaties with Canada, China, Netherlands, Philippines, Singapore, and South Africa.
[123] Article 11(5) of Tanzania's treaties with Denmark, Italy, Norway; Article 11(6) of Tanzania's treaties with Finland, South Africa; Article 12(6) of Tanzania's treaty with India.
[124] Article 11(6) of Tanzania's treaty with Canada.
[125] Article 11(6) of Botswana's treaties with Czech Republic, Ireland, Lesotho, Malta, South Africa, Zambia, and Zimbabwe.
[126] Article 11(5) of Tanzania's treaty with United Kingdom; Article 11(6) of Tanzania's treaties with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, Zambia, Zimbabwe.

income (formal owner).[127] Article 11(2) of the UN Model copies Article 11(2) of the OECD Model.[128]

All of Nigeria's tax treaties, except the treaty with the United Kingdom, include the anti-abuse rule in Article 11(2) of the OECD and UN Model.[129] Currently, the benefit of reduced withholding tax rate for interest payment in Nigeria's tax treaty with the United Kingdom applies to income received by residents of the United Kingdom who are not the real owners of the payment. It is recommended that Nigeria amend its tax treaty with the United Kingdom to include the anti-abuse rule in the OECD and UN Models.

None of Tanzania's treaties, except the treaties with Canada and South Africa, include the anti-abuse provision in the OECD and UN Models, denying the benefit of the reduced withholding tax rate under Article 11 to persons who are not the owners and are only acting as agents on behalf of the owner of the interest payment.[130] It is argued that Tanzania should amend its treaties to include the anti-abuse provision in Article 11(2) of the OECD and UN Models.

All of Botswana's treaties include the term "beneficial owner" in both the OECD and UN Models to qualify the application of the provision to interest paid by a resident of a contracting state to a beneficial owner resident in the other contracting state to deny the benefit of the provision to residents of the other contracting state acting in the capacity of agent or nominee for another person who in fact receives the benefit of the income (formal owner).[131]

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[127] *Ibid*. see the OECD Commentary on Article 11(2), *supra* note 4 at 259-260.
[128] Article 11(2) of the UN Model, *supra* note 7.
[129] Article 11(2) of Nigeria's tax treaties with Belgium, Canada, China, Czech Republic, France, Netherlands, Pakistan, Philippines, Romania, Singapore, and South Africa.
[130] Article 11(2) of Tanzania's tax treaties with Canada and South Africa.
[131] Article 11(2) of Botswana's tax treaties with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, United Kingdom, Zambia, and Zimbabwe.

Article 11(6) of the OECD Model contains another anti-abuse provision that restricts the operation of the provision of Article 11 concerning payment of interest that exceeds the amount which would have been agreed upon by the payer and the beneficial owner had they stipulated at arm's length.[132] Where due to a special relationship between the payer and the beneficial owner or between both of them and some other person, such interest exceeds the arm's length payment, the provisions of Article 11 will only apply to the arm's length part of the interest while the excess part will remain taxable according to the laws of the contracting states.[133] Article 11(6) of the UN Model reproduces Article 11(6) of the OECD Model.[134] All of Nigeria's tax treaties include the anti-abuse rule in Article 11(6) of both the OECD and UN Models to deny the operation of the provision to non-arm's length interest payments.[135] All of Tanzania's treaties include the anti-abuse rule in the OECD and UN Model to deny the application of Article 11 to payments exceeding the amount which would have been agreed to but for the special relationship between the payer and recipient (non-arm's length payments).[136]All of Botswana's treaties include the anti-abuse rule in Article 11(6) of both the OECD and UN Model.[137]

Nigeria's tax treaties with Belgium, Canada, Pakistan, Romania, South Africa, and the United Kingdom contain additional anti-abuse provisions, excluding the operation of the provision for interest created or assigned mainly for the purpose of taking advantage of this Article and not for

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[132] Article 11(6) of the OECD Model, *supra* note 4, See also OECD Commentary on Article 11(6) *supra* note 4.
[133] *Ibid*.
[134] Article 11(6) of the UN Model, *supra* note 7.
[135] Article 10(6) of Nigeria's tax treaty with Czech Republic; Article 11(5) of Nigeria's tax treaty with Belgium; Article 11(6) of Nigeria's tax treaties with Pakistan, Romania; Article 11(7) of Nigeria's tax treaties with Canada, France, Netherlands, Philippines, Singapore, South Africa, United Kingdom; Article 11(8) of Nigeria's tax treaty with China.
[136] Article 11(6) of Tanzania's tax treaties with Denmark, Italy, Norway, Sweden; Article 11(7) of Tanzania's tax treaties with Canada, Finland, South Africa; Article 12(7) of Tanzania's tax treaty with India; Article VIII(3) of Tanzania's tax treaty with Zambia.
[137] Article 11(6) of Botswana's tax treaty with United Kingdom; Article 11(7) of Botswana's tax treaties with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, Zambia, Zimbabwe.

bona fide commercial reasons.[138] It is proposed that other tax treaties signed by Nigeria be amended to include the additional anti-abuse provision to deny the benefits of the provision to avoidance transactions.

None of Tanzania's treaties include the additional anti-abuse provision in Nigeria's tax treaties with Belgium, Canada, Pakistan, Romania, South Africa, and the United Kingdom excluding the operation of the provision to interest created or assigned mainly for the purpose of taking advantage of this Article and not for bona fide commercial reasons. It is proposed that Tanzania should amend its tax treaties to include this additional anti-abuse provision.

Botswana's tax treaties with China, Lesotho, and the United Kingdom contain the additional anti-abuse provisions in Nigeria's treaties. It is proposed that other tax treaties signed by Botswana be amended to include the additional anti-abuse provision to deny the benefits of the provision to avoidance transactions.

Since interest payments are deductible expenses, MNC entities can use related-entity or third-party debt to increase interest deductions, thereby reducing the tax base at source. Strong anti-avoidance rules are, therefore, necessary to prevent excessive interest deductions. The comparator countries all have strong domestic anti-avoidance rules to limit interest expense deductions. Based on the provisions of the Income Tax Laws of the countries, any amount not wholly, exclusively and necessarily laid out or expended for the purpose of providing assessable income is not allowed to be deducted as expenses.[139] Tanzania has specific provisions in its Income Tax Act, limiting interest deductibility to a maximum amount. Article 12(2) of Tanzania's Income Tax Act provides

[138] Article 11(6) of Nigeria's tax treaty with Belgium; Article 11(7) of Nigeria's tax treaties with Pakistan, Romania; Article 11(8) of Nigeria's tax treaties with Canada, South Africa, and United Kingdom.
[139] See Nigeria's *Companies Income Tax Act, supra* note 21, s 24; *Income Tax Act (Tanzania),* 2019, s 11(2); and *Income Tax Act (Botswana), 2021*, s50(5).

that interest deductibility shall not exceed the sum of interest equivalent to debt-to-equity ratio of 7 to 3.[140] The comparator countries also have transfer pricing regulations that seek to ensure that transactions between related entities are assessed at arm's length prices.[141] The transfer pricing regulations ensure that deduction of expenses involving related parties are at arm's length. Altogether, strong anti-avoidance rules in the tax treaties signed by the comparator counties and domestic anti-avoidance rules will work to help prevent base eroding payments by non-residents in form of interest payments.

Similar to my reform recommendations to the comparator countries for taxation of dividends in the preceding section, my recommendations for taxation of interest virtually endorse most of the provisions of the OECD and UN Models for adoption by the three countries. I recommend that they: first, include provisions of the OECD and UN Models allowing source taxation of interest payments in their tax treaties in order to increase their tax revenue from interest income derived by non-residents within their respective jurisdictions. Second, reform their tax treaties and domestic tax laws to increase the rates for taxation of outbound interest payments to 15% to boost domestic revenue generation. I also argue that they align the rates prescribed for source taxation of interest in their treaties with the rates specified in their domestic tax laws in order to maximize the opportunities for increased tax revenue from outbound interest payments. Third, I recommend that they include the force of attraction rule present in the UN Model in all their tax treaties to limit the benefit of the reduced rate for residents of their treaty partners. Lastly, I advance an argument for the inclusion of the anti-avoidance provisions in the OECD and the UN Models (beneficial ownership rule, non-arm's length transactions), and the additional anti-avoidance rule in some of

[140] Article 12(2) of Tanzania's *Income Tax Act, ibid*.
[141] *Income Tax (Transfer Pricing) Regulations (Nigeria)*, 2018; *The Tax Administration (Transfer Pricing) Regulations (Tanzania), 2018*; *Income Tax (Transfer Pricing) Regulations (Botswana)*, 2019.

Nigeria's tax treaties in all their treaties to deny treaty benefits to non-residents for transactions created for the purpose of obtaining a more favourable tax treatment. The implementation of these proposals by the three states will lead to effective taxation of interest paid to non-residents and eventually increased tax revenue generation.

It is important to note that my acceptance of the OECD and UN Model provisions does not mean the OECD and the UN are looking out for Africa. Rather, the reality of the investment climate makes it wise for African states to domesticate some of those provisions, not just under bilateral tax treaties, but in domestic tax laws as well, to give them greater leverage by which to secure greater tax revenue from investment income derived by non-residents within their respective jurisdictions.

4. Taxation of Royalties

It is also possible that the return on investment paid by a company resident in the source country to a person resident in another state, is in the form of royalties arising from the source country.[142] As early as the eighteenth century, the difference between the economic origin and physical origin of income was well settled.[143] It may be that the tools required for producing are physically present in one country. It may also be that the equipment necessary for producing the income is non-physical (e.g. software, know-how, or other forms of intellectual property) and is present in another country.[144] In the latter case, economists agreed to assign taxing rights over income from intangibles (royalties) earned in the source country to governments to whom the taxpayer owes economic allegiance – the residence state.[145] Royalties are payments received in consideration of

[142] Garbarino, *supra* note 5 at 126.
[143] League of Nations, *Report on Double Taxation, Submitted to the Financial Committee by Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp*, April 5, 1923, EFS 73 F19.
[144] *Ibid* at 20.
[145] *Ibid*.

the use of, or the right to use intangible property. Royalties can be payments for the use of copyright, intangible industrial property, tangible property, or technical assistance (know-how).[146] A detailed discussion of technical or digital services which may fall into the category of royalties is contained in the next section.

The increase in globalization, changing understandings about the value of intangibles, and growth of transfer of technical knowledge have resulted in increased outflow of payments in the form of royalties from developing countries to developed countries.[147] Source taxation of royalty payments will go a long way to help the comparator countries (and African countries in general) to maximize these massive outflow of royalties in terms of tax revenue. However, the extent to which the comparator countries are able to do so depends on whether the provisions of their tax treaties follow the provisions of the OECD or UN Model on taxation of royalties.

Exclusive residence taxation of royalties ignores the contributions provided by the source state that result in income from royalties, such as infrastructure, highly skilled workforce that can be employed in the technology sector, and an orderly market for the taxpayer to exploit.[148] Several arguments have been proffered in favour of exclusive residence taxation of royalty payments. First, it is argued that exclusive residence taxation is justifiable based on the investment of the residence state to the development of the intangible.[149] Second, it is argued that only residence states can adequately recognize expenses associated with the production of the intangible property resulting

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[146] Kim Brooks, "Tax Treaty Treatment of Royalty Payments from Low-Income Countries: A Comparison of Canada and Australia's Policies" (2007) 5:2 eJournal of Tax Research 168.
[147] According to a data by the World Bank, Israel, South Korea, Switzerland, Sweden, Japan, Austria, Germany, Denmark, united States, Belgium, spend the largest proportion of GDP on research and development activities, see World Economic Forum, online: < https://www.weforum.org/agenda/2020/11/countries-spending-research-development-gdp/>
[148] Brooks *supra* note 146 at 179-184.
[149] *Ibid*.

in the royalty income.[150] Another argument is that source countries cannot effectively enforce and collect withholding taxes on royalty payments.[151] It is also argued that source states do not have effective systems in place to enforce and collect the withholding tax.[152] None of these arguments, however, are compelling enough to justify the signing away of source taxing rights over royalty payments.

Though the residence state may have invested a lot in the development of the intangible property that is being exploited in the source state, the source state also deserves to tax the income. As discussed above, source states provide an enabling environment for intangibles developed in residence states to be exploited, resulting in the royalty income. Source taxing rights over royalty income earned within source states is an appropriate way to compensate these states for their contributions to the production of royalty income. Also, it is not clear how the second argument justifies exclusive taxation of royalty income. Given that dividends and interest qualify for source taxation on a gross basis, it is not clear how source states are unable to tax royalty income on the basis that they are unable to recognize expenses associated with the production of property giving rise to royalty income. At least, residence states can and should recognize taxes paid on royalty income to source states to solve double taxation concerns. Lastly, the arguments against source taxation of royalty income on the ground that source states do not have effective systems in place to enforce and collect the withholding tax is without basis. Source states tax business profits associated with permanent establishments in their jurisdictions. They enforce and collect other taxes from non-residents, such as interest and dividends. It is not clear why source states cannot enforce and collect royalties if they enforce and collect other taxes.

[150] *Ibid*.
[151] *Ibid*.
[152] *Ibid*.

It is true that source states face tax administration challenges, but that is not enough reason to deny them their fair share in taxing rights. Moreover, the OECD and UN have both referenced the need to provide technical assistance to low-income countries to ensure increased domestic resource mobilization.[153] This is an area that can be worked on to solve tax administration challenges in source states. In the meantime, the need for capacity for improved domestic resource mobilization in source states is not a valid reason to exclude source states from collecting their fair share of revenue from international trade in the form of royalty payments from economic activities carried out in their jurisdictions.

4.1 Allocation of Taxing Rights

Article 12(1) of the OECD Model lays down the principle of exclusive taxation of royalties in the state of the beneficial owner's residence.[154] The provision of the UN Model on royalties differs significantly from the OECD provisions. While Article 12(1) of the OECD Model grants exclusive taxing rights over royalties arising within a source state to the beneficial owner's state of residence,[155] the UN Model departs from the principle of exclusive residence State's right to tax royalties.[156] In the OECD Model, there are only two instances where the source state can tax royalties arising within its jurisdiction. The first is when the royalty arising within the source state is not beneficially owned by a resident of the other state.[157] The second instance is when the royalty payment is effectively connected to a permanent establishment in the source state.[158] The

[153] United Nations, "International Tax Cooperation: Capacity Building", online: < https://developmentfinance.un.org/international-tax-cooperation-capacity-building>.
[154] Article 12(1) of the OECD Model, *supra* note 4. See also the OECD Commentary on Article 12(1) *supra* note 4 at page 271.
[155] Article 12(1) of the OECD Model, *supra* note 4.
[156] Article 12(1) of the UN Model, *supra* note 7.
[157] Article 12(1) of the OECD Model, *supra* note 4.
[158] Article 12(3) of the OECD Model, *supra* note 4.

opportunities for taxation of royalty payments outside of a PE provided for in the UN Model does not exist under the OECD Model.

All of Nigeria's tax treaties allow source taxation of royalties, following the provisions of the UN Model.[159] All of Tanzania's tax treaties, except the treaty with Zambia, allow source taxation of royalties.[160] Tanzania should amend its tax treaty with Zambia to allow source taxation of royalties. All of Botswana's tax treaties allow source taxation of royalties.[161]

4.2 Maximum Rates

Similar to the provision of the UN provision on taxation of dividends and interest, Article 12 of the UN Model does not prescribe a withholding tax rate for source taxation of royalties, but leaves it to bilateral negotiations.[162] Though the drafters of the UN Model believed that the low withholding tax rates in the OECD Model would entail too large a loss of revenue for the source country[163], they left the rates to states to decide, hoping that it would give room for source countries to insist on higher withholding tax rates during bilateral treaty negotiations. The over-reliance of the UN Model on bilateral negotiations fails to account for the disparities in bargaining power between developed and developing countries during negotiations, and the difficulties for developing countries to secure higher withholding tax rates. In practice, many tax treaties between developed and developing countries contain the OECD withholding tax rates, while a few provide for even lower rates.[164] The decision to leave the rate for source taxation of royalties, and in

[159] Article 11(2) of Nigeria's treaty with Czech Republic; Article 12(2) of Nigeria's treaty with Belgium, Canada, China, France, Italy, Netherlands, Pakistan, Philippines, Romania, Singapore, South Africa, United Kingdom.
[160] Article 12(2) of Tanzania's tax treaties with Canada, Denmark, Finland, Italy, Norway, South Africa, Sweden; Article 13(2) of Tanzania's tax treaty with India.
[161] Article 12(2) of Botswana's tax treaties with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, United Kingdom, Zambia, and Zimbabwe.
[162] Article 12(2) of the UN Model, *supra* note 7.
[163] UN Commentary on Article 10(2), *supra* note 7 at page 260.
[164] UN Commentary on Article 10(2), *supra* note 7 at page 262.

general, passive income to bilateral negotiations opens up opportunities for developed countries to pressure developing countries to agree to low rates. It would have been more useful to have the UN Model set a fixed withholding tax rate for source taxation of royalties to give source countries some leverage during negotiations. Fifteen per cent (15%) withholding tax rate for source taxation of royalties appears reasonable, considering the contributions of the source state to the production of the royalty income.

Similar to the provision in the OECD Model, the UN Model lists certain factors that should be considered in fixing the withholding tax rate, such as the expenses allocable to the royalty and expenditure incurred in the development of the property whose use gave rise to the royalty; the fact that royalty payments flow almost entirely from developing countries to developed countries; the relative importance of revenue sacrifice; the extent of assistance that developed countries should, for a variety of reasons, extend to developing countries; and the special importance of providing such assistance in the context of royalty payments.[165] All these factors are important, but what is far more important is the need to consider the contributions of the source state to the royalty payment, and the need to ensure that the source state has expansive taxing rights on royalty payments that have a source in its jurisdiction.

Nigeria's tax treaties with Belgium, Canada, France, the Netherlands, Romania, and the United Kingdom prescribe a maximum rate of 12.5%.[166] Nigeria's treaties with China, Singapore, and South Africa prescribe a maximum rate of 7.5%.[167] Nigeria's treaty with the Czech Republic prescribes a 15% rate,[168] while the treaty with the Philippines prescribes a rate of 20%.[169] Royalty

[165] Commentary on Article 12(2) of the UN Model, *supra* note 7 at 299.
[166] Article 12(2) of Nigeria's tax treaties with Belgium, Canada, France, Netherlands, Romania, the United Kingdom.
[167] Article 12(2) of Nigeria's tax treaties with China, Singapore, and South Africa.
[168] Article 11(2) of Nigeria's tax treaty with Czech Republic.
[169] Article 12(2) of Nigeria's tax treaty with the Philippines.

is another type of base-eroding payment and is deductible against the source country's tax base. Therefore, low withholding tax rate or total exemption of royalties from source taxation is against the interest of the source state. Nigeria's domestic withholding tax rate for royalties is 10%, lower than Tanzania and Botswana's domestic withholding tax rates of 15%.[170] Considering the different rates in Nigeria's tax treaties and the low domestic withholding tax rate of 10% for royalty payments, I make two recommendations: First, I recommend that Nigeria's tax treaties with rates lower than the domestic rates (China, Singapore, and South Africa) be amended to increase the rates to 10%. Second, I recommend that Nigeria should amend its domestic law to increase the withholding tax rate for royalties to 15%, and then reform all its tax treaties to reflect the domestic withholding tax rate of 15%.

Tanzania's treaties with Canada, Denmark, Finland, India, Norway, and Sweden prescribe a withholding tax rate of 20% for source taxation of royalties.[171] Tanzania's treaty with Italy prescribes a rate of 15%.[172] The treaty with South Africa prescribes a rate of 10%.[173] Tanzania's domestic withholding tax rate for royalty payments is 15%[174], which means that the highest rate that Tanzania can collect for royalty payments by residents of contracting states is 15%. With that in mind, I propose that Tanzania should amend its tax treaties with South Africa to adopt the domestic withholding tax rate of 15%. A low withholding tax rate reduces revenue that should accrue to the Tanzanian government over exploration of its natural resources and other economic activities over which royalties are paid to non-residents.

