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TAX EVOLUTION:

South Africa's Role in Shaping the Global Landscape

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TAX EVOLUTION:

South Africa's role in shaping the global landscape

AMIT CHADHA, Director and Africa leader for Global Transfer Pricing, KPMG Services (Pty) Ltd
and **ROY NAUDÉ,** Director and Africa leader for International Tax, KPMG Services (Pty) Ltd

South Africa, a nation marked by profound socioeconomic disparities, yet boasting a relatively sophisticated tax system, stands at unique crossroads within the global tax arena.

Its journey, characterised by both challenges and triumphs, provides invaluable insights and contributes significantly to the ongoing evolution of international tax policy and practice. This article delves into South Africa's influential role in shaping this global landscape, highlighting key areas of impact.

The South African tax system is tasked with the formidable challenge of generating adequate revenue to support essential social programmes while simultaneously fostering economic growth amid high levels of inequality. This necessitates a delicate balancing act between implementing progressive taxation and attracting foreign investment. The country's adept navigation of this complexity serves as a compelling case study for other developing nations striving to achieve similar objectives. The ongoing discourse surrounding tax incentives for specific sectors continues. Considering that the ongoing reforms in logistics, energy, and infrastructure are expected to bolster growth and investment, supported by structural improvements in energy supply, the question should be raised whether South Africa is doing enough with the existing available tax incentives. In addition, the efficacy of tax amnesties (voluntary disclosure program) and the hurdles of tax collection within an informal economy are areas where South Africa's experiences offer profound insights.

It is equally important for South Africa to keep an eye on the global environment that remains mixed. Globally, certain challenges have caused heightened uncertainty such as geopolitical tensions (including ongoing conflicts in Ukraine and the Middle East), a slow recovery in China's property market, and the change of administration in the USA.

In addition, following the seventh democratic election in South Africa's history, a new political dispensation has commenced in the formation of a Government of National Unity (GNU). The GNU is intended to provide the necessary stability and political certainty to allow the South African government to tackle the economic and social challenges that South Africa faces. Such challenges and differences were displayed during the recent budget proposal on 12 March 2025, where a VAT increase of 0,5% was announced. This increase was subsequently set aside, following extensive consultations with political parties and careful consideration of the recommendations of the parliamentary committees. Robust and healthy debate among various stakeholders steered the matter to a favourable outcome for all South Africans. A win for democracy and how developing economies are able to address their own domestic differences. The ongoing debate has led to a new and amended budget, which is expected to be presented on 21 May 2025.

As an active participant in the Organisation for Economic Co-operation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) project, South Africa demonstrates a steadfast commitment to combating multinational tax avoidance and ensuring a more equitable distribution of tax revenue. The implementation of BEPS measures in South Africa, including the adoption of country-by-country reporting, the fortification of transfer pricing rules, the introduction of additional interest limitation rules, and the adoption of BEPS Pillar 2 global minimum tax rules, provides a practical blueprint for how developing countries can adapt and implement international tax standards. The challenges encountered in enforcing these measures and the lessons gleaned from this process are pivotal to advancing the global BEPS agenda.

Moreover, the digital economy poses an arduous challenge to traditional tax systems worldwide. South Africa, akin to many other nations, grapples with the complexities of effectively taxing the profits of multinational digital enterprises. Its active participation in international discussions on digital taxation, including exploring potential solutions such as a global minimum corporate tax rate or a digital services tax, enriches the ongoing global debate on this critical issue. South Africa's experience in navigating the intricacies of taxing the digital economy will be closely observed by other developing nations confronting similar challenges.

South Africa's unwavering commitment to tax transparency and capacity building is instrumental in shaping the global landscape. Its involvement in initiatives promoting international cooperation on tax matters, including the exchange of tax information and the provision of technical assistance to other developing countries, fortifies the global fight against tax evasion and illicit financial flows. The country's experience in enhancing its own tax administration capacity serves as a model for other nations seeking to refine their tax systems.

- Despite its contributions, South Africa continues to face persistent challenges in its tax system. These include addressing tax evasion, improving tax compliance, and ensuring the equitable distribution of tax revenue. The country's future role in influencing the global tax landscape will hinge on its ability to surmount these challenges and maintain active participation in international tax policy discussions. This includes advocating for global governance systems to be more inclusive and reflective of the needs of developing countries and ensuring that international tax rules are both fair and effective. One has to agree that the stage is set for South Africa to capitalise on these objectives through its G20 Presidency in 2025 to champion an Africa-focused global agenda, emphasising the continent's priorities in global discussions and ensuring that African perspectives are represented in shaping international policies. Aptly, the theme for South Africa's G20 Presidency is Solidarity, Equality, Sustainability.

Another priority during the G20 will be to attract foreign investment into South Africa and the broader region by showcasing the continent's vast economic potential and positioning it as a critical player in the global economy. This will involve highlighting investment opportunities in infrastructure, energy, digital technology, and manufacturing, all aimed at fostering sustainable growth. Being able to convince foreign investors of certainty around government spending and tax policy is of the utmost importance.

In conclusion, South Africa's journey in tax evolution is a complex and dynamic narrative. Its experiences, encompassing both successes and challenges, offer valuable lessons to the global community. By actively engaging in international tax initiatives and sharing its knowledge and expertise, South Africa continues to play a pivotal role in shaping the future of global tax policy and practice.

"South Africa's unwavering commitment to tax transparency and capacity building is instrumental in shaping the global landscape"

15minutes CPD

THE G20'S TAX REFORM AGENDA:

Where does South Africa stand?

▶ **KARL MULLER,** Chartered Tax Advisor (SA)

The G20 was founded in 1999 as an informal forum for the Finance Ministers and Central Bank governors of the most important industrialised and developing economies to discuss international economic and financial stability. It comprises 19 countries and two regional bodies; one of the regional bodies is the African Union (AU).

There is no permanent secretariat or staff; the G20 Presidency rotates annually among the members.[i] South Africa assumed the Presidency of the G20 on 1 December 2024 under the theme Solidarity, Equality and Sustainability.[ii]

This article focuses on the Financial track and, more specifically, on the aspects of international taxation for which there is no formal working group, but the respective member countries and regions' finance ministers and central banks discuss tax challenges which exist globally to increase efficiency and reduce inequality.[iii] South Africa can play a leading role in this regard, as the tax issues straddle all the themes under its Presidency.

Initial steps taken

The OECD plays a key role in influencing the tax landscape. South Africa has requested the OECD to prepare a scoping report on taxation and inequality.[iv] This report is still in progress, but in the OECD's report to the G20 Finance Ministers and Central Bank Governors, it has highlighted not only support for the G20 initiatives and the Inclusive Framework, but also commitment to give regular feedback on the G20 priorities such as tax transparency, addressing base erosion and profit shifting, and the Pillar 2 solution.[v] This report was delivered to the G20 for its meeting in Cape Town in February of this year.

While clearly having to focus on the domestic agenda for tax reform, South Africa has a key role to play in international cooperation on tax issues and, specifically, in leading tax reform in Africa as a member of the AU. In addition, as one of the 141 members of the OECD/G20 Inclusive Framework, it has a voice in developing international standards to counteract tax avoidance. South Africa has been very active in the sphere of combating illicit flows.[vi]

Role players in South Africa

The main role players are the National Treasury, Reserve Bank, Ministry of Finance, African Tax Administration Forum, South African Revenue Services, academia, and civil society.

While each may have specific focus areas, cooperation among all the parties will be required to achieve optimal outcomes.

Actions already taken

It is not possible to list everything that has been done, as there is a vast amount of data that the different role players have delivered; consequently, this article will only list a few of the significant items

The 2023/2024 annual report of SARS makes for interesting reading.[vii] It mentions that SARS has leadership roles in a number of strategic workgroups and organisations such as the:

- World Customs Organisation (WCO) (executive leadership role);
- OECD Forum on Tax Administration;
- OECD Global Forum on Transparency and Exchange of Information for Tax Purposes. Edward Kieswetter is the Vice Chair of the African Initiative established by the Global Forum; and
- Crypto-Asset Reporting Framework (CARF) (South Africa is Co-Chair with the UK).

This clearly shows that South Africa, through SARS, plays an active role in the international arena. The roles played in the OECD Global Forum on transparency and exchange of information and the CARF highlight the importance of Tax Transparency.

Annexure 4 of the report shows outlays made in connection with Tax Inspectors without Borders (TIWB), as well as capacity-building workshops and benchmarking, offering expert assistance to African Revenue authorities under the TIWB programme, to name but a few. Clearly, significant attention is placed on capacity building, enhancing compliance, and combating tax leakage. All of these also have an impact on the theme of equality.

ATAF has also been very active; the Pillar 2 solution drafted by the OECD was significantly influenced by the work done by ATAF. In addition, regarding tax treaties, ATAF has developed its own Model Tax Agreement, which provides valuable guidance to its membership.[viii] This model is currently being revised.

Significant proposals that will impact South Africa

The OECD tax report highlights priority areas, including Pillar 1 and 2, Harmful Tax Practices, Tax Treaty Abuse, Country by Country Reporting, Mutual Agreement procedures, Transfer Pricing, Tax and Inequality, Tax Certainty, Digital Transformation, Tax Policy, and Tax and Development.[ix] South Africa has adopted Pillar 2 rules and this reform will need bedding down. The OECD Inclusive Framework will be critical in assisting all developing countries, including South Africa, to provide technical support at the country level.

Tax transparency will continue to be a significant part of the Tax reform, specifically the Exchange of Information. SARS indicated in their report that they had received 597 Country-by-Country Report (CbCR) packages, consisting of 109 700 CbCRs from Multinational Entities in 52 partner jurisdictions and sent 214 CbCR packages to 62 partner jurisdictions.[x] They also listed that they had received and sent a number of other exchange of information reports. In the latest peer report in 2022, SARS was given a largely compliant rating as the OECD required more work on the availability of ownership and identity information relating mainly to trusts, accounting and banking information, and the quality and timeliness of EOI requests.[xi] Given the increased focus in the past two years in these areas, one can see that there is a drive to reach a fully compliant status. This will, however, continue to be a focus area in the short term, which would include assistance to other developing countries.

In the 2024 report on Tax Transparency in Africa, the effectiveness of EOI is reaping benefits—the value of taxes identified or recovered in 2023 amounts to €2,2billion. The cumulative total for 2014 to 2022 amounted to only €0,3billion.[xii]

Digital transformation is another key aspect. SARS is developing data-driven capabilities and resources to detect non-compliance. They have developed machine learning models and risk engines that can analyse both structured and unstructured data to assist in detection and investigations.[xiii] This, coupled with an increased focus on using third-party data to gather information, will remain a key focus.

Another area of focus is revisiting the Tax Treaty Network and renegotiating tax treaties. While South Africa has 73 Double Tax Agreements in place and is growing, there is more work to be done here.

As global tax reforms gain momentum, it is critical that strong Mutual Agreement Procedures (MAP) are in place. According to the OECD Mutual Agreement procedures statistics, South Africa had 34 open MAP cases; 14 were opened in 2023, while 20 were closed. These cases take between 17 and 21 months to complete.[xiv] As tax reforms increase, one could expect MAP cases to increase; therefore, this should also be a key focus area.

Conclusion

This article has focused on a few initiatives only; it is certain that South Africa will be active in all focus areas. However, my view in the short term is that these are the areas of most significance. One should consider keeping a close eye on future reports to the G20 on tax issues.

