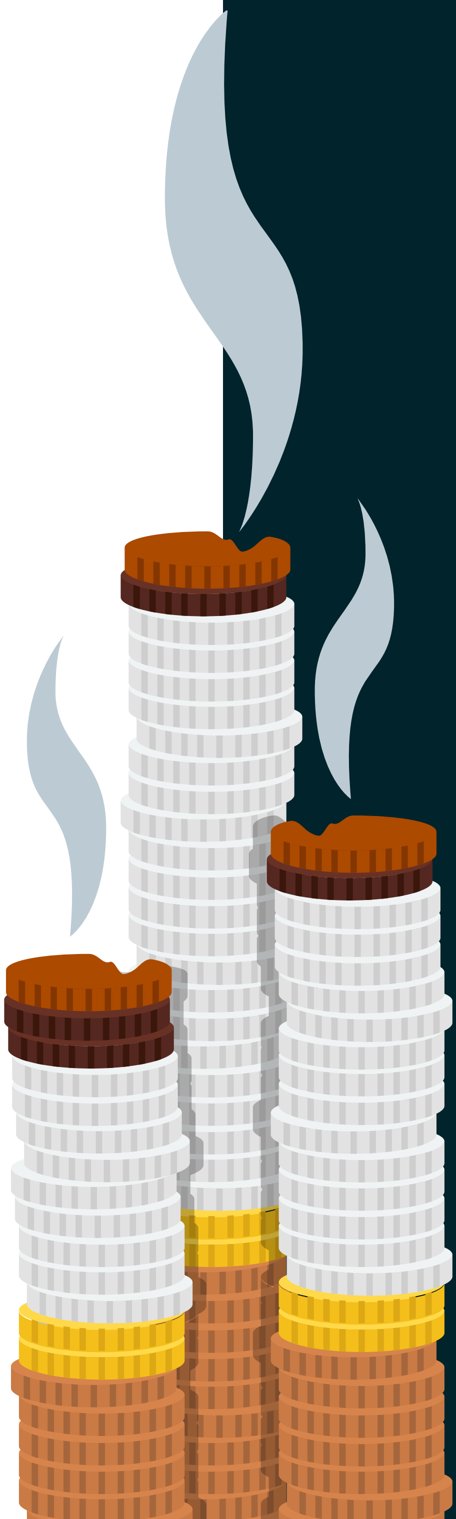
# ASHES TO ASHES

## HOW BRITISH AMERICAN TOBACCO AVOIDS TAXES IN LOW AND MIDDLE INCOME COUNTRIES



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tax justice network

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**$700 million**
will be lost in tax revenue by 2030 from just one tobacco company if business continues as usual

# SUMMARY

The massive damage to human health caused by tobacco is now well-known. So too are the efforts of major tobacco companies to avoid disclosing the health consequences of smoking in order to continue marketing their deadly products. But as regulation tightened in the high income countries that used to generate most of the tobacco companies' profits, their focus shifted. Marketing is especially targeted at younger age cohorts (the 'economic future of the tobacco industry'),[1] and at lower income countries.[2] Today, as a direct result, around 80 per cent of the 1.1 billion smokers worldwide live in low and middle income countries – and it is estimated that tobacco is responsible for the deaths of up to half of all users.[3]

The tobacco companies have long stressed the economic contribution made through tobacco duties, while at the same time lobbying intensely against meaningful increases in duty rates.[4] According to the World Health Organisation, "raising tobacco [excise] taxes to more than 75 per cent of the retail price [a high proportion of it] is among the most effective and cost effective tobacco control interventions" –but only 32 countries in the world have so far achieved this.[5]

At the same time, tobacco remains among the most profitable industries in the world.[6] While much research has focused on the benefits of tobacco duties, which are borne by the consumer and so can change behaviour for the better,  this report assesses the extent to which a major tobacco company pays tax in lower income countries – specifically, corporate income tax on profits.

Are tobacco companies making a fair tax contribution to the societies where their profitmaking activities cause the greatest human and economic costs? We have looked at British American Tobacco (BAT), the only tobacco company to feature in the top 100 of Forbes' Global 2000 list of the world's largest public companies.[7] The answer, based on the analysis we have carried out for Bangladesh, Indonesia, Brazil, Guyana, Trinidad and Tobago, Kenya, Uganda and Zambia, is a resounding 'no'. The operations we've looked at reveal the efforts that BAT goes to to minimise the tax contribution made to those countries.

