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The UK's tax treaty with Malawi is outdated and unfair: It's time Malawi got a better deal

The UK's treaty with Malawi, which sets out how money moving between the countries is taxed, was originally signed in 1955 while Malawi (then Nyasaland) was under UK colonial rule. Malawi is now one of the poorest countries in the world[1], with its entire national budget roughly equivalent to the budget of the London Borough of Hackney[2].

ActionAid's research shows that the way the UK-Malawi tax treaty allocates taxing rights unfairly favours the UK and limits the ability of the Government of Malawi to tax UK firms operating there. ActionAid is campaigning in both the UK and Malawi for a fairer treaty to ensure that Malawi can raise more tax revenue to fight poverty and provide quality public services. The current UK Government bears no responsibility for the colonial-era treaty being signed, but has the opportunity to put this unjust historical legacy right.

Why tax rules matter

In 2014, developing countries received US$134 billion in aid from wealthy nations, but research from the IMF estimates that they lose US$200 billion a year from tax avoidance[3]. Malawi and other developing countries must be able to raise more revenue to fund their development and corporation tax is of particular importance in developing countries.

Some of the changes needed will require updating the global tax rules which allow companies to get away with paying little or no tax – including measures to address tax avoidance and limit harmful tax competition. However, the negotiation of a new tax treaty between the UK and Malawi is a matter solely for those two countries, and one they can take action on now. A fairer and more just treaty would help bring in tax revenue that Malawi desperately needs for hospitals, schools and more.

What are tax treaties?

Tax treaties regulate when a country can, and can't, tax foreign-owned companies operating within their jurisdiction and the money these companies send out of the country. They are negotiated in order to avoid an individual or company being taxed twice on the same income by both countries, and set out whether it is the residence country (where a multinational company is based) or the source country (where the economic activity happens, e.g. where a factory, mine or office is based) that has the right to tax. In its tax relationships with richer countries, Malawi (and other developing countries) is more frequently a source country – as there is a higher value of money being invested from developed countries into Malawi, than from Malawi to developed countries. However, ActionAid research shows that the global network of tax treaties is unfairly stacked in favour of richer residence countries.

In addition to deciding who gets to tax which income streams, tax treaties often also set the maximum level at which they can be taxed, or even disallow certain types of taxation altogether – taking taxing rights away from countries and limiting the ability of democratic governments to enact policy changes. Global companies are using these treaties to limit their tax contributions in the developing countries where they generate their profits.

[1] Malawi is the poorest country in the world according to World Bank data on GDP per capita. Available at: http://data.worldbank.org/indicator/NY.GDP.PCAP.CD?order=wbapi_data_value_2013+wbapi_data_value&sort=asc
[2] Source: Scotland-Malawi Partnership, available at: http://www.scotland-malawipartnership.org/files/9214/3377/1573/SMP_Ken_Ross_Paper.pdf
[3] http://uncounted.org/2015/06/01/imf-developing-countries-beps-revenue-losses-exceed-200-billion/

Most current tax treaties are simply not fit for the 21st century. They are helping money to flow untaxed from developing to rich countries, making the world more unequal and exacerbating poverty. Tax treaties are voluntary – neither the UK nor Malawi needs to sign a bad tax deal, and both Governments have the ability to renegotiate or cancel the treaty at any time.

The UK-Malawi tax treaty

The UK-Malawi treaty limits the ability of the Government of Malawi to tax UK companies operating in Malawi. ActionAid believes that the way it divides these taxing rights is unfair, depriving Malawi of the ability to raise sufficient tax revenues.

UK companies had investments worth US$157 million in Malawi in 2010 (the latest year for which UN data is available)[4]. While this may seem small by UK standards, Malawi's economy is so small that it equates to 13.7% of all foreign investment, making the UK the third largest investor in the country (after Switzerland and South Africa). This means renegotiating this treaty could potentially have a significant effect on Malawi's tax revenues, at little relative cost to the UK.

A fairer treaty would help raise Government revenues in Malawi. There is a strong case for action on several counts:

- Malawi's treaty with the UK dates back to 1955: nine years before Malawi gained independence. It was negotiated under colonial rule, between the UK Government and the UK Government's appointed Governor of Nyasaland, Geoffrey Francis Taylor Colby. It has only been minimally revised since.
- It is so out of date that not only does it not deal with the taxing of digital goods and services; it does not cover the taxing of TV-related goods.
- Malawi's treaty with the UK affords no rights to charge withholding taxes (taxes on money leaving a country) to Malawi whatsoever. British multinationals can therefore move money out of Malawi via interest or management fee payments, dividends or royalties freely without making any tax contributions there. If there were no tax treaty in place, UK companies would be subject to Malawi's standard 15% withholding tax rate on dividends, interest and royalty payments.
- The lack of withholding taxes in the treaty could also incentivise companies from countries other than the UK or Malawi to use the UK-Malawi treaty to avoid tax. The Netherlands-Malawi treaty also prevented Malawi from charging withholding taxes, and ActionAid found that the Australian mining company Paladin lowered its tax bill in Malawi through the use of a subsidiary in the Netherlands with no employees[5].
- While the treaty contains some provisions to prevent it being used artificially for aggressive tax avoidance, its anti-abuse measures are severely outdated and not in line with the latest internationally agreed recommendations.

Time for a fairer deal

ActionAid understands that a revised version of the treaty has been negotiated with Malawi but that the signing and ratifying process has stalled for political reasons. The revised treaty is bound to be better than the previous one – the current Malawi-UK treaty couldn't get much worse. Marginally improving on the current treaty isn't enough though.

ActionAid is calling on UK Financial Secretary to the Treasury David Gauke and Malawi Finance Minister Goodall Gondwe to work together to put a new treaty in place in 2016 that ensures UK multinationals operating in Malawi pay their fair share of tax.

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[4] Source: UNCTAD Bilateral FDI Statistics database, available at: http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx

[5] See ActionAid (2015) 'An Extractive Affair'. Available at: http://www.actionaid.org/sites/files/actionaid/malawi_tax_report_updated_table_16_june.pdf

A new, fairer treaty would:

- include **strong anti-abuse clauses** that will disincentive aggressive tax planning;
- have **broad definitions of permanent establishments** (i.e. definitions of when a business or person can be taxed) which means that more businesses actually operating in Malawi will be considered to have a taxable presence there; and
- ensure that **withholding taxes are not eliminated or excessively reduced** from the rate that would normally be charged by the Government of Malawi (currently 15% in most cases).

There should also be thorough Parliamentary scrutiny of any new treaty by the Parliaments of both the UK and Malawi.

Negotiating a fairer tax treaty would not be an act of charity. It is a matter of justice that a colonial-era agreement which unfairly favours the UK be put right.

Stella: A primary school teacher in Malawi

Stella Machinjiri (right) teaches at Mbwetu Primary School in Lilongwe, Malawi.

Public services, including primary schools, are very underfunded in Malawi. There are 1,704 children at Mbwetu Primary School and only 12 qualified teachers, and 8 student teachers. Stella teaches Grade 1 and has **285 children in her class** and says it is 'very difficult' to teach a class of this size. The school doesn't have enough buildings, with many students having to learn outside.

Stella says: *"Education is important for Malawi as education is the key to everything. The future for the children here would be brighter if we had enough teachers, learning materials and classrooms for the pupils. It is very hard to hear that there are big companies that come to Malawi and don't pay their taxes. I wish they could have been paying their taxes to Malawi because had it been that they were paying I think we wouldn't have faced these problems."*

"I pay almost 17,000 kw 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. If it had been that these monies had been in Malawi I think Malawi would be richer."

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