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[v] OECD Secretary-General tax Report to G20 Finance Ministers and Central Bank Governors G20 South Africa, February 2025 p4
[vi] Illicit Financial Flows Report ; African Union July 2021.
[vii] SARS-AR-29 – Annual Report – 2023-2024
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[ix] OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors G20 South Africa, February 2025
[x] SARS-AR-29 – Annual Report – 2023-2024,p48
[xi] OECD (2022), Global Forum on Transparency and Exchange of Information for Tax Purposes: South Africa 2022 (Second Round, Combined Review): Peer Review Report on the Exchange of Information on Request, Global Forum on Transparency and Exchange of Information for Tax Purposes, OECD Publishing, Paris, https://doi.org/10.1787/0cb5c667-en.
[xii] Tax Transparency in Africa 2024 Africa Initiative Progress Report, OECD 2024 p22 Figure 1
[xiii] SARS-AR-29 – Annual Report – 2023-2024,p41
[xiv] Mutual Agreement Procedure Statistics per jurisdiction - South Africa pdf p2

30minutes
CPD

ACT 46 OF 2024 AND INTERNATIONAL CORPORATE TAX POLICY:

A digital economy dilemma for South Africa

DR LIEZEL TREDOUX, Associate Professor & Head of Tax Law, University of South Africa

The emergence of the global and digital economy enables multinational enterprises (MNEs) to generate significant worldwide income in innovative manners that transcend the traditional boundaries of most national tax systems which are traditionally based on territoriality inherent to principles such as residence, source, domicile, nationality and citizenship (Oguttu *International Tax Law: Offshore Tax Avoidance in South Africa* (Juta 2015) 67, 517–518; Stiglingh et al *Silke: South African Income Tax 2025* (LexisNexis 2025) 873; Papadopoulus and Snail ka Mtuze *Cyberlaw@SA; The Law of the Internet in South Africa* (Van Schaik 2022) 143).

Inevitably, the inability to track and tax specific transactions online, the emergence of 'stateless income' and harmful tax practices and/or competition can lead to an increase in BEPS as well as harmful tax competition (Oguttu "Preventing International Tax Competition and the Race to the Bottom: A Critique of the OECD Pillar Two Model Rules for Taxing the Digital Economy – A Developing Country Perspective" International Bureau of Fiscal Documentation (2022) 1; Oguttu (2015) 517-542; Harpaz "Taxation of the Digital Economy: Adapting a Twentieth-Century Tax System to a Twenty-First-Century Economy" Yale Journal of International Law 46 (2021) 58; Olbert and Spengel "International Taxation in the Digital Economy: Challenge Accepted?" World Tax Journal (2017) 3–4; Eliffe "The Brave (and Uncertain) New World of International Taxation under the 2020s Compromise" World Tax Journal 14:2 (2022) 2). A fundamental change of the foundational principles in domestic law, coupled with amended regional and international instruments is required to address both globalisation and digitalisation. This change also requires enhanced international tax co-operation and political consensus (Eliffe 3–4).

South Africa took a leading step on the African continent by promulgating the Global Minimum Tax Act 46 of 2024 on 24 December 2024 (with retroactive effect from 1 January 2024), as the first African state to implement global minimum tax (GMT). This brief overview analyses whether this choice aligns with selected recent international and regional policy trends in the quest to develop new measures to tax corporate income earned in the digital economy.

International initiatives to address BEPS in the digital economy

The OECD assumed a dominant role in the quest to address harmful tax competition and BEPS arising from the global and digital economy leading to several initiatives over many decades, the most recent

being the OECD/G20 Inclusive Framework on BEPS (OECD IF) (OECD (2021), *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two):Inclusive Framework on BEPS*, OECD Publishing, Paris, https://doi.org/10.1787/782bac33-en (2025-05-20)(GloBE Model Rules) 3). The GloBE Model Rules were signed by over 135 OECD IF member states that represent more than 95% per cent of global GDP, on 8 October 2021 (The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS), *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*, 8 Oct. 2021 (OECD 2021), 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 (2025-05-20) 1; GloBE Model Rules 3). The GloBE Model Rules apply to 'in scope' Constituent Entities as members of an MNE group if the ultimate parent entity (UPE) has an annual global turnover of EUR 750 million or more in its consolidated financial statements in two of the last four years (Article 1.1.1 of the GloBE Model Rules). If an MNE is 'in scope' a subject to tax rule (STTR) as well as the Income Inclusion Rule (IIR) and Undertaxed Payment Rule (UTPR) determines whether a top-up tax must be paid in the state where the income arises (Article 2 of the GloBE Model Rules; OECD (2025), Tax Challenges Arising from the Digitalisation of the Economy – Consolidated Commentary to the Global Anti-Base Erosion Model Rules (2025): Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/a551b351-en. 9). This top-up tax is referred to as global minimum tax (GMT), which is payable at a rate of 15% in respect of each jurisdiction where the MNE earns income and is calculated in terms of Article 5 of the GloBE Model Rules (Stiglingh et al at 951).

The GloBE Model Rules mark a significant change to fundamental tax principles. Its acceptance is sometimes portrayed as ostensible political acceptance of multilateralism and a willingness of states to waive a portion of their 'original' taxing rights (based on traditional nexus rules) in favour of the market jurisdiction (GloBE Model Rules at 3; Oguttu (2022) 4; Eliffe 1–29). It is criticised as limited in its response to digitisation as it primarily targets harmful tax competition by a small group of entities and a limited portion of their profit (Brauner "Agreement? What Agreement? The 8 October 2021, OECD Statement in Perspective" *Intertax* 50:2 (2022) 3). An overwhelming body of scholars argue that developing countries view the decision-making processes at the OECD as undemocratic, exclusive and misaligned to their socio-economic context, capacity constraints and policy interests (among others, see for example, Legwaila "Global Minimum Corporate Tax- Developing Countries Beware" *Obiter* 45:4 (2024) 964–978; Brauner (2022) 3–5; Titus "The Role of the United Nations in Ensuring Equitable Tax Policies for Developing Countries" *Journal of International Economic Law* 27 (2025) 624–631). As a result, it is not surprising to note that most developing countries are resistant and reluctant to implement GMT.

The UN's sustainable development agenda and inclusive approach is better aligned to the interests of developing nations (See for example the 2030 Agenda for Sustainable Development and other projects available at United Nations "Our Work"https://www.un.org/en/our-work/support-sustainable-development-and-climate-action (2025-05-20)). The UN, therefore, received considerable support from the African Group and Global South Countries who played an active role in driving the process to create an alternative approach. On 22 December 2023 the UN General Assembly, through its adoption of Resolution 78/230, established an *ad hoc* committee to draft a new UN Framework convention on international tax cooperation in which it recognises several challenges faced by developing nations such as illicit financial flows, inclusiveness, cooperation, capacity constraints, financing gaps (UN General Assembly "Resolution adopted by the General Assembly on 22 December 2023 – 78/230- Promotion of Inclusive and Effective International Tax Cooperation at the United Nations https://docs.un.org/en/A/RES/78/230 (2025-05-21); Parada "UN International Tax Cooperation: The Terms of References Final Draft" *Tax Notes International* 116 (2024) 773). The UN Terms of Reference (TOR) include the taxation of the digitalised economy as one of the first priorities (Parada 776). The existing Article 12B of the UN Model Double Tax Convention between Developed and Developing Countries (2021)(UN MTC) provides for the taxation of income from automated digital services but it is not contained in many tax treaties nor incorporated in the national legislation of all UN member states, rendering its application limited, which necessitates the need for a new multilateral solution.

Developed nations are also not all in favour of the GloBE Model Rules anymore. On 21 January 2025 the proverbial 'Trump card' was played when the USA withdrew from the 'Global Tax Deals' and expressly re-asserted its state sovereignty and reliance on bilateral tax treaties (Lawder "Trump effectively pulls US out of global corporate tax deal" 21 January 2025 Reuters https://www.reuters.com/world/us/trump-declares-oecd-tax-deal-has-no-force-or-effect-us-2025-01-21/ (2025-05-20)). Despite the USA withdrawal of both its support for the OECD IF and UN, negotiations at the UN to create a new tax convention commenced in 2025 and still continue (UN "Advancing fair and inclusive tax cooperation for sustainable development" https://www.un.org/en/desa/advancing-fair-and-inclusive-tax-cooperation-sustainable-development(2025-05-20)).

Similarly, many states continue to implement the Globe Module Rules in their national legislation as is evident in the OECD's Central Record of Legislation with Transitional Qualified Status for purposes of the Global Minimum Tax as approved on 13 January 2025, which includes 28 states, but

does not include any African countries nor South Africa, with the only developing nations listed being Barbados, Vietnam, Turkey, and Romania (OECD (2025), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules – Central Record*, OECD/G20 Inclusive Framework on BEPS, OECD, Paris, https://www.oecd.org/content/dam/oecd/en/topics/policy-sub-issues/global-minimum-tax/administrative-guidance-globe-rules-pillar-two-central-record-legislation-transitional-qualified-status.pdf. at 1–10).

In the EU, the GloBE Model Rules were adopted by the EC through the EU Minimum Tax Directive (Council Directive (EU) 2022/2523 dated 14 December 2022). Several EU states (amongst others, France, Belgium, Austria, Greece, Italy, and Spain) transposed it into its national tax codes. However, there is some opposition to it as German industry called for the delay and/or suspension of GMT in the EU (citing that it would be costly to comply and harm the competitiveness of the German economy given the crisis after USA withdrawal), while Hungary has opposed it at EU level (PwC's Pillar Two Country Tracker Online https://www.pwc.com/gx/en/services/tax/pillar-two-readiness/country-tracker.html (2025-05-20); Reuters "German industry calls for delay to global minimum tax – BDI" https://www.euronews.com/next/2022/11/07/g20-tax-germany (2025-05-20)).

An African regional response to taxing the digital economy

In the African context, ATAF has assumed a leading role to facilitate regional tax cooperation since 2009 though many initiatives aimed at enhanced regional cooperation and modernisation of African tax regimes to effectively tax the digitalised economy and improve capacity (See ATAF "Digitalisation" at https://events.ataftax.org/index.php?page=documents&folder=107 (2025-05-20)) This includes, inter alia, the current review of its Model Tax Convention (ATAF Communication "ATAF's Model Tax Agreement Under review" 29 April 2025 https://www.ataftax.org/atafs-model-tax-agreement-under-review (2025-05-20)). Notable research in response to the GloBE Model rules prior to the withdrawal of the USA from the OECD GloBE agreements and UN negotiations, include a 2024 study commissioned by WATAF, ATAF and the South Centre which empirically analysed the revenue effect of many alternative options for law reform, such as VAT/GST, digital services tax, digital PEs, withholding taxes and the incorporation of the UN Model Tax Convention's Article 12B in tax treaties.

Although the research mainly related to Amount A of Pillar One and Digital Services Tax the research also analysed how many states would have 'in scope' MNE's applying a EUR 750 million threshold, aligning it with the GloBE Model Rules' threshold. Member states were advised to wait and see whether the USA Congress accepts the GloBE Model Rules before embarking on African law reform. This study (the first of its kind which measured the digital footprint of MNEs in over 85 developing states) also concluded that a wide definition of digital services coupled with a low or moderate tax rate will encourage voluntary compliance, lead to a higher amount of revenue collection in the destination state, and lower enforcement costs, which would benefit developing countries (Vladimir Starkov and Alexis Jin "A Toss Up? Comparing Tax Revenues from the Amount A and Digital Service Tax Regimes for Developing Countries" Research Paper 199 The South Centre, African Tax Administration Forum & West African Tax Administration Forum dated 10 June 2024 at 1–30). This aligns with the budgetary principle which seems to have become more dominant recently as states aim to maximise their collection of tax revenue to meet spending needs.

