



**CDR**  
CENTRE FOR  
DEVELOPMENT  
RESULTS

# Improving Impact and Value for Money

Addressing Inconsistencies in Tax Exemptions in UK Overseas  
Development Assistance

Centre for Development Results

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## Contents

Introduction .....	1
The UK Approach .....	1
Challenges for UK Development Partners .....	2
International Comparisons.....	3
Levelling the Playing Field .....	5
Recommendations .....	6
Appendix: Overseas Examples .....	8

## Introduction

Most donor countries have a policy of seeking tax exemptions from beneficiary developing countries receiving overseas development assistance. Tax exemptions ensure that aid funding is spent directly on project objectives and protect suppliers from exposure to corruption and bureaucracy associated with weak tax and public finance management administration in developing countries.

The UK has a policy that tax exemptions should be utilized in beneficiary countries where possible, however this policy is not being applied fully and consistently. Inconsistencies exist between countries and between contracts within the same country. This causes problems for DFID and its suppliers, having a negative impact on DFID's ability to achieve value for money and its development objectives.

The UK Government has rightly been focused on how we can improve results, value for money and transparency in our UK taxpayer funded aid budget. Increasing the consistency in which tax arrangements are made for DFID's implementing partners is one way in which this can be achieved.

## The UK Approach

Tax arrangements that affect the work of partners delivering and managing UK aid funded programmes differ from country to country. Broadly there are two approaches:

1. Exemption from local taxation in an overall agreement with the beneficiary country

The UK has this form of agreement with countries like Zambia, Pakistan, Afghanistan, Tanzania, Nepal and Bangladesh. The benefits of broad tax exemption MoUs are significant. However in some countries where these agreements exist they are not uniformly applied and in others, such as Kenya or Uganda, there is considerable confusion over their application.

In addition, the process for securing the exemption can be very onerous. For instance, in Afghanistan (1) tax exemption rulings need to be secured, (2) tax filings and tax assessment reviews are still required despite the exemption and (3) exemption is denied for withholding tax on foreign subcontractors unless they have applied for the exemption themselves.

2. Tax exemption is covered in individual project or programme MoUs

DFID has these types of arrangements in countries like India and Malawi, and include specific clauses within project MoUs exempting duties and taxes. However some recent programme specific MoUs do not provide for exemptions, rather they entitle DFID to seek reimbursement of overseas tax costs passed on to them. In some countries certain programmes have tax exemption, where others do not.

In some countries no arrangements are yet in place. Many of these countries are the more fragile ones where problems with corruption are worst. The variety of liabilities suppliers face e.g. income tax, pension contributions, withholding tax, and VAT, has been a source of considerable confusion in countries where overall agreements do not exist. For example Nigeria, one of the UK's priority countries and largest UK aid recipients, is one of these countries and the absence of any arrangements governing DFID suppliers has resulted in significantly increased costs and considerable time spent dealing with tax related issues.

## Challenges for UK Development Partners

As a result of an inconsistent approach to the application of tax exemptions within and between countries, DFID implementing partners face a number of challenges to their ability to deliver value for money and DFID's development objectives. In particular of note to HMG:

- It is a disadvantage to British companies

In countries where other donors ensure tax exemption but the UK does not, there is a disadvantage to British companies. Their ability to deliver results is affected as resources are diverted into tax payments, and the willingness of consultants to work for UK aid funded programmes is reduced. Demand for qualified consultants is high, therefore they are less likely to work programmes that reduce their income and expose them to the risk of dealing with developing country tax regimes, especially in dangerous countries.

- It exposes suppliers to high levels of fiduciary risk

DFID suppliers deliver programmes in some the poorest and most troubled countries in the world. They suffer from high levels of corruption and weak public finance management administrations. This leaves HMG implementing partners exposed to these risks where tax exemption agreements do not exist or are inconsistently applied. Moreover, this risk is shared by HMG.

- It creates an uneven playing field for suppliers

DFID is seeking to widen its supply base and in particular encourage SMEs to provide more services. The cost of maintaining a large central tax department capable of dealing with changing requirements in multiple countries, plus the cost of hiring multiple local tax advisers is considerable. These costs are prohibitive to smaller suppliers and would encourage them to ignore tax requirements, operate under the radar, or decline to proceed in the country in question.

Moreover in those countries where some HMG programmes are tax exempt and others not, those suppliers that have a base in a tax exempt programme are clearly advantaged over those that do not.

