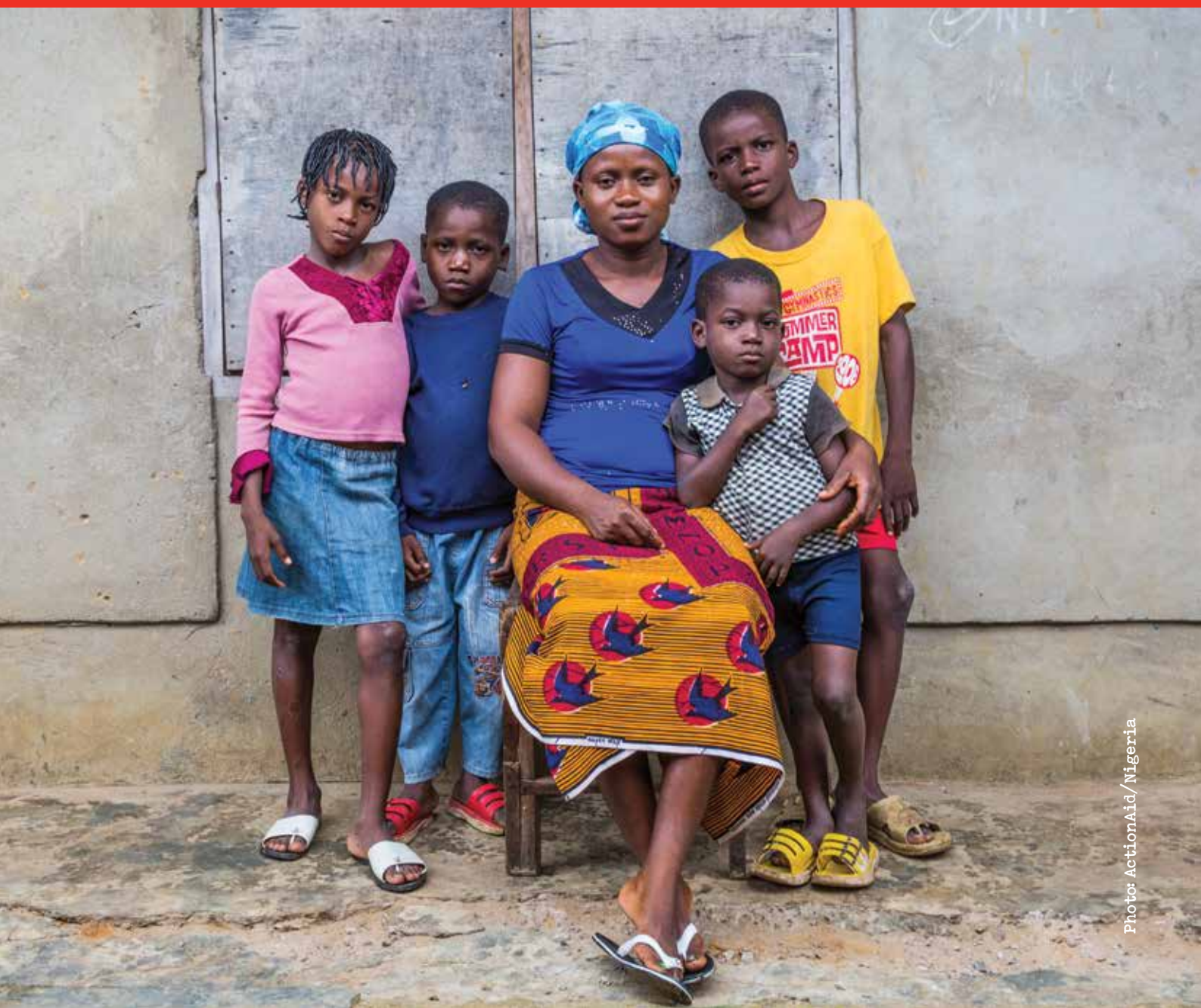


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Leaking revenue

How a big tax break to European gas companies has cost Nigeria billions



Acknowledgements

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This briefing also builds on ActionAid's previous research on economic governance particularly, 'Give us a break',² 'Race to the bottom',³ 'Elephant in the room – how to finance our future'⁴ and ActionAid's recent report 'The West African Giveaway: Use and Abuse of Corporate Tax Incentives in ECOWAS'.⁵

Acronyms

AU	African Union
BEPS	Base erosion and profit shifting
CIT	Corporate income tax
EU	European Union
FDI	Foreign direct investment
FIRS	Federal Inland Revenue Service
IMF	International Monetary Fund
LNG	Liquefied Natural Gas
MDG	Millennium Development Goals
NEITI	Nigeria Extractive Industries Transparency Initiative
NLNG/The Consortium	Nigeria Liquefied Natural Gas
NNPC	Nigeria National Petroleum Corporation
OECD	Organisation for Economic Co-operation and Development
UN	United Nations
UN-ECA	United Nations Economic Commission for Africa
UNDP	United Nations Development Programme

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Executive summary

Nigeria, Africa's most populous country, has lost out on US\$3.3 billion as result of an extraordinary ten year tax break granted by the Nigerian government to some of the world's biggest oil and gas companies: Shell, Total and ENI.

The US\$3.3 billion is urgently needed in a country where 110 million people live in extreme poverty⁶ and more than half of the population does not have access to clean water. 11 million children are out of school and US\$3.3 billion is more than the Federal Government's education budget for 2015, which at 11.29% of the aggregate budget remains lower than UNESCO's recommended education budget of a minimum 15% of a nation's annual budget.⁷ Fifteen out of every hundred children die before the age of five and US\$3.3 billion is three times the Nigerian healthcare budget for 2015. Nigeria is Africa's largest economy, the continent's largest oil producer and it has the continent's largest reserves of natural gas.⁸ But it is a country marked by big inequalities, and more than 60% of the population live on less than one dollar a day

The massive tax break was enabled by a unique law passed in 1990. It was a triple whammy – a tax break in three parts – stretching from 1999 to 2012. First came a regular five year tax holiday granted to most investors in Nigeria; second, an extension for a further five years exceptionally allowed for this particular deal, and third, tax allowances that would have been used during the tax holiday were rolled over and exempted the companies from tax for a further 2 years. The tax holiday extension meant US\$2 billion of revenue was lost, and the rolled over allowances, where the same tax was effectively foregone twice, a further US\$1.3 billion. We do not count the tax foregone in the first five years, as this is the 'normal' tax break.

Addressing how much this tax break cost Nigeria is particularly pertinent as there is a proposed bill to amend the country's Companies Income Tax Act 2004. This new tax law would allow more companies to obtain 10-year tax holidays in Nigeria.

