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International tax agreements and domestic resource mobilisation: Norway's treaty network with low-income countries in Africa

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This report is the product of its authors, and responsibility for the accuracy of data included in this report rests with the authors alone. The findings, interpretations, and conclusions presented in this report do not necessarily reflect the views of the Evaluation Department.

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Foreword

Support for mobilization of domestic tax revenues in developing countries, is a prioritized area for Norwegian development assistance to low-income countries. Norway's Tax for Development program coordinates and ensures quality of Norway's work in areas related to taxation, capital flight and development.

This study sheds light on the main provisions in Norwegian bilateral tax treaties and their implications for tax revenue generation in low-income partner countries. The study argues that tax treaties function in tandem with domestic legislation in treaty partner countries. While there is a potential for strengthening the position of low-income developing countries in the existing bilateral tax treaties -most of which are dated, the study also emphasizes the need for revisiting domestic legislation to reduce leakage of tax revenues from the host countries. We hope that this study will inform the design and programming of Norwegian effort to support domestic revenue mobilization in developing countries.

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Any remaining errors are my own. The information contained herein is not intended to be a source of investment advice with respect to the material presented. The Evaluation Department assumes no responsibility or liability for any errors or omissions in the content of this paper.

Executive Summary

The impact of tax treaties on domestic revenue mobilisation in developing countries has become a seminal point of discussion in international taxation. This study seeks to understand and assess the main provisions under bilateral tax agreements of Norway with low-income and low-middle-income countries in Africa.

The main findings of the study are as follows:

The primary impetus for the conclusion of a tax treaty is the desire to attract investment through elimination of double taxation. Studies that have sought to determine the impact of tax treaties on foreign investment however are inconclusive at best.

With few exceptions, most of the bilateral tax agreements of Norway with low-income African countries follow the Organisation for Economic Co-operation and Development OECD model. This contrasts with use of the United Nations model by Norway in its bilateral tax agreements with Asian countries. The UN model is cited as more favorable to developing countries as it widens the taxing rights of the country of source. Most of Norway's tax agreements with low-income African countries are dated and need renegotiation. This may partly explain the prevalence of OECD model so far.

Currently no Norwegian tax treaty applies the African Tax Administration Forum model –the model established by the African Tax Administration Forum. The provisions in the African Tax Administration Forum model could play a role in reformulation of specific clauses in tax treaty renegotiations based on the United Nations model.

Majority of Norway's treaty partners in Africa have incorporated treaty provisions regulating transfer pricing whereby firms misprice internal transaction to move profits to low-tax jurisdictions.

Most of Norway's treaty partners in Africa are yet to incorporate treaty provisions to effectively deal with thin capitalisation due to cross-border debt bias that encourages investors to finance their investments through debt in order to take advantage of the deduction of interest payments from taxable business income.

Irrespective of the nature of the underlying tax treaty:

- Tax preferences to incentivise priority sectors (ex. agriculture, renewable energy) through rules (such as accelerated depreciation allowances and special allowable deductions related to the development costs) limit the revenue raising potential through the taxation of business profits of foreign investments in these priority sectors.

- Weaknesses in capital gains taxation in source countries or third jurisdiction through which Development Finance Institutions (DFIs) invest, together with tax-free status awarded to state owned DFIs in their home countries runs the risk of double non-taxation –i.e. the avoidance of taxation on capital gains derived from the transaction.

- The net impact of a tax treaty on domestic revenues is dependent on the context. Nature of domestic corporate taxation, type of investment, investment sector and, notably, the type of investor are some of the important contextual factors that determine the net impact.

The principle of equitable taxation of capital gains, earned by DFIs, has become a seminal point of discussion in international taxation. Capital exporting countries need to assure equitable taxation of capital gains –in particular, gains accruing to official developmental assistance financed DFIs such as Norfund -the primary channel for Norway's official developmental assistance financed investments in low-income African countries. There is a need to focus on double non-taxation resulting from preferential tax treatment of DFIs in their home country.

1. Background and context

The primary impetus for the conclusion of a tax treaty is the desire to attract investment. Thus, a country will choose to forfeit its taxing rights in return for a prospective investment it might receive in return for such forfeiture. The validity of the premise, that compromising taxing rights leads to an increase in investments, has been subject to scrutiny in recent years. Studies that have sought to determine the impact of tax treaties on foreign investment are inconclusive at best. Some studies have found that there is no direct evidence that the conclusion of a treaty results in the mobilisation of foreign investments.[1] Other conclude that tax treaties have a positive effect on foreign investment in low and middle-income countries.[2] Interestingly, some studies have found that capital-importing countries find themselves in a "prisoner's dilemma".[3] This is because these countries are required to forsake taxing rights in hopes that such forfeiture will give them a competitive advantage for investment purposes while the envisaged investments remain uncertain.[4]

The impact of tax treaties on domestic revenue mobilisation in developing countries has become a seminal point of discussion in international taxation. In 2014, the Organisation for Economic Cooperation and Development (OECD) implored developing countries to sign treaties with judiciousness due to the perceived loss of revenue resultant from such treaties.[5] The UN has also released practical guidance to effectively negotiate double tax treaties and, in particular, those drawing upon the United Nations Model Double Taxation Convention between Developed and Developing Countries.[6] Some authors have questioned the significance of studies that seek to determine the impact of tax treaties on revenue mobilisation, pointing to the inadequacies of domestic legislation as the primary cause for concern.[7] A recent study by Action Aid[8] highlights the role of tax treaties in the corrosion of the tax revenue of developing countries. The study brings the legitimacy of tax treaties into disrepute[9] forcing countries to adopt a heuristic approach, such as the renegotiation of tax treaties, to address revenue forfeiture. This study seeks to understand and assess the main provisions under bilateral tax agreements that determine the tax liability of Norwegian companies that are operating in Norway's low-income tax treaty partners. It departs by identifying the treaties and the model convention in accordance with which the treaties have been modelled. It then identifies the seminal provisions affecting the tax contribution payable by Norwegian entities under the identified treaties. Lastly, using a case study it illustrates the impact of domestic tax provisions, the nature of investment activity, and the type of investor on domestic tax revenue mobilisation in the source country.

1 Baker (2012); Coupe et al (2009); Blonigen (2014).

2 Barthel et al (2010).

3 The "prisoner's dilemma" is a concept in game theory where individuals, who act in their own interest, and as a result find themselves in a worse off position in comparison to the position that would have resulted had they cooperated with each other see Baird et al (1994).

4 Barthel and Neumayer (2012).

5 International Monetary Fund (2014); Tax Justice Network (2014).

6 UN (2015), Papers on selected topics in negotiation of tax treaties for developing countries, UN, New York http://dx.doi.org/10.18356/9b6574be-en

7 Eberhartinger et al (2014).

8 ActionAid (2015).

9 Dagan (2000).

2. Limitations

This study does not seek to provide a quantification of the forfeited revenue through the quantification of the tax expenditure ensuing from the surrender of taxing rights. Rather, it is a doctrinal analysis that looks at the manner in which the provisions contained in the treaty limit domestic tax provisions. It then looks at the way in which the provisions are applied - taking cognisance of additional legislative provisions that have a bearing on the application of the treaty provisions.

