Dalhousie Law Journal

Volume 44
Issue 1 *44:1 (2021) Special Issue: Purdy Crawford Workshop: The Role of Business Regulation in Advancing the Sustainable Development Goals*

Article 10

6-2021

Domestic Revenue Mobilization through Corporate Income Tax in an East African Developing Country Context

Afton Titus
University of Cape Town, Faculty of Law

Recommended Citation
Afton Titus, "Domestic Revenue Mobilization through Corporate Income Tax in an East African Developing Country Context" (2021) 44:1 Dal LJ 151.

Afton Titus*

Domestic Revenue Mobilizaton through Corporate Income Tax in an East African Developing Country Context

The laudable objective of making the Sustainable Development Goals (SDGs) a reality requires the targeted use of financial resources. It has become imperative for governments to raise such financial resources through mechanisms that facilitate the domestic mobilization of revenues. This paper argues that in an African developing country context, corporate income tax represents the most effective means by which governments may raise the required funds. Corporate income tax remains an important source of revenue for African countries. This paper further proposes: (i) the design of the essential features of a corporate income tax system that properly accounts for the economy within which it is to operate;(ii) the appropriate policy decisions that are to be made to achieve specified government objectives; and (iii) the administrative capacity challenges that must be addressed to ensure its effective implementation. In so doing, it is envisaged that the SDGs may become an achievable goal for developing countries, rather than a mere hope.

L'entreprise louable de faire des objectifs de développement durable (ODD) une réalité nécessite une utilisation ciblée de ressources financières. Il est devenu impératif pour les gouvernements de lever ces ressources financières par le biais de mécanismes qui facilitent la mobilisation nationale des revenus. Cet article soutient que dans le contexte des pays africains en développement, l'impôt sur les sociétés représente le moyen le plus efficace pour permettre aux gouvernements de réunir les fonds nécessaires. L'impôt sur les sociétés reste une source importante de revenus pour les pays africains. Ce document propose en outre : (i) la conception des caractéristiques essentielles d'un système d'impôt sur les sociétés qui tienne correctement compte de l'économie dans laquelle il doit fonctionner; (ii) les décisions politiques appropriées qui doivent être prises pour atteindre les objectifs gouvernementaux spécifiés; et (iii) les défis de capacité administrative qui doivent être relevés pour assurer sa mise en œuvre efficace. Ce faisant, il est envisagé que les ODD puissent devenir réalisables pour les pays en développement, plutôt qu'un simple espoir.

* Associate Professor in Commercial Law, University of Cape Town.

Introduction

Global trade has increased, the world is more interconnected than ever before, and the number of places on the planet that are truly remote is growing smaller every day. However, developing countries still face significant challenges in taking advantage of these global developments. In recognition of these challenges, the United Nations in 2015 adopted a programme that identified seventeen Sustainable Development Goals (SDGs). If realized, the gap between the developed and the developing world would drastically reduce.

Setting aside the idealism attached to the SDGs, implementation and achievement of the SDGs require significant financial resources. It was noted at the Addis Ababa Financing for Development Conference in 2015 that the achievement of the SDGs would need a substantial increase in financial resources, particularly revenues that have been domestically mobilized.[1]

To understand how this may be done, it is necessary to place the SDGs in the context of a developing country faced with the (perhaps uphill) task

1. United Nations, *"Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda), 69/313*" (2015), online (pdf): <sustainabledevelopment.un.org/content/documents/2051AAAA_Outcome.pdf> [perma.cc/B4WX-NQWF].

of realizing its SDGs. In doing so, the author is cognizant of the fact that the term "developing country" is an amorphous one. As such, the author has identified a particular African developing country context that would be appropriate for this discussion—that of the East African Federation.

The East African Federation is not yet in existence, but is a political federation that the Partner States making up the East African Community (EAC) aim to form in the near future. This East African Federation provides a suitable test jurisdiction for evaluating the best way for an African developing country to approach domestically mobilizing revenues to realize its SDGs. The East African Federation is a suitable context, despite its current non-existence, because it provides a clean slate by which policy proposals may be made without the hindrance of already embedded policy decisions that may distort the projected outcomes of policy-related research.

Accordingly, this paper argues that the corporate income tax system is an appropriate vehicle for increasing financial resources to enable the East African Federation to meet its SDGs. It has been recognized that corporate income tax continues to play a key role in the revenue-raising ability of African developing countries, and this would be true for the East African Federation as well.[2] Given the importance of a suitably designed corporate income tax system to African developing countries in general, this paper joins a broader conversation about the tax policy issues facing African developing countries today.

I. *Methodology*

This paper argues that the corporate income tax system is a fitting mechanism for the East African Federation to increase financial resources and finance government expenditure on plans to meet its SDGs. Focus is placed on corporate income tax for the following reasons:

(a) Corporate income tax continues to be the most important revenue-raising tool available to African governments.[3] It is therefore more likely to raise the required funds than other taxes.

(b) Corporate income tax is a flexible mechanism for meeting myriad government policy objectives in a cost-effective manner.[4]

(c) From an administrative perspective, it is much easier for a government to effectively tax corporates than individuals. This is because record-

2. Anne W Oguttu, "Tax Base Erosion and Profit Shifting in Africa—Part 1: What Should Africa's Response Be to the OECD BEPS Action Plan?" (2015) 48:3 Comp & Intl LJ Afr 516 at 526.

3. *Ibid*.

4. Mark B Smith, "Chapter 1: Introduction" in *The Taxing Road to Sustainable Growth, Resource Productivity and Corporate Taxation* (Amsterdam: IBFD, 2013) at 1.4.

keeping of corporates is better than that of individuals, and it is easier to locate and track corporates than individuals.[5]

(d) Since taxation is as much a political imperative as it is an economic one, the taxation of corporates in a manner that is seen to be effective would tie into the populist narrative that corporations should pay their "fair share of taxes."[6] This would allow the East African Federation to gain favour with the general population, and, in so doing, lend credibility and legitimacy to its plan to finance SDG-building through corporate income tax.

Moreover, a study conducted on domestic revenue mobilization and the tax capacity, effort and gaps of a range of countries,[7] indicates that a country's ability to raise revenue depends on the following three factors:

(a) The composition of the country's economy;
(b) The policy choices made by the country; and
(c) The administrative capacity of the country.[8]

Accordingly, this paper follows a similar order. It details the EAC context by setting out the corporate income tax positions of the EAC Partner States, while also discussing the relevant drivers of the economy in the East African region. This context is followed by a proposal of the policy choices that the East African Federation may make in designing a corporate income tax system that could assist in raising the financial resources required to meet its SDG targets. Next, the administrative capacity challenges facing the East African Federation are considered, and proposals are made as to how some of these may be addressed.

II. *Corporate Income Tax Design*

1. *The East African Community context*

Three of the EAC Partner States have some of the highest economic growth rates in the East African region—Kenya, Rwanda and Tanzania—while others exhibit some of the lowest—South Sudan and Burundi.[9]

---

5. Richard M Bird, "Why Tax Corporations?" (2002) 56 Bull Intl Taxation 194 at 199.
6. John Schoen, "Do Companies Pay "Fair Share"? Depends Whom You Ask" *CNBC* (21 September 2014), online: <www.cnbc.com/2014/09/21/axes-do-companies-pay-their-fair-share-of-taxes-depends-how-you-ask.html> [perma.cc/CJ3B-ZF46].
7. Graham Glenday, Ipchita Bharali & Ziyuan Wang, "Enhancing Domestic Revenues: Constraints and Opportunities—A cross country comparative study of tax capacity, effort and gaps" (2019), online (pdf): *Centre for Policy Impact in Global Health* <centerforpolicyimpact.org/wp-content/uploads/sites/18/2019/04/CPIGH-Report_Tax-report_Enhancing-Domestic-Revenues__April-2019_FINAL.pdf> [perma.cc/TM5B-9C5Y].
8. *Ibid* at 11.
9. "East Africa Economic Outlook 2019" (2019) at 2, online (pdf): *African Development Bank Group* <www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/2019AEO/REO_2019_-_East_Africa_.pdf> [perma.cc/8TMV-9476].