This is only one of many examples of wasteful tax incentives to foreign investors across the African continent. Previous ActionAid research shows that tax incentives cost developing countries at least US\$138bn every year.⁹ While international institutions such as the International Monetary Fund (IMF) and the United Nation Economic Commission for Africa (UN-ECA) are concerned about the race to the bottom over tax incentives,¹⁰ an adequate national and/or regional response is still largely absent.

With this briefing, ActionAid encourages Nigeria and other resource rich developing countries to review their tax incentive policies, to publish those policies and practises and all communications with corporations pertinent to tax incentives, and to collaborate with other countries to end harmful regional tax competition. It recommends international companies to be transparent about their finances, including reporting their profits, sales, assets, number of employees and tax payments to governments in each country where they operate (including taxes not paid due to tax breaks).

Introduction

Nigeria, Africa's most populous country, has lost out on an astonishing US\$3.3 billion as result of an extraordinary ten year tax holiday granted to some of the world's biggest oil and gas companies.

This tax break, granted in 1990 (when Nigeria was still under military rule), kicked in in 1999, lasted 10 years, and its impacts are still being felt. The US\$3.3 billion is the equivalent of twice the Nigerian healthcare budget for 2015, in a country where almost 15 out of one hundred children die before their fifth birthday.¹¹

This massive tax break was a triple whammy. First came a five year tax holiday granted to most international energy investors in Nigeria; second, an extension for a further five years exceptionally allowed

for this particular deal, and third, tax allowances that would have been used during the tax holiday were rolled over and exempted the companies from tax for a further 2 years.

This report shows how such a US\$3.3 billion tax break was reached, what this means for Nigeria, and discusses the global problem of harmful tax incentives. Lastly we look at the way forward, in Nigeria and globally.



A teacher in Nigeria's Delta state teaching children outdoors under a mango tree as there are not enough classrooms.

Photo: ActionAid/Nigeria

Oil rich state where students study under the tree

When Mrs. Dafe Rose (53) was assigned as the head teacher of Abuator Primary School in Delta State in mid-2015, she came expecting a decently well-equipped public school. It is, after all, in the heart of Nigeria's immensely wealthy oil region. A large oil and gas installation is just a stone's throw away. But what greeted Dafe on her first day of work was far from decent.

The school has no library, no toilets, no blackboards, and no educational materials. It doesn't even have a sufficient number of classrooms; three rooms cater for students from primary one to primary six. To accommodate the different grades, each room has been partitioned into two with planks and disused sacks. Students struggle to hear and concentrate as noise filters easily between the partial, plank and bag walls.

The fourteen kindergarten children at Abuator Primary School have it even worse than their elder schoolmates. Their class takes place under a mango tree, where they sit on dirty, disused cement sacks laid on the bare ground. Soldier ants frequently drop from the tree and crawl under the children's clothes. Dafe says it grieves her every time she has to send the children to their 'classroom' under the mango tree. It is far from an ideal learning environment.

What makes the situation even more frustrating is that on the school grounds sits an uncompleted

three-classroom block, now in virtual ruins. It was built by the Delta State Primary Education Board around 2005. "That building has been abandoned for many years" says Dafe. "If the government can complete that, we would be able to accommodate all our children under a roof away from the elements." The community has written many letters of protest to the State Primary Education Board over the abandoned building, but has not received any favourable response.

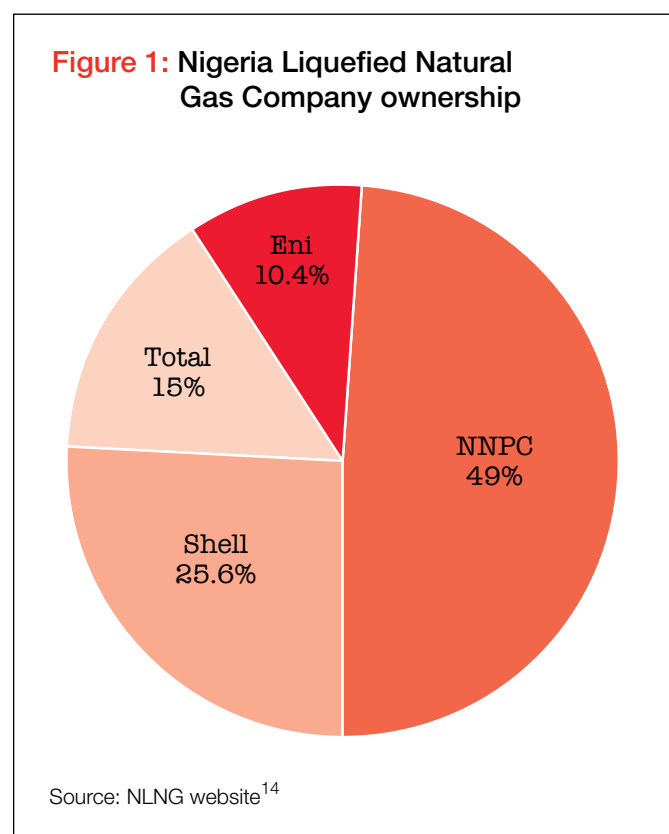
Dafe has since taking matters into her own hands. The community is gripped by poverty, but she managed to convince the parents to contribute a portion of their already meagre earnings to the purchase of plastic chairs and tables for the kindergarten children. She then got a nearby church to let out its building to serve as a classroom.

All across Nigeria, even in the oil-rich south-east, there are dedicated teachers like Dafe struggling passionately to educate the country's children with little or no provisions from the government. But this need not be the reality. Billions of dollars in public revenue can be saved if the Nigerian government stopped the granting of harmful tax incentives to foreign investors. An exceptional ten-year tax holiday offered to three of the world's largest oil and gas companies, Shell, Total and ENI, cost the public purse US\$3.3 billion alone. In a country where 10.5 million children are out of school, this is an amount greater than the 2015 federal education budget.

What happened? How the Nigerian government gave away \$3.3 billion

A unique tax holiday with its own special law

Oil and gas is central to Nigeria's economy and liquefied natural gas is an important part of this sector. Thus, the formation in 1989 of a joint venture between NNPC (Nigeria), Royal Dutch Shell (Netherlands & Britain), Total (France) and Eni (Italy) called NLNG, to exploit Nigeria's huge reserves of gas was important for Nigeria. The Consortium is Nigeria's major company in the liquefied gas sector.¹² Together the three European companies hold a 51% stake in the Consortium, while the state-owned NNPC holds the rest.¹³



The Consortium was founded in 1989 by its current shareholders and in 1990 the Nigerian parliament passed the unique 'NLNG Act' granting the ten-year tax holiday – making the company exempt from all corporate tax payments for the first ten years of operations. The Act also permanently exempts the Consortium from a range of other taxes. The law stayed dormant for nearly a decade before entering into force in October 1999, when the Consortium started operations.

