POLICY BRIEF ON DOUBLE TAXATION AGREEMENTS: THE CASE OF ZIMBABWE 2017

Introduction and Background

The elimination of double taxation of income and capital involving cross border transactions is at the forefront of international taxation, which emphasizes the need for cooperation on economic, financial and fiscal matters. Double taxation arises when two or more tax jurisdictions overlap, such that the same item of income or profit is subject to tax in each. Double Taxation Agreements were therefore instituted as an international tax instrument for avoiding double taxation of the same income or capital to the same taxpayer in the same period in two jurisdictions and promoting international tax compliance and information sharing. However, in recent years, there has been increasing global debate regarding the effectiveness of double taxation agreements in relation to 1) determining investor decisions; 2) increasing Foreign Direct Investment (FDI) and expanding the tax base through new investments; 3) elimination of certain forms of double taxation; 4) how certain profits are to be calculated; 5) providing certainty of treatment; and 6) Promoting international tax compliance and information exchange.

The effectiveness of DTAs on FDI, despite the contestation is on the basis that they provide certainty to investors on the taxing rights of contracting parties. On that basis, investors will be able to assess their tax liabilities that accrue by investing in the source country. However, a cocktail of political, economic, social and technological factors determines FDI, and DTAs have insignificant influence on the decision to invest, if any. The debate, however, prompted the renegotiation of double taxation agreements, especially those signed between developed and developing countries. In essence, when the contracting states are at different economic levels the flow of income becomes one directional, from the developing country (source country) to the developed country (resident country).

1. An area, city, municipality, county, country with its own distinct regulations for taxation. (http://thelawdictionary.org/tax-jurisdiction/)
2. Inland Revenue Department, The Government of the Hong Kong Special Administrative Region, downloaded from http://www.ird.gov.hk/eng/pol/dta.htm
3. Irish, C.R (1974) International Double Taxation Agreements and Income Taxation at Source; The International and Comparative Law Quarterly, Vol. 23, No. 2, (Apr., 1974), pp. 292-316; Cambridge University Press on behalf of the British Institute of International and Comparative Law.

This has seen a major shift from the Organization for Economic Cooperation and Development (OECD) model whose provisions takes away taxing rights from the source country, towards the United Nations (UN) model which represents a compromise between the source principle and the residence principle, although it gives more weight to the source principle (UN Model, (updated) 2011).

In recent years, it emerged that DTAs are used as a conduit for tax avoidance by multinational corporations (MNCs) across tax jurisdictions through tax planning schemes, treaty shopping and round tripping resulting in "double non-taxation". Despite the increasing debate regarding its effectiveness, the number of DTAs stands at more than 3000 to-date. Zimbabwe alone has signed 17 DTAs with both developed and developing countries, as of 31 December 2015.

Considering the role that Switzerland and Mauritius play in banking secrecy and as a tax haven Zimbabwe could have lost money from these and other tax treaties signed to date. In Zimbabwe, most tax treaties apply to income tax, nonresident shareholder tax, capital gains tax and nonresident tax on fees, royalties and interests. Furthermore, all the DTAs signed by Zimbabwe limit the rate of tax on technical fees to 10% or less.

RATIONALE

This policy brief provides an overview of DTAs within the international taxation framework with a particular focus on those signed by Zimbabwe and partner countries. It therefore interrogates the implications of DTAs on social and economic rights of citizens of Zimbabwe in particular and developing countries in general as well as key recommendations for Zimbabwe.

KEY FINDINGS

As of December 2015, Zimbabwe had signed 17 DTAs with both developed and developing countries, with the first between Zimbabwe and Switzerland having been signed in 1961.

Figure 1: Total number of Double Taxation Agreements concluded as of 1 June 2011

	Partner Country	Type of Agreement	Date of Signature
1.	Botswana[1]	Income and Capital	16-June-04
2.	Bulgaria	Income and Capital	12-Oct-88
3.	Canada	Income and Capital	16-Apr-92
4.	China	Income and Capital	01-Dec-15
5.	France	Income and Capital	15-Dec-93
6.	Germany	Income and Capital	22-Apr-88
7.	Malaysia	Income and Capital	28-Apr-94
8.	Mauritius	Income and Capital	06-Mar-92
9.	Netherlands	Income and Capital	18-May-89
10.	Norway	Income and Capital	09-Mar-89
11.	Poland	Income and Capital	09-Jul-93
12.	Serbia	Income and Capital	19-Oct-96
13.	South Africa	Income and Capital	10-Jun-65 reviewed 4-Aug-15
14.	Sweden	Income and Capital	10-Mar-89
15.	Switzerland	Income and Capital	30-May-61
16.	United Kingdom	Income and Capital	19-Oct-82
17.	Zambia	Income and Capital	29-Nov-12