Tax treaties are often negotiated in conjunction with investment treaties. While a scrutiny of the investment treaty may allude to the impetus behind the conclusion of a particular tax treaty, this study will not extend itself to an extensive analysis of investment treaties. In addition to this, it is common for countries to conclude limited tax treaties that are applicable to specific subject matters, however, limited treaties will not be considered in this study. Lastly, the importance of implementation of tax legislation –the administrative procedures, instruments and capacity for effective implementation of the same cannot be overstated. However, this study will not consider administrative tools, such as exchange of information agreements or administrative provisions contained in treaties, but will limit itself to the substantive provision limiting taxing rights.

3. Methodology

This study synthesises legislation affecting the revenue contribution of foreign companies in the focus countries. It concludes with a case study that goes beyond a tax treaty analysis but also considers the impact of domestic tax provisions, the nature of investment activity and type of investor on domestic tax revenue mobilisation in the source country.

This study will focus on low-income countries that have concluded a tax treaty with Norway. The country typology is defined with reference to the World Bank's country lending group information. Low income countries are defined with reference to gross national income (GNI) per capita calculated employing the *World Bank Atlas Method*. While economies can be demarcated into several sub-categories, it is generally understood that low-income countries are countries with a GNI per capita equivalent to or below USD 1025.[10] These countries include Benin, Egypt, The Gambia, Kenya, Malawi, Morocco, Senegal, Sierra Leone, Tanzania, Tunisia, Uganda, Ukraine, Zambia and Zimbabwe (low income countries). While South Africa (with a GNI per capital of USD 12 860) is not a low-income country, it too will be considered. References to treaties with similar group of Asian countries – Bangladesh, India, Indonesia, Nepal, Pakistan, Philippines, Sri Lanka will be made where relevant.

10 World Bank World Bank Country and Lending Groups available www.worldbank.org accessed 7 April 2017.

4. A brief history of tax treaties

Tax treaties are premised on the desire to do away with double taxation where cross-jurisdictional activities are embarked upon.[11] Tax treaties may have grown in popularity as the preferred instruments for the alleviation of double-taxation since their inception in the 1920s. However, it is worth noting that they are not the only *modus operandi* at the disposal of countries. States may adopt a unilateral approach to do away with double taxation. This provides states with complete autonomy to unilaterally determine the extent of relief from double-taxation it is to afford to its residents.[12] Nevertheless, there has been a surge in the number of tax treaties in the recent years.[13]

Statutory double taxation occurs when more than one country imposes the same type of tax on the same income. The eradication of double taxation is desirable in order to ensure the equitable distribution of the tax burden and the minimisation of distortions on economic activities as a result of the restriction on capital flows in which double taxation amounts.[14] In eliminating double taxation by way of treaties two elements require determination: the first being the identification of the government which is to waive its taxing rights, and the second being the extent of such waiver.[15] The former is premised on the willingness of governments to forego revenue (in the form of taxation) in the interests of attracting foreign capital investments, while the latter is dependent on a plethora of theories that will be summarised below. The purpose of tax treaties was later extended beyond the confines of double-taxation to double non-taxation. They are also believed to be instrumental in the formation of a coherent and harmonised international tax regime.[16]

Justification for the allocation of taxing rights in tax treaties is premised on a variety of theories. The first theory is what is referred to as the doctrine of economic allegiance. According to this doctrine, the allocation of taxing rights is premised on the *contribution made by the contracting states to the production of income.*[17] There are four elements that determine the economic allegiance of income, they are the:

- Origin and situs of the activities giving rise to the income: this refers to the place where the income producing asset and exploitation of such asset is located and can be defined with reference to the community of economic life which enables the generation of income. Factors that serve as indicators for the location of the community of economic life include;
  - The place of management, labour production and organisation
  - The place where sales take place
  - The place of control

11 Zucman (2014). Although the emergences of DTAs is accredited to the 1920s, this was not the first occurrence of tax agreements aimed at eliminating double taxation. Similar agreements were included in the late 1800s for the benefit of exempting German consular in Brazil, Serbia and South Africa (see Ecker & Ressler (2011).

12 Dagan (2000).

13 It is estimated that there are over 3000 treaties worldwide see Lang & Owens (2014).

14 Bruins, Einaudi, Seligman & Stamp on behalf of the Economic and Financial Commission of the League of Nations (1923).

15 Bruins et al& Stamp on behalf of the Economic and Financial Commission of the League of Nations (1923).

16 Dagan (2000).

17 Forgione (2007).

– The residence of the agents of transportation which are pivotal to the relocation of goods to locations where value may be imputed onto the goods.

- Residence and domicilium: this refers to the location where the income earned is spent, or, the area where the enforcement of rights to the income takes place.[18]

Another theory on which the allocation of taxing rights is premised is the *national base theory*. This theory allows for the proportional allocation of taxing rights between contracting states in relation to income derived - by residents and non-residents alike - from the exploitation of national resources in the production of income.[19] This theory allows the country of residence to impose a tax on foreign sourced income on account of such residency. It further allows the country of source to tax income originating within its jurisdiction. Determining the origin of income is a complex exercise that requires the creation of a nexus between the income and the source country's right to tax such income. To this end, concepts such as the benefits theory, entitlement theory and market access theory found their application in international law.[20]

18 Bruins et al & Stamp on behalf of the Economic and Financial Commission of the League of Nations (1923) 25.

19 Forgione (2007); Graetz & O'Hear (1997).

20 Forgione (2007).

The *benefits theory*, often cited as the primary justification for the allocation of taxing rights in international law, seeks to avoid rent seeking by allocating taxing rights to governments that contribute to the production of income. This contribution takes an array of forms, including but not limited to, access to infrastructure, legislative frameworks that allow for the procurement of capital, labour, access to markets and the protection of property rights. There are a plethora of criticisms concerning the adequacy of the benefits theory as justification for the allocation of property rights. The most prevalent being the inability of the theory to provide sufficient guidance on the extent to which taxing rights should be allocated and the weight that should be placed on each nexus created between the income and a state. Despite the extensive scholarship on the theories proffered as justification for the allocation of taxing rights over business profits, some scholars opine that the theories are fallacious at best and lack sound justification.[21]

In addition to these theories, principles concerning *efficiency* play a pivotal determination. Efficiency in the context of international law, refers to capital export and capital import neutrality. In addition to neutrality considerations, the administrative capacities of contracting states or their ability to enforce the treaty provisions are also considered. It is believed that the allocation of taxing rights is favourably biased towards net capital exporting countries.[22] It is worth noting that a limitation of taxing rights results in the obvious consequence of foregone revenue. In order to fully appreciate the impact of such limitation - an understanding of the effects a disparity in conditions between contracting states has, on revenue mobilisation, is required.[23] Although the purpose of this study is to determine the impact of tax treaties on the tax payable by Norwegian entities conducting business in foreign jurisdictions, there are implicit benefits associated with such an analysis. For example, the disparate negotiating strengths of countries may be evidenced when countries within the same typology are compared.[24]

21 Forgione (2007).

Double Taxation Agreements (DTAs) are usually, modelled in accordance with the United Nations (UN) Double Taxation Convention between Developed and Developing Countries (UN model) or the OECD Model Convention on Income and Capital (OECD model). Table 1 provides a summary of the model in accordance

22 Brooks & Krever (2015); Daurer & Krever (2014).

23 Bruins et al & Stamp on behalf of the Economic and Financial Commission of the League of Nations (1923).

24 Daurer & Krever (2014).

with which the Norwegian bilateral tax treaties that form the subject matter of this study have been concluded.

