

Mistreated

The tax treaties that are depriving the world's poorest countries of vital revenue



Front cover image

Stella is a dedicated teacher who knows a thing or two about overcrowding. The picture displays her classroom in Lilongwe, Malawi, which is packed with 285 children. 'I pay almost 17,000 kw (US\$23) in tax every month and then when I go to the shops and I buy a packet of sugar or a tablet of soap I have to pay VAT. Big companies have to start paying as well.' When told about the UK-Malawi tax treaty Stella stated that 'if the agreement was made under the colonial government and now we are in multi-party democracy then it has to be revised'.



Executive summary

Women and girls in the world's poorest countries need good schools and hospitals. To pay for this, these countries urgently need more tax revenue. A little-known mechanism by which countries lose corporate tax revenue is a global network of binding tax treaties between countries. This report marks the release of the ActionAid tax treaties dataset – original research that makes these tax deals made with some of the world's poorest countries easily comparable and open to public scrutiny.

Tax avoidance strategies used by some multinational corporations deprive the world's most impoverished communities of vital revenues. Tax revenue is one of the most important, sustainable and predictable sources of public finance there is. It is a crucial part of the journey towards a world free from poverty – funding lasting improvements in public services such as health and education. The communities that ActionAid works with around the world are demanding increased public funds to promote development – particularly for the realisation of women and girls' human rights.

Tax treaties – agreements between countries that carve up tax rights – play a facilitating role in many of these tax avoidance schemes. Tax treaties have played a part in most well-known cases of aggressive tax planning, such as in Google's¹ and Amazon's² tax schemes. Many of the tax treaties that ActionAid has scrutinised are ensuring that money flows untaxed from poor to rich countries, making the world more unequal and exacerbating poverty.

Tax treaties have so far received little public scrutiny – but this is changing. ActionAid has commissioned original research that makes the content of more than 500 binding treaties signed by lower-income countries (those classified as low and lower-middle income by the World Bank) in Asia and sub-Saharan Africa available to the public and open to scrutiny for the first time.³ These important tax agreements decide when, how and even if some of the world's poorest countries can tax foreign-owned corporations that are making money within their borders.

Global corporations use tax treaties to limit their tax contributions in the lower-income countries where they generate profits. Tax treaties that aggressively lower

tax contributions in lower-income countries are harming revenue collection in these countries and the rights of the world's most vulnerable people. They have no place in the 21st century. The era of outdated and unscrutinised tax treaties that create opportunities for multinational tax avoidance must come to an end. It's time to ensure that all investors pay their fair share and put an end to aggressively lowered taxes and double non-taxation on investment income.

Developing countries lose billions

Bangladesh is losing approximately US\$85 million every year from just one clause in its tax treaties that severely restricts its right to tax dividends. With an annual total health expenditure of approximately US\$25 per capita,⁴ remedying this alone could pay for health services for 3.4 million people.

In 2004, Uganda signed a tax treaty with the Netherlands that completely takes away Uganda's right to tax certain earnings paid to owners of Ugandan corporations, if the owners are resident in the Netherlands. A decade later, as much as half of Uganda's foreign investment is owned from the Netherlands, at least on paper. The result of the current treaty is lost tax revenue in Uganda, which could have paid for essential public services for the Ugandan people.

As IMF staff wrote in 2014,

“the use of tax treaty networks to reduce tax payments...is a major issue for many developing countries, which would be well-advised to sign treaties only with considerable caution.”⁵

On a global scale, just two rules in tax treaties – dividend and interest payment rules – cost developing countries billions of dollars each year. Tax treaties also cause many other losses – such as lost profit tax contributions and lost tax on capital gains, royalties and services fees – but the size of these losses is still unknown.

ActionAid has identified the most restrictive treaties

All tax treaties restrict the right to levy tax, but some treaties take away far more tax power than others. The ActionAid tax treaties dataset shows that the overall number of tax rights that lower-income countries give up varies widely from treaty to treaty.

ActionAid's new research identifies the treaties that remove more tax rights than most – which we call very restrictive treaties. It finds that the United Kingdom and Italy are tied as the countries with the largest number of very restrictive treaties with lower-income Asian and sub-Saharan African countries, followed by Germany. China, Kuwait and Mauritius also have a rapidly growing number of very restrictive treaties with some of the world's poorest countries.