The AU's African Model Agreement for the Elimination of Double Taxation with Respect to Taxes on Income and the Prevention of Tax Avoidance and Evasion (31/12/2019), the Treaty of the South African Development Community (12/9/200), the SADC Memorandum of Understanding on Cooperation in Taxation and Related Matters (8/08/2002) and the SADC Protocol on Finance and Investments (18/08/2006), all pre-date the GloBE Model Rules and do not contain articles regulating the taxation of the digital economy. All these instruments encourage general regional policy cooperation. Article 5 of the SADC Protocol (to which South Africa is a signatory) provides that "State Parties shall cooperate in tax matters and co-ordinate their tax regimes within the region as set out in Annex 3" making regional cooperation mandatory. In turn, Annex 3 defines e-commerce but has no specific provisions on how it should be taxed, while Articles 2–5 provide for the sharing of information, capacity building to create an enabling environment, indirect taxes, incentives and the development of a common policy for the negotiation of tax agreements with countries outside the region.

Titus convincingly advocates for a regional response to the taxation of the digitalised economy (Afton Titus "Global Minimum Corporate Tax: A Death Knell for African Country Tax Policies?" *Intertax* Vol 50 issue 5 (2022) 423) as well as the development of an African international tax governance structure in the AU (Afton Titus "From Africa to the world: pathways to Inclusivity and Political Justice at the UN" *Intertax* Vol 53 Issue 1 (2025) at 89). The recent creation of the African Continental Free Trade Area, and formal collaboration between ATAF and the AU Commission further support this stance (Titus "The role of the UN (2025) 629) as the quest for a uniquely African solution continues.

South Africa's national response

In contrast with the growing opposition of developing nations to OECD decision- making and the GloBE Model Rules, South Africa promulgated the Global Minimum Tax Act 46 of 2024 (GMT Act) on 24 December 2024 (with retroactive effect to 1 January 2024), which directly include the GloBE Model Rules in domestic legislation. (Preamble to the GMT Act). The Preamble of this Act further explains the purpose of the GloBE Model Rules as introducing "global minimum tax, designed to ensure large multinational enterprises pay a minimum level of tax on the income arising in each jurisdiction where they operate, as part of the solution for addressing the tax challenges of the digital economy". The charging section (s4) is directly based on the GloBE Model Rules and once an MNE is 'in scope' and subject to tax, it imposes a top-up tax liability on domestic constituent entities under the IIR and the Undertaxed Payment Rule (UTPR) with exceptions to these rules listed in section 5 (s5(a)–(b) of the GMT Act, excluding Articles 2.4 to 2.6 (UTPR charging provisions) and Article 9.3 (exclusion from the UTPR of MNE Groups in the initial phase of their international activity) of the GloBE

- Model Rules). Section 8 provides that the Calculation of Domestic Minimum Top-up Tax for constituent entities of an MNE group and a domestic joint venture group must be determined in the exact same manner as it is determined under the GloBE Model Rules, with exceptions (s9–19 contain specific exclusions from the methodology used in the GloBE Model Rules formulae and calculations).

The fact that South Africa embarked on unilateral reform despite being appointed as chair of ATAF on 4 December 2024, and being a signatory to the SADC protocol above, which requires regional cooperation, is surprising (SARS Media Release "South Africa elected as new chair of the African Tax Administration Forum (ATAF)" https://www.sars.gov.za/latest-news/media-release-south-africa-elected-as-new-chair-of-the-african-tax-administration-forum-ataf/ (2025-05-20). While at first glance it seems to contradict South Africa's earlier commitment to regional tax cooperation, the AU, SADC and ATAF Conventions do not yet mention the taxation of the digitalised economy as an objective. The Standing Committee on Finance reasoned that the purpose of implementing GMT is to align South Africa with the international standards created by the OECD IF, to ensure that MNEs pay their fair share of tax, to protect the South African tax base and prevent BEPS (Parliamentary Monitoring Group "ATC241125: Report of the Standing Committee on Finance on the Global Minimum Tax Bill [B20 - 2024] (National Assembly - section 77)", dated 20 November 2024 https://pmg.org.za/tabled-committee-report/6027/ (2025-05-20)). Thus, directly aligning it with the OECD perspective.

While not expressly stated by the Standing Committee on Finance, effective taxation does align with the South African government's policy goals to encourage the improvement and growth of the digital economy and revenue generated from this sector as part of its sustainable development strategy (For more on policies that encourage this growth, see National Planning Commission "National Development Plan 2030: Our Future – make it work" (2012) 189-196; Department of Communications Republic of South Africa "South Africa Connect: Creating Opportunities, Ensuring Inclusion-South Africa's Broadband Policy" GG 3 December 2013 no 37119; Department of Communications and Digital Technologies, "Presidential Commission on the Fourth Industrial Revolution: Summary Report and Recommendations" (2020) GG 23 October 2020 No 43834 (2020); The National Digital Skills and Futures Strategy GG 23 September 2020 No 43730 (2020) including the ICT and Digital Economy Masterplan for South Africa (2021), Department of Communications and Digital Technologies, "National Data and Cloud Policy" GG 31 May 2024 No 50741 (2024)).

Legwaila, commenting on the GMT Bill in 2024, validly points out many flaws of GMT, including lack of benefits for developing states, financial benefit to developed countries, high administrative costs, complexity, and a mass buy-in of states required for its enforcement (Legwaila 971, 978). GMT mainly addresses harmful tax competition and the prevention of tax avoidance by constituent entities operating in multiple jurisdictions. This is the tip of the iceberg when considering the challenge of taxing income in the digital economy in South Africa. In 2016, the Davis Tax Committee recommended the strengthening of the source rules and PE concept to effectively tax the digital economy (The Davis Tax Committee "Summary of DTC Report on Action 1: Addressing the Tax Challenges of the Digital Economy"' (2016) 4–6), both of which have not materialised yet. In the absence of amended source rules, the GMT Act has a very limited scope of application and will not capture all income earned by MNEs in the digital economy.

Conclusion

The recent international policy developments in attempting to create a harmonised approach to taxing corporate profit earned in the digital economy remain inconclusive. In the aftermath of the USA's withdrawal from the 'Global Tax Deals', the future of GMT is uncertain. There seems to be a partial shift in the policy approach of several nations from free trade, globalisation, multilateralism, and re-distribution of tax revenue to trade fragmentation, trade restrictions, deglobalisation, protectionism, bilateralism, and a preference for state sovereignty in designing unilateral approaches that are aligned to their socio-economic policies.

In addition, it would be advisable for South Africa to strengthen its source rules and consider in the enactment of a new part in section 9 of the Income Tax Act, to capture 'digital' income that is not in the scope of the GMT or the current South African source rules in section 9 of the Income Tax Act. This policy choice further protects the tax base, requires minimal legislative change and was suggested by the DTC after thorough research. Legwaila points out that many states have abandoned GMT and that the advantages thereof for developing countries remain indeterminable. He advises developing countries to align their specific tax systems with their developmental needs after careful analysis of its impact and warns against blindly adopting GMT as the consequences could be irreparable (Legwaila 978-979). South Africa, as the newly appointed leader of ATAF, will inevitably be involved in the creation of a regional African response and should remain open to domestic inclusion of such new developments. It remains to be seen whether the hasty implementation of GMT in South Africa will be amended to align with tax regimes in other African states or those of its trade partners. South Africa might have acted in haste, only to later repent at leisure—or not.

15minutes CPD

CAN SOUTH AFRICA COMPETE IN THE global tax race for investment?

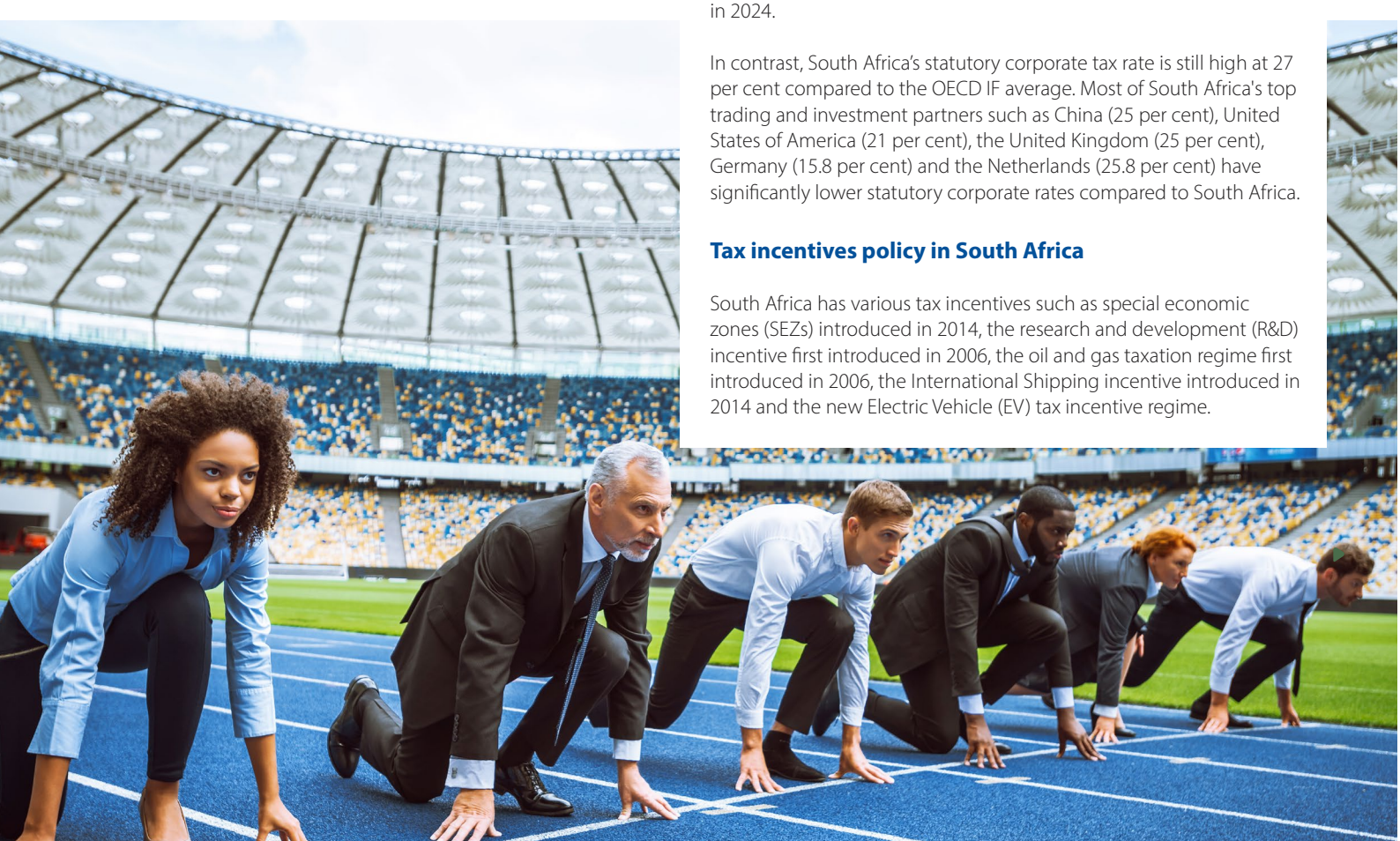
LUTANDO MVOVO, Executive Head: International Tax, Vodacom Group

South Africa's corporate income tax rate exceeds the Organisation for Economic Co-operation and Development Inclusive Framework (OECD IF) jurisdiction average of 21 per cent.

