#TaxPower - ActionAid's campaign explained

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Front cover image:
Jalena Mohamed, 50, and Hawa Amiry, 41, pictured in Miyuyu Primary School, Miyuyu village, Tanzania. Jalena is a school commitee member and is involved in making sure the school is being run well. Hawa is involved in planning and finance within the community.

Credit: Andrew McConnell/Panos Pictures/ActionAid

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Introduction

Recent months have seen a number of high profile exposés of the schemes big-name companies such as Google, Apple and Starbucks use to cut billions off their tax bills. The news has shocked a lot of people: the huge amounts of money involved, and the brazenness of some of the manoeuvres, has caused justifiable outrage.

But not only are these kinds of practices morally and sometimes legally dubious – they are doing untold damage to developing countries. For decades multinational companies have been shifting profits, concealing information and avoiding taxes in the countries where they make their sales or buy their raw materials.

They often don't discriminate on the basis of whether a country is rich or poor; they are merely seeking to avoid any taxes higher than the minimum they can get away with. But of course the less developed a country is, the more the loss hurts, and the less likely it is that they will have the resources to recover the money. The result is that developing countries lose hundreds of billions of dollars every year– money that could have gone towards providing vital resources such as education, healthcare and agriculture – while large companies make huge profits from their natural resources and workforce.

And there's another layer of irony: the companies that avoid paying tax on their profits are the same companies that want roads and power for their businesses, well-educated workers, and prosperous people to fuel markets for their goods. They are sabotaging their own future.

Tax Power is ActionAid's response to this global scandal: a coordinated campaign across 20 countries. This campaign will serve to harness the Tax Power of people and governments by working on the local, national and international levels to bring an end to harmful tax incentives, tax avoidance of all kinds, and the tax havens and lack of transparency that make tax avoidance possible.[1]

Tax havens – places such as Bermuda, Switzerland and Mauritius – charge very low tax rates and offer high levels of secrecy. They serve as holding pens for company money, or sometimes just technical transit stops, allowing corporations to take advantage of a variety of tax breaks before moving their money on to other jurisdictions. The absence of meaningful transparency requirements on tax matters for companies and governments, even outside of tax havens, further facilitates tax avoidance.

> "These strategies, though technically legal, erode the tax base of many countries and threaten the stability of the international tax system."
> **OECD Secretary General Angel Gurria[2]**

And then there's the uncollected tax that is not so much avoided, it's effectively given away by developing countries themselves. In the scramble for foreign investment – which so many believe is a must-have for spurring development – developing countries compete with one another to attract investors with tax breaks that exempt companies from some or all their tax obligations. This competition has become a 'race to the bottom', with many countries losing out on revenue, and often, at the end of the day, deriving little benefit from the foreign investment they do attract.

In February 2013, ActionAid revealed[3] that corporate tax avoidance and unfair incentives are a huge problem in Zambia, estimating that a combination of tax breaks for and tax avoidance by Zambia Sugar, a subsidiary of the UK-based multinational Associated British Foods (ABF), has cost the Zambian government US$27 million since 2007.

Caroline Muchanga, a small business owner in Mazabuka, Zambia, sells sugar produced by the company, which is headquartered a few kilometres from her stall. In three of the last six years she has paid more tax on her business income – in absolute terms – than the multinational company next door.[4] As Caroline knows all too well, in most developing countries the ones who pay the biggest price and find the least opportunity are women and young people just like her – the same people who lose out most when services such as healthcare and education are absent or deficient, and the same people on whom societies depend for their sustenance and future.

Case study - *Caroline, Zambia*

This is Caroline Muchanga, a mother of three, who owns a market stall in Nakambala Market, Mazabuka, Zambia - holding up a receipt for the market stall tax she has to pay. "*The tax we have to pay is too high considering that the profit that we realise is very little,*" says Caroline, who works almost 15 hours a day, seven days a week. She pays a tax levy of 30,000 kwacha and must pay for rent for her stall, home and food. "*Our profits are never enough,*" she says.

Just down the road Zambia Sugar, one of the largest sugar production companies in the country, makes millions of dollars every year. Over the last five years it has paid just 0.5% of its profits in tax, due partly to legitimate capital allowances, but also to special tax breaks, and tax haven transactions that have also wiped out cross-border taxes.[5]

Zambia Sugar has suggested that the areas it operates in will become 'islands of relative prosperity'. But while it continues to avoid paying taxes, the Zambian government struggles to provide quality healthcare and education for its citizens.

Caroline can't afford to send her children to better schools or provide them with healthy meals. "*When we go to government hospitals you find there is no medicine,*" she says. "*We feel so bad because we are suffering a lot. We feel so bad because Zambia Sugar does not pay tax.*"

Credit: Jason Larkin/Panos Pictures/ActionAid.

How much money are developing countries missing out on?

