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# The impact of corruption on tax revenues, tax compliance and economic development: Prevailing trends and mitigation actions in Africa

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## ***Abstract***

The impact of corruption on development is well-documented and a multitude of international instruments and domestic laws are in place to address corruption. Despite these initiatives, the prevailing trend across Africa is that socio-economic decisions by government are informed by the interests of patronage networks that are further advanced through institutional weaknesses. The pervasiveness of these conditions has a severe impact on domestic resource mobilisation because it complicates enforcement efforts on the part of tax authorities. Over and above increasing their own efficiencies, tax authorities are thus under pressure to identify and implement mitigating actions to address the impact of corruption in conjunction with other stakeholders.

**Keywords:** Africa, corruption, fraud, regulation, tax evasion

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## 1. INTRODUCTION

control political institutions to do so. It can therefore be argued that good governance of institutions may result in a higher tax effort. Bird, Martínez-Vázquez and Torgler (2008, pp. 58-66) find that an encompassing and legitimate state is an essential precondition to an adequate tax system and if taxpayers perceive that their interests (preferences) are properly represented in political institutions, they will be more willing to contribute to the state through taxes.

*Corruption*, when applied in a civil service context, is defined variously as: (i)



Bank, 1997, ch. 2; for a recent study finding an impact of mining on local corruption in Africa, see Knutsen et al., 2017). This abuse can take a variety of forms including asking bribes for the issuing of licences of any kind, in awarding contracts or in granting exemptions, diverting funds from the fiscus, by selling government property at black market prices or manipulating tender processes in favour of politically connected persons or entities, and also creates an uncontrolled environment for smuggling and diversion of revenues from the treasury to other ministries.<sup>8</sup>

Corruption, like tax evasion, also promotes distrust in the government, and creates equity costs by imposition of additional tax burdens that are arbitrary and capricious (Asher, 2001, p. 5). Although traditional analysis generally refers to petty corruption, grand corruption and state capture (Graycar, 2015, p. 88), six categories of corruption have also more particularly been identified in the literature that include: administrative

Corruption Perceptions Index over a four-year period shows that the prevailing trend in Africa is that corruption is increasing (see Table 1). Of the 10 countries selected, seven showed increased levels of corruption, one remained unchanged and two showed slight improvement. The level of corruption in low-scoring countries (i.e., high corruption), such as Angola, is described as rampant corruption; the archetypal captured state. In higher scoring countries (lower corruption), such as South Africa, it is described as pervasive, even systemic. Some key questions following from this data are, for instance, what forms of corruption drive this prevalence and are there measures in place to address corruption?

**Table 1: Transparency International Corruption Perception Index 2016**

Country	2016	2015	2014	2013	Global Rank <sup>10</sup>	Change
Angola	18	15	19	23	164	
Botswana	60	63	63	64	35	
DRC	21	22	22	22	156	
Kenya	26	25	25	27	145	
Malawi	31	31	33	37	120	
Mozambique	27	31	31	30	142	
Nigeria	28	26	27	25	136	
South Africa	45	44	44	42	64	
Tunisia	41	38	40	41	75	
Uganda	25	25	26	26	151	

Source: Transparency International, Corruption Perceptions Index 2016.

A media search of these 10 African countries shows an apparent prevalent trend of vast amounts of money being channelled to ministers and senior government officials through corrupt practices. There are also some examples of good practices that have emerged on the continent as illustrated below.

### 3.1 Angola

Literature describes Angola as a country that sufcohr(y)11(bo )-42((as)7( 7(oney)7(9(t)6(r)-sou3s 254





### 3.4 Kenya

Corruption in Kenya is pervasive, dominating the provision of public services, the formation of contracts and, of course, political life (Hope, 2017, p. 62). According to Hope (2017, p. 63), corruption persists in Kenya primarily because those in power benefit from corruption and the existing governance institutions lack both the will and capacity to stop them from doing so. For example, the office of the president was drawn into allegations of misappropriation of funds amounting to USD 50 million that were intended for use for free maternity care in hospitals across the country. Reportedly, an electronic payment system at the Ministry of Health was manipulated to make double payments to vendors and to divert funds to individuals and private companies that are associated with the president (Osiro [2016]). According to Hope (2017, p. 63), the main reason for high levels of corruption is the deliberate undermining of the basic institutions that underpin and support the rule of law and good governance.