[170] *Supra* note 19.
[171] Article 12(2) of Tanzania's treaties with Canada, Denmark, Finland, Norway, Sweden; Article 13(2) of Tanzania's treaty with India.
[172] Article 12(2) of Tanzania's treaty with Italy.
[173] Article 12(2) of Tanzania's treaty with South Africa.
[174] *Supra* note 30.

Similar to the provision on taxation of dividends and interest payments, the rates for source taxation of royalties in Botswana's tax treaties are low and not uniform. The treaty with China prescribes a withholding tax rate of 5% for source taxation of royalties.[175] The treaty with Malta prescribes a maximum withholding tax rate of 5% for the use of, or the right to use industrial, commercial or scientific equipment; and 7.5% in all other cases.[176] The treaties with the Czech Republic and Ireland prescribe a rate of 7.5%.[177] The treaties with Barbados, France, India, Lesotho, Russia, Seychelles, South Africa, the United Kingdom, Zambia, and Zimbabwe prescribe a rate of 10%.[178] The treaty with Mauritius prescribes a maximum withholding tax rate of 12.5%.[179] Botswana's treaty with Sweden prescribes a withholding tax rate of 15%.[180] Similar to the situation with interest, only one of Botswana's tax treaties (with Sweden) allows full taxation of royalty payments in line with the domestic withholding tax rate of 15%. Other treaties signed by Botswana restricts its taxing rights significantly by prescribing maximum withholding tax rates of 5%, 7.5%, 10%, and 12.5%. These rates are low considering the high level of foreign investment in the mining and natural resources sectors, against the domestic rate of 15%.[181] I would recommend that Botswana amends its tax treaties with other signatory countries to prescribe a withholding tax rate of 15% for royalty payments.

4.3 Ordering and Force of Attraction

Article 12(3) of the OECD Model excludes the operation of Article 12 for royalties arising from a permanent establishment in the source state and the right or property in respect of which the

[175] Article 12(2) of Botswana's tax treaty with China.
[176] Article 12(2) of Botswana's tax treaty with Malta.
[177] Article 12(2) of Botswana's tax treaties with Czech Republic and Ireland.
[178] Article 12(2) of Botswana's tax treaties with Barbados, France, India, Lesotho, Russia, Seychelles, South Africa, the United Kingdom, Zambia, and Zimbabwe.
[179] Article 12(2) of Botswana's tax treaty with Mauritius.
[180] Article 12(2) of Botswana's tax treaty with Sweden.
[181] *Supra* note 38.

royalties are paid is effectively connected with such permanent establishment.[182] In this case, Article 12(3) of the OECD Model provides that Article 7 will apply.[183]

Article 12(4) of the UN Model reproduces Article 12(3) of the OECD Model with some modifications.[184] Article 12(4) of the UN Model adds royalties received in connection with business activities of the same or similar kind as those of a permanent establishment in the source country, and royalties from independent personal services from a fixed base situated in the source state to the excluded items under Article 12. In such cases, Article 12(4) of the UN Model provides that Articles 7 and 14 will apply respectively.[185]

All of Nigeria's treaties copy the provisions of Article 12(4) of the UN Model.[186] None of the treaties, however, includes the force of attraction rule in the UN Model, excluding royalties received in connection with business activities of the same or similar kind as those of a permanent establishment in the source country in the UN Model.[187] It is recommended that all the treaties adopt the extended exclusion under the UN Model to limit reduced tax rates over royalty payments to non-residents. An extended exclusion of the operation of the reduced withholding tax rates for royalty payments in Nigeria's tax treaties will expand the restrictions in the provisions, and thereby increase tax revenue from outbound royalty payments.

All of Tanzania's treaties, except the treaties with Italy and South Africa, include the provisions of the UN Model, denying the operation of the Article on taxation of royalty payments if they are

[182] Article 12(3) of the OECD Model, *supra* note 4.
[183] *Ibid*.
[184] Article 12(4) of the UN Model, *supra* note 7.
[185] *Ibid*.
[186] Article 11(3) of Nigeria's tax treaty with Czech Republic; Article 12(3) of Nigeria's tax treaties with Belgium, France, Pakistan, Romania, United Kingdom; Article 12(4) of Nigeria's tax treaties with Canada, China, Netherlands, Philippines, Singapore, and South Africa.
[187] *Ibid*.

paid in respect of rights or property forming part of the assets of the permanent establishment, or otherwise connected with the permanent establishment, or from independent personal services from a fixed base in the source state.[188] The treaties with Italy and South Africa only exclude the operation of the provision for royalties arising from a permanent establishment in the source state similar to the OECD provision.[189] The extended exclusion under the UN Model will deny the benefit of the reduced rate under Article 12 to artificial characterizations done to exploit the provision. It is recommended that all the treaties adopt the extended exclusion under the UN Model to limit the benefit of the reduced tax rate over outbound royalty payments.

All of Botswana's tax treaties, except the treaties with the Czech Republic, Ireland, Lesotho, Malta, South Africa, Zambia, and Zimbabwe include the provisions of the UN Model to deny the operation of the Article on taxation of royalty payments if they are paid in respect of rights or property forming part of the assets of the permanent establishment or otherwise connected with the permanent establishment or from independent personal services from a fixed base in the source state.[190] The treaties with the Czech Republic, Ireland, Lesotho, Malta, South Africa, Zambia, and Zimbabwe only exclude the operation of the provision for royalties arising from a permanent establishment in the source state similar to the OECD provision.[191] The extended exclusion under the UN Model will deny the benefit of the reduced rate under Article 12 to artificial characterizations done to exploit the provision. I recommend that Botswana should amend its

[188] Article 12(4) of Tanzania's tax treaties with Canada, Denmark, Norway, Sweden; Article 12(5) of Tanzania's tax treaty with Finland; Article 13(4) of Tanzania's tax treaty with India.
[189] Article 12(4) of Tanzania's tax treaties with Italy and South Africa.
[190] Article 12(4) of Botswana's tax treaties with Barbados, China, France, India, Mauritius, Russia, Seychelles, Sweden, United Kingdom.
[191] Article 12(4) of Botswana's treaties with Czech Republic, Ireland, Lesotho, Malta, South Africa, Zambia, Zimbabwe.

treaties to reflect the extended exclusion under the UN Model to limit the benefit of the reduced tax rate over royalty payments to non-residents.

4.4 Income Definition and Geographic Source Rules

Article 12(2) of the OECD Model contains a definition of the term "royalties".[192] The definition applies to payments for the use of, or for the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.[193] The OECD excludes payment in consideration for the full transfer of the full ownership of an element of property referred to in the definition.[194]

Article 12(3) of the UN Model reproduces Article 12(2) of the OECD Model, which defines royalties as payments received in consideration of the right to use or use of literary, artistic, scientific work or for information concerning industrial, commercial, or scientific experience.[195] Article 12(3) of the UN Model, however, expands the definition in the OECD Model by including payments received for films or tapes used for radio or television broadcasting, and the use of, or the right to use industrial, commercial or scientific equipment.[196] The inclusion of the use of, or the right to use industrial, commercial, or scientific equipment, as explained by the drafters of the UN Model, is to address situations in which the owner of the equipment earns business profits from letting another person use that equipment without establishing a presence in the state where

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[192] Article 12(2) of the OECD Model, *supra* note 4. See also the OECD Commentary on Article 12(2), *supra* note 4 at page 275.
[193] *Ibid*.
[194] *Ibid*.
[195] Article 12(3) of the UN Model, *supra* note 7.
[196] *Ibid*.

it is used, thus failing to satisfy the permanent establishment condition under Article 5 for source taxation of business profits.[197]

All of Nigeria's treaties copy the expansive definition of royalties in the UN Model.[198] All of Tanzania's treaties, except the treaty with South Africa,[199] copy the expansive definition of royalties in the UN Model.[200] It is proposed that the treaty with South Africa be amended to include the expanded definition of royalties in the UN Model. All of Botswana's treaties copy the expansive definition of royalties in the UN Model.[201]

Given that the OECD Model does not allow source taxation of royalties, there is no source rule for royalties in the OECD Model. Article 12(5) of the UN Model prescribes the source rule for royalties. According to Article 12(5) of the UN Model, royalties borne by a permanent establishment or a fixed base in another contracting state are excluded from source taxation.[202]

All of Nigeria's treaties copy the source rule in the UN Model.[203] Only Tanzania's treaty with Canada copies the source rule in the UN Model.[204] The rest include a source rule, but exclude royalties borne by a permanent establishment in a third state.[205] Botswana's treaties with Barbados,

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[197] UN Commentary on Article 12(3), *supra* note 7 at page 312.

[198] Article 11(6) of Nigeria's tax treaty with Czech Republic; Article 12(3) of Nigeria's tax treaties with Canada, China, Netherlands, Philippines, Singapore, South Africa; Article 12(7) of Nigeria's tax treaties with Belgium, France, Pakistan, Romania, and the United Kingdom.

[199] Article 12(3) of Tanzania's tax treaty with South Africa.

[200] Article 12(3) of Tanzania's tax treaties with Canada, Denmark, Italy, Norway, Sweden; Article 12(4) of Tanzania's tax treaty with Finland; Article 13(3) of Tanzania's tax treaty with India.

[201] Article 12(2)(a) of Botswana's tax treaties with Czech Republic; Article 12(3) of Botswana's tax treaties with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, United Kingdom, Zambia, and Zimbabwe.

[202] *Ibid*.

[203] Article 11(4) of Nigeria's treaty with Czech Republic; Article 12(4) of Nigeria's treaties with Belgium, France, Romania, United Kingdom; Article 12(5) of Nigeria's treaties with Canada, China, Netherlands, Pakistan, Philippines, Singapore, and South Africa.

[204] Article 12(5) of Tanzania's treaty with Canada.

[205] Article 12(40 of Tanzania's treaty with Italy; Article 12(5) of Tanzania's treaty with Denmark, Finland, Norway, South Africa, Sweden; Article 13(5) of Tanzania's treaty with India.

China, France, India, Mauritius, Russia, Seychelles, Sweden, and United Kingdom copy the source rule in the UN Model.[206] The rest include a source rule, but exclude royalties borne by a permanent establishment in a third state.[207] These provisions seek to prevent double taxation. They ensure that only the country where the payer is resident has the primary right to tax the income.

4.5 Anti-avoidance Provisions

Article 12(2) of the UN Model includes the term "beneficial owner" to deny the benefit of reduced withholding tax rate to royalty payments made to intermediaries acting on behalf of another person who in fact receives the benefit of the royalties.[208]

Similar to the provision of Article 12(2) of the UN Model, all of Nigeria's treaties, except the treaties with the Philippines and the United Kingdom include the qualification of beneficial ownership to limit the operation of the reduced withholding tax rate for source taxation of royalty payments to only instances where the beneficial owner of the royalties is a resident of the other Contracting State.[209] It is proposed that these two treaties be amended to include the anti-abuse rule to deny the application of the provision to persons acting for another person who in fact receives the benefit of the royalties.

Only two of Tanzania's treaties (with Canada and South Africa) include the qualification of beneficial ownership in Article 12(2) of the UN Model.[210] It is proposed that other treaties be amended to include this anti-abuse rule to deny the application of the provision to a person acting

[206] Article 12(5) of Tanzania's treaties with Barbados, China, France, India, Mauritius, Russia, Seychelles, Sweden, United Kingdom.
[207] Article 12(5) of Tanzania's treaties with Czech Republic, Ireland, Lesotho, Malta, South Africa, Zambia, and Zimbabwe.
[208] Article 12(2) of the UN Model, *supra* note 7.
[209] Article 11(2) of Nigeria's tax treaty with Czech Republic; Article 12(2) of Nigeria's tax treaties with Belgium, Canada, China, France, Netherlands, Pakistan, Romania, Singapore, and South Africa.
[210] Article 12(2) of Tanzania's tax treaties with Canada and South Africa.

for another person who in fact receives the benefit of the royalties. All of Botswana's treaties include the qualification of beneficial ownership in Article 12(2) of the UN Model.[211]

Article 12(6) of the UN Model restricts the operation of the provisions of Article 12 to non-arm's length royalty payments due to a special relationship between the payer and the beneficial owner, or between both and some other person.[212] In such instances, Article 12(6) of the UN Model provides that the provisions of Article 12 will only apply to the amount which would have been agreed upon by the payer and the beneficial owner had they stipulated at arm's length, and the excess amount will be taxed according to the laws of the two Contracting States.[213]

All of Nigeria's treaties include the provisions of Article 12(6) of the UN Model.[214] All of Tanzania's treaties, except the treaty with Zambia, include the provision of Article 12(6) of the UN Model.[215] It is proposed that the treaty with Zambia be amended to allow source taxation of royalties and an anti-abuse rule be included to deny the benefit of a reduced withholding tax rate to royalty payments exceeding the arm's length amount. All of Botswana's treaties include the anti-abuse rule in Article 12(6) of the UN Model.[216]

Nigeria's tax treaties with Belgium, Canada, China, France, Pakistan, Romania, South Africa, and United Kingdom contain additional anti-abuse provisions. These exclude the operation of the provision if the right or property giving rise to the royalties was created or assigned mainly for the

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[211] Article 12(2) of Botswana's tax treaties with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, United Kingdom, Zambia, and Zimbabwe.
[212] Article 12(6) of the UN Model, *supra* note 7.
[213] *Ibid*. see also the UN Commentary to Article 12(6) of the UN Model, *supra* note 7 at 316.
[214] Article 11(5) of Nigeria's tax treaty with Czech Republic; Article 12(7) of Nigeria's tax treaty with China; Article 12(5) of Nigeria's tax treaties with Belgium, France, Pakistan, Romania, United Kingdom; Article 12(6) of Nigeria's tax treaties with Canada, Netherlands, Philippines, Singapore, and South Africa.
[215] Article 12(5) of Tanzania's tax treaty with Italy; Article 12(6) of Tanzania's tax treaties with Canada, Denmark, Finland, Norway, South Africa, Sweden.
[216] Article 12(6) of Botswana's tax treaties with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, United Kingdom, Zambia, and Zimbabwe.

purpose of taking advantage of this Article and not for bona fide commercial reasons.[217] It is proposed that other tax treaties signed by Nigeria be amended to include the additional anti-abuse provision to deny the benefits of the provision to avoidance transactions.

None of Tanzania's treaties include the additional anti-abuse provision in Nigeria's tax treaties. It is proposed that Tanzania's tax treaties be amended to include this additional anti-abuse provision to deny the benefits of the provision to avoidance transactions. Botswana's tax treaties with China, Lesotho and the United Kingdom include the additional anti-abuse provision in Nigeria's treaties.[218] It is proposed that other tax treaties signed by Botswana be amended to include the additional anti-abuse provision to deny the benefits of the provision to avoidance transactions.

Similar to interest deductions, royalty payments are also deductible against the tax base at source. Therefore, strong anti-avoidance rules are necessary to prevent base eroding royalty payments. The comparator countries have provisions in their Income Tax Laws ensuring that deductible expenses in the form of royalty payments involving related entities are at arm's length.[219] The countries also have transfer pricing regulations to ensure that in the determination of arm's length prices involving licences, sales or other transfers of intangibles between related entities, the contractual arrangements and other specific factors are taken into consideration.[220] The other factors include: (a) the perspective of both the transferor of the property and the transferee; (b) the

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[217] Article 12(6) of Nigeria's tax treaties with Belgium, China, France, Pakistan, Romania, United Kingdom; Article 12(7) of Nigeria's tax treaties with Canada and South Africa.
[218] Article 12(7) of Botswana's tax treaties with China, Lesotho and the United Kingdom.
[219] Nigeria's *Companies Income Tax Act, supra* note 21, s27; *Tanzania's Income Tax Act, supra* note 140, s33(1); *Botswana's Income Tax Act, supra* note 140, s36.
[220] Regulation 7 of Nigeria's *Transfer Pricing Regulations*; Regulation 11 of *Tanzania's Transfer Pricing Regulation*; *Regulation 10 of Botswana's Transfer Pricing Regulation, supra* note 142.

pricing at which a comparable independent enterprise would be willing to transfer the property; and (c) the value and usefulness of the intangible property to the transferee in its business.[221]

Nigeria adds a special provision to place limitations on the amount deductible as royalty payments to related entities. Regulation 7(5) of Nigeria's Transfer Pricing Regulations provides that the maximum amount allowed to be deducted is 5% of the earnings of the company before interest, tax, depreciation, amortization, and that consideration derived from the commercial activity conducted by the person in which the rights transferred are exploited.[222] The 5% deductibility limit is a strong anti-avoidance provision against base erosion through outbound royalty payments. The revenue authority can easily apply this by obviating the hurdles of finding comparable transactions for hard-to-value intangibles.[223] I recommended that Tanzania and Botswana should adopt similar provisions in their transfer pricing regulations. Strong domestic anti-avoidance rules in tax treaties signed by the comparator countries will help prevent excessive royalty deductions and protect the tax base of the countries.

5. Taxation of Fees (Technical and Digital)

The UN Model also allows source taxation of technical fees and income from automated digital services.

5.1 Fees for Technical Service

The UN includes Article 12A in its Model Convention to expand source taxing rights beyond business profits under Article 7 which requires the physical presence of the taxpayer.[224] Article

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[221] *Ibid*.
[222] Regulation 7(5) of Nigeria's *Transfer Pricing Regulation, supra* note 142.
[223] Okanga Ogbu Okanga, "Intangibles and Transfer Pricing Regulation in Nigeria: An Exposition", (2020) [unpublished, archived at Dalhousie University Schulich School of Law], online: <https://digitalcommons.schulichlaw.dal.ca/cgi/viewcontent.cgi?article=1645&context=scholarly_works>.
[224] Article 12A of the UN Model, *supra* note 7.

12A of the UN Model allows the source state to tax payments in consideration for any service of a managerial, technical or consultancy nature arising within its jurisdiction paid to a resident of the other state without the need to establish physical presence in the source state.[225] The OECD Model does not have a similar provision and the implication is that source taxation of fees for technical services under the OECD Model will come under Article 7, which requires the physical presence of the taxpayer captured under the permanent establishment threshold required for source taxation of business profits of non-residents.

The drafters of the UN Model discuss the import of Article 12A, which is to capture cross-border payments for technical fees performed in a contracting state without a fixed base or permanent establishment in that state.[226] The provision allows for taxation of technical fees irrespective of whether the enterprise providing the technical services has a permanent establishment or a fixed place in that state.[227] Without a provision to cover taxation of technical fees, in the absence of a permanent establishment or a fixed base in the source state, such services will escape source taxation. The situation is more problematic for developing countries because they are disproportionate importers of technical services.[228] The non-inclusion of any threshold, such as a permanent establishment, fixed base, or minimum period of presence in a Contracting State as a condition for the taxation of fees for technical services, greatly expands source taxing rights.[229] As underscored by the Experts, modern technology makes it possible to perform technical services for customers in another state without a physical presence.[230]

[225] *Ibid.*
[226] UN Commentary on Article 12A, *supra* note 7 at 319.
[227] UN Commentary on Paragraph 2 of Article 12A, *supra* note 7 at 334.
[228] UN Commentary on Article 12A, *supra* note 7 at 322.
[229] UN Commentary on Article 12A, *supra* note 7 at 329-330.
[230] *Ibid*.

5.1.1 Allocation of Taxing Rights

Article 12A of the UN Model allows taxation of technical fees by the residence and source state.[231] None of Nigeria's treaties adopt the provision in the UN Model for taxation payments of fees for technical services made to non-residents. However, Nigeria's domestic tax law allows source taxation of fees arising from the furnishing of technical, management, consultancy or professional services by a non-resident company to a person resident in Nigeria as long as the company has significant economic presence in Nigeria.[232] A non-resident company is deemed to have significant economic presence in Nigeria if it derives gross turn-over or income of more than ₦25 million or its equivalent in Nigeria in any accounting year from activities, such as streaming or downloading services of digital content, provision of goods or services directly or indirectly through a digital platform, etc.[233] The implication of the provision in Nigeria's domestic tax law on taxation of technical fees paid to non-residents is that though none of Nigeria's tax treaties includes similar provisions, non-residents will be taxed on technical fees derived from Nigeria pursuant to Nigeria's domestic tax law.