Tax incentives: ActionAid estimates that eliminating corporate tax incentives in developing countries could raise over **US$138 billion** in revenue annually.[6]

Tax avoidance and evasion: developing countries are estimated to lose between US$120 and US$160 billion a year in revenue owing to money hidden in tax havens[7] – more money than they receive in aid.[8]

What could the money buy?

The over **US$138 billion** (the amount currently given away in corporate tax incentives) could:

- put the 57 million children who currently don't go to primary school, into the classroom.[9]
- AND provide the agricultural investment (US$42.7 billion, according to the UN Food & Agriculture Organization) needed to achieve a world free from hunger.[10]
- AND meet international goals to reduce ill health more than twice over (costing a maximum of US$58.9 billion), according to the Organization for Economic Cooperation & Development (OECD).[11]

The challenge

Multinational companies are good at finding ways to avoid paying tax that are technically not illegal, and also in persuading governments to offer them tax deals as the price of their investment. A vast network of well-paid lawyers, accountants and executives support them in circumventing the tax systems that were created precisely in order to provide funding for government services and democratic structures.

But there is hope. We can fight for the integrity of the tax system, and the revenues it is supposed to provide for governments and poor people. Those corporations avoiding taxation do not see themselves as criminals, and indeed we are not accusing them of acting unlawfully. In many cases they are simply acting as competitors do: if they don't push the limits of the rules, they will lose ground to those who do.

We are, however, accusing those responsible for the current tax system of failing to establish and enforce rules fit for their purpose. And we are demanding that corporations and investors perceive and act on their 'enlightened self-interest' by recognising that focusing solely on maximising profits ultimately erodes the societies where they operate. What we seek are fair rules governing corporate taxation, ensuring that everyone pays their way to promote development and the decent public services on which both business and ordinary people rely.

To put an end to poverty, everyone has to pay their fair share. ActionAid believes we must create fully accountable and fair tax systems in ALL countries because they will:

- Provide services. Tax is what already pays for most public services – schools, hospitals and clinics, roads, power, water – in most countries, including developing countries.
- Reduce inequality. Tax can reduce the gap between rich and poor both through the services and development it finances, and by ensuring that those who can afford to contribute more do so.
- Foster accountability. Development of a sound tax system establishes mutual accountability between citizens and government, encouraging better governance and more independent and responsive policy-making. The more a country relies on its own money (as opposed to foreign aid), the more it can follow its own agenda rather than those of donors.

Case study - *Charles, Kenya*

Charles Ochieng is the school director of St. Christine's Education Centre, in Kibera, Nairobi. This Education Centre is a privately run school with 371 pupils, and it receives under US$8 per year per student from the government. The students are charged, but the money is not enough to pay teachers well and cover costs. Only 50 out of 371 students can afford school lunches, with many pupils going hungry during the day.

"My school is in Kibera – a slum in Nairobi with more half a million residents. We are 10 kilometres from the State House, but it is as if the government has given up on us – they do not provide the resources we need. They cannot afford to help everyone in this country. Outside the school, they are building the new southern bypass that costs billions of shillings and cuts through the slums of Kibera. Inside the school, we are lacking even the most basic necessities like running water and electricity. Our students are starving because nobody can afford to buy them lunch for 15 shillings (17 US cents)."

Credit: Piers Benatar/Panos Pictures/ActionAid

ActionAid's **Tax Power** campaign has three main demands:

1. End harmful tax incentives

Developing country governments offer a wide range of tax breaks to encourage companies to invest in their country rather than another, or in a particular industry within their country. Just one set of exemptions - statutory exemptions from corporate income tax - is currently worth an estimated US$138 billion per year. Incentives may be 'statutory' – available to all qualifying investors by law – or they may be 'discretionary' incentives negotiated with particular companies. They can apply to any of the many different types of tax that companies pay (on income, property, sales, as well as excise taxes and import and export tariffs). Some discretionary incentives are publicly acknowledged, with full details published, but most suffer from some degree of non-transparency. But whichever type they are, they are more often than not based on a false premise.

Numerous studies have found that corporate investment decisions are primarily determined by factors such as political stability, economic policy predictability, working infrastructure – roads, power, ports – and the presence of a skilled and well-educated workforce. Tax incentives generally rank much lower down the list of influencing factors. For example, a recent study by the International Finance Corporation (part of the World Bank Group) found that 92% of international investors in countries in east Africa would have invested anyway, even without the tax incentives they were given.[12] That means that in most cases, the government is sacrificing substantial revenues needlessly, and in the process encouraging more companies to seek special breaks they have no need for.

There are many different types of tax incentives, and some have more potential to cause harm than others. For example, tax holidays are exemptions from tax for a set time period. Rather than encouraging permanent investment, these tend to encourage footloose investment that ups and leaves when the holiday ends, perhaps finding another tax holiday in the country next door. Many tax authorities would like to eliminate tax holidays altogether.

Another problem with tax incentives aimed at multinationals is that, like tax havens, they implicitly put domestic business at a disadvantage, flying in the face of many national development strategies. Many countries have over-emphasised foreign investment at the expense of developing domestic businesses; it is time to redress this balance.