The main drivers for the strong economic growth in Kenya, Rwanda and Tanzania are the service and agricultural sectors.[10] Conversely, the weak economic growth in Burundi and South Sudan is attributed to the continuing political instability in the two countries.[11] The extractive industry also plays a significant role in the EAC Partner States, including oil extraction in South Sudan and the recent discovery of natural gas and oil in Kenya, Tanzania and Uganda.[12] A further important element of the EAC structural economic composition is the large informal sector in the East African region, which plays a significant part in securing employment opportunities for the youth in the region.[13] In terms of economic risks for the EAC, it is important to note the rising debt exposure that EAC Partner States, such as Kenya, Tanzania and South Sudan, are undertaking with respect to the finance provided to them by China.[14] Notwithstanding this, the East African region has produced good performance indicators, with Rwanda ranked second in Africa of the 2017 World Bank's Doing Business Report.[15] The East African region was also the biggest recipient of foreign direct investment in Africa for 2017, with Kenya receiving the most foreign direct investment projects.[16]

Given this understanding of the structural composition of the economy in the EAC, it is useful to also analyze the manner in which the six Partner States of the EAC tax corporate profits before considering a proposal designed for the East African Federation. All six Partner States employ the classic corporate income system in taxing corporate profits. The key element of the classical corporate income tax system, as initially described by Van den Tempel,[17] is the tax treatment of companies as separate legal entities, and the economic double taxation of dividends in the hands of the companies and shareholders.[18] Table 1 below indicates the budgetary performance of this tax in the six Partner States for three financial years: 2015/16, 2016/17 and 2017/18.

10. *Ibid* at 1.
11. *Ibid* at 5.
12. *Ibid* at 2.
13. *Ibid* at 16.
14. *Ibid* at 8.
15. *Doing Business 2017: Equal Opportunity for All*, 14th ed (Washington, DC: World Bank, 2017) at 7.
16. "Turning Tides: EY Attractiveness Program Africa" (2018) at 16, online (pdf): *Ernst & Young* <assets.ey.com/content/dam/ey-sites/ey-com/en_za/topics/attractiveness/ey-turning-tides-2018.pdf> [perma.cc/XP8J-RYE9].
17. AJ Van den Tempel, *Corporation Tax and Individual Income Tax in the European Communities* (Brussels: Commission of the European Communities, 1970).
18. Sijbren Cnossen, "Corporation Taxes in the European Union: Slowly Moving Toward Comprehensive Business Income Taxation?" (2017) 25:3 Intl Tax & Public Finance 808 at 820.

*Table 1: Corporate Income Tax Performance in the EAC Partner States**

Country	Corporate Income Tax 2017/18	Corporate Income Tax 2018/19	Corporate Income Tax 2019/20	Percentage of Corporate Tax to Total Tax 2017/18	Percentage of Corporate Tax to Total Tax 2018/19	Percentage of Corporate Tax to Total Tax 2019/20
Kenya (in KSh billions)	278 133	339 186	416 172	43,42%	45,7%	47,06%
Rwanda (in RWF billions)	65 615	93 418	104 414	5.5%	6.9%	6.62%
South Sudan (in SSP billions)	1 753	1 375	2 180	12,5%	6,05%	8,07%
Tanzania (in Tsh billions)	1 961	1 878	2 074	22%	17%	18%
Uganda (in Shs billions)	885	904	1 288	6%	6%	7%

*Author's own calculations based on country budget information. Budget information for Burundi is not currently available.

As Table 1 indicates, corporate income tax is more important to some Partner States (such as Kenya) than others (such as Uganda). In terms of trends, the collection of this tax has increased over the three-year period in all Partner States (aside from South Sudan and Tanzania, which both saw a slight dip in collections in the 2018/2019 fiscal year). This trend of increasing collections is interesting because both Rwanda and Kenya introduced corporate tax holidays over the 2015-2018 period as a mechanism to encourage foreign direct investment.[19] Rwanda has seen a substantial increase in its collections over the three-year period.

The corporate income tax's performance varied across the other Partner States over the period. Despite the variance in performance, Table 1 indicates that corporate tax collection is an important source of revenue across the EAC, as is the case in the rest of Africa.[20]

In terms of the collection of taxes, it has been noted that governments should collect at fifteen per cent of gross domestic product (GDP) to

19. See *Law Nº 006/2021 of 05/02/2021 on Investment Promotion And Facilitation* (Rwanda), Annex item I; *Export Processing Zones Act*, 1990 (Kenya), c 517, s 29.
20. Oguttu, *supra* note 2 at 526.

adequately finance government functions.[21] However, in terms of Table 2 below, aside from Kenya, all of the EAC Partner States have tax-to-GDP ratios below fifteen per cent. In terms of the relation of these ratios to more global averages, France has the highest tax-to-GDP ratio of the OECD countries at 46.1 per cent while Mexico has the lowest at 16.1 per cent.[22]

Table 2: Tax-to-GDP Ratio for East African Community Partner States* and selected OECD States**

Country	Most Recent Year Available	Tax-to-GDP Ratio
Burundi	2013	13.5
Kenya	2017	15.7
Rwanda	2017	13.6
South Sudan	Not Available	Not Available
Tanzania	2018	11.6
Uganda	2017	13.7
France	2018	46.1
Mexico	2018	16.1

* Source: World Bank Data **Source: OECD Revenue Statistics 2019

According to the above table, Kenya has the highest tax-to-GDP ratio of 15.7 per cent, while Tanzania has the lowest (in terms of reportable data) of 11.6 per cent. This means that most of the EAC Partner States are not collecting enough taxes to properly sustain government functions. This has exacerbated the high debt exposure of the EAC Partner States as mentioned earlier in this paper as the EAC Partner States use debt to fund government expenditure.

The collection of corporate tax in the EAC Partner States must also be considered against the general fiscal budget of the Partner States. All of the Partner States have recorded a fiscal deficit for the 2018/2019

21. "East Coast Economic Outlook 2019," *supra* note 9 at 12.
22. OECD, *Revenue Statistics 2019* (Paris: OECD Publishing, 2019) at 19.

financial year. The deficits are quite dire, but vary across Partner States, with Kenya reflecting a deficit of 5.6 per cent of GDP,[23] while at the lower end of the scale, Tanzania reflected a deficit of 2.3 per cent of GDP for the same period.[24] Moreover, aside from Rwanda[25] and Uganda,[26] most of the Partner States failed to meet their budgeted targets for the collection of income tax.[27] As a result, Partner States like Tanzania, Kenya and Uganda have prioritized in their budget announcements the improvement of the tax administration in their respective countries.[28]

Bearing this context in mind, the corporate tax base of the six Partner States will now be analyzed. All six Partner States employ the classical corporate income tax system with corporate profits being taxed in the hands of the corporate, while the distributed profits are taxed in the hands of the shareholders as dividends. The taxable income of companies is the result of reducing income by allowable deductions.

In terms of the definition of income, Kenya,[29] Rwanda,[30] Tanzania[31] and Uganda[32] have a comprehensive definition of income in their respective income tax legislation. The definition of business profits includes rental income and investment income, with a long list of specifically included

23. Kenya, *Budget Statement FY2019/20, Creating Jobs, Transforming Lives—Harnessing the 'Big Four' Plan* (2019) at 9, online (pdf): <www.treasury.go.ke/component/jdownloads/send/201-2019-2020/1442-budget-statement-for-fy-2019-20-final.html> [perma.cc/99HM-ZTB5] [Kenya Budget Statement].

24. Tanzania, *Speech by the Minister for Finance and Planning, Hon. Dr. Philip I. Mpango (MP), Presenting to the National Assembly, the Estimates of Government Revenue and Expenditure for 2019/20* (13 June 2019) at para 32, online (pdf): <gbt.go.tz/files/documents/BudgetSpeech2019-En.pdf> [perma.cc/M2WL-KWSP] [Tanzania Budget Speech].

25. Rwanda, *Budget Speech Financial Year 2019/20: Transforming lives through Industrialization and Job Creation for Shared Prosperity* (June 2019) at para 16, online (pdf): <www.tralac.org/documents/resources/by-country/rwanda/2862-rwanda-budget-speech-2019-20/file.html> [perma.cc/39D5-87FS] [Rwanda Budget Speech].