We uncovered a range of mechanisms reducing tax, including cross-border payments made within the multinational group for royalties, research, intra-group lending and as dividends. If the implied foregone tax revenues that we find are taken to reflect 'business as usual' from now until 2030, the year in which the world aspires to reach the UN Sustainable Development Goals, the countries in question would suffer a total loss of nearly US$700 million – from the tax avoidance of a single tobacco company.

While the multinational tobacco companies are highly profitable, the scale of the profits and the corporate income tax paid by them is relatively small, in comparison with the scale of the economic damage caused by smoking. For example, in 2016 BAT Bangladesh made a net profit of around 7.6 billion BDT – much less than the estimated 158 billion BDT of economic damage caused by smoking. Yet, even though the corporate income tax they pay is a relatively small potential recompense, the companies still avoid making the full corporate income tax contribution that would be expected. Rather, they should pay a

higher distribution from profit towards mitigating the damage.

Any claim that tobacco companies make an economic contribution to offset their massive health costs rings hollow, when they appear to go to such efforts to avoid paying taxes. The only thing that can be taken for granted is that tobacco companies will not support sustainable development unless they are forced to. Tobacco companies must be set higher standards of transparency to ensure greater public accountability for their tax behaviour. And tax authorities must approach tobacco companies with great scepticism and apply rigorous scrutiny to the claims they make.

> "In 2016, BAT Bangladesh made a net profit of around 7.6 billion BDT – much less than the estimated 158 billion BDT of economic damage caused by smoking."

These are our recommendations for urgent action to discipline tobacco companies and to curtail the human development damage they are causing. Governments must take action immediately to stem the syphoning of much needed funds from their countries by an industry already exacting a heavy toll in terms of lives lost to tobacco use.

**Governments**

- Prioritise regulation and administration that enables the maximisation of corporate tax revenue from tobacco companies (to be spent on essential public services)
- Ensure public accountability of tobacco companies by requiring publication of country by country reporting alongside company accounts – a measure which has been shown to cut tax avoidance immediately and also provides insights into where tax authorities should challenge abuse
- Closely scrutinise the tax affairs of tobacco companies, to reduce or eliminate profit shifting, with particular attention to crossborder related party royalty fees and IT recharge payments, financing, routing of dividend payments, and procurement
- Review and renegotiate tax treaties that are excessively disadvantageous to lower income countries
- Assess the overall level of tobacco related revenues and the share that is accounted for by spending to reduce health and other costs of tobacco consumption

**International community**

- Support tax treaty standards more beneficial to lower income countries
- Require multilaterally the publication of multinational companies' country by country reporting to ensure accountability for mechanisms that shift taxable profits away from the location of real economic activity

# I. INTRODUCTION

British American Tobacco (BAT) says in its 2017 global annual report, "Cigarettes are a reliable source of tax revenue for governments worldwide," and "tobacco is one of the world's most regulated and most taxed industries."[8] BAT Bangladesh says that government taxation policies "negatively impact not only [the company] but also government revenue earning capacity from the industry."[9]

Overwhelmingly, these claims relate to excise taxes rather than corporate income taxes. That is, tobacco companies highlight the duties which add to the price of tobacco paid by customers of the company, much like VAT and other sales taxes. These duties are borne by tobacco consumers and are recognised as one of the most powerful instruments to reduce consumption – and thereby obviate the enormous health damages, including massive excess mortality, that tobacco consumption causes.

Precisely because they can change consumer behaviour, the tobacco companies have seen the threat to their profits and lobbied powerfully against meaningful increases in duty rates.[10] At present, only 32 countries in the world – overwhelmingly high income countries – have introduced tobacco excise taxes that account for more than 75 per cent of the retail price.[11] This is despite excise taxes levied in order to increase prices being recognised under the globally agreed WHO Framework Convention on Tobacco Control as an important and effective means of reducing tobacco consumption.[12]

But these taxes are not borne by the companies, however much they might like to claim credit for the resulting revenues. Rather, they are 'sin taxes', designed to be borne by, and to change the behaviour of, the ultimate consumer in a socially damaging production chain - be that of tobacco, carbon dioxide emissions or any other public 'bad'.

Corporate income taxes are entirely different. They are borne directly by companies and represent not an attempt to change consumer behaviour, but are a distribution of the profits from corporate activity: a distribution back to the state in which the underlying economic activity occurs. The state which invests in public health and education to provide the skilled workforce necessary. The state that pays for public infrastructure and administration, the system of law and order, and market regulation, without which no businesses could function. The state which maintains the economy where companies produce and/or into which they sell their product and from which they profit.

