Africa Tax Update: Quarterly Newsletter

Second edition, July 2019

Welcome to the second edition of the Africa Tax Update. We are excited to publish a quarterly newsletter with the purpose of bringing you thoughts from KPMG Africa Tax leadership on the dynamic African tax landscape as well as a summary of key news, events, updates contributed by tax professionals in KPMG member firms across the continent.

On 30 May 2019, an important milestone in the history of Africa was reached when the Agreement establishing the Africa Continental Free Trade Area (AfCFTA) entered into force.

In this edition, our contributors look at the AfCFTA from two different angles.

The Head of KPMG Africa's Trade & Customs practice, Venter Labuschagne takes a look at the establishment of the AfCFTA and the impact this will have for businesses operating on the continent.

McDonald Onyema, a Senior Tax Consultant from KPMG in Nigeria, considers what AfCFTA seeks to achieve and the possible challenges it may face.

We do hope that this edition provides interesting reading and helps you navigate this dynamic environment.

You are welcome to contact Preshnee Govender at preshnee.govender@kpmg.co.za for suggestions on future content you would be interested in reading.

Contents

1. Trade Peace in Africa – The Continent welcomes the AfCFTA 2 - 3
2. AfCFTA – To be or not to be? 5 - 7

From the Africa Tax Centre:

Wole Obayomi
Head of Tax, KPMG Africa
P: +234 803 402 0946
E: wole.obayomi@ng.kpmg.com

Dermot Gaffney
COO of Tax, KPMG Africa
P: +27 82 686 9345
E: dermot.gaffney@kpmg.co.za

Preshnee Govender
Tax Coordinator, KPMG Africa
P: +27 76 511 2536
E: preshnee.govender@kpmg.co.za

KPMG

Trade Peace in Africa – The Continent welcomes the AfCFTA

While the USA and China are sharpening their tariff spears and taking aim with licencing requirements and other non-tariff barriers, in what quite possibly can turn out to be an epic and protracted trade war, Africa has chosen a different path. One could in fact muse that in Africa, trade peace has broken out.

The moment has arrived

On 30 May 2019, the Agreement establishing the Africa Continental Free Trade Area (AfCFTA) entered into force, following the deposit by Sierra Leone and the Saharawi Republic of their instruments of ratification with the depository in Addis Ababa on 29 April 2019. This brought to 22 the number of ratifications, breaching the threshold required for the entry into force of the agreement, which is 30 days after the deposit of the 22nd instrument of ratification.

A road less travelled

Although the AfCFTA Agreement covers substantially more than the creation of a Free Trade Area, it is the reduction of tariffs on qualifying imports between member countries that will ultimately have the most profound impact on businesses based on the continent. In terms of World Trade Organisation (WTO) definitions *"a Free Trade Area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce … are eliminated on substantially all trade between the constituent territories on products originating in such territories."*

Historical international practice suggests that the following process, in simplified terms, should be followed when negotiating and concluding an agreement to establish a free trade area:

- Following public consultation, countries or territories agree to enter into negotiations to create a free trade area;
- Trade talks are conducted, texts published online and technical instruments are agreed;
- All texts required for implementation are finalised and the agreement establishing the free trade area is signed;
- The agreement is ratified by the appropriate legislative body in each member state, and the agreement enters into force; and
- Implementation of agreed time lines and technical measures to make benefits of the Free Trade Area available between traders in member states.

For the establishment of the AfCFTA, sovereign African countries, under the umbrella membership of the African Union (AU), chose a substantially different approach when in January 2012, they decided to establish a Continental Free Trade area. Work commenced on the drafting of the Agreement establishing the AfCFTA, as well as its associated Protocols on Trade in Goods and Services, as well as Settlement of disputes. The consolidated texts of these documents, without all the supporting annexures were signed in Kigali on 21 March 2018 by 44 countries, and subsequently by another 8 AU member states. Only 3 African countries, Benin, Eritrea and Nigeria have not signed the Agreement.

With the requisite number of countries now having ratified the Agreement, Phase 1 of the AfCFTA has now entered into force. Phase 2 of the AfCFTA will cover the Protocol on Competition Policy, the Protocol on Intellectual Property, and the Protocol on Investment, and will require its own ratification. The deadline for completion of these texts and submission to the AU Assembly for adoption has been set for January 2021.