26. Uganda, *Budget Speech FY2019/20: Industrialization for Job Creation and Shared Prosperity* (June 2019) at para 23, online (pdf): <budget.go.ug/content/budget-speech-7> [perma.cc/M2WL-KWSP] [Uganda Budget Speech].

27. See Kenya, 2019 Budget Review and Outlook Paper (September 2019) at 15, online (pdf): <https://www.treasury.go.ke/component/jdownloads/send/201-2019-2020/1303-the-fiscal-budget-for-the-financial-year-2019-20.html>; Tanzania Budget Speech, *supra* note 24, at para 14; South Sudan, FY: 2019/2020 Approved Budget Book (19 December 2019) at ii, online (pdf): <www.mofep-grss.org/docs/fy-2019-2020-approved-budget-book> [perma.cc/V7UD-R7XP]; Budgetary information for Burundi is not available.

28. Kenya Budget Statement, *supra* note 23 at 8; Tanzania Budget Speech, *supra* note 24 at paras 33-34; Uganda Budget Speech, *supra* note 26 at paras 111-112.

29. *Income Tax Act*, 1973, Chapter 470 (Kenya), s 3(2).

30. *Law No.16/2018 of 13 April 2018 Establishing Taxes on Income* (Rwanda), arts 19, 35, 40–43.

31. *Income Tax Act*, 2004 as amended, c 332 (Tanzania), ss 6–9.

32. *Income Tax Act*, 1997, c 340 of the Laws of Uganda (Uganda), ss 17–20.

amounts.[33] Having said that, the definition of income is rather minimal in the fiscal legislation of Burundi[34] and South Sudan.[35]

The general rule for the deductions is similar across Kenya,[36] Tanzania[37] and Uganda,[38] with the requirements for an expenditure or loss to have been incurred in the production of income. Rwanda[39] and Burundi,[40] however, require a more methodical approach to deductions, likely with a view to identify real economic activity. These Partner States require that the expenditure must be incurred for purposes related to business, must result in the reduction of net assets, must correspond to real expenditure, and must be related to the particular financial year. In terms of specific deductions, a deduction for research and development related expenditure is allowed in Burundi,[41] Kenya,[42] Rwanda,[43] Tanzania[44] and Uganda.[45] Moreover, while all six Partner States allow for capital allowances and depreciation deductions, the rates and capital projects differ across the Partner States. Possible tax leakages may arise in this area as many of the Partner States provide capital allowances which may be considered excessive. For instance, all the Partner States except for Burundi and South Sudan routinely provide for initial capital allowance rates of 50%[46] while Kenya provides for a 150% capital allowance for the construction of bulk storage and handling facilities for supporting the Standard Gauge railway operations, provided that certain conditions are met.[47]

A further area for possible tax leakage lies in the rules for the carry forward of losses across the Partner States. An indefinite carry forward of

33. The list of specifically included amounts does not appear to hamper the interpretation of income in the EAC Partner States. For instance, see *Heritage Oil and Gas Limited v Uganda Revenue Authority* [2011] UGTAT 6 and *Kenya Revenue Authority v Yaya Towers Limited* (2016) eKLR.
34. *Law No. 1/02 of 24 January 2013 Regarding Income Taxes*, (*Loi No. 01/02 Du 24 Janvier 2013 Relative Aux Impots Sur Les Revenus*), as amended (Burundi), art 37. This legislation is only available in French, online (pdf) <www.assemblee.bi> [perma.cc/MG94-C52E].
35. *Taxation Act, Statutes of South Sudan 2009*, s 64.
36. *Supra* note 29, s 15(1).
37. *Supra* note 31, s 11(2).
38. *Supra* note 32, s 22(1).
39. *Supra* note 30, art 25.
40. *Supra* note 34 at art 53.
41. *Ibid*, art 68.
42. *Supra* note 29, s 15(2)(n).
43. *Supra* note 30, art 30.
44. *Supra* note 31, s 15(1).
45. *Supra* note 32, s 32(1).
46. *Tax Laws (Amendment) Act*, 2020 (Kenya), Second Schedule; *Law Nº 006/2021 of 05/02/2021 on Investment Promotion And Facilitation* (Rwanda), Annex item XX; *supra* note 31 at Third Schedule; *supra* note 32, s 28(1).
47. *Supra* note 29, s 24E; *Business Laws (Amendment) Act, 2020* (Kenya), s 11.

losses is allowed in Tanzania[48] and Uganda.[49] On the other hand, Burundi,[50] Kenya (in all other industries),[51] Rwanda[52] and South Sudan[53] place a restriction on the number of years for which a loss may be carried forward.

While the EAC region did undergo a tax rate harmonization to thirty per cent after the production of a report on tax harmonization in the region some years back,[54] this tax rate harmonization is more of an illusion than a reality. Now, the only Partner State that does not offer a special corporate income tax rate for an identified sector or taxpayer is Uganda. All the other Partner States have made significant reductions in the standard corporate income tax rate, with South Sudan's[55] reduced rate sinking to ten per cent for certain sectors.

However, the tax incentives offered by most Partner States have the effect of reducing the varying tax rates to relative insignificance. The only Partner State that does not offer corporate income tax holidays is South Sudan, and that is because it is embroiled in political conflict. Burundi, Kenya, Rwanda, Uganda and Tanzania all offer exemptions from the payment of corporate tax. Some offer exemptions for five years and others for ten years, as discussed further in Part II.2.b below. These tax incentives are all offered with the aim of attracting foreign direct investment, and in the hopes of differentiating themselves from other EAC Partner States. While the EAC region has performed well in terms of attracting more foreign direct investment than other countries in Africa, it is nonetheless questionable whether the EAC would not have won such investment without the deep cuts into the corporate tax the Partner States could have collected.

For some companies, corporate tax is not a cost they have to bear when doing business in the EAC Partner States. As such, in designing its corporate income tax system, the East African Federation should consider the role of tax incentives when determining the objectives it hopes to achieve with its corporate income tax. The next part will discuss this

48. No provisions restricting the carry forward of losses in the Income Tax Act (Tanzania), see *supra* note 31, s 19.
49. *Supra* note 32, s 38.
50. *Supra* note 34, art 75.
51. Supra note 29, s 15(4).
52. *Supra* note 30, art 32.
53. *Supra* note 35, s 78(2).
54. Hans-Goerg Petersen, ed, *Tax Systems and Tax Harmonisation in the East African Community (EAC): Report for the EAC/GTZ Program "Support to the EAC Integration Process* (Potsdam: University of Potsdam 2010).
55. *Supra* note 35 at Second Schedule.

aspect of the design of a corporate income tax system for the East African Federation, along with other relevant factors for the East African context.

2. *Policy choices*

Tax policy cannot be conceived in a vacuum. For tax policy to be effective, it is necessary to take into account the social, economic and political realities of the country in which the policy is to operate.[56] From an East African Federation perspective, therefore, it is important for corporate income tax policies to be formulated while bearing in mind the reality in which the policies are to operate.

To do this, it is important to identify what the East African Federation hopes to achieve from a corporate income tax. The critical objective of the corporate income tax in the East African Federation would be to increase government revenues. Corporate income tax is an amenable policy tool for achieving this revenue-raising aim. Bowler Smith notes that corporate income tax as a regulatory instrument is cost-effective, flexible and efficient.[57] Corporate income tax is especially effective in promoting the more efficient use of resources.[58] However, as a system, the corporate income tax does have some drawbacks. These drawbacks include questions about the fairness of corporate income tax in taxing the income from capital, both in the hands of the company and the shareholder,[59] and the manner in which the complexity of the corporate income tax system distorts investment decisions.[60]

In practical terms, however, the great disparity between the rates of corporate income tax to total tax across the Partner States indicates that corporate income tax is a potential growth factor on which the East African Federation should focus. Moreover, the fact that all of the Partner States are presently in dire budget deficits—some are critical—adds impetus to the need to realize the growth potential of corporate income tax. It is therefore key that the East African Federation take measures to broaden the tax base of corporate income tax. This could be done by evaluating the EU's proposed common consolidated corporate tax base and is further discussed under part II.2.a (*EU's proposed CCCTB*).

