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Collateral damage:
How government plans to water down UK anti-tax haven rules could cost developing countries – and the UK – billions.

Introduction

All eyes will be on the forthcoming budget on 21 March, but what may be less apparent in the Chancellor's speech are the government's plans to open up a huge new tax loophole specifically for multinational companies.

This loophole will make it much easier for UK-based global businesses to avoid taxes in the developing countries they operate in, at an estimated cost of £4 billion a year.[1] Some of the poorest countries in the world, with minimal public services, will be losing vital revenues they could be investing in healthcare and education, keeping them more dependent on foreign aid.

It will also allow the same multinationals to enjoy a tax rate of just 5.75% on the profits of some group companies based in tax havens, costing the UK Treasury £1 billion a year.[2] At a time of global economic turmoil, the poorest will lose most.

A new poll commissioned by ActionAid reveals just how concerned the British public is, with nearly 80% saying the government is not doing enough to tackle tax avoidance by large companies.

The government recognises that tax revenues are essential for development, and admits that "tax avoidance in developing countries deprives governments of the vital income needed to build and maintain their public services."[3] David Cameron has noted both the importance of "effective tax systems" to ensure that developing countries benefit from British investment,[4] and also the way that companies "use the complexity of the tax and legal system to try and endlessly reduce their tax payments."[5]

Yet this new tax loophole would be a huge step backwards for developing countries, a major contradiction in the UK's international development policy. The government has so far refused to assess the impact of the proposed changes on developing countries, despite requests to do so from ActionAid over the last two years.

Some multinational businesses, including many involved in high profile tax avoidance disputes, have lobbied hard to make this new loophole – a relaxation of what is known as "controlled foreign company" rules – as big as possible. Some 30 companies, with a total of well over 3,000 subsidiaries located in tax havens, lobbied for the changes through advisory groups set up by the Treasury.

This intimate corporate involvement may explain why the tax advantage to businesses grew by £100 million following the final stage of consultation.

The Treasury has not only ignored ActionAid as it develops changes to anti-tax haven rules: organisations such as the OECD and IMF also recommend "spillover analyses" of the impacts on developing countries for changes of this type, but their advice has not been heeded.

Unless this is rectified, developing countries will suffer huge collateral damage, from changes that will primarily benefit multinational companies that make the most use of tax havens.

ActionAid is calling for an urgent rethink of the proposals, before the budget changes become law.

79% say the government isn't doing enough to tackle tax avoidance

Recent polling[6] of the British public undertaken by You Gov for ActionAid shows a demand for tougher government action on corporate tax avoidance. We found strong support right across the political spectrum and in all regions.

- 74% of Conservative voters, 83% of Labour voters and 87% of Liberal Democrat voters said the government should be doing more to tackle tax avoidance.
- Just 14% supported the proposed changes to Controlled Foreign Companies rules. 55% oppose the changes, rising to 68% of Liberal Democrat voters.
- 72% said that companies that use legal loopholes to avoid their tax bills in the UK or developing countries were behaving irresponsibly.

UK PLC in developing countries

Many British companies have significant operations in the world's poorest countries. The profits they make in developing countries are taxed in those countries, where they are a major source of public funds. In Zambia, for example, taxes on companies contribute 31% of the government's tax revenue, many of them multinationals.

A glimpse at some typical British companies shows quite how much potential tax revenue they generate in developing countries. Barclays makes almost £1 billion profit in Africa alone; the brewing company SABMiller makes £1.9 billion across Africa, Asia and Latin America; mining giant Anglo American declares profits of £2.8 billion in Africa and Latin America.[10] At the 2011 average global rate of 23%,[11] the corporation tax on these three companies' profits alone would contribute well over £1 billion to government revenue in developing countries.

The challenge of taxing multinational companies...

Tax is important for development

Most developing countries are rightly and steadily increasing their tax take to fund health, education and other vital public services, rather than rely upon international aid. For example, taxes now constitute 72% of government revenue in Zambia,[7] and 71% in Ghana.[8] Across Africa as a whole, governments raise 10 times more revenue through taxes than they receive in aid.

Tax avoidance by multinational companies is a major obstacle to increasing tax revenue bases to internationally accepted minimums.

The OECD estimates that tax havens cost developing countries three times the amount they receive in aid,[9] massively reducing the money that's available to tackle poverty.

So it comes as no surprise that developing countries are working hard to stamp out tax dodging by multinational companies, as part of a broader effort to raise more taxes.