The majority of Tanzania's tax treaties allow source taxation of management or professional fees arising from the source state, paid to a resident of the other contracting state.[234] Tanzania's tax treaties with South Africa and Zambia are silent over source taxation of technical/professional fees arising in the source state, which means there is no restriction on Tanzania's taxing rights over technical fees as long as there is a provision in Tanzania's domestic tax law covering taxation of technical fees. Section 83 of Tanzania's Income Tax Act allows taxation of management or

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[231] UN Commentary on Article 12A, *supra* note 7 at 318.

[232] Section 13(2) of Nigeria's *Companies Income Tax Act, supra* note 21 LFN, as amended by *Finance Act* (Nigeria) 2019 s4(b).

[233] *Companies Income Tax (Significant Economic Presence) Order (Nigeria),* 2020, Order 1(1).

[234] Article 14(2) of Tanzania's tax treaty with Canada, Denmark, Finland, Norway, Sweden; Article 15(2) of Tanzania's tax treaty with India; Article 21(2) of Tanzania's tax treaty with Italy.

technical fees paid to residents/non-residents for business in the extractive industry (mining, oil, gas).[235] The implication is that Tanzania can only impose withholding taxes on residents of contacting states for management/technical fees in the mining, oil, or gas industries. To expand Tanzania's tax revenue, it is recommended that Tanzania amends its domestic law to remove the restrictions of management/technical fees to the extractive industry.

Botswana's tax treaties, except the treaties with China and the Czech Republic, include provisions for taxation of fees paid to non-residents in consideration for any service of a managerial, technical or consultancy nature arising within its jurisdiction without the need to establish a physical presence in the source state.[236] Imports of services forms a major component of Botswana's GDP. In the first quarter of 2019, imports of goods and services recorded a growth of 16.6%.[237] The lowered threshold for technical fees, therefore, increases the opportunities to tax profits arising from technical services outside of a permanent establishment or fixed base in Botswana. Though Botswana's domestic tax law allows a withholding tax rate to be applied to management and consultancy fees arising from Botswana and paid to non-residents.[238] The lack of specific provisions in Botswana's tax treaties with China and the Czech Republic assigning taxing rights over technical fees paid to non-residents to the source state, and provisions assigning exclusive taxation rights over other income not expressly dealt with by the other allocation rules in the tax treaties to the residence state,[239] create a negative ripple effect for Botswana.

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[235] Section 83 of Tanzania's *Income Tax Act,* supra note 140.
[236] Article 13(1) of Botswana's tax treaties with India, Lesotho, United Kingdom, Zambia, Zimbabwe; Article 20(1) of Botswana's tax treaties with Ireland, Malta, South Africa; Article 21(1) of Botswana's tax treaties with Barbados, France, Russia, Seychelles, Sweden; Article 22(1) of Botswana's tax treaties with Mauritius.
[237] Statistics Botswana, Gross Domestic Product, online: <https://statsbots.org.bw/sites/default/files/publications/Gross%20Domestic%20Product%20Q1%202019.pdf>.
[238] Section 33 of Botswana's Income Tax Act, *supra* note 140.
[239] Allocation rules over other income in the tax treaties signed by the comparator countries is discussed in the next chapter.

Ordinarily, Botswana could tax technical fees paid to non-residents even in the absence of tax treaty provisions on taxation of technical fees, because its domestic law allows the imposition of such taxes. However, the limitation of Botswana's taxing rights over technical fees paid to residents of China and the Czech republic comes from Article 20 of Botswana's treaty with the Czech Republic and Article 21 of Botswana's treaty with China which assign exclusive taxation rights over other income not expressly dealt with by other allocation rules to the residence state.[240] To expand Botswana's domestic tax revenue from technical fees, Botswana should reform its treaties with China and the Czech to include a provision for source taxation of technical fees paid to non-residents.

5.1.2 Maximum Rates

Paragraph 2 of Article 12A of the UN Model imposes a maximum rate (to be established through bilateral negotiations) for source taxation of fees for technical services if the beneficial owner of the income is a resident of the other Contracting State.[241] As discussed above, leaving the rates to bilateral negotiations ignores the disparities in bargaining power between developed and developing countries. The drafters of the UN Model list some factors to be considered by contracting states in establishing the maximum tax rates for source taxation: the possibility that a high rate of withholding tax imposed by a country might cause non-resident service providers to pass on the cost of the tax to customers in the country; the possibility that a tax rate higher than the foreign tax credit limit in the residence country might deter investment; the fact that a reduction of the withholding rate has revenue and foreign-exchange consequences for the country imposing the withholding tax; the relative flows of fees for technical services (e.g., from developing to

[240] Article 20 of Botswana's treaty with the Czech Republic, Article 21 of Botswana's treaty with China.

[241] Article 12A (2) of the UN Model, *supra* note 7.

developed countries).[242] All these reasons may be valid, but none justifies a low withholding tax rate for source taxation of technical fees.

Though none of Nigeria's tax treaties includes provisions on source taxation of technical fees, technical fees paid to non-residents are taxable under Nigeria's domestic law. The implication is that Nigeria can tax those non-residents pursuant to the provisions of its domestic law on taxation of technical fees. Pursuant to Section 81(3) of Nigeria's Companies Income Tax Act, the FIRS issued a circular on prevailing tax rates for withholding tax payments in 2021.[243] The prevailing domestic withholding tax rate for non-resident companies for management and technical services is 10%.[244] The 10% rate in Nigeria's domestic tax law is quite low compared to Tanzania and Botswana's domestic rate of 15% discussed below. Thus, Nigeria should reform its domestic tax law to increase the withholding tax rate for technical/management services to 15% in order to increase tax revenue generation.

Tanzania's tax treaties, except the treaties with Italy, South Africa and Zambia, prescribe a maximum withholding tax rate of 20% for source taxation of technical fees.[245] The rates in Tanzania's tax treaties are quite high, considering that the domestic tax rate for technical fees for non-residents in Tanzania is 15%.[246] In any case, the implication is that though majority of Tanzania's tax treaties prescribe 20% withholding tax rates, Tanzania cannot collect more than the rate in its domestic tax law – 15%, because tax treaties do not impose taxes.[247] Regarding the treaty with Italy that has no prescribed rate, the 15% domestic tax rate will apply. Though Tanzania can

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[242] UN Commentary on Article 12A(2) of the UN Model, *supra* note 7 at 333.
[243] *Supra* note 19.
[244] *Ibid*.
[245] *Supra* note 235.
[246] *Supra* note 30.
[247] Peter Harris, *International Commercial Tax Law* (United Kingdom: Cambridge University Press, 2020).

increase its domestic tax rate for non-residents to 20% to take advantage of the high withholding tax rate in most of its tax treaties to boost domestic tax revenue, 15% rate is reasonable since it is applied on the gross payment to the non-resident. The cost of the technical services provided by the non-resident, and the fact that the withholding tax rate is applied on the gross payment, should be considered in prescribing the withholding tax rate to avoid the possibility of excessive taxation.

The rates for source taxation of technical fees in Botswana's tax treaties vary. Botswana's tax treaties with France, Ireland, Malta, and the United Kingdom prescribe a maximum withholding rate of 7.5%.[248] The treaties with Barbados, India, Lesotho, Russia, Seychelles, South Africa, Zambia, and Zimbabwe prescribe a maximum of 10%.[249] Botswana's tax treaties with Mauritius and Sweden prescribe a maximum withholding tax rate of 15%.[250] The 7.5% and 10% rates for source taxation of technical fees in Botswana's tax treaties are low. They should be adjusted to 15%, which is the domestic withholding tax rate for taxation of technical fees.[251]

5.1.3 Ordering and Force of Attraction Rules

Paragraph 4 of Article 12A of the UN Model suspends the application of Article 12A if the person who provides the services has a permanent establishment or fixed base in the State in which the fees arise and the fees are effectively connected with that permanent establishment or fixed base, or if the fees for technical services are effectively connected with business activities in the State in which the fees arise that are of the same or similar kind as those effected through the permanent

[248] Article 13(2) of Botswana's tax treaty with the United Kingdom; Article 20(2) of Botswana's tax treaties with Ireland, Malta; Article 21(2) of Botswana's tax treaty with France.
[249] Article 13(2) of Botswana's tax treaties with India, Lesotho, Zambia, Zimbabwe; Article 20(2) of Botswana's tax treaty with South Africa; Article 21(2) of Botswana's tax treaties with Barbados, Russia, Seychelles.
[250] Article 21(2) of Botswana's tax treaty with Sweden; Article 22(2) of Botswana's tax treaty with Mauritius.
[251] *Supra* note 38.

establishment.[252] In such cases, Article 12A(4) provides that Articles 7 and 14 should be applied to tax such fees.[253]

Botswana's tax treaties with Barbados, France, India, Mauritius, Russia, Seychelles, Sweden, and the United Kingdom, limit the application of the provision if the technical fees are effectively connected with business activities carried on through a permanent establishment, or independent personal services carried on from a fixed base situated in the source state.[254] This provision partly mirrors the provision of Paragraph 4 of Article 12A of the UN Model. To maximize returns from taxation of technical fees, it is proposed that Botswana should amend its tax treaties to wholly reflect the provisions of the UN Model. This will remove the benefits of a reduced withholding tax rate applicable under the provision, and expand Botswana's taxing rights, as those fees will be taxable at full domestic rates for business profits and independent personal services.

5.1.4 Income Definition and Geographic Source Rules

Fees for technical services are defined as payments for services of a managerial, technical or consultancy nature.[255] Though some countries take the view that the definition of royalties as "information concerning industrial, commercial or scientific experience" covers the provision of technical services, the Experts believe that royalties involve the transfer of the use of, or the right to use property or know-how (brain-work), but not the provision of services, hence the separate provision for technical services.[256]

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[252] Article 12A(4) of the UN Model, *supra* note 7. See also the UN Commentary on paragraph 4 of Article 12A, *supra* note 7 at 353.

[253] *Ibid*.

[254] Article 13(4) of Botswana's tax treaties with India, United Kingdom; Articles 21(4) of Botswana's treaties with Barbados, France, Seychelles, Sweden; Article 22(4) of Botswana's treaty with Mauritius.

[255] *Ibid*.

[256] *Ibid*.

Article 12A(3) clarifies the scope of Article 12A. The provision applies to fees for technical services (services of a managerial, technical or consultancy nature), and not to all payments for services.[257] The Experts explain that the services must involve the application, by the service provider, of specialized knowledge, skill or expertise on behalf of a client, or the transfer of knowledge, skill or expertise to the client, other than a transfer of information covered by the definition of "royalties" in Article 12(3) of the UN Model.[258]

All of Tanzania's tax treaties, except the treaties with South Africa and Zambia, copy the extensive definition of technical services under Article 12A of the UN Model,[259] and all of Botswana's treaties, except the treaties with China and the Czech Republic, copy the extensive definition of technical services under Article 12A of the UN Model.[260]

The extensive definition of professional/management fees under the UN Model is beneficial to the comparator countries, as it assigns taxing rights over consideration for any services of a managerial, technical, professional or consultancy nature to the source state.

Article 12A(5) of the UN Model stipulates the source rule for technical fees. According to the provision, the source state for technical fees is the State of which the payer of the fees is a resident or the State in which the payer has a permanent establishment or fixed base if the fees for technical services are borne by the permanent establishment or fixed base.[261] The source rule in the UN

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[257] Article 12A(3) of the UN Model, *supra* note 7. See also the UN Commentary on Article 12A(3), *supra* note 7 at 339.

[258] UN Commentary on Article 12A(3), *supra* note 7 at 340.

[259] Article 14(3) of Tanzania's tax treaties with Canada, Denmark, Finland, Norway, Sweden; Article 15(3) of Tanzania's tax treaty with India; Article 21(3) of Tanzania's tax treaty with Italy.

[260] Article 13(3) of Botswana's tax treaties with India, Lesotho, United Kingdom, Zambia, Zimbabwe; Article 20(3) of Botswana's tax treaties with Ireland, Malta, South Africa; Article 21(3) of Botswana's tax treaties with Barbados, France, Russia, Seychelles, Sweden; Article 22(3) of Botswana's tax treaty with Mauritius.

[261] Article 12A(5) of the UN Model, *supra* note 7. See also the UN Commentary on Article 12A(5), *supra* note 7 at 354.

Model seeks to prevent double taxation. It ensures that only the country where the payer is resident has the primary right to tax the income.

Article 12A(6) provides an exception to the rule in Article 12(A)(5). According to the provision, where the payer, though resident of a contracting state, carries on business in the other Contracting State through a permanent establishment situated in that other State, or performs independent personal services through a fixed base situated in the other state, and such fees are borne by that permanent establishment or fixed base, fees for technical services shall be deemed not to arise in the Contracting State of which the payer is a resident.[262] In such a case, the state with an economic link to the fees – the state where the permanent establishment or a fixed base is situated – will be allowed to tax the fees.[263]

All of Tanzania's tax treaties copy the source rule in the UN Model.[264] Botswana's tax treaties with the United Kingdom, France, Russia, Barbados, Seychelles, Sweden, and Mauritius copy the source rule in the UN Model.[265] Botswana's treaties with India, Lesotho, Zambia, Zimbabwe, Malta, Ireland, and South Africa include a source rule but only exclude source taxation of technical fees borne by a permanent establishment in a third state.

5.1.5 Anti-avoidance Provisions

Article 12A(2) of the UN Model includes the term "beneficial owner" as an anti-abuse provision.[266] The requirement to look to the beneficial owner restricts the exploitation of the rate

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[262] Article 12A(6) of the UN Model, *supra* note 7. See also the UN Commentary on Article 12A(6), *supra* note 7 at 355.

[263] *Ibid*.

[264] Article 14(4) of Tanzania's tax treaties with Canada, Denmark, Finland, Norway, Sweden; Article 15(4) of Tanzania's tax treaty with India; Article 21(4) of Tanzania's tax treaty with Italy.

[265] Article 13(5) of Botswana's treaty with the United Kingdom; Article 21(5) of Botswana's treaties with France, Russia, Barbados, Seychelles, Sweden; Article 22(5) of Botswana's treaty with Mauritius.

[266] Article 12A(2) of the UN Model, *supra* note 7.

by residents of the other contracting state who are not beneficial owners, but direct recipients of the fees who are acting as agent, nominee, and conduit company acting as a fiduciary or administrator.

None of Tanzania's tax treaties include the term "beneficial owner" to restrict the exploitation of the low withholding tax rate for taxation of technical fees by residents of the other contracting state who are not beneficial owners, but direct recipients of the fees who are acting as agent, nominee, conduit company acting as a fiduciary or administrator. It is proposed that Tanzania should amend its tax treaties to include this anti-abuse provision.

Only four of Botswana's tax treaties (with India, Lesotho, the United Kingdom, and Zambia include the term "beneficial owner" to restrict the exploitation of the low withholding tax rate for taxation of technical fees by residents of the other contracting state who are not beneficial owners, but direct recipients of the fees who are acting as agent, nominee, conduit company acting as a fiduciary or administrator.[267] Botswana should amend its tax treaties to include this anti-abuse provision.

Article 12A(7) of the UN Model seeks to limit the application of Article 12A to non-arm's length payments, where due to a special relationship between the payer and the beneficial owner of the fees, or between both of them and some other person, the amount of the fees paid exceeds the amount that would have been agreed upon by the payer and the beneficial owner if they had stipulated at arm's length.[268] In such a case, Article 12A(7) provides that Article 12A will only apply to the arm's length amount while the excess amount will be taxed according to the domestic

[267] Article 13(2) of Botswana's treaties with India, Lesotho, United Kingdom, and Zambia.
[268] Article 12A(6) of the UN Model, *supra* note 7. See also the UN Commentary on paragraph 7 of Article 12A, *supra* note 7 at 361.

laws of the contracting states.[269] This anti-abuse rule, if effectively implemented, will prevent profit shifting from source states to low and no-tax jurisdictions through inflated payments for technical fees.

Only one of Tanzania's tax treaties (with India) includes the anti-avoidance provision in Article 12A(7) of the UN Model denying non-arm's length amounts in the form of technical fees paid to a related entity.[270] Other tax treaties signed by Tanzania should be amended to include this anti-abuse provision to deny the benefits of the provision to avoidance transactions.

All of Botswana's tax treaties, except the treaties with China and the Czech Republic, include the anti-abuse provision in Article 12A(7) of the UN Model.[271] Botswana's tax treaty with the United Kingdom contains an additional anti-abuse provision, limiting the operation of the provision if the main purpose or one of the main purposes is for any person concerned with the creation or assignment of the rights in respect of which the technical fees are paid, to take advantage of this Article by means of that creation or assignment.[272] It is proposed that other tax treaties signed by Botswana be amended to include this additional anti-abuse provision to deny the benefits of the provision to avoidance transactions.

6. Conclusion

Capital investment inflows contribute significantly to the economies of the three countries analysed in this chapter (Nigeria, Tanzania, and Botswana). The analysis raises important findings for consideration by these countries to drive reforms of their tax treaties to improve domestic

[269] *Ibid*.
[270] Article 21(6) of Tanzania's tax treaty with India.
[271] Article 13(6) of Botswana's tax treaties with India, Lesotho, Zambia, Zimbabwe; Article 20(6) of Botswana's tax treaties with Ireland, Malta, South Africa; Article 21(6) of Botswana's tax treaties with Barbados, France, Russia, Seychelles, Sweden; Article 22(6) of Botswana's tax treaty with Mauritius.
[272] Article 13(7) of Botswana's tax treaty with the United Kingdom.

resource mobilization to help finance socio-economic development through effective taxation of investment income earned in those countries. Below are pointers regarding the implications of the analysis for the possibility of reforms necessary to expand tax revenue generation for socio-economic development in those countries.

All the treaties signed by the comparator countries, except Tanzania's treaty with Zambia, allow source taxation of dividends, interest, and royalties. The most potent tool for Tanzania to fight against treaty shopping and to increase domestic resource mobilization from non-residents is to reform its treaty with Zambia to allow source taxation of investment income. Currently, Tanzania's treaty with Zambia is designed in a way that allows non-residents to move investment income earned in Tanzania to conduit companies established in Zambia for further repatriation abroad without paying taxes to the Tanzanian government. Reforms to Tanzania's treaty with Zambia will prevent such tax planning.

For technical fees, none of Nigeria's tax treaties allow for their taxation. Majority of Tanzania's tax treaties allow source taxation of management or professional fees arising from the source state paid to a resident of the other contracting state. Tanzania's tax treaties with South Africa and Zambia are silent over taxation of technical fees. All of Botswana's tax treaties, except the treaties with China and the Czech Republic, include provisions for taxation of technical fees. Regarding taxation of fees for digital services, none of the tax treaties signed by the comparator countries includes provisions for source taxation of fees paid for digital service.

The implication of the lack of provisions for taxation of technical fees in Nigeria's tax treaties, Tanzania's treaties with South Africa and Zambia, and Botswana's tax treaties with China and the Czech Republic, is found in the provisions of those treaties covering taxation of residual income which is discussed in the next chapter. Suffice to say at this juncture that in situations where the treaties allocate taxing rights over residual income to the residence state, the countries cannot tax technical fees. In other words, whether the countries can tax technical fees paid by residents of contracting states is determined by the presence of provisions in those tax treaties allowing the source state to tax other income not dealt with by other allocation rules in the treaties. Where the treaties allocate taxing rights over residual income to the residence state, the comparator countries cannot exercise their taxing rights even if there are provisions in their domestic laws allowing source taxation of technical fees.

To cure this major gap and expand the tax base of the comparator countries, I make three recommendations: First, Tanzania should amend its tax treaty with Zambia to allow for source taxation of technical fees. Nigeria should amend its tax treaties to include a provision allowing source taxation of technical fees. Also, Botswana should amend its tax treaties with China and the Czech Republic to allow for source taxation of technical fees. Taxation of services is a powerful tool to help increase domestic resource mobilization in the comparator countries. Therefore, the treaties signed by the comparator countries should be amended to allow source taxation of technical services.