The preservation of indigenous forests is crucial for environmental health and climate change mitigation, especially as these forests store carbon. However, increasing land use pressures, along with economic and social factors, are leading to deforestation for agriculture, urbanisation, and infrastructure development.

Many countries across the globe, including those in Africa, have reduced their income tax rates over the past 20 years. According to the OECD Corporate Tax Statistics 2024 published in January 2025, the average combined (central and sub-central government) statutory corporate tax rate for all OECD IF jurisdictions covered declined dramatically from 28.0 per cent in 2000 to 21.7 per cent in 2019. From 2019 to 2024, the average statutory corporate tax rate has remained relatively stable, with a rate of 21.7 per cent in 2019 and 21.1 per cent in 2024.

In contrast, South Africa's statutory corporate tax rate is still high at 27 per cent compared to the OECD IF average. Most of South Africa's top trading and investment partners such as China (25 per cent), United States of America (21 per cent), the United Kingdom (25 per cent), Germany (15.8 per cent) and the Netherlands (25.8 per cent) have significantly lower statutory corporate rates compared to South Africa.



Tax incentives policy in South Africa

South Africa has various tax incentives such as special economic zones (SEZs) introduced in 2014, the research and development (R&D) incentive first introduced in 2006, the oil and gas taxation regime first introduced in 2006, the International Shipping incentive introduced in 2014 and the new Electric Vehicle (EV) tax incentive regime.

In 2010, South Africa introduced a headquarter company regime with the intention of attracting foreign direct investment to South Africa and for multinational corporations to use South Africa as a springboard to invest in other African countries through South Africa. The introduction of this regime was based on the view that South Africa's strong economy, well-developed infrastructure, its location and its strong financial services have made South Africa a natural holding company location. The headquarter company regime offers benefits such as exemptions from dividends tax, exemption from withholding tax on interest, exemption from South African controlled foreign company rules, exemption from transfer pricing rules under certain circumstances and the benefit of participation exemption.

However, the headquarter company regime failed to live up to expectation due to, among other reasons, its restrictive nature, being costly and administratively burdensome.

In the 2022 Budget Review published on 23 February 2023 (2022 Budget Review), the National Treasury explained its position on tax incentives. In Chapter 4 of the 22 Budget Review, the National Treasury stated that tax incentives create complexity and preferential treatment for certain taxpayers. It further stated that, based on the recommendations of the Katz Commission and the Davis Tax Committee, expiring incentives that have not widened social or economic benefits will not be renewed. The National Treasury indicated that government would continue to assess existing incentives to enhance transparency and efficiency and that the incentives that are found to be effective, and which create the intended benefits, will be retained and where necessary, redesigned to improve performance.

African Continental Free Trade Area (AfCFTA) and Tax Treaties

In addition to the tax incentives currently in place, South Africa has concluded numerous trade agreements, including the African Continental Free Trade Area (AfCFTA) which was signed on 21 March 2018. AfCFTA aims to create an integrated, continent-wide free trade zone, encompassing 55 countries and over 1.3 billion people and accounting for revenue of over US$3.4 trillion in terms of GDP. The World Bank estimates that it will boost regional income by nine per cent or US$450 billion and lift 50 million people out of extreme poverty by 2035. In addition, the AfCFTA could generate combined consumer and business spending of $6.7 trillion by 2030, according to the Mo Ibrahim Foundation. The potential AfCFTA's benefits for South Africa include job creation and economic growth, enabling South African based businesses to join regional and global value chains as well as attracting foreign investment.

Further, compared to other African countries and developing countries, South Africa has a wide network of tax treaties with all its trading and investment partners with 79 tax treaties in force. These include 23 tax treaties with other African countries (three with North African partners, four with West African partners, five with East African partners and 11 with Southern African partners) and 56 tax treaties with the rest of the world.

All these agreements generally place South Africa in a good position to attract foreign direct investment into South Africa and enhance its position as a potential gateway to Africa for multinational corporations seeking to expand to the rest of the continent.

Impact of GloBE rules on tax incentive

South Africa has recently enacted Pillar II legislation, also known as the OECD Global Anti-Base Erosion rules (GloBE rules). GloBE rules are aimed at stopping the race to the bottom by ensuring that large multinational enterprises (MNEs) with global consolidated annual revenues of more than €750 million and by ensuring that they pay a minimum effective tax rate of at least 15 per cent on profits arising in each jurisdiction in which they operate. The Ultimate Parent Entity (UPE) of the MNE Group that falls within the scope of the GloBE rules has the responsibility to calculate top-up tax liability for each jurisdiction that has an effective tax rate which is below the minimum level of taxation of 15 per cent.

While GloBE rules do not expressly stop countries from introducing tax incentives, some tax incentives are more likely to reduce the effective tax rates for MNES to below the global minimum effective tax rate of 15 per cent.

With more countries offering tax incentives to attract foreign business: Does South Africa need to rethink its corporate tax strategy?

Several countries that have adopted GloBE rules have also announced the introduction of measures to address the impact of GloBE rules on tax incentives and to attract foreign direct investment. These countries include the United Arab Emirates (UAE), the United Kingdom (UK), Luxembourg, Ireland, Hungary, Italy, France, Denmark, Portugal, Finland, Australia, Singapore. Currently, no African country has introduced any measures to counter the effects of GloBE rules on tax incentives.

The government of the UAE has announced the introduction of the R&D tax credit of 30 to 50 per cent of the qualifying R&D expenditures. This tax credit would apply to years of assessment starting on or after 1 January 2026. It would be refundable based on the revenue and the number of employees of the business in the UAE.

According to the KPMG E-News Issue 189, Luxembourg has, with effect from January 2024, introduced a new tax credit for investments in digital transformation and energy transition. This credit is calculated based on the acquisition cost assets and qualifying deductible expenses. Luxembourg also announced its intention to amend the tax credit for global investment by increasing the basic tax rate from 8 to 12 per cent.

In Ireland, the government has amended its R&D tax credit to ensure that it meets the qualifying refundable tax credit for Pillar II purposes. According to information published by KPMG Ireland, companies now have an option to request payment without offsetting against other tax liabilities first.

- In the 2025 Budget Statement, the government of Portugal announced the reduction of corporate income tax rate from 21 to 20 per cent.

  Based on the information obtained from KPMG E-news Issue 187, the government of Hungary has introduced new R&D tax credit of 10 per cent of eligible R&D expenses. This credit provides taxpayers a cash refund where the credit has not been used against the corporate income tax liability within a period of four years. Further, the credit will be considered a refundable tax credit under the GloBE rules.

  In the same way as the countries mentioned above, South Africa needs to evaluate the existing tax incentives to determine whether they are in line with GloBE rules. Any tax incentives that are likely to trigger top-up tax liability will need to be restructured. For example, such tax incentives could be limited to companies with annual consolidated revenues below €750 million and to wholly domestic companies. This would ensure that while South Africa implements the GloBE rules it also attracts foreign direct investment. If South Africa considers introducing new tax incentives, it should avoid any tax incentives that reduce the effective tax rate below 15 per cent. Instead, it should consider tax incentives that have lower impact on the effective tax rate such as grants, subsidies qualified refundable credits. A decision to introduce new tax incentives should be carefully considered because while tax incentives are considered good for attracting foreign direct investment, there is also a risk of potential loss of revenue for the fiscus that needs to be taken into account.

  Further, South Africa needs to also reconsider the current corporate tax rate of 27 per cent as it is still considered to be too high compared to its peers.

"Compared to other African countries and developing countries, South Africa has a wide network of tax treaties with all its trading and investment partners with 79 tax treaties in force"

30minutes CPD

THE DOMINO EFFECT:

Analysing the impact of global tax policy shifts on South Africa

HENRY MUNDEYA, CEO, Taxation Helpdesk

The global tax landscape is transforming significantly, driven by pivotal initiatives from key international bodies such as the Organisation for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF), and the G20.

These initiatives primarily aim to counter tax avoidance tactics employed by multinational enterprises (MNEs) and promote fair taxation practices across borders. Central to this reform is the OECD's Base Erosion and Profit Shifting (BEPS) framework, along with the proposed global minimum tax, which together seek to harmonise international tax regulations and mitigate competitive imbalances.

The implications of these reforms manifest as a 'domino effect', influencing domestic tax structures worldwide, particularly in emerging economies like South Africa. This discourse aims to critically analyse the implications of these global tax developments on South Africa's legislative framework, the compliance burdens faced by businesses, and the overarching competitiveness of its economy. The need for adaptation becomes evident as these reforms necessitate a re-evaluation of existing tax policies to align with international standards.

Moreover, the challenges posed by such sweeping reforms are significant; South Africa must navigate potential pitfalls while seizing the opportunities that arise from improved tax compliance and transparency. By creating a supportive environment for sustainable economic growth, the nation cannot only fulfil its tax obligations but also improve its appeal as a destination for foreign investment. This examination will clarify the critical interplay between global initiatives and local tax dynamics, positioning South Africa within the changing global tax framework.

Global tax policy developments and their influence on South Africa

1. The OECD's BEPS Project and South Africa's legislative response

The OECD's BEPS initiative, established in 2013, aims to close loopholes that allow MNEs to illicitly shift profits to low-tax jurisdictions (OECD, 2015). Comprising 15 action points, this initiative addresses critical issues such as treaty abuse, transfer pricing, and harmful tax practices. As a participant in the OECD's Inclusive Framework on BEPS, South Africa has implemented various measures aligned with the initiative, thereby enhancing its anti-avoidance framework while simultaneously introducing complex compliance requirements for domestic businesses.

The implementation of stringent transfer pricing regulations under Section 31 of the Income Tax Act represents a significant enhancement of South Africa's tax framework (SARS, 2021). By aligning its practices with the Organisation for Economic Co-operation and Development's (OECD's) Base Erosion and Profit Shifting (BEPS) Action 13 concerning country-by-country reporting, South Africa has strengthened its tax compliance landscape. Additionally, the introduction of limitations on interest deductions, as outlined in BEPS Action 4, alongside the enforcement of general anti-avoidance provisions, aims to mitigate aggressive tax planning strategies that undermine the tax base.

Moreover, South Africa's amendments to its tax treaties aimed at thwarting treaty abuse, particularly the inclusion of Principal Purpose Test (PPT) clauses, reflect its ongoing endeavour to align with global standards in tax governance (OECD, 2017). While these measures strengthen the country's anti-avoidance framework, they also increase compliance costs for businesses operating within its borders.

2. The implications of the global minimum tax on South Africa

In 2021, a landmark agreement among over 130 countries established a 15% global minimum tax under the OECD/G20 Inclusive Framework (OECD, 2021). This reform, commonly referred to as Pillar Two, is designed to ensure that MNEs are subject to a minimum level of taxation, irrespective of their operating jurisdiction. The potential implications of this reform for South Africa are manifold.