In addition to the OECD and the UN model conventions, The African Tax Administration Forum (ATAF) has also established its own tax model convention on income and capital referred to as the *ATAF Model Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (ATAF model). The ATAF model was formulated in 2016 However currently there are no Norwegian tax treaties that have been concluded in accordance with the ATAF model. The provisions in the ATAF model could play a role in reformulation of specific clauses in renegotiations based on the UN model. This study will be limited to the OECD and the UN model.

It is worth pointing out the primary distinctions between the OECD and the UN model. The UN model is cited as more favourable to developing countries because it seeks to widen the taxing rights of the country of source. For example, it contains a wider construction of the term Permanent Establishment (PE), a legal fiction that allows for the taxing of business profits by the country of source. The UN model extends the application of the PE concept and introduces the "limited force of attraction rule" in article 7(1).

TABLE 1 // MODEL TREATY ADOPTED

Country	Model	Limited Force of Attraction	Specific limitations on deductions
Bangladesh	UN	No	No
Benin	OECD	No	No
Egypt	OECD	No	No
The Gambia	OECD	No	No
India	UN	No	Yes
Indonesia	UN	Yes	Yes
Kenya	OECD	No	No
Malawi	OECD	No	No
Morocco	OECD	No	No
Nepal	OECD	No	No
Pakistan	UN	Yes	Yes
Philippines	UN	No	Yes
Senegal	OECD	No	No
Sierra Leone	UK*	No	No
South Africa	OECD	No	No
Sri Lanka	UN	Yes	Yes
Tanzania	OECD	No	No
Tunisia	OECD	No	No
Uganda	OECD	No	No
Ukraine	OECD	No	No
Zambia	OECD	No	No
Zimbabwe	UN	Yes	Yes

* The UK model convention served as a blueprint for the formation of the OECD model convention

The “limited force of attraction rule” extends the source country’s taxing rights to profits earned because of transactions similar to those of the PE regardless of whether or not the transactions were carried out by the PE.[25]

The OECD model limits the profits taxable by the country of source to principles of economic connection. Furthermore, prior to its amendment on 2010, the OECD model did not limit the deductions that may be made in the determination of the taxable profits of a PE.[26]

Most of the tax agreements with low-income African countries are dated and could need renegotiation. As per the comments received from informed sources, to the earlier versions of this paper, Norway is open for renegotiation, however currently there is limited interest for this amongst its treaty partners. In some cases, it may be due to limited commercial relations between Norway. In other cases, the low-prioritisation of renegotiation could be a result of limited administrative capacity in partner countries. More recently, impact of tax treaties on domestic revenue mobilisation in developing countries has become a seminal point of discussion in international taxation and this may explain the lack of appetite among the partner countries to sign new agreements. Norway has recently signed new treaties with Ghana and Zambia and has taken the similar initiatives with respect to Tanzania and Kenya.

25 Yaffar & Lennard (2012) 594.

26 Yang & Song (2011).

5. Treaty provisions considered

The articles to which this study applies include: article 7 (business profits), article 5 (permanent establishment), article 9 (associated enterprises) article 10 (dividends), article 11 (interest), article 12 (royalties) and article 13 (capital gains).

5.1 BUSINESS PROFITS

Common to both the OECD and the UN model is the strictest limitation on the country of source's right to tax business profits.[27] The allocation of taxing rights over business profits is provided for in article 7 read with article 5 of both the UN model and the OECD model. In accordance with article 7 of the UN and OECD model, business profits are only taxable by the resident country – except for profits earned by a Permanent Establishment (PE) in the country of source.[28] This essentially means that the taxing rights allocated to the country of source only extend to profits generated by the PE in the country of source and such taxing rights do not extend to other profits earned by the parent company.[29]

Thus, a nexus between the income and the PE must be established particularly in the absence of the force of attraction rule.

There are four substantive requirements (also commonly referred to as the threshold) that give effect to the exception created in article 7(1). First, it must be determined whether it can be said that an enterprise is carrying on a business. Second, a determination must be made whether such business is carried through a permanent establishment, third, it must be established whether the income earned by the PE constitute business profits. Lastly, it must be determined whether the profits earned can be attributed to the PE.

5.1.1 Permanent Establishment (PE)

The PE concept introduces definitional complexities. The PE itself lacks an adequate definition. It fails to provide, with certainty, instances where a PE will be deemed to have been formed, particularly where electronic commerce is concerned.

The definition of a PE, as contained in the OECD model has not been amended since 1977. However, Action 7 of the OECD's Base Erosion and Profit Shifting Plan[30] gives recognition to the need to amend the PE concept in order to prevent its artificial avoidance. The action plan puts forth a myriad of suggestions which are, at the time of construction of this report, yet to be incorporated in the countries subject to this study and will, therefore, not be elaborated upon any further. This has bred the formation of intricate tax avoidance strategies aimed at circumventing the operation of article 5.[31] This is partially because of the manner in which the provision is structured. For example, article 5(4) excludes specific business activities from the activities that would constitute a PE. However, the peculiarity of this provision lies in qualification for the exclusion. The provision requires that the entity restrict itself to the performance of a single listed activity per fixed location and not a combination of activities contained in the section, unless such

27 Daurer & Krever (2014).

28 Article 7(I) of the UN and OECD model.

29 Olivier & Honiball (2011).

30 OECD (2015) BEPS Action 7: Preventing the Artificial Avoidance of PE Status.

31 Sasseville (2015).

performance is preparatory in nature. If the entity were to embark on a combination of activities contained in the provision, the conduct would be sufficient to amount to the formation of a PE. However, under the provision, an entity may still perform a combination of the listed activities without forming a PE if these activities are carried on at different locations.[32]

Notwithstanding the formation of a PE, it is imperative that the PE meet the minimum domestic threshold required for the imposition of domestic corporate tax. Some countries provide specific exemptions from corporate income tax based on the industry a company is engaged in, or, a maximum turnover that the entity does not exceed.