To reduce the benefits of reduced withholding tax rates for source taxation of dividends, interest, and royalties, the OECD excludes the provisions of Articles 10, 11, and 12 of the OECD Model if the income is effectively connected with a permanent establishment in the source state. In such a case, the OECD Model provides that the income will be taxed fully at source. The UN Model expands the scope of the exclusions by adding income from business activities of the same or similar kind as those of a permanent establishment in the source country, and income from independent personal services from a fixed base situated in the source state. Not all the treaties signed by the comparator countries copy the extended restrictions in the UN Model. For example, none of Nigeria's tax treaties includes the force of attraction rule in the UN Model, thus excluding royalties received in connection with business activities of the same or similar kind as those of a permanent establishment in the source country in the UN Model. It is necessary for these countries to amend their treaties to reflect the UN provision to increase domestic resource mobilization from investment income earned by non-residents.

The analysis shows variations in withholding tax rates for investment income in the treaties signed by the comparator countries. For example, Tanzania's treaty with Canada prescribes a maximum withholding tax rate of 20% of the gross amount of the dividends if the recipient is a company which controls directly or indirectly at least 15% of the voting power in the company paying the dividends; and 25% in all other cases, Nigeria's tax treaty with Canada prescribes maximum withholding tax rates of 12.5% of the gross amount of the dividends if the recipient is a company which controls directly or indirectly at least 10% of the voting power in the company paying the dividends; and 15% in all other cases. These variations show asymmetries in international tax policies. This chapter argues that these variations can be leveraged by the comparator countries to insist on higher withholding tax rates following the rates in the tax treaties signed by other African countries.

The analysis also shows that the rates in some of the treaties are either higher or lower than domestic withholding tax rates. For example, while Botswana's domestic withholding tax rate for interest payment by non-resident companies is 15%, only one of Botswana's tax treaties (treaty with Sweden) allows maximum revenue collection of withholding taxes from non-residents in line with its domestic law. Other tax treaties restrict Botswana's taxing rights by prescribing lower withholding tax rates. On the other hand, while Tanzania's domestic withholding tax rate for royalty payments is 15%, Tanzania's treaties with Canada, Denmark, Finland, India, Norway, and

Sweden prescribe a withholding tax rate of 20% for source taxation of royalties.[273] For tax treaties with withholding tax rates higher than the domestic rates, there is no serious consequence – only that the comparator countries cannot collect more than the domestic withholding tax rate. For tax treaties with withholding tax rates lower than the domestic rates, however, there is a serious negative consequence; which is that the comparator countries cannot collect more than the treaty rate. Given this, it is my view that the comparator countries should review their tax treaties and those with withholding tax rates lower than the domestic rate should be reformed to align the rates with the domestic rate.

It has been pointed out that Botswana's tax treaties have the lowest withholding tax rates for source taxation of dividends. Majority of Botswana's tax treaties prescribe withholding tax rates of 5% of the gross amount of the dividends if the beneficial owner is a company which holds directly, at least 25% voting shares, and 10% in other cases. Tanzania's treaties have the highest withholding tax rate for source taxation of dividends. A majority of Tanzania's tax treaties prescribe rates as high as 20% and 25% of the gross amount of the dividends. Nigeria is a bit progressive with most of its withholding tax rates being 12.5% if the beneficial owner is a company which holds, directly, at least 10% voting shares, and 15% in other cases. Altogether, I recommend that the tax treaties signed by the comparator countries be reformed to prescribe withholding tax rates of 10% for source taxation of dividends to increase their domestic resource mobilization. Given that the non-resident companies will already be subject to income tax, the 10% withholding tax rate on outbound dividend payments sounds reasonable to avoid excessive taxation.

[273] Article 12(2) of Tanzania's treaties with Canada, Denmark, Finland, Norway, Sweden; Article 13(2) of Tanzania's treaty with India.

Again, the discussion highlights that Botswana's tax treaties have the lowest withholding tax rates for source taxation of interest payments. Majority of Botswana's tax treaties prescribe a maximum withholding tax rate of 10% for source taxation of interest payments. This chapter recommends that the tax treaties signed by the comparator countries be reformed to prescribe withholding tax rates of 15% for source taxation of interest to increase domestic resource mobilization in the countries. Tanzania is more progressive with the majority of its treaties prescribing a 15% withholding tax rate. The rates in Nigeria's treaties for source taxation of outbound interest payment are also low, most being 12.5%. Nigeria's tax treaties with China, Singapore, and South Africa prescribe a maximum withholding tax rate of 7.5% for interest payments, which is lower than the domestic rate of 10%. Given that interest payments are deductible against the source country's tax base, I make two recommendations. First, Nigeria and Tanzania should raise their domestic withholding tax rates for interest payments to 15% to increase tax revenue generation. Second, Nigeria, Tanzania, and Botswana should amend their tax treaties to increase the withholding tax rates to 15%. In the interim, Nigeria's tax treaties with China, Singapore, and South Africa should be amended to increase the rate to the domestic tax rate of 10%. Low tax rates for taxation of interest increases the opportunities for outflow of interest payments without giving the countries adequate opportunity to maximize revenue from capital outflows.

The analysis reveals that Botswana's tax treaties have the lowest rates for source taxation of royalties with most treaties prescribing rates of 10%. Nigeria follows with most of its treaties prescribing rates of 12.5%. Tanzania has the highest rate – most of its treaties prescribe rates of 20%. Nigeria's domestic withholding tax rate for royalty payments is 10%, while the rates in Tanzania and Botswana is 15%. Three recommendations are made. First, I recommend that Nigeria's tax treaties with rates lower than the domestic rates (treaties with China, Singapore, and

South Africa) be amended to increase the rates to 10%. Second, that Nigeria should amend its domestic law by increasing the withholding tax rate for royalties to 15%, and reform all its tax treaties to reflect the domestic withholding tax rate of 15%. Third, I recommend that Tanzania and Botswana should reform their tax treaties to prescribe withholding tax rates of 15% for outbound royalty payments. As discussed above, source states provide an enabling environment for intangibles developed in residence states to be exploited, resulting in the royalty income. Therefore, a 15% withholding tax rate for royalty payments is adequate compensation for the contributions of the comparator countries and should be included in their tax treaties.

Another major finding from the analysis is the variation in the rates for source taxation of fees for technical service. While none of Nigeria's tax treaties include a provision for source taxation of technical fees, majority of the tax treaties signed by Tanzania and Botswana have provisions allocating taxing rights over technical fees to the source state. Though Nigeria has a similar provision in its domestic law prescribing a withholding tax rate of 10%, the withholding tax rate in Tanzania and Botswana is respectively 15%. The rates for technical fees in Tanzania's tax treaties are quite high; none is below the domestic rate of 15%. Unlike Tanzania, only two of Botswana's tax treaties (with Mauritius and Sweden) prescribe a maximum withholding tax rate of 15%. Other tax treaties signed by Botswana prescribe rates lower than the domestic rate (7.5% and 10%).

As discussed above, the lowered threshold for technical fees increases the opportunities to tax profits arising from technical services outside of a permanent establishment or a fixed base in the comparator countries. I therefore make three recommendations. First, Nigeria should reform its domestic tax law to increase the tax rate for technical/management services to 15% in order to increase tax revenue generation. Second, Nigeria should amend its tax treaties to include provisions for source taxation of technical fees, prescribing 15% tax rate. Third, Botswana should amend its tax treaties to increase the tax rates to 15%, which is the domestic withholding tax rate for taxation of technical fees.

Another interesting observation from the analysis is that some of the tax treaties signed by the comparator countries contain unique provisions preserving source taxation of investment income that are not present in either the OECD or the UN Model. For example, all Nigeria's tax treaties, except the treaties with the Czech Republic, the Netherlands, Philippines, Singapore, and the United Kingdom, contain special anti-abuse provisions, limiting the operation of the provision on source taxation of dividends if the right giving rise to the dividends was created or assigned mainly for the purpose of taking advantage of the Article, and not for bona fide commercial reasons. Only three of Botswana's tax treaties (China, Lesotho, and the United Kingdom) contain this special anti-abuse provision present in Nigeria's tax treaties. This anti-abuse provision is not present in any of the tax treaties signed by Tanzania. Clearly, the special anti-abuse rule should be included in all the tax treaties signed by Nigeria, Tanzania, and Botswana to prevent excessive base eroding payment and to protect the tax base of the countries.

Not all the treaties include the anti-abuse provisions included in the OECD and UN Models to prevent abuse of provisions governing taxation of capital investment income. For example, only two of Tanzania's tax treaties (those with Canada and South Africa) include the term "beneficial owner" to qualify the application of the provision to interest paid by a resident of a contracting state, to a beneficial owner resident in the other contracting state, to deny the benefit of the provision to residents of the other contracting state acting in the capacity of agent, or nominee for another person who, in fact, receives the benefit of the income (formal owner) anti-abuse provision. All of Nigeria's tax treaties, except the treaty with the United Kingdom) include this anti-abuse provision, and all of Botswana's tax treaties include the anti-abuse provision. Again, I would propose that all the treaties signed by Nigeria, Tanzania, and Botswana should be amended to include the anti-abuse rule to prevent the grant of treaty benefits in inappropriate circumstances.

Overall, the analysis in this chapter raises useful findings about greater opportunities for increased withholding tax rates and expansive anti-abuse provisions for source taxation of investment income earned by non-residents for the consideration of the governments of Nigeria, Tanzania, and Botswana. With increasing rates of poverty and the rising need for structural solutions to economic development problems in these countries, reforms to tax treaties can be useful tools to increase domestic resource mobilization for socio-economic development. Key areas where reforms are necessary regarding provisions for taxation of capital investment income in the tax treaties signed by these three countries have been identified and analysed. If efforts are made in these areas, they will strengthen domestic resource mobilization from capital investment flows in the three countries.

Chapter VI - Nigeria, Tanzania, And Botswana: Other Source-Restricting Tax Treaty Provisions Regarding Income Derived by Non-Residents

1. Introduction

Chapters 4 and 5 analysed the source-restrictive provisions for taxation of business profits and investment income in the tax treaties signed by the comparator countries. This chapter examines other allocation rules in the tax treaties signed by these countries. Those rules relate to taxation of income from shipping and aircraft operations, taxation of fees for digital service, capital gains, income from independent personal services, and other income not expressly dealt with by other allocation rules. This chapter argues that source-restrictive provisions in the tax treaties signed by the three countries for those categories of income should be removed and replaced with expansive source-taxation rights. This is because the restrictions are unwarranted, considering the financial constraints that impede the implementation of sustainable development projects in those countries.

Regarding fees paid to non-residents for digital services, this chapter argues that Tanzania and Botswana should follow Nigeria's lead to enact domestic laws imposing digital taxes on non-residents to raise tax revenue. Trade in digital goods and services account for a growing share of international trade.[1] This is why therefore Tanzania and Botswana should harness the opportunities in this sector by subjecting non-resident digital companies to tax on profits generated from economic activities carried out in their countries.

The main argument of this chapter is that income derived from economic activities carried on in the comparator countries by residents of the states with whom they have signed tax treaties, from aircraft and shipping operations, digital services, alienation of property, independent personal

[1] *Digital trade: Opportunities and Actions for Developing Countries*, (2022), UNCTAD/PRESS/PB/2021/10.

services, and other income not expressly dealt with by other allocation rules, should be taxed in the comparator countries. To come to this conclusion, section 2 discusses the provisions on taxation of income from aircraft and shipping operations in the OECD Model, UN Model, and the comparator countries. The analysis in section 2 reveals that majority of the tax treaties signed by the comparator countries exempt source taxation of profits from aircraft and shipping operations. For the treaties that allow source taxation of income from aircraft and shipping operations, the tax rate is very low - the rates are between 1%, 1.5% and 5%, with some treaties requiring further reduction of taxable profits by 50%.

Section 3 analyses the provision in the UN Model, allowing source taxation of fees paid to non-residents for automated digital services done in the source state. The analysis shows that none of the tax treaties signed by the comparator countries allows source taxation of fees for digital services, and only Nigeria has a domestic legislation imposing digital taxes on non-resident companies. Section 4 analyses the provisions on taxation of income from capital gains in the OECD Model, UN Model, and the comparator countries. The analysis reveals that none of the treaties signed by the comparator countries allows source taxation of gains from alienation of all taxable assets situated in the source state. A similar analysis is done for taxation of income from independent personal services in section 4. The analysis shows that few of the tax treaties signed by the comparator countries fully reflect the provisions of Article 14 of the UN Model, which allows source taxation of income from independent personal services attributable to a fixed base maintained by the recipient of such income, or if the recipient stays in the source state, for a 183-day period in a fiscal year and the activities are derived from that stay. It is also shown that none of the treaties allows source taxation of income from independent personal services performed outside the source state to customers in the source state.

Section 5 examines the provisions on taxation of other income not expressly dealt with by the allocation rules in the OECD Model, UN Model, and the comparator countries. The analysis in section 5 discloses a lack of uniformity in the provisions of the tax treaties signed by the comparator countries regarding source taxation of other income. All except two treaties signed by Nigeria allow source taxation of other income. Only two of Tanzania's treaties allow source taxation of other income. Five of Botswana's tax treaties allow source taxation of other income. To maximize revenue from economic activities performed by non-residents in the comparator countries, this chapter proposes reforms to the tax treaty provisions signed by the comparator countries.

2. Taxation of Income from Shipping and Air Transport

2.1 Allocation of Taxing Rights

Article 8 of the OECD Model serves as the special rule allocating taxation rights over shipping and aircraft operations in international traffic.[2] It gives exclusive taxation rights over shipping and aircraft operations in international traffic to the residence state.[3] The OECD Commentary clarifies that contracting states are free to substitute "residence state" with the "place of effective management".[4] The burden of multiple taxation, associated cost of allocating revenues and expenses to other jurisdictions, effective lobbying from enterprises engaged in international shipping and air transport, were some of the factors that influenced the assignment of this exclusive taxing rights to the residence state or place of effective management.[5]

[2] Article 8 of the *Model Tax Convention on Income and Capital* (Paris: OECD, 2017).
[3] *Ibid.*
[4] Commentary on Article 8(1) of the OECD Model, *supra* note 1 at para 2.
[5] Daniel Lang, "Taxation of International Aviation: A Canadian Perspective" (1992) 40:4 Can Tax J 884.

Exclusive residence taxation is detrimental to source states that do not have resident shipping companies but have ports that are used to a significant extent by ships from other countries.[6] Reciprocal exemption at source means little revenue for these countries. Maritime trade, the backbone of international trade, accounts for 80% of this trade.[7] In terms of volume, developing countries account for a greater proportion of global maritime exports and imports.[8] The maritime industry contributes significantly to the economy of the comparator countries. This is why I argue against exclusive residence taxation of income from shipping operations derived in those countries.

According to the report released by UNCTAD on maritime trade in Botswana for 2020, merchandise trade amounted to a total of $10,778 million (USD), while transport services trade was valued at $1,235 million.[9] For Tanzania, total trade merchandise for 2020 was valued at $13, 950 million, while transport services trade amounted to $3, 499 million.[10] The value is higher for Nigeria: while its total value of merchandise trade was $91, 024 million, transport services trade stood at $23, 826 million.[11] These statistics show the contributions of the comparator countries to international maritime trade, and thus, the benefits of the maritime industry that ought to be spread evenly among states relative to their contributions to this trade. The exclusive residence state taxing right deprives source states of sharing in the benefits in the maritime industry. The same

[6] Commentary on Article 8(1) (Alternative A) of the *Model Tax Convention Between Developed and Developing Countries on Income and Capital*, (New York: UN, 2017) at para 9; Guglielmo Maisto, "The History of Article 8 of the OECD Model Treaty on Taxation of Shipping and Air Transport" (2003) 31:6-7 Intertax 232 at 232-3; Richard Vann, "Current Trends in Balancing Residence and Source Taxation" in Y Brauner, P Pistone, eds, *Current Trends in Balancing Residence and Source Taxation in BRICS and the Emergence of International Tax Coordination* (Amsterdam: IBFD, 2015) 367 at 378.
[7] UNCTAD, "Review of Maritime Transport", 2021, online: https://unctad.org/system/files/official-document/rmt2021_en_0.pdf.
[8] *Ibid* at 4.
[9] UNCTAD, "Maritime Profile: Botswana", online: https://unctadstat.unctad.org/countryprofile/maritimeprofile/en-gb/072/index.html.
[10] UNCTAD, "Maritime Profile: Tanzania", online: https://unctadstat.unctad.org/countryprofile/maritimeprofile/en-gb/834/index.html.
[11] UNCTAD, "Maritime Profile: Nigeria", online: https://unctadstat.unctad.org/countryprofile/maritimeprofile/en-gb/566/index.html.

argument applies for aircraft operations. The International Air Transport Association (IATA) estimates that air transport industry, including airlines and its supply chain, are estimated to support US $600 million of GDP in Nigeria, with cargo and passenger inflow and outflow from all over the world. Though statistics is unknown for the value of aircraft operations to Tanzania and Botswana, it is expected that the value will be a bit lower than Nigeria's.

In any event, if general businesses by those non-residents were carried out in the comparator counties, they would be taxed therein. Therefore, there is no reason why these countries should sign away their taxing rights for profits derived from aircraft and shipping operations. Exclusive residence taxation of income derived from aircraft and shipping operations carried out in the comparator countries is not in their interest. The revenue loss to the comparator countries is compounded by the fact that non-resident companies engage in port management in addition to direct maritime trade. Thus, profits derived from those companies from both activities will altogether escape source taxation where tax treaties with the home countries of those companies, or the country of the vessel's registration (the flag state)[12] exempt source taxation of profits from shipping operations.

The UNCTAD reports that 80% of global terminal operations are managed by 21 private companies.[13] The UNCTAD further reports that several of these companies are part of, or are closely linked to the following top shipping lines: APM Terminals/Maersk; Terminal Investment Limited/Mediterranean Shipping Company; Mitsui Osaka Shosen Kaisha Lines; Yang Ming Marine Transport Corporation; HMM and COSCO.[14] Developing countries privatize their ports

[12] The Flag state of a vessel denotes the country of the vessel's registration. The flag state is important in the maritime sector because it is a notice to the public about the country that has control over the vessel.
[13] *Review of Maritime Transport* (Geneva: UNCTAD, 2020) 58 – 60.
[14] *Ibid*.

for the following reasons: to increase efficiency in port operation, decrease cost of port services to stakeholders, decrease cost to the government and to attract private sector participation.[15] However, attractive privatization of ports carries an important lesson that the comparator countries, and African countries in general, must bear in mind. This is that the need for proper regulation to manage the ports and ensure that the benefits from the shipping industry do not go only to private operators, but that the government also shares in its benefits. One of the ways by which to ensure adequate returns to the governments is to enact domestic legislations and amend tax treaties to allow source taxation of maritime operations, both for carriage of goods and persons, and regarding other business activities by non-resident companies engaged in shipping operations.

Arguments are raised about compliance and administrative challenges regarding shipping in the comparator countries. Even so, the revenue authorities of these countries must boost their efforts to improve tax compliance and revenue collection. Nigeria, for example, issued a circular in 2020 for non-resident companies engaged in aircraft and shipping operations to provide guidance on the taxation of the sectors.[16] The Circular specifies that where the total profits of the company cannot be determined, its assessable profits shall be computed as a fair percentage of the total sum receivable from the carriage of passengers, mails, livestock or goods shipped or loaded in Nigeria.[17] The Nigerian tax authority (the FIRS) has consistently applied 20% of the total sum receivable as the total profits in such cases.[18] The FIRS assumes that 20% of the total profits received by the entity is profit, while the remaining 80% is operating costs. The standard companies' income tax rate of 30% is then applied to the 20% of total profits, which results in a

[15] Yingigba Chioma Akinyemi, "Port Reform in Nigeria: Efficiency Gains and Challenges." (2016) 81:5 GeoJournal 681.
[16] FIRS, Taxation of Companies Engaged in Shipping, Air Transport and Cable Undertakings, Circular No 2021/14, online: <https://www.firs.gov.ng/wp-content/uploads/2021/06/TAXATION-OF-COMPANIES-ENGAGED-IN-SHIPPING-AIR-TRANSPORT-AND-CABLE-UNDERTAKINGS.pdf>.
[17] *Companies Income Tax Act (Nigeria)* 2004, s14(3).
[18] *Supra* note 16.