The UK government, like many others, is supporting efforts to build the capacity of tax administrations in developing countries, including to tax multinational companies - but the organisations responsible for assisting developing countries say they are overwhelmed with requests for help in this particular area. Despite these efforts, developing countries continue to haemorrhage revenues through tax avoidance.

The challenge of corporate tax avoidance

Recent examples vividly demonstrate the problems faced by many developing countries. ActionAid exposed tax avoidance by SABMiller that shifted £100 million of profits from Africa into tax havens, with an estimated tax loss of £20 million.[12] Mining giant Glencore stands accused of evasion that may amount to as much as £76 million per year in Zambia, which came to light last year in a leaked tax audit report.[13] Vodafone recently won a significant victory in a tax dispute with India worth over £1 billion over its purchase of an Indian company, despite using a web of tax haven vehicles to avoid capital gains tax.[14]

It's unsurprising that African revenue officials have declared that "the taxation of international transactions...has become increasingly difficult,"[15] and South Africa's finance minister Pravin Gordhan has described aggressive tax avoidance as "a cancer eating into the fiscal base of many countries."[16]

...and how the UK is making it worse

How a new loophole will hurt developing countries

Proposed changes in the 2012 budget will water down Controlled Foreign Company (CFC) rules, which are designed to deter British multinational companies from exploiting the low tax rates offered by tax havens. Under the CFC rules, if a multinational shifts its profits into a tax haven in order to lower its bills **anywhere in the world**, the UK tops up its tax bill at home, bringing it into line with the standard UK rate. This covers all UK companies, and the rules work if a multinational is trying to avoid its tax in the UK, or in developing countries.

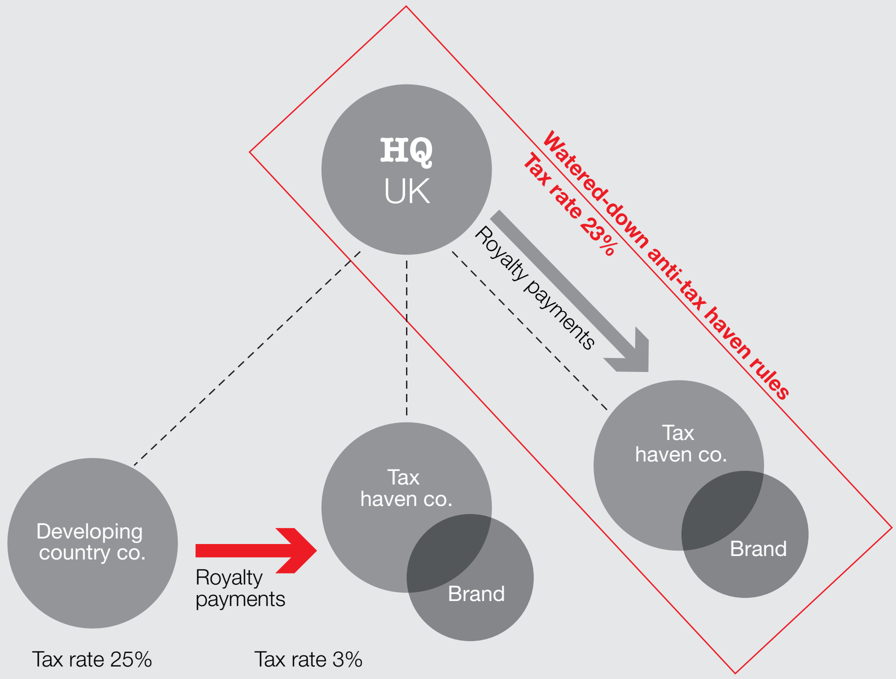
Controlled Foreign Companies rules in action

Current anti-tax haven rules:

- This UK multinational is a group of 4 companies located in different countries. International tax rules say each company pays tax on the profits it makes in each country.
- The multinational's brand is owned by a tax haven company and other companies in the group must pay royalty fees to use it. Charging high fees enables the multinational to shift profits out of the country in which it does business and into tax havens.
- However, current anti-tax haven rules deter profit shifting by imposing the standard rate of UK corporation tax on all the tax haven companies. This protects the tax base of the UK and developing countries.

Proposed changes:

- The Treasury is proposing to reduce the scope of the UK's anti-tax haven rules, so the standard UK tax rate is only imposed if profits are shifted out of the UK, into tax havens.
- This will make it much easier and more lucrative for companies to shift their profits out of developing countries and into tax havens. This reduces their profits in the developing world, enabling them to pay less tax there.