Taxing DFID activities serves to:

- Increase already high operating costs
- Diminish the resources being spent on the objectives of the project, thus undermining value for money
- Involve DFID suppliers and individual consultants in very substantial bureaucratic activity
- Dissuade good consultants from working in-country or make them increase their fees
- Reduce tax revenue in the UK and expose DFID to reputational risk regarding the use of revenues gained by developing countries from UK aid funds

## International Comparisons

In most countries development assistance receives a broad range of tax exemptions, but these are often subject to the exemptions being confirmed in bilateral agreements between the respective countries. Each donor has its own agreement with the respective country.

These agreements consistently cover a full range of issues faced by organisations delivering development cooperation including: licences for imports; exemptions from customs duties, sales taxes, taxes on personnel, turnover and profits; exemption from obligation to register for professional authorization; prompt issuance of relevant visas and a waiver of fees; prompt issuance of residence, work and other permits; the right to import and re-export goods for personal use free of tax; the right to open and operate bank accounts; the right to establish corporate entities; extension of these privileges to spouses; liability for damages to third parties; a requirement to report corruption; free movement within the country; and security issues. Some examples are included below:

### Australia

Australia seeks tax exemptions for personnel who are not nationals or permanent residents of the country in which they are delivering programmes. A 2013 agreement for AusAID's activities Liberia states:

*3. For the purposes of the Program, the GoL will, in accordance with Liberian law, facilitate the deployment of Activity personnel who are not nationals or permanent residents of Liberia by granting exemptions from income taxes on salaries and allowances, and from important and other duties on Personal and Household Effects.*

*4. The GoL will expedite the issue of all documentation required from the entry and exit of Activity personnel and their dependant(s) into and from Liberia for the Republic of Ghana, and*

*for the performance of work by Activity personnel, including the granting of exemption from visa fees.*

## Sweden

Sweden's 2009 Agreement with the Government of Liberia is considered a best practice example of general terms and conditions for development cooperation. Broadly it protects Swedish funds from foreign exchange controls and charges, customs duties, sales taxes:

- 1.2 The use of funds provided by Sweden for agreed purposes shall not be impeded or delayed by currency or foreign exchange controls or charges imposed by Liberia. No such charges shall be paid from Swedish contributions.*
- 1.3 No customs, duties, sales taxes or related fees shall be charged to Sweden by Liberia on goods or other resources provided or financed by Sweden. If such fees or costs are demanded, they shall be paid by Liberia. This exemption does not apply to indirect taxes of a kind which are normally incorporated in the price of goods and services purchased in Liberia.*
- 1.4 Necessary licenses for imports financed by Sweden shall be promptly granted by Liberia.*

The Agreement also grants expatriate institutions and consulting companies who receive funds from Sweden the right to import and re-export, free of customs duty and other similar charges, professional equipment and goods that they need to accomplish their undertaking; exemption from taxes and similar levies on company profits, fees and remuneration; the right to open external bank accounts and exemption from all obligations to register themselves in Liberia for professional authorization, taxes or other reasons.

Personnel are also guaranteed prompt clearance and issuance of visas, relevant permits, free movement within the country, exemption from personal income tax and any other direct tax and a right to import and re-export, free of customs duty and other charges, professional equipment and goods needed by the personnel to accomplish their assignment.

## United States

The US Congress has passed a law making taxation of US development assistance illegal. They have a series of Agreements with overseas governments for economic and technical assistance which set out the rights and exemptions of USAID funded organisations and individuals. Broadly, USAID seeks the following exemptions:

- Customs duties, tariffs, import taxes, or other levies on the importation, use and re-exportation of goods or the personal belongings and effects (including personally-owned automobiles) for the personal use of non-national individuals or their family members.
- Taxes on the income (including social security), profit or property of all non-national organisations of any type, non-national employees of national and non-national organisations, or non-national individual contractors and grantees.
- Taxes levied on the last transaction for the purchase of goods or services financed by USAID including sales taxes, value-added taxes (VAT) or taxes on purchase or rental of real or personal property.

More information on clauses contained within these Agreements is contained in an Appendix.

## Levelling the Playing Field

The UK Government should be focused on levelling the playing field for its implementing partners within markets and between countries to ensure that it is supporting them to deliver best value for money and greatest impact.

There are a number of steps the UK Government can take to increase transparency around tax arrangements and address the inconsistencies in the application of tax arrangements:

1. Increase transparency around tax arrangements

DFID should share the agreements reached with governments overseas. Information should be available at the early stages of a bid so that necessary arrangements can be put in place. This will be particularly helpful to smaller organisations that do not have the resource to support a central tax department nor monitor changes within local tax regimes. A central repository of tax information would also help suppliers understand their commitments and liabilities.

