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The Place of Multilateralism in Tax Reforms: Exclusionary Outcomes of a Purported Inclusive Framework

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Countries have come to accept the wide application of international tax rules in both their domestic and international tax affairs. However, where international tax rules fall short of the legitimate expectations of countries and fail to provide necessary guidance, countries may be compelled to seek other sources of guidance. In this paper, it is argued that in the absence and failure of international tax rules to provide adequate guidance and encourage a fair tax system, countries should not be prohibited from exercising their fiscal sovereignty.

On July 1, 2021, the Organisation for Economic Co-operation and Development (OECD) secured the votes of 130 members out of 139 members of the Inclusive Framework, on a two-pillar plan to reform the global tax rules. The July statement was followed by a second statement by the OECD on October 8, 2021, that 136 members of the Inclusive Framework have agreed to a two-pillar solution to address the tax challenges arising from the digitalization of the economy. The OECD also stated that a small number of the Inclusive Framework have not yet joined the two-pillar solution at this time. Notably, two African countries—Kenya and Nigeria—, active members of the Inclusive Framework withheld their support for this plan, which has been described by many as "historic".

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Nigeria is a major economic force in West Africa and the largest economy, by Gross Domestic Product (GDP), on the African continent. Kenya is East Africa's gateway and the region's largest economy. What must have influenced their decisions not to support a historic global tax reform, and what are the consequences of such action?

A bit of history. The current rules that govern international taxation were designed a century ago, under the auspices of the League of Nations, and subsequently deposited within the OECD. Note that the OECD is a 38-member country club and has no African country as a member of the club, just as the League of Nations had no African members. Through the OECD Model Tax Convention, commentary, guidelines, and other relevant documents, this 38-member club legislate on the tax practices of countries across the globe, both domestically and internationally. Agitation of the power, non-inclusivity and bias of the OECD led to the introduction of the United Nations (UN) Model Tax Convention, commentary, and guidelines in the 1970s, though some may argue that the difference between both treaties is not significant.

While there are other model tax conventions, especially at the national level, these two tax conventions (the OECD's and the UN's model tax conventions) have become law in the tax space (the question where they are hard law or soft law, in many respects, is academic). Countries negotiate bilateral tax treaties on their basis and by virtue of Article 26 of the Vienna Convention on the Law of the Treaties, countries are bound by tax treaties entered into and are expected to perform them in good faith. However, it must be stated that the OECD's Model Tax Convention, due to its history and wide acceptance, is the more used treaty among the two. Some may argue that it has elevated itself to become hard law, and is no longer in the realm of persuasive soft law. Such an argument will not be misplaced, when one considers recent reforms which see the use of multilateral instruments in reforming domestic tax laws of countries. As argued, these soft laws have had tangible impacts on countries and countries have been known to change their tax regimes to align with the transactional legal order of international taxation established by these bodies.

Back to the model treaties and their purpose. At the end of the first world war and resumption of international trade, there were fears by firms trading abroad that their income and capital would be taxed more than once—the country where they are resident (home country) and the country where they trade or invest in (host country). To avert this double taxation and encourage foreign direct investment and international trade, these firms lobbied their countries to sign bilateral tax treaties with other countries for the sole purpose of preventing double taxation of taxpayers, as seen in model tax conventions and tax treaties entered into by countries in the 20th century. For example, Article 1 of both the London and Mexico Model Tax Convention drafts of the League of Nations expressly state that the "present convention is designed to prevent double taxation in the case of taxpayers of the contracting States…".

Not long after countries agreed on a model tax treaty for the prevention of double taxation, they realized that they may have empowered firms to create "homeless income", leading to the non-taxation of firms, in addition to the prevention of double taxation. Wells and Lowell remind us that even the early debates recognized that the flaw in the foundational premise was that multinational entities (MNEs) could create holding companies in tax favorable jurisdictions that could produce income not materially taxed in any country. The creation of "homeless income" by tax treaties caused countries to introduce domestic tax base safeguarding measures, such as Controlled Foreign Corporation (CFC) rules, foreign tax credit (FTC) limitation, earnings stripping prevention rules, thin capitalization rules and other general anti-avoidance rules (GAAR). In the absence of uniform tax reform at the global level, tax competition and tax spillover could lead to conflict among countries.