Tax holidays are not uncommon in Nigeria. Domestic and foreign companies in industries considered vital to Nigeria's economic development have been granted pioneer status tax holidays for years. In 1989 companies with pioneer status were given tax holidays for the first three or five years of operations.¹⁵ Had there been no special arrangements, this would probably have applied to the Consortium.

However, while tax holidays are normal, ten-year tax holidays are not, nor are tailor-made laws. The Consortium is the only company in Nigeria with its own law defining its tax framework. Unfortunately there is little publicly accessible information about how a special tax framework was created for the Consortium.

The triple whammy tax break

The Consortium was effectively given three tax-free periods over a period of 12 years:

- 1 Years 1-5 of operations when all companies with pioneer status are tax exempt
- 2 Years 6-10 of operations when typically all pioneer status companies start paying corporate income tax (CIT) at 30%
- 3 Years 11-12, when the Consortium enjoyed a further CIT-free period due to deferred tax assets accumulated during their extraordinary tax holiday

Hit 1 – The first five years' tax holiday

The Consortium paid no corporate income tax for its first five years of operation between 1999 and 2004. This was a normal incentive for investors in Nigeria and as such this tax exemption enjoyed by the Consortium could have been granted under pioneer status without the requirement for a special law. As such, the breaks enjoyed by the Consortium during these first five years are not included in our calculation of the US\$3.3 billion lost to tax breaks. However, it still represents a full five years' exemption from corporate tax.¹⁶

Hit 2 – The main exemption in the second five years

The period between 2005 to 2009 marks the beginning of the unusual corporate tax exemption granted to the Consortium. The part of the tax break attributable to the three international investors adds up to nearly US\$2 billion – 60 per cent of the US\$3.3 billion. This sum has been calculated by taking the tax base (the amount of profit on which tax would have been paid without the tax holiday) and calculating the foregone tax at the prevailing CIT tax rate of 30% and 2% for the education tax. There are several points that must be explained about how this calculation works.

The tax base: Only the European 51%

When calculating the tax lost to the Nigerian state, only the tax that would have been due from the 51% of the Consortium that is owned by Shell, Total and Eni has been included, because it is presumed that income to the NNPC, the state-owned 49%, ends up with the Nigerian government.

It is nevertheless unclear how or if the NNPC's income finds its way to Nigerian government accounts, and there is no publicly available information on how this is accounted for. Auditors have raised this question in the Nigerian Extractive Industry Transparency Initiative (NEITI): "There is a need to confirm the ownership of the 49% investments in the Consortium – Is it for the benefit of the Federation, or the Federal Government, or NNPC itself?"¹⁷ NNPC has not proved that financial flows from the Consortium (dividends, loan and interest repayments) – which by the end of 2012 amounted to US\$11.6 billion – have been remitted to the Federation accounts.¹⁸

The tax base: Excluding some profits

The pre-tax profit stated in the Consortium annual accounts does not automatically equal the tax base. Companies in Nigeria normally have to pay tax on profits made by foreign subsidiaries, but this is not the case for the Consortium. The NLNG Act exempts the Consortium permanently from paying tax on profits of its shipping companies.¹⁹ The pre-tax profit in the accounts includes dividend income from two shipping companies owned by the Consortium: Bonny Gas Transport²⁰ and Nigeria LNG Ship Manning.²¹ This income is not included in the tax base.²²

The tax rate: Different types of corporate tax

The major portion of the relevant tax is corporate income tax, but other taxes would also have been due had the tax break not been granted.

- **Corporate income tax (CIT):** After its exemption period, a company with a normal five-year pioneer status is obliged to pay a 30% CIT on its profits. Lost tax revenue attributable to the three international investors: US\$ 3.2 billion
- **Education tax:** This tax is earmarked for the advancement of education in Nigeria. After the tax exemption period, companies with a pioneer status have to pay 2% of their profits in education tax. The same arrangement is made in the NLNG Act. Lost tax revenue: US\$141 million
- **Other taxes:** The Consortium is permanently exempt from a long list of other taxes, including as we have seen, on profits of its shipping companies.²³ However, accurate data on these exemptions and what they amount to is not available and so these tax breaks are excluded from the US\$3.3 billion

Hit 3: A tax break on a tax break

This is the third part of the triple tax break. Not only did the three oil and gas companies get a 10-year tax holiday, they also acquired several more corporate-tax-free years. This happened through a twist in the law. An investing company often gets to deduct capital allowances when it buys e.g. equipment, and the three oil companies were eligible for these during the tax holiday. They were then allowed to roll over these tax breaks to a period where corporate tax

would have been due, after the end of the tax holiday. The companies had accrued tax allowances on capital expenditure during the period where they paid no tax, so they used it later. This is a standard accounting practice known as ‘deferred tax’.²⁴

A company with pioneer status is allowed to deduct the costs of interest payments and investments in physical capital, capital allowances, from its pre-tax profits, making it easier to borrow to invest in capital equipment.²⁵ During the tax holiday period, a company can calculate what its tax benefits from interest costs and capital allowances would have been if it had paid CIT, and then carry these deductible cost items forward on its balance sheet, deducting its reservoir of deferred tax assets from its CIT obligations. This is what the Consortium did (permitted by the Act).²⁶ The 10-year tax holiday ended in 2009, but the Consortium did not start paying CIT until 2012.

During its tax holiday, the Consortium built up a total of US\$ 2,157 billion in tax assets.²⁷ This explains why the Consortium paid no corporate income tax in 2009 (October to December), 2010 or 2011, and only part of its CIT in 2012 was reported as due.^{28 29}

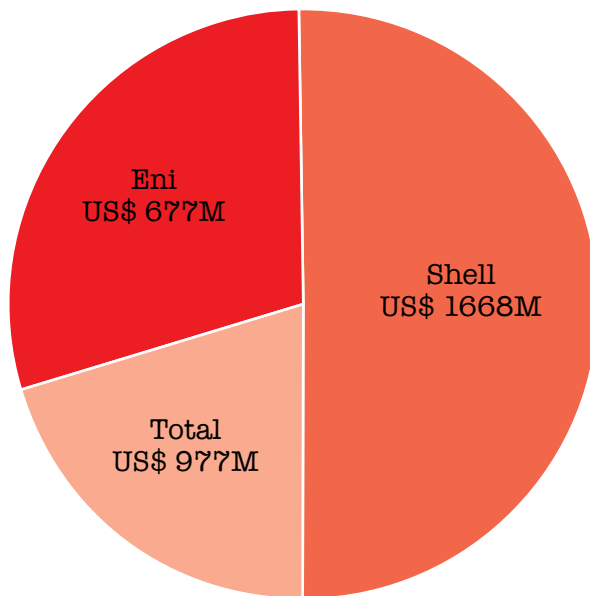
The US\$1,148 billion that would have been due in 2012 after the reservoir of deferred tax assets was depleted was however delayed, as the Consortium reported further unrelieved tax obligations which were reported in 2012 as a ‘deferred tax liability’. This kind of deferred payment will be paid eventually, although sometimes not for many years.³⁰ It is not known when the Consortium will settle this payment, although the company stated in its accounts that “no part of the (deferred tax) liability is expected to be settled within the next 12 months”.³¹

In 2013, although US\$1,402 billion was booked under “current tax liabilities” in the company’s balance sheet, the Consortium paid no CIT. This is common practice and the booked amount usually becomes payable once the tax return is filed the following year.