### 3.5 Malawi

In August 2017, Malawi police announced that an arrest warrant for former president, Joyce Banda,

to change culturally entrenched attitudes, reduce the opportunities for abuse and increase the likelihood that offences are detected and punished . Also, like Malawi, the scale of corruption affects donor programs and transparency in the budgeting process has, for example, emerged as a key aspect for measuring accountability in how donor funding is spent (Schmitt, 2017, p. 246).

### 3.7 Nigeria

Nigeria has been the victim of many examples of grand corruption (Anaedozie, 2016). For example, in 2014 it was reported that USD 20 billion was not remitted to the federal government by the Nigerian National Petroleum Corporation (NNPC). Between 2011 and 2015, the NNPC reportedly with







financial institutions (FFIs) to report to the US Internal Revenue Service information about financial accounts held by US taxpayers, or by foreign entities in which US taxpayers hold a substantial ownership interest.

Domestic legislation in some countries places emphasis on the briber, for example, the UK Bribery Act of 2010 sets out two offences that are specifically aimed at commercial bribery. Section 6 creates an offence relating to bribery of foreign public officials for the purpose of obtaining or retaining business or an advantage in conducting business. Section 7 establishes a new form of corporate liability for failing to prevent bribery on behalf of a commercial organisation.<sup>22</sup> The statutory formulation of the UK Bribery Act abandons the agent/principal relationship<sup>23</sup> in favour of a model based on an intention to induce improper conduct.

By introducing similar legislation, African countries can better position themselves to

concern that a wider interpretation of corruption is necessary to deal with

Looking at the selected countries, all have anti-corruption laws in place as reflected hereunder.

**Table 2: Anti-Corruption Instruments and Legislation in African Countries**

<b>Country</b>	<b>Anti-Corruption Instruments and Legislation</b>
Angola	Law on the Criminalization of Infractions Related to Money Laundering (CIML); Public Probity Law 2010; Public Contracting Law; Decree 48/06; Law on Access to Administrative Documents; Penal code 1886 and the Law of Crimes against the Economy criminalise active and passive corruption 2002; In 1996, the Law of the High Authority Against Corruption was passed for the creation of an anti-corruption body (yet to be established).
Botswana	Directorate on Corruption and Economic Crimes (1994); National Anti-Corruption



## 5. PREVENTATIVE MEASURES

Various preventative measures are available to reduce the incidence of corruption. Where these measures are combined as part of the regulatory framework, a greater impact in reducing corruption may be possible.

### 5.1 Increased transparency

In recent times, a number of mass public interest disclosures by whistleblowers has highlighted tax and corporate practices which are characterised by aggressive tax avoidance and use of corporate structures to hide profits. The Luxembourg Leaks (Luxleaks), Panama Papers are probably the best known. The effect of the scandals has been a re-ignition of the debate on international tax reform to counter practices contributing to all forms of illicit financial flows, including corruption.

The UN *Convention against Corruption* also emphasises the importance of transparency in public administration. Under Article 10 of the *Convention*, Parties are required to undertake the measures that are necessary to enhance transparency in public administration, which includes aspects such as the organisation, functioning and decision-making processes. The measures may include

adopting procedures or regulations allowing members of the general public to obtain, where appropriate, information on the organization, functioning and decision-making processes of its public administration and, with due regard for the protection of privacy and personal data, on decisions and legal acts that concern members of the public; (b) simplifying administrative procedures, where appropriate, in order to facilitate public access to the competent decision-making authorities; and (c) publishing information, which may include periodic reports on the risks of corruption in its public administration.

In many instances corruption is fuelled in part by either the indifference or resignation (or both) of the popul

540). Campbell (2016, p. 541) also points out that a failure on the part of an investing to put any real pressure on nations to institute internal reforms (e.g., human rights considerations or corporate social responsibility) represents a lost opportunity to assist the host country and to mitigate risks for investing entities because well-designed BITs have the ability to promote the rule of law through international arbitration and other conditions. Such conditions may motivate developing host countries to improve domestic administrative practices and laws to avoid future disputes and for countries to better deal with negative externalities caused by foreign involvement (Campbell, 2016, p. 546).