However, domestic general anti-avoidance measures (GAAR) by countries did not wholistically address issues of base erosion and profit shifting, and harmful tax practices of corporations, in some instances, aided by jurisdictions through tax laws and policies. Thus, a multilateral approach to address issues of base erosion and profit shifting was desirable. Under pressure by the Group of Seven (G7) and Group of Twenty (G20) countries, the OECD in 2013 launched the Base Erosion and Profit Shifting (BEPS) initiative, to close gaps for companies that allegedly avoid taxation or reduce tax burden in their home country by engaging in tax inversions (moving operations) or by migrating intangibles to lower tax jurisdictions. 15 Action Items were issued by the OECD, which formed the BEPS Action Plans. They were to address tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax. In 2015, the BEPS package of 15 measures were delivered. Important to note that this package of 15 measures was developed by 44 jurisdictions including all OECD and G20 members participating on an equal footing, as well as through widespread consultations with more than 80 other jurisdictions. The OECD's desire was to introduce "soft law", which will be adopted by most countries both in their domestic and international tax dealings. To achieve this and to obtain legitimacy, the OECD in 2016 established the Inclusive Framework. The Inclusive Framework came as a result of the call by G20 Finance Ministers to the OECD to build a framework by early 2016 with the involvement of interested non-G20 countries and jurisdictions, particularly developing economies, on an equal footing. The mandate of this Inclusive Framework is to implement the BEPS package and finalize the remaining technical work to address BEPS challenges. For context, the delineation of the global tax issues, decision on priorities and solutions to these tax issues were decided by 44 countries between 2012 and 2015. In 2016, other countries (mostly developing countries) were invited to participate in the implementation of these global tax reforms, "on an equal footing". This act by the developed countries led to the metaphor, if you are not on the table, you are on the menu, among civil societies and campaigners. Nevertheless, African countries joined the Inclusive Framework and actively participated in its deliberations. After all, you cannot complain of non-inclusion when you are not part of the decision-making process.

At the conclusion of the first BEPS Initiative, the OECD initiated BEPS 2.0, essentially blueprints on two pillars on finding solutions to the tax challenges arising from the digitalization of the economy. Note that the 2013 BEPS Action Plan 1 focused on addressing the tax challenges of the digital economy and failure to reach a multilateral consensus on it, in addition to its heralded importance for all countries, led to its elevation into BEPS 2.0. The Inclusive Framework is saddled with the responsibility of achieving multilateral consensus on this very important issue.

Without going into the details, Pillar One of the blueprint sets out to develop a new right to tax highly digitalized companies but also consumer-facing companies who reach consumers in a jurisdiction through digital means. Important here is the agreement on the nexus for establishing presence in a jurisdiction, given the limitations of permanent establishment nexus contained in tax treaties. Pillar Two focuses on ensuring that large internationally operating businesses pay a minimum level of tax regardless of where they are headquartered or the jurisdictions they operate in. These two pillars have pre-occupied the focus of the international tax community for the last five years, with countries and experts heavily investing in the process. Nigeria's active involvement saw the then head of the international tax department and now head of the tax policy department of the Federal Inland Revenue Service become the Vice-Chairman of the Inclusive Framework. Thus, it is safe to claim that Nigeria, as many other African countries, sought a multilateral solution to the global tax issues and actively participated in the negotiation. However, Nigeria, in addition to Kenya, Sri Lanka and Pakistan, withheld its vote on the global solution, whose process it actively participated in.