The second manner in which the corporate income tax could raise more revenue is by ensuring that the East African Federation is competitive

56. Helen Bullock, Juliet Mountford & Rebecca Stanley, *Better Policy-Making* (London: Centre for Management and Policy Studies, 2001).
57. M Bowler Smith, "Chapter 3: Corporate Tax Objectives" in *The Taxing Road to Sustainable Growth, Resource Productivity and Corporate Taxation"* (Amsterdam: IBFD, 2013).
58. *Ibid*.
59. David L Weimer, "A Better Corporate Tax?" (2002) 21:4 J Policy Analysis & Management 693.
60. *Ibid*.

within the global market. Like many other developing countries, the East African Federation would seek to attract foreign direct investment. Tax incentives are typically used to fulfill this function, and it is therefore key for the East African Federation to determine whether it will use such mechanisms and how best to use them to suit the East African context. This will be further discussed under part II.2.b (*Tax incentives*).

A third manner of raising more corporate income tax is to reduce the large informal sector in the East African region. The informal sector here means "all economic activity—and income earned from it—that circumvent government regulation, taxation or observation."[61] The manner in which the East African Federation may reduce the informal sector is discussed under part II.2.c.

a. *Broaden the corporate income tax base*

The European Union's proposed CCCTB

The idea of establishing a common corporate income tax base in the EU has been the subject of debate for decades. It has been recognized that the corporate income tax systems across Member States vary greatly, and that great costs to taxpayers are involved in conducting cross-border trade within the EU.[62]

The idea of developing a meaningful commonality in the corporate tax base in the EU was first posited in 1992 by the Committee of Independent Experts in Company Taxation (the Ruding Committee),[63] followed by further action taken in 1999 through the Council inviting the Commission to present a study on company taxation in the EU.[64] In its most recent attempt at corporate tax commonality, the Commission first tabled its formal proposal for a Common Consolidated Corporate Tax Base in 2011. It proved too difficult to obtain the necessary Member State consensus to pass the proposal, and the proposal was later replaced with a relaunched two-part proposal in 2016. The first part of this proposal envisages a directive on a Common Corporate Tax Base[65] (CCTB proposal) to be later

61. Andreas Buehn, Roberto Dell'Anno & Friedrich Schneider, "Exploring the Dark Side of Tax Policy: An Analysis of the Interactions between Fiscal Illusion and the Shadow Economy" (2018) 54:4 Empirical Economics 1609 at 1611.
62. Marjaana Helminen, *EU Tax Law—Direct Taxation* (Amsterdam: IBFD, 2018) at 4.4.1.
63. Jan van de Streek, "Chapter 11: A Common (Consolidated) Corporate Tax Base (C(C)CTB)" in Peter J Wattèl, Otto Marres and Hein Vermeulen, eds, *Terra/Wattel—European Tax La*w, 7th ed (Netherlands: Wolters Kluwer, 2018) at 29.
64. *Ibid*.
65. Proposal for a directive on a Common Corporate Tax Base (CCTB), COM(2016)685 final [CCTB Proposal].

followed by a directive on a Common Consolidated Corporate Tax Base (CCCTB proposal).[66]

The CCTB/CCCTB proposals have two general policy objectives: encouraging growth and investment within the EU and making the corporate income tax more fair within the EU.[67] To meet the first policy objective, Van de Streek points to several measures within the CCTB/CCCTB proposals, including: the move to harmonize the tax base, the super deduction for research and development for start-up companies, and the allowance for corporate equity.[68] The second objective is met through the introduction of measures that counter cross-border tax avoidance, including the mandatory application of the CCTB/CCCTB proposals to groups of companies with consolidated global turnover of more than €750 million,[69] and the proposed sharing mechanism in the CCCTB proposal.[70]

The essence of the proposal is that the taxable income of companies and permanent establishments within the EU is to be determined according to uniform rules applied across the Member States. Moreover, the financial performance of group companies is to be consolidated. Such consolidated taxable income is to be apportioned amongst the group member companies according to an apportionment formula comprised of the production factors, including sales, labour and capital. The taxable income apportioned to each member of the group is to be subject to tax at the rate determined by the Member State in which the group member companies are operating. On a practical level, this development would result in only one tax return being filed by the parent company of the group on behalf of the entire group. This tax return would be filed in the Member State in which the parent company is resident.

Determining the tax base of companies and permanent establishments under the CCTB proposal involves determining revenues, excluding exempt revenue, followed by the deduction of expenses.[71] "Revenues" is broadly defined in article 4(5) and includes: monetary or non-monetary proceeds derived from a sale or any other transaction (net of value added tax and other taxes); proceeds from the disposal of rights and assets; interest; dividends and other profit distributions; proceeds of liquidations; royalties; gifts received and ex gratia payments. Revenues does not,

66. Proposal for a directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2016) 683 final [CCCTB Proposal].
67. *Supra* note 65, preamble at para 2.
68. *Supra* note 63 at 432.
69. *Ibid* at 434-435.
70. CCCTB Proposal, *supra* note 66 at 2-4.
71. CCTB Proposal, *supra* note 65, art 7.

however, include receipts arising from the repayment of a debt or the raising of equity.[72] Despite its inclusion in revenues, income which is to be exempted includes: the profits of foreign permanent establishments; the proceeds from the disposal of shares where the taxpayer has maintained a minimum holding of ten per cent in the shareholding or voting rights of the company during the twelve months preceding the disposal; profit distributions from companies where the taxpayer has a minimum holding of ten per cent in the shareholding or of the voting rights of the distributing company for twelve consecutive months; proceeds from the disposal of pooled assets; and subsidies directly related to the acquisition, construction or improvement of depreciable assets.[73] Moreover, while interest and royalty income are to be subject to tax, the withholding tax paid on such receipts are to be credited.[74]

Article 9 of the CCTB Proposal allows for the deduction of expenses to the extent that they are directly incurred in the business interest of the taxpayer. Such deductible expenses may include research and development costs and also costs arising from the raising of debt or equity for the purpose of business.[75] The term "expenses" is further defined in article 4(6) as meaning:

> decreases in net equity of the company during the accounting period in the form of outflows or a reduction in the value of assets or in the form of a recognition or increase in the value of liabilities, other than those related to monetary or non-monetary distributions to shareholders or equity owners in their capacity as such.

The CCTB Proposal allows for the super-deduction of research and development costs by way of an additional deduction of fifty per cent of such costs up to a maximum of €20 million and a further twenty-five per cent deduction for costs over €20 million.[76]

The CCTB Proposal also includes a special research and development deduction for "small starting companies."[77] In addition to the deduction of research and development costs in full under article 9(2), article 9(3) allows companies to deduct a further one hundred per cent of their research and development costs if the following conditions are met: the company is unlisted with fewer than 50 employees; it has an annual turnover and/

72. *Ibid*, art 4(5).
73. *Ibid*, art 8.
74. *Ibid*, art 55.
75. *Ibid*, art 9(2).
76. *Ibid*, art 9(3).
77. *Ibid* at 10.

or annual balance sheet total that is less than €10 million; it is not the result of a merger; it has been registered for no longer than five years or its economic activity has endured for a period of five years or less; and it has no associated enterprises.[78]

The CCTB also attempts to work towards the elimination of the debt-equity bias through the allowance for growth and investment. This elimination allows for the cost of equity to be deductible in instances of an incremental increase in equity as compared to a reference point. For the first ten years, this reference point will be the first day of the first year of the application of the CCTB rules.[79] After ten years, the reference year is annually moved forward one year.[80] The CCTB also provides that should there be a decrease in the equity base, an amount equal to the defined yield calculated in terms of article 11(5) shall become taxable. The defined yield shall be calculated with reference to the Euro Area ten-year government benchmark bond in December of the year preceding the relevant year, along with a risk premium increase of two percentage points.[81]

The CCTB continues in the calculation of the tax base by detailing a list of non-deductible expenses in article 12. Non-deductible items include:

- profit distributions and repayments of equity or debt
- fifty per cent of entertainment costs (up to an amount still to be determined)
- transfers of retained earnings to an equity reserve
- taxes on profits and corporate tax
- bribes and other illegal payments
- fines and penalties
- expenses incurred in the deriving of exempt income
- gifts and donations
- capital costs related to fixed assets that are deductible elsewhere in the CCTB rules; and
- losses of a permanent establishment situated in a third country.

