actionaid

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Malawi's tax treaties

From independence to year 2015

What's a tax treaty?

A tax treaty is an agreement between two countries to divide up and limit each country's' taxing rights. Among other things, tax treaties regulate when a country can or can't tax foreign-owned companies. Sometimes a country's right to apply a specific tax is cancelled altogether. Once signed and ratified, tax treaties apply until they are terminated or renegotiated. Even though some treaties are very old, they are still as powerful as they were when they were first agreed. Tax treaties are voluntary; they can be renegotiated and cancelled.

Why can Tax Treaties be Problematic?

Tax treaties are squeezing the taxing rights of developing countries and impairing their ability to collect revenue urgently needed to fund essential services, infrastructure, development goals and the promotion of women's rights.[1] In several cases, they are helping money to flow untaxed from developing to rich countries, making the world more unequal and exacerbating poverty.

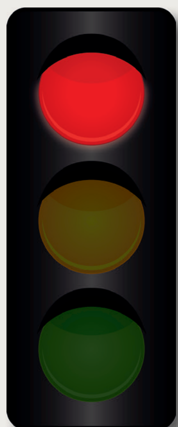
> "Double taxation agreements can contain provisions that are harmful to domestic resource mobilization and can be used to facilitate illicit financial outflows."
>
> Report of the High Level Panel on Illicit Financial Flows from Africa[4]

It is often said that tax treaties will stimulate increased foreign investment and will therefore be a net positive to a nation's economy. However the available evidence suggests that any benefits that tax treaties might bring cannot be guaranteed.[2] Tax treaties always have costs and as a result they should be approached with caution, particularly by developing countries.

For example, Malawi lost out on US$27 million in taxes, as the Australian mining company Paladin shifted significant sums of money out of Malawi and back to Australia via the Netherlands. The tax savings were made possible due to the old Malawi - Netherlands tax treaty that exempts interests and management fees from tax in Malawi.[3] If the US$27 million could have been spent on public services for the people of Malawi instead, it could have paid for 275,000 annual HIV/AIDS treatments; or 5,400 annual doctors' salaries; or as many as 25,000 annual teachers' salaries.

Malawi's tax treaties

From year 1964 to year 2015, Malawi has signed tax treaties with South Africa, Norway, the Seychelles and the Netherlands. These have been provided with a 1-100 treaty score in the ActionAid tax treaties dataset, where a higher number indicates that the lower-income country has kept more taxing rights in the settlement.[5] Treaties that ActionAid consider very restrictive treaties are given a red light, treaties that include several restrictions on tax collection in lower-income countries are given a yellow light and progressive treaties are given a green light.[6]



28/100

Tax treaty with South Africa

1971

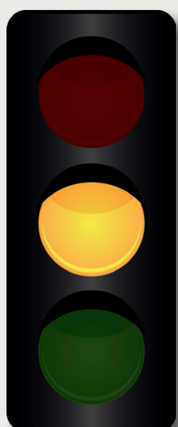
Doesn't limit capital gains taxation

Extensive profit tax limitations

Completely bans tax on certain cross-border payments incl. royalties

New treaty:

No treaty was previously in place between the countries



44/100

Tax treaty with Norway

2009

Stronger profit tax rights than in Malawi's other treaties

Very low taxing right of dividend payments - only 5% in most cases

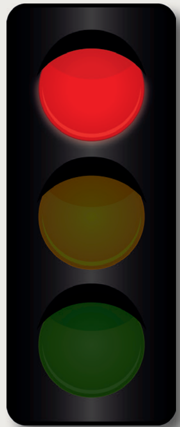
Lacks a clause that protects against corporations avoiding capital gains tax

Renegotiation:

This treaty replaces the extension of the Norway-UK tax treaty to Malawi which was agreed in 1955.

Malawi's tax treaties

From independence to year 2015



37/100

Tax treaty with the Seychelles

2012
Not yet in force

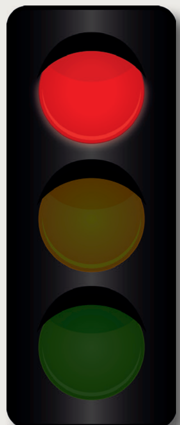
Includes clause that protects against corporations avoiding capital gains tax

Very low taxing right of dividend payments - only 5% in most cases

Only gives limited right to tax capital gains on shares

New treaty:

No treaty was previously in place between the countries



32/100

Tax treaty with the Netherlands

2015
Not yet in force

Includes clause that protects against corporations avoiding capital gains tax

Very low taxing right of dividend payments - only 5% in most cases

Only gives limited right to tax capital gains on shares

Renegotiation:

This treaty replaces the extension of the Netherlands-UK tax treaty to Malawi which was agreed in 1969.