As it happens, multinational tobacco companies are among the world's most profitable companies.[13] And this is despite decades of revelations about, first, the health damage caused by tobacco consumption and, second, the aggressive actions of the industry in distorting and suppressing that evidence.

British American Tobacco – the focus of this report - has fought in the courts in Kenya and Uganda in an attempt to prevent these governments from regulating to limit the harm done by smoking. "In one undisclosed court document in Kenya, seen by the Guardian, BAT's lawyers demand the country's high court 'quash in its entirety' a package of anti-smoking regulations and rails against what it calls a 'capricious' tax plan," said The Guardian newspaper in July 2017. BAT denies it is opposed to all tobacco regulation, but says it reserves the right to ask the courts to intervene where it believes regulations may not comply with the law.[14] BAT is also under investigation by the UK Serious Fraud Office on suspicion of corruption over claims that it bribed officials in East Africa to undermine anti-smoking laws.[15]

The continuing profitability of multinational tobacco companies owes much to their ability to resist regulation in all countries, but also to the speed with which they exploited the relative lack of regulation in lower income countries and switched their focus from the high income home countries that had long been their largest markets.


*Front entrance to British American Tobacco PLCs UK headquarters in London Credit ©Philafrenzy*

According to the World Health Organisation, around 80 per cent of the 1.1 billion smokers worldwide live in low and middle income countries.[16] Coupled with the research evidence that tobacco is likely to be responsible for the deaths of half of all users,[17] the future scale of mortality will be dramatic – even if no further users were hooked.

And globally, cigarette consumption is still rising, entirely because of the expansion of markets in lower income countries.[18] Regulation of marketing is often lax or poorly enforced and sales practices long abandoned in the global North – such as the selling of flavoured cigarettes to appeal to young people or sale of single cigarettes near schools - are commonplace.[19] Of course, the health risks are the same – indeed, the stakes are higher, in the sense that far fewer smokers are likely to have access to decent healthcare in lower income countries and public health systems in the global South must survive with much lower levels of resources.

More tax revenue is critically needed in lower income countries. For example, it is estimated that low and lower middle income countries need to raise public finance by an average annual US$69 to US$89 billion by 2030 – the year in which the world aspires to meet the UN Sustainable Development Goals - to meet the health related Sustainable Development Goal 3.[20] Tax accounts for a much lower share of the economy in low and lower middle income countries than in high income ones. Despite some progress overall in the last decade, many countries have overall ratios of tax to GDP below 20 per cent or even 15 per cent - a rate which is sometimes used as an informal rule of thumb to indicate state fragility.

As the following section sets out in detail, corporate income taxes are an important part of government revenues, and especially so in lower income countries. As a former US Internal Revenue Service director says:

> "The world's poorer countries are chronically short of the public revenues needed to combat persistent severe poverty, and as a practical matter the income generated by multinational companies within those countries represents one of the few realistically accessible sources of additional public funding."[21]

This is where the tobacco companies' behaviour is especially offensive. The companies claim to be essential revenue providers through duties that are actually being paid by consumers – consumers, whose health is damaged with each puff. But in the same breath, major tobacco companies are using a range of methods to shift profits out of lower income countries to reduce their tax payments in those countries and indeed, in some cases, their tax payments overall. Far from being bounteous public providers, they are tax avoiders who knowingly deprive lower income countries of the revenue they need to fund health services to their citizens.

This report shows how this tax avoidance is perpetrated, and despite the challenges posed by the opaque accounting practices involved, estimates the scale of revenues foregone in a series of countries.