The changes proposed by the Treasury mean that CFC rules would only apply if the tax dodge is costing the UK money. They will no longer apply when British companies try to avoid tax in developing countries, which will make it much easier and much more lucrative to do so.

If the government pushes forward with these changes, the world's poorest countries are in danger of becoming the collateral damage. Based on the current economic activity of UK multinationals in the developing world, ActionAid estimates that poor countries may lose as much as £4 billion[17] in tax revenues a year.

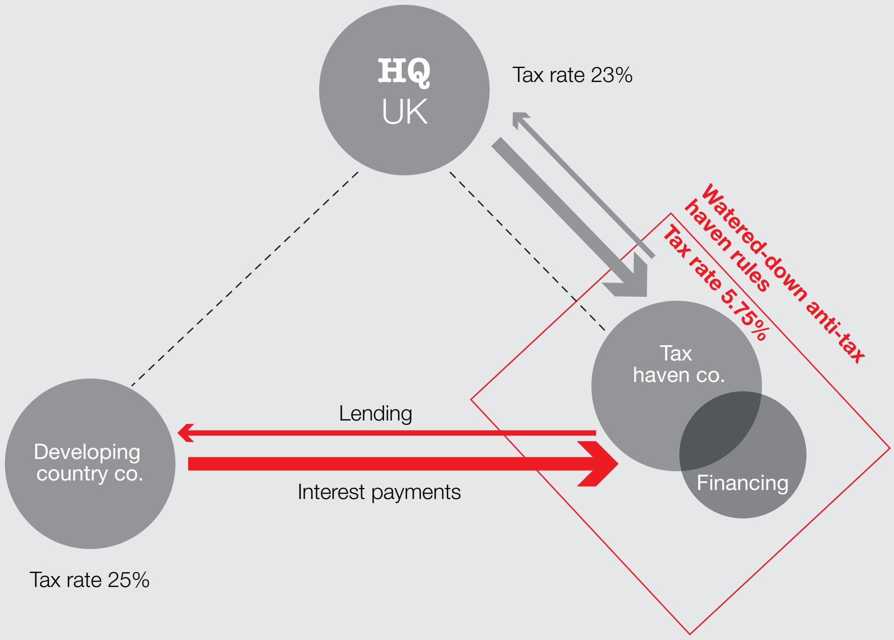
There's a cost to the UK too. Treasury estimates show that this new loophole is likely to cost £1 billion a year by the end of this parliament.[18] This is part of the government's "corporate tax roadmap" under which large companies will eventually receive a total annual tax cut of £7 billion.

The Treasury is proposing to make it easier for internal financing arms of multinationals to operate in tax havens through a 'partial finance company exemption'. Rather than imposing the standard UK corporation tax rate, they'll be allowed to pay just 5.75% in tax.

This will make it more attractive for UK multinationals to register their financing companies in tax havens, which will also encourage profit shifting, and the consequent revenue losses, in developing countries and the UK.

Financing companies in tax havens means everyone loses out

- The UK's anti-tax haven rules are being watered down even further for the internal financing arms of multinationals. The UK will only impose a 5.75% tax rate on this type of group company when it's based in a tax haven.
- The Treasury estimates that the UK will lose £1 billion a year as a result – and developing countries will also lose out.



The CFC rule changes move the UK away from a 'worldwide' tax regime, under which British-based companies are liable to tax on profits made anywhere in the world, towards a more 'territorial' regime which taxes them only on profits made in the UK. In a document written for the G20 last year, the IMF, OECD, UN and World Bank raised concerns about this type of reform's potential to hurt developing countries, calling on all rich nations to conduct "spillover analyses" to assess the potential impact on developing countries.

ActionAid research showed that 98 of the FTSE 100 largest companies on the London Stock Exchange have subsidiaries in tax havens. Eighty-two also operate in the developing world. We found a total of 8,492 subsidiary companies in tax havens, as well as 6,163 in developing countries. As the examples below show, many of these tax haven companies are set to become potentially more lucrative vehicles for tax avoidance once this new loophole opens up.