ActionAid's latest report, Give us a break, **has estimated the revenue lost across all developing countries due to corporate income tax breaks.** Because many countries do not provide all the relevant information, our calculation started with tax expenditure reports from 16 developing countries of varying sizes, per capita incomes and regions. We applied the 16-country average for revenue foregone as a share of GDP. The result is an estimate that over US$138 billion is likely given away by governments every year, just in statutory corporate income tax exemptions. These figures are just the tip of the iceberg, because they only consider corporate income tax. An East African Community report calculates the cost of import exemptions for Uganda, Tanzania and Kenya to be over US$1 billion in 2008 alone. Discretionary tax exemptions, about which less is published, would no doubt make the figure much higher.[13] See table below.

Estimated revenue foregone through corporate income tax exemptions

	Annual corporate income tax foregone (US$ billion)
Developing countries by region	
Europe and Central Asia	24.5
Middle East and North Africa	4.7
East Asia and Pacific	55.1
South Asia	13.8
Sub-Saharan Africa	7.6
Latin America and the Caribbean	33.2
Developing countries by income group	
Low	2.5
Lower-middle	29.2
Upper-middle	104.5
Total	**138.9**

Source: ActionAid calculations

For more information on tax incentives and this calculation, please see the report Give us a break: How big companies are getting tax-free deals.

Using tax incentives is part of the policy toolkit that needs to be available to governments. For example, governments may wish to develop particular sectors of their economy that have been prioritised in their national development strategies, and may wish to use this tool to encourage the flow of investment into these sectors. But when governments offer the same kind of deal as their neighbors in the hope of winning over investors, that's the sort of "tax competition" that ends up denying anyone the full benefits of the investment.

However, the tide may be turning against tax incentives, with signs of change in at least two African countries, Rwanda and Uganda. ActionAid Rwanda and its partners recently calculated that Rwanda was losing US$200 million per year in harmful tax incentives.[14] Following subsequent campaigning, the Rwandan government reduced tax incentives substantially.[15] The extra money was allocated towards giving more rural people access to electricity, and ensuring every family has a cow, among other uses that will benefit the poorest people in Rwanda.

Sweet? Examples of a tax incentive

In 2005 Zambia Sugar, subsidiary of UK food giant Associated British Foods, took the Zambian government to court to win the right to reclassify all its revenue as 'farming income' – even though its own accounts show that three quarters of its income and profits are in fact derived from industrial sugar manufacture. This reduces its tax rate from 35% to 15%. In 2011 Zambia Sugar also won the right to offset the costs of an expanded factory with a tax break intended for new foreign investment; the details of this deal remain confidential. We estimate that these incentives will in future cost Zambia at least US$3 million a year in revenue, just from this one company.[16]

Ghana offers agricultural processing companies a five-year holiday from corporate income tax, while companies operating in free zones (which include subsidiaries of multinational food giants Cargill, ADM, Barry Callebaut and Nestlé) benefit from a 10-year holiday.[17]

In 2011, ActionAid Sweden revealed the outrageous terms of the tax incentive negotiated between the government of Tanzania and PanAfrican Energy Tanzania Ltd, a Jersey-based company created with the support of the Swedish government-owned Swedfund, as part of a joint venture to exploit Tanzania's SongoSongo gas field. Although the Tanzanian State Development Corporation receives less than one fifth of the joint venture's profits, it agreed to pay 100% of its corporate income tax, exempting PanAfrican Energy from its corporate tax bill for 25 years.[18]

According to media reports in May 2013, tax incentives in Uganda will soon be substantially reduced. The government intends to phase out tax holidays, and to ensure that all other incentives are sector-wide (rather than discretionary). Ugandan Finance Minister Maria Kiwanuka said, "Investors want all-weather good roads, piped water and electricity. Government needs to provide these, but how shall we deliver such infrastructure if you are busy asking for tax exemptions? Where will we get the money?"[19]

Action to stop tax incentives

As these examples show, governments can decide to reduce the tax incentives they offer, in particular the most harmful types such as tax holidays and discretionary incentives. They can also ensure that they systematically assess the full costs of tax incentives through published 'tax expenditure studies', and that tax incentives are subject to parliamentary scrutiny and public debate.

Tax competition may also be fruitfully tackled at a regional level, with groups of countries agreeing to co-ordinate the incentives they offer to prevent companies playing them off against each other. An example of this is the East African Community's proposed Code of Conduct on Harmful Tax Competition.