Source: UNCTAD, 2013 (edited by the author)

Zimbabwe recently signed two more DTAs with China and Zambia on 1 December 2015 and 29 November 2012 respectively. On 4 August 2015, Zimbabwe and South Africa signed a DTA which will, once ratified by both countries, replace the outdated 1965 treaty between South Africa and the then Southern Rhodesia. This is an important step towards aligning the DTAs with recent national and global economic developments and also reclaiming the lost taxing rights on the basis of the resident based treaties, which dominate the agreements signed by Zimbabwe. Zimbabwe adopted both the OECD and the UN model conventions in the various DTAs signed to date and sometimes embrace a hybrid of the two.

4. The Organization for Economic Cooperation and Development (OECD) is a unique forum where the governments of 34 democracies with market economies work with each other, as well as with more than 70 non-member economies to promote economic growth, prosperity, and sustainable development. (https://usoecd.usmission.gov/mission/overview.html)
5. The Institute of Chartered Accountants in England and Wales accessible at http://www.icaew.com/en/library/key-resources/double-tax-treaties
6. ZIMRA website: Fiscal Incentives Made Available for Investors, downloaded from http://www.zimra.co.zw/index.php?option=com_content&view=article&id=74&Itemid=73

About 75% of these tax treaties where signed within a period of 15 years (between 1982 and 1996) with the balance shared equally before independence and most recently with Botswana, China and Zambia.The current economic crisis bedeviling the country has rendered all the existing DTAs unidirectional which compromises the benefit that should arise from the signed DTAs. Article 12 of the DTA between the Government of the Republic of Zimbabwe and the Government of the Peoples Republic of China, for instance provides for the taxation of royalties in the contracting state in which they arise at a rate not exceeding 7.5% of the gross amount of royalties. Considering the current trend of investment, particularly into the mining sector by the Chinese into Zimbabwe, such a rate will impact on the total revenue collection into the Zimbabwean fiscus.The table below illustrates the difference between the normal nonresident tax compared to a selected rates agreed in the respective treaties.The variance between the normal tax rate and the DTA rate represents the tax foregone by Zimbabwe and notable is the 2.5% levied on Chinese investments against the standards nonresident tax on dividends of 10%.

Withholding Tax: Treaty against non - Treaty Rates

	Normal Tax Rate %	UK	Germany	Netherlands	Sweden	South Africa	China	Botswana
Non Resident tax on Dividends (Minimum of 25% shareholding10	10	5	10	10	15	5	2.5	5
Non-Resident tax on Dividends (In all other).	10	5	10	10	15	10	7.5	10
Non Resident tax on interest (repealed with effect from 30 Sept 2009)	-	-	-	-	-	5	7.5	10
Non Resident tax on Fees	15	10	7.5	10	10	5	10	10
Non Resident tax on Remittances	15	20	20	20	20	-	-	-
Non Resident tax on Royalties	15	10	7.5	10	10	10	7.5	10

Source: PKF11, 2013

THE IMPLICATIONS OF DTAS ON THE EXTRACTIVE INDUSTRY

It is particularly important to note that the mining sector is regarded as a unique sector as it involves high sunk costs, and as such is treated differently from the other sectors of the economy. Under the Zimbabwean law for instance, the carrying over of loses indefinitely was meant to cushion the mining companies from the high sunk costs they incur. However, the facility is abused as some mining companies declare losses indefinitely as well. In the event of double tax treaties, companies can even shift profits to the destination country (without any economic activity). Double taxation agreements further minimize tax payment by mining companies who already enjoy the following incentives in Zimbabwe;

- All capital expenditure on exploration, development, and operating incurred wholly and exclusively for mining operations is allowed in full.
- There is no restriction on carryover of tax losses; these can be carried forward for an indefinite period.
- Taxable income of a holder of special mining lease is taxed at a special rate of 15%.

Furthermore, the mining companies enjoy stabilization clauses, which imply that any changes in domestic laws do not affect the terms agreed in the mining contract. In the event of a renegotiation of DTAs, for instance, the mining companies will not be affected by the new terms. Over and above that, all the mining agreements in the case of Zimbabwe are

7. Agreement between the Government of the People's Republic of China and the Government of the Republic of Zimbabwe, 2015
8. Treatypro:downloaded from http://www.treatypro.com/treaties_by_country/zambia.asp
9. View Point Africa, Zimbabwe Ratifies Double Taxation Treaty with South Africa, Celia Becker, 2016

- protected by secret clauses such that the public does not have access to the terms of the agreement. This makes the sector more vulnerable to tax evasion and avoidance by MNCs. The United Nations Economic Commission for Africa estimates that, over the period 2000- 2009, 56 per cent of illicit financial flows from Africa came from the oil, precious metals and minerals, ores, iron, steel and copper sectors.