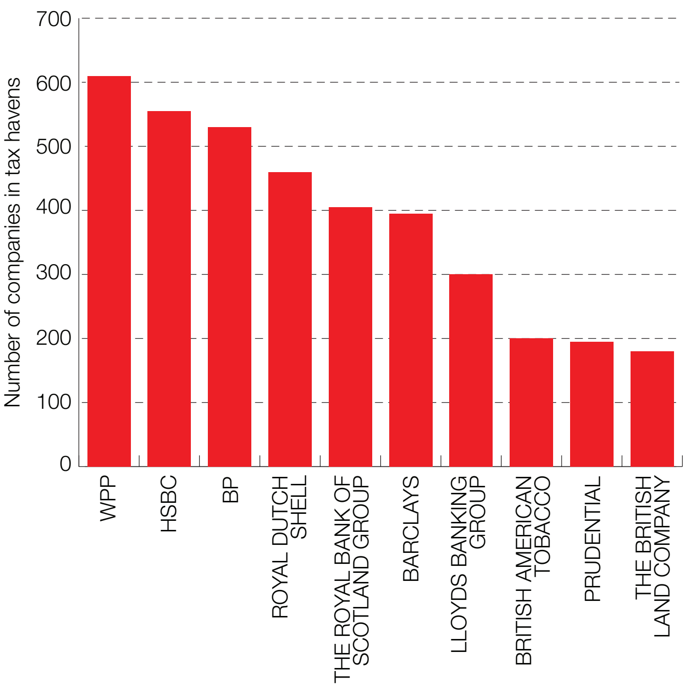
Barclays: banking on the Cayman Islands

The banking sector is the biggest user of tax havens and, as research published by ActionAid last year showed, banks are still doing a brisk business offshore despite efforts to clean up the industry. The big four high street banks have 1,649 tax haven subsidiaries between them – more than half of all their 3,067 overseas subsidiaries.[19]

In the Cayman Islands, banks have by far the biggest presence of British companies. Barclays – described by Vince Cable as "the market leader in tax avoidance schemes"[20] – has registered 174 companies there alone. Some of these companies, as well as other Barclays subsidiaries in Luxembourg, featured in tax avoidance plans worth billions of pounds leaked to the Guardian in 2009. Last year, the Financial Times uncovered another tax avoidance scheme through which Barclays and US partners were able to save around £500 million.[21] Small wonder then that Barclays' global tax bill in 2009 came to less than 10% of its profits.

In evidence submitted to parliament's Treasury committee last year, Barclays said that the "majority" of its Cayman Islands companies were "managed and controlled in the UK and are therefore subject to tax in the UK…under the UK CFC legislation."[22] It is likely that some of these tax haven companies that are currently covered by the CFC (anti-tax haven) rules will be exempted after the changes. Barclays also has 278 subsidiaries in developing countries, and currently makes almost £1 billion per year in Africa, so it has a lot at stake through the changes.

The biggest tax haven users in the FTSE 100



Zambian market traders pay their taxes

Tax avoidance and evasion by multinational companies has a profound impact on developing countries. Take Zambia. Two in every three Zambians live below the poverty line and the country spends less per child on education than any other country in southern Africa.

Several multinational companies, including brewing giant SABMiller and commodities trader Glencore, are facing big questions about their tax contribution in Zambia – or lack of it.[23]

The contrast with many small traders in Zambia like Katharine Mwape is stark.

Katherine works most days, selling vegetables in a market near to Glencore's vast Mopani mine in Kankoyo. "It's very, very unfair that we pay our taxes but Mopani doesn't," she says.

"They make profits from our environment, so we should be compensated. If I don't pay my taxes in the market every day, they'll give my stall to someone else."

Amazingly, Katherine pays more corporation tax in Zambia than Glencore's mine, which has paid nothing in the last ten years. If the government goes ahead proposed changes to water down UK anti-tax haven rules, Katherine's experience will become increasingly common.

Katherine Mwape is a market trader in Zambia. She pays her taxes. Why should multinationals dodge theirs?

Photo: Jason Larkin/Panos Pictures/ ActionAid

Anglo American: tying developing countries to tax havens[24]

UK-registered mining group Anglo American makes a large proportion of its income in developing countries – it realises profits of £2.8 billion in Africa and South America. So it's particularly worrying that, as well as having 325 companies in developing countries, it also has 117 in tax havens. Even more concerning are the names of 26 of these tax haven companies, which suggest a connection to developing countries. This is not evidence of tax avoidance per se, but it suggest that the group's developing country interests are already deeply entwined with its tax haven operations, and that the company may be well placed to benefit from the proposed changes to CFC rules.