Table 1: Calculation of foregone tax revenues³²

The figures represent total amounts for the whole Consortium joint venture. The last column shows the share of the three private international shareholders (51% of total)

	Tax losses due to longer than normal tax holiday	Tax losses due to deferred tax credits				Total period for which there is data available	
	2005-2009	2010	2011	2012	2013	2005-2013	2005-2013, Share of the three private companies (51%)
All figures in US\$ million	2005-2009	2010	2011	2012	2013	2005-2013	2005-2013, Share of the three private companies (51%)
Pre tax profit	14487	2799	4885	5321	4510	32002	16321
Dividend from shipping companies	-677	-150	-166	0	-225	-1218	-621
Tax base	13810	2649	4719	5321	4285	30784	15700
Hypothetical CIT, 30%	-4,143	-795	-1416	-1596	-1285	-9235	-4710
Adjustment for deferred tax assets	528	0	0	0	0	528	269
Actual CIT paid or payable	0	0	0	1134	1321	1321	674
Lost CIT revenue	-3615	-795	-1416	-462	36	-7386	-3767
Hypothetical education tax, 2%	-276	N/A	N/A	N/A	N/A	-276	-141
Lost education tax revenue	-276	0	0	0	0	-276	-141
Lost tax revenue	-3891	-795	-1416	-1596	36	-7662	-3908
Correction for deferred tax liabilities at the end of 2013						1148	585
Total lost tax revenue						-6514	-3322

Figure 2: Foregone tax revenue divided by shareholders**Foregone tax revenue from**

- Shell's 25,6% share: US\$ 1 668 million
- Total's 15% share: US\$ 977 million
- Eni's 10,4% share: US\$ 677 million

Source: Calculations based on NLNG Annual Accounts. See SOMO, 2016 for further details

This brings the estimated loss of tax revenue from the Consortium alone for the period between 2005 and 2013 to US\$3.3 billion. This is a conservative estimate for the following reasons:

- 1 The estimate only includes lost tax revenues from two taxes: corporate income tax and education tax. It excludes all other taxes exempted under the tax holiday
- 2 The calculations only include lost tax revenues from the three private companies' 51% share of the joint venture
- 3 At the end of 2013 US\$1.15 billion of tax that the Consortium had been due to pay to the Nigerian government in 2012 had not yet been paid. To allow for the possibility that this amount might be paid in the future, it has been excluded from the estimates
- 4 Finally, the figure takes account of the commonplace use of incentives in Nigeria. The comparator used to estimate loss assumes that the normal (five year) incentive has been given rather than the exceptionally generous 10-year incentive given to the Consortium

Further dealings between the Consortium and the tax authority

There are several questions regarding the Consortium's taxes that are still unanswered. The Consortium and the Nigerian tax authority, the Federal Inland Revenue Service (FIRS) have different views on the Consortium's tax obligations beginning with FIRS' discontent with the tax holiday granted through the NLNG Act. In a 2012 newsletter from FIRS, the then Director of Oil and Gas, FIRS, Mr Bamidele Ajayi, stated:

“...upon the expiration of the tax holiday in 2009, it has been difficult to get them to clear up tax liabilities because of the complex clauses in the tax holiday document which made it an open-ended document.”³³

There have been disputes between the Consortium and FIRS. The Consortium's 2013 annual accounts states that after a series of engagement sessions between the Consortium and FIRS teams, a Memorandum of Understanding was signed, containing the settlement agreement between the Consortium and FIRS on various tax issues. Consequently, the Consortium reportedly made a payment of US\$148.6 million.³⁴ However, this payment is not reflected in the 2013 annual accounts, but might have been paid in 2014 (for which no accounts were available at the time of writing).

Was it necessary to provide the Consortium with a 10-year tax holiday?

One argument frequently used in favour of tax incentives, is that the initial investment costs often are so high that companies would not be able to invest were they not given a reduced tax rate the first few years. While that may be true in some cases, the Consortium accounts suggest differently. Even with a normal five-year tax break, the Consortium would have been highly profitable. As Table 1 shows, the Consortium would have earned a profit every year since 2004 if its tax holiday had ended in 2004. The difference in the Consortium's actual profit (with the 10-year tax holiday) and the estimated profit that the Consortium would have earned with a five-year tax holiday is less than 20% on average over the years 2004-2013.³⁵

The Consortium's investment costs are available in their annual Facts and Figures overview. According to the 2015 overview, total investment costs have so far been over US\$14 billion. More than half of total investment costs seem to have occurred prior to 2005, before a five-year tax holiday would have expired.³⁶

The billion-level profits that the Consortium would have made with a five-year tax holiday, with the same investment costs, suggests that the Consortium would still have been highly profitable. In this case, it seems clear that the 10-year tax holiday was not necessary to compensate for high investment costs.

The long period of tax incentives is sometimes justified on the basis that it discourages wasteful flaring. Flaring is the burning off of gases during oil production, an illegal,³⁷ wasteful and harmful practice with terrible consequences for humans and the environment. The liquefied natural gas industry reduces the harm from flaring, by capturing and making use of the gas.^{38 39} Since gas flaring is illegal in Nigeria, tax breaks to discourage it are unnecessary.

The lack of accessible maternal health care for women like Elohor puts both their and their babies' lives in danger.

Photo: ActionAid/Nigeria



Elohor Siakiere (30) remembers vividly the day she lost her baby. It was July 19th, 2015, an unusually sunny day, she says, for that time of year in Delta State, Nigeria.

"I was pregnant and when my labour started, I was transported in a canoe to Ukperhren where I was put on a motorcycle to go to the general hospital in Warri," says Elohor. "But the road was very bad and I fell down many times. It was a painful ordeal to get to the hospital."

Elohor survived the precarious journey in the canoe and the 15 kilometres on the muddy and slippery road, but unfortunately her unborn child did not. "At the hospital, the doctor told me the baby was dead," Elohor says quietly. "They did an operation to remove it. I felt very bad losing my baby."

With the hospital so far away, many women in the community of 6,000 have little choice but to turn to traditional birth attendants in their community who rely on herbs and unscientific practices that often have disastrous consequences for the mother and/or the child.