In addition to the exemptions granted above, several jurisdictions provide for reduced rates of corporate income tax depending on the industry type or business activity the entity conducts. For example, The Gambia imposes a turnover tax at 0% for entities that hold special investment certificates or an export promotion zone license, Tanzania imposes a tax at 0.3% on companies engaged in agriculture, healthcare or education. Reduced tax rates based on an entity's annual turnover are also

32 OECD: Centre for Tax Policy and Administration (2004) par 81-82.

TABLE 2 // CORPORATE INCOME TAX EXEMPTION AS PER DOMESTIC LEGISLATION

Country	Corporate Income Tax Exemption	Exemption Criteria
Bangladesh	Yes	Public Private Partnerships in select industries exempt for a period of 10 years
Benin	Yes	Companies investing NOK 7184758 and creating 20 new jobs exempt from on approved commercial and industrial profits
Egypt	No	N/a
The Gambia	No	N/a
India	No	N/a
Indonesia	Yes	Profits of PE reinvested into new incorporated Indonesian Company Reinvestment of PE profits into existing Indonesian company Profits of a PE invested in fixed asset used by PE to conduct business in Indonesia Profits of PE invested in intangible goods to be employed by PE
Kenya	No	N/a
Malawi	No	N/a
Morocco	Yes	Export companies for the first 5 years from the first export Hotels for income earned in foreign currency for the first 5 years from the date of first accommodation provision Agricultural companies with turnover < NOK 505530 Capital Risk Companies Companies located in free trade zones Casablanca Finance City Companies

→

Country	Corporate Income Tax Exemption	Exemption Criteria
Nepal	Yes	Specific Industries capitalised to the value of NOK 81 323 145 providing employment to 500 persons Tourism and international flights operations with a capital structure of NOK 162 646 291
Pakistan	No	N/a
Philippines	Yes	Non-stock entities Non-profit educational institutions Other non-profit organisations
Senegal	No	N/a
Sierra Leone	Yes	Crop farmers
South Africa	Yes	Income generated from the exploitation of film rights
Sri Lanka	No	N/a
Tanzania	No	N/a
Tunisia	Yes	Companies located in regional development zones Companies in agricultural sector
Uganda	No	N/a
Ukraine	No	N/a
Zambia	No	N/a
Zimbabwe	No	N/a

The table above excludes exempt associations/organisation contained in the domestic provisions such as religious associations, charitable organisations etc

provided for in some jurisdictions. For example, South Africa provides for a presumptive tax regime for entities with a turnover of less than NOK 654240 per annum.

The manner in which a PE is capitalised will also bear significant impact on its conformity with the minimum taxable threshold. A thinly capitalised PE will result in the erosion of taxable profits due to high level of interest deductions.

a) Attribution of profits to PE

The UN and OECD model require that the profits attributed to the PE be determined as if the PE was a separate legal entity. Thus, the models require that the arms-length principle be applied. In 2010 the OECD published revised transfer pricing guidelines titled *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators* (OECD guidelines) which seek to provide direction for the application of the arm's-length principle. The OECD guidelines were partially revised in 2013 and extensively revised in 2017. The guidelines read together with the OECD Report on the Attribution of Profits to Permanent Establishment (OECD report) provide for the application of the separate functional entity approach.[33] In 2013, the UN published its *Practical Manual on*

33 OECD (2010) Attribution of Profits to PE 12

Transfer Pricing for Developing Countries (UN guidelines) transfer pricing guidelines. The UN guideline seeks to reiterate the recommendations contained in the OECD model and provide a detailed instructional on their application.[34] While consistency with the OECD transfer pricing guidelines was sought in the drafting of the UN transfer pricing guidelines, there are some primary distinctions between the guidelines. For example, UN transfer pricing guidelines contain an in-depth analysis of location savings and rents that are to be considered when determining the economic circumstances in which transactions are concluded.[35] The OECD allows for the allocation of savings based on the arm's length principle and must consider the risks assumed by the parties, their functions and assets. The guidelines also differ where intangibles are concerned. The UN model differentiates between the legal party that owns the intangibles and the party that receives the benefits associated with the intangibles. The UN model also places emphasis on market competitiveness.[36] Given the similarities between the guidelines, the discussion that follows will be made primarily in reference to the OECD guidelines.

34 UN (2013).

35 UN (2013).

36 UN (2013).

b) PE capital structure

The following section provides a summation of the manner in which the capital structure of a PE is determined and how domestic laws, particularly those relating to its capitalisation, bear a significant impact on its gross profits and, thus, taxability. The separate entity approach afforded to a PE and its parent company means that any finance extended by the parent company to the PE is classified as debt. In order to avoid the thin capitalisation of the PE, and consequently the erosion of taxable profits of the PE through excessive interest deductions, some of that debt is reclassified as free capital of the PE in accordance with the Authorised OECD Approach (AOA). The purpose of the AOA is to give effect to the arm's length principle by attributing profit and debt to the PE in accordance with the risk it assumes, its functions and assets.[37]

Thin capitalisation rules are implemented in order to prevent base erosion as a result of the extensive use of debt over equity in financing transactions that are designed to take advantage of the tax benefits associated with the use of debt. In addition to the base erosion which results, it also exacerbates market inefficiencies. This is because investment decisions are influenced by the after-tax rate of return which may induce inefficient financing choices. In order to combat this, some jurisdictions have implemented thin capitalisation rules.

37 Nouel (2013) in Gutiérrez & Perdelwitz.

Thin capitalisation in its widest sense refers to the excessive use of debt.[38] The OECD guidelines, read together with the OECD report (2010) recognise a variety of methods that can be applied when determining the free capital of the PE. These methods include the:

- Capital allocation approach;
- Economic capital allocation approach;
- Thin capitalisation approach;
- Safe harbour approach;
- Miscellaneous methods applicable to the insurance sector; and
- Miscellaneous methods applicable in the attribution of profits to a PE of a thinly capitalised entity.

Thin capitalisation rules are ineffective in the absence of provisions targeted at hybrid equity instruments. This is because debt and equity instruments can encompass entitlements that make the distinction between debt and equity elusive. For example, equity instruments can sometimes afford the holder of such

38 Kumar (2015).

equity the right to a dividend distribution or the right to a capital distribution in the case of illiquidity or even the right to have shares recapitalised at a predetermined date for a predetermined amount. In this instance, the equity instrument becomes indistinguishable from a debt instrument but, however, it is not referred to as such for capitalisation purposes. Thus, it is imperative that measures be put in place in order to prevent the circumvention of thin-capitalisation regulation through the use of such hybrid instruments. Furthermore, it is imperative that legislation be enacted to prevent double deduction schemes, foreign tax credit generators other deduction schemes that often to result from hybrid mismatches. To achieve this, some countries incorporate hybrid mismatch rules.

c) Intercompany transaction Pricing

Interparty (or intercompany) transactions are part and parcel of a multinational's operations. Thus, transfer pricing provisions adopted by countries impact revenue collection significantly where domestic entities enter into transactions with associated enterprises (including through the formation of a PE). Transfer pricing provisions are pivotal in determining income derived from, and deductions resultant from, intercompany transactions. Companies may shift profits through transfer income from high income tax jurisdictions to lower income tax jurisdictions through transfer mispricing. Transfer mispricing is the practice of selling of goods and services to related parties at prices that do not reflect the market value of the goods and services. In an effort to rectify this, many countries have adopted transfer pricing provisions that employ the arms-length method.[39]

Article 9 of the OECD and the UN model stipulate the conditions that may give rise to the adjustment of intercompany pricing for double taxation purposes and allows a downward adjustment mandatory in accordance with transfer pricing provisions. However, the adjustment is only mandatory where the other contracting state agrees on the method and the amount of the original adjustment. Thus, it is imperative that the adopted transfer pricing methods be harmonious., The OECD guideline recognises five methods to be applied when determining the arm's length amount. These methods include, the:

› Comparable uncontrolled price method;
› Resale price method;
› Cost plus method;
› Transactional net margin method; and
› Transactional profit split method.