Recommendations

Developing countries should:

- Eliminate all tax holidays.
- Publicly review all tax incentives to determine how much revenue is being foregone and whether the deals are, overall, beneficial for citizens.
- Ensure that all phases of new incentives require parliamentary approval, and also that any new incentive offered is grounded in legislation which makes it available to all qualifying investors, foreign or domestic. This would effectively mean an end to discretionary tax incentives.
- Publish a costing and justification for each incentive offered, followed by monitoring of conditions and a tally of costs and benefits, so the public can see the impact of tax incentives.
- Grant the Finance Ministry and not just the investment promotion agencies powers over tax incentive decisions.
- Reject stabilisation clauses in contracts, which lock in tax incentives over a long period.
- Audit existing tax incentives to make sure companies are fulfilling their part of the deal (e.g. providing promised jobs, building promised facilities, etc).
- Co-ordinate statutory tax incentives within groups of neighbouring countries, in order to counter tax competition.

2. End corporate tax dodging

Many multinational companies are good at tax dodging – shifting money around the world to exploit legal loopholes and avoid tax, often using the secrecy and low-tax regimes provided by tax havens. Many company structures are set up specifically to facilitate this.

International taxation is regulated through national tax laws, some of which are based on international standards from bodies such as the OECD[20] or the UN. In addition to national legislation and international standards, a web of 'double taxation treaties' between countries governs tax interactions. They establish how the right to tax income earned in country A by residents (including companies) of country B will be divided between the two countries. Double tax treaties were originally developed to prevent the same income being taxed in two different countries – a reasonable aim – but over the years some cases have become very unbalanced, and so people can get away with double *non* taxation. These unbalanced treaties are often tilted against the less powerful negotiating partner, particularly smaller developing countries.

Tax dodging happens in many ways. Just a few are described here:

Transfer mispricing. When companies that are part of the same multinational corporation trade with each other – for example when one subsidiary provides a service to another – international rules require them to base the price on what would be paid if the companies were unrelated (the 'arms-length' price). However, sometimes prices can be inflated or under-stated, effectively shifting profit from one jurisdiction to a lower-tax one, with the result that companies can effectively choose where they pay their taxes – or don't pay, if they find a place where no tax would be charged. Transfer mispricing is in theory illegal, but for many of these trades, especially those involving hard-to-value services like fees for management or use of trademarks, establishing an arms-length price is next to impossible, so it passes into the legal grey area of tax avoidance.

Thin capitalisation. If a company is financed mostly through loans, it is 'thinly capitalised'. This can facilitate tax avoidance. Almost all countries' tax rules allow some or all of the interest paid on debt to be deducted from profits before they are taxed, therefore leaving less to tax. If one company in a multinational group lends to another in a different country, this situation may allow profit shifting for tax avoidance purposes.

Treaty shopping. Multinational companies may exploit particularly favourable features of a double taxation treaty between countries A and B in order to lower cross-border taxes on income paid to country C, to which the treaty was never intended to apply. Essentially the money passes through 'stepping stones': large, often tax-deductible cross-border payments can be made from a subsidiary company in country A to a 'conduit company' in country B, avoiding taxes in A thanks to the unbalanced tax treaty between A and B; and can then be paid straight on to the real destination of the money in country C.

"No region has suffered more from tax evasion, aggressive tax planning and plunder of national wealth through offshore-registered companies [than Africa]. These are global problems that demand multilateral solutions."

Former UN Secretary General Kofi Annan[21]

So what can developing countries do in the face of these kinds of practices? As well as defending themselves through their tax rules, countries may also claw back some revenue through strong '**withholding taxes**', which take the form of a tax of a certain percentage on payments made to foreign companies. This kind of withholding tax is especially common on payments between related companies. However treaty shopping can offer multinationals a way round this kind of tax.

A further way for countries to prevent tax avoidance is through a type of law called a '**general anti-avoidance rule**'. This is a legal presumption that, in some circumstances, if a transaction *looks* like tax avoidance then that is what it is, and it can be automatically counteracted by revenue authorities. It shifts the burden of proof.

In December 2010, ActionAid showed that the world's second biggest brewer, SABMiller, was siphoning up to £100 million in profits out of African and South Asian countries every year. The taxes that would otherwise have been paid on this money would have been enough to put 250,000 children in school.

The company did this is a number of ways.

- Beer brands originally developed and used in Africa were moved to a company in the Netherlands, and the African subsidiaries paid the Dutch subsidiary for their use.
- The African subsidiaries also paid a Swiss subsidiary for expensive management services.
- Goods for use in Ghana were procured from Mauritius (even though the actual goods clearly did not pass through Mauritius).
- SABMiller's Ghanaian subsidiary had a very large loan from another SABMiller subsidiary in a low-tax jurisdiction – an example of thin capitalisation.[22]

Rules and standards implemented at the international level may be as important as those at national level. Following the recent political outcries around the world about corporate tax dodging, some of these are to be reviewed by the OECD, although the current review excludes most developing countries.[23] There is also ongoing debate about how best to apportion the profits of multinational companies between different countries for taxation purposes. These include simplified versions of arms-length pricing, and various methods of apportioning the profits of a multinational between jurisdictions according to a formula. These discussions are occurring at the OECD and the UN Committee of Experts on International Cooperation in Tax Matters, the latter having more developing country voices and being more open to a range of options.