The Global Minimum Tax Act 46 of 2024 marks the formal introduction of the Global Minimum Tax (GMT) framework in South Africa. This legislation integrates the Global Anti-Base Erosion (GloBE) Model Rules, establishing a 15% minimum tax rate applicable to multinational enterprises (MNEs) with annual revenues exceeding €750 million (National Treasury, 2024). The Act delineates two primary mechanisms: the Income Inclusion Rule (IIR), which mandates the taxation of South African parent companies on their share of low-taxed income accrued from foreign subsidiaries and the Domestic Minimum Top-Up Tax (DMTT), ensuring that South African subsidiaries fulfil the minimum tax rate on their domestic earnings.

The South African Revenue Service (SARS) has articulated several administrative protocols fundamental to the enforcement of the GMT, which encompass the calculation of adjusted covered taxes, comprehensive reporting requirements for MNEs related to their global tax obligations, and the imposition of penalties for non-compliance (SARS, 2024). The anticipated impacts of the GMT are substantial; it is expected to mitigate tax avoidance by curbing the shifting of profits to low-tax jurisdictions, enhance revenue collection to bolster South Africa's fiscal sustainability, and align the nation with international tax standards, potentially fortifying its standing in global trade and investment.

However, implementing a global minimum tax poses notable challenges, particularly regarding South Africa's corporate tax competitiveness. With a corporate tax rate of 27%, which exceeds the established minimum, South African MNEs could incur increased tax liabilities in jurisdictions that invoke top-up taxes (EY, 2023). Furthermore, navigating the complexities inherent in implementing the GMT, especially the IIR and the Undertaxed Payments Rule (UTPR), presents significant administrative hurdles, underscoring the complex landscape associated with global tax reforms (National Treasury, 2023). This evolving scenario necessitates heightened awareness and compliance efforts from businesses operating in South Africa.

3. The challenges of digital taxation in South Africa

The advent of the digital economy has incited considerable interest in the potential for taxing digital services. The OECD's Pillar One seeks to redistribute taxing rights to market jurisdictions, thereby empowering countries like South Africa to levy taxes on digital giants such as Google and Facebook (OECD, 2020). In response, South Africa has contemplated introducing a Digital Services Tax (DST), although a definitive move awaits global consensus to circumvent potential trade disputes (National Treasury, 2021).

Additionally, South Africa has imposed value-added tax (VAT) on electronic services since 2014, capturing revenue from foreign digital providers and acknowledging the need for equitable taxation in the digital realm (SARS, 2019). By striving to implement these frameworks, South Africa underscores its commitment to adapting to the evolving global tax landscape, while also grappling with the complexities that accompany such initiatives.

Economic and compliance implications

1. Increased compliance burden on businesses

The transformative global tax reforms necessitate heightened compliance expectations for South African businesses, mandating adherence to comprehensive and intricate reporting standards, such as Country-by-Country Reporting (CbCR) and Mandatory Disclosure Rules (MDR). The latter aims to facilitate transparency concerning aggressive tax planning strategies (OECD, 2018).

Whereas these measures enhance oversight and strengthen tax governance, they also impose significant administrative costs, particularly on small and medium-sized enterprises (SMEs). The disproportionate burden of compliance may inadvertently hinder entrepreneurial growth and innovation in the domestic market.

2. The effect of global tax reforms on foreign direct investment (FDI)

Although BEPS and the global minimum tax endeavour to establish a level playing field, their implementation may profoundly affect South Africa's attractiveness as a destination for foreign direct investment. Notably, there are potential positive ramifications: reduced opportunities for profit-shifting could enhance tax fairness, thereby fostering genuine investments (World Bank, 2022).

- Conversely, the rigid compliance landscape could deter MNEs from investing in South Africa, particularly if the costs associated with compliance outweigh the benefits offered by the country's economic landscape (UNCTAD, 2023). The contrast of benefits and drawbacks highlights the importance of navigating policy reforms carefully to optimise the country's investment climate.

3. Revenue implications for South Africa

The National Treasury of South Africa estimates that the implementation of BEPS-related measures could reclaim between R10 and R15 billion annually in previously lost tax revenue (National Treasury, 2023). While the prospect of revenue recovery is promising, the actual net impact of the global minimum tax remains shrouded in uncertainty. To maximise the potential benefits of these reforms, South Africa must not only enhance compliance mechanisms but also ensure that these frameworks are effectively communicated to stakeholders.

Challenges and future directions

1. Balancing compliance and economic growth

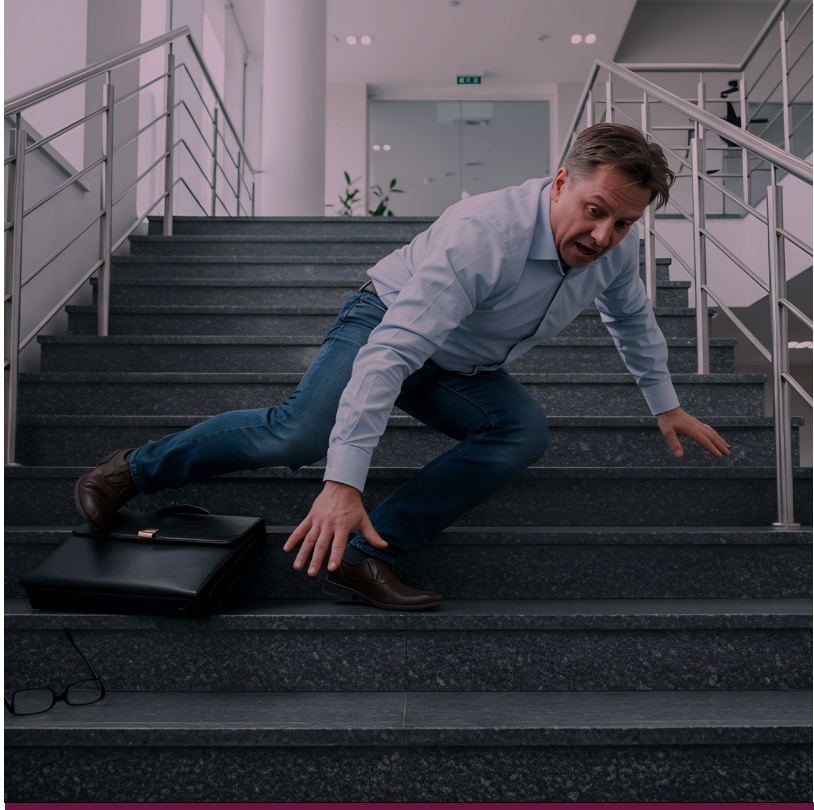
As South Africa initiates significant transformations in its tax frameworks, it is vital to strike a balance between rigorous compliance standards and fostering economic growth. Policymakers must prioritise the development of simplified compliance mechanisms tailored for SMEs while simultaneously offering clear and accessible policy guidance to businesses navigating the evolving tax landscape.

Furthermore, actively engaging stakeholders, including industry representatives, tax experts, and civil society organisations, can facilitate a more inclusive approach to tax policy reform. By fostering dialogue and collaboration, South Africa can introduce tax policies that are equitable, sustainable, and conducive to economic prosperity.

2. Strengthening international collaboration

In light of the interconnected nature of global tax policy, South Africa must enhance its collaborative efforts with other nations to promote greater coherence and alignment in the international tax framework. Participating in dialogues facilitated by the OECD and G20 can offer valuable insights into the evolving global landscape and enable South Africa to position itself as a proactive player in international tax matters.

Additionally, bilateral agreements with other nations can help mitigate the exploitation of tax loopholes, further solidifying South Africa's commitment to equitable tax practices. Fostering harmony in tax policy will not only bolster domestic compliance but also enhance the country's attractiveness to international investors.



Conclusion

In conclusion, the evolving landscape of global tax policy presents significant challenges and opportunities for South Africa. The country stands at a critical juncture where it must carefully consider the implications of international initiatives such as the OECD's BEPS framework and the global minimum tax. These initiatives aim not only to combat tax avoidance but also to create a level playing field for nations worldwide.

To harness the potential benefits of these reforms, South Africa must align its compliance frameworks with its economic growth objectives. This alignment requires a balanced approach that promotes equitable taxation while encouraging foreign investment and economic development. By fostering international collaboration, South Africa can actively participate in shaping a tax environment that supports sustainable development.

Moreover, South Africa's success in adapting to these shifting models will be pivotal in securing its position in the global economy. Embracing these changes can lead to a fairer tax system, which is essential for social equity and the realisation of national developmental goals. By implementing progressive taxation policies and improving compliance, South Africa can promote wealth redistribution, fund essential services, and create opportunities for all citizens, ultimately fostering sustainable economic growth and stability.

As South Africa navigates this complex terrain, proactive engagement with the evolving international tax landscape is crucial. Policymakers must prioritise strategic reforms that respond to global standards while considering local economic conditions. Ultimately, the path forward lies in the nation's ability to innovate, collaborate, and adapt, ensuring it not only meets the demands of global taxation but also advances the well-being of its citizens and the health of its economy.

15minutes
CPD

GLOBAL TREND, LOCAL QUESTION:

Is it time to tax Big Tech in South Africa?

EDZANI RATSHITANGA, Operational Specialist: Investigative Audit

The European Commission and a number of nations, mostly in Europe, have suggested or enacted taxes on the money that multinational corporations (MNCs) make from operations connected to their citizens' user-based activities in specific 'digital economy' sectors. Most people refer to these plans as 'digital services taxes' (DSTs).

Digital services are referred to as any services that offer a variety of features and applications that are provided using digital technology such as software, mobile apps, and the internet. These services have a substantial impact on many aspects of daily life and business, ranging from simple communication tools such as emails to complex systems such as precision agriculture technology.

According to the OECD, globalisation and digitalisation have had a significant impact on people's lives and economies worldwide, which has increased in the twenty-first century. In order to restore confidence in the system and to guarantee that profits are taxed where economic activities take place and value is created, policymakers must take decisive action. These changes have brought challenges to the rules for taxing international business income, which have been in place for more than a century and have created opportunities for base erosion and profit shifting (BEPS).

TAXTALK 23

> **"According to some analysts and policymakers, multinational corporations operating in the digital economy are either 'undertaxed' or do not pay their due share of taxes in their respective countries"**

Rather than being a tax on corporate profits, DSTs are designed to be a selective tax on revenue, similar to an excise tax. DSTs differ from 'corporate taxes' in that they are 'turnover taxes' that are levied on the money received from taxable operations, regardless of the expenses a business incurs.

According to international tax rules, a country must establish a 'permanent establishment' to impose tax on a foreign company. This means there should be a physical presence in a foreign country for that particular country to levy tax on the profits that are attributable to its jurisdiction. Digital services are provided on the internet which does not constitute physical presence. Therefore, provision of such digital services to South African residents via the internet is being done in the form of a 'digital presence' which is not a physical presence. If South Africa is to adopt DSTs, it should expand on the definition of 'permanent establishment' to also include 'digital presence', similar to what has been done in Europe. This will allow South Africa to tax MNCs that have a significant 'digital presence' in South Africa.

There have been changes since Covid-19, which resulted in isolation and growth in the digital economy. This has resulted in most MNCs expanding their online services in order to provide services in various countries without being physically present in those countries. According to Darmayasa and Partika (2024), the concept of 'Significant Economic Presence' (SEP) as per the OECD consultation document can be used as an alternative in determining 'Physical Presence'. There are three factors of the SEP framework, with the first one being an 'income-based factor', the second a 'digital factor', and the third a 'user-based factor' (Darmayasa & Partika, 2024). If South Africa were to adopt DSTs, it could also consider this SEP concept when developing the DST policy.

