TAX AND FINANCIAL IMPLICATIONS OF THE AFRICAN CONTINENTAL FREE TRADE AGREEMENT (AfCFTA) FOR AFRICAN DEVELOPMENT

1. Introduction/Scope

The scope of this presentation is the tax implications of AfCFTA on Nigeria (and Africa's) development. There will be a brief explanation of the nature of the AfCFTA agreement and how it will impact the Nigerian tax environment. The presentation will then look broadly at the implications of AfCFTA on African development.

The paper evaluates AfCFTA impact on the federal tax authority in Nigeria. The selected areas of focus are:

(a) Article 15 of the Protocol on services (general exceptions)

(b) Value Added Tax implementation and

(c) Information Technology (ICT)

Although implementation of AfCFTA substantially concerns Duties, the presentation will focus on taxes particularly as administration of Duties and taxes are segmented in Nigeria i.e. taxes are collected by Revenue Authorities, while Duties are collected by the Nigeria Customs Service (NCS). The discourse will then assess the issues that are germane to the broader discussion on implementation of AfCFTA in Africa.

The aim of the presentation is to assess how AfCFTA will impact tax administration in Nigeria first and then in Africa.

2. The AFCFTA Agreement

The African Continental Free Trade Area (AfCFTA) is a landmark Trade Agreement that was signed by 54 African countries in 2018 and officially launched on January 1, 2021. It aims to create a single market of 1.3 billion people, making it the largest free trade area in the world.

The (AfCFTA) Agreement has eight (8) parts which are made up of the following: Definitions, Purpose, Objectives and Origin Conferring Criteria, Administration and Organization, Transparency, Continental Preferences, Dispute Settlement and Final Provisions. These Parts are made up of thirty (30) Articles and various Protocols.

The Protocols include (a) Trade in Goods (b) Trade in Service (c) Rules and Procedures on the Settlement of Disputes (d) Investment (e) Intellectual Property Rights (f) Competition Policy.

The AfCFTA is a trade and not a taxing Agreement. The main Agreement and its Protocols provide for the typical processes and procedures found in other trade Agreements. However, taxation could be said to a back-end result of the Agreement as profits or income on good or services traded would be taxed in the appropriate jurisdictions (by virtue of residence, source or nexus).

3. Projections of the Impact of AfCFTA on African Countries Viz a Viz the Nigerian Tax Environment

Different studies have projected the expected impact of AfCFTA on the African tax environment, and these include:

(a) An IMF report that notes that the AfCFTA could pose a challenge despite its noble objectives, as African governments must ensure that they do not lose significant tax revenues due to trade liberalization (IMF, 2019).

(b) A United Nations Economic Commission for Africa (UNECA) study which observes that the AfCFTA is expected to significantly increase intra-African trade by 2020. The study also projects that the AfCFTA could generate significant tax revenue in the long term, with the majority of the revenue coming from Value-Added Tax (VAT) and Customs Duties. In the short term however, the creation of a single market for goods and services, resulting from the implementation of the Agreement can be expected to lead to increased tax competition as countries may lower their tax rates to attract investment. This holds the potential for reduction in tax revenue in the short term.

(c) An African Development Bank (AFDB) report which posits that, AfCFTA could boost intra-African trade significantly by 2022, with significant benefits to African countries. In addition to the benefits to businesses and consumers, the AfCFTA Agreement will also have a significant impact on government revenues. As tariffs come down, African governments will lose tax revenues, which will need to be replaced by other forms of taxation. This could be a challenge for many African countries, as they are already struggling to raise revenue through taxation.

The AFDB report notes that African countries will need to be creative in their approach to revenue generation, and may need to consider alternative forms of taxation, such as VAT or Excise taxes, to replace lost revenue from tariffs. The report also notes that African countries may need to strengthen their tax administration systems to ensure that they are able to effectively collect taxes and enforce tax laws.