6% rate. Even if those non-resident companies are eventually taxed at 6% because of administrative challenges, it is better than not being taxed at all. I recommend that Tanzania and Botswana follow Nigeria's lead by making provisions in their domestic laws to similarly tax non-resident companies engaged in aircraft and shipping operations. The three countries should eliminate the restrictions in their treaties for source taxation of aircraft and shipping operations to increase tax revenue generation.

The UN Model proposes an alternative to the provisions of the OECD Model, although it bears a striking amount of similarity to the OECD Model. The UN Model includes an alternative provision that allows for a certain percentage of shipping profits to be taxed in the source state where the activities of the shipping enterprise have been more than casual. The UN defines the term "more than casual" as a scheduled or planned visit of a ship to a particular country to pick up freight or passengers.[19] The definition of "scheduled" or "planned" are left open by the UN Commentary, which leaves the precise application of the provision to litigation. Similar to the provision of the OECD Model, aircraft operations are totally exempted from source taxation.[20] Provisions on source taxation of income from aircraft and shipping activities in the tax treaties signed by the comparator countries are discussed next.

Nigeria's treaties with Belgium, France, Pakistan, Singapore, South Africa allocate taxing rights over income from shipping and air transport in international traffic to the residence state.[21] An exception is provided for source taxation if such operations are carried on by an enterprise of only one of the Contracting States.[22] Nigeria's treaty with Canada also allocates exclusive taxing rights

[19] Commentary on Article 8(2) (Alternative B) of the UN Model, *supra* note 6 at para 13.
[20] Article 8(1) (Alternative A), Article 8(1) (Alternative B) of the UN Model, *supra* note 6.
[21] Article 8(2) of Nigeria's treaties with Belgium, France, Pakistan, Singapore, South Africa.
[22] *Ibid*.

to the residence state over profits from aircraft and shipping operations.[23] An exception is provided for source taxation of the first earnings from air operations carried out by a resident of the other state.[24] Nigeria's treaties with China, Italy, and the United Kingdom totally exempt source taxation of income from shipping and air operations in international traffic.[25] Nigeria's treaty with the Czech Republic does not include a provision for taxation of income from shipping and aircraft operations in international traffic, which means full source taxation is allowed for residents of those countries. Nigeria's treaty with the Netherlands exempts source taxation of income from shipping and aircraft operations on a reciprocal basis.[26] In other words, income from shipping and aircraft operations derived by residents of the Netherlands in Nigeria is exempt from tax in Nigeria.[27]

Nigeria's treaty with the Philippines is unique; it allows source taxation of income from shipping and aircraft operations without introducing any exception.[28] Nigeria's treaty with Romania exempts source taxation of profits from shipping operations in international traffic.[29] The provision allows source taxation of income from aircraft operations only if the operation is not reciprocal – where it is only residents of Romania that engage in aircraft operations in Nigeria, and no resident of Nigeria engages in similar operations in Romania.[30] The provision further qualifies source taxation of income from aircraft operations – where the competent authorities of both contracting states agree to exempt such profits on a reciprocal basis.[31]

[23] Article 8(2) of Nigeria's treaty with Canada.
[24] *Ibid*.
[25] Article 8(1) of Nigeria's treaties with China, United Kingdom; Article 3(1) of Nigeria's treaty with Italy.
[26] Article 8(1) of Nigeria's treaty with Netherlands.
[27] *Ibid*.
[28] Article 8(2) of Nigeria's treaty with the Philippines.
[29] Article 8(1) of Nigeria's treaty with Romania.
[30] Article 8(2) of Nigeria's treaty with Romania.
[31] Article 8(3) of Nigeria's treaty with Romania.

Nigeria should amend its tax treaties to allow source taxation of income from shipping and air operations conducted by residents of the contracting states. Conditions on reciprocity, such as the one included in the tax treaties with Netherlands and Romania, should be removed. Provisions on reciprocity are problematic and invariably create opportunities for total tax exemption at source, where Nigeria is unable to achieve equal outcomes in terms of the number of resident companies engaging in shipping and aircraft activities in the contracting states. Foreign companies engaging in aircraft and shipping operations in Nigeria are taxable on profits accruing in, derived from, brought into, or received in Nigeria.[32] Also, Nigerian companies engaging in aircraft and shipping operations are taxed on their profits.[33] So in a bid to foster an effective and fair tax system, non-resident companies engaged in aircraft and shipping operations should be taxed on profits derived from those economic activities. Reforming the provisions of the tax treaties to allow source taxation of income from aircraft and shipping operations will not only increase tax revenue to help finance government spending but also foster a progressive tax system.

There are similarities in the provisions of Tanzania's treaties regarding taxation of profits from shipping and aircraft operations. All of Tanzania's treaties exempt source taxation of income from aircraft operations.[34] All the treaties, except the treaty with Zambia, allow source taxation of profits from shipping operations.[35] Tanzania should amend all its tax treaties to allow for source taxation of income from aircraft operations to increase tax revenue generation. Tanzania should also amend its treaty with Zambia to allow for source taxation of income from shipping operations.

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[32] Nigeria's *Companies Income Tax Act, supra* note 17, s9 & 14.
[33] Nigeria's *Companies Income Tax Act*, *supra* note 17, s13.
[34] Article 8(1) of Tanzania's treaties with Canada, Denmark, Finland, Italy, Norway, South Africa, Sweden.
[35] Article 8(2) of Tanzania's treaties with Canada, Denmark, Finland, Italy, Norway, South Africa, Sweden; Article 9(1) of Tanzania's treaty with India. Tanzania's treaty with Zambia exempt source taxation of income from aircraft and shipping operations – similar to the provision on taxation of investment income (dividends, interest, royalties) discussed in the preceding chapter.

Concurrently, Tanzania should amend the provisions of its domestic tax law to specifically subject profits of non-residents derived from aircraft and shipping operations to tax. Currently, there is no provision in Tanzania's Income Tax Act that subjects non-residents to tax on profits from aircraft and shipping operations accruing in, derived from, brought into, or received in Tanzania similar to the provisions of Section 9 and 13 of Nigeria's Companies Income Tax Act.[36] The closest provision in Tanzania's Income Tax Act is Section 4, which subjects the total income of every person (natural and artificial) and the repatriated income for the year of a domestic permanent establishment of a corporation to tax.[37] The Tanzanian provision is problematic in different ways. It eliminates the possibility of capturing all the profits accruing to, derived from, brought into, or received by foreign companies of its treaty partners engaged in aircraft and shipping operations in Tanzania for tax purposes. Clearly, Tanzania should amend its domestic tax legislation to specifically allow source taxation of all profits attributable to non-residents engaged in aircraft and shipping operations in Tanzania. Only then can the reform of its tax treaties to allow source taxation of income from aircraft and shipping operations have an impact.

All of Botswana's treaties exempt source taxation of profits from aircraft and shipping operations.[38] This is a gap in Botswana's treaties that should be amended to increase tax revenue from non-residents that engage in aircraft and shipping operations. Though not all of Nigeria and Tanzania's treaties allow full source taxation of profits from aircraft and shipping operations, Botswana should take a cue from the existing provisions in the tax treaties signed by both countries. For example, Nigeria's treaties with France and South Africa allow source taxation of

[36] *Supra* note 32 and 33.
[37] *Income Tax Act* (Tanzania) 2019, s4.
[38] Article 8(1) of Botswana's treaty with Barbados, China, Czech Republic, France, India, Ireland, Lesotho, Malta, Mauritius, Russia, Seychelles, South Africa, Sweden, United Kingdom, Zambia, Zimbabwe.

profits from air and shipping operations if such operations are carried on by an enterprise of only one of the Contracting States. Botswana has treaties with France and South Africa too, so there is no reason to be an outlier. Also, all of Tanzania's treaties allow source taxation of profits from shipping operations. Tanzania has treaties with India, South Africa, and Sweden. Botswana has treaties with these countries as well. Botswana should therefore amend its treaties to allow source taxation of profits from aircraft and shipping operations earned in the state.

To buttress the argument for the reform of Botswana's tax treaty, Botswana's domestic tax statue provides that the taxable income, that is, the total amount accrued or deemed to have accrued to every person in that tax year from every source situated or deemed to be situated in Botswana shall be chargeable to tax.[39] The statute further provides that an amount accrued to any person shall be deemed to have accrued from a source situated in Botswana where it has accrued to such person in respect of any service rendered or work done by such person in Botswana, whether the payment therefore is made by a resident or a non-resident and wherever payment is made.[40] In other words, Botswana's domestic tax statute subjects all income derived by non-residents from economic activities carried out in the country to tax.

It is justifiable for Botswana to amend its domestic tax statute by including provisions on source taxation of income from shipping and aircraft operations. This will align the provisions of Botswana's tax statute with the provisions of its tax treaties since tax treaties do not impose tax. The non-inclusion of specific provisions on source taxation of aircraft and shipping operations in Botswana's domestic law and tax treaties implies that income of non-resident companies engaged in those operations will be classified as business income under Article 7, raising the need to satisfy

[39] *Income Tax Act* (Botswana) 2019, ss 8, 9.
[40] Botswana's *Income Tax Act, ibid,* s 11(b).

the permanent establishment threshold under Article 5. The presence of a permanent establishment is, however, not relevant for source taxation of income from aircraft and shipping operations under Article 8, hence my argument that Botswana should include specific provisions for source taxation of income from aircraft and shipping operations in its domestic law and tax treaties to obviate the permanent establishment hurdle.

2.2 Maximum Rates

Since the OECD Model does not allow source taxation of profits from aircraft and shipping operations, there are no rates for source taxation of both activities in the OECD Model. The UN Model, however, provides that profits from shipping operations to be taxed in the source state shall be determined by the authorities of the place of effective management of the enterprise.[41] The UN Model further provides that the rate for source taxation of income from shipping operations will be at a reduced rate. (The percentage is to be established through bilateral negotiations.)[42] These restrictions disproportionately impact source states, and it is unclear why the provisions remain unchanged despite the contributions of source states in supporting the operations of foreign aircraft and shipping enterprises. Also, countries have unilateral mechanisms for preventing double taxation, so the argument that exclusive residence taxation seeks to prevent double taxation of these enterprises is not tenable. That the UN Model calls for bilateral negotiation to determine applicable rates of tax also hinders its potential as an effective means by which to promote source taxing rights in developing countries. It would have been more useful to have the UN Model set a fixed tax rate to give source countries some leverage during negotiations.

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[41] Commentary on Article 8(2) (Alternative B) of the UN Model, *supra* note 6 at para 14.
[42] Article 8(2) (alternative B) of the UN Model, *supra* note 6.

The rates for source taxation of income from aircraft and shipping operations are as follows: Nigeria's treaties with Belgium, France, Pakistan, Singapore, South Africa stipulate that where the source state exercises taxing rights over income from shipping and air operations, the tax charged shall not exceed 1% of the earnings of the non-resident.[43] Nigeria's treaty with Canada stipulates the rate for source taxation of income from shipping and air operations.[44] According to the provisions of the treaty, the tax shall not exceed the lesser of one percent of the earnings from such operations and the lowest amount of Nigerian tax that would have been imposed on such earnings if derived by a resident of a third state.[45] Nigeria's treaty with the Netherlands does not specify the rate for source taxation. It is assumed that the domestic rate will apply. Nigeria's treaty with the Philippines stipulates the lesser of a maximum rate of 1.5% applied on the gross revenue or the lowest rate of Philippine tax applied on such profits derived by an enterprise of a third state.[46] Nigeria's treaty with Romania stipulates a maximum tax rate of 1% of the earnings of the enterprise derived from aircraft operations in international traffic.[47]

The rates in Nigeria's tax treaties are too low and should be increased. The rates are even lower than the "fair and reasonable percentage of 6% rate", which is applied to non-resident companies engaged in aircraft and shipping operations where the assessable profits of such companies cannot be easily determined by the Nigerian tax authority.[48] There is no justification for allowing source taxation of profits from aircraft and shipping operations and then prescribing maximum rates of 1% or 1.5%. Nigeria should be allowed to fully tax income from these activities carried out within the country. Tax rates similar to what is levied on resident companies should be incorporated into

[43] Article 8(2) of Nigeria's treaty with Belgium, France, Pakistan, Singapore.
[44] Article 8(2) of Nigeria's treaty with Canada.
[45] *Ibid*.
[46] Article 8(2) of Nigeria's treaty with Philippines.
[47] Article 8(2) of Nigeria's treaty with Romania.
[48] *Supra* note 16.

Nigeria's treaties, which is 30% for large companies with gross turnover greater than 100 million naira, and 20% for medium companies with gross turnover greater than 25 million and less than 100 million naira.[49] Nigeria's tax authority clarifies in a recent information circular that foreign companies of treaty partners engaged in aircraft and shipping operations will be taxed at the rate specified in the respective tax treaties.[50] To increase tax revenue from aircraft and shipping operations, Nigeria has to increase the rates for taxation of these operations in its tax treaties. The rates should be increased to the rate applicable to domestic companies – 20% for medium companies and 30% for large companies.

Tanzania's treaties with Canada, Denmark, Finland, Norway, South Africa, Sweden provide that taxable profits for shipping operations shall not exceed five percent of the profits from shipping operations in the source state.[51] Tanzania's treaties with Canada and South Africa provide that the tax chargeable shall not exceed fifty percent of the taxable profits.[52] The treaties with Denmark, Finland, India, Italy, Norway, Sweden provide that the tax chargeable shall be reduced by fifty percent of the taxable profits.[53] Although Tanzania's tax treaties do not prescribe maximum tax rates for source taxation of shipping operations, which means that the domestic tax rate of 30% is what applies, the reduction of assessable profits of non-resident companies engaged in such operations is unjustifiable. If non-resident enterprises engage in economic activities in Tanzania

[49] Nigeria's *Companies Income Tax Act, supra* note 17, s40; *Finance Act* (Nigeria) 2019, s24.
[50] *Supra* note 16.
[51] Article 8(2) of Tanzania's treaties with Canada, South Africa; Article 8(3) of Tanzania's treaties with Denmark, Finland, Norway, Sweden.
[52] Article 8(2) of Tanzania's treaties with Canada, South Africa.
[53] Article 8(2) of Tanzania's treaty with Italy; Article 8(3) of Tanzania's treaties with Denmark, Finland, Norway, Sweden; Article 9(1) of Tanzania's treaty with India.

which result in profits, adequate taxes should be levied on those enterprises similar to what is levied on domestic enterprises that engage in similar operations, which is 30%.[54]

Given that none of Botswana's treaties allows source taxation of income from aircraft and shipping operations, the analysis turns to the rate in Botswana's tax statute for taxation of foreign companies. Botswana's Income Tax Law specifies that non-resident companies are taxable on all income accrued or deemed to have accrued from every source situated or deemed to be situated in Botswana at the rate of 25%.[55] Botswana should replicate this rate in its tax treaties. Foreign companies of treaty partners engaged in aircraft and shipping operations should be taxed at the applicable rate for domestic companies that engage in similar operations. This would increase tax revenue and foster a progressive tax system in Botswana.

2.3 Income Definition and Geographic Source Rules

The OECD Model sets down two categories of profits covered by the provision. The first is profits obtained by the enterprise from the carriage of passengers or cargo by ship or aircraft in international traffic. The second category is profits from activities to permit, facilitate, or support international traffic operations which can either be directly connected to the operations or ancillary. The OECD Model lists some examples of profits covered by the provision: profits from leasing a ship or aircraft on charter; profits from sale of tickets for transportation on ships or aircraft even if done by another enterprise; profits from advertising aboard ships or aircraft; profits from the lease of containers directly connected or ancillary to operation of ships or aircraft in international traffic.[56] The OECD Model specifically exempts profits from leasing a ship or aircraft on a bare boat charter basis except when such lease is ancillary to carriage of passengers or cargo

[54] First Schedule to Tanzania's *Income Tax Act, supra* note 37.
[55] Table III, Eight Schedule to Botswana's *Income Tax Act, supra* note 39.
[56] Commentary on Article 8 of the OECD Model, *supra* note 2 at paras 4-10.

by ship or aircraft in international traffic.[57] The UN Model copies the definition of profits in the OECD Model.[58]

Most of Nigeria's treaties rely on the definition of the term "profits" under the OECD and UN Models, but none includes all the examples of profits incorporated in both Models. Most notably, none includes income from advertising aboard ships or aircraft. Few address profits from leasing a ship or aircraft on charter and profits from lease of containers directly connected or ancillary to operation of ships or aircraft in international traffic. For example, Nigeria's treaty with Belgium gives the definition of income from shipping and air operations as income from freight, mails and sale of tickets and other such income less refunds and payments of wages and salaries of ground staff.[59] Nigeria's treaties with France, Pakistan, and Romania define income from shipping and aircraft operations as income arising from the carriage of passengers, mails, livestock or goods less refunds and payments of wages and salaries of ground staff.[60] Nigeria's treaty with Canada gives a restrictive definition of the term "earnings". Only the amount by which the gross revenues exceed the aggregate of any refund to the resident state and the remuneration of personnel located in that State is taxable by the source state.[61] The provision also specifically excludes income from services rendered aboard an aircraft.[62] This element is included in the definition of profits in the OECD and UN Models.

[57] Commentary on Article 8 of the OECD Model, *supra* note 2 at para 5.
[58] Commentary on Article 8 of the UN Model, *supra* note 6 at para 11.
[59] Article 8(3) of Nigeria's treaty with Belgium.
[60] Article 8(2) of Nigeria's treaties with France, Pakistan, Romania, Singapore.
[61] Article 8(2) of Nigeria's treaty with Canada.
[62] *Ibid*.

Nigeria's treaties with the Netherlands, Singapore, and South Africa give an extended definition of income.[63] In addition to income directly derived from aircraft and shipping operations, income includes profits from the rental on a bareboat basis of ships or aircraft operated in international traffic.[64] This is an element that is specifically exempted from the OECD and UN Models. Nigeria's treaties with Singapore and South Africa, include profits from the use or rental of containers in international traffic where such profits are incidental to the aircraft and shipping operations.[65] These elements are included in the OECD and UN Models. Nigeria's treaty with the Philippines provides that taxable profits shall be determined under the domestic law of the source state.[66] In this circumstance, a broad tax base depends on the provisions of Nigeria's domestic laws.

The possibilities for increased revenue from aircraft and shipping operations in Nigeria is threatened by a reduced tax base. So, Nigeria should amend its treaties to copy the extended definition of profits under Article 8 of the OECD and UN Models. In addition, income from rental on a bareboat basis of ships or aircraft operated in international traffic, which is not included in both Models, should be included in all of Nigeria's treaties. Section 14 of Nigeria's Companies Income Tax Act contains rules that deal with the taxation of profits of non-resident companies engaged in aircraft and shipping operations in Nigeria.[67] The rules divide taxable profits into two categories: Freight income – income earned from the carriage of passengers, mails, livestock or goods shipped or loaded into an aircraft in Nigeria; and non-freight income – income earned from other business activities including but not limited to commission, demurrage, container clearing

[63] Article 8(2) of Nigeria's treaty with Netherlands; Article 8(5) of Nigeria's treaty with Singapore; Article 8(3) of Nigeria's treaty with South Africa.
[64] *Ibid*.
[65] *Ibid*.
[66] Article 8(3) of Nigeria's treaty with Philippines.
[67] *Companies Income Tax Act (Nigeria), supra* note 17, s14.

fees, container damage fees, stevedoring, etc.[68] To further expand the tax base of non-resident companies engaging in shipping and aircraft operations in Nigeria, it can be argued that the extended definition of profits in Article 8 of the OECD and UN Models is covered in Nigeria's domestic law through the non-exhaustive list in section 14 of the Companies Income Tax Act. In addition, income from rental on a bareboat basis of ships or aircraft operated in international traffic, which is not included in both Models, can also be said to fall under the scope of Section 14. The amendment of Nigeria's tax treaties to reflect the extended tax base of non-resident companies engaged in aircraft and shipping operations in Nigeria's domestic law will broaden the tax base of those companies and increase Nigeria's tax revenue.