According to Elohor, the community became fed up with the government's lack of action and

decided to build a healthcare centre themselves. The clinic, which served Esaba and four other communities, was staffed solely by one nurse. Unfortunately, the nurse passed away in February 2015 and as of October 2015 the government still had not provided a replacement, despite the community's repeated requests. Elohor says that in this time period about five children have died "because we could not get them to hospital fast enough."

The great and tragic irony of Esaba is that a mere four kilometres away sits a huge source of potential public revenue that could pay for roads, a school and a proper clinic for the community: Otorogun gas plant, operated by Shell Petroleum Development Company.

Meanwhile, the Nigerian government passed a unique law that gave an exceptional ten year tax holiday to Shell as well as Total and ENI, three of the world's biggest oil and gas companies. This wasteful act has resulted in the loss of US\$3.3 billion of public revenue.

If the Nigerian government were to stop offering such harmful tax incentives to foreign investors, women like Elohor may not be mourning the unnecessary death of their children and worrying about the futures of their surviving ones.

Why does it matter?

The human cost of the tax holiday

With its 182 million inhabitants, Nigeria is the most populous country in Africa, and the seventh most populous country in the world.⁴⁰ Nigeria is endowed with enormous natural resources including more than 30 different minerals. Nigeria is the largest oil producer in Africa and holds the largest natural gas reserves on the continent.⁴¹ Nigeria is also Africa's largest economy. By 2050, Nigeria is expected to become one of the largest 20 economies in the world.

But while the country is building its economy, Nigeria also has the third largest population of extreme poor in the world.⁴² More than 60% of the population lives in extreme poverty.⁴³ This means that more than 110 million Nigerians live on less than one US dollar a day. Research by the UN Development Programme (UNDP) shows that less than half of the population has access to clean water.⁴⁴ Nigeria is one of the countries in the world with the largest income inequality between the few super rich and the majority living in extreme poverty.

Looking at social spending, the Nigerian government budgeted a total of US\$2.61 billion for education, and US\$1.4 billion for healthcare in 2015.⁴⁵ This means that if the Consortium would have been given a five-year tax holiday instead of a decade, the additional revenue to the Nigerian government could have paid education at the current level for over a year, or healthcare at the current level for over two years.

Increasing the education budget is a necessary investment. Almost half of the Nigerian population is under 15 years old.⁴⁶ This puts an enormous pressure on the educational system. Despite an increase in the enrolment rates in recent years, approximately 11 million children are out of school, out of which 4.7 million children of primary school age are not in school.⁴⁷ While an inadequate budget is not the only factor preventing children from going to school, more funds in education could greatly improve access to education. A higher budget could pay for more qualified teachers, build new schools, buy necessary materials and eliminate school fees, the latter a crucial factor for the poorest.⁴⁸

Similarly, a better and more accessible health care system is needed to fulfil basic rights for Nigerians living in poverty. Child mortality rates illustrate this. Skilled health personnel attend just over half of all births in the country, and out of thousand live births, 61 infants do not survive the birth, and an additional 95 children die before their fifth birthday. Of the children that survive, one in four is under weight.⁴⁹

In its 2010 strategy for reaching the Millennium Development Goals (MDGs), the Nigerian Presidential Committee on the Strategy and Prioritisation of the MDGs estimated that meeting the MDGs would cost Nigeria approximately US\$163 per person per year between 2010-2015. With US\$3.3 billion extra on its books and accompanied by effective policies, the Nigerian government could have ensured that in that period⁵⁰ 4 million persons had access to the basic services described in the MDGs.

US\$3.3 billion would do a lot for Nigeria

What is the value of US\$3.3 billion to the Nigerian economy?

- ▶ More than the US\$2.4 billion Nigeria allocated to education in the 2015 budget, in a country where 11 million children and young people do not go to school.⁵¹
- ▶ Three times the US\$1.1 billion⁵² Nigeria allocated for healthcare in the 2015 budget, in a country where almost 15 out of 100 children die before their fifth birthday.⁵³

What is the value of US\$3.3 billion to Shell, Total and Eni?

- ▶ Just over 4% of the three companies' total world wide reported net profits in 2013.⁵⁴
- ▶ 22% of the three companies' profit from the Consortium between 2004-2013.⁵⁵

Wasteful tax incentives in Africa and beyond

The Consortium's tax holiday in Nigeria is one of many examples of corporations being offered generous tax terms in developing countries. Benefits can include reduced tax rates, exemption from specific taxes or tax holidays granted for a period of time. In a 2014 paper, the OECD names tax holidays as one of the two potentially most harmful types of tax incentive.⁵⁶ Tax incentives can be offered in a specific sector, aiming to boost investments in strategic sectors of the economy. They can also be offered in specific geographical areas, often called special economic zones.

Not all tax incentives are harmful. The tax system may be used to promote domestic policy choices, such as environmental objectives, or the development of particular domestic sectors, in accordance with a country's national development plan. Tax incentives for corporate investment are meant to generate economic benefits which outweigh the cost of lost revenue, but they can just be a handout. In order to assess the public benefits of tax incentives, it is necessary to set clear objectives for them and consistently evaluate whether or not these objectives are being met. Where objectives are not being met, this should trigger the removal of the tax incentives. Finally, the potential economic benefits of tax incentives need to be balanced against the lost revenue in a systematic fashion. Incentives which do not meet these criteria are harmful.

The main reasoning behind granting tax relief to corporations is the idea that it will promote investments that attract capital and contribute to job creation, and that this will deliver a high return in the long run or promote investments into a specific sector such as renewable energy. Other potential benefits are technology transfer and increased demand that can boost local and national industry. Investors will sometimes ask for tax incentives on the basis that a particular investment will not be viable without them. While this has been the predominant narrative, evidence suggests differently. International institutions such as the World Bank, the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) now increasingly warn against excessive tax incentives.⁵⁷

Countries' fear of losing out on investments if not granting generous tax deals has created a harmful competition based on large tax incentives. A 2012 IMF paper confirms a 'partial race to the bottom' over tax incentives.⁵⁸ While this may be good for international businesses whose tax bills are lowered, evidence shows that tax incentives are not efficient in attracting investments. A 2006 IMF study shows that the countries that have been the most successful at attracting foreign investors have not offered large tax or other incentives. The report also shows that providing such incentives was not sufficient to attract large foreign investment if other essential conditions were not in place.⁵⁹ A report prepared for the G20 by the IMF, OECD, United Nations and World Bank in 2011 concludes along the same lines: "Incentives, including corporate income tax (CIT) exemptions in free trade zones, continue to undermine revenue from the CIT; where governance is poor, they may do little to attract investment – and when they do attract foreign direct investment (FDI), this may well be at the expense of domestic investment or FDI into some other country."⁶⁰