What furthermore makes the AfCFTA process different and raises some eyebrows in legal circles, is the fact that the Agreement has now entered into force, without some of the legal texts dictating its implementation having been finalised. As mentioned above, countries usually complete all negotiations and finalise the legal requirements they would be bound to, prior to ratification. In the case of the AfCFTA, countries have effectively agreed to be bound by provisions, and be burdened by some actions, which have not yet been finally negotiated and agreed.

So what is the fuss about?

Minimum requirements for the implementation of a Free Trade Agreement include clear and specific rules to determine origin of goods, and the tariff schedules setting out the preferential rates of duty for trade between member countries. Recent indications are that work on the Rules of Origin is at an advanced stage, and it is believed that up to 80% of the current SADC rules will be accepted. This will differ from industry to industry. Member countries have been requested to present their draft tariff schedules that will form the basis of negotiations at the 12th Extraordinary Session of the Assembly of the Union on the AfCFTA in Niamey, Niger on 7 July 2019. The deadline for the completion of negotiations on these schedules have been set for January 2020.

It is the objective to progressively reduce and ultimately eliminate customs duties and non-tariff barriers for 90% of products, over a 5, 10 or 15 year period for different countries, depending on their level of economic development. While this process is carrying on, it is likely that trade within the existing Regional Economic Communities, such as SADC, ECOWAS and the EAC will continue, and even grow.

Another challenge to the AfCFTA's stated objectives of enhancing efficiencies in customs, trade facilitation and transit, as well as the promotion of regional and continental value chains, is the current exclusion of one of Africa's largest economies, which forms the basis of the ECOWAS block, from the operation of the Agreement. Nigeria in May 2019 indicated its willingness to participate, and has the option to accede to the agreement at a time in the future. Uncertainty about the process to be followed to do so, as well as the procedures to negotiate concessions, may however complicate and prolong the process.

When will traders be able to benefit from the AfCFTA then?

As the Trade Law Centre (TRALAC) points out in its Working Paper on the Ratification of the AfCFTA Agreement, there cannot be a functional Free Trade Agreement under the AfCFTA until such time as the Rules of Origin have been finalised, and tariff schedules and concessions have been finalised and published. Furthermore, certain key Institutions necessary for the administration of a Free Trade Agreement still have to be created. Most notably, the AfCFTA Secretariat, staffed with representatives from various member countries, needs to be created, and its identity, role and powers finalised.

At this point therefore, it appears that traders can do little more than put pressure on their Governments to expedite the completion of the tools and institutions required for meaningful implementation of beneficial tariffs, and start doing long term planning for future supply and regional value chains. Industries should ensure that their Governments have taken into account all relevant information when compiling the Tariff Schedules that have to be submitted in July 2019 at the Niamey Session of the AU Summit.

In our next contribution, we will deal with the efforts made by specific countries to drive progress and prepare for meaningful implementation of the Agreement that has the potential to change the future of a continent.

For more information, contact:

Venter Labuschagne
Partner, KPMG South Africa
Head of Africa Trade & Customs Practice
P: +27 83 677 7744
E: venter.labuschagne@kpmg.co.za

AfCFTA - To be or not to be?

The Agreement establishing the AfCFTA has been touted as the document with the potential to alter the economics of the African continent. Its ratification by African countries would create an open and free trade regime between participating nations. It has the potential to be the largest trade agreement after the formation of the World Trade Organisation. The argument, however, seems strong in recent times on whether or not Africa is ripe for such a level of intra-continental trade engagements. This concern may be valid given the woeful state of infrastructural development in most African countries.

Another area of concern is Africa's heavy dependence on extractives, which seems to dominate its trade environment. Other visible areas of concern are the strength of the various policies guiding trade within individual African countries as well as the political will to implement these policies. Disturbing too, is the fact that most of the legislation guiding trade in most African countries is outdated and does not reflect the current trade realities. The big question is that beyond putting pen to paper and executing the various documents, will Africa be willing to truly harmonize its trade interests and leverage the many opportunities that a free continental trade area presents? Can Africa utilise this opportunity as an effective tool for the balancing of the trade imbalances among African nations? In the following paragraphs, we will try to explore the perceived opportunities and the likely challenges of undertaking this ambitious project.

Current state of trade in Africa

Currently trade between African countries is considerably low. As at 2014, whilst Africa was rated last in terms of the volume of internal continental trade with an abysmal 18%, Europe topped the list with 69%, Asia had 52% while North America recorded 50%[1]. A quick look at the continents with seemingly high volume of internal trade reveals that they share certain positive variables that may have aided the high level of trade. These variables range from the improved infrastructure, such as power, good transport networks, affordable internet services, to more efficient trade structures and policies. Conversations around tariffs and taxes are also clear and there is enhanced certainty around trade policies and their implementation.