2. Increase transparency of the impacts of tax arrangements at bid stage

To better understand the impact that tax arrangements are having on delivering programme objectives, DFID could consider separating the cost of expected taxation from programme budgets at bid stage. This would encourage evaluation of bids based on the pre-tax price. Implementing partners could then invoice tax paid separately from programme costs with evidence for it to be reimburse.

Whilst this approach encourages competition, it still prejudices companies who do not have the resources for the necessary tax advice they would need and does not protect implementing partners from potentially predatory tax authorities. It would also potentially require greater resource from DFID to understand the tax affairs and corporate structures of all of its implementing partners.

3. Increase consistency in the application of tax arrangements

At present agreements that do exist are inconsistently enforced. The plethora of tax liabilities that companies face when delivering overseas development assistance is a hindrance to their ability to effectively deliver programming. Time and resource is spent on understanding and complying with the tax obligations and cost-effectiveness is reduced as the resource is diverted from programme delivery.

The agreements should clearly state: (1) the taxes covered by those tax exemptions, and (2) the parties for which the tax exemptions apply (e.g. subcontractors and employees) to avoid misinterpretations.

4. Seek tax exemption arrangements with all overseas partners where they do not yet exist

Like other international donors, DFID should seek tax exemptions and a number of other assurances from beneficiary country governments. This will help to support British companies and UK development objectives. Exemptions improve value for money, ensure aid is being directed towards

its objectives and levels the playing field with other donor countries, making British organisations competitive. As more UK aid is spent across Government Departments there is a strong role for DIT and the FCO in helping to negotiate and agree these arrangements so that there is a consistent cross-government approach. The MoU between the UK Government and the Government of the People's Republic of Bangladesh concerning British Overseas Development Cooperation could be used as a model example for this type of agreement.

DFID should secure written commitments from the overseas Ministry of Finance that they will put in place arrangements to ensure that the exemptions are granted in practice without the need for onerous application processes.

## Recommendations

A coherent centrally driven process is required to resolve the various outstanding tax issues affecting organisations delivering overseas development assistance programmes.

Steps should be taken to improve transparency and consistency in UK Government tax arrangements.

We have outlined a number of options above, but we believe the only way to truly achieve DFID's objectives and support UK companies delivering overseas development assistance is to negotiate tax exemption arrangements with all UK beneficiary countries.

This approach takes into account the temporary nature of development projects, mitigates against higher costs and ensures that organisations delivering UK aid are not prejudiced against other donors' suppliers.

CDR is committed to working with HMG to improve transparency and enhance the impact of its overseas work. Ensuring tax arrangements are in place across the board will support the UK government in its drive to improve impact, value for money and accountability in UK aid spending.

#### The case for tax exemptions:

- Aid will be more effective. When taxes are applied they divert UK taxpayer money away from projects and effectively provide general budgetary support. They also reduce cost-effectiveness as more project time is diverted to understanding and complying with complex tax regimes.
- They support UK Government policy. DFID provides general budget support to only a few countries. It is Government policy not to provide direct budgetary support where there is high fiduciary risk.
- Public support for UK aid will increase. Aid will enjoy more political support in the UK if the entire amount of aid is devoted to the specific programmes.
- They give UK Government greater control over where UK aid is going. We cannot ensure that taxes paid to beneficiary governments will be spent on the same objectives as those to which the aid is directed.
- They reduce the risk of corruption, provided that they are automatic. Exposure to tax authority places projects at greater risk of corruption. Any interaction with the government may be an occasion for bribes and diversion of funds into private hands, which is inappropriate for development assistance. In many of the countries receiving UK aid, tax and customs administration is weak, corrupt and not in compliance with international standards. Public expenditure management are also weak and not transparent, leading to the diversion of funds in the budget.
- Taxes paid overseas by UK individuals and companies are diverted from the UK exchequer. Tax should be paid in the home countries of the companies and individuals carrying out the aid project, reflecting the fact that it is those countries which are funding the aid
- They mitigate against an increased cost or reduction in quality of consultants who do not want to be exposed to the risk or financial penalty of dealing with developing country tax administrations.

## Appendix: Overseas Examples

### *Australia*

The Australian government agreed for AusAID's activities in support of the Natural Resources Tax Unit 2013:

3. For the purpose of the Program, the GoL will, in accordance with Liberian law, facilitate the deployment of Activity personnel who are not nationals or permanent residents of Liberia by granting exemptions from income taxes on salaries and allowances, and from important and other duties on Personal and Household Effects.
4. The GoL will expedite the issue of all documentation required from the entry and exit of Activity personnel and their dependant(s) into and from Liberia for the Republic of Ghana, and for the performance of work by Activity personnel, including the granting of exemption from visa fees."