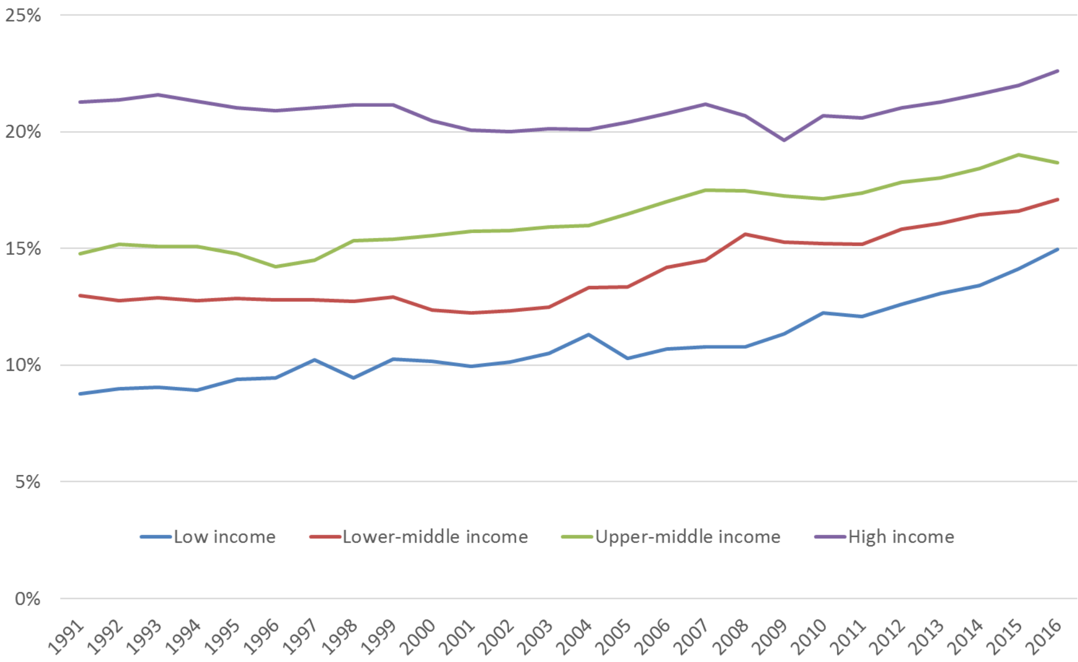
In Section 2, we provide an overview of how multinational corporate taxation works. In Section 3, we describe the strategies commonly used by multinational companies to avoid tax and explore their application in the context of the multinational tobacco company that we focus on in this report: British American Tobacco. We also present the headline findings, estimating the tax loss to the countries we have looked at for a given year. In Section 4 we look at the damage caused by smoking and the costs of dealing with it, in the framework of the Sustainable Development Goals. In Section 5, we ask whether BAT avoids tax in the destination countries, not just in lower income countries. And in the Appendix we look in detail at the tax avoidance approaches in eight lower-income countries around the world. These countries were chosen for their geographical spread and because they are countries where financial statements have been published.

Finally, we draw recommendations for governments and international actors to take the vital steps to end these harmful practices and to ensure that tobacco companies make a fair tax contribution in the lower income countries where they make so much money while imposing massive public health costs.

### The importance of corporate taxation for low and middle income countries

Lower income countries raise a much smaller proportion of their national income in tax than higher income ones. This situation has improved in recent years though the gaps remain large.

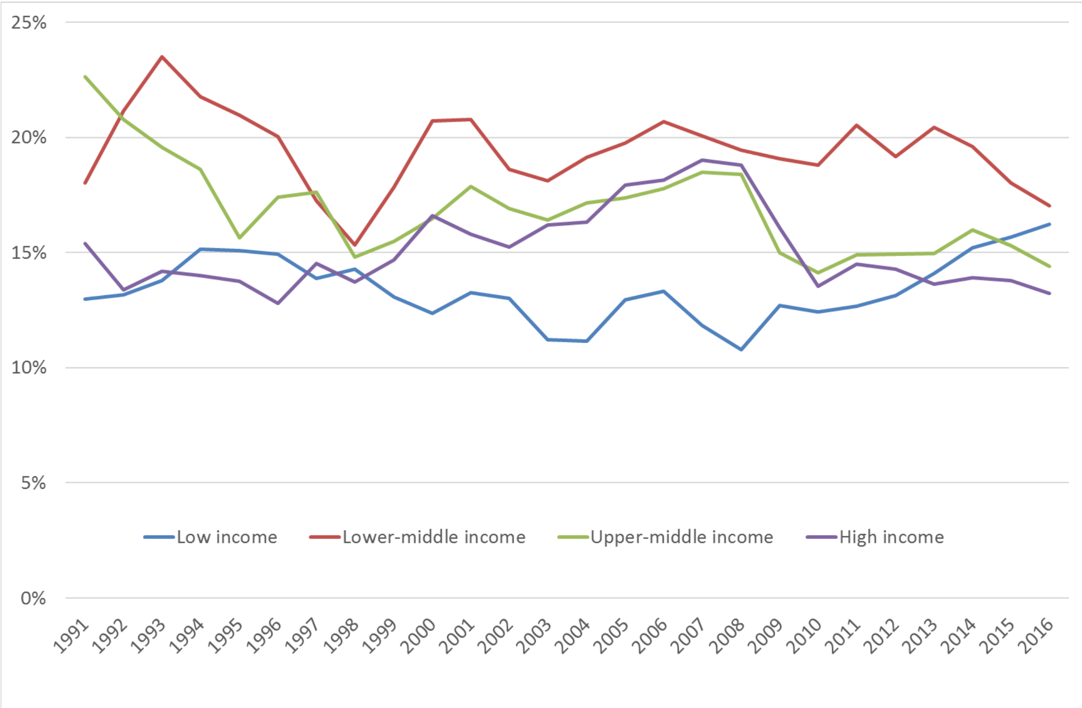
*Non-resource tax revenue as a proportion of GDP*