If these variables are the major catalysts of intra-continental trades in these other regions, one will then not be surprised by the abysmal level of trade amongst African nations. There is a visible imbalance of the required variables and most African countries are still battling the dual monsters of a tremendous infrastructural deficit and policies that are impossible to implement, given the present structure. Furthermore, the continent has consistently operated on a faulty trade equation, where nations consume what they have no capacity to produce and produce what it has no intention to consume, at least not in the raw state of production. Hence, its only option of a meaningful exchange is to explore external markets. This explains the reason for a higher level of trade engagements between Africa and American and European nations, than among nations within Africa.

Trade barriers, outrageous tariffs and rigorous custom procedures have not helped matters either. Available reports suggest that Africa generates about $4.1billion from trade tariffs between African countries. While this may be a positive indicator of the volume of trade within the continent, it also points to the huge financial burden on exports in the region.

In the face of these seemingly overwhelming challenges, it will be necessary to take a more critical look at the need and timeliness of a Continental free trade agreement.

The Agreement: What it seeks to achieve

The primary aim of the Agreement is to achieve an increased volume of trade amongst African countries. Trade remains a key driver in the economic advancement of nations and getting intra-African trade right may be the much needed catalyst to stir the African economy up. There is no doubt that it will bring about the much needed economic expansion of African countries by taking the focus off extractives to other non-mineral products. It is believed that AfCFTA will be a catalyst for the diversification of the African economy. It is also expected that it will bring about a consciousness for African economies to make a shift towards building a production-based continental economy as no nation would want to be entirely on the consumption scale of the competition. This will create more job opportunities that would further absorb the millions of jobless young Africans.

It also will address the low volume of trade between African countries which is presently at an abysmal 18% according to the United Nations Conference on Trade and Development (UNCTAD) report. It is obvious that intra-Africa has a far greater potential, and AfCFTA will no doubt ensure an increased movement of goods and services between African nations. This will also help to address possible skills imbalance as the movement of technically skilled individuals freely from one country to another will help to balance out any technical imbalance in production sectors. It is hoped that this integration will also help to address the economic imbalance as participating nations can freely tilt towards receiving more goods of interest. In addition, Economies will be able to leverage the areas of strength and African taste will really be preserved as the taste of African products is mutually shared. It is therefore expected that where the AfCFTA is successfully executed and implemented, Africa will be able to pull her weight amongst the economic power brokers of the world. The ACFTA would birth more indigenous companies with global outlook as a more competitive environment is expected to drive companies towards providing quality of global standards. The potential of a successful trade agreement is limitless if achieved.

Possible challenges

Having considered the numerous potential benefits, it may not yet be *uhuru* for the African nations as there are bound to be areas of conflict that may test the resolve of Africa to build her economy. There are obvious reservations and possible setbacks that this ambitious project might have to overcome before the impact can be felt.

There is no gainsaying the fact that, in the interim, African nations would lose about $4.8bn in tariff from regional trades as projected by the UNCTAD. This is a substantial amount of money that would take a lot of willpower for the beneficiary nations to let go of, especially in the face of uncertainties about the success of the AfCFTA.

Presently, Africa has the weakest economy among the world's continents. There is the fear that Africa has not changed its narratives of depending on external economies and hence may not be able to sustain the growth or demand that will likely be spurred by the trade agreement. The consequence of this is the flooding of African market with foreign goods.

This possibility will definitely defeat a major aim of African market by Africans for Africans and may be a driver for an unhealthy competition between local players.

An area of importance is the conflicting interests of participating nations. Beyond the generic promise of a prosperous and economically stable Africa, the question at the individual level of participating nations then becomes who wins and who loses. As expected, the gains and losses are not going to be equal across the board, hence the decision to ratify and implement this Agreement will be fueled by the perceived potential gain or loss to individual countries. For instance, Nigeria, with its over 180 million people in a willing market has, so far, approached the AfCFTA project with lack of enthusiasm. Taking the Nigerian example further, the major concern has always been what it stands to gain from such trade collaborations. It boasts the largest market in Africa, and commands a relatively high level of unemployed young people, a developing economy and a consumption-based market. These indices present a faulty equation which would make Nigeria a vulnerable victim of such trade agreements. These and many more are the reasons Nigeria, who should have been in the forefront of uniting the African economy, appears not to be keen on ratifying the agreement and does not look like it may be prepared to do so any time soon. Nigeria is just one out of many that may have such concerns. It is however expected that all such concerns would be sorted out by participating countries before they ratify the agreement. The advice remains that individual nations should be more strategic in their approach towards positioning themselves to reap from the benefits of a more unified economy. Boycotting the process is not the way forward, rather, economies should better position themselves and work out modalities that would better position them for a unified African market.