### *Sweden*

2009 Agreement between Sweden and Liberia on General Terms and Conditions for Development Cooperation:

- 1.5 The use of funded provided by Sweden for agreed purposes shall not be impeded or delayed by currency or foreign exchange controls or charges imposed by Liberia. No such charges shall be paid from Swedish contributions.
- 1.6 No customs, duties, sales taxes or related fees shall be charged to Sweden by Liberia on goods or other resources provided or financed by Sweden. If such fees or costs are demanded, they shall be paid by Liberia. This exemption does not apply to indirect taxes of a kind which are normally incorporated in the price of goods and services purchased in Liberia.
- 1.7 Necessary licenses for imports financed by Sweden shall be promptly granted by Liberia.

### ARTICLE 5 – Conditions for Expatriate institutions and consulting companies

When consultant companies, institutions, Non Governmental Organisation or other legal persons from countries other than Liberia are contracted by Sweden to perform tasks in Liberia within the framework of development cooperation between Sweden and Liberia, the following shall apply:

- 5.1 Such legal persons shall not be held responsible for failure to fulfil their undertakings if this is due to security instruction or recommendations issued by the Swedish Government.
- 5.2 They shall have the right to import and re-export, free of customs duty and other similar charges, professional equipment and goods that they need to accomplish their undertaking, or to sell such equipment within Liberia against payment of customs and similar charges, when no longer needed to provide the services.
- 5.3 They shall be exempted from taxes and similar levies on company profits, turnover or any similar ground, and on fees and remuneration financed by Sweden for their services within the programme of development cooperation. This exemption does not apply to indirect taxes

of a kind which are normally incorporated in the price of goods and services purchased in Liberia.

5.4 They shall have the right to open external bank accounts and operate them for the fulfilment of their undertaking. The efficient handling of the accounts shall not be hampered by foreign exchange controls, and balances in these external accounts shall be freely transferable to any convertible currency.

5.5 They shall be exempted from all obligations to register themselves in Liberia for professional authorization, taxes or other reasons, and shall be under no obligation to present information to the tax authorities of Liberia unless they conduct business activities in Liberia that do not fall under this Agreement. If however asked by Liberia, they should provide information on their operations in Liberia.

6.4 The laws of Liberia apply to the personnel, unless otherwise agreed in this or other agreements between the parties.

Liberia shall guarantee the personnel the following:

- a) Prompt clearance and issue, of multiple entry, re-entry and exit visas for the entire duration of their assignment. Prompt issue of all required permits or licences such as residence permits, work permits, research permits and professional permits as well as exemption from immigration restriction and alien registration during the periods they are covered by this Agreement.
- b) Free movement within the country and the right to enter and leave the country to the extent necessary for the implementation of the project/programme.
- c) Exemption from personal income tax and any other direct tax in respect of emoluments paid to them by Sweden, or by an employer who has undertaken to perform services or deliver goods in a contract with Sweden directly or as a sub consultant
- f) A right to import and re-export, free of customs duty and other charges, professional equipment and goods needed by the personnel to accomplish their assignment.

### *United States*

Agreement for Economic, Technical and related assistance between South Africa and USA 1995:

#### ARTICLE 5

1. In order to assure the maximum benefits to the people of South Africa from the assistance to be furnished hereunder, the agency designation by the Government of the United States of America to administer its responsibilities in terms of this Agreement shall be exempt from taxes, duties, levies, deductions or other imposts of any kind, whether considered to be direct or indirect, other than such as represent payment for specific services rendered (i.e. utilities): without limitation this exemption includes stamp, registration and similar duties. Notwithstanding, individual employees of or contractors financed by the Government of the United States of America under this Agreement shall be subject to the regulations and practices of the Government of the Republic of South Africa regarding payment of taxes normally included in the price of goods and services.