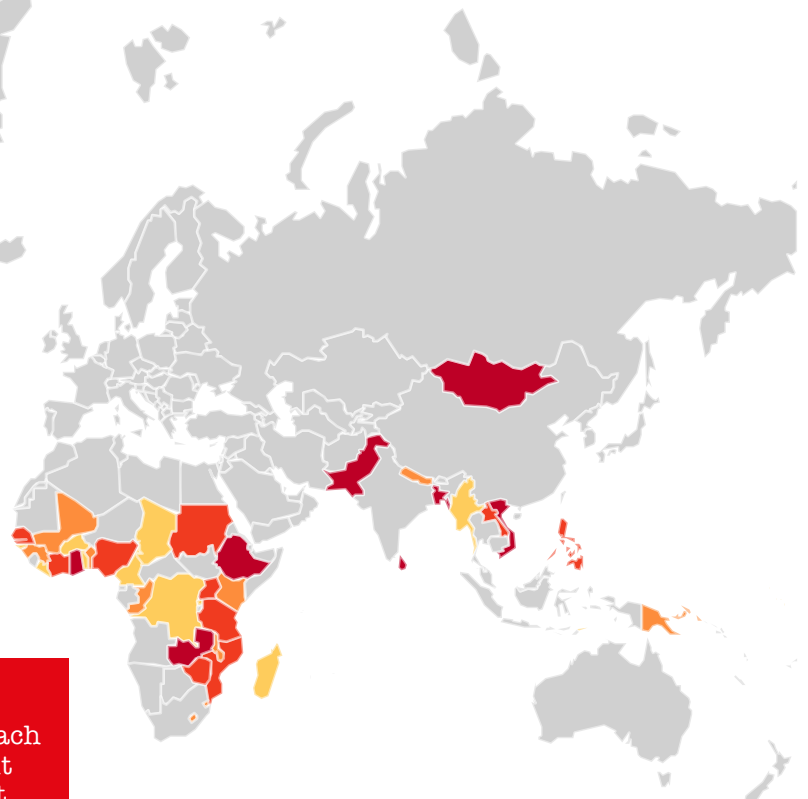
Treaties that lower-income countries have with OECD countries (a club of rich, industrialised countries) take away more rights to tax than those with non-OECD countries. Worryingly, the deals struck with OECD countries are getting worse over time.

Tax treaties with tax havens such as Mauritius can come at a particularly high cost. Money is often routed through tax havens as part of tax avoidance strategies that rely on tax cuts contained in treaties signed by those havens.⁶

Three tax rights that urgently need to be restored

This report highlights three tax rights where lower-income countries need a drastically better deal in their tax treaties with wealthier countries and tax havens.

- **Profit tax:** tax treaties set the rules about how established a foreign multinational has to be before it pays tax on its profits. This has led to absurd results, such as some foreign corporations employing thousands of people without having any liability to pay local profit taxes. China's tax deals with Mongolia and Laos mean that those countries can only tax the profits of Chinese multinationals making money in Mongolia or Laos in very restricted circumstances.



An ActionAid online tool will display the number of very restrictive treaties held by each lower-income country. To find out more about your country's very restrictive treaties, visit <http://www.actionaid.org/tax-power>

- **Withholding tax:** a straightforward ‘grab it before it goes’ strategy that should help guarantee that foreign-owned businesses don’t transfer earnings out of a country before it is time to pay profit tax. However, the dataset reveals a disturbing trend whereby the rights of lower-income countries to levy withholding tax on royalties and dividends have been declining over time. We estimate, for example, that restrictions on Bangladesh’s ability to levy withholding taxes on dividend payments result in a revenue loss of US\$85 million annually. Many lower-income countries have signed away their rights on certain types of withholding tax all together.
- **Capital gains tax:** this tax has delivered multimillion dollar tax payments in lower-income countries, but the right to tax capital gains may be undermined in 49% of treaties examined by ActionAid, which lack a clause that protects against a well-known form of tax avoidance. In addition, more than 70% of tax treaties with lower-income countries prohibit those countries from taxing gains made by foreign corporations when they sell shares in local corporations.

Tax treaties limit poor countries the most

ActionAid is deeply concerned that the balance of tax rights created by tax treaties is not fair. In practice, the taxing restrictions within tax treaties impose an unfair burden on lower-income countries compared to wealthier countries. While both parties to a tax treaty give up some tax rights, the dominant model treaty squeezes the tax rights of the capital-importing (lower-income) country more than the capital-exporting (wealthier) country.

In 2015-16, the OECD, the European Parliament and the European Commission have acknowledged that the balance of tax rights in tax treaties is a problem for developing countries.⁷

Some treaties result in multinational corporations not paying certain types of taxes either in the lower-income country where they operate, or in the country where they are based, so called double non-taxation. This practice cuts urgently needed tax contributions in some of the world’s poorest communities. Uganda’s tax deal with the Netherlands blocks Uganda from taxing income that investors bring home from Uganda and the income is routinely not taxed in the Netherlands either.⁸ These investors enjoy double non-taxation while Uganda misses out on vital tax contributions.

Political action is needed

Tax treaties are voluntary; they can be renegotiated and cancelled. Rwanda’s successful renegotiation with Mauritius in 2013 is a strong example, and included five important triumphs that re-established Rwanda’s rights to tax construction sites, business services, interest and royalty payments. Mr Moses Kaggwa, Commissioner for tax policy at the Ugandan Ministry of Finance, Planning and Economic Development said in 2014:

“We have stopped negotiations of any new agreement until we have a policy in place that will not only offer guidelines but give clear priorities of what our interests and objectives are.”⁹

Lower-income countries should not sign bad tax deals with other governments that take away their taxing power. Wealthier countries can act to align the rules of their tax treaties with development objectives.

