ANNUAL TAX WORKSHOP PRESENTATION: HARMONISATION OF TAXES IN EAST AFRICA

VENUE: MOMBASA WHITESANDS

DATE: 16th September 2014

Learning Objectives

- To review types of economic integration among countries
- To examine the costs and benefits of integrative arrangements
- To understand the structure of the European Union and its implications for firms within and outside Europe
- To explore the emergence of other integration agreements, especially in the East Africa
- To suggest corporate response to advancing economic integration and Tax administrators benefits/challenges

Introduction

- Economic integration is best viewed as a spectrum with the various integrative agreements in effect today lying in the middle of this spectrum
- The level of integration defines the nature and degree of economic links among countries

Levels of Economic Integration

- **Trading bloc: preferential economic arrangement among a group of countries**
- **Trading blocs may take various forms:**
  - Free trade area
  - Customs union
  - Common market
  - Economic union

The Free Trade Area and the Customs Union

- The *free trade area* is the least restrictive and loosest form of economic integration among countries
- In a free trade area, all barriers to trade among member countries are removed
- Members of a *customs union* dismantle barriers to trade in goods and services among themselves
- A customs union establishes a common trade policy with respect to nonmembers

The Common Market and the Economic Union

- A common market has no barriers to trade among members and has a common external trade policy
- Factors of production are mobile among members
- Members of a common market must be prepared to cooperate closely in monetary, fiscal, and employment policies
- The creation of a true economic union requires integration of economic policies in addition to the free movement of goods, services, and factors of production
- Under this union, members would harmonize monetary policies, taxation, and government spending and a common currency would be used by all members

Arguments Surrounding Economic Integration

- **A number of arguments surround economic integration**
- **These arguments center on:**
  - Trade creation and diversion
  - The effects of integration on import prices, competition, economies of scale, and factor productivity
  - The benefits of regionalism versus nationalism

Trade Creation and Trade Diversion

- **Whereas *trade creation* is positive in moving toward freer trade, and therefore lower prices for consumers within the EU, the impact of *trade diversion* is negative**

Reduced Import Prices

- When a small country imposes a tariff on imports, the price of the goods will typically rise, which will in turn result in lower demand for the imported goods
- When a bloc of countries imposes the tariff, the fall in demand for the imported goods will be substantial

Increased Competition and Economies of Scale

- **Integration increases market size and may result in a lower degree of monopoly in the production of certain goods and services**
- **Certain industries may not be economically viable in smaller, trade protected countries**
  - Internal economies of scale
  - External economies of scale

Higher Factor Productivity and Regionalism Versus Nationalism

- **When factors of production are freely mobile, the wealth of the common market countries, in aggregate, will likely increase**
- **Factor mobility will not benefit each country in the common market**
- **The biggest impediment to economic integration remains the reluctance of nations to surrender a measure of their autonomy**

European Integration

- **Economic integration in Europe from 1948 to the mid 1980s:**
  - Organization for European Economic Cooperation (OEEC)
  - Treaty of Rome
  - European Free Trade Association (EFTA)
  - Common agricultural policy (CAP)

Organization of the EU

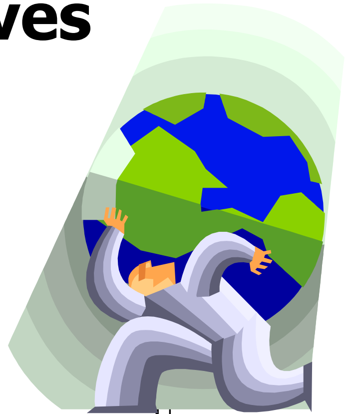
- The executive body of the EU is the European Commission, headquartered in Brussels
- The Council of Ministers has the final power to decided EU actions
- The future expansion of the EU will cause changes in the decision making processes

Implications of the Integrated European Market

- **Perhaps the most important implication for Europe is the economic growth that is expected to result**
- **Several specific sources of increased growth have been identified:**
  - Gains from eliminating transaction costs
  - Achievement of economies of scale
  - More intense competition
  - Cheaper transaction costs and reduced currency risks

Economic Integration and the International Manager

- **Regional economic integration creates opportunities and challenges for the international manager**
- **Economic integration may have an impact on a company's entry mode**
- **Decisions regarding integrating markets must be assessed from four different perspectives**
  - Effects of change
  - Strategic planning
  - Reorganization
  - Lobbying



MNE Tax Planning Strategies

Not surprisingly, the international tax and effective tax rate ("ETR") strategies of MNEs evolved based on this treaty model. Common structures included what we today describe as:

1. Global/regional principal
2. Centralized risk-taker, intangibles owner
3. Limited risk activities in high tax countries

ANATOMY OF INCOME SHIFTING (BASE EROSION)

Think Different

Apple Computer, Inc.

STARBUCKS COFFEE

Capgemini

ULTING.TECHNOLOGY.OUTSOURCING

Tax Havens/ Low tax regimes

facebook

Google

accenture

High perf… ce. Delivered.

amazon.com

& many more…

EAST AFRICAN COMMUNITY

1. Comprises the Republics of Burundi, Kenya, Rwanda, Uganda and the United Republic of Tanzania

2. Combined population of approximately 132 million

3. Total combined area of 2.01 million sq km

4. Total GDP of 98 billion Dollars/ Kenya 44.1billion(2013)

SAFEGUARDS AGAINST ANOTHER COLLAPSE

SAFEGUARDS IN THE EAC TREATY :

Drawing lessons from the experience of the erstwhile EAC, the Treaty Provides for:

1. A gradual approach to the Regional Integration Process

1st Phase - Customs Union (Entry Point)

2nd Phase - Common Market

3rd Phase - Monetary Union

4th Phase - Political Federation

- **Customs Union**: When two or more countries remove tariffs and other barriers on the movement of goods originated from among member states

Common Market

- **Common Market**: When two or more states come together to trade as a block thereby creating a bigger consumer base for their products and services

Objectives of the EAC Common Market

The objectives of establishing a Common Market are to:-

- Accelerate economic growth and development through the attainment of free movement of goods, labour, services, capital, persons, and right of establishment and residence;
- Strengthen, coordinate and regulate the economic and trade relations among Partner States in order to promote their accelerated harmonious and balanced development;
- Sustain expansion and integration of economic activities, the benefit of which shall be equitably distributed.
- Promote common understanding and cooperation among the people of EA for their economic, social, cultural and technological advancement.

The freedoms and rights under Common Market

In accordance with the provisions of Articles 76 and 104 of the Treaty , the draft Protocol on EAC-CM shall provide for : -

- **Free movement of goods;**
- **Free movement of persons;**
- **Free movement of labour;**
- **Right of establishment;**
- **Right of residence;**
- **Free movement of services; and**
- **Free movement of capital;**

- Common Market Protocol singed 20th November, 2009
- Ratification by Partner States
- To enter into force by 1st July, 2010
- Study on Institutional Structure
- Amendments of Laws and the Treaty

Challenges to tax Administrators

- Possibility of product dumping through a partner state
- Reduced revenue collection in the block due to tax base shifting.
- Currently different local tax rates e.g VAT, Excise and levies

Taxpayers benefits

- **Reduced tax transaction costs in value process.**
- **Quick tax resolutions in cases of transfer pricing among partner states entities.**

Questions Session