39 Arnold (1995).

It may be noted that tax treaties are not self-executing and require domestic legislation to give effect to them. Thus, in the absence of domestic transfer pricing provisions, tax authorities cannot impose adjustments to intercompany prices based solely on the provisions contained in the treaty.[40] Some countries, subject to this study, are yet to incorporate transfer pricing regimes into their domestic legislation. While the majority of the countries subject to this study possess transfer pricing rules that apply mutatis mutandis to the capital structure of an entity, a significant number of countries are yet to incorporate specific thin capitalisation rules into their domestic legislation. Lastly, an even greater number of countries are yet to incorporate hybrid equity instrument rules, rendering the adoption of thin capitalisation rules ineffective. Table 3 provides a summary of domestic regulation in selected countries.

40 United Nations (2017).

TABLE 3 // STATUS OF INCORPORATION OF IMPORTANT TREATY PROVISIONS IN DOMESTIC REGULATION IN SELECTED COUNTRIES

Country	Absence of Transfer pricing regimes in domestic regulation	Absence of thin capitalisation rules in domestic regulation	Absence of hybrid equity instrument rules in domestic regulation(1)
Bangladesh		x	X
Benin	x	x (2)	X
Egypt			X
The Gambia		x	X
India			X
Indonesia			X
Kenya			X
Malawi			X
Morocco	x	x	X
Nepal			X
Pakistan			X
Philippines			X
Senegal		x (3)	X
Sierra Leone	x	x (4)	X
Sri Lanka			X
Tanzania			X
Tunisia	x	x (5)	X
Uganda			X
Ukraine			X
Zambia			X
Zimbabwe			X

Notes:

1. Non incorporation of hybrid equity instrument rules is a loop hole that makes the reduces the effectiveness thin capitalisation rules.
2. Benin does not impose specific thin capitalisation requirements, however, the country does prescribe a minimum equity to losses incurred ratio and a maximum interest rate deductible by shareholders.
3. Senegal does not contain specific thin capitalisation but does prescribe maximum interest rates chargeable on the debt instrument.
4. Sierra Leone does not contain specific thin capitalisation but does prescribe maximum interest rates chargeable on the debt instrument.
5. Tunisia does not prescribe specific thin capitalisation regulations but does limit the interest rate applicable to the debt instrument

5.2 PASSIVE FORMS OF INCOME

The discussion thus far has been limited to income generated through business activities. However, entities are also able to generate passive forms of income (capital income) in foreign jurisdictions. The term capital income lacks a concise definition in the model conventions and, similar to the concept business income, scholars are divided in opinion concerning the interpretation of the term capital.[41] In the absence of an express definition in the model conventions, the term is afforded its widest definition and includes all forms of capital. It goes without saying that the taxation of capital income presents the greatest source of contention in the conclusion of DTAs between capital importing and capital exporting countries. The types of investment income provided for in double tax treaties include withholding taxes on; dividends, interest, royalties and capital gains.

Reviews of tax treaties often reiterate the same sentiment, and that is, that tax treaties significantly reduce the taxing rights over dividends, interest and royalties. However, the table above suggests that this is not always the case. In fact, where dividends are concerned, in many instances the treaty between the country of source and Norway imposes a higher withholding dividends tax rate than that contained in domestic legislation. This is true for Bangladesh, Benin, Egypt, The Gambia, Kenya, Senegal, Sri Lanka, Tanzania, Tunisia, Pakistan, Nepal, Uganda, Vietnam, Zambia and Zimbabwe. Admittedly, the perception holds greater validity where interest income is concerned. Even where interest income is concerned, the percentage of countries with reduced withholding rates on income constitute less than 50% of the countries summated in this section. However, in the case of the withholding on royalties, the treaty almost consistently limits the country of source's ability to tax such royalties save for a few exceptions. This is in conformity with the OECD model's recommendation that royalties be taxable only by the country of residence. In industries that require a significant use of intangible assets (e.g. food, forestry, chemicals, electricity etc.) the restriction on the ability to tax royalties has corrosive effects on revenue.

41 Ismer & Blank (2015).

TABLE 4 // DOMESTIC WITHHOLDING TAX RATES VERSUS TAX RATES UNDER NORWEGIAN BILATERAL TAX TREATIES WITH LOW TO LOWER-MIDDLE INCOME COUNTRIES (%)

Country	Dividend Domestic rate	Dividend-Treaty rate	Interest Domestic rate	Interest Treaty rate	Royalty Domestic rate	Royalty Treaty rate
Bangladesh		10/15		10		10
Benin	15	18	15	25	12	0
Egypt	5 [(1)] /10	15	20	0	20	15
The Gambia	0/15	5 [(2)]/ 15	15	15	15	12.5
India	0	10	20	10	10	10
Indonesia	20	15	20	10	20	10/15 [(3)]
Kenya	10	15 [(4)]/25		20	10/15/25 [(5)]	20
Malawi	10	0 [(6)]/5 [(7)]/15	15	10	15	5
Morocco	15	15	10	10	10	10
Nepal		5 [(8)]/10 [(9)]/15		10 [(10)]/15		15
Pakistan		15		10		12
Philippines	15 [(11)]/30	15 [(12)] /25	20	15	30	10
Senegal	10	16	16	16	20	16
Sierra Leone	10	0 [(13)]/5	15	0	25	0
South Africa	20	15/5	15	0	15	0
Sri Lanka		15		10		10
Tanzania	10	20	10	15	15	20
Tunisia	5/25	20	20/25	12	15/25	5/15/20 [(14)]
Uganda	15	10 [(15)] /15	15	10	15	10
Ukraine	15	5 [(16)] /15	15	10	15	5/10 [(17)]
Vietnam	0	5 [(18)] /10 [(19)] /15	5	10	10	10
Zambia	15	15	15	10	20	10
Zimbabwe	15	15 [(20)] /20	0	10	15	10

Source: Table compiled from data obtained from Deloitte International Tax Source and Crowe Horwath Africa Tax Facts Guide 2016.

Notes:

1. Applicable to companies that hold a minimum of 25% shares
2. Where the entity holds 25% capital
3. Depending on the type of intangible
4. Entity that holds more than 25%
5. Depending on the type of debt instrument
6. To government
7. To entities that hold a minimum of 10% ownership
8. Applicable to companies that hold a minimum of 25% shares
9. Applicable to companies that hold a minimum of 10% shares
10. Interest payable to banks
11. On condition that country of residence allows a synonymous credit
12. Applicable to companies that hold a minimum of 10% shares
13. Applicable to companies that hold a minimum of 25% shares
14. Depending on the type of intangible to which the royalty applies
15. Applicable to companies that hold a minimum of 25% shares
16. Applicable to companies that hold a minimum of 25% shares
17. Depending on the type of intangible property
18. Applicable to companies that hold a minimum of 70% shares
19. Applicable to companies that hold a minimum of 25% shares
20. Applicable to companies that hold a minimum of 25% shares

5.2.1 Capital gains

It is imperative to note that from a tax planning perspective, the exit strategy adopted for inbound investments, or the form repatriated income will assume, is of importance. This is because the tax implications upon the eventual repatriation of returns on investments have a significant impact on the overall profitability of the investment. Where returns are repatriated in the form of capital gains such repatriation may attract tax liability. To avoid this tax liability, tax planners adopt a variety of exit strategies based on the nature of the asset, the legal nature of the entity host to the investment and the legal framework of the host country.