Tax, trade and related legislation

In the economics of the 21st century, tax is no doubt a big conversation in most African countries and a major driver of Africa's GDP. Just like every other continent, African countries have their different and independent tax regimes all backed up by valid pieces of legislation. In light of the proposed trade integration, the question will then arise on what the tax structure would be. Are the participating nations going to come up with a common document guiding the taxation of trades, or will they maintain their various tax regimes and take the option of double taxation treaties (DTTs)? They may also adopt a tax free structure in addition to the tariff free structure. There may not be answers now, however, these are interesting conversations that need to come to the fore within the shortest possible time. However, given the number of countries that has signed the agreement, it is obvious that a majority is optimistic about the success and potentials of this integration. There is also a growing need to critically review and harmonize labour laws amongst the participating countries. This will be critical to the overall success of the Agreement, if properly implemented.

Conclusion

In the face of these challenges, it may not be too easy to conclude that a united African trade front would serve the African economy better as a quick glance at similar treaties from Europe to North America seem to point to that fact. While nations count their gains from such alliances, there also exist obvious imbalances and the need to renegotiate the terms of the agreements from time to time is inevitable. This was the case in one of President Donald Trump's moves to initiate the renegotiation of the North American Free Trade Agreement. It is a testimony to the obvious inadequacies of existing trade agreements and also the fact that each agreement would favour some parties at the expense of others. However, individual nations should adopt strategic trade and economic policies to address these inadequacies. As new trade alliances are being forged across the world, such as EU-Japan EPA, EU-Mexico trade agreement etc., this is a pointer to the fact that trade agreements remain an effective tool for driving both inter- and intra-national trades.

For more information, contact:

McDonald Onyema
Senior Tax Consultant
KPMG Advisory Services
Nigeria
P: +234 814 275 1461
E: McDonald.Onyema@ng.kpmg.com

Contact Us:

Country	Contact	E-mail	Telephone
Algeria	Ramzi Ouali	rouali@kpmg.dz	+213982400877
Angola	Luis Magalhães	lmagalhaes@kpmg.com	+351210110087
Botswana	Gosego Motsamai	gosego.motsamai@kpmg.bw	+267 7130 7285
Cameroon	Jacques Pierre Bounang	jbounang@kpmg.cm	+23733439679
Côte d'Ivoire & Francophone Region	Jean-Luc Ruelle	jruelle@kpmg.ci	+22520225753
Democratic Republic of the Congo	Louison Kiyombo	lkiyombo@kpmg.cd	+243851638754
Egypt	Khaled Balbaa	Kbalbaa@kpmg.com	+20235362211
eSwatini (Swaziland)	Rob Webb	rob.webb@kpmg.co.sz	+26824057020
Ghana	Emmanuel Asiedu	easiedu@kpmg.com	+233302731007
Kenya	Benson Ndung'u	bndungu@kpmg.com	+254709576905
Mauritius	Wasoudeo Balloo	wballoo@kpmg.mu	+2304069891
Morocco	Aziz El Khattabi	aelkhattabi@kpmg.com	+212537633702
Mozambique	Quintino Cotao	qcotao@kpmg.com	+258843144220
Namibia	Robert Grant	robertgrant@kpmg.com	+26461387500
Nigeria	Wole Obayomi	wole.obayomi@ng.kpmg.com	+2348034020946
South Africa	Joubert Botha	joubert.botha@kpmg.co.za	+27834567734
Tanzania	David Gachewa	dgachewa@kpmg.com	+255202600330
Tunisia	Dhia Bouzayen	dbouzayen@kpmg.com	21671194344
Zambia	Michael Phiri	mphiri@kpmg.com	+260966779830
Zimbabwe	Vinay Ramabhai	vramabhai@kpmg.com	+263782403877

KPMG Africa Twitter

KPMG Africa Facebook

KPMG Africa LinkedIn