The CCTB Proposal further allows for losses to be carried forward indefinitely.[82]

The CCCTB Proposal, on the other hand, provides the rules for the consolidation of profits of group companies, and the allocation of such profits across the group members operating in different Member States according to the apportionment formula. Article 7(1) provides that the tax

78. *Ibid*.
79. *Ibid*, art 11(4).
80. *Ibid*.
81. *Ibid*, art 11(5).
82. *Ibid*, art 41.

bases of all group members are to be added together, while article 7(2) states that should such consolidation result in a negative tax base, this is to be carried forward for set-off against a positive consolidated base. Only a positive consolidated tax base may be apportioned.

Such apportionment is set out in articles 28 to 42 and details the formulary apportionment with its three equally weighted factors of sales, capital and labour. The formula to determine the share of the tax base for a particular group member (Company A) is set out in article 28(1) as follows:[83]

$$\text{Share A} = \left(\frac{1}{3}\frac{\text{Sales}^{A}}{\text{Sales}^{\text{Group}}} + \frac{1}{3}\left(\frac{1}{2}\frac{\text{Payroll}^{A}}{\text{Payroll}^{\text{Group}}} + \frac{1}{2}\frac{\text{No of employees}^{A}}{\text{No of employees}^{\text{Group}}} \right) + \frac{1}{3}\frac{\text{Assets}^{A}}{\text{Assets}^{\text{Group}}} \right) * \text{Con'd Tax Base}$$

In terms of the calculation of the above figures, the CCCTB Proposal provides special rules for the oil and extractive industry. Article 42 states that the sales amount of the group member actually conducting the exploration or production of oil or gas business shall be attributed to the group member situated in the Member State where the business is conducted. Moreover, in the event that the group member conducts the exploration or production of oil or gas business in a third country where such group member does not have a permanent establishment, the sales amount arising from such business shall nonetheless be attributed to such group member.[84] However, should there be no group member situated in the Member State where the exploration or production of oil or gas business is conducted, the sales amount is to be attributed to all the other group members in proportion to their labour and assets factors.[85]

Once the consolidated tax base has been apportioned in terms of the above formula, article 45 provides that such apportioned tax base is to be subject to tax according to the varying tax rates of the Member States involved. Administrative provisions are set out in articles 46 to 68, including details such as the notice to form a group and the information that is to be included in such notice, the obligation of the principal taxpayer to file the consolidated return, the information to be included in such return, the failure to file a tax return, and the procedures to follow should a dispute arise between the Member State and taxpayer.

More recently in May 2018, the Commission proposed that once the relevant CCCTB legislation is in place, a three per cent call rate should be applied to the CCCTB to bolster the EU's own resources.[86] In

83. CCCTB Proposal, *supra* note 66, art 28(1).
84. *Ibid*, art 42.
85. *Ibid,* arts 38(4)-(5), 42.
86. European Commission, *EU Budget: Commission Proposes A Modern Budget for a Union that*

March 2018, the European Parliament passed a resolution that approved recommendations to the CCCTB Proposal, as proposed by the Economic and Monetary Affairs Committee.[87] These recommendations include:

(i) The introduction of a fourth factor, the data factor, to the formulary apportionment;
(ii) While initially the CCCTB should be mandatory for groups of a certain size, this threshold should be lowered to zero over seven years;
(iii) The introduction of a digital permanent establishment concept;
(iv) Losses in respect of a consolidated tax base shall be carried forward for a period of five years;
(v) A compensation mechanism shall be introduced to weather the transitional sudden shock to tax revenues of Member States that implement the CCCTB. This mechanism is to be financed by the fiscal surpluses of Member States to experience gains in fiscal revenues. This mechanism is to remain in place for an initial period of seven years;
(vi) As a transitional measure, the Commission is to draft guidelines on how the formulary apportionment method may co-exist with other allocation methods employed by the non-EU States;
(vii) A dispute resolution mechanism should be put in place when the formulary apportionment produces a result that does not fit the actual economic activity;
(viii) The CCCTB should be implemented in one step. If the Council fails to reach unanimous consensus on this, article 116 of the TFEU[88] should be invoked. This means that the European Parliament and the Council should act under the ordinary legislation procedure.[89] As a last resort, the enhanced cooperation procedures may be used by Member States wishing to participate in the implementation of the CCCTB;

Protects, Empowers And Defends (2 May 2018).

87. European Parliament, *European Parliament legislative resolution of 15 March 2018 on the proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB) (COM(2016)0683–C8-0471/2016–2016/0336(CNS))* (15 March 2018).

88. Consolidated Version of the Treaty of the Functioning of the European Union (TFEU), article 116, OJEU C 326/47 (2012), EU Law IBFD.

89. The ordinary legislative procedure allows for the European Parliament and the Council to jointly decide on the proposals for law made by the Commission (the only body which may initiate legislative proposals). The vast majority of European laws are passed in this way. However, in respect of taxation, the special legislative procedures are to be followed which means that the European Parliament is only able to provide an advisory opinion on the legislative proposal while the Council, acting unanimously, is to make the decision whether to accept, reject or amend the Commission’s legislative proposal.

(ix) The CCCTB regime is to be evaluated by an interparliamentary conference and the European Parliament shall report its findings to the Commission and the Council. Moreover, five years after the implementation of the CCCTB, the Commission is to conduct an assessment of its implementation and report to the European Parliament and the Council;

(x) The provisions are to apply from 1 January 2020.

The recent proposed recommendations to the CCCTB Proposal indicate a more decisive approach than those proposed in the two-part CCTB/CCCTB proposals. A compensation mechanism is a novel way to ensure that arguments cannot be raised of a loss to revenues as a result of the implementation of the CCCTB. Moreover, the recommendation of the CCCTB to take into account the digital economy is a necessary change to make the CCCTB more relevant to modern reality.

The recommendations indicate an awareness of the possibility of factor manipulation of the formulary apportionment by the provision acknowledging that the formulary apportionment method may result in an outcome that does not match the economic activity actually undertaken. To overcome this result, the amendments propose that this be resolved through a dispute resolution mechanism. While this proposal is not ideal because one would prefer that mechanisms be put in place to ensure that the workings of the formulary apportionment mirrors the economic reality, the proposed resolution of disputes via dispute resolution is a workable solution under the circumstances.

Moreover, it is a prudent measure to have the CCCTB regime and its implementation evaluated to determine whether the policy objectives of the CCCTB are being achieved. Most importantly, the recommendations include a planned way forward in the event of the Council failing to reach consensus on the CCTB/CCCTB Proposals. In the author's view, this is a bold step forward towards making the CCCTB a reality.

The CCTB/CCCTB Proposals and their predecessors have been the subject of much criticism.[90] While the recent amendments to the CCTB/

90. See e.g. Jeanette C Borg, "The Tax Treatment of Losses under the Proposed Common Consolidated Corporate Tax Base Directive" (2013) 41:11 Intertax 581; Maarten F De Wilde, "Tax Competition within the European Union – Is the CCCTB Directive a Solution?" (2014) 7:1 Erasmus L Rev 24; Monica Erasmus-Koen, "Common Consolidated Tax Base: A Fair Share of the Tax Base?" (2011) 18:4 Intl Transfer Pricing J 245; Eric CCM Kemmeren, "CCCTB: Enhanced Speed Ahead for Improvement" (2011) 20:5 EC Tax Rev 208; Erik Röder, "Proposal for an Enhanced CCTB as Alternative to a CCCTB with Formulary Apportionment" (2012) 4:2 World Tax J 125; Marc Temme, Eduard Sporken & Rezan Okten, "Why Re-Invent the Wheel in the European Union? The Common Consolidated Corporate Tax Base Proposal" (2011) 18:5 Intl Transfer Pricing J 330; Edoardo Traversa & Charles-Albert Helleputte, "Taxation of EU-resident companies under the current CCCTB

CCCTB Proposals would address some of the criticisms levelled against the CCCTB concept, particularly the concern that the CCCTB fails to cater to the digital economy, some of the broader criticisms remain. These criticisms include that Member States will lose their tax sovereignty over corporate tax;[91] that the formula remains unbalanced;[92] that there is no compensation for minority shareholders of individual group companies involved in the consolidation;[93] and the fact that multinational companies could still locate the formulary apportionment factors in low-tax jurisdictions.[94] Moreover, concern has been raised that the AGI may be counter-productive in encouraging the raising of equity because an additional tax liability would arise in the event of equity decreases.[95] Spengel and others argue that a "pure" allowance for corporate equity would have had decreases in equity merely to attract a lower equity allowance rather than an additional tax burden.[96] A detailed discussion of these concerns are beyond the scope of this paper, and have been discussed elsewhere.[97]

Recommendations

From an East African Federation perspective, the CCCTB Proposal and its recommendations offer the East African Federation the opportunity to align and simplify the varied corporate tax bases of the Partner States. To do this effectively, it is advisable for the CCCTB-like system to apply to all companies operating within the East African Federation.