4. AfCFTA Impact on Nigerian Value Added Tax (VAT) Administration/Rate

Since AfCFTA deals with tariffs and external trade, it is not expected that there will be an increase in VAT or income tax rates simply because of shortfalls that might ensue as a result of implementation of the Agreement. Increase or decrease in tax rates in Nigeria is influenced by many other factors. The Nigerian VAT rate was 5% from introduction of the tax in 1992. It was only increased to 7.5% via Section 42 of Finance Act 2020.

This is one of the lowest rates in the regional grouping of Economic Community of West African States (ECOWAS). As a result of having one of the lowest VAT rates within the West African sub region, the country is already at an advantage (in respect of external trade). Increasing the VAT rate would in fact throw up the possibility of losing this advantage. The thrust in the internal Nigerian tax environment as regards VAT is to expand the collection base rather than increase the rate. Some of the programs to expand VAT collection in Nigeria include automation of the processes, access to the informal sector (segments of the business community that are within the VAT threshold but are under the radar) and also introduction of incentives like VAT lottery which compensates the VAT compliant taxpayers by introducing lottery wins.

Accessing VAT revenues from the informal sector has necessitated signing a Memorandum of Understanding with market groups like the Market Traders Association of Nigeria (MATAN). These internal VAT improving measures when implemented will lead to more tax being collected and ultimately improve the tax to GDP ratio which currently stands at 10.8%. It should also be noted that VAT is imposed on residents and will not normally be paid by a non-resident businesses.

5. Tax Treaties

How will AFCFTA affect Nigerian tax treaties and Nigerian income taxes?

Articles 15(d) and (e) of the AfCFTA Protocol on goods and services provide general exceptions to the expectations of National Treatment and Most Favoured Nation (MFN) status for member States respectively.

Article 15(d) of the Protocol provides that exceptions to national treatment arise where 'the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other States Parties'. This provision is reflective of s.13 (2) (b) of the Companies

Income Tax Act (CITA) and s.6(a) and 7 of the Personal Income Tax Act (PITA). These sections of Nigerian income tax laws reflect the nexus and sourcing principles for incomes subject to Nigerian taxes. In Nigerian domestic law, the national treatment for Nigerian residents allows for worldwide taxation of the income of residents (individuals and companies). While taxation of non-residents on the other hand is based on sourcing rules i.e. only incomes of a non-resident derived from Nigeria are subject to Nigerian taxes. Therefore, this mode of taxation for non-resident companies protects the non-residents from double taxation. It should also be noted that this practice of ensuring that trade laws do not affect the tax Acts of individual States is also present in other continental trade blocks e.g. in Europe.

In respect of Most Favoured Nation (MFN) status for member States, once again the provisions of Nigerian treaties on double taxation override the expectation of Most Favoured Nation treatment. Article 15(e) provides that the status can be done away with where 'the difference in treatment is the result of an Agreement on avoidance of double taxation or provisions on the avoidance of double taxation in any other international Agreement or Arrangement by which the State Party is bound.' Nigerian tax treaties do not typically provide for MFN status, save for that negotiated with Singapore and Sweden. Where an MFN provision is included in a treaty between two countries, it allows for a treatment accorded a third-party State to be accorded to the treaty partner of an MFN negotiated treaty.

Newer tax treaties make no provision for MFN. Particularly, the tax treaties on double taxation with 15 ECOWAS countries, approved by their heads of government on 22nd December 2018 do not provide for MFN treatment. The treaties will come into force in the respective countries upon publication in same.

This provision will therefore not be of much use in Nigeria, since the Treaties that have it are with countries outside Africa. Worthy of note is whether it (MFN) will affect the oldest tax Treaty that Nigeria has with an African country i.e. South Africa. The answer is no, since the MFN provision is no longer applied by Nigeria.

6. Synergizing e-taxation with other African countries

Electronic payments to Nigeria (from outside the country), are coordinated through the Central Bank of Nigeria. As yet there is no plan to synchronize Nigerian internal digital e-payment with other African countries. This of course may not hold true for tariffs.