Finally, it is not only international treaties and standards that matter. The national tax rules of one country, especially a wealthy one, may have inadvertent 'spillover' effects on others. ActionAid has proposed that 'spillover analyses' of changes to tax rules on other countries should be required of large and wealthy economies. The UN, OECD, IMF and World Bank have also proposed this course of action.[24]

The role of tax havens

Tax havens are jurisdictions – sometimes independent, sometimes with a special status as part of a larger country (such as the British Virgin Islands, a UK 'overseas territory'; or the US state of Delaware) – which offer a combination of low- or no-tax rates for income from outside their borders, and high degrees of secrecy. In terms of damage to other economies, tax havens are equal opportunity offenders, with both rich and poor countries suffering losses, though of course developing countries can least afford the losses, and have less capacity to protect their interests.

Corporate tax avoidance schemes such as those described above often involve tax havens, where companies often conduct no real business activity. Profits shifted into tax havens often go largely untaxed, and tax haven secrecy makes the schemes harder to trace. Recent evidence suggests that revenue generated in developing countries is even more likely to be subjected to multinational profit-shifting into and via tax havens than revenue from developed countries.[25]

The flexibility and savings offered to multinationals with the legal and accounting expertise to take advantage of tax havens' laws creates unfair competition with domestic companies in developing countries. Moreover, multinationals have a further advantage, as their structures allow them to create networks of subsidiaries based in tax havens that enable their tax avoidance.

Almost half of reported corporate investment in developing countries is now being routed from or via a tax haven – this has risen from 19% in 2009.[26] The upside-down world of tax havens shows us some revealing absurdities about the lengths companies go to lower their tax bills.

- Bermuda is now apparently the biggest source of foreign investment in Nigeria,[27]
- Mauritius is the source of nearly 40% of foreign investment in India.[28]
- During 2011 the tiny Caribbean islands of Barbados, Bermuda and the British Virgin Islands appear – on paper – to have been the source of more investment into the rest of the global economy than Germany, and 118 times more than their own combined GDPs.[29]
- The British Virgin Islands (population: 32,000) appear to be the source of more overseas investment than Canada (population: 34,000,000) or Spain (population: 47,000,000).[30]

This signals that enormous sums that should be paid to countries' treasuries are being lost. For example, sales of companies, mines or other valuable assets can be structured through 'nowhere deals', so that they occur in a tax haven rather than in the country where the economic activity is taking place – or indeed in the country of the buyer or the seller, avoiding capital gains tax across the board.

Tax havens also facilitate the abuse of tax incentives. Tax incentives are usually granted for new investment. An estimated 30% of 'foreign' investment into developing countries is in fact domestic money – earned within the country – and then re-invested through an offshore location.[31] Often this takes the form of 'round-tripping', where the money goes to a tax haven company and is then sent back into the country. Round-tripping can be used to benefit for a second time from a tax incentive an investor has already received: if the profits from an existing investment are transferred to a tax haven company before being reinvested in the business, it may look like 'new' investment, qualifying for a second tax break. These practices are harder to detect because of tax haven secrecy.

Action on corporate tax dodging

Action on tax avoidance can take place in three main ways – through countries' national tax laws, through changes to international agreements and standards, and through changes to double taxation treaties. Some companies have also started to take action, recognising that the reputational and financial risks of tax avoidance are high.

What can be done to close down tax havens? There are a range of actions to increase transparency, which are detailed in the last section of this paper.

First, we need an **agreed working definition of tax havens**, so that a broad range of countries will have a common reference point and logic for actions they take. The definition would include a high degree of confidentiality (secrecy) about the identity and activities of companies and account-holders and unusually low tax rates for non-resident individuals or companies, or companies with no substantial domestic business activities.[32] An alternative to a single definition would be to list several characteristics associated with tax havens and use the list to give jurisdictions a cumulative score.[33] Such an approach would have the virtue of avoiding a simple "yes or no" label, since many jurisdictions have *some* tax haven characteristics but not *all* of them.

Any country can take steps to **discourage their own taxpayers from shifting money to tax havens**. A country can impose penalties on taxpayers shifting income into tax havens place strict limits on the tax-deductibility of large transfers into tax havens, or requiring companies – rather than the tax authority – to prove that such transfers are justified and not simply for the purposes of minimising tax liabilities.

But the key question, after defining the problem, is how to **enforce sanctions on tax havens that refuse to clean up**. What kind of sanctions (or, stated positively, incentives) would move the havens to action? To really be effective, such measures should be applied multilaterally by as many countries as possible, though their application should not be delayed on the excuse of broadening participation. The US's Foreign Account Tax Compliance Act (FATCA) has recently proven to be unusually effective in getting jurisdictions to provide the US with information about its taxpayers' offshore assets. It does this by targeting the money itself: if jurisdictions do not cooperate, a 30% withholding tax will be charged on financial flows from US sources going into overseas banks. This works because the US holds such a pivotal position in the global economy; it may not be so effective for smaller and poorer countries. But all rich countries, at least, should be encouraged to adopt such measures towards tax havens.[34]

Governments should also **cancel or suspend double taxation treaties with tax havens**, which would make it harder to shift income into tax havens, and easier for countries where real business takes place to tax the income on the way out.