Even businesses themselves say that tax incentives are not key deal-breakers. Investment decisions depend more on factors such as stable economic and political conditions.⁶¹ In the World Bank's recent Investor Motivation Survey for the East African Community, 93% of investors said that they would have invested anyway, had tax incentives not been on offer. Tax incentives ranked only 17th, behind a host of factors including exchange rates, utility and transport infrastructure.⁶²

Generous tax incentives may even contribute to undermining what investors seem to value the most. In a 2014 study, the OECD cautions that ineffective tax incentives may erode resources for the more important drivers of investment decisions.⁶³ Investors attach great value to factors such as good infrastructure, security, a stable energy supply and not least a healthy and well-educated work force. Tax revenue is a prerequisite for the existence of these public goods, and businesses may make higher profits if they contribute their fair share of taxes and get public goods in return. The OECD warns that tax incentives that lower government revenues cannot compensate for or be an alternative for a poor investment climate. Discretionary tax incentives – that is, incentives that are granted on an ad-hoc basis to individual investors – are particularly undesirable because they undermine consistency of treatment between investors.

ActionAid estimates that corporate tax incentives cost developing countries over US\$138 billion every year.⁶⁴ Apart from the sheer value of the lost revenues from tax incentives, decisions to grant them are often shrouded in secrecy, and not based on a thorough public cost-benefit analysis. Corporate tax incentives are frequently unaccounted for in the national budget and are non-transparent, reducing public accountability.⁶⁵

Tax incentives, like cuts to headline tax rates on corporate profits, have negative long-term impacts by encouraging harmful tax competition. Apart from the immediate losses of tax revenue, the practice also runs a risk of encouraging a race to the bottom, where countries undercut each

other's effective tax rates in order to attract investment, with all countries involved losing out on tax revenue as a result. As Christine Lagarde of the IMF has pointed out – “By definition, a race to the bottom leaves everybody at the bottom”.⁶⁶

Some governments are however responding to this problem. In April 2015, Kenya was reported to be considering a proposal from its tax authority to scrap tax exemptions, including a 10-year tax holiday for foreign investors in its export processing zones.⁶⁷ Tanzania passed new laws in 2014 to curb tax incentives, aiming to collect another US\$500 million a year in revenues.⁶⁸ In the Philippines, however, a new law to bring more transparency to tax incentives appeared to be contested by the government.⁶⁹

What should happen next?

In Nigeria

Addressing how much these types of tax breaks cost Nigeria is pertinent as there is a proposed bill to amend the Companies Income Tax Act 2004. This new tax law would allow even more companies to obtain 10-year tax breaks in Nigeria.⁷⁰

The proposed amendment aims to provide additional tax incentives for gas utilisation, mining sectors and businesses located in areas with inadequate infrastructure. It suggests increasing the length of specific sectors' tax holidays, and offering 10-year tax holidays to companies established where no infrastructure i.e., electricity, water, or tarred road, is provided by the government.⁷¹ As a consequence of this new bill, more foreign companies would be allowed to benefit from large tax breaks as the three oil companies in this case study did.

The Nigerian government must ensure that the proposed amendment to the Companies Income Tax Act of 2004 effectively extending pioneer status tax holidays from five to 10 years does not go ahead. The practice of granting five-year tax holidays to companies with pioneer status is already being questioned. This briefing has shown that extending the practice by a further five years for one entity such as the Consortium has cost Nigeria at least US\$3.3 billion. Extending this type of tax holiday to most companies will have severe detrimental effects on the ability of the Nigerian state to collect tax revenue and fund vital public services.

The Nigerian Government should review current policies and practices and discontinue the granting of excessive and harmful tax incentives. Any tax incentives granted should build on a solid cost-benefit analysis to ensure the immense social needs in the country are taken into consideration. The decision process should be open to public debate, scrutiny and parliamentary oversight. To secure accountability to its electorate, the government must publish an analysis of the expected costs and benefits of the incentives. The federal government should systematically count and

publish the full cost of tax incentives through published tax expenditure reports.⁷² Regarding the Consortium, the government and parliament should investigate what led to the NLNG Act and make the findings public.

Regionally

To end harmful tax competition, governments need to cooperate with each other at regional level. The African Union (AU), of which Nigeria is a member along with 53 other African states, is showing positive signs in this regard. In January 2015 the summit of Heads of States of the AU adopted the report of the High Level Panel on Illicit Financial Flows; a Panel under the UN Economic Commission for Africa, led by former South African president Thabo Mbeki.⁷³ In its Report, the High Level Panel identifies the close link between illicit financial flows and tax incentives and calls for cost-benefit analysis and regional cooperation to end the race to the bottom.⁷⁴ The AU Heads of State have committed to implementing the findings of this report.

Globally

Internationally, the general narrative around tax incentives is changing, but concrete policies are missing. International institutions such as the IMF and the OECD now advise governments to be cautious. Current efforts by the G20 and the OECD to address tax avoidance through the so called Base Erosion and Profit Shifting (BEPS) process do not deal with tax incentives, and therefore cannot lay claim to addressing the range of problems developing countries face in taxing multinational corporations (MNCs).

In any case, most developing countries are not members of the OECD, and looking to the future, these issues would best be dealt with on the global level by a tax body under the auspices of the UN, where all countries could participate.

Corporate transparency

The dispute settlement between the Consortium and FIRS illustrates that transparency around laws, accounting details and payments is crucial for accountability to governments of countries where MNCs operate. Transparency is also crucial for accountability of governments towards their citizens. The Consortium's shareholders and other international companies can ensure much greater accountability by publicly reporting financial details in each country that they operate in.

The home and host governments of international companies (in this case the Netherlands, UK, France, Italy and Nigeria) should require MNCs to publicly disclose information on sales, deductions, incentives, profits, number of employees, profits made and taxes paid in each jurisdiction in which they operate (including taxes not paid due to tax breaks). These governments should also encourage companies to refrain from seeking special tax deals, in accordance with the OECD Guidelines for Multinational Enterprises.⁷⁵

Recommendations

To the Nigerian Parliament

- Revoke the proposed amendment to the Companies Income Tax Act, which aims to extend pioneer status tax holidays from five to 10 years.
- Investigate the process that led to the NLNG Act, and make the findings known to the Nigerian public.
- Demand that the executive arm of government follows up on the previous government's statement of intent to review the tax incentive practices in Nigeria.

To the Nigerian government

Tax policies and practices

- Tax incentives must be based on a thorough cost-benefit analysis, including an assessment of impact on the poor and vulnerable groups. The analysis must be made subject to public debate, scrutiny and parliamentary oversight.
- Create a public policy framework for granting tax incentives.
- Ensure that tax incentives, if granted, are subject to systematic monitoring and evaluation, and are revocable if the company fails to reach the agreed development objectives.
- Do not grant discretionary tax incentives.
- Publish an annual overview of the costs of tax incentives to Nigeria.
- Publish the terms of contracts with companies in the oil and gas sector.
- Implement the relevant recommendations of the Mbeki report on Illicit Financial Flows.