The ways in which capital gains are taxed differ from country to country. Some countries do not distinguish between capital gains and ordinary business income[42] while others do. The table below provides a general indication of how capital gains tax (CGT) is imposed on the sale of shares save for specific exemptions contained in domestic legislation and shares held in and property-owning company.

TABLE 5 // CGT RATE (%) CAPITAL GAINS PAID TO RESIDENTS AND NON-RESIDENTS

Country	Domestic treatment of capital gains	Separate CGT regime for capital gains earned by non-residents	Capital gains taxed as business income of non-resident
Benin	30	0	
Egypt	22.5	10	
The Gambia	x = max (10 consideration, 25 capital gain)	x = max (10 consideration, 25 capital gain)	
Kenya	5	5	
Malawi	30		30
Morocco	10 or 20 or 31	0	
Senegal	30		30
Sierra Leone	30	30	
South Africa	22.4		
Tanzania	30		30
Tunisia	25	5 transfer price ≥ 25 gain	
Uganda	30		30
Ukraine	18	15	
Zambia			
Zimbabwe	20	5/1	

Information sourced from International Bureau of Fiscal Documentation

While Zambia does not consider capital gains a form of taxable income. The rest of the countries summated above impose a CGT. The contents of article 13 concerning capital gains leave the taxation of such gains to the discretion of the contracting parties. A number of countries, including Malawi, Senegal, Tanzania and Uganda do not distinguish between capital gains and business income. Essentially, this means that in order to impose tax on capital gains earned by non-residents a PE must first be established. In the absence of such PE, the country of source cannot impose taxes on CGT. Furthermore, 13 of the countries

42 Thuroyni 1998) The primary purpose of distinguishing between capital income and ordinary income is for financial accounting purposes. In order to provide an accurate reflection of an entity's performance, it seeks to classify gains according to their regularity.

above[43] create a more favourable treatment of the repatriation of income in the form of capital gains as opposed to dividend income. This creates the incentive to characterise income as capital income as opposed to dividend income. A common arbitrage strategy that gives effect to this is what is referred to as a wash-trade transaction. This is where the equity is alienated to a third party, triggering CGT. However, before payment is made by the third party, the instrument is sold back to the initial seller. This results in the creation of a capital gain but an unchanged position in ownership. This is arguably the repatriation of a dividend income in a manner that circumvents dividend taxation. While wash trade transactions may be prohibited in Some of the jurisdictions summated above, i.e. South Africa, Tanzania, Kenya, Malawi, it remains a strategy at the disposal of tax planners in jurisdictions with lagging securities regulation.

The assumption is made that a company will not structure its investments solely for the attainment of a tax benefit. Tax is an ancillary factor when investments are structured. A company will not invest in a stable, high dividend yielding company with low growth prospects, with the expectation that the return on the investment will ultimately made on the disposal of the asset, unless, the asset is of such a nature that a buy-hold[44] strategy is likely to be most profitable. To illustrate this, a distinction between the classification of shares is necessary.

Investment stocks are usually classified into one of three categories; income, value or growth stocks. Income stocks provide regular dividend declarations and are associated with entities that have stable sources of income. These stocks are unlikely to increase significantly in value and simply allow investors increase their fixed-income portfolios. Value stocks are stocks that do not reflect a company's performance according to its financial status and technical trading indicators. This may be due to public perception, high dividend pay-outs or low financial ratios.[45] Growth stocks are stocks belonging to companies with high growth prospects and yield significant capital gains upon their eventual disposal.[46] Entities with growth stocks have the highest performance when held long term and typically do not declare high dividends but instead, retain their profits to grow investments.[47] This means that profits are eventually repatriated in the form of capital gains and, as observed above, capital gains are either, subject to a tax much lower than dividends tax, subject to tax only upon the formation of a PE or, simply, not taxable at all. Growth stocks are observed in industries which display significant potential for growth. In Africa, these industries include wholetail retail, food and agri-processing, health care, financial services, construction and light manufacturing.[48] It is interesting to note that these sectors presently constitute Norway's Development Finance Institution (Norfund's) investment sectors of choice.[49]

To achieve a favourable tax treatment in the sale of shares it is common for companies to route their investment through intermediaries located in preferential tax jurisdictions. It is common for holding companies to be placed in the corporate group for the main purpose of holding shares in companies and other assets. The use of holding companies is not solely premised on the potential to derive tax benefits. They enable the access to new capital sources, attainment of group synergies,

43 Benin, Egypt, Kenya, Malawi, Morocco, Senegal, Sierra Leone, South Africa, Tanzania, Tunisia, Uganda, Zambia and Zimbabwe. It is uncertain whether the same can be said of the Ukraine and The Gambia.

44 A buy-hold strategy, unlike a buy-sell strategy, is the purchase of shares with intention to retain such shares for an extended period of time.

45 Public perceptions can create fluctuations in share values that have no bearing on a company's performance.

46 Beneda (2002).

47 Yufen (2011).

48 Leke & Paul (2016).

49 Availabe www.norfund.no accessed 7 April 2017.

increase flexibility and reduce costs associated with control.[50] However, the introduction of holding companies in the corporate structure increase the risk for double taxation. Therefore, tax planners find it beneficial to establish holding companies in low-level tax jurisdictions which enable tax efficient methods of income repatriation. However, in the absence of the appropriate anti-avoidance provisions, these structures can be subject to abuse (e.g. transfer mispricing).

The European Union and the OECD have published a list of preferential jurisdictions.[51] This list is one amongst several lists published. Criteria common to all these lists include a country's ability to share information and its ability to enable taxpayers to move their income from to low tax jurisdictions.[52] The jurisdictions contained in these lists include; America Samoa, Bahrain, Barbados, Guam, South Korea, Macau, Marshall Island, Mongolia, Namibia, Palau, Panama, Saint Lucia, Samoa, Trinidad and Tobago, Tunisia and the United Arab Emirates.

The table on the next page contains Norwegian entities, contained in the Osiris database (a database containing the financial reports of companies listed on various stock exchange around the world), that have subsidiaries in one or more of the preferential jurisdictions within their group structure.

It must be stressed that the mere positioning of an affiliated enterprise in a preferential jurisdiction is insufficient to suggest that such an entity is strategically placed in order to derive a tax benefit. Such a determination cannot be made without knowledge of the activities of the subsidiary. A more telling indication of such an intent would be entities that are established solely for channelling investments into other jurisdictions. Such a function may be an indication of an entity's exit strategy.