Furthermore, according to international tax regulations, countries cannot tax an MNC's cross-border profits just because their citizens buy products or services from the company. Instead, a country's right to tax a portion of an MNC's profits is justified by its ownership of assets. The fact that citizens of a nation buy digital services from an MNC does not, in accordance with these regulations and their guiding principles, constitute an excuse for taxing the MNC's earnings.

According to some analysts and policymakers, multinational corporations operating in the digital economy are either 'undertaxed' or do not pay their due share of taxes in their respective countries. These emotions are frequently motivated by two concerns: (1) the potential of the digital economy MNCs are able to offer services without setting up a 'permanent establishment' or physical presence in the nation, where their clients live and (2) the digital economy's MNCs ability to move their earnings to low-tax jurisdictions, where they are engaged in little to no real economic activity, rather than countries where they engage in real economy activity (such as sales, development, or manufacture) (Lowry, 2019).

The OECD tax framework prevents foreign companies from being taxed if there is no permanent establishment. South Africa will have to justify why they will be imposing DSTs even though international tax rules do not allow for this.

DSTs on intermediate services are probably going to have the same economic impact as an excise tax. Buyers of taxable services (such as businesses paying digital economy enterprises for advertising, marketplace listings, or user data) and potentially downstream consumers are likely to bear the economic impact of a DST.

- Most countries are implementing digital services taxes.

Potential risks and implications of adopting such tax

Should South Africa adopt DST, the risks and implications have to be explored. This means SARS might have to dedicate additional resources (i.e. new staff members) to administer this tax. In addition, the complexity that comes with the administration of this tax type also has to be considered. SARS might have to invest in software that will accurately provide data on South African residents who are using these services to ensure completeness and accuracy of the tax that will be imposed on these tech giants. This means SARS must ensure that MNCs, which have to pay these taxes, are complying.

These digital services are provided via the internet, which poses many administrative challenges. There might be privacy rules which prevent the transfer or sale of third-party information, which might prevent SARS from obtaining information on the South African citizens who utilise such services. In addition, the internet is also subject to manipulation, where users are able to reroute their traffic to countries outside South Africa, making it difficult for South Africa to levy DSTs.

Another important aspect to consider is the use of a Virtual Private Network (VPN), which masks the user's IP address. VPN encrypts the user's internet traffic and disguises the user's online activity, making it difficult for third parties to track the user's online activities and data theft. This might create administrative challenges as SARS might not be able to track citizens who are using these online services to levy DSTs.

As it is highly likely that consumers (SA citizens in this instance) are the ones who will bear the economic impact of these taxes, they might simply not want to utilise these services anymore due to the tax implications that will likely arise. Again, this will not be good for the business as they will not be able to reach more customers online, which is where business has most likely taken place since the pandemic. In addition, more people spend time on social media platforms and this is where most businesses advertise their products.

In conclusion, South Africa will have to ensure that proper research is conducted before implementing DST to ensure that enough taxes will be collected from these MNCs. The administration of DSTs does come at a cost and challenges which must be addressed to ensure completeness and accuracy of the DSTs that will be collected. In addition, the European countries that have adopted DSTs expanded on their definition of permanent establishment to include a 'digital presence' to be able to tax MNCs— something South Africa might have to consider as well.

30minutes
CPD

THE AFRICAN CONTINENTAL FREE TRADE AREA AND ITS IMPACT ON CUSTOMS DUTIES:

South Africa's role and regional trade dynamics

▶ **DR RODRICK VAN ROOYEN,** Customs and International Trade Advisor

The African Continental Free Trade Area (AfCFTA) represents a significant milestone in the pursuit of economic integration across the African continent. By establishing a single market for goods and services among member states, the AfCFTA aims to enhance intra-African trade, stimulate economic growth, and foster development.

This article discusses the implications of the AfCFTA on customs administrations and traders, with a focus on South Africa's pivotal role in supporting and implementing the AfCFTA agreement, as well as the influence of regional trade agreements on customs duties and trade tariffs.

Considering trade agreements and preferential rates of customs duties

World Trade Organisation (WTO) member countries can enter free trade agreements like the AfCFTA to enhance economic cooperation by reducing or eliminating customs duties on specific products.

This involves negotiations to identify eligible products and set preferential tariff rates, considering trade interests, market access, and local industry impacts.

Rules of origin play a crucial role, requiring a certain percentage of local content such as 40% for tariff reductions.

Additionally, agreed-upon manufacturing processes ensure products are genuinely produced in the region, preventing 'trade deflection', where goods are routed through non-member countries to exploit lower tariffs without meeting production criteria.

Understanding AfCFTA and customs duties

In January 2011, the African Union (AU) Heads of States and Government endorsed a recommendation from the 2010 AU Ministers of Trade meeting to establish a Pan-African Free Trade Agreement by January 2012.

The AfCFTA Agreement aims to create a single market for goods and services and allow free movement of people and investments. This initiative sets the stage for a future customs union and includes a framework agreement and various protocols, such as the Protocol on Trade in Goods.

The AfCFTA aims to reduce or eliminate tariffs on a substantial majority of goods traded among its member states. The agreement encourages member states to adopt preferential tariff rates that are lower than the general column duties, thereby promoting trade within the continent. Under the AfCFTA provisions, goods that originate from member states and comply with specific rules of origin can benefit from these reduced tariffs.

As indicated in Schedule No.1 and the General Notes of the South African Revenue Service (SARS) Customs and Excise Act, 1964 and paragraph "O", the following non-SADC Member States have implemented the Provisional Schedules of the Tariff Concessions, that is Algeria, Cameroon, Egypt, Ghana, Kenya, Rwanda, Tunisia, Burundi, Morocco, and Uganda.

These countries have committed to implementing lower duty rates by specific deadlines. South Africa, as a key player in this regional trade agreement, must align its customs duties with the AfCFTA framework, ultimately influencing trade dynamics within the Southern African Development Community (SADC) and beyond.

The role of customs administrations in trade agreements and rules of origin

Customs administrations play a custodian role in the implementation of trade agreements and the enforcement of rules of origin, particularly in the context of the AfCFTA. As the primary authorities overseeing the import and export of goods, customs officials are tasked with ensuring compliance with the diverse and often complex rules that govern preferential trade. This involves not only verifying the origin of goods to facilitate legitimate trade but also managing the necessary controls to prevent fraud and ensure fair revenue collection.

To apply the AfCFTA, customs administrations focus on Annex 2 of the AfCFTA Protocol on Trade, which deals with rules of origin. This section is important for customs administrations because it outlines how to determine the origin of goods traded under the AfCFTA.

Understanding these rules is essential for enforcing trade agreements, ensuring compliance, and facilitating smooth trade flows among member states. Proper implementation helps prevent fraud and supports fair revenue collection.

Evaluating the effectiveness of the AfCFTA and its dependency on foreign investment

The effectiveness of the AfCFTA in facilitating trade among member countries largely depends on the diversity and complementarity of the products traded.

With countries like Algeria, Kenya, Ghana, and Morocco involved, the AfCFTA has the potential to enhance trade in various sectors, including agriculture, textiles, and manufacturing. The presence of both resource-rich nations and emerging economies can stimulate intra-African trade and create opportunities for value addition within the continent.

However, the AfCFTA's success also hinges on attracting investment from developed countries such as the USA, UK, and those in Europe. These investments are crucial for establishing manufacturing facilities that can leverage the lower tariff rates and facilitate trade among African nations.

While the AfCFTA aims to reduce dependence on external markets, collaboration with developed nations can provide the necessary capital, technology, and expertise to boost local industries and enhance the overall effectiveness of the agreement. Ultimately, a balanced approach that fosters both intra-African trade and foreign investment will be essential for realising the AfCFTA's full potential.

South Africa's role in supporting AfCFTA implementation

South Africa has emerged as a leader in the AfCFTA initiative, given its economy and strategic positioning within the African continent. The country's participation is necessary for the successful implementation of the AfCFTA. It has actively engaged in discussions to harmonise its tariff regimes with those of other member states.

From a customs and import-export perspective, the AfCFTA presents both opportunities and challenges for South Africa. As one of the continent's largest economies, South Africa stands to benefit significantly from reduced tariffs on exports to other member countries, enhancing its competitive edge in regional markets. This can lead to an increased demand for South African goods, stimulating local industries and creating jobs.

However, the implementation of the AfCFTA also requires South Africa to adapt its customs processes to accommodate the rules of origin and ensure compliance with the agreement. Customs authorities must be vigilant in monitoring imports to prevent misuse of preferential rates, ensuring that goods meet the established criteria. This may involve additional training for customs officials and investment in technology to facilitate efficient processing and verification of trade documentation.

Furthermore, as South Africa navigates the changes brought by the AfCFTA, local businesses may need to rethink their supply chains and sourcing strategies to maximise the benefits of preferential tariffs. This could involve increasing local content in products or forming partnerships with manufacturers in other member countries.

The influence of regional trade agreements on customs duties and trade tariffs

South Africa's involvement in the AfCFTA will reshape its customs duties and trade tariffs. Existing agreements like the SADC Trade Protocol may be reviewed to align with the AfCFTA, phasing out conflicting provisions while integrating compatible elements to enhance regional trade and economic cooperation.

The table below presents key factors impacting South Africa's engagement with the AfCFTA:

Item	Topic	Detail
1	Tariff concessions	With the AfCFTA's emphasis on reducing tariffs, South Africa may need to adjust its tariff schedules to remain competitive. The preferential duty rates established under the AfCFTA could lead to decreased revenue from customs duties, prompting the government to evaluate its fiscal strategies.
2	Reciprocal trade agreements	South Africa's engagement in the AfCFTA necessitates a commitment to reciprocity in trade. If other member states do not comply with the agreed-upon tariff phasedowns or fail to demonstrate reciprocity, South Africa may need to reassess its own tariff policies, potentially suspending preferential duty rates for non-compliant states.
3	Customs administration and compliance	The successful implementation of the AfCFTA will require enhanced customs administration and compliance mechanisms in South Africa. This includes ensuring that importers can provide valid proof of origin for goods entering the country at preferential rates and that customs officials are equipped to handle the complexities of regional trade agreements.

As per the table above, South Africa's strategy regarding the AfCFTA must prioritise tariff concessions, reciprocity in trade agreements, and robust customs administration. By managing these areas effectively, South Africa can enhance its economic position and contribute to regional integration and sustainable development across the continent.

Lessons from the Trump administration on tariffs and trade agreements

South Africa can learn valuable lessons from the Trump administration's approach to tariffs and trade agreements. President Trump emphasised the need for countries to reassess their trade deals, suggesting that previous agreements may not have favoured USA interests. For South Africa, this underscores the importance of conducting thorough evaluations of its own trade agreements to ensure they align with national priorities and economic goals.

The USA administration's focus on reciprocal trade relationships highlights the need for South Africa to seek fairness in its agreements, ensuring that trade partners uphold their commitments. Additionally, the experience of navigating trade disputes serves as a reminder for South Africa to establish strong mechanisms for addressing grievances.

By learning from these experiences, South Africa can shape its trade policy to promote sustainable economic growth and enhance its position within the AfCFTA and beyond.