Furthermore, the East African Federation may find the comprehensive definition of revenues in article 4 of the CCTB Proposal useful given that South Sudan, for instance, has a minimal definition of income or revenue.[98]

Framework: Descriptive and Critical Approach to Selected 'Extraterritorial' Aspects" in Michael Lang, ed, *Corporate Income Taxation in Europe: The Common Consolidated Corporate Tax Base and Third Countries* (United Kingdom: Edward Elgar, 2013); Marius Vascega & Servaas van Thiel, "The CCCTB Proposal: The Next Step towards Corporate Tax Harmonization in the European Union" (2011) 51:9/10 EuroTax 379.

91. Vascega & van Thiel, *supra* note 90; Maarten F de Wilde, "Chapter 2: The CCCTB Relaunch: A Critical Assessment and Some Suggestions for Modification" in Pasquale Pistone, ed, *European Tax Integration: Law, Policy and Politics* (Online Books: IBFD, 2018).

92. Vascega & van Thiel, *supra* note 90.

93. Borg, *supra* note 90.

94. De Wilde, *supra* note 91; Leon Bettendorf et al., "Corporate Tax Reform in the EU: Weighing Pros and Cons" (2011) at 3, online (pdf): *Academia* <academia.edu/1427439/Corporate_Tax_Reform_in_the_EU_Weighing_Pros_and_Cons> [perma.cc/B3WE-Y8JW].

95. Christopher Spengel et al, "Addressing the Debt-Equity Bias within a Common Consolidated Corporate Tax Base (CCCTB) – Possibilities, Impact on Effective Tax Rates and Revenue Neutrality" (2018) 10:2 World Tax J 165 at 171.

96. *Ibid*.

97. Afton Titus, "How Can the East African Community Guard Against Base Erosion and Profit Shifting While Working Towards Deeper Integration?" (2017) 9:4 World Tax J 565.

98. *The Taxation Act (South Sudan), 2009*, s 64.

According to section 64 of the *Taxation Act* in South Sudan, gross income means "all income earned or accrued, including, but not limited to, income from production, trade, financial investment, professional or other economic activities within the tax period."[99] These categories are broad, and the CCTB definition of "revenues" would clarify the exact scope of income that falls within the tax base.

Moreover, the CCTB Proposal's definition of expenses in article 4 ties in with the definition adopted in Rwanda and Burundi, which focuses on the objective indicators of an expense, such as the reduction of asset values or a decrease in net equity.[100] Rwanda's Law Establishing Taxes on Income, for instance, provides at article 25 that expenses may be deducted if the following conditions are met: the expenses are directly chargeable to income and are directly incurred for the purpose of business; the expenses are real expenses that can be substantiated with proper documentation; the expenses result in a decrease in net assets; and the expenses are incurred in the same tax year as the activities to which they relate.[101]

All of the Partner States already account for research and development deductions in full in the year in which they are incurred.[102] Therefore, the deduction for such expenditure under the CCTB Proposal would not be out of place within the East African Federation. However, the extent of the deduction would have to be carefully considered by the Federation as to whether it should allow a super-deduction for research and development, as the CCTB Proposal has done. Given that a super-deduction has not been a trend in the East African region and that such a super-deduction would narrow the tax base (albeit in a bid to encourage research and development in the region), it is recommended that the East African Federation not incorporate a super-deduction immediately upon the implementation of its corporate income tax system. The East African Federation may wish to revisit this decision after some years once its corporate income tax system has been in place for a number of years.

Having said that, there is a point of similarity between the allowances offered under the CCTB Proposal and Uganda's income tax laws for small, start-up companies. While the CCTB Proposal offers a research and development super-deduction of one hundred per cent of relevant costs

99. *Ibid*.
100. *Law Regarding Income Taxes* (Burundi), 2013, art 53; *Law Establishing Taxes on Income* (Rwanda), 2018, art 25.
101. *Law Establishing Taxes on Income* (Rwanda), 2018, art 25.
102. *Law Regarding Income Taxes* (Burundi), 2013, art 68; *Income Tax Act, 1973* (Kenya), 1973, s 15(2)(n); *Law Establishing Taxes on Income* (Rwanda), 2018, art 30; *Income Tax Act* (Tanzania), 2004, s 15(1); *Income Tax Act* (Uganda), 1997, s 32(1).

for small companies that meet the specified requirements under article 9(3), Uganda offers a deduction of twenty-five per cent per annum for four years of the costs incurred in starting up a business to produce income.[103] While the CCTB Proposal deduction allows for a greater amount of qualifying expenditure to be deducted, Uganda's deduction allows for a broader spectrum of expenditures to be deducted other than just research and development expenditures. To encourage the development of small business, it is recommended that the East African Federation incorporate a deduction for small, start-up companies similar to that implemented in Uganda. It would be more feasible to encourage the growth of small business in industry broadly in the East African Federation rather than just in the one that incurs research and development expenditures.

The CCTB Proposal would also allow the East African Federation to create unity across its corporate income tax base by aligning the varying rates of depreciation allowed within the Partner States.[104] Moreover, the CCTB Proposal offers the East African Federation the opportunity to create more symmetry across the tax treatment of debt and equity through its Allowance for Growth and Investment (AGI). Should the East African Federation implement provisions similar to the AGI in the CCTB Proposal, it would allow the Federation to move towards the elimination of the debt-equity bias in the tax treatment of interest and equity. An AGI may also encourage more taxpayers to incorporate companies, which would increase the number of taxpayers subject to corporate income tax in the Federation. It is therefore advisable for the East African Federation to consider implementing an AGI-like provision in its corporate income tax system. It is not recommended that the Federation follow the CCTB Proposal in determining that decreases in equity should result in a further tax liability for the taxpayer company. Such a provision would likely deter taxpayers from forming companies.

In terms of the consolidation aspect proposed in the CCCTB Proposal, it would be particularly useful to the East African Federation because it would enable it to deal more effectively with situations of corporate failures. One of the reasons for the dismantling of a previous regional integration attempt in the East African region was the lack of participation

103. *Income Tax Act* (Uganda), 1997, s 30.

104. There are differences in depreciation rates implemented in the Partner States. For instance, industrial buildings depreciate at a rate of twenty per cent per annum in Uganda (*Income Tax Act* (Uganda), 1997, Sixth Schedule, Part 1) while Rwanda and Tanzania use a rate of five per cent per annum (*Law Establishing Taxes on Income* (Rwanda), 2018, art 28; *Income Tax Act* (Tanzania), 2004, Third Schedule, item 3(6)).

of other Partner States when a corporate failed.[105] It was left to one Partner State, the country in which the entity was registered, to account for and deal with the consequences of a corporate failure. If the East African Federation were to implement a system similar to the CCCTB, it would mean that, in the event that the group realizes a loss, such loss would result in no tax being paid by the group. Such loss would then be allowed to be carried forward to the next year in a coordinated fashion until the group is once again profitable. It is more likely that a group would turn a profit at some point in the future than a single company. Therefore, the East African Federation would more likely be in a position to receive the group's tax portion in a shorter time once the group is again profitable than would be the case if one Partner State were waiting for a single company operating within its borders to turn its losses into profits.