Finally, for those tax havens that are part of or dependent on large countries, **increased political and financial pressure by the 'mother country'** should be applied. The UK, which has the most tax haven territories linked to it, has finally started to apply such pressure.[35]

Recommendations on tax avoidance

Developing countries should:

- Strengthen their toolbox of legal and administrative defences against tax dodging by multinational companies.[36] This could include robust withholding taxes, transfer pricing rules, thin capitalisation rules, anti-treaty shopping provisions and general anti-avoidance rules. They should focus on implementation as well as policy, and capacity building where necessary.
- Play a vocal role in international debates about how developing countries can and should combat tax dodging and apportion profits of multinationals for taxation, ensuring that their interests are heard.

The international community should:

- Consider alternatives to current methods for (1) restricting the shifting of profits into low-tax jurisdictions; (2) stopping double non-taxation, and (3) apportioning the profits of multinational companies. These alternatives should be easier for developing countries to administer and more effective at preventing tax dodging.
- Agree new international rules to prevent tax avoidance through shifting intangible assets such as patents, brands and other intellectual property into tax havens, or routing the provision of services through tax haven subsidiaries.

Developed countries should:

- Assess their tax regimes against likely 'spillover' effects on the tax base of other countries.
- Agree to renegotiate tax treaties to address bias in existing arrangements.
- Support capacity strengthening of developing country tax authorities.

Multinational companies should:

- Stop using corporate structures and transactions that result in the artificial avoidance of tax liabilities.
- Publish full tax policies, to clearly explain the company's tax behaviour in different jurisdictions, and clearly rule out the use of artificial transactions and arrangements to minimise tax liabilities.

Recommendations on tax havens

Developing countries should:

- Discourage their taxpayers from shifting money to tax havens by using penalties, strictly limiting the tax-deductibility of transfers into tax havens, and/or reversing the burden of proof for the justification of such transfers from the tax authority to the company.
- Cancel or renegotiate double taxation treaties with tax havens that act as conduits for tax avoidance.

Developed countries should:

- Use their diplomatic and political resources to get any tax havens linked with their jurisdiction to clean up.

The international community should:

- Agree a working definition of a tax haven or a system of scoring tax haven characteristics.
- Agree and enforce multilateral sanctions on tax havens that do not comply with transparency requirements and reform abusive tax regimes.

3. Increase transparency of governments and big corporations

Transparency measures are important in the fight against tax avoidance. Profit-shifting mechanisms and corporate structures are often complex, and then further obscured by financial and corporate secrecy. Tax havens provide this service: for many, the greatest appeal of tax havens, even more than their low tax rates, is the secrecy they provide, so that the dubious shifting of profits and revenues is hard to trace.

Transparency of government spending is important too. Governments need to budget transparently, and demonstrate that their actual spending benefits their citizens.

Action on transparency to fight tax dodging

The first important area is **exchange of information about non-residents' income and activities.** If income of a taxpayer resident in country A surfaces in tax haven B, often the only way country A can know how much income and how much tax has been paid is if country B tells it. Because of taxpayer confidentiality, special legal authority is needed. This can happen through double taxation treaties or through 'tax information exchange agreements'. The exchange of tax information (which is usually restricted to the tax authorities involved,) can be at three levels – on request, spontaneous (when information judged relevant is found) or automatic. Double taxation treaties or tax information exchange agreements are usually limited to the first two.

Tax havens tend to minimise the amount of information they exchange. So agreements on better information exchange are a crucial way to increase tax haven transparency and deter tax dodging – as well as identifying illegal tax evasion, where money and assets are hidden from tax authorities. Multilateral agreements, rather than the bilateral ones mentioned above, are more effective for developing countries because they avoid the need to conduct a lot of separate negotiations with potentially powerful partners. Some developing countries and some tax havens are currently joining the OECD's Multilateral Convention on Mutual Assistance in Tax Matters, which provides an option for automatic information exchange – although no automatic information exchange agreements have yet been signed under the Convention.

African countries co-operate against tax dodging

ActionAid's work on tax avoidance by brewing giant SABMiller caught the attention of tax officials across Africa and even further afield. In June 2011, a number of tax authorities from African countries featured in ActionAid's investigation met in South Africa, under the auspices of the African Tax Administration Form (ATAF), intending to consider the report's findings. But participants were legally barred from discussing some of the crucial specifics of SABMiller's taxpayer records. To surmount this, ATAF has facilitated the development of a multilateral tax cooperation treaty. This treaty will allow African countries to work together to investigate the tax affairs of international companies operating across the continent.[37] The first signatories are expected in 2013. As *The Economist* magazine commented, "Galvanised by the SABMiller case, tax authorities in emerging markets are starting to push back against the transnationals, setting up cross-border bodies to share expertise."[38]