The recent agreements signed by Zimbabwe are based on the UN Model convention which considers a permanent establishment in its broader perspective to encompass:

(a) a building site, a construction, assembly or installation project or supervisory activities in connection therewith, b) the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State.

Whereas the UN Model requires that such site/installation/assembly project or supervisory activities last more than 6 months, the OECD model requires that it last more than 12 months to qualify as a permanent establishment. However Zimbabwe selectively applies the qualifying period based on each agreement. The most recent MoUs with Botswana, South Africa and Zambia applied the 6-month period whilst the one with China is based on the OECD model. This prohibits the country from benefiting, as it does not allow Zimbabwe to assert taxing power over short-term investments. Despite being a recent treaty, the Chinese DTA should be renegotiated on that basis, as most of the Chinese investments into Zimbabwe are of a short-term nature.

THE CASE OF CALEDONIA'S BLANKET MINE

Blanket Mine (1983) Private Limited (BML) is a typical company that enjoys the double taxation agreements with South Africa and the United Kingdom through its subsidiaries Caledonia (Pty) Limited and Greenstone Management Services Limited respectively. Before moving the parent company to Jersey in 2016, Kinross Gold Corporation was headquartered in Canada, which signed a tax treaty with Zimbabwe in 1992. In that case, Blanket mine enjoyed the concessionary tax rates as agreed in the three treaties. By adding two subsidiaries in South Africa and the UK, Caledonia reduced withholding taxes payable to Zimbabwe. Further, by moving the parent company to Jersey, Caledonia reduced the shareholder withholding tax in Canada. This is referred to as treaty shopping where companies create new subsidiaries in order to take advantage of taxation treaties. As a result, such a company enjoys related party transactions that take place within Caledonia Group of companies.

This makes it complicated for ZIMRA to trace the web of cross border transactions whilst Blanket Mine leverage on that to engage in aggressive tax planning. Such transactions involve what is referred to as abusive transfer pricing which occurs when a multinational corporation takes advantage of its multiple structures to shift profit across different jurisdictions. While it is not wrong for trade to take place between companies that are part of a single group, they would have to comply with the "arm's-length principle" upon which the new transfer-pricing framework that was introduced into the Zimbabwe tax law as of 1 January 2016 is based.

IMPACTS OF DOUBLE TAXATION AGREEMENTS TO ZIMBABWE

The most obvious cost of DTAs is the lost revenue arising from taxing rights surrendered to the resident countries of multinationals investing in Zimbabwe. The foreign investors will pay less in Zimbabwe, a similar amount of tax that will be enjoyed by the resident country, which does not have an economic activity-taking place. Considering that all DTAs signed by Zimbabwe offer reduced rates of withholding taxes on dividends, interest, royalties and technical fees, Zimbabwe loses revenue of the same magnitude determined by the different rates agreed in each bilateral treaty. The United Nations Economic Commission for Africa (UNECA) in its report on Illicit Financial Flows from Africa pointed out that the reduction of tax in a developing country simply translates to a corresponding increase in taxes collected by the resident country. On the other hand, the government further offers investment incentives within the DTAs and a case in point is the limiting of the rate of tax on technical fees to 10% or less, and the levying of the 7.5% or less of the gross amount of royalties in the case of China which is far less than the 10% determined under the OECD Model.

The incurred costs can only pay off if Zimbabwe were to receive more foreign direct investment (FDI) in return and maximize on the economies of scale (Neumayer, 2007). Resultantly, the government will transfer the tax burden from the MNCs to the general citizenry by levying indirect taxes such as VAT. In 2016, VAT (on imports and local sales

10. Payable by all non-resident persons, including companies. For the lower rate to apply, the non-resident shareholder must hold a minimum of 25% of the Zimbabwe Company's shares.
11. Zimbabwe Tax Guide, Published by the PKF International Limited, 2013
12. ZIMRA, Fiscal Incentives Made Available for Investors available on http://www.zimra.co.zw/index.php?option=com_content&view=article&id=74&Itemid=73
13. United Nations Convention Between Developed and Developing Countries, Updated, 2011
14. UNECA, Illicit Financial Flows: Report of the High Level Panel on Illicit Financial Flows from Africa, 2015
15. UNECA, Illicit Financial Flows: Report of the High Level Panel on Illicit Financial Flows from Africa, 2015

combined) contributed about 29% to total tax, ahead of individual tax (23%) (ZIMRA, 2016), thereby increasing the vulnerability of citizens to poverty.

