Transfer Pricing Seminar: Fairness in Taxing Multinationals and Extractives

Case Study From Zambia
Sweet Nothings: The human cost of a British sugar giant avoiding taxes in southern Africa
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Purpose of the Study

• To highlight revenue losses incurred by developing countries due to tax avoidance/tax evasion by multinational companies.

• To highlight the linkage between tax and development. Tax pays for teachers, to train nurses, to maintain roads etc. The study aimed to illustrate highlight the consequences of tax avoidance/tax evasion on people living in poverty and unable to access basic services due to inadequacy of government revenue.

• To identify and propose ways in which developing countries and the international community can work together to stop corporate tax avoidance and increase revenue for developing countries for basic social services delivery.
What We Found

- Zambia Sugar, the ABF subsidiary, uses an array of transactions that have seen over a third of the company’s pre-tax profits paid out of Zambia.

- ActionAid found that Zambia Sugar is taking advantage of tax treaty loopholes and tax haven regimes to reduce its tax bill.

- The report found that the company essentially uses 3 methods to reduce its tax bill in Zambia. These include complicated web of transactions, shuffling transactions across different jurisdictions resulting in a decrease in tax payable in Zambia.
  - Mystery Management
  - A Dublin Dog Leg
  - A Tax-Free Takeaway
Mystery management

• Zambia Sugar has paid out large ‘purchasing and management’ fees to an Irish sister company – a company that seems to have no physical presence in Ireland.

• Every year since 2006, this company’s audited Irish accounts have also repeatedly stated that the company has no employees, while providing Zambia Sugar with nearly US$2.6 million worth of management services each year.
Mystery Management

Figure 4: Mystery management

1. Zambia Sugar
   Pays fees to sister companies in Ireland and Mauritius

2. Illovo Sugar Ireland
   Profits made on ‘management fees’: 26%*

3. Illovo Project Services Ltd (Jersey)
   Money paid on from Illovo Sugar Ireland

4. Illovo Group Marketing Services Ltd (Mauritius)
   Staff in Mauritius: 0 (according to Illovo representative)

US$8m a year
Including
US$2.1m ‘secondment fees’
US$5.5m ‘management’ fees
US$3.4m unspecified

US$3m a year
As ‘export agency commission’ payments

Zambia Sugar tax haven payments for intra group services 2007-12

- Fees to tax haven companies US$54m (ZK 240bn)
- Operating Profit US$187m (ZK 867bn)
Mystery Management

1. Shift Profits into Tax Havens

Since 2007, Zambia Sugar has paid its Irish arm $47.6m for ‘management fees’ despite the company accounts stating they have no employees.

We estimate Zambia has lost $7.4m.
A Dublin Dog Leg

Large loans from South African and US commercial banks, borrowed to finance the recent expansion of the company’s estate and sugar mill in Zambia, have been ‘dog-legged’ through Ireland – despite being borrowed in Zambian currency and repaid via a bank account held by the Irish company at a bank branch in downtown Lusaka.

This arrangement – sometimes described as ‘treaty shopping’ – takes advantage of a particularly unfair tax treaty between Zambia and Ireland, which prevents the Zambian government from charging any of the tax that would normally be levied on the interest payments made on these loans.
A Dublin Dog Leg

Why would a loan to expand a sugar factory in southern Zambia actually be made to a company registered in a Dublin office block over 8,000 kilometres away?

Figure 5: The Dublin dog-leg: following the money

Ordinary loan

Citibank & Standard Bank
London branches

Withholding tax to Zambian Government (10%)

Interest

$70m loan

Zambia Sugar

The dog-leg

Ilovo Sugar Ireland,
International Financial Services Centre, Dublin

No withholding tax

Interest

$70m loan

Ilovo Sugar Ireland bank account
No. 100144945) at Citibank Zambia, Cha Cha Cha road, Lusaka

No withholding tax

Interest

Zambia Sugar

Unbalanced tax treaties can provide conduits for avoidance
A Dublin Dog Leg – Dodgy Banking…..

2

Dodgy Banking

In November 2007 Zambia Sugar took a bank loan of $70m. On paper this loan is routed through Ireland. This avoided tax on the interest charges costing Zambia $3m.
Order a Tax Free Takeaway

Zambia Sugar is able to send profits back to its parent company, Illovo Sugar Ltd, nearly tax-free by re-shuffling the ownership of the company through a string of Irish, Mauritian and Dutch holding companies, taking advantage of tax treaty loopholes and tax haven regimes to cancel tax on its dividend payments.
A Tax Free Takeaway

3 The Big Shuffle

By shuffling the ownership of Zambia Sugar between Ireland, the Netherlands and Mauritius the company has reduced its Zambian tax bill by an estimated $7.4m since 2007.
Transfer Pricing Challenges for Zambia

- Zambian tax law does not require companies to keep or produce documentation evidence of transactions, rationale or the way fees and payments to affiliated companies have been calculated.
- The Zambia Revenue Authority often has difficulties corroborating information from other countries to check the reality of transactions if this happens to be in a tax haven.
- The International Tax System provides an incentive for multinational companies to locate ‘high-value’ functions, intellectual property and expertise in low-tax jurisdictions, outside developing countries,
The Cost of Transfer Pricing
Thank You!