Similar to the provisions in Nigeria's tax treaties, most of Tanzania's treaties do not give an extended definition of income. For example, Tanzania's treaties with Denmark, Finland, India, Italy, Norway, Sweden do not provide any definition of taxable profits or shipping and aircraft operations. The implication is that the terms will be given meaning under the domestic law of the contracting states. Taxable profit from shipping and aircraft operations in Tanzania's treaty with South Africa is given a restricted definition. The treaty includes only profits derived from the rental on a bare boat basis of ships or aircraft used in international traffic; and profits derived from the rental of rail or road transport vehicles in the definition of taxable profits as long as those profits are incidental to profits from shipping activities.[69] Only Tanzania's treaty with Canada gives an expanded definition of profits. The treaty includes profits, net profits, gross receipts and revenues derived directly from the operation of ships or aircraft in international traffic, and interest on sums generated directly from the operation of ships or aircraft in international traffic provided that such

[68] *Ibid*.
[69] Article 8(4) of Tanzania's treaty with South Africa.

interest is incidental to the operation.[70] Shipping and aircraft operation is also broadly defined as the charter or rental of ships or aircraft, the rental of containers and related equipment, and the alienation of ships, aircraft, containers and related equipment, by that enterprise provided that such charter, rental or alienation is incidental to the operation by that enterprise of ships or aircraft in international traffic.[71] This broad definition increases Tanzania's tax base over Canadian corporations engaging in shipping and aircraft operations.

To increase revenue from profits derived by non-residents from aircraft and shipping operations carried on in Tanzania, Tanzania should amend its tax treaties in line with the provisions of its treaty with Canada which includes profits from aircraft and shipping operations whether directly connected or incidental. In addition, profits from rental of aircraft or ships included in the treaty with Canada should be included in all of Tanzania's treaties.

The possibility of an expansive tax base over shipping and aircraft operations depends on how broad the provisions of Tanzania's tax treaties and domestic tax law are. Unfortunately, Tanzania's Income Tax Act does not define profits from shipping and aircraft operations. To maximize revenue from shipping and aircraft operations by non-residents, it is proposed that Tanzania should amend its tax treaties and Income Tax Act by including the extended definition of income in Article 8 of the OECD and UN Models. In addition, income from rental on a bareboat basis of ships or aircraft operated in international traffic, which is not included in both Models should be included in Tanzania's Income Tax Act and all of Tanzania's treaties.

[70] Article 8(3) of Tanzania's treaty with Canada.
[71] *Ibid*.

3. Taxation of Fees for Digital Service

In addition to source taxing rights over royalty payments under Article 12, and source taxation of income from technical fees under Article 12A, the UN Committee of Experts have adopted Article 12B for model treaty rules on digital services. Article 12B expands source taxation rights by allowing source taxation of income arising from automated digital services done in the source state and paid to a resident of the other contracting state.[72] Similar to the provision of Article 12A, which dispenses with physical presence, physical presence is not required to invoke source taxation of income paid to providers of automated digital services who are resident in the other contracting state.[73] Income from automated digital services is defined as "any payment in consideration for any service provided on the internet or an electronic network requiring minimal human involvement from the service provider".[74] Services qualifying as automated digital services are online advertising services; online intermediation platform services; social media services; digital content services; cloud computing services; sale or other alienation of user data; standardised online teaching services.[75] The allocation of taxing rights over income from digital services to source states is highly commendable in our world where firms are highly invested in digital services and significant economic activities occur in source states without physical presence.

While the OECD is yet to finalize its proposed solution to taxation of digital services, the G7 countries (Canada, France, Germany, Italy, Japan, the UK, and the US) have agreed on a 15% global corporate minimum corporate tax on multinational corporations in each country in which

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[72] United Nations, "New Article 12B – Income from Automated Digital Services", online: https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-08/TAX%20TREATY%20PROVISION%20ON%20PAYMENTS%20FOR%20DIGITAL%20SERVICES.pdf.

[73] Radhakishan Rawal, "United Nations Taxation of Digitalized Economy – Proposed UN Solution" (2020) 26:3 Asia-Pacific Tax Bulletin.

[74] Article 12B(4), *supra* note 72.

[75] Commentary on Paragraph 4 of Article 12B of the UN Model, *supra* note 72 at para 34.

they operate.[76] On June 5, 2021, G7 Finance ministers met and agreed to reforms to tackle challenges arising from the global digital economy. The first component of the agreement would apply to global companies with at least a 10 percent profit margin. A twenty percent of any profit above the 10% margin of such multinational corporations will be reallocated and then subjected to market jurisdictions, where sales are made.[77] The second component is a commitment to introduce a global minimum corporate tax rate of fifteen percent.[78] Among those expected to be affected by the reforms are technology giants, such as Amazon, Facebook, and Google.

There are fundamental challenges with the agreement of the G7 countries in terms of a few countries making decisions for the rest of the world. The UN had an opportunity to propose a high withholding tax rate for source taxation of income from automated digital services but failed to take advantage of the opportunity. Now that the G7 countries have proposed a rate of 15%, it will be difficult for developing countries to secure a higher rate. Developing countries risk being pressured to accept low withholding tax rates for income from automated digital services. In line with the overarching argument of this thesis, African countries should come together to make a counteroffer to the proposed reforms by the G7. While it is true that reforms to tax treaty rules are necessary to solve tax challenges arising from the digital economy, select countries should not decide how to make those reforms.

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[76] G7, "G7 Finance Ministers Agree Historic Global Tax Agreement", online: < https://www.g7uk.org/g7-finance-ministers-agree-historic-global-tax-agreement/>.

[77] *Ibid*; Rasmus Corlin Christensen, "The G7 Tax Deal: 'Historic' and 'Global'?" (7 June 2021), ICTD (blog), online: <https://www.ictd.ac/blog/g7-tax-deal-historic-global/?s=03>.

[78] *Supra* note 76.

3.1 Allocation of Taxing Rights

Article 12B(1) assigns taxing rights over income from automated digital services to the source state.[79] Similar to the provisions of Articles 10, 11, 12, 12A of the UN Model, which give taxing rights to the source state over income from dividends, interest, royalties, and technical fees arising in the source state, Paragraph 1 of Article 12B of the UN Model also allows the source state to tax income from automated digital services arising in that state.

According to paragraph 2 of Article 12B, income arising from automated digital services in a source state can be taxed by the source state according to its domestic law.[80] According to the provisions of paragraph 2 to Article 12B, source states are only permitted to tax income from digital services if there are provisions for such a tax in their domestic laws. In other words, even if tax treaties signed by source states were amended to include the provisions of Article 12B, only states that have enacted unilateral digital services tax laws can safely enforce and collect taxes on income from digital services earned by residents of treaty partners. (This is true of all treaty articles: they only restrict taxing rights; they do not enable countries to impose new taxes.)

Applying this rule to the comparator countries, only Nigeria can tax income from digital services earned by residents of its treaty partners. Nigeria's Companies Income Tax Order (2020) implements a digital tax introduced by Nigeria's Finance Act, 2019.[81] According to the provisions of the Order, non-resident companies carrying on digital services in the country with significant economic presence are liable to tax on income arising from such digital services.[82] Nigeria took the right step by enacting a digital services tax law to ensure that non-resident companies are liable

[79] Article 12B(1) of the UN Model, *supra* note 72.
[80] Article 12B(2) of the UN Model, *supra* note 72.
[81] *Companies Income Tax (Significant Economic Presence) Order (Nigeria),* 2020.
[82] *Ibid*.

to tax on profits derived from carrying on digital businesses. To solve issues with attribution of profits to digital non-resident companies, the Finance Act, 2021, amends Section 30 of Nigeria's Income Tax Law, allowing the Federal revenue authority (FIRS) to charge those non-resident companies a fair and reasonable percentage of that part of the turnover attributable to that significant economic presence.[83] Nigeria's Minister of Finance, Budget and National Planning, Mrs. Zainab Ahmed, recently disclosed that non-resident digital companies would be charged at 6% on their turnover attributable to the significant economic presence in Nigeria.[84] The amendment of Nigeria's tax treaties to include the provisions of Article 12B will make it easy to enforce and collect digital services tax from residents of its treaty partners without concerns that such action would violate the terms of the treaties. For Tanzania and Botswana to tax income from digital services, they have to first enact digital services tax laws; otherwise, there would be no domestic law upon which the treaty provision will be based even if they amend their tax treaties to include the provisions of Article 12B.

3.2 Maximum Rates

Paragraph 2 to Article 12B sets a maximum rate of withholding tax (to be agreed through bilateral negotiations) that the source state can collect over income from automated digital services arising in its jurisdiction.[85] This is similar to the provisions in Articles 10, 11, 12, 12A, where maximum withholding tax rates are prescribed for source taxation of dividends, interest, royalties, technical fees, and states are left to fix those rates through bilateral negotiations. To encourage increased tax revenue from digital services carried out in source states, the Experts ought to have prescribed a fixed withholding tax rate that will allow source states to receive more tax revenue. Leaving the

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[83] *Nigeria's Finance Act, supra* note 49, s2.
[84] Arise TV, "Nigeria Introduces 6% Tax on Digital Services, Non-Resident Companies", (6 January 2022), online: < https://www.arise.tv/nigeria-introduces-6-tax-on-digital-services-non-resident-companies/>.
[85] Article 12B(2) of the UN Model, *supra* note 72.

rates to negotiations between source and residence states ignores the power imbalance between states,[86] and the difficulties that source states face in seeking to secure high withholding tax rates to increase domestic resource mobilization. Suggesting a precise withholding tax rate will better support the UN's effort to secure treaty provisions that allow source countries to derive significant tax revenue from automated digital services arising within their jurisdictions.

Article 12B(3) provides an opportunity to tax income from digital services on a net basis.[87] The paragraph allows the beneficial owner of the income from automated digital services to request the source state to subject its qualified income from such services to tax at the rate provided in the domestic laws of that state. [88]

3.3 Ordering and Force of Attraction Rules

Article 12B(5) of the UN Model excludes income from automated digital services arising from a permanent establishment of a fixed base situated in the source country.[89] In such cases, the paragraph provides that the provisions of Articles 7 and 14, and not Article 12B, will apply respectively. [90]

3.4 Income Definition and Geographic Source Rules

Article 12B(4) of the UN Model gives a broad definition of income from automated digital services.[91] Income from automated digital services is defined as income from services provided on

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[86] Tarcisio Diniz Magalhães, "What Is Really Wrong with Global Tax Governance and How to Properly Fix It" (2018) 10:4 World Tax Journal 499.

[87] Article 12B(3) of the UN Model, *supra* note 72.

[88] *Ibid*. Qualified income is defined in Article 12B(3) of the UN Model as 30 percent of the amount resulting from applying the beneficial owner's profitability ratio or the profitability ratio of its automated digital business segment, if available, to the gross annual revenue from automated digital services derived from the Contracting State where such income arises.

[89] Article 12B(5) of the UN Model, *supra* note 72.

[90] *Ibid*.

[91] Article 12B(4) of the UN Model, *supra* note 72.

the internet, requiring minimal human involvement.[92] This broad definition will ensure expansive taxing rights for source states over income from digital services.

Article 12B(6) of the UN Model contains the source rule for automated digital services.[93] According to the provision, the source state is the state in which the payer of the income is resident or the state in which the payer has a permanent establishment or fixed base if the payments for the automated digital services are borne by the permanent establishment of fixed base.[94]

Article 12B(7) of the UN Model qualifies the source rule in Article 12B(6).[95] According to the provision, the state in which the payer of the income is resident can only tax income from automated digital services where there is a clear economic link between the services and the permanent establishment or fixed place situated in that state.[96] If the payer, though a resident of the first contracting state, carries on business in the other Contracting State through a permanent establishment situated in that other State, or performs independent personal services through a fixed base situated in that other State and such expenses are borne by that permanent establishment or fixed base, the income from automated digital services shall be deemed not to arise in the first Contracting State.[97]

3.5 Anti-avoidance Provisions

Article 12B(8) contains an anti-abuse provision that restricts the application of Article 12B to income from automated digital services which is not at arm's length due to a special relationship between the payer and the beneficial owner of the income, or between them and some other

[92] *Ibid*.
[93] Article 12B(6) of the UN Model, *supra* note 72.
[94] *Ibid*.
[95] Article 12B(7) of the UN Model, *supra* note 72.
[96] *Ibid*.
[97] *Ibid*.

person.[98] The paragraph states that the provisions of Article 12B will only apply to the arm's length price and the excess amount will be taxable according to the laws of the contracting states.[99]

4. Taxation of Capital Gains

Many countries subject gains from the disposition of assets located within their borders to capital gains tax. An equivalent tax is levied on gains realized from disposition of shares in domestic entities. Some countries have additional rules subjecting gains realized from sale of foreign entities if such entities hold (directly or indirectly) taxable shares of domestic companies.[100] Extending the tax base covering taxation of gains from direct and indirect transfer of assets situated in the source state increases tax revenue from capital gains. The provisions on taxation of capital gains in the OECD Model, UN Model, and tax treaties signed by the comparator countries are discussed below.

4.1 Allocation of Taxing Rights

The OECD Model allows source taxation of gains from alienation of immovable and movable property forming a part of a permanent establishment as well as the alienation of the permanent establishment itself situated in the source state.[101] Under the OECD Model, exclusive taxing rights over capital gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircraft or boats is assigned to the State in which the place of effective management of the enterprise is situated.[102] To prevent avoidance of capital gains tax in the source state, the OECD Model allows source taxation of capital gains from alienation of shares or comparable interests of

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[98] Article 12B(8) of the UN Model, *supra* note 72.
[99] *Ibid*.
[100] Wei Cui, "Taxing Indirect Transfers: Improving an Instrument for Stemming Tax and Legal Base Erosion" (2014) 33:2 Va Tax Rev 653.
[101] Article 13(1) & (2) of the OECD Model, *supra* note 2.
[102] Article 13(3) of the OECD Model, *supra* note 2.

a company situated in another contracting state that directly or indirectly derive their value from immovable property situated in the source state.[103] The provision applies where the shares, during the 365 days preceding the alienation, derive more than 50 per cent of their value directly or indirectly from immovable property situated in the source state.[104] This provision acts as an anti-avoidance provision to protect source taxation of capital gains from the sale of immovable property situated in the source state.[105]

The UN Model copies the rules in the OECD Model on taxation of capital gains but extends source taxing rights to profits derived from alienation of immovable and movable property forming part of a fixed base for the purpose of performing independent personal services situated in the source state.[106] The UN Model also includes a unique provision that allocates additional taxing rights over gains derived from alienation of shares not covered in Article 13(4) of the UN Model to source states.[107] This provision allows source taxation of gains derived by a resident of a contracting state from alienation of shares or comparable interests of a company resident in the source state of which the alienator directly or indirectly owns or owned a substantial participation of the shares (a certain percentage of shares to be determined during bilateral negotiations) within a 365-day period preceding the alienation.[108] Article 13(4) of the UN Model takes care of gains from alienation of shares of resident companies that are not tied to immovable property situated in the source state. This provision would benefit the comparator countries if it is included in their tax treaties.

[103] Article 13(4) of the OECD Model, *supra* note 2.
[104] *Ibid*.
[105] Stephanie Uribe Villamil "Taxation of Capital Gains: The Substantial Participation Clause" in Anna Binder and Viktoria Wöhrer eds, *Special Features of the UN Model Convention* (Linde: Vienna, 2019) 351 at 360.
[106] Article 13(1) & (2) of the UN Model, *supra* note 6.
[107] Article 13(5) of the UN Model, *supra* note 6.
[108] *Ibid*.

Although the UN Model allocates more taxing rights over income from capital gains to the source state than the provisions of the OECD Model, its provisions are still not broad enough.[109] Countries agree that the right to tax a gain from the alienation of a business asset should be assigned to the country that has the right to tax the business income (the source state), hence the provision on taxation of capital gains. While there are provisions that address disposition of immovable assets, movable assets, shares, and disposition of shares deriving their value from immovable property in source states in the UN Model, there is no provision allowing source taxation of gains from shares deriving their value from movable property in the source state. If it is agreed that there should be no distinction in the assignment of taxing rights over business income from source states and gains from the disposition of business assets situated in source states, then the scope for taxation of capital gains should be broadened to cover all forms of direct and indirect transfer of assets situated in the source state. The UN Committee of Tax Experts (drafters of the UN Model) proposed that a new paragraph 6 be included in the UN Model to cover taxation of all taxable assets in the source state. The new provision will expand the taxing rights of source states significantly. The provision is as follows:

> Subject to paragraphs 4 and 5, gains derived by a resident of a Contracting State from the alienation of shares of a company, or comparable interests of an entity, such as interests in a partnership or trust, may be taxed in the other Contracting State if
> a) the alienator, at any time during the 365 days preceding such alienation, held directly or indirectly at least [] percent [the percentage is to be established through bilateral negotiations] of the capital of that company or entity; and
> b) at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from
> (i) a property any gain from which would have been taxable in that other State in accordance with the preceding provisions of this Article if that gain had been derived by a resident of the first-mentioned State from the alienation of that property at that time, or

[109] Commentary on Article 13 of the UN Model, *supra* note 6 at para 4.

(ii) any combination of property referred to in subdivision (i).[110]

Currently, under the OECD and UN Model, source states are not allowed to tax gains derived by non-resident companies from alienation of shares or comparable interest of a non-resident company unless these shares or comparable interests derive more than 50 per cent of their value directly or indirectly from immovable property situated in the source state. If those shares derive less than 50 percent of their value from immovable property or other types of assets in the source state, the taxing right belongs to the residence state.[111] The new provision will plug this gap and ensure adequate compensation from direct, indirect, onshore, and offshore transfer of assets situated in source states. It would be greatly beneficial for the comparator countries if they include this provision in their treaties.

Nigeria's tax treaties allow source taxing rights of capital gains derived by residents of contracting states from alienation of assets in the country, but none expands source taxing rights over such gains to all taxable assets situated in the country. For example, Nigeria's tax treaties with Belgium, Pakistan, Philippines, and Romania allow source taxation of capital gains from alienation of immovable and movable properties situated in the source state.[112] The treaties also allow source taxation of gains from alienation of shares of resident companies.[113] Nigeria's treaties with Belgium, Philippines, Romania exempt source taxation of gains from alienation of aircraft or ships

[110] *United Nations Committee of Experts on International Cooperation in Tax Matters, Update of the UN Model Double Taxation Convention between Developed and Developing Countries –Capital Gains on Offshore Indirect Transfers*, (October 2020) EUN Doc/C.18/2020/CRP.36.

[111] Article 13(5) of the OECD Model, *supra* note 2; Article 13(6) of the UN Model, *supra* note 6.

[112] Article 13(1) of Nigeria's treaty with Belgium; Article 13() & (2) of Nigeria's treaty with Pakistan; Article 13(1) of Nigeria's treaty with Philippines; Article 13(1) of Nigeria's treaty with Romania.