Another example of an exit strategy that allows for a reduction in CGT liability is the adoption of employee stock ownership plans (ESOP) in order to transfer equity without attracting capital gains. Several countries provide in their legislation for some variation of ESOPs to encourage inclusive economic growth. Of the treaty partners subject to this study, countries with an ESOP include South Africa (employee share scheme, black economic empowerment schemes in terms of the Black Economic Empowerment Act), Kenya (share purchase plans), Zimbabwe (employee ownership scheme instead of nationalisation). ESOPs enable employees to purchase company stock. This allows the owner to transfer ownership to employees while allowing for an exemption from CGT provided that the conditions set out in the scheme are met.

50 Perdelwitz (2015).

51 The Financial Action Task Force publishes a list of non-cooperative jurisdictions based on a country's implementation of anti-money laundering standards. The G20 also seeks to publish a list of on-cooperative jurisdictions.

52 Unfortunately, the EU list does not include countries that are members of the EU. According to Oxfam, EU countries that should be included in this list include Ireland, Luxembourg, Netherlands and Malta.

TABLE 6 // NORWEGIAN PUBLICLY LISTED COMPANIES WITH SUBSIDIARY IN PREFERENTIAL JURISDICTION

Company name	Country code (incorp)	Latest account date	Operating Rev./Turnover th NOK Last avail. Yr	Subsidiary – Country (1 or more subsidiaries in jurisdiction)
Yara International Asa	NO	30/09/2017	97 170 000	Panama
Dnb Asa	NO	30/09/2017	52 165 000	United Arab Emirates
				Panama
				Marshall Islands
Marine Harvest Asa	NO	30/09/2017	31 894 879	Panama
				Republic of Korea
Aker Solutions Asa	NO	30/06/2017	25 557 000	United Arab Emirates
				Republic of Korea
Kongsberg Gruppen Asa	NO	30/09/2017	15 845 000	United Arab Emirates
				Panama
				Republic of Korea
Akastor Asa	NO	30/09/2017	9 926 000	United Arab Emirates
				Republic of Korea
				United Arab Emirates
Odfjell Asa	NO	30/09/2017	7 110 733	United Arab Emirates
				Republic of Korea
Storebrand Group - Storebrand Asa	NO	30/09/2017	6 690 000	Marshall Islands
				Republic of Korea
Tomra Systems Asa	NO	30/09/2017	6 641 200	United Arab Emirates
				Republic of Korea
Borregaard Asa	NO	30/09/2017	4 505 000	United Arab Emirates
Scatec Solar Asa	NO	30/09/2017	1 084 949	Namibia
Spectrum Asa	NO	30/09/2017	748 664	Panama
I.M. Skaugen Se	NO	30/09/2017	611 511	Bahrain
Aqualis Asa	NO	30/09/2017	237 602	United Arab Emirates
				Republic of Korea

Source: Osiris - a fully integrated public company database and analytical information solution produced by Bureau van Dijk Electronic Publishing, SA (BvDEP). A publicly quoted company on OSIRIS is defined as a company with publicly listed equity. This definition has an impact on the inclusion criteria for companies on OSIRIS. Data for Norwegian state owned companies such as Norfund, SN Power, Statkraft etc. is not available on Osiris. See https://osiris.bvdinfo.com.

6. Revenue mobilisation and renewable energy investments in South Africa – an illustration

Foreign investments in taxable commercial activities primarily take the form of portfolio investments (FPI) and direct investments (FDI). The two forms differ, for example in the latter case the investor transfers funds to establish a direct business interest (services, manufacturing, trading) in the host country through takeover or establishment of a commercial enterprise. In case of FPI the business interest is limited to investment in financial assets such as stocks or bonds in business entities of the host country. Given the nature of involvement, the exposure to domestic tax legislation under the two forms would differ. While a direct investor may be a subject for both business and capital gains taxation, a portfolio investor's tax exposure would be limited to only capital gains taxation.

Traditionally, the primary source of FPI and FDI has been the private sector. Development Finance Institutions financed by official developmental assistance (ODA) however are now increasingly participating both as portfolio and direct investors in low and low-middle income countries. Norway makes most its overseas developmental assistance (ODA) financed private sector targeted investments through Norfund. The main priority sector for Norfund investments are renewable energy, financial institutions and food and agribusiness. Renewable energy however is the most important of the three sectors in terms of its share in the portfolio. Norfund, through Scatec Solar, has invested in establishment of a solar power generation facility in South Africa. The establishment of the power plant was in accordance with a tender awarded to Scatec Solar ASA in terms of the Renewable Energy Independent Power Project Procurement Programme in 2011.

The discussion that follows focuses on the revenue mobilisation potential of renewable energy investments in South Africa given the current domestic tax legislation applicable to such investments. The discussion is general in character and is not an assessment of Norfund's investment. The accelerated depreciation allowance provision is contained in section 12B and, until its amendment in 2016, allowed for the deduction of the depreciation of an asset at 50% of the base cost value in the first year, 30% in the second year and 20% in the third year. The section applies to movable assets used in the production of energy from specified renewable energy sources including solar.[53] Section 12N allows for an accelerated depreciation allowance on immovable assets where the energy project is in terms of an independent power producer procurement programme. This allowance applies where improvements and foundations are made to a leased asset and allows for the depreciation to be calculated as if the lessee were the owner of the leased property.[54]

Section 11D provides for a research and development allowance. The section allows for a deduction of up to 150% of expenditure incurred for research and development purposes. This deduction is applicable to the operating expenses incurred, accelerated

53 This section has since been amended to allow for the deduction of 100% of the base cost value of the asset in its first year of use.

54 An additional incentive targeted towards encouraging the use of renewable energy Section 12L creates an energy efficiency incentive which takes the form of a deduction allowance.

depreciation of any building, plant, machinery etc. and it is subject to the qualifying criteria set in the section being met.

Section 12I is a financial assistance incentive scheme targeted towards Greenfield and Brownfield investments. A Greenfield investment is defined in the Income Tax Act (SA) as an investment in a wholly new industrial project and a brownfield investment is defined as an investment made into the expansion or upgrading of an existing industrial project. Section 12I(2) allows for the deduction of 55% of the costs relating to a new and unused manufacturing asset designated for an industrial project or 100% of such costs where the asset is located in a special economic zone provided that the project is afforded a preferred status. The section provides alternative deductions where the project is not afforded preferred status.[55] The section also affords a training allowance to the taxpayer for any costs incurred for procured training and training materials.

In addition to the specific tax incentives aimed at the energy sector, the Income Tax Act also provides for a venture capital incentive scheme contained in section 12J. Section 12J is aimed at provided tax benefit to investors who invest through a venture capital vehicle as defined by the Act. The section provides for the indefinite deduction of 100% of the cost incurred for the acquisition of a venture capital company share.

Tax incentives for incentivising investments in renewable energy are now common in a number of low and low middle-income countries. For example, India's Income Tax Act of 1961 has incentives directed towards the renewable energy sector that include an income tax holiday and an accelerated rate of depreciation. India[56] imposes a corporate tax rate at 30%. However, according to section 80 of the Indian Income Tax Act, entities in the renewable energy sector are allowed deductions equivalent to 100% of their profits. The companies remain liable for a minimum alternate tax (MAT),[57] at a rate of 18.5%,[58] imposed on companies that report a book profit but pay tax less than the computed MAT on the reported profits. Section 115JAA of India's Income Tax Act allows for an MAT credit equivalent to the difference between the tax paid in terms of the MAT regime and the tax calculated in accordance with the

55 However, due to the fact that the renewable energy project envisaged by Scatec Solar AS, as per the agreement notes, was afforded a preferred status, consideration will not be given to sections applicable to projects of non-preferred status.