Anglo American subsidiary company name	Location
Ambase Exploration **(Morocco)** Limited	British Virgin Islands
Ambase Exploration **(Tanzania)** Limited	British Virgin Islands
Ambase Investments **(Tanzania)** Limited	British Virgin Islands
Anglo **African** Exploration Holdings Limited	British Virgin Islands
Anglo **African** Holdings Limited	British Virgin Islands
Anglo American Corporation De **Chile** Holdings Limited	British Virgin Islands
Anglo American **Venezuela** Holdings Limited	British Virgin Islands
Anglo **South America** Limited	British Virgin Islands
Minorco **Peru** Holding Limited	British Virgin Islands
Anmercosa Services **(Eastern Africa)** Limited	Isle Of Man
Anmercosa Services **(West Africa)** Limited	Isle Of Man
Anglo American Exploration **Colombia** Sarl	Luxembourg
Anglo Platinum International **Brazil** Sarl	Luxembourg
Anglo **South America** Investments Sarl	Luxembourg
Anglo **Venezuela** Investments Sarl	Luxembourg
Kumba **West Africa** Sarl	Luxembourg
Anglo **South America** Investments Limited	Mauritius
Sichuan Platinum Investments (Mauritius)	Mauritius
Aa Holdings **Argentina** B.V.	Netherlands
Anglo American Exploration **(India)** B.V.	Netherlands
Anglo American Exploration **(Phillipines)** B V	Netherlands
Anglo American **India** Holdings B.V.	Netherlands
Kumba Holdings **West Africa** Bv	Netherlands
Kumba Investments **Guinea** Bv	Netherlands
Kumba Investments **West Africa** Bv	Netherlands
Minorco Exploration **(Indonesia)** B.V.	Netherlands

The lobbying at the heart of the CFC rule changes

The new loophole in the UK's CFC rules has been several years in the making, dating back to 2008. One of the first things the government did was to establish a series of liaison groups, consisting of business representatives. Most of the companies mentioned in this briefing – including SABMiller, Anglo American and Vodafone – were represented on the groups, the minutes of whose meetings show that they functioned as forums for extensive lobbying to water down the existing CFC regime.[25] The 30 companies represented have well over 3,000 tax haven subsidiaries between them, and stand to gain significantly from the changes.

The tax planning possibilities opened up by the rule changes will mean extra business for tax advisers such as KPMG, who note in a promotional document that, while the 5.75% tax rate made possible by the changes will be 'particularly attractive' for companies, "careful structuring is likely to be required to achieve this rate."[26] This 'structuring', probably using tax haven vehicles, is something they'll happily provide to large corporate clients.

Given the potentially enormous impact on revenue streams of developing countries, ActionAid has also been lobbying the Treasury on these rule changes, though with rather less success. In spite of the numerous warnings we've made, both in written submissions to consultations and in meetings with senior officials, the impact on developing countries has not been considered. Even recommendations made in November 2011 by the IMF and OECD that all G20 countries should undertake a spillover analysis when considering rule changes of this type have been ignored.[27]

Some multinational companies are already acting on the benefits they're likely to receive. Advertising giant WPP, which had moved its HQ to Ireland, said that it would move back to the UK as a direct result,[28] and earlier this year the US insurance firm Aon announced its intention to move its tax registration to the UK from the US, a move that commentators suggested was likely to be partly attributable to the CFC rule changes.[29]

WPP happens to be the biggest user of tax havens in the FTSE100, with a huge 611 tax haven companies and 513 in developing countries.[30] A spokesperson for the company has candidly admitted that "I am not saying there are not any companies [based in tax havens] for tax planning reasons."[31] Aon's most recent filing with the Securities Exchange Commission shows that it too has almost 200 tax haven companies, and over 100 in developing countries.[32] The potential impact on tax receipts in the developing world is huge.

SABMiller: claims current CFC rules stop tax avoidance

ActionAid's report *Calling time: why SABMiller should stop dodging taxes in Africa*,[33] showed how the Grolsch and Peroni brewer shifts an estimated £100 million of taxable profit from developing country subsidiaries where genuine economic activity is taking place into tax havens, where it incurs a much lower tax rate. This includes royalty payments for the use of trademarks, management and service fees, procurement payments and interest on loans from sister companies, all of which are treated as tax deductible.

ActionAid estimates that payments to Switzerland, the Netherlands and Mauritius from SABMiller's subsidiaries in Africa and India resulted in a total tax loss to governments in those countries of £20 million, enough to put 250,000 children in school, and equivalent in Africa to almost one-fifth of the company's estimated tax bill.