NLNG specific

- Publish any cost-benefit analysis or arguments behind the NLNG Act and publicly explain the reason behind the ten-year tax holiday to the Nigerian people.
- Make a cost-benefit analysis of current tax incentives granted to the Consortium and propose to change the Act as appropriate.

Corporate transparency

- Require that all companies operating in Nigeria report and publicly disclose information on sales, the number of employees, profits made, taxes paid and other information relevant to their tax contributions in Nigeria. Ensure that company accounts are easily available to the public. Require that companies publish these on their website,

and make the company accounts and annual reports in the company register publicly available to everyone that is interested.

To the governments of Italy, the Netherlands, France and the UK

Corporate accountability

- Require that companies registered under specific country legislation report and publicly disclose information on sales, the number of employees, profits made and taxes paid in each country and jurisdiction in which they operate.
- In promoting international trade/business/ investments, resident governments must not engage in political or other activities that will lead to the private sector organisations being offered excessive and harmful tax incentives in other countries.

Global recommendations

- As the OECD and G20 will never be able to facilitate negotiations that give all countries an equal say, a well-resourced and authoritative UN tax body should be created with universal membership.

To Shell, Total and Eni

Codes of conduct

- Pay taxes at prevailing rates without seeking tax incentives in (developing) countries as a requirement to establishing businesses there. Seek a level tax playing field with other corporate taxpayers, domestic and multinational, in all jurisdictions where you operate.

Transparency

- Publish information that enables stakeholders in Nigeria and other jurisdictions where you have a subsidiary, branch or tax residence to:
 - ▶ See how taxable income, profits and gains are calculated and internationally distributed; and
 - ▶ Understand all significant determinants of the tax charge on those profits.
- Publicly disclose information on sales, the number of employees, profits made and taxes paid and other information relevant to tax contributions in each jurisdiction in which you operate, i.e. public country-by-country reporting.