Conclusion

The AfCFTA represents a transformative opportunity for enhancing trade across Africa, with significant implications for customs duties and tariffs. South Africa's role in supporting and implementing the AfCFTA is crucial for realising its potential benefits, both domestically and regionally. By aligning its trade policies with the AfCFTA framework, South Africa can facilitate increased intra-African trade, promote economic growth, and support the broader objectives of regional integration.

> ***"While the AfCFTA aims to reduce dependence on external markets, collaboration with developed nations can provide the necessary capital, technology, and expertise to boost local industries and enhance the overall effectiveness of the agreement"***

As the AfCFTA continues to evolve, it will be essential for South Africa and other member states to navigate the complexities of customs duties and trade tariffs, ensuring that the agreement yields tangible benefits for all parties involved. Ultimately, the AfCFTA has the potential to reshape Africa's economic landscape, fostering a more interconnected and prosperous continent.

15minutes
CPD

WHEN TRADE MEETS CLIMATE:

The growing role of green controls in customs taxation

DR MARK GOODGER, PD International Business and Trade, Managing Director, Global Maritime Legal Solutions Ltd (GMLS)

No international trade transaction can be completed without customs compliance in relation to export and import declarations and the harmonised system codes utilised. In international trade, customs administrations play a key role in determining how products are classified for tariff, duty and tax purposes.

This classification of traded goods affects how much duty or tax is applied to goods entering a country. Customs administrations, besides the responsibility for duty and tax collection, also act on behalf of other governmental agencies and administer controls over global trade security, counterfeit irregularities, including green compliance. Green customs controls arise from the Basel Convention. The Basel Convention on the control of transboundary movements of hazardous wastes and their disposal is an international treaty designed to control the trade in hazardous and other wastes. It aims to protect human health and the environment by reducing hazardous waste generation and ensuring its environmentally sound management, wherever the waste is disposed of. However, changes in global standards and the accession to international conventions and agreements such as the Basel Convention can create confusion and challenges for customs administrations. One such example is the conflict between existing tariff rulings and new classifications introduced by the World Customs Organisation (WCO) based on the green customs controls initiative. This article explores the issues surrounding tariff rulings, the impact of the green customs initiative, and recommends a way forward for purposes of trade facilitation.

Understanding tariff rulings

Tariff rulings are decisions made by customs administrations that clarify how specific products should be classified under the WCO Harmonised System (HS) codes. This is an international convention to which South Africa is a party in terms of the provisions of Section 47 of the Customs Act. These HS codes determine the customs duties that apply to goods. When a customs authority issues an HS ruling known in RSA as a Tariff Determination Notice (TDN), it creates certainty on how to classify the goods and it also provides guidance to importers and exporters, helping them understand their obligations under trade law. It is also an article (no 4) in the World Trade Organisation (WTO) Agreement on Trade Facilitation, which provides for the competency of the customs authority to issue advance rulings. Delays in issuing tariff rulings by a customs authority naturally do not facilitate trade.

However, tariff rulings can become outdated. Changes in technology and trade practices often lead to new products, technology or production methods. As a result, the WCO updates the HS codes every five years to reflect these changes. Customs administrations must be aware and adapt to these updates to ensure accurate classification.

The Green Customs Controls initiative

The Green Customs Controls initiative was introduced to address environmental issues related to trade. It focuses on promoting sustainable practices and controlling the movement of environmentally harmful products such as e-waste. E-waste includes discarded electronics that can contain hazardous materials.

Under this initiative, the WCO has revised specific tariff subheadings to improve control on the trade of e-waste. This change aims to help countries monitor and manage the import and export of these materials, reducing their environmental impact. The new tariff subheadings are designed to support customs administrations in enforcing regulations and controls related to e-waste. The latest version is the 2022 version in which the WCO included a new tariff head 85 49 for electronic waste.

The conflict between old and new rulings

The challenge arises when a customs administration insists on applying an outdated tariff ruling that was issued before the Green Customs initiative. This situation can lead to confusion and frustration. Customs officials may find themselves in a position where they have to apply an old classification to a product that now falls under a new subheading due to the updated version.

For instance, if a customs administration has issued a ruling for a specific type of electronic device, that ruling may be based on a tariff classification that does not account for new e-waste controls. If the WCO later changes the classification to reflect the Green Customs initiative, the customs administration must decide which ruling to follow. Continuing to apply the old ruling may hinder efforts to monitor and control e-waste effectively and indeed frustrate and delay such shipments. This is particularly the case when old HS rulings rule the product as it would have been classified before the introduction of the new HS code.

The need for clear guidance

Given the potential for confusion, it would seem logical for the WCO to issue directives to its member countries. These directives could clarify how customs administrations should handle situations where previous rulings conflict with new classifications. Clear guidance would help ensure that customs administrations can apply the most appropriate tariff subheadings, allowing for better control of environmentally harmful products.

However, as it stands, there may not be a unified approach to resolving these conflicts. Customs administrations may be left to interpret the situation on their own, leading to inconsistent applications of tariff rules. This inconsistency can complicate trade and regulatory compliance for businesses involved in the import and export of goods.

Weighing the importance of rulings

In deciding whether to apply an outdated tariff ruling or a new Green Customs tariff subheading, customs administrations face a significant dilemma. On one hand, adhering to an established ruling may provide certainty for businesses and uphold legislation such as the Customs and Excise Act, 1964 (the Customs Act) and section 47(9) of the Customs Act. On the other hand, applying outdated rules may undermine the goals of the Green Customs initiative.

The question arises: Which carries more weight? Is it more important to stick with an old ruling that may no longer reflect current standards or to adopt new classifications that facilitate better control and monitoring of e-waste? Given the growing emphasis on environmental protection, applying the new tariff subheading seems more appropriate and would be legally correct under the General Rules of Interpretation to the WCO HS tariff.

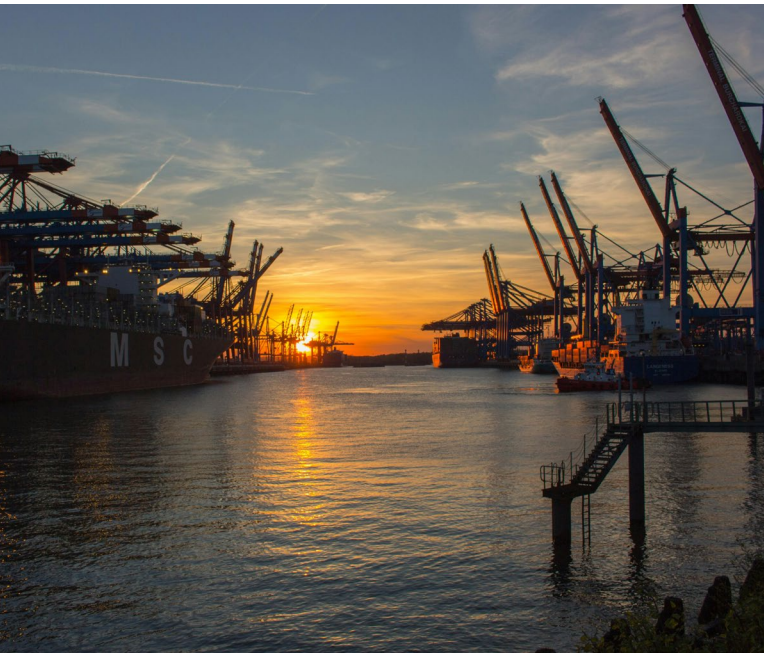
"Clear guidance would help ensure that customs administrations can apply the most appropriate tariff subheadings, allowing for better control of environmentally harmful products"

Proposing a way forward

To navigate the challenges posed by outdated tariff rulings, customs administrations should consider the following steps:

- Review existing rulings: Customs administrations should regularly review existing tariff rulings to identify those that may conflict with new classifications. This review can help ensure that outdated rulings do not hinder compliance with current environmental standards.
- Establish clear procedures: Customs administrations should create clear procedures for handling situations were old rulings conflict with new tariff classifications or updates to the version of the WCO. This could include guidelines for updating rulings when new classifications are introduced.
- Training and awareness: Training customs officials on the importance of the Green Customs initiative and its implications for tariff classifications is essential. Raising awareness can help ensure that customs officers are well equipped to make informed decisions.
- Collaboration with stakeholders: Engaging with stakeholders, including businesses and environmental organisations, can provide valuable insights. Collaboration can lead to a better understanding of how tariff classifications impact trade and environmental goals. It also places RSA in a position of international compliance, especially with environmental conventions such as the Basel Convention to which RSA is a party.

"The conflict between outdated tariff rulings and new classifications introduced by the Green Customs initiative presents significant challenges for customs administrations which impact trade facilitation to traders"



- Advocacy for WCO guidance: Customs administrations should advocate for the WCO to provide more explicit guidance on navigating tariff rulings considering the Green Customs initiative. A unified approach can help reduce confusion and promote consistency across member countries.

Conclusion

The conflict between outdated tariff rulings and new classifications introduced by the Green Customs initiative presents significant challenges for customs administrations which impact trade facilitation to traders. As the global landscape of trade evolves, customs authorities must adapt to new standards that prioritise environmental protection. By reviewing existing rulings, establishing clear procedures, training officials, collaborating with stakeholders, and advocating for WCO guidance, customs administrations can better navigate these challenges and support sustainable trade practices. Furthermore, delays in issuing or updating rulings of any nature do not facilitate trade.

15minutes CPD

THE FUTURE OF DOUBLE TAXATION AGREEMENTS:

Are South Africa's treaties still effective?

▶ **DR LINDELWA NGWENYA,** Senior Lecturer, University of Pretoria

By signing tax treaties, developing countries provide foreign investors with security and stability regarding the issue of taxation in addition to the relief from double taxation (Neumayer, 2007).

South Africa has a wide Double Taxation Agreement (DTA) network comprised of 79 DTAs. This may seem negligible in comparison to the over 3 000 bilateral income tax treaties in force around the world (Avi-Yonah, 2024). There are multiple reasons why a country may choose to enter into DTAs. Not least among them is the avoidance of double taxation. However, the main purpose of DTAs is not only the avoidance of double taxation (which is also achievable through unilateral credit or exemptions) but rather the implementation of the Benefits Principle through the shifting of tax on passive income to the residence country while allowing the source country to tax active income attributable to a permanent establishment (Avi-Yonah, 2024). An additional reason for entering into a DTA includes the curbing of tax avoidance and fiscal evasion (Selezen, 2017; Baker, 2014).

Of concern to this article is whether South Africa's DTAs protect businesses from unfair taxation. Before delving into the implications of DTAs on the protection of businesses from unfair taxation, it is imperative that the term 'unfair taxation' be understood. Unfair taxation would arise in instances where double taxation would result. Double taxation occurs when two countries impose tax on the same income. A distinction is made between economic double taxation and juridical double taxation. Economic double taxation refers to the taxation of the same income in the hands of different taxpayers. An example of economic double taxation is the taxation of income first in the hands of an entity and then the taxation of the same income in the hands of the entity's shareholders in the form of dividend withholding tax. ▶

Juridical double taxation occurs where the same income is taxed in the hands of the same taxpayer in more than one country. For instance, where a South African company has an Australian subsidiary and a transfer pricing adjustment is made for that subsidiary; double juridical taxation may arise if an adjustment is not subsequently made in South Africa. DTAs contain reduced withholding rates for dividends, interest, and royalties. To the extent that the withholding rates are lower than the rates imposed by domestic legislation, such rates are beneficial to doing business. Determining whether tax treaties protect businesses from unfair taxation requires a scrutiny of each of the treaties that are still in force. In the absence of such an analysis, reference is made to select provisions contained in the OECD Model Tax Convention.