It is important, however, that the carry forward of losses be limited to encourage the group's return to profitability. As many of the Partner States already limit the carry forward of losses,[106] the similar provision in the most recent recommendations to the CCCTB Proposal would work well within the East African Federation.

The purpose of applying an apportionment-like formula in the East African Federation would be to allow the corporate income tax collected at the Federal Government level to be redistributed to the Constituent States (which the EAC Partner States will become once the Federation is formed) according to the operations conducted there by the group company members. Redistribution on such terms would foster more efficiency amongst the Constituent States because apportionment would incentivize Constituent States to find non-tax related reasons to encourage companies to operate within their province. Having said that, an apportionment based only on the location of group company operations may result in the lesser developed Constituent States being in a worse off position than their more developed Constituent States, as companies would be more inclined to operate from the more developed Constituent State.

To avoid the least developed Constituent States from losing out on an allocation of the corporate income tax, it is proposed that the East African Federation supplement the apportionment formula with a macro-economic element that is tied to the GDP of the Member States, as suggested by

105. DAK Mbogoro, "The East African Community: An Economic Analysis of the Integration Scheme" (1978) 8:1/2 African Rev 55 at 61.
106. *Law Regarding Income Taxes* (Burundi), 2013, art 75; *Income Tax Act, 1973* (Kenya), 1973, s 15(4); *Law Establishing Taxes on Income* (Rwanda), 2018, art 32; *The Taxation Act (South Sudan), 2009*, s 78(2).

Kellerman and others.[107] A macro-economic element would address the need to ensure regional development through redistributing resources to the Constituent States who need it most. In practical terms, this means that a portion of the tax base calculated by an application of the CCCTB rules would be retained and then redistributed to all Constituent States, irrespective of whether such Constituent State has any tie to the companies involved. The amount each Constituent State is to receive from such distributed tax base would depend on the Constituent State's GDP.[108] Constituent States with the lowest GDP would receive a greater proportion of the retained and redistributed tax base.[109]

In an East African Federation context, this would mean that each of the Constituent States of the East African Federation would always receive a portion of the tax base collected through a system similar to the CCCTB. For example, where a group has located its factors in the Constituent States formerly known as Kenya and Uganda, the majority of the CCCTB tax base would be allocated to the Constituent States formerly known as Kenya and Uganda because they are the Constituent States housing the apportionment factors—let's say an allocation of seventy per cent. The other thirty per cent of the tax base would accordingly be divided amongst all the Constituent States, with the lowest GDP-generating Constituent State receiving the largest portion of the redistributed thirty per cent tax base. Such redistribution would allow the less developed Constituent States, such as the Constituent States formerly known as South Sudan and Burundi, the opportunity and the means to catch up with the more developed Constituent States in the East African Federation.

In terms of the above discussion, it is envisaged that the total corporate income tax collected at the Federal Government level would be redistributed to the Constituent States. This is based on the understanding that the Federal Government would be funded by other taxes, such as personal income taxes, value-added tax and/or property taxes.

The East African Federation would not be hindered by some of the political sensitivities that surround the Member States. Therefore, it would be possible for it to implement a regime similar to the CCCTB in one phase and also to have the regime apply to all companies and permanent establishments within the East African Federation. Moreover, it is recommended that the East African Federation emulate the checks to

---

107. Christian Kellerman, Thomas Rixen & Susanne Uhl, "Europeanizing Corporate Taxation to Regain National Tax Policy Autonomy" (2007) at 3, online (pdf): *International Policy Analysis* <http://library.fes.de/pdf-files/id/04760.pdf > [perma.cc/3XA6-6ABS]
108. *Ibid*.
109. *Ibid*.

be built into the CCCTB regime, as proposed in the recommendations, to ensure that the CCCTB regime achieves the objectives it is intended to bring about.

It is questionable whether the East African Federation should consider implementing the data factor and the concept of a digital permanent establishment. Such implementation would certainly place the Federation at the vanguard of navigating the digital economy and all its implications for the effective taxation of corporate profits. However, the author has some concern that including this digital component would complicate the implementation of a CCCTB regime to the extent that more resources would be devoted to the complexities of a CCCTB at the expense of implementing the simpler aspects well. The author therefore suggests that the East African Federation initially implement the three-factor formulary apportionment, with the digital components to be introduced later after it has settled into implementing and administering a CCCTB system.

In making this suggestion, the author is aware of the growing importance of the service industry within the East African region and of the forecast that the service industry will constitute 51.3 per cent of the EAC's GDP by 2050.[110] The figures suggest that the East African Federation must therefore account for intangibles at some point. The author is of the view that notwithstanding the projected importance of intangibles to the East African Federation, it would have much more to gain from a prudent, staggered approach to a CCCTB regime implementation than an "everything-at-once" approach, for which the East African Federation may not yet have the institutional capacity to support.

The East African Federation should seriously consider implementing a regime similar to the CCCTB proposed in the EU. This implementation would allow the East African Federation to replace the varied corporate tax bases across the Partner States with a system that has some synergies with the existing corporate income tax bases of the Partner States, while allowing it to make some difficult decisions in reforming the corporate income tax regime in the Federation. It is encouraged that difficult decisions be made, such as substantially narrowing the number of capital and depreciation allowances on offer in the Partner States and implementing one corporate income tax rate. Overall, the CCCTB regime, even in its proposed form, holds a great deal of promise for the East African Federation.

110. East African Community, "East African Community Vision 2050: Regional Vision for Socio-Economic Transformation and Development" (2015), online (pdf): *EAC Information Repository* <repository.eac.int/handle/11671/567> [http://hdl.handle.net11671/567].

b. *Attract foreign direct investment*

Tax incentives

Tax incentives are commonly used in developing countries. The principal aim of these incentives is to attract foreign direct investment. However, there is great debate (and uncertainty) about whether tax incentives in fact serve to increase foreign direct investment and thereby increase economic growth.[111]

Despite the doubt in the true efficacy of tax incentives, tax incentives feature strongly in the tax policies of the EAC Partner States. Kenya offers corporate income tax holidays under both its *Special Economic Zones Act* (SEZ Act)[112] and its *Export Processing Zones Act* (EPZ Act).[113] Uganda offers exporters an exemption from income tax for a period of ten years if certain conditions are met, including that the exporter export at least eighty per cent of the completed goods.[114] Rwanda offers a corporate income tax holiday in its headquarter company regime.[115]

Recommendations

In light of the doubts as to whether tax incentives actually do bring in greater foreign direct investment, it is recommended that the East African Federation carefully consider whether to make use of tax incentives. In making this decision, it would be useful to evaluate whether the tax incentives used in the EAC Partner States were effective in meeting the objective of attracting foreign direct investment. This evaluation should weigh the incoming foreign direct investment against the cost of corporate income tax not collected from the qualifying taxpayers.

In the event that such evaluation produces the decision that tax incentives should be used in the East African Federation, it is recommended that the East African Federation consider making use of tax

111. Marios B Obwona, "Determinants of FDI and Their Impact on Economic Growth in Uganda" (2001) 13:1 African Development Rev 46 at 59; Rachel L Wellhausen, "Innovation in Tow: R&D FDI and Investment Incentives" (2013) 15:4 Bus & Politics 467; Franklin R Root & Ahmed A Ahmed, "The Influence of Policy Instruments on Manufacturing Direct Foreign Investment in Developing Countries" (1978) 9:3 J Intl Bus Studies 81; Alexander Klemm & Stefan Van Parys, *Empirical Evidence on the Effects of Tax Incentiv*es (2009) (IMF, 2009); Eric M Zolt, "Tax Incentives: Protecting the Tax Base" in Alexander Trepelkov, Harry Tonino & Dominika Halka, *United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries,* 2nd ed (United Nations, 2015) 451 at 452.

112. *Special Economic Zones Act* (Kenya), No 16 of 2015.

113. *Export Processing Zones Act* (Kenya), c 517.

114. *Income Tax Act* (Uganda), 1997, s 21(1)(y).