Nigerian tax collection is segmented between taxes and tariffs. As noted in the introductory paragraph a major aim of AfCFTA is to reduce or eliminate tariffs and non-tariff barriers to intra-African trade to promote economic growth. This implies that internal taxes will not be directly impacted.

7. Challenges of AFCFTA in African Development in the Tax Sphere (and Implications of the Agreement on the Continent as a Whole)

While the African Continental Free Trade Area (AfCFTA) and the African Development agenda have the potential to significantly boost economic growth and development in Africa, there are also significant challenges that must be addressed.

One major challenge of the AfCFTA is that the reduction or elimination of import tariffs could lead to revenue loss for African governments. According to the United Nations Conference on Trade and Development (UNCTAD) 2019, African countries could lose significant tariff revenue per year as a result of the AfCFTA. This could be particularly challenging for some African countries that rely heavily on tariff revenue for their budgets.

Another challenge of the AfCFTA is the need to harmonize tax policies and administration systems across African countries. Without a common taxation framework, businesses may struggle to navigate the different tax regimes in different countries. In addition, differences in tax policies could lead to distortions in trade and investment patterns across the continent.

Furthermore, there is the need to expand the tax base in order to finance infrastructure development. According to a report by the International Centre for Tax and Development (ICTD) 2019, significant number of Africans are currently not paying VAT, and many African countries have low levels of tax compliance. In addition, African countries face challenges related to the administration of tax policies. Many African countries have weak tax administration systems that are prone to corruption and lack the capacity to effectively enforce tax laws. This makes it difficult for African countries to generate the revenue needed to finance infrastructure development.

Addressing these challenges will require significant reforms and investments in tax policies and administration systems. African countries will need to focus on expanding the tax base, improving tax compliance, and strengthening tax administration systems to generate the revenue needed for economic growth and development.

One potential solution to the challenges of taxation in Africa is the adoption of technology-based solutions. For example, digital platforms could be used to improve tax compliance and administration, and blockchain technology could be used to improve transparency and reduce corruption in tax administration.

The AfCFTA is expected to have significant implications for taxes in Africa. The Agreement will boost trade within Africa, leading to increased economic activity and job creation. The AfCFTA integration scheme will necessitate African countries' harmonization of tax policies to facilitate trade, promote investment, and sustain the growth trajectory of African countries. Through commitment and collaboration, African countries can harmonize their VAT systems, adopt a common approach to the taxation of digital products and services, review and enhance their investment incentive programs, adjust to tariff reductions, and improve institutional capacity and regulatory framework on taxation systems for sustained economic growth and development in Africa.

Though AfTCFA is likely to have a discouraging effect on tax revenue in the short term because of reduction and/or harmonization of tariff, African countries should be encouraged by the fact that it will result in improved revenue generation in the long term as a result of increased investments and an expanded tax base.

8. **RECOMMENDATIONS**

Based on the tax implications discussed above, the following are recommendations on how African countries can improve their tax systems to facilitate trade, promote investment and achieve economic growth and development under the African Continental Free Trade Agreement:

i. Adopt a common approach to taxation of digital products and services: African countries should develop a common approach or framework for taxing digital products and services, including but not limited to e-commerce transactions, to promote their domestic tax revenue and sustain macroeconomic stability.

ii. Review and optimize investment incentives: In considering AfCFTA, African countries must review their current tax incentive programs, especially those that could have a negative impact on domestic industries. Thus, they should adopt a more objective evaluation of their tax incentive regimes to attract investment in the country, boost economic growth, and create employment opportunities in their respective countries.

iii. Strengthen institutional capacity and regulatory framework: African countries should increase their institutional capacity and regulatory framework on taxation systems to achieve a consistent business environment and foster economic growth and development. African governments can collaborate on tax reforms concurrently as the AfCFTA is implemented to measure progress and identify gaps.

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