The benefits of international tax cooperation: tax justice for Timor Leste

Timor Leste, which gained independence from Indonesia in 2002, has been engaged for almost a decade in a struggle to access the books of Australian companies that have profited from the country's offshore oil and gas deposits. The Timorese government was unable to audit the expenditures and deductions that companies were claiming to reduce their taxable profits in Timor Leste. In 2010 an arrangement with Australia's Taxation Office enabled the Timorese government to reportedly identify US$362 million in taxes due from Australian companies, equivalent to nearly four times the country's annual health spending. On the basis of their findings, the government says it is now reviewing expenditure deductions claimed by other extractives companies that may net a further US$3 billion in revenue.[39]

Automatic exchange of financial account information is particularly important for detecting tax evasion through the straightforward concealment of money. Owing to capacity constraints, developing countries may initially need to be able to use information without the obligation to reciprocate. The US demands such information in many of its FATCA arrangements with other countries, so there is no reason to deny the same facility to developing countries.

Secondly, you need to know **who owns whom**. Laws in most countries, including many tax havens, allow the real owners of some companies, funds and trusts to be kept secret, either by simply not recording shareholdings, or by hiding real owners behind 'nominee shareholders'. Hiding ownership in this way is big business for some tax havens. It clearly makes the enforcement of laws around tax evasion, and also other issues such as corruption, much more difficult.

The solution would be for all jurisdictions to require the real ultimate owners (known as the 'beneficial owners') of all companies, funds and trusts to be placed on public record.

Finally, all countries should require companies registered in their jurisdictions to file publicly available annual accounts. If multinational companies reported a range of financial information such as profits made, taxes paid and number of employees in each country where they operate, rather than only in consolidated form in the 'headquarter country' as is often currently required, it would allow citizens and tax authorities to identify more clearly where tax avoidance might be taking place. This is commonly known as country-by-country reporting.

Recommendations

Developing countries should:

- Take part in multilateral information exchange platforms where beneficial.
- Consider multilateral information exchange arrangements on a regional level.

- Create publicly accessible, statutory registers of company accounts together with an obligation for all domestic and foreign-owned companies (including branches) to file annual accounts.

The international community should:
- Develop a multilateral information-exchange platform which includes access to automatically-exchanged information for all countries, and take steps to ensure that tax havens join such a platform.
- Support developing countries with the technical facilities and secure information systems needed for access to automatically-exchanged information.
- Create an international, legally binding standard requiring the public registration of the beneficial ownership of all companies, trusts and other corporate bodies.
- Create an international standard whereby multinational companies report meaningful financial and tax information country by country, both publicly and to tax authorities.

Action on transparency in revenue spending

So far we have focused on transparency to fight tax dodging, targeting mainly multinational companies and tax havens. But transparency of national governments is equally important, so that tax revenues are used responsibly to provide services to those most in need and are not lost to corruption.

Government transparency is crucial in creating tax policies, including those that will discourage tax avoidance. But it is even more important when it comes to decisions about how tax revenues are spent. Mutual accountability between citizens and governments requires that governments make relevant information widely available in comprehensible formats, and that citizens make use of this information to monitor government actions and participate constructively in debating spending priorities.

Spending transparency

It is important for citizens to see what their government is spending so that they can ensure that government is doing what it has promised, and that the money is being well-spent to provide the services most needed by the country's population, and especially the most impoverished. In many cases this will be health care and education, but it can also include social protection, agricultural programs, water provision and infrastructure such as roads, etc.

Many developing countries now have medium or long term national development strategies and those countries which do not, should introduce them. Governments should ensure that there are fully participatory processes for developing these strategies, including their implications for budget priorities, including open parliamentary debates.

Most governments now publish detailed annual budgets and subject them to parliamentary debate. Beyond that, they should provide regular, transparent, and accessible reports on their actual spending and outcomes to parliament and the public. Similar processes should be put in place where sub-national governments (states, counties, municipalities, etc) are responsible for spending programs. When this information is shared, citizens can participate in debates on spending allocation, and hold the government to account if the promised services do not materialise. This is often called 'budget monitoring'.

'Budget monitoring' can happen at all levels, from the very local to the international and can happen on specific issues. For example, women's organisations in many countries conduct gender-based budget monitoring, to establish the differential impacts of public spending on women. Such procedures should be institutionalized, with statutory 'social audits' by citizens of spending on and delivery of public services. In countries around the world, local communities are getting together to monitor local public spending and to claim their rights if these are not being realised, often supported by NGOs like ActionAid, as seen in the box below. National civil society groups, as well as parliaments, monitor budgets and spending at the national level. At international level, Development Finance International has made an international comparison of spending in developing countries, overall and by sector, on www.governmentspendingwatch.org.