### 5.3 Establishment of anti-corruption bodies

Institutional responses to corruption have also come in the form of anti-corruption bodies whereby states attempt to enhance their institutional capacity to prevent corruption. The typical role assumed by these bodies is implementing and/or overseeing and coordinating the implementation of anti-corruption policies. Implementation of anti-corruption policies is, however, dependent on institutional cohesion (i.e., all government departments buying in and supporting the initiative) since the responsibility for implementation of the various individual components of the anti-corruption policy lies with the particular sector or government agency (Terracino, 2012, p. 138). Terracino (2012, pp. 138-139), further points out that functional and financial independence should be established in law (rather than by executive decree) to ensure that the entity is able to carry out its functions

2. to what extent are corruption cases pursued and what is the quality of judicial rulings; in other words, were there instances of judicial abuse either procedurally or substantively?
3. what is the monetary value of corruption-related freezing, seizure and confiscation of assets?
4. are anti-corruption bodies fully operational?
5. how functionally effective are financial investigation units within the larger criminal justice

proceeds of tax evasion and corrupt acts and also the sources of these funds. A comprehensive anti-corruption strategy therefore requires a properly functioning anti-money laundering regime where predicate offences, such as tax evasion, are clearly recognised.

## 5.6 Implementation of a legislative and regulatory environment for revenue collection

The OECD very relevantly points out that the lack of a clearly defined legal and regulatory framework may constitute a major driver of corruption (OECD 2014, p. 67). The problem is exacerbated through the absence of a well-functioning tax administration. In this context, the *African Tax Outlook* (African Tax Administration Forum, 2017, p. 100) also highlights that manual registration, filing and payment procedures involve person-to-person interaction between tax officials and taxpayers that can create opportunities for corruption. The IMF (International Monetary Fund, 2015, p. 35) advises that in view of the cost of corruption in revenue administrations in terms of both short-term revenue losses and long-term erosion of compliance, a range of ris

(c) auditing the transactions and entities involved; and (d) reporting the results in detail;

6. strengthening the ability to detect and pursue criminal activity by adoption of whole-of-government approach to fighting tax and other financial crimes.

Country by Country Reporting<sup>25</sup> is useful in providing tax administrations with a means to risk assess multinational enterprises through provision of data on the overall allocation of profits within the group across multiple jurisdictions, and whether a bias exists towards low-tax jurisdictions or whether intragroup trading reflects trade mispricing practices.

### 5.7 Implementation of beneficial ownership requirements

A wide range of business activities are conducted through corporate entities and other types of legal structures such as companies, trusts, partnerships and foundations, and while these corporate vehicles play an essential and legitimate role in the global economy, they can also be used in some circumstances for illicit purposes such as corruption and tax evasion (Financial Action Task Force, 2014, p. 3).

The Financial Action Task Force (2014, p. 3) highlights that a meaningful reduction of various abuses of corporate vehicles could be brought about if there was information available to authorities regarding the legal owner and the beneficial owner of such vehicles, the different sources of their assets, and its business activities. Beneficial ownership information facilitates better identification of perpetrators of predicate crimes and following the money through identification of assets and accounts held through corporate vehicles, particularly in cross-border situations (Financial Action Task Force, 2014, p. 3). There are, however, significant challenges involved in implementing beneficial ownership information measures. Many African countries do not have automated company registers in place nor are there interfaces between public institutions and revenue bodies which can ensure better integration of data. Therefore it may take considerable time for many African countries to develop, implement and have beneficial ownership requirements available for the purposes of domestic law enforcement and international exchange.

### 5.8 Addressing the cultural aspects that fuel corruption

According to the *African Tax Outlook*, tax and customs rank third after government procurement and land administration on the corruption scale (African Tax Administration Forum, 2017, p. 24). While disciplining of corrupt staff is recommended, and stringent pre-screening and vetting when recruiting carried out, the African Tax Administration Forum (2017, pp. 104, 106) considers that upstream action should, however, take precedence in that revenue authorities should build integrity and anti-corruption into corporate culture and require their staff to work and behave in accordance with ethical standards. Anti-corruption and integrity have become key agenda items for meetings year round of, for example, the Botswana and Burundi revenue authorities; in addition, employees should be financially literate and

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means by which multinational enterprises (MNEs) must report annually and for each tax jurisdiction in which they do business: OECD, *Country by Country Reporting*, <<http://www.oecd.org/tax/beps/country-by-country-reporting.htm>>.



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