Prologue

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PROLOGUE

The research for this book took an unexpectedly personal turn as I arranged fieldwork in Africa. A Kenyan organization, Tax Justice Network Africa (TJNA), had agreed to cover my travel costs through a consultancy fee. Kenya imposes a 20 percent tax on service fees paid to providers based abroad, but I was glad to learn that I would have to pay only 12.5 percent, thanks to a four-decades-old treaty between Kenya and the United Kingdom (UK). This saved me (and cost Kenya) a few hundred pounds. In total, British multinational companies have invested over a billion dollars in Kenya, earning over $100 million per year from this investment.¹ When they bring those earnings back home, they also benefit from reduced tax rates thanks to the Kenya-UK treaty.

As I emailed the digitally signed contract back to Nairobi, I realized that the treaty in question had been concluded in a building just opposite my office at the London School of Economics. Somerset House was the headquarters of the Inland Revenue for much of the nineteenth and twentieth centuries. As with all tax treaties, the design of the Kenya-UK treaty can be traced back to a model convention negotiated among the major powers when Kenya was still under British colonial rule. The “London Draft” of 1946, as it is universally known, was also concluded at Somerset House. It seems fitting that this grandiose building had previously been the headquarters of the Navy Board, the administration of Britain’s maritime force at the peak of its empire.

Throughout the twentieth century, Inland Revenue officials at Somerset House worked to create a set of postcolonial power structures that would cement British capital’s enduring ability to profit from the former empire and further afield. A
global network of over three thousand bilateral treaties shields multinational companies from millions of dollars of tax payments on their foreign activities. They are all descendants of the London Draft, produced by the League of Nations’ Fiscal Committee. Britain exerted a strong influence on the committee, in recognition of what one committee member called its status as a “great economy.”

It now has more bilateral tax treaties than any other country, and many of those in force today were negotiated in that very same building.

Historical records show that the particular clause from which I benefited nearly ended the negotiations. In January 1972, a British negotiator in Nairobi sent a telegram to his colleagues back at Somerset House. “Talks with Kenya have broken down,” he wrote, “over treatment of management fees and royalties. The Keanyans [sic] have pressed me to obtain confirmation from the Board that the UK cannot agree to a 20% withholding tax.”

Kenya wanted to replace a treaty inherited at independence with one that would give it more rights, including the right to impose a 20 percent tax on gross fees paid by Kenyan companies to British managers and consultants. It would be a withholding tax, deducted by the payer in the same way that personal income tax is usually deducted from an employee’s salary. The UK had never agreed to this before, taking the view that such payments should be taxable only in the UK.

Kenya was focused and determined, choosing to terminate the old colonial agreement in order to put pressure on the UK to relent on its point of principle. A meeting with business representatives in Somerset House in March 1972 appears to have been instrumental in the British climbdown, with the minutes recording how “the general feeling of the meeting was that it was necessary to hold out for a low rate on royalties, but that management fees could be treated differently.”

Kenyan and British officials eventually initialed a treaty permitting Kenya to tax management and consultancy fees paid to the UK, but only at rates up to 12.5 percent. For over forty years, this would be the lowest cap that Kenya had agreed to in any treaty.

The British did not give up without a fight and in a tense exchange during the Nairobi talks, a Kenyan negotiator asserted that “the UK wanted to make UK management cheaper in the Kenyan market than Swedish management.” Sweden, along with Norway and Denmark, had already agreed to the 20 percent rate, which meant that Scandinavian firms would have needed to charge 20 percent more than their British counterparts for the same post-tax return had the UK got the zero rate that it sought.

The final sentence of the January 1972 telegram illustrates how times have changed between the negotiation of the treaty and its impact on my own tax liability. “I would be grateful if you could get a message to my wife that I will probably not be home until Wednesday,” wrote the British negotiator, giving a home
telephone number. In contrast, thanks to the excellent mobile internet coverage across Africa and Asia today, my wife had no such uncertainty to endure. It seems unlikely that either side in 1972 could have been thinking of a world dominated by email, WhatsApp, Zoom, and Skype.

Today, as trade in services becomes a larger share of the global economy, lower-income countries’ right to tax service fees paid to providers overseas is one of the biggest North-South flashpoints in global tax politics. The UK, for example, has changed its mind again. The service fees clause became a routine concession for decades after Kenya broke the mold, but since the turn of the twentieth century it has become a red line in negotiations. During interviews for this book I heard of at least three UK negotiations in which this had led to a stalemate.

The UK is on one side of a global conflict. In 2013, after years of protracted discussions and several knife-edge votes, a United Nations (UN) committee voted to amend its model bilateral treaty to introduce a clause permitting withholding taxes on technical service fees like that in the Kenya-UK treaty. The UN model is supposed to articulate a suitable compromise for negotiations between lower-income and higher-income countries, and the more influential equivalent published by the Organisation for Economic Co-operation and Development (OECD) continues to outlaw withholding taxes on service fees. In practice, lower-income countries have rarely obtained anything like the new UN clause in their bilateral tax treaties, even though most levy such taxes in their domestic laws.

Just as neither TJNA nor I considered the UK-Kenya tax treaty until after we had decided to work together, evidence suggests that tax treaties may only rarely influence multinational companies’ investment decisions. If that is the case, lower-income countries have little to show for the revenue sacrifices they must make to obtain them. Some have started to reconsider individual tax treaties or even their whole networks, and organizations as diverse as African civil society groups and the International Monetary Fund (IMF) have adopted a critical stance. From 2012 to 2020, Mongolia, Argentina, Rwanda, Senegal, Malawi, and Zambia have repudiated a total of 11 tax treaties, apparently due to fears that they were open to abuse or overly generous. Back in Nairobi, the fieldwork I had conducted with TJNA supported its legal challenge to Kenya’s treaty with Mauritius, which culminated in 2019 when the treaty was struck down by the High Court.

The rate at which lower-income countries are signing new tax treaties, however, shows no sign of declining. Kenya, for example, has already negotiated a new agreement with Mauritius. This book is an attempt to understand the inconsistency between fifty years of negotiations that have resulted in thousands of tax treaties binding lower-income countries into an international regime, on the one hand, and the evidence that this regime may cost them more than they gain, on the other.