Responsible and accountable spending, with active citizen participation and monitoring, is crucial to addressing social inequality – the gap between the rich and the poor that has been growing in most countries in recent years. A necessary part of tackling social inequality is public spending on quality services that open doors for those who have been historically disadvantaged: comprehensive education in slums, for example, or empowering women to know and claim their rights to livelihoods and land, or inputs for the small farmers who feed most of the people in many developing countries.

To assess whether social inequality is being reduced, and whether and how tax and spending practices of the government are contributing to the effort, governments should perform regular distributional impact analyses of the whole fiscal system. These studies should look at how tax policy changes affect different portions of the population, and how spending on social services is (or is not) opening new doors for vulnerable people.

This kind of mutual accountability and transparency leads to a strong "social contract" between citizens and state, the basis for genuine democracy.

Recommendations

Governments should:

- Publish both budgets and actual spending, in a timely and accessible fashion, so that citizens can hold them to account for their revenue spending.
- Publish distributional analyses of the fiscal system as a whole, assessing the impacts of both tax and spending policies.
- Encourage meaningful citizen participation in budgeting processes and budget monitoring at both the local and national levels.

Women don't want to live in poverty – budget monitoring in a village in Ghana

Tax revenues are improving life for people in Mampehia, Ghana, at the very local level of providing a "capitation grant" for the school (that is, an annual payment per pupil). The capitation grant comes from public revenue, which is funded mainly through taxation. ActionAid is supporting the local people there to ensure it stays that way, by holding the government to account.

Mampehia is a village overlooked by rolling hills, reached in a couple of hours from Accra, the last few miles via a potholed, deep red dirt road. The word 'Mampehia' means 'women don't want to live in poverty' – but its residents nonetheless do live in poverty. They are mostly smallholder farmers, growing cassava and maize, plantains and yams, keeping a few chickens and goats, and earning about US$ 30 per year after the harvest.

Emmanuel Sackey, 60, is the chair of the school's parent-teacher association (PTA). He has 10 children, and the youngest, Mary, is still at school. He explains that children used to have to walk several miles to school but a decade ago the village decided it needed its own school. It formed a school committee, started classes and built a school 'pavilion' of sticks with a grass roof. ActionAid helped build the school and convinced the local government to manage it.

In 2005 the school started to receive a capitation grant. Supported by ActionAid, the community learnt about their rights, and now have a say in how the grant is spent and monitor its use against the school improvement plan. It has been spent on replacing locks on the school windows, and on building houses for teachers, but people want to see many other things – improved buildings, water containers, books, extra uniforms for the poorest children and footballs and seesaws for the new preschool "so that the tinies will learn to love going to school."

Emmanuel intends to ensure the PTA continues to follow up in detail exactly how the money is spent. "Education is a big opportunity for our children – even the little writing I can do helps me hold our government accountable", he says.

Emmanuel Sackey, chairman of the P.T.A of the Mampehia D/A Primary School in Mampehia, Ghana.

Credit: Piers Benatar/Panos Pictures/ActionAid

Endnotes

1. In this paper we use 'tax avoidance' to refer to artificial schemes which reduce tax liabilities through exploiting deficiencies and unintended loopholes in tax laws, but may not technically break them; and 'tax evasion' to refer to violations of applicable laws to reduce tax payments.
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4. This is accomplished partly through legitimate capital allowances, but also through special tax incentives, and by routing fees, loans and dividends through tax haven sister companies benefiting from unbalanced tax treaties, which has – perfectly legally – saved the company millions of dollars of Zambian withholding taxes.
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16. ActionAid (2013) *Sweet nothings – the human cost of a British sugar giant avoiding taxes in southern Africa.*
17. Ghana Investment Promotion Centre and Ghana Free Trade Zone Board websites, http://www.gipcghana.com and http://www.gfzb.com.gh
18. http://www.actionaid.se/vart-fokus/ansvar-politik/skattesmitning/swedfund
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21. http://www.nytimes.com/2013/05/10/opinion/global/stop-the-plunder-of-africa.html?_r=0
22. For the full story, see ActionAid, *Calling time – why SABMiller should stop dodging taxes in Africa (2012 update)*.
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36. These should include wider tools to disallow abusive corporate tax structures, and to attribute taxable profits to their jurisdictions, should they wish to do so. This means, for example, robust withholding taxes on payments into tax havens; the more permissive use of benchmarks; fixed margins or ceilings in transfer pricing and 'thin capitalisation' rules; deductibility limits on payments into tax havens; anti-treaty shopping provisions and stronger definitions of permanent establishments in tax treaties; and general anti-avoidance rules.
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ActionAid is a global movement of people working together to achieve greater human rights for all and defeat poverty. We believe people in poverty have the power within them to create change for themselves, their families and communities. ActionAid is a catalyst for that change.

International Registration number: 27264198

Website: **www.actionaid.org**
Telephone: **+27 11 731 4500**
Fax: **+27 11 880 8082**
Email: **mailjhb@actionaid.org**

ActionAid International Secretariat,
Postnet Suite 248, Private Bag X31, Saxonwold 2132,
Johannesburg, South Africa.

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