We met Marta Luttgrodt, who works 12-hour days running a small bar in Accra, and must pay £47 per year in taxes. In contrast, the SABMiller brewery from which she purchases supplies paid no income tax at all as a result of its payments to tax havens. "We small businesses are suffering from the authorities," Marta told us. "If we don't pay, they come [to lock our stalls] with a padlock."

SABMiller claimed that at least one of the tax haven companies we uncovered "is not a tax avoidance vehicle [because] its full profits are subject to full UK tax as a UK controlled foreign company (CFC)."[34]

That's evidently not the whole story, as SABMiller paid barely any UK tax in the financial years we looked at, but it demonstrates that the proposed changes to CFC rules will make the types of tax avoidance undertaken by SABMiller more lucrative and attractive in developing countries.

What the government should do

ActionAid is calling on the Treasury to seriously rethink these rule changes before the budget. We want the government to assess and help mitigate the impact of any changes on developing countries. This follows the recommendation from the IMF, OECD, UN and World Bank that:

> It would be appropriate for G-20 countries to undertake "spillover analyses" of any proposed changes to their tax systems that may have a significant impact on the fiscal circumstances of developing countries…they may point to remedial measures to be incorporated into the reform and should be published…to enable developing countries to respond with parallel changes to their own systems if that would be helpful in protecting their revenue bases.[35]

The Treasury refuses to conduct this analysis, arguing that it would be too difficult to do, in spite of this recommendation from four organisations whose economic advice it regularly refers to. If the Treasury itself cannot conduct the analysis, it could be outsourced to these organisations, which have considerable expertise and data on the tax systems of developing countries. The analysis should include:

- The potential change in companies' behaviour that may result from the changes.
- The characteristics of developing countries (for example investment patterns, tax legislation, enforcement capacity) that would be likely to increase exposure to this impact.
- The remedial measures that developing countries or the UK could take to help mitigate any impact.

Whatever the precise size of the impact, it's clear the changes will leave developing countries at much greater risk of tax avoidance by multinational companies. ActionAid believes that the government has a responsibility to respond to this in two further ways:

- By providing additional funding to help developing countries fight tax avoidance, a good way to spend development aid with guaranteed value for money.
- Looking for international solutions to the problem of tax avoidance. The government should lead international efforts to close tax loopholes, crack down on tax havens and make it harder for multinationals to avoid their taxes. This should begin with greater transparency, forcing companies to disclose their financial results on a country-by-country basis – including tax havens. Tax havens should also be made to share vital information with the tax authorities of developing countries, enabling them to track down the tax cheats.

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Endnotes

1 To estimate a figure for UK-owned companies' profits in developing countries, ActionAid looked at a representative sample of 10 publicly-listed UK companies whose segment reporting allowed for an analysis of their financial results in developing countries. The sample showed pre-tax profits in developing countries of £16 billion in 2009. The combined market capitalisation of the sample was £345 billion, 21% of the London Stock Exchange (total: £1.8 trillion). This leads to an estimate of UK listed companies' profits in developing countries of £75 billion. Applying the 2009 average global corporation tax rate of 25%, the nominal tax incurred by UK companies in 2009 would be £19 billion. If developing countries were to lose one-fifth of this amount to tax avoidance following the CFC rule changes (one-fifth is ActionAid's estimate of the proportion of SABMiller's African tax bill that the company was estimated to dodge in 2010) the tax loss would be £4 billion.

2 This is the estimated fiscal impact in 2015-16, given in http://bit.ly/ySRzTZ

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6 Full details can be found at www.actionaid.org.uk All figures, unless otherwise stated, are from YouGov Plc. Total sample size was 1,764 adults. Fieldwork was undertaken between 19th – 20th February 2012. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+).

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22 Supplementary written evidence submitted by Barclays to Treasury Select Committee, 2 April 2011. Available at http://bit.ly/lovpMg

23 Doward, J. 'Glencore denies allegations over copper mine tax', The Observer 17 April 2011. Available at http://bit.ly/zvpaLG. ActionAid, 'Calling Time: Why SABMiller should stop dodging taxes in Africa', November 2010. Available at http://bit.ly/e9V2gC

24 This data can be accessed from ActionAid's FTSE 100 tax haven tracker http://bit.ly/o5VxP3

25 Controlled Foreign Companies (CFCs) working groups and committees information. Available at HM Treasury website http://bit.ly/wek6ZW

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