[113] Article 13(1) of Nigeria's treaty with Belgium; Article 13(3) of Nigeria's treaty with Pakistan; Article 13(2) of Nigeria's treaty with Philippines; Article 13(1) of Nigeria's treaty with Romania.

in international traffic.[114] None of the treaties includes the provision on source taxation of shares deriving their value from immovable property situated in the source state as provided under Article 13(4) of the OECD and UN Models. Nigeria's treaties with Canada and the United Kingdom allow source taxation of capital gains according to the domestic law of the source state.[115] The implication of the provisions of these treaties is that Nigeria is free to tax gains derived from disposition of all taxable assets in the country, whether directly or indirectly, offshore or within the country as long as the domestic law allows such taxation. The treaties exempt source taxation of gains from alienation of ships and aircraft in international traffic.[116]

Nigeria's treaty with France contains provisions similar to those in Nigeria's treaty with Canada, except that the former allows source taxation of gains from disposition of shares in companies.[117] Nigeria's treaty with France is, however, not as expansive as it should be. Nigeria's treaty with Singapore copies the provisions of the UN Model on taxation of capital gains, except that it does not include the provision allowing source taxation of gains derived from disposition of shares of resident companies.[118] Nigeria's treaties with China, the Czech Republic, South Africa copy the provisions of Article 13 of the UN Model, except that they do not include the provision for source taxation of gains from alienation of shares deriving their value from immovable property situated in the source state. Nigeria's treaties with the Czech Republic and South Africa add that other gains from alienation of other types of property shall be taxable in the residence state.[119] Nigeria's treaty with the Netherlands also copies the provisions of the UN Model, including the provision

[114] Article 13(2) of Nigeria's treaty with Belgium; Article 13(3) of Nigeria's treaty with Philippines; Article 13(2) of Nigeria's treaty with Romania.
[115] Article 13(1) of Nigeria's treaty with Canada; Article 13 of Nigeria's treaty with United Kingdom.
[116] Article 13(2) of Nigeria's treaty with Canada; Article 13 of Nigeria's treaty with United Kingdom.
[117] Article 13(1) of Nigeria's treaty with France.
[118] Article 13 of Nigeria's treaty with Singapore.
[119] Article 12(4) of Nigeria's treaty with Czech Republic; Article 13(4) of Nigeria's treaty with South Africa.

allowing source taxation of gains from alienation of shares of resident companies.[120] The treaty, however, does not include the provision for source taxation of shares deriving their value from immovable property situated in the source state.

To maximize tax revenue from gains derived by non-residents from alienation of assets situated in Nigeria, it is proposed that Nigeria should amend its tax treaties to include provisions of the UN Model which include taxation of gains derived from movable and immovable properties; shares deriving their value from movable and immovable property situated in the source state; gains from shares of resident companies, whether deriving their value from movable or immovable property or not as long as those assets are situated in their jurisdictions. In addition, the treaties should be amended to allow source taxation of gains from alienation of aircraft or ships earned in the source state. An omnibus provision should allow source taxation of gains from all taxable assets situated in the country. It is also proposed that Nigeria should amend its Capital Gains Act to include provisions on source taxation of non-residents on gains derived from the economic activities listed above. Although Section 3 of Nigeria's Capital Gains Act provides that all forms of property shall be assets for the purposes of the Act[121], it will be more beneficial to include specific provisions on taxation of non-residents. Provisions that guarantee an extended tax base, such as the one that allows source taxation of gains from alienation of all taxable assets situated in the source state, will allocate more taxing rights to Nigeria.

Similar to the provisions of Nigeria's tax treaties, only Tanzania's treaty with Canada fully copies the provision of the UN Model on taxation of capital gains.[122] Tanzania's treaty with South Africa also copies the provisions of the UN Model, except that it does not allow source taxation of gains

[120] Article 13 of Nigeria's treaty with Netherlands.
[121] *Capital Gains Tax Act* (Nigeria), 2004, s3.
[122] Article 13 of Tanzania's tax treaty with Canada.

derived from alienation of shares of companies resident in Tanzania.[123] The treaty also exempts gains derived from alienation of ships or aircraft operated in international traffic from source taxation.[124] Tanzania's treaties with Denmark, Finland, India, Italy, Norway, Sweden, Russia, and Seychelles partly copy the provisions of the UN Model on taxation of capital gains.[125] The treaties allow source taxation of gains from immovable property situated in Tanzania, and gains from movable property forming part of the business property of a permanent establishment or a fixed base which an enterprise of a Contracting State has in the source state.[126] The treaties, however, do not include the provision in the UN Model allowing source taxation of gains from alienation of shares, the value of which is derived principally from immovable property situated in the source State, and gains from alienation of shares of a company resident in the source state. Tanzania's treaties with India, Russia, and Seychelles exempt source taxation of gains from alienation of ships or aircraft operated in international traffic.[127] Tanzania's treaty with Zambia does not allow source taxation of capital gains.

As already intimated, this thesis proposes expansive taxing rights for the comparator countries. It is in view of this that this chapter argues that Tanzania should amend all its tax treaties (including its treaty with Zambia) to fully reflect the provisions of the UN Model. In addition, the treaties should be amended to allow source taxation of gains from alienation of aircraft or ships earned in the source state and an omnibus provision allowing source taxation of gains from all taxable assets situated in the country. As argued in the previous chapter, low tax rates or outright exemption of income earned in Tanzania holds no benefit for Tanzania and only creates opportunities for treaty

[123] Article 13(3) of Tanzania's treaty with South Africa.
[124] *Ibid*.
[125] Article 13(1) & (2) of Tanzania's treaties with Denmark, Finland, India, Italy, Italy, Norway, Sweden, Russia, Seychelles.
[126] *Ibid*.
[127] Article 13(3) of Tanzania's treaty with India, Russia, Seychelles.

shopping where residents of developed countries enjoy the benefits of tax treaties not intended for them to the detriment of the source state.[128] An investor can easily set up a conduit company in Zambia and route income earned in Tanzania through the conduit, thereby paying little or no tax to the Tanzanian government. In turn, the income in turn is transferred to the residence state or tax havens, which translates to no tax revenue for both the Tanzanian and Zambian governments.[129]

It is also proposed that Tanzania should amend its Income Tax Act to allow source taxation of gains from all forms of alienation of taxable assets situated in the country. There is no separate capital gains tax in Tanzania. The Income Tax Act requires a person who derives a gain from the realisation of an interest in land or buildings situated in the country to pay income tax by way of a single instalment.[130] The scope of source taxation of gains derived by non-residents from alienation of assets in Tanzania would be broadened by the amendment. Source taxation of gains would not be restricted to gains from alienation of interest in land or buildings but other forms of alienation, e.g., shares, aircraft, ships, and other taxable assets situated in the country would also be covered.

Similar to the position in Tanzania's tax treaties, only Botswana's treaty with Lesotho copies the entire provisions of the UN Model on taxation of capital gains.[131] The treaty allows taxation of gains derived from alienation of immovable property situated in the source state.[132] Further, it allows source taxation of gains from movable property forming part of the business property of a permanent establishment or a fixed base which an enterprise of a Contracting State has in the

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128 Luc De Broe, *International Tax Planning and Prevention of Abuse* (Amsterdam: IBFD, 2008).
129 Action Aid, "How Tax Havens Plunder the Poor", (May 2013), online: < http://www.gfintegrity.org/wp-content/uploads/2014/05/ActionAid-Tax-Havens-May-2013.pdf>.
130 Tanzania Revenue Authority, "Capital Gain from Realisation of Interest in Land or Buildings", online: https://www.tra.go.tz/index.php/capital-gains-tax.
131 Article 13(1) of Botswana's treaty with Lesotho.
132 *Ibid*.

source state.[133] Again, it allows source taxation of gains from alienation of shares of a company resident in Botswana[134], and also gains from alienation of shares deriving their value directly or indirectly from immovable property situated in the source State.[135] Finally, the treaty exempts source taxation of gains from alienation of ships or aircraft operated in international traffic.[136]

Botswana's treaties with Barbados, the Czech Republic, Mauritius, and Sweden copy the provision of the UN Model, except that they do not include a provision for source taxation of gains from alienation of shares the value of which is derived principally from immovable property situated in the source State.[137] The treaties also exempt gains derived from alienation of ships or aircraft operated in international traffic from source taxation.[138] Botswana's treaties with China, France, India, and the United Kingdom copy the provisions of the UN Model, except that they do not include a provision for source taxation of gains from alienation of shares of a company resident in Botswana.[139] They also exempt gains derived from alienation of ships or aircraft operated in international traffic from source taxation.[140] Botswana's treaty with Ireland copies the provision of the OECD Model on taxation of capital gains, but it includes the UN Model provision allowing source taxation of gains from the alienation of shares or comparable interest deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the source state.[141] The treaty includes what appears to be a source expanding provision, allowing the source state to tax gains from the alienation of any property derived by a resident of the other contracting

[133] Article 13(2) of Botswana's treaty with Lesotho.
[134] Article 13(6) of Botswana's treaty with Lesotho
[135] Article 13(4) of Botswana's treaty with Lesotho.
[136] Article 13(3) of Botswana's treaty with Lesotho
[137] Article 13 of Botswana's treaties with Barbados, Czech Republic, Mauritius, Sweden.
[138] Article 13(3) of Botswana's treaties with Barbados, Czech Republic, Mauritius, Sweden.
[139] Article 13 of Botswana's treaties with China, France, India, United Kingdom.
[140] Article 13(3) of Botswana's treaties with China, France, India; Article 13(4) of Botswana's treaty with United Kingdom.
[141] Article 13(4) of Botswana's treaty with Ireland.

state and has been a resident of the other contracting State at any time during the five years immediately preceding the alienation of the property.[142] This provision is similar to the new paragraph 6 of the UN Model except for the qualification that the taxpayer must have been a resident of the other contracting state for five years, which is an anti-avoidance provision that prevents persons from benefitting from treaty provisions where none was intended.

The provisions of Botswana's treaties with Malta, South Africa, Zambia, and Zimbabwe are a mix of the provisions of the OECD and the UN Model. All the treaties allow source taxation of gains from alienation of immovable property situated in the source state similar to the provisions of the OECD and UN Model.[143] The treaties allow source taxation of gains from movable property forming part of the business property of a permanent establishment in the source state similar to the provision of the OECD Model.[144] The treaties exempt source taxation of gains from alienation of ships or aircraft operated in international traffic – copying the provisions of the OECD and UN Model.[145] Botswana's treaty with Zimbabwe allows source taxation of gains from alienation of shares in a company the assets of which consist principally of immovable property situated in the source state.[146] Botswana's treaties with Malta, South Africa, and Zambia allow source taxation of gains from the alienation of shares deriving more than 50% of their value directly or indirectly from immovable property situated in the source state – reflecting the provision of the UN Model.[147] All the treaties allow source taxation of gains from alienation of shares of a company resident in

[142] Article 13(6) of Botswana's treaty with Ireland.
[143] Article 13(1) of Botswana's treaties with Malta and South Africa, Zambia, Zimbabwe.
[144] Article 13(2) of Botswana's treaties with Malta and South Africa, Zambia, Zimbabwe.
[145] Article 13(3) of Botswana's treaties with Malta and South Africa, Zambia, Zimbabwe.
[146] Article 13(1) of Botswana's treaty with Zimbabwe.
[147] Article 13(4) of Botswana's treaties with Malta, Zambia; Article 13(6) of Botswana's treaty with South Africa.

the source state.[148] Gains from any property other than those mentioned in the treaties are assigned to the residence state.[149]

To expand its taxing rights over capital gains, Botswana should amend its tax treaties to allow for more taxing rights over gains from alienation of taxable assets situated in the country. First, all the treaties should be reformed to include the provisions of the UN Model which allows more taxing rights over capital gains derived by non-residents. In addition, provisions allowing source taxation of gains from alienation of aircraft and ships operated in international traffic and provisions reflecting the new paragraph 6 proposed by the UN Committee of Tax Experts allowing source taxation of gains from all taxable assets in the source state should be included in all the treaties. Domestically, Botswana taxes gains derived by non-residents from alienation of any property including residential property and any shares or debentures held in a company.[150] Again, Botswana should amend its domestic law to include gains from all forms of alienation of all property situated in the country. This broad domestic tax base will complement the extended base in the tax treaties when that expansion is accomplished.

5. Taxation of Independent Personal Services

The provision of Article 14 covering taxation of income from independent personal services was deleted from the OECD Model in 2000 upon the recommendation of a committee set up to examine a number of problems of interpretation and application of Article 14 of the OECD Model.[151] Some

[148] Article 13(6) of Botswana's treaties with Malta, Zambia; Article 13(5) of Botswana's treaties with South Africa, Zimbabwe.
[149] Article 13(5) of Botswana's treaties with Malta, Zambia; Article 13(4) of Botswana's treaties with South Africa and Zimbabwe.
[150] KPMG, "Botswana: Income Tax", online: https://home.kpmg/xx/en/home/insights/2011/12/botswana-income-tax.html#:~:text=Generally%20Botswana%20tax%20treaties%20exempt%20capital%20gains%20accruing,in%20a%20company%20that%20is%20not%20property%20rich.
[151] *Issues Related to Article 14 of the OECD Model Tax Convention* (Paris: OECD, 2007).

of the issues considered are as follows: First, it was considered that the term "activities of a similar independent nature" under Article 14 was too broad, and could include any entrepreneurial activity that Article 7 would otherwise cover. Another problem was the uncertainty about the scope of Article 14, whether it applied to individuals only or to all legal persons – corporations and partnerships included. If it did apply to all legal persons, it could be exploited for tax avoidance purposes – where entities could arrange their affairs to choose to be taxed under Article 7 or 14. The last issue considered was the unclear distinction between fixed base and permanent establishment, since both concepts had varying degrees of permanence.[152] The committee concluded that there was no difference between the provisions of Article 7 governing taxation of business income, and Article 14 governing taxation of income from independent personal services. Thus, the taxation of independent personal services was assimilated to the taxation of business profits in article 7.[153]

Before 2000, Article 14 of the OECD Model allocated taxing rights over income from professional services, or other activities of an independent character, to the residence state.[154] Concurrent taxing rights were allocated to the source state if the services had been derived from a "fixed base" held in the source state, and if the fixed base had been "regularly available" to the taxpayer for the purposes of his or her activities.[155] The income taxable by the source state was restricted to income attributable to the fixed base in the source state. Article 14(2) listed examples of professional services as independent scientific, literary, artistic, educational, or teaching activities, as well as the independent activities of physicians, lawyers, engineers, architects, dentists, and

[152] Keefe Han, "The Mistaken Removal of Article 14 from the OECD Model Tax Convention" (2010) 16:1 Auckland U L Rev 192 at 196-199.
[153] *Ibid*.
[154] Article 14(1) of the *Model Double Taxation Convention on Income and on Capital* (Paris: OECD, 1977).
[155] *Ibid*.

accountants.[156] The OECD noted that this definition was not exhaustive,[157] it did not define the term "fixed base", but gave examples, such as a physician's consulting room, or the office of an architect, or that of a lawyer.[158]

Article 14 of the UN Model allocates taxation rights over income derived from professional services and other activities of an independent character to the residence state.[159] The provision gives concurrent taxing rights over such income to the source state if either of these two conditions are met: if the non-resident has a fixed base regularly available to him in the source State for the purpose of performing his activities, or if his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate, 183 days within a twelve month period.[160] The provision further clarifies that only so much of the income as is attributable to that fixed base or the year of presence is taxable in the source state.[161] Under the UN Model, the term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities, as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants. Concerning the scope of Article 14 vis-à-vis the provisions of Article 7, the UN clarifies that when remuneration is paid directly to an individual for the performance of activity in an independent capacity, then it falls under the purview of Article 14. When the remuneration for the same activity is paid to an enterprise, Articles 5 and 7 would apply.[162]

The UN Model allocates greater taxing rights to source states over income from independent personal services derived from their jurisdictions in two ways. First, by creating a separate

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[156] *Ibid*.
[157] Commentary on Article 14 of the OECD Model, *supra* note 154 at para 2.
[158] Commentary on Article 14, *supra* note 154 at para 4.
[159] Article 14(1) of the UN Model, *supra* note 6.
[160] Article 14(1)(a) &(b) of the UN Model, *supra* note 6.
[161] *Ibid*.
[162] Commentary on Article 14 of the UN Model, *supra* note 6 at para 9.

provision for taxation of income from independent personal services and second by including a 183-day provision as an alternative to the fixed base requirement. Although the concepts of "permanent establishment" and "fixed base" are similar, fixed base indicates a lesser degree of permanence.[163] Therefore, the separation of both concepts creates a distinction which broadens the tax base of source states. Also, the alternative requirement of 183 days in the UN Model gives more taxing rights to the source state because it avoids the obligation to establish a fixed base from which the income is derived.[164]

The benefits of the UN provision on taxation of income from independent personal services to source states is quite clear. However, it is important to discuss a major gap in the provision that might impede greater source taxing rights. The possibility of delivery of services through communication technology without a fixed base in the source State and without any substantial physical presence in that State makes it imperative to modify the provisions of Article 14 to state that it is not necessary for the services to be performed in the source state before it is taxed at source. This is the position maintained under Article 12A of the UN Model governing taxation of fees for technical services where the UN affirms that it is not necessary for the technical service to be performed in the source state before the source state can exercise taxing rights over such fees.[165]

Regarding the provisions of treaties signed by the comparator countries on taxation of independent personal services, only two of Nigeria's tax treaties (Singapore and South Africa) have provisions that fully reflect those of Article 14 of the UN Model governing source taxation of income from

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[163] E Michaux, "An Analysis of the Notion 'Fixed Base' and its Relation to the Notion 'Permanent Establishment' in the OECD Model" (1987) 68 Intertax 64; Ekkehart Reimer & Alexander Rust, *Klaus Vogel on Double Taxation Conventions* (Kluwer Law International: London, 1997); Arvid Skaar *Permanent Establishment* (Kluwer Law and Taxation Publishers: Boston, 1991).

[164] Keefe Han, *supra* note 152 at 201.

[165] Commentary on Article 12A of the UN Model, *supra* note 6 at para 1.

independent personal services.[166] Both treaties include the alternative requirements for source taxation of such income: the presence of a fixed base in the source state from which the income is attributable, or the 183-day minimum presence in the source state. Other treaties signed by Nigeria allow source taxation of such income in line with the provisions of the UN Model, but omits the alternative 183-day minimum period.[167]

The provisions of Tanzania's treaties on taxation of income from independent personal services are not uniform. Those with South Africa and Zambia do not include any provision for taxation of such services. But the provisions of those with Canada, India, Finland, and Norway are similar to the provisions of the UN Model which allows source taxation of income from independent personal services attributable to a fixed base maintained by the recipient of such income, or if the recipient stays in the source state for a 183-day period in a fiscal year and the activities are derived from that stay.[168] The provisions of Tanzania's treaties with Denmark, Italy, and Sweden partly mirror Article 14 of the UN Model.[169] The treaties allow source taxation of income from independent personal services but restricts it to income attributable to a fixed base in the source state from which the income arises.[170]

Botswana also does not uniformly tax income from independent personal services. Its treaties with Barbados, China, France, India, Mauritius, Russia, Seychelles, Sweden, and the United Kingdom fully reflect the provisions of Article 14 of the UN Model.[171] They allow source taxation of income

[166] Article 14 of Nigeria's treaties with Singapore and South Africa.
[167] Article 13(1) of Nigeria's treaty with Czech Republic; Article 14(1) of Nigeria's treaties with Belgium, Canada, China, France, Netherlands, Pakistan, Philippines, Romania, United Kingdom.
[168] Article 15(1) of Tanzania's treaties with Canada, Finland, Norway; Article 16(1) of Tanzania's treaty with India.
[169] Article 13 of Tanzania's treaties with Demark, Italy, and Sweden.
[170] *Ibid*.
[171] Article 14(1) of Botswana's treaties with Barbados, China, France, Mauritius, Russia, Seychelles, Sweden; Article 15(1) of Botswana's treaties with India and United Kingdom.

from independent personal services attributable to a fixed base maintained by the recipient of such income, or if the recipient stays in the source state for a 183-day period in a fiscal year and the activities are derived from such stay.[172] Botswana's treaties with the Czech Republic, Ireland, Lesotho, Malta, South Africa, Zambia, and Zimbabwe do not include provisions allowing source taxation of income from independent personal services.

Altogether, the argument here too is that the comparator countries should amend their tax treaties to fully reflect the provisions of Article 14 of the UN Model. The alternative 183-day minimum period in the UN Model should be inserted in all the treaties to extend time where source taxation may arise. In addition, the treaties should be amended to include provisions that allow source taxation of income from independent personal services performed outside the source state to customers in the source state. In that event, the 183-day rule would become redundant. This is similar to the proposal by the UN Committee on Experts on International Cooperation in Tax Matters to eliminate a physical presence requirement for source-country taxation of technical services.[173] The ability to carry out business activities in source states without maintaining physical presence therein due to modern technological developments calls for the amendment of tax treaties to recognize and respond to such technology-based interventions. This reform will further extend the situations where source taxation may arise and secure additional tax revenue for the countries.