115. *Law Nº 006/2021 Of 05/02/2021 on Investment Promotion and Facilitation* (Rwanda), Annex item I.

credit accounts[116] rather than the traditional tax holiday model. According to Tanzi and Zee, tax credit accounts grant each qualifying investor a set amount of tax relief, such as US$250 000 for example, against which such investor's actual tax liability would be set off.[117] For instance, in year one, after the investor files a tax return and its tax liability in that year amounts to US$50 000, the investor's tax credit account would be reduced to US$200 000 for the subsequent years.[118] This method allows for greater certainty for the taxpayer and the revenue service while also allowing for the tax incentive to be managed in an open and transparent manner.[119] Moreover, this method would allow the East African Federation to have a better sense of the exact cost of the corporate tax revenues it is losing to attract foreign direct investment.

Uganda has been monitoring some of its tax incentives on a basis similar to the tax credit account. In terms of section 166(2) of the *Income Tax Act* in Uganda, companies benefitting from tax holiday periods are nonetheless required to submit their tax computations as though they were not exempt from tax.[120] The East African Federation would therefore be able to draw from the Ugandan experience in administering a tax credit account-like system.

It is also recommended that the East African Federation focus on creating non-tax reasons for investors to invest in the region. One of these non-tax reasons should include creating a favourable investment environment for investors, as it has been noted that such an environment is directly related to ensuring the efficacy of any tax incentives offered.[121] Moreover, the budget of the East African Federation should focus on building infrastructure while the executive should focus on relaxing the bureaucracy around conducting business in the region. A further means of attracting foreign investment is through making the capital market more open and allowing for a greater mobility of capital.[122] Through a careful and targeted devotion of resources, the Federation could easily create an attractive destination for foreign investment—all without surrendering its tax base.

116. See Vito Tanzi & Howell H Zee, *Tax Policy for Emerging Markets: Developing Countries* (IMF, 2000).
117. *Ibid*.
118. *Ibid*.
119. *Ibid*; Zolt, *supra* note 111 at 474.
120. *Income Tax Act* (Uganda), 1997, s 166(2).
121. *Ibid* at 456.
122. Paul L Baker, "An Analysis of the Corporate Income Tax Policy of Less Developed Countries" (2018) 120:2 Scandinavian J Economics 400 at 414.

c. *Corporate income tax and the informal sector*

The size of the informal sector or shadow economy is particularly problematic. A large informal sector has the effect of substantially narrowing the tax base to a small group of formal taxpayers.[123] This, in turn, results in low income tax rates as the government fears that higher rates would force more taxpayers into the informal sector and out of the government's range.[124] A study conducted by Waseem indicates that informality remains one of the biggest barriers to emerging economies developing better fiscal capacity.[125] According to Buehn et al, these large informal sectors in developing countries are the product of high tax burdens.[126]

Mitra argues that there are two ways to reduce the size of a large informal sector: improve tax enforcement and increase the formal sector's access to credit.[127] Once the enforcement and administrative capacity of revenue authorities are significantly improved, Mitra argues that this corresponds to a significantly increased risk of errant taxpayers being caught and penalized.[128] Similarly, greater access to quality sources of finance for the formal sector acts as an incentive for businesses to migrate from the informal to the formal sector.[129] Mitra's study also produces the interesting result that once these factors are present in the economy, the link between the raising of taxes and the rise of the informal sector is broken.[130] These two factors therefore enable government to actually raise taxes without a consequent increase in the size of the informal sector.[131]

Recommendations

In the light of the above discussion, the East African Federation would be well advised to devote resources towards the significant improvement of the administrative and enforcement capacity of its revenue authority. The East African Federation should also work towards improving the quality and capacity of the credit market and credit institutions. This could be done through making more government funding available for credit institutions and devoting more resources into developing the micro-lending market

123. Mazhar Waseem, "Taxes, Informality and Income-Shifting: Evidence from a Recent Pakistani Tax" (2018) 157 J Public Economics 41.
124. *Ibid*.
125. *Ibid* at 57.
126. Buehn, Dell'Anno & Schneider, *supra* note 61 at 1627.
127. Shalini Mitra, "To Tax or Not to Tax? When Does It Matter for Informality?" (2017) 64 Economic Modelling 117.
128. *Ibid* at 118.
129. *Ibid*.
130. *Ibid*.
131. *Ibid*.

and suppliers within the East African region. In doing so, however, the East African Federation should not forget to also increase the regulation around the provision of credit so as to protect vulnerable debtors from unscrupulous debt-collection mechanisms. Should it devote the necessary resources in this targeted way, there is great potential for the Federation to substantially increase its corporate income tax collections.

3. *Administrative Capacity Issues*

It is envisaged that administrative capacity within the East African region should improve once the formation of the Federation pools the government personnel. It is possible that some staff from one Partner State may be more expert in one area while others may be more expert in another. It would therefore be possible for internal training measures to be adopted to bring all government officials to a certain minimum level of expertise. Beyond that level, perhaps the East African Federation should consider bringing in experts to train staff. The OECD is also making "toolkits" available that may assist the East African Federation in developing its expertise in the relevant fields.

Moreover, it is suggested that a central database of taxpayers be formed so that each Constituent State authority may have easy access to all relevant information pertaining to a taxpayer operating within its province. This database may include details of the taxpayer, including incorporation details, details of shareholders or owners and perhaps stakeholders, location of operations, history of filed tax returns, history of audits conducted and the outcomes thereof, and financial records of the taxpayer if available. This central database may also be used to coordinate audits across local government authorities regarding a taxpayer operating in more than one region.

The formation of such a database would be facilitated by the East African Federation implementing the OECD's BEPS Action 13, which requires Country-by-Country Reports to be filed by multinational enterprises operating across several jurisdictions.[132] Moreover, the Federation should consider signing treaties that would facilitate cooperation amongst revenue authorities to access taxpayer information. Such treaties include Tax Exchange Information Agreements, DTAs, which include automatic exchange of information provisions, and the Multilateral Convention on Mutual Administrative Assistance in Tax Matters,[133] of which Kenya and Uganda are signatories.

132. OECD, *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, (Paris: OECD, 2015).
133. OECD and Council of Europe, *The Multilateral Convention on Mutual Administrative Assistance*

In a similar fashion, the East African Federation should consider developing a protocol for the collection of taxes owed. This protocol should clearly set out the progression of tax collection methods to ensure that all taxpayers in the East African region are afforded the same treatment. Such progression may include notices of taxes due, the imposition of penalties and interest, the point at which judgment should be sought against a recalcitrant taxpayer, when garnishee orders should be sought, and when third parties (such as banks) may be enlisted to seize funds directly from taxpayer accounts. It is also suggested that such protocols be made publicly available so that taxpayers are aware of the collection mechanisms available to the East African Federation's tax authority.

It is further suggested that the East African Federation pass legislation specifically addressing the tax administration measures to be implemented within the region. This legislation should bear in mind that an appropriate balance should be sought between the rights of the taxpayer and that of the East African Federation's revenue authority.

The process of building administrative capacity cannot be completed overnight, and the creation of a strong administrative network should remain a longstanding item on the agenda of the East African Federation.

Conclusion

For an African developing country to achieve its SDGs, it is vital that it mobilize domestic financial resources to finance the expenditure required to make the SDGs a reality. This paper argues that for the proposed East African Federation, corporate income tax may be a significant tool for acquiring such financial resources.

This paper further argues that the corporate income tax system may significantly increase the financial resources of the EAC Partner States in three ways: (i) broadening the corporate income tax base according to the rules proposed in the EU's CCTB/CCCTB proposal; (ii) effectively using tax incentives by identifying concrete objectives to be achieved and monitoring the revenues lost by implementing such incentives; and (iii) taking measures to reduce the large informal sector in the region through increasing access to finance for formal businesses and developing an effective tax administrative authority.

Although premised on a fictional supranational organization, this paper has present-day value. It proposes how an African regional integration project may offer possible solutions to the rest of the world on how to successfully integrate several corporate income tax bases into one

in Tax Matters: Amended by the 2010 Protocol (Paris: OECD, 2011).

coherent and functioning tax base, while properly balancing policy with the real-world factors that influence its implementation.