2. Any supplies, materials, equipment or funds introduced into or acquired in South Africa by the government of the United States of America, or any contractor or grantee financed by that Government, for purposes of any program or project conducted hereunder or any Southern Africa Regional program financed by the United States Government, shall, whilst such supplies, material, equipment or funds are used in connection with such a program or project, be exempt, including retroactively, from any taxes on ownership or use of property and any other taxes, investment or deposit requirements, and currency controls in South Africa, and the import, export, purchase, use or disposition of any supplies, materials, equipment or funds in connection with such a program or project shall be exempt, including retroactively, from any tariffs, customs duties, import and export taxes, taxes on purchase or disposition of property, and other taxes or similar charges in South Africa. The exemption from currency controls shall not apply to funds acquired in the Republic of South Africa for purposes not related to the official function of the Government of the United States of America. No tax (whether in the nature of an income, profits, business or other tax), duty or fee of whatsoever nature shall be imposed upon any contractor in respect of work financed by the Government of the United States hereunder.
3. The exemption from taxation referred to in this Article, excepting the taxation referred to in paragraph two above, will not apply to such dues and taxes payable under the law of the Republic of South Africa by persons contracting with the agency designated to administer the responsibilities of the Government of the United States of America under this Agreement or any contractor financed by the Government of the United States of America who are citizens and/or permanent residents of the Republic of South Africa.

Individuals shall

4. (a) not be subject to income or similar taxes in respect of salaries and other similar payments, and emoluments;  
(b) be entitled, within six months of arriving in the Republic of South Africa, to import free of customs and import duties, taxation and surcharge, personal effects (including one vehicle for personal or family use) and household goods and to export the same free of export duties and other fiscal charges, at the end of their stay in the Republic of South Africa.  
(c) be exempt from social security provisions and compulsory military service.

#### ARTICLE 6

2. The Government of the Republic of South Africa will facilitate the issue of all visas, permits and other authorisations required to enable employees of the agency designated to administer the Government of the United States of America's obligations under this Agreement, and of contractors and grantees financed by that Government under this Agreement, to work in the Republic of South Africa, and for such employees and their families to enter, remain and reside in and leave the Republic of South Africa at any time and from time to time, as requires, in order to carry out the Government of the United States of America's responsibilities under this Agreement.
3. The Government of the Republic of South Africa will, as far as possible, give favorable consideration to applications for work permits for spouses and personnel of the agency designated by the Government of the United States of America to carry out its responsibility under this agreement

1957 General Agreement for a Programme of Technical co-operation between the Government of the United States of America and the Government of Ghana

#### ARTICLE IV – RIGHTS AND EXEMPTIONS

1. All technical and administrative personnel financed by the Government of the United States of America, except citizens or permanent residents of Ghana, whether employed directly by that Government or under contracts financed by that Government with public or private organizations, who are present in Ghana to perform work for the technical co-operation programme and whose entrance into the country has been approved by the Government of Ghana under the terms of Article III hereof, shall be exempted from all income and social security taxes levied in Ghana with respect to income upon which they are obligated to pay taxes of a similar kind to the Government of the United States of America; from taxes on the ownership or use of personal property (including automobiles) intended for their own use; and from payment of any other taxes, duties or fees from which diplomatic personnel of the Embassy of the United States of America in Ghana are now exempt.
2. The technical and administrative personnel referred to in the foregoing paragraph may at any time during official residence in Ghana import or export free of customs duties, import and export taxes, consular fees and similar taxes and fees, their household goods, baggage and personal effects (including an automobile for each such individual) as well as other articles necessary for their own use and that of their families.
3. Any supplies, material, equipment or funds introduced into or acquired in Ghana by any Government of the United States of America, or any contractor financed by that Government, for purpose of any programme or project conducted pursuant to this Agreement shall, while such supplies, materials, equipment or funds are used in connection with such a programme or project, be exempt from any taxes on ownership or use of property, and any other taxes, investment or deposit requirements and currency controls in Ghana; and the import, export, purchase, use or disposition of any such supplies, materials, equipment or funds in connection with such a program or project shall be exempt from any tariffs, customs duties, import and export taxes, taxes on purchase or disposition of property, and any other taxes or similar charges in Ghana.

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USAID considers the following taxes exempt:

1) Exemption 1. Customs duties, tariffs, import taxes, or other levies on the importation, use and re-exportation of goods or the personal belongs and effects (including personally-owned automobiles) for the personal use of non-national individuals or their family members.

Exemption 1 includes, but is not limited to, all charges based on the value of such imported goods, but does not include service charges directly related to service performed to transfer goods or cargo.

2) Exemption 2. Taxes on the income, profit or property of all (i) non-national organisations of any type, (ii) non-national employees of national and non-national organisations, or (iii) non-national individual contractors and grantees. Exemption 2 includes income and social security taxes of all types and all taxes on the property, personal or real, owned by such non-national organisations or persons.

3) Exemption 3. Taxes levied on the last transaction for the purchase of goods or services financed by USAID under this Agreement including sales taxes, value-added taxes (VAT) or taxes on purchase or rental of real or personal property.