6. Taxation of other Income

Article 21 of the OECD Model contains allocation rules for residual income not expressly dealt with by the other allocation rules. Article 21 of the OECD Model allocates exclusive taxing right

[172] *Ibid*.

[173] See the *Committee of Experts on International Cooperation in Tax Matters, Revised Draft Article XX and Commentary*, (2015) UN Doc E/C18/2015/CRP5.

over such income to the residence state[174], except for income from immovable property arising from a permanent establishment situated in the source state and the right or property in respect of which the income is paid is effectively connected with such permanent establishment.[175] In such cases, the provision of Article 7 governing taxation of business profits will apply.[176] In contrast to the provisions of the OECD Model, the UN Model allows the source state to retain all its taxing rights over other income.[177] The UN Model reproduces the provisions of the OECD Model but includes a unique provision to preserve the taxation rights of the source state over residual income.[178]

All of Nigeria's tax treaties, except those with China and the United Kingdom allow source taxation of other income.[179] While Nigeria's tax treaty with China assigns exclusive taxing rights over other income to the residence state[180], the one with the United Kingdom is silent on taxation of other income. The implication of the absence of a provision covering other income in Nigeria's treaty with the United Kingdom is that there is no restriction of source taxing rights. This means that Nigeria can tax other income in line with the provisions of its domestic tax laws. For example, though none of Nigeria's tax treaties includes provisions on source taxation of technical fees, technical fees derived by residents of signatory countries are taxable under Section 81 of Nigeria's Companies Income Tax Act. Therefore, it does not matter that there are no provisions covering taxation of technical fees, nor any provision on source taxation of other income. The operative

[174] Article 21(1) of the OECD Model, *supra* note 2.
[175] Article 21(2) of the OECD Model, *supra* note 2.
[176] *Ibid*.
[177] Veronika Daurer & Richard Krever, "Choosing between the UN and OECD Tax Policy Models: An African Case Study" (2014) WU International Taxation Research Paper No 16 at 20.
[178] Article 21(3) of the UN Model, *supra* note 6.
[179] Article 21 of Nigeria's treaties with Czech Republic, South Africa; Article 22 of Nigeria's treaties with Belgium, Canada, France, Netherlands, Pakistan, Philippines, Romania, Singapore.
[180] Article 22(1) of Nigeria's treaty with China.

factor for source taxation of these categories of income is Nigeria's domestic law in the absence of provisions in Nigeria's tax treaties assigning exclusive taxing rights to the residence country.

For the treaty with China though, Nigeria cannot tax other income not expressly dealt with by the treaty because of the provision assigning exclusive taxing right to the residence state. It is recommended that Nigeria should reform its treaty with China to either expressly include a provision allowing source taxation of other income or delete the current provision from the treaty. As discussed in the previous chapter, none of Nigeria's tax treaties includes provisions on source taxation of technical/management fees. Though Nigeria's domestic tax law allows source taxation of technical fees arising from Nigeria and paid to a non-resident, Nigeria could not tax such fees paid to a resident of China because of the provision of its treaty with China assigning taxing rights over income not expressly dealt with by other provisions of the treaty to the residence state. To prevent all these situations and negative circumstances, it is recommended that Nigeria should reform its treaty with China.

Only two of Tanzania's treaties allow source taxation of other income – treaties with Canada and South Africa.[181] Tanzania's tax treaty with Zambia is silent on taxation of other income. Other treaties signed by Tanzania assign exclusive taxation rights over other income to the residence state.[182] The implication is that, unlike Nigeria, majority of Tanzania's tax treaties give the residence state more taxing rights over residual income. It would have been better if no provision exists in Tanzania's tax treaties covering residual income, and that would mean that Tanzania could tax those other income in accordance with the provisions of its domestic tax laws. Only five

[181] Article 22 of Tanzania's tax treaty with Canada; Article 20 of Tanzania's tax treaty with South Africa.
[182] Article 21 of Tanzania's tax treaty with Italy; Article 22 of Tanzania's tax treaties with Denmark, Finland, Norway, Sweden; Article 24 of Tanzania's tax treaties with India.

of Botswana's treaties – with China, the Czech Republic, Ireland, Malta, and Mauritius – do not allow source taxation of other income.[183]

It is almost impossible to envisage all categories of income in tax treaties, hence the importance of a "catch-all-clause"[184] as in Article 21 of the UN Model, which protects the tax base of the source country. To expand domestic resource mobilization in the comparator countries, it is argued that they should amend their tax treaties to include provisions allowing source taxation of other income not dealt with by other allocation rules in their treaties. This will be an opportunity to broaden their taxing rights over income not dealt with by other allocation rules.

7. Conclusion

In keeping with the theme of this thesis – expanding source taxing rights in the tax treaties signed by the comparator countries as a pathway to increase domestic resource mobilization – this chapter advances arguments for reform of treaty provisions on taxation regarding shipping and aircraft operations, capital gains, independent personal services, and other income not expressly dealt with by the other allocation rules. The analysis shows that the provisions of the tax treaties signed by the comparator countries on taxation of income from aircraft and shipping operations are not uniform. Only one treaty signed by Nigeria (Philippines) allows source taxation of such income. The other treaties signed by Nigeria contain restrictions that impede the exercise of source taxing rights, e.g., the exercise of source taxing rights only if operations are carried on by an enterprise of only one of the contracting states. All of Tanzania's tax treaties exempt source taxation of income from aircraft operations. All of Botswana's tax treaties exempt source taxation of income

[183] Article 21(1) of Botswana's treaties with Czech Republic; Ireland, Malta Article 20(1) of Botswana's treaty with China; Article 23(1) of Botswana's treaty with Mauritius.
[184] Daurer & Krever, *supra* note 177.

from shipping and aircraft operations. For the treaties signed by Nigeria and Tanzania that allow source taxation of income from aircraft and shipping operations, the rates are between 1%, 1.5% and 5%, with some treaties requiring further reduction of taxable profits by 50%. To improve their domestic resource mobilization, the comparator countries should reform their treaties to include provisions allowing source taxation of income from aircraft and shipping operations. The rate for source taxation of such income should also be increased to equivalent rates for domestic companies.

None of the treaties signed by the comparator countries allows for source taxation of digital services. Article 12B of the UN Model expands the scope of source taxation of business income earned by non-residents without the requirement for a physical presence. To capture income earned by non-residents from digital services, the comparator countries should reform their treaties to include provisions for source taxation of fees for digital services. Although, as discussed above, Nigeria can tax income from digital services earned by residents of its treaty partners because it has implemented a digital tax, it is recommended that Nigeria should amend its tax treaties to include the provisions of Article 12B to make it easy to enforce and collect digital services tax from residents of its treaty partners without concerns that such an action would violate the terms of the treaties. For Tanzania and Botswana to tax income from digital services, they have to first enact digital services tax laws; otherwise, there would be no domestic law upon which the treaty provision will be based even if they amend their tax treaties to include the provision on fees for digital service.

Regarding capital gains, only Tanzania's treaty with Canada fully reflects the provisions of the UN Model on their source taxation. As discussed above, the UN Model allocates more taxing rights over capital gains to source countries. Obviously, therefore, the comparator countries should amend their treaties by including the source-expanding provisions for taxation of capital gains in the UN Model. Although this Model allocates more taxing rights to source countries over capital gains, it contains gaps that impede greater source taxing rights. Consequently, the comparator countries should amend provisions allocating taxing rights over gains from alienation of aircraft and ships to the residence state: gains derived within their jurisdictions from alienation of such properties should be assigned to the source states. They should also include provisions allowing source taxation of gains from disposition of all taxable assets within their jurisdictions.

There are variations in the provisions of the treaties signed by the comparator countries on taxation of income from independent personal services. Only two of Nigeria's tax treaties have provisions that fully reflect the provisions of the UN Model on taxation of this income. As discussed earlier, unlike the OECD Model, the UN Model advances greater source taxing rights over income from independent personal services. It does this by adding a separate provision on taxation of income from independent personal services, and by including a 183-day alternative to the fixed base requirement. Only two of Nigeria's treaties, four of Tanzania's, and nine of Botswana's have provisions that fully reflect the UN Model. Again, it is beneficial for these countries to amend their tax treaties to include provisions that fully reflect the provision of the UN Model on taxation of income from independent personal services. To further advance source taxing rights over this income, the treaties should be reformed to include provisions allowing source taxation of such income from services performed outside the source state to customers in the source state. The possibility of delivery of services through communication technology makes it imperative to amend treaty provisions on taxation of income from independent personal services to reflect modern realities.

Lastly, not all the treaties signed by the comparator countries allow source taxation of residual income – income not expressly dealt with by the other allocation rules. This is a unique provision in Article 21 of the UN Model, allowing source states to retain taxing rights over income derived within their jurisdictions but not covered by the other allocation rules. Only two of Tanzania's tax treaties include this provision. Two of Nigeria's tax treaties and five of Botswana's tax treaties do not have it. The comparator countries must include it in their reformed treaties.

In sum, this chapter highlights additional elements that prevent the comparator countries from fully exercising taxing rights over significant economic activities carried out in their jurisdictions. The reform proposals presented here regarding the comparator countries' treaty provisions on taxation of income from shipping and aircraft operations, digital services, capital gains, independent personal services, and other income must be implemented in order for them to improve their domestic resource mobilization to support their economic development aspirations

Chapter VII - Conclusion

Africa, home to more than one billion people,[1] is in dire need of socio-economic development. According to estimates by the Brookings Institution, an American Research Group, of the world's 28 poorest counties, 27 are in sub-Saharan Africa.[2] The development challenges that affect African countries are multidimensional; they go beyond lack of income. They include lack of access to basic infrastructure, such as safe drinking water, health services, sanitation, and education.[3] Among other problems, African countries have been unable to tackle their development challenges because of structural barriers that limit increased tax revenue collection. Poverty, in its myriad forms across Africa can be alleviated by, among others, measures taken by the individual African countries to eliminate structural barriers to improved tax collection.

Relevant to the theme of my thesis and my proposals for reforms to tax structures in African countries, is the reality that the League of Nations, the OECD, and the United Nations tax regimes have ignored the socio-economic realities of the developing states, particularly African states, in the course of creating their regimes on international taxation. Privileging developed state taxation interests, African states have been deprived of tax revenue from investment by non-residents. These countries have been stuck in the colonial and post-colonial international tax regime on the basis of which their bilateral tax treaties have been framed. As a consequence, they allow exploitation of their resources without being able to generate internal revenue through fair taxation

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[1] *UNDESA, How certain are the United Nations Global Population Projections?* UN Doc 2019/6.
[2] Nirav Patel, "Figure of the week: Understanding poverty in Africa"(21 November 2018), *Brookings* (blog), online: < https://www.brookings.edu/blog/africa-in-focus/2018/11/21/figure-of-the-week-understanding-poverty-in-africa/#:~:text=As%20of%202015%2C%20most%20of,Saharan%20Africa%20(Figure%201).&text=The%20average%20poverty%20rate%20for,poverty%20rate%20above%2030%20percent.>.
[3] *Poverty and Shared Prosperity 2018: Piecing Together the Poverty Puzzle* (Washington DC: World Bank, 2018).

of economic activities carried out by non-residents within their jurisdictions. To change this trajectory, African countries must reform their tax treaties and examine their participation in the international tax treaty regime. They must also reform their domestic tax laws. This is because tax treaties cannot extend a country's taxing rights.[4] Without corresponding amendments to expand the taxing rights of the comparator (and other African countries) through reforms to their domestic tax laws, they will not benefit from any tax treaty reform. This need is particularly salient because the African states have not escaped base erosion and profit shifting under their bilateral treaties fashioned within the structure of the multilateral treaty regimes under which the bilateral treaties operate.

Both theoretically and practically, African countries have two problems. The first one is that the philosophy of international law presumes that Western ideas are global. For this reason, African countries need a framework for analysing and presenting juridical and practical justification for their push to change the rules of the international tax regime. In this thesis, I employed the ideas of Third World Approaches to International Law (TWAIL) and the principle of "Common but Differentiated Responsibilities" (CBDR), to frame and explain my arguments for change. First, following TWAIL's analysis, I argue that the international tax rules do not take African states' interests into account; they were developed by the West and transplanted in African states. The practical implication is that the transplanted rules entrenched the exploitation of African states' economies in the dealings with the West. Consequently, as source states, the operations of their bilateral tax treaties did not unhinge them from continuing exploitation, namely, inability to obtain fair tax revenue from investment and other economic activities by foreigners within their

[4] S Leduc & G Michielse, "Are Tax Treaties Worth It for Developing Economies?" in Ruud A de Mooji, Alexande D Klemm & Victoria Perry, eds, *Corporate Income Taxes under Pressure (*USA: International Monetary Fund, 2022) 123 at 127.

jurisdictions. In other words, the tax treaties have obstructed the right of African states to collect equitable revenue from non-residents because of the basic rule that treaties must be fulfilled by state parties in good faith.[5]

Secondly, the principle of “common but differentiated responsibilities” in international law, established that it is the joint responsibility of the comparator countries and their treaty partners, to meaningfully and willfully commit to foster the development of strong economic foundations, including equitable tax revenue structures, that would enable tax revenue generation to ensure that the comparator states could fund their sustainable economic development efforts. The “common but differentiated responsibilities” principle, founded in international environmental law, recognizes the lesser capabilities of low-income countries to comply with the terms of the international environmental agreements regarding the protection of the climate system.[6] In regard to the theme of this thesis, this translates into the need for the comparator states (and other developing states) to be given help to fund their socio-economic development as envisaged under the UN SDG Agenda. My argument has been that the differential responsibility for achieving the SDG goals in the developing African states requires an honest recognition by the developed countries that they have a duty to facilitate international tax reforms that ensure equitable revenue to the poor states to undertake this task.

African countries need finance, technology, and strong institutions to develop. So, in seeking global solutions to underdevelopment problems, including poverty alleviation in Africa (and elsewhere), these two theories go together. TWAIL forces a revision of international law and its claims to universality. The common but differentiated responsibilities concept reaffirms this.

[5] I Lukashuk, “The Principle Pacta Sunt Servanda and the Nature of Obligation under International Law” (1989) 89:3 AJIL 513.
[6] Christopher Stone, “Common but Differentiated Responsibilities in International Law” (2004) 98:2 AJIL 276.

Together, they make it obvious that if high-income countries are sincerely willing to deliver on their commitment to help the developing countries to do better economically, they must ensure that the "rules of the game" actually change. In terms of this thesis, this means that the developed countries must be willing to recraft the prescriptive rules of the international tax regime under which the bilateral tax treaties operate, so that the developing states can actually access the financial and other resources necessary for their socio-economic development through, among others, their ability to equitably tax foreign economic actors within their jurisdictions.

Applying these considerations to my analysis of the provisions in the tax treaties signed by the comparator countries, I sought to not only point out their juridical shortcomings in the form of source-restrictive provisions. Further to this, the analysis offered reasons to push for fresh policy positions for the individual African countries studied, and also for Africa as a regional bloc to embrace a stronger front to pursue the realization of a more equitable international tax regime that better reflects its glaring socio-economic interests.

My analysis shows that all the three comparator countries studied in this thesis (Nigeria, Tanzania, and Botswana) have similar problems in common areas of taxation – their rights to tax are restricted, and the bases for their taxation are limited. The limitations extend to the taxation of business profits, investment income, aircraft and shipping operations, technical services, digital services, capital gains, independent personal services, and other income not dealt with by the allocation rules in the treaties they have signed. Throughout each segment of the analysis, specific findings for consideration by the comparator countries to drive reforms to their tax treaties were highlighted. It was repeatedly affirmed that by pushing through the reform recommendations to their bilateral tax treaties, the three countries could improve domestic resource mobilization to help finance their socio-economic development efforts. It was also highlighted that given the imprimatur of the UN SDG Agenda, the tax treaties signed by the three countries can be reformed into efficient tools for improving domestic resource mobilization to finance these efforts.

Consequently, the analysis also reveals that there are gaps in the domestic tax laws of the comparator countries that prevent increased tax revenue collection from non-residents. Obviously, therefore, it was argued that reforms of the domestic tax laws of the comparator countries are necessary to allow for expansive source taxation of income derived by non-resident companies. This is because no matter how expansive the provisions of a tax treaty, if there are not similar provisions in domestic laws to allow the taxation, a contracting state cannot enforce the treaty provisions. African states must apply themselves to this two-pronged approach as individual states, and also as a regional bloc. The individual African states must change their domestic tax rules to allow for expansive taxation rights over income earned by non-residents within their jurisdictions. Complementary to this, they must begin to harmonize their domestic tax regimes among themselves across the continent. Doing these would position the African countries to advance concrete proposals in the international arena regarding how the international treaty rules should be reworked to accommodate their interests.

Though there is no clear evidence for the positive impact of tax treaties on FDI, and unilateral mechanisms can help prevent double taxation without the need for tax treaties, it would take the African governments some time to settle for a no-tax treaty situation. This is why I recommend that the comparator countries should start by adopting tax treaty provisions that allow source-expanding provisions in the tax treaties they sign with fellow African countries, and to build upon this to reform or cancel tax treaties they signed with the rest of the world. A common African position is important to reinforce the interest of African countries in order to ensure that income earned by non-residents from economic activities carried on in the continent is taxed in the respective jurisdictions.

The foregoing observations and the recommendations made throughout this thesis must be appreciated in light of, for instance, UNCTAD's estimates that it would take $3.3 trillion to $4-5 trillion annually to realize the basic SDGs, such as water sanitation, food security, health and education, and roads improvement in developing countries.[7] It also estimates that developing countries face a funding gap of $2.5 trillion annually in these sectors.[8] As I have done in this thesis, so too do others urge that developing countries should increase their tax collection to 15% of their GDPs to fund the SDGs.[9] By pushing for reforms to their current tax treaties and their domestic tax laws that promote base erosion, the African countries will be better able, sooner than later, to raise more tax revenues to fund their development activities.

My analysis debunks the belief that the tax treaty arrangements African countries are party to are inevitable for them. In contrast, my urging is that they can secure source-expansive taxing rights over income derived by non-residents from the exploitation of their natural resources. It must not be forgotten that the majority of the treaties are relics of colonization. They were signed by the African countries without the requisite technical knowledge of the exact nature or valuation of their costs and benefits. Now that these have become clear, their amendment is the duty the African states must procure. Complementary to this is that they must not continue to endure the institutional arrangements that produced the current international tax treaty models upon which their bilateral tax treaties are based. It is imperative that the African states claim and exercise the

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[7] *Investing in the SDGs: An Action Plan* (UNCTAD: Geneva, 2014) at XXVI.
[8] *Ibid*.
[9] Vitor Gaspar et al, "Fiscal Policy and Development: Human, Social, and Physical Investment for the SDGs" (2019) IMF Discussion Note No SDN/19/03.

right to influence the ongoing rules that inevitably become entrenched as they are applied to the new tax treaty arrangements they must make.

My analysis of the areas of economic activity from which African states could generate revenue has not pretended to be exhaustive. It is preliminary to prescribe detailed formulations for reform and amendment regarding tax treaty rules and domestic tax laws. However, some starting positions are obvious following the detailed and careful review of the current arrangements offered in this thesis. Among these starting positions are the need to expand the tax base, increase withholding tax rates, and include anti-abuse provisions in all the tax treaties. Even so, the thesis has sought to be a selective pointer, a highlighter, and an indicator of what could be done regarding the few areas of activity it focused on. Hopefully the light it sheds is sufficiently bright to make this effort worthwhile. I should re-emphasize that the most poignant policy view this thesis advocates is this: African countries deserve to be full partners in the world's international tax arrangements. If this legitimate need is honestly accommodated, it will benefit both developed and developing countries because socio-economic development in Africa through fair gains earned from investment revenues will give the developed countries also some respite from their fatigue from having to give the African countries endless loans, aids, grants, etc. In the words of an African proverb, my point is this: "When everyone has something to eat in the village, the rich man can enjoy his wealth without having to lock his door with iron bars."

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