56 India is another country with Scatec Investments supported by Norwegian ODA funding.

57 Section 115JA Income Tax Act (India) 1961.

58 Including applicable surcharge and an education cess.

TABLE 7 // TAX INCENTIVES UNDER THE INCOME TAX ACT COVERING RENEWABLE ENERGY COMPANIES IN SOUTH AFRICA

Tax and deductions	Rates
Corporate tax rate	28%
Deductions	
Depreciation rate plant and machinery	Year 1 - 50%, Year 2 - 30%, Year 3, 20%
R&D expenditures	150%
Training expenditures	Up to NOK19.7 million
Investment through approved venture capital company	100% of the acquisition value of the venture capital company share. Unlisted companies maximum amount R 750 000
Greenfield investment outside industrial Zone	55% costs relating to new and unused manufacturing assets to a maximum value of NOK 5.9 million
Deduction for improvements to immovable property leased from the government under a public private partnership	Expenses for making improvements to land or buildings

ordinary income tax regime (MAT – Income Tax calculated in accordance with the ordinary income tax regime). The MAT credit may be carried over for a period of 10 assessment years and is then offset against the normal income tax payable after a period of 10 years. An additional incentive is the accelerated depreciation allowance. The ordinary rate of depreciation for plant and machinery is 15%. Until March of 2017, India had allowed a maximum depreciation allowance claim of up to 80% in the first year upon commissioning of solar power plant. Additionally, the installation of plant material for the purposes of manufacturing provided for a further 20% depreciation allowance. Thus, a qualifying entity could claim 100% depreciation for a solar power project. It is worth noting that India has since introduced a revised accelerated depreciation regime, the effect however, remains the same.[59] Essentially, entities engaged in the renewable energy sector are afforded extensive depreciation deductions resulting in reduced taxable profits.

In light of the preferential tax regime afforded to the renewable energy sector, revenue potential of investments from direct taxation of business profits of new investments in this sector is limited. However, the same does not apply for the revenue potential from capital gains taxation. Taxation of capital gains accruing to Development Finance Institutions (DFI) whose investment strategy focusses on investing in growth stocks is of particular importance in this context.

Most European DFIs are members of The Association of European Development Finance Institutions EDFI that advocates for the adoption of responsible tax practices. The EDFI sets a responsible taxation "social contract" which its member FDIs and their agreement and implementing partners are expected to abide by. This contract requires that tax laws be complied with and companies refrain from engaging in inappropriate and artificial, corrosive tax practices. The EDFI encourages the entities through which ODA is advanced to adopt 6 key principles pertaining to taxation in developing countries. These include:

- The adoption and publication of a tax policy;
- Compliance with the host country's tax laws;
- The prevention of potentially harmful tax practices;
- Avoiding the use of complex corporate structures designed solely for the purpose of attaining tax benefits;
- Promotion of transparency; and
- Recognise the role of tax in development effectiveness reports.[60]

An interesting question that arises in the context of ODA supported investments is how the exit strategies, relate to the principles concerning equitable taxation as adopted by the EDFI. The question is particularly relevant keeping in view that most of the DFIs are state owned and may not be subject to corporate taxes in their home countries.

For example, the Norwegian DFI Norfund is a state-owned enterprise established under Norfund Act of 1997. Norfund main business idea is to develop sustainable business enterprise though active ownership. Although Norfund does not face a specific rate-of-return requirement from its owners -the Norwegian State; the underlying logic is that it shall generate profits at the portfolio level that can be redeployed in its investment business. Expectation of capital gains at the time of exit is an essential component of Norfund's strategy. As per the Act, Norfund is not subject to domestic corporate taxation in Norway. Most of its capital gains may not be subject to taxation outside Norway as well. This may be due two

59 Section 32 Income Tax Act 1961 (India).

60 Available https://www.norfund.no/getfile.php/136838/Dokumenter/17%2010%2026%20EDFI%20Responsible%20Tax%20Policy_Consultation%20draft%20%28002%29%20%28ID%20249904%29.pdf accessed 30 November 2017.

factors. Some of the investments are routed through third jurisdictions – the so-called low-level tax jurisdictions and may not attract capital gains taxation in the source country. In other cases, source countries may have domestic tax legislation with minimal taxation of capital gains. This begs the question whether the tax contribution made by DFI such as Norfund if any is equitable in light of the economic return made from investment activities. The DFIs home and source countries need to assure that taxation of capital gains is equitable.

7. Conclusion

All countries have laws that function in a hierarchy ranging from its constitution down to the laws passed by legislature, executive orders and regulations and procedures issued by lower levels of law making authority. International treaties are a part of this hierarchy and their enforcement depends on the extent of their incorporation in domestic legislation. It is evident that a homogenous approach to determining the impact of tax treaties on domestic revenue mobilisation offers limited insight. What is required is a country specific analysis that results in the provision of actionable information. This is achieved through an analysis that goes beyond the superficial tax treaty analysis and considers the domestic tax law hierarchy, the investment activities being conducted in the country of source and the type of investor from whom the investment is derived.

It is trite that capital import countries administer tax systems despite great resource constraints. Thus, it is imperative that the resources that are available be directed in the most efficient way possible. This study illustrates that rather than the renegotiation of tax treaties, what is pressing for some of the countries subject to this study is the amendment of domestic legislation. These countries should:

- Revisit sector specific incentives that result in the corrosion of taxable profits;
- Introduce the appropriate anti-avoidance provisions (such as thin capitalisation regulation and hybrid mismatch) rules; and
- Ensure that anti-avoidance provisions do not curb one form of avoidance behaviour only to encourage another (e.g. the introduction of thin capitalisation to prevent excessive debt deduction yet failing to curb deductions resulting from other forms of financially engineered instruments).

It is also evident that the disharmonious treatment of capital income creates regulatory arbitrage opportunities. This may result, not only in significant revenue being forfeited but also, in double non-taxation as a result of preferential tax treatment being afforded to specific forms of investors, such ODA financed DFIs in their country of residence.

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Acronyms

AOA	Authorised OECD Approach
ATAF	African Tax Administration Forum (ATAF)
ATAF model	ATAF Model Agreement for the Avoidan ce of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income
CGT	Capital Gains Tax
DFIs	Development Finance Institutions
DTAs	Double Taxation Agreements
EDFI	Association of European Development Finance Institutions
ESOP	Employee Stock Ownership Plans
FDI	Foreign Direct Investment
FPI	Foreign Portfolio Investment
GNI	Gross National Income
ODA	Official Developmental Assistance
OECD	Organisation for Economic Cooperation and Development
OECD model	the OECD Model Convention on Income and Capital
MAT	Minimum Alternate Tax
Norfund	Norway's Development Finance Institution
PE	Permanent Establishment
UN model	United Nations (UN) Double Taxation Convention between Developed and Developing Countries

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