Malawi also has colonial era treaties with the UK (1955), Switzerland (1961) and France (1963). For an example of the content of the colonial era treaties, see the ActionAid briefing 'The UK's tax treaty with Malawi is outdated and unfair: It's time Malawi got a better deal'.[7] In 2016, a treaty was signed with Botswana, which is not yet in force.

African countries' demanding a better deal - three examples:

1

In May 2013, South Africa was successful in renegotiating its treaty with Mauritius, allowing South Africa to collect more withholding tax and to collect capital gains tax where a Mauritian company sells shares in a company which derives more than 50% of its value from immovable property in South Africa. Neither was possible under the previous treaty.[8]

2

In February 2013, ActionAid showed that Zambia's tax treaty with Ireland was used by food giant Associated British Foods to dodge tax in Zambia.[9] In March 2015, a renegotiated treaty between Zambia and Ireland was signed. The clause that enabled tax avoidance on interest payments was successfully renegotiated as a result.[10]

3

In June 2014, Uganda decided to suspend negotiations of new tax treaties until there were clearer guidelines on how the country should benefit from such agreements.[11] During the budget reading in June 2016, Uganda's Finance minister designate made important remarks on the government commitment to review and renegotiate all tax treaties.[12]

ActionAid is calling on the government of Malawi

1. To cancel tax treaties with tax havens and refuse to sign new treaties with tax havens.
2. Not to sign tax treaties based on the OECD model which is more restrictive than the UN model.[13]
3. To consider where a tax treaty with a developed country gives the lion's share of taxing rights to the latter, that treaty should be renegotiated. If renegotiation does not lead to improvements, Malawi should consider withdrawal from the treaty.
4. To ensure that its negotiators get a good deal on:
   - Withholding tax: 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).
   - Permanent establishment definitions: ensure broad definitions of permanent establishment (i.e. definitions of when a foreign business can be taxed) to ensure that businesses making a profit in Malawi are taxed in Malawi.
   - Capital gains tax: ensure that clauses that protects against corporations avoiding capital gains tax by selling immoveable assets through share sales and by ensuring Malawi's right to tax profits from share sales in local corporations.
   - Anti-abuse clauses: include strong anti-abuse clauses that will disincentive aggressive tax planning.
5. To publish an impact assessment for all tax treaties prior to ratification and at least every five years thereafter.
6. To ensure that draft versions of tax treaties are made public prior to signature for public scrutiny.

Notes:

References

1 See ActionAid's publication: *Taxation Rights Slipping Through the Cracks: How developing countries can get a better deal on their tax treaties.* September, 2015

2 See ActionAid's publication: *Mistreated: The tax treaties that are depriving the world's poorest countries of vital revenue.* February, 2016

3 See ActionAid's publication: *An Extractive Affair: How one Australian mining company's tax dealings are costing the world's poorest country millions.* June, 2016. Note that the saving were made in accordance with the treaty from year 1969. A new treaty has been renegotiated but the old treaty is still in force.

4 United Nations. Economic Commission for Africa, 2015. *Illicit financial flow: report of the High Level Panel on illicit financial flows from Africa.* p.81.

5 The full analysis of each of these treaties is freely available on the websites of ActionAid and the International Centre for Tax and Development (ICTD). The dataset is produced by consultant Martin Hearson. Hearson, M. 2016. *The ActionAid tax treaties dataset.* Brighton: International Centre for Tax and Development. http://www.ictd.ac/datasets/action-aid-tax-treaties-datasets

6 The overall score and traffic lights are indicative – they do not tell you everything that you would necessarily want to know about an individual treaty. More information about our classification of very restrictive treaties is available in ActionAid's publication: *Mistreated: The tax treaties that are depriving the world's poorest countries of vital revenue.* February, 2016

7 See http://scotland-malawipartnership.org/files/1814/5492/3154/UK-Malawi_Tax_Treaty_v5.pdf

8 See ActionAid's publication: *Taxation Rights Slipping Through the Cracks: How developing countries can get a better deal on their tax treaties.* September, 2015

9 See ActionAid's publication: *Sweet nothings: The human cost of a British sugar giant avoiding taxes in southern Africa.* February, 2013

10 See ActionAid's publication: *Mistreated: The tax treaties that are depriving the world's poorest countries of vital revenue. Irish edition.* April, 2016

11 Commissioner for tax policy addressing the two-day East African regional workshop organised by ActionAid and SEATINI in Kampala, Uganda. See Daily Monitor Uganda, 6 June 2014. Govt suspends double taxation pacts. http://www.monitor.co.ug/Business/Govt-suspends-Double-Taxation-pacts/688322-2338432-dkw4jwz/index.html

12 Daily Monitor Uganda, 10 June 2016. Government to plug gaps used in tax evasion. http://www.monitor.co.ug/Business/Government-to-plug-gaps-used-in-tax-evasion/688322-3242026-uv3fyi/index.html

13 The UN Model Double Taxation Convention between Developed and Developing Countries 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 model proposed by the OECD does.