The issues plaguing global corporate tax rules can be summarized thus: conflict of allocation of taxing rights between residence (mostly developed countries) and source states (mostly developing countries); treatment of subsidiaries of MNEs as separate entities, base erosion and profit shifting activities of MNEs through transfer mispricing and earnings stripping activities; and finally, tax competition through low or no tax rates. Note that countries can address these issues through their domestic laws, however (as feared in the 1920s), it is the conviction that unilateral actions of countries will lead to double taxation of firms and adversely affect foreign investments, making it important to adopt a global consensus on addressing these tax challenges. Hence, the BEPS process and the establishment of the Inclusive Framework. What is clear from the reactions of the African and other developing nations, is that while the OECD may have achieved something historic (getting 136 jurisdictions to "agree" on a global approach to tax MNEs is no mean feat), the global solution has failed to meet its demands. One such demand is that the global minimum tax must be at least 20% (25% for civil societies), however, the OECD has opted for a global minimum tax of 15%. The two-pillar solution excludes extractive industries and financial services from its scope, two important economic sectors to Nigeria, in terms of employment and GDP contribution. It is arguable that the Inclusive Framework achieves little or nothing for Nigeria, which may explain the country's withdrawal of support for the "historic" global tax plan.

Now, what becomes of Nigeria and other African countries? First, it must be stated that tax is a sovereignty issue and the sovereignty of national taxation should be protected. Where soft law fails to achieve fair and equitable treatment of all countries, countries will assert their sovereignty on tax matters, which must be respected. As Benjamin Franklin echoed, "we must, indeed, all hang together, or most assuredly we shall all hang separately." For Nigeria, this means taxing profits of any company, which accrue in, are derived from, brought into, or received in Nigeria, as provided for in S. 9 of the Corporate Income Tax of Nigeria. Options such as alternative corporate minimum tax (ACMT), formulary apportionment of profits of MNEs and digital services tax (DST) should be adopted by the country in the exercise of its sovereign power to tax income and profits with significant economic presence within its territory. Tax regimes should be at the determination of the country, without fear of being black-listed or "punished" by the developed countries. It is therefore puzzling that the OECD in the October 2021 agreement has asked countries to remove all digital services taxes and other similar measures with respect to all companies, and to commit not to introduce such measures in the future. Note that Pillar I of the two-pillar solutions only applies to in-scope companies (about 100 global MNEs), leaving out the thousands of MNEs operating in developing countries. What rules apply to them? The existing arm's length principle, adjudged to be flawed, which led to the current BEPS process? In the absence of guidance or any guiding international law, countries should not be berated for introducing and implementing domestic measures. After all, nature abhors a vacuum.

Second, a new international soft law regime and global sovereign should be created by Nigeria and other African countries. For decades, scholars and stakeholders have called for the establishment of a UN tax body, with obvious merits for developing countries. While this may still be desirable, it is high time the African Union (AU) played an important role in tax matters. There are reasons for this. An AU tax body and regime will provide African countries with stronger bargaining power, akin to the roles of the United States congress and the European Union parliament on tax matters. Decisions reached at the OECD and other global platforms are subject to approval at the legislative houses of these unions, offering further protection and influence. An AU tax body negotiating on behalf of all African countries will better represent the continent and influence decisions at the global level. The other reason is that, since the coming into effect of the African Continental Free Trade Area (AfCFTA) agreement, tax issues pose non-tariff barriers to the successful implementation of the free trade area, especially corporate income tax. Hence, an AU tax regime on corporate income taxation of firms trading within the free trade area will avert tax avoidance, tax evasion and tax competition, which may act as barriers to the success of the AfCFTA.

Finally, corporate income tax is of great economic relevance to Nigeria (largest contributor of non-oil tax to the country's revenue) and other African countries. According to African Tax Administration Forum (ATAF), large taxpayers (usually MNEs) account for 78% of total tax revenue collected by African countries, and corporate income tax is a significant part of the total tax revenue. Thus, preserving the corporate income tax is of great relevance to Nigeria and other African countries. The failure of multilateralism in achieving a fair and equitable global tax solution leaves countries with no choice but to seek unilateral measures and new alliances. Such actions are justifiable, and Nigeria, just like Kenya, is right to have taken the first step in not supporting the global tax plan. It must now be bold in its next steps, by (1) protecting its fiscal sovereignty and exercising it without fear in accordance with laws of the state; and (2) by rallying other African countries, under the auspices of the African Union to develop a tax regime that will work for the continent and ensure the successful implementation of the AfCFTA.

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