To determine whether tax treaties hurt or help businesses, it is worth considering the substantive and definitional articles of the Model Tax Conventions where relevant. While there are multiple provisions worth considering, for succinctness, this analysis will limit itself to Article 5 concerning permanent establishment and to Article 7 concerning business profits. Where a more specific provision does not cover profits, they are catered for in terms of Article 7 of the OECD and UN Model Tax Convention. Article 7 provides that an enterprise of a contracting state is exempt from tax by the other contracting state on its profits derived from business carried on in the other contracting state, unless the business is carried out through a permanent establishment located in the source jurisdiction.

Furthermore, the profits are taxable in the source state only to the extent that the profits are attributable to the permanent establishment. A permanent establishment is defined in the OECD and the UN Model Treaties in Article 5 as a fixed place of business, such as an office, a branch, a factory, or a mine. A permanent establishment also includes a so-called dependent agent. Prior to 2017, the dependent agent provision was limited to agents who had the ability to bind their principals. After 2017, dependent agents include commissionaire arrangements in terms of Article 5(5). Many multinationals have incorporated commissionaire arrangements in order to avoid establishing a permanent establishment in a particular country. This broadened definition of a permanent establishment hurts business.

"Determining whether tax treaties protect businesses from unfair taxation requires a scrutiny of each of the treaties that are still in force"

Moreover, article 5(3)(b) of the UN Model Tax Convention provides that an entity is deemed to have a permanent establishment where it performs services through employees or other personnel for a period of 183 days. Prior to 2017, article 5(3)(b) required that the services be provided for the same or a connected project, however, this requirement was deleted. Article 5(4) contains a list of exemptions subject to the condition that the activities are preparatory or auxiliary in nature. In 2017, Article 5(4) was revised to ensure that the exemption applied only to the extent that the activities were auxiliary or preparatory in nature (Arnold, 2023). This makes it harder for entities to fall within the exemption of a permanent establishment. To the extent that the definition of permanent establishment is broadened, treaties may be said to be harmful to business practices. However, a blanket statement as to the harmful of beneficial nature of treaties cannot be made. Each provision requires analysis in order to determine its effect on businesses.

15minutes CPD

KENYA'S TAXATION OF THE INFORMAL ECONOMY:

Can South Africa learn from Kenya's approach?

▶ **ALLAN WANG'ANG'A,** Tax Associate, Viva Africa Consulting LLP and **JOHN OGOLA,** Intern, Viva Africa Consulting

The informal sector is closely related to the tax system, so much so that we often conceptualise the informal economy as comprising economic activity that falls outside the tax system or lacks a tax registration status.

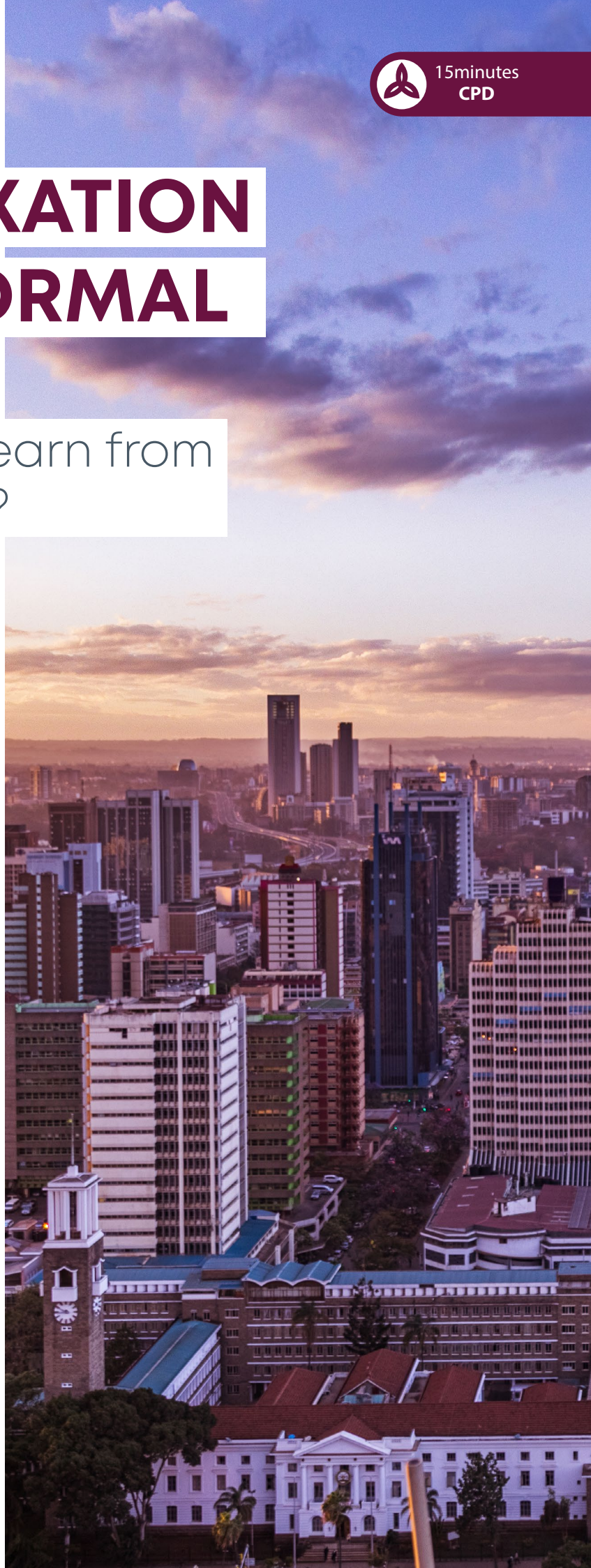
However, according to the International Conference of Labor Statisticians (ICLS), informal enterprises are enterprises that are not legally incorporated or registered with a national government authority, and informal occupations are those without social protection or paid annual and sick leave from an employer.

Some studies estimate that in Kenya, the informal sector captures 83 per cent of total employment and contributes upwards of 30 per cent of our GDP. However, despite its significant presence in the Kenyan economy, taxation of the informal sector has largely remained elusive. The lack of a defined structure, reliable income data and a fixed location complicates the taxation of the informal sector. Kenya's growing need to expand its tax base to increase revenue collection has introduced measures to include the informal sector in the tax bracket.

We discuss some of the measures below.

Turnover tax

Many countries typically resort to presumptive tax systems to tap into the informal sector. Businesses in the informal sector may be unable to comply with their accounting and tax obligations without paying for professional support, which may be quite costly. As revenue authorities may be unable to ascertain the taxpayer's income, or cannot verify the accuracy thereof, presumptive regimes allow them to 'presume' the amount of income according to an alternative base determined by the revenue authority. ▶



In Kenya, the main form of a presumptive tax is the Turnover Tax (TOT), which came into effect on 1 January 2020. It is a tax payable by any resident person whose turnover from business is more than KShs.1 Million but does not exceed or is not expected to exceed KShs.25 Million during any year of income. It is payable monthly at the rate of 3% on the gross sales by the 20th day of the following month. It simplifies the need for complex records and investment in computers and electronic tax registers, as taxpayers are only required to keep records of gross sales. KRA has also simplified filing and payment processes, including payment through mobile phones, to enable easy use and adoption.

Under the Medium-Term Revenue Strategy FY 2024/25 - 2026/27, the Government of Kenya will be looking to explore suitable presumptive tax regimes based on various factors that affect the taxation of the informal sector upon carrying out a comprehensive study and analysis. The regimes are to bring equity and fairness to the taxation of the informal sector.

Electronic tax invoice system (eTIMS)

In 2023, the Kenya Revenue Authority (KRA) launched the Electronic Tax Invoice System (eTIMS), a digital platform designed to ensure businesses report their sales in real time. Through the eTIMS platform, all persons in business, including those in the informal sector and non-VAT registered businesses, are required to electronically generate and transmit invoices to the KRA. The Finance Act, 2023 stipulated that businesses can only claim expenses from their taxable income if they are supported by eTIMS-compliant invoices. This would force larger, formal businesses to demand eTIMS invoices from their informal sector suppliers, thereby enabling KRA to tap into business activities in the informal sector.

To ensure easy adoption, KRA has availed an eTIMS simplified solution, dubbed 'eTIMS Lite', for non-VAT registered taxpayers that is accessible through a mobile phone app. KRA has also made efforts towards awareness of eTIMS transition and tax literacy through stakeholder engagements and taxpayer education targeted at players in the informal sector who include farmers, jua kali traders and artisans, among others.

Access to mobile phone records

The Finance Bill, 2025 proposes to delete a provision in the Tax Procedures Act, 2015, preventing KRA from demanding that a taxpayer integrate or share data concerning trade secrets or personal information. It is noteworthy that the Tax Laws (Amendment) Act, 2024, which came into effect on 27 December, 2024, had allowed the KRA to integrate data management and reporting systems with corporates, including banks, but expressly barred access to data classified as trade secrets or personal customer information. The latest proposal removes this safeguard, thereby providing KRA unfettered access to personal data, including data contained in mobile phone records and mobile phone transactions.

Whereas this has been part of KRA's long-standing attempt to tap into the informal sector, it has, naturally, raised concern amongst civil society organisations regarding taxpayers' rights not to have the privacy of their communications infringed. We therefore anticipate that the proposed amendment may be vacated given that it raises constitutional and human rights concerns.

Public education and engagement

KRA has partnered with informal sector associations such as jua kali traders, to raise awareness about tax obligations and encourage compliance. KRA has also partnered with the Kenya National Chamber of Commerce and Industry (KNCCI) to engage businesses across all 47 counties to sensitise them on KRA functions and services. These functions include enhancing tax awareness, streamlining registration processes, simplifying complex tax processes and providing practical guidance to enhance compliance.

Summary

In the Kenya National Tax Policy, 2024, the Government noted that efforts to tax the informal sector, including the use of Turnover Tax, have not yielded the expected tax revenues. For instance, the actual contribution to tax revenue by the agricultural sector, which forms a major part of this category, is not commensurate with the sector's contribution to GDP, which averages 21.4 per cent.

This shows that a long-term solution would not necessarily reside in identifying more efficient or user-friendly ways of collecting tax but perhaps incentivising smaller businesses to formalise and contribute to national tax revenue. Perhaps a more feasible approach would be to provide tax reliefs or incentives that allow businesses to build to scale, especially in the nascent stages of their growth. In addition, nothing would go further towards tapping into the informal sector than improving tax morale through government accountability in the use of the revenue it collects through effective service delivery.

South Africa has taken measures to tap into the informal sector, particularly through the turnover tax system under the Sixth Schedule to the Income Tax Act No. 58 of 1962. This is a simplified tax system designed to bring small and medium-sized enterprises into the tax net. However, in order to allay the fears of micro businesses relating to registration and arrear taxation tied to this system, the Davis Tax Committee Report (2016) recommended means of boosting tax morale such as a voluntary tax disclosure programme for businesses qualifying for turnover tax.

As with the Kenyan tax experience, it would take more than a simplified tax system to tap into the informal sector. This will require more trust and structured dialogue with government agencies.

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