1. Please see www.somo.nl
2. http://www.actionaid.org/sites/files/actionaid/give_us_a_break_-_how_big_companies_are_getting_tax-free_deals_2.pdf
3. http://www.actionaid.org/sites/files/actionaid/eac_report.pdf
4. <http://www.actionaid.org/publications/elephant-room-how-finance-our-future>
5. <http://www.actionaid.org/publications/west-african-giveaway-use-abuse-corporate-tax-incentives-ecowas>
6. According to Nigeria Millennium Development Goals, 2013 Report, the poverty rate in Nigeria is 62.6%. See http://www.ng.undp.org/content/dam/nigeria/docs/MDGs/UNDP_NG_MDGsReport2013.pdf
According to the CIA World Fact Book, the population was approximately 177 million mid 2014. See <https://www.cia.gov/library/publications/the-world-factbook/geos/ni.html>
7. The education sector, including Universal Basic Education Commission, was allocated N492,034,986,591 in the 2015 budget <http://www.slideshare.net/foefogbuikenna/a-review-of-the-federal-government-2015-budget>
8. AfDB Nigeria country strategy, 2012-2016 . <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2012-2016%20-%20Nigeria%20-%20Country%20Strategy%20Paper%20-%20Draft%20Version.pdf> and U.S. Energy Information Administration, 2015, Nigeria country overview <http://www.eia.gov/countries/cab.cfm?fips=NI> (5. May 2015).
9. http://www.actionaid.org/sites/files/actionaid/give_us_a_break_-_how_big_companies_are_getting_tax_free_deals_-_aug_2013.pdf
10. See for example James, S., 2013, Tax and Non-tax Incentives and Investment: Evidence and Policy Implications and <https://www.imf.org/external/np/pp/eng/2011/030811.pdf>
11. According to the Nigeria Federal Ministry of Finance, Budget 2015 Speech, healthcare accounts for N278.8 billion. <http://www.fmf.gov.ng/component/content/article/5-latest-news/204-budget-2015-speech.html> (9. April 2015) Child mortality: Nigeria Millennium Development Goals, 2013 Report, p.29.
12. Liquefied natural gas (LNG) is gas that has been cooled to about -162°C (-260°F) for shipment and/or storage as a liquid. The liquid volume is about 600 times smaller than it is in gaseous form. In this compact form, natural gas can be shipped in special tankers to terminals in other countries. At these terminals, the LNG is returned to its gaseous form and transported by pipeline to distribution companies, industrial consumers and power plants.
13. The direct owners are the following subsidiaries of the ultimate owners: Shell Gas B.V., Total LNG Nigeria Ltd, Eni International N.A. See <http://www.nlng.com/PageEngine.aspx?&id=43>
14. See <http://www.nlng.com/PageEngine.aspx?&id=43> (5. May 2015)
15. This is laid down in the Industrial Development (Income Tax Relief) Act of 1971; http://www.placng.org/new/laws_of_nigeria3.php?sn=203 (1 April 2015) In very particular cases, under criteria that the Consortium would not fulfil, a seven-year tax holiday could be given.
16. We have used the Industrial Development (Income Tax Relief) Act of 1971 as a basis for the estimate. We have no information that any other regulations than the Industrial Development Act was prevailing in 1989.
17. NEITI, 2012, Financial Audit: An Independent Report Assessing and Reconciling Financial Flows within Nigeria's Oil and Gas Industry – 2009 to 2011, p. 19, http://neiti.org.ng/sites/default/files/pdf_uploads/NEITI-EITI-Core-Audit-Report-Oil-Gas-2009-2011-310113-New.pdf.
18. NEITI, 2015, Financial, Physical and Process Audit: An Independent Report Assessing and Reconciling Physical and Financial Flows within Nigeria's Oil and Gas Industry 2012, p.325,
19. Government of Nigeria, 1990, Nigeria LNG Act, article (6.8).
20. Bonny Gas Transport Ltd. is a Bermudan incorporated fully owned subsidiary of NLNG that provides shipping services for the Consortium
21. Nigeria LNG Ship Manning Limited –incorporated in Nigeria in 2008 - provides personnel for all of the Consortium's vessels.
22. NLNG 2013 Annual Accounts. We have therefore subtracted the dividend income from these two subsidiaries from the pre-tax profit in order to find the correct tax base. For example, as table 1 shows, the Consortium's total pre tax profit in 2013 was US\$4,51 bn. Dividend income was US\$225m. The tax base was therefore US\$4,285bn.
23. The following particular tax incentives in the NLNG Act that do not apply to companies with regular pioneer status have not included in our calculations of foregone tax revenues: No tax on cross-border interest payments by the Consortium, no tax on payments by the Consortium for services provided by non-Nigerian companies or individuals, not capital gains tax on transfer of shares in company or any other company connected with it, no tax on profits of shipping companies owned by the Consortium exemption from customs duties for NLNG or its contractors, exemption from all shipping regulations for shipping companies owned by the Consortium Sources: Pioneer status as presented in Industrial Development (Income Tax Relief) Act of 1971, and Nigeria LNG Act, 1990. <http://www.eisourcebook.org/cms/Nigeria%20Liquified%20Natural%20Gas%20Act.pdf> (18 October 2012)
24. For further explanations of deferred taxes, see for example Murphy, 2012, CBI tax misinformation – effective tax rates include the deferred tax charge <http://www.taxresearch.org.uk/Blog/2012/04/23/cbi-tax-misinformation-effective-tax-rates-include-the-deferred-tax-charge/> or Tax Justice Network, 2010, On the need for improved deferred tax accounting: <http://taxjustice.blogspot.nl/2010/11/on-need-for-improved-deferred-tax.html>
25. Industrial Development (Income Tax Relief) Act of 1971, <http://www.placng.org/new/laws_of_nigeria3.php?sn=203>
26. NLNG Annual Accounts 2013, p.22
27. NLNG Annual Accounts 2013, p. 22. Please see further details in ActionAid commissioned SOMO report 2015.
28. See overview in NLNG Annual Accounts 2013, p. 22.
29. NLNG Annual Accounts 2013, p. 21. Please see further details in ActionAid commissioned SOMO report xxx
30. Murphy, 2012, CBI tax misinformation –effective tax rates include the deferred tax charge
31. NLNG Annual Accounts 2013, p. 22. Please see further details in ActionAid commissioned SOMO report 2015
32. This report has used publicly available accounts to calculate what the lost tax revenue to Nigeria is. However, not all accounts are public and the ones that are contain several discrepancies which has made it harder to calculate the exact tax loss. Any discrepancies in the calculations in this report are a direct result of discrepancies in NLNG's financial accounts.
33. FIRS, 2012, "NLNG Has Enjoyed 10 Years Abnormal Tax Holiday"- D/Oil & Gas; <http://www.firs.gov.ng/> (1 April 2015)
34. The taxes included in the settlement include CIT, education tax, value added tax (VAT), capital gains tax, and withholding tax. See Annual Accounts NLNG 2013, p. 39
35. The difference in NLNG's actual profit and the estimated profit that NLNG would have earned with a five-year tax holiday, is less than 20% on average over the years 2004-2013. Since the time period includes the years after the actual 10-year tax holiday ended, the difference is smaller than the 30% CIT and 2% education tax it would have been obliged to pay starting 2004 instead of starting 2009.
36. NLNG Facts and Figures 2015, p.29
37. <http://business-humanrights.org/en/human-rights-impacts-of-oil-pollution-nigeria-0>
38. NLNG, FAQs: <http://www.nlng.com/faqs.aspx> (5. May 2015)
39. According to NLNG, 2015,Facts & Figures on NLNG 2015, as of 2015, NLNG has converted about 4.68 Tcf (trillion cubic feet) of Associated Gas (AG) to exports as LNG and Natural Gas Liquids (NGLs). http://www.nigeriaing.com/publications/Facts_and_figures_2015.pdf
40. http://esa.un.org/unpd/wpp/Publications/Files/Key_Findings_WPP_2015.pdf
41. AfDB Nigeria country strategy, 2012-2016 . <http://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/2012-2016%20-%20Nigeria%20-%20Country%20Strategy%20Paper%20-%20Draft%20Version.pdf> and U.S. Energy Information Administration, 2015, Nigeria country overview <http://www.eia.gov/countries/cab.cfm?fips=NI> (5. May 2015).
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44. Nigeria Millennium Development Goals, 2013 Report
45. Nigeria Federal Ministry of Finance, Budget 2015 Speech
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47. UNICEF, undated. http://www.unicef.org/nigeria/children_1937.html
48. British Council Nigeria, 2012, Gender in Nigeria Report 2012. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/67333/Gender-Nigeria2012.pdf
49. Nigeria Millennium Development Goals, 2013 Report, p.29.
50. Nigeria Millennium Development Goals, Countdown Strategy 2010-2015, p.46. <http://web.ng.undp.org/mdgs/MDG-Count-Down-strategy-report.pdf>
51. According to the Nigeria Federal Ministry of Finance, Budget 2015 Speech the total Education spending is N521.27 billion or 11.7 percent of the aggregate Budget. See <http://www.fmf.gov.ng/component/content/article/5-latest-news/204-budget-2015-speech.html> (9. April 2015) According to Save the Children in Nigeria's website, 11 million children are out of school. <http://www.savethechildren.org/site/c.8rKLXMGlpl4E/b.9086271/k.C5BA/Nigeria.htm> (17. 4.2015)
52. <http://www.politicoscope.com/n4-493-trillion-2015-budget-passed-education-defence-get-highest-allocations/>
53. According to the Nigeria Federal Ministry of Finance, Budget 2015 Speech, healthcare accounts for N278.8 billion. <http://www.fmf.gov.ng/component/content/article/5-latest-news/204-budget-2015-speech.html> (9. April 2015) Child mortality: Nigeria Millennium Development Goals, 2013 Report, p.29.
54. Global profit in 2013 were for Shell US\$ 34 bn, for Total US\$ 27 bn, and for Eni US\$ 19 bn. For Total and Eni we have used the average euro/USD exchange rate from December 2013. Source: The three companies' 2013 annual reports.
55. Figures from NLNG's Annual Accounts. See details in SOMO, 2015.
56. OECD, 2014, Tax and development - Draft principles to enhance the transparency and governance of tax incentives for investment in developing countries; <http://www.oecd.org/ctp/tax-global/transparency-and-governance-principles.pdf>
57. See for example James, S., 2013, Tax and Non-tax Incentives and Investment: Evidence and Policy Implications and <https://www.imf.org/external/np/pp/eng/2011/030811.pdf>
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66. <https://www.imf.org/external/np/speeches/2014/062714.htm>
67. The East African. Kenya in bid to retire tax breaks to foreign investors. 4th April 2015.
68. The East African. Tanzania's law amendment seeks to boost tax collection. 17th May 2014.
69. Manila Times. PH needs updated tax incentives – DOF. 11th March 2015.
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71. PricewaterhouseCoopers, 2012, Tax Alert. <https://www.pwc.com/en/ng/ng/pdf/proposed-amendments-to-companie-income-tax-act-in-nigeria.pdf>
72. Such expenditure reports can be of the kind that ActionAid used in its estimation of foregone revenue to developing countries from tax incentives. See ActionAid, 2013: Give us a break: How big companies are getting tax-free deals
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