Considering the fact that Zimbabwe has bilateral tax treaties with tax havens like Switzerland, Mauritius and Netherlands, the country is vulnerable to treaty shopping, round tripping and aggressive tax planning by multinational corporations. Resultantly, the MNCs will pay little or no taxes in Zimbabwe and sometimes no tax payment is made in both contracting states resulting in what is commonly known as double non taxation, (OECD). The tax havens are also suspicious of the secrecy, which violates the article on exchange of information. Switzerland for instance insists on exchange of information upon request against the global call to end tax evasion and avoidance through automatic exchange of information.

The negotiations, ratification and implementation of DTAs are done in secrecy in Zimbabwe, thereby excluding other key stakeholders, particularly the ordinary citizens from engaging. This has major ramifications on the outcome of the negotiation that are in most cases unfavourable for Zimbabwe. Whilst promoting exchange of information between Zimbabwe and the partner countries, such information exchange is treated as secret and is only disclosed to persons or authorities (including courts and administrative bodies) concerned upon request, in violation of the new global standard on Automatic Exchange of Information (AEOI) which provides for the exchange of non-resident financial account information with the tax authorities in the account holders' country of residence. Under the AEOI, participating jurisdictions should rather send and receive pre-agreed information each year, without having to send a specific request. This is also contrary to the provisions of the section 62 sub section 1 of the Constitution of Zimbabwe which provides for every Zimbabwean citizen or permanent resident, including juristic persons and the Zimbabwean media to have access to information held by the state or any institution or agency of government at every level, in so far as the information is required in the interest of public accountability. Such lack of transparency and accountability breeds corruption which has the potential to facilitate tax evasion, thereby further perpetuating illicit financial flows (ECA, 2013).

The loss of tax revenue impedes efforts to improve infrastructure, fight poverty and inequality and ultimately ensuring sustainable development in its three dimensions, that is, economic, social and environmental (UN, 2015).

CONCLUSION

If poorly negotiated, double taxation agreements will infringe on the sovereign right of a state to levy taxes within its jurisdiction. This has serious repercussions on the tax revenue collection and ultimately on service delivery for poverty reduction and addressing inequality. The decision to enter into bilateral tax agreements should, therefore, be based on the understanding that both contracting states will benefit, preferably when cross border transactions are reciprocal. In the event that the commercial transactions are not reciprocal and that it is between developed and developing countries, source based taxation should be adopted to avoid base erosion and profit shifting.

The provisions regarding the distribution of taxes (resident or source) form the basis for the negotiations between the contracting states. As long as the flow of FDI remains non-reciprocal, the DTAs between Zimbabwe and partner countries will remain a cost to Zimbabwe. This calls for the renegotiation of the current DTAs especially those entered between Zimbabwe and the developed countries such as Canada, France, German, Netherlands and Norway. By entering into resident based DTAs, Zimbabwe increases its vulnerability to exploitation by giving away her taxing rights.

POLICY RECOMMENDATIONS

The Zimbabwe government should renegotiate DTAs with partner countries to ensure that the country retains more taxing rights (as a source country) over corporates doing business in its jurisdiction. This will enable the country to collect a fair share of tax whilst committing to eliminating double taxation of income and capital.

Zimbabwe should also step up efforts to curtail illicit financial flows perpetrated by MNCs that abuse the double taxation agreements through treaty shopping by enforcing anti avoidance provisions especially towards aggressive tax planning structures in line with the current transfer-pricing framework that was introduced into the Zimbabwe tax law as of 1 January 2016.

The government should make information available with respect to negotiation, ratification and implementation of DTAs including publication of the contents of existing DTAs. The government should further provide information regarding DTAs under negotiations and any plans for renegotiations to allow stakeholder input.

Civil society should take responsibility to raise awareness on the implications of DTAs to social and economic development and build the capacity of members of

16. OECD, Automatic Exchange of Information, downloaded from http://www.oecd.org/tax/transparency/automaticexchangeofinformation.htm
17. Constitution of Zimbabwe Amendment (No. 20) Act, 2013

parliament to analyse and debate DTAs before approval which is consistent with the Public Finance Management Act.
The Zimbabwe Government should take an initiative to influence other African member states to develop hybrid models at regional and continental levels and conclude the current efforts to enforce the COMESA and the SADC model conventions.

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END

18. In this context, the Zimbabwe government refers to the different departments of government responsible for negotiation and drafting of double taxation agreements such as Ministry of Finance, ZIMRA, AG's office, Parliaments and other relevant departments.

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