ActionAid is calling for governments to:

- **Urgently reconsider the treaties that restrict the tax rights of low and lower-middle income countries most.**
- **Subject treaty negotiation, ratification and impact assessments to far greater public scrutiny.**
- **Take a pro-development approach to the negotiation of tax treaties by adopting the UN model tax treaty¹⁰ as the minimum standard.**

ActionAid is calling for multinational corporations to:

- **Be transparent about their interactions with developing country governments regarding treaty terms and refrain from lobbying governments to conclude tax treaties that are particularly advantageous to their own business interests, but of limited or unclear benefit to the developing country concerned.**

'There is a health crisis in Malawi. There is currently a direction that hospitals should limit the food they give out to patients in order to save money.' Harriet Bwalali, Executive Director of the National Organisation of Nurses and Midwives Malawi



- 1 Zucman, G. 2014. *Taxing across borders: tracking personal wealth and corporate profits*. The Journal of Economic Perspectives, 28(4), pp. 121-148; In relation to tax paid by Google in the UK, see House of Commons Committee of Public Accounts, Tax avoidance – Google, Ninth Report of Session 2013-14, <http://www.publications.parliament.uk/pa/cm201314/cmselect/cmpubacc/112/112.pdf>, p 7.
- 2 It is alleged that the UK's treaty with Luxembourg allowed Amazon to reduce its taxable presence in the UK, Bergin, T, After Google, Amazon to be grilled on UK tax presence, Reuters 17 May 2013 <http://uk.reuters.com/article/uk-britain-tax-amazon-idUKBRE94G06320130517>; Griffiths, I and Bowers, S, *Fresh questions for Amazon over pittance it pays in tax*, The Guardian 16 May 2013, <http://www.theguardian.com/technology/2013/may/15/amazon-tax-bill-new-questions>. Following operational changes in 2015 that resulted in increased UK tax being paid, a spokesman said Amazon was “now recording retail sales made to customers in the UK through the UK branch. Previously, these sales were recorded in Luxembourg”. Bowers, S. *Amazon to begin paying corporation tax on UK retail sales*, The Guardian 23 May 2015, <http://www.theguardian.com/technology/2015/may/23/amazon-to-begin-paying-corporation-tax-on-uk-retail-sales>.
- 3 The analysis of each of these treaties is freely available on the websites of ActionAid and the ICTD. The analysis in this report is based on data produced by consultant Martin Hearson. For further detail on the research see Hearson, M. 2016. *The ActionAid tax treaties dataset*. Brighton: International Centre for Tax and Development. Available at <http://www.ictd.ac/datasets/action-aid-tax-treaties-datasets>. The analysis of the dataset in this report is ActionAid's own.
- 4 WHO, last updated 2015, *Bangladesh: statistical profile* <http://www.who.int/gho/countries/bgd.pdf?ua=1>.
- 5 See Keen, M et al, 9 May 2014. *IMF policy paper, spillovers in international corporate taxation*, 2014 p. 24.
- 6 Ibid. pp. 26-28.
- 7 On 2 July 2015, at a conference hosted by the Dutch Ministry of Foreign Affairs, Mr Saint-Amans, Director of the OECD's Centre for Tax Policy and Administration, said “Source residence is an extremely important debate that should take place and developing countries should probably have more source taxation, I have no doubt”; European Parliament Committee on Economic and Monetary Affairs, 2015. *Report with recommendations to the Commission on bringing transparency, coordination and convergence to corporate tax policies in the Union*, A8-0000/2015, p.19; *European Commission, Communication from the Commission to the European Parliament and the Council on an external strategy for effective taxation*, COM(2016), 24, p 9.
- 8 The Netherlands has instigated the renegotiation of treaties with developing countries to include anti-abuse clauses. This initiative is welcome given that it may reduce opportunistic reliance on tax treaties for tax minimisation purposes. See renegotiated treaty with Malawi (signed April 2015) <https://zoek.officielebekendmakingen.nl/trb-2015-75.html>, Zambia (signed July 2015) <https://zoek.officielebekendmakingen.nl/trb-2015-113.html> and Kenya (signed July 2015) <https://zoek.officielebekendmakingen.nl/trb-2015-114.html>. However, in some respects the renegotiations have further restrained the tax rights of the lower income treaty partner. For example the new Dutch treaty with Zambia caps withholding taxes on dividends and royalties at a rate lower than the old treaty did.
- 9 Addressing the two-day East African regional workshop organised by ActionAid and SEATINI in Kampala, Uganda. Ladu, I M, *Govt suspends double taxation pacts*, *Daily Monitor Uganda* 6 June 2014 <http://www.monitor.co.ug/Business/Govt-suspends-Double-Taxation-pacts/-/688322/2338432/-/qc4jofz/-/index.html>.
- 10 The UN Model Double Taxation Convention between Developed and Developing Countries, 2011 provides a template for countries negotiating tax treaties. It allows lower income countries negotiating with wealthier countries to maintain significantly more tax rights than the OECD Model Tax Treaty does.

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