*Source: ICTD/UNU-WIDER, 'Government Revenue Dataset', 2018.*[22]

The structure of lower income countries' tax systems is different from developed countries: among other differences, corporate income tax tends to form a higher proportion of non-resource tax revenue. This has long been the case for lower middle income countries and since 2014 for low income countries too.

*Revenue from corporate income tax as proportion of total non-resource tax revenue*




*Source: ICTD/UNU-WIDER, 'Government Revenue Dataset', 2018.*[23]

This reflects that with a much higher proportion of people living on low incomes, and a less highly resourced tax system, it is difficult to raise as much from, for example, personal income tax as in higher income countries.

## Principles for multinationals paying tax and its global regulation

Most multinational companies reduce their tax bills by shifting profits around the world through their different subsidiaries in various ways, often via tax havens.

There are a few guiding principles for multinational corporate taxation to balance this tendency to tax minimisation:

1. Corporate income tax – tax on a company's profits – should be paid where the profit is made. There is widespread agreement that profits should be aligned with the location of the underlying, real economic activity (eg employment and sales). In practice, reducing the misalignment of profits and real activity was the single aim of the biggest reform effort for decades, the OECD Base Erosion and Profit Shifting (BEPS) initiative.[24]
2. Under OECD rules, transactions between companies which are part of the same overall multinational company (related parties) must be priced as they would be on the open market – as if the parties to the transaction were unrelated to each other. This is known as the arm's length principle.[25] The Tax Justice Network has argued that the BEPS initiative will be seen as the last great - and failed - defence of arm's length pricing, but for the moment it remains the accepted basis for corporate tax.
3. The process should be increasingly transparent. One useful contribution of OECD BEPS has been the introduction of country by country reporting, which requires multinationals to provide tax authorities with consistent data on the jurisdiction-level location of their economic activity, profits and tax paid. The Tax Justice Network published the first draft of an international accounting standard for country by country reporting in 2003 and has led the global campaign for this data to be made public – an aim which is increasingly the subject of policy discussions.

Most countries set a corporate tax rate and have laws mandating the use of the arm's length principle in transfer pricing (pricing of trades between related companies). They also have laws setting rates of tax – known as withholding tax – levied on funds shifted out of the country by multinational companies to their other subsidiaries.

There is no international regulation of corporate taxation, as such. Instead there are guidelines produced by the Organisation for Economic Co-operation and Development (OECD), which are voluntary but sometimes adopted into national law, and there are the 3,000-plus bilateral legally-binding tax treaties which aim to divide up taxing rights between countries where corporations are resident and those where they invest. These treaties set rates of withholding tax for each treaty partner for different kinds of profit shifting (not always all kinds), and sometimes these rates are different from those in general national laws. The tax treaty network can itself be a source of problems because the less powerful treaty partner often ends up with the worse deal – a trend which has accelerated over the last decade or two.[26]

The OECD provides a commonly used Model Tax Treaty[27] and runs several systems to enable states to exchange tax information on a multilateral basis. In recent years, in the wake of the high political profile of tax avoidance, the OECD ran a global process attempting to improve tax rules resulting in the Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting.[28] This came into force on 1 July 2018. The UN Tax Committee also provides a Model Tax Treaty[29] – with better terms for lower income countries than the OECD model – but the Committee is extremely under-resourced.

In practice the arm's length pricing model presents insurmountable problems: it is often not possible to identify suitable price comparators and, as this report shows, it enables companies to avoid tax. An alternative 'unitary' approach, as has been proposed by the Tax Justice Network and others,[30] requires that the profits of each multinational are assessed at the unit of the global group, rather than of the individual entities within the group. These profits can then be allocated for tax purposes to the various jurisdictions in which the multinational operates, in proportion to the share of economic activity taking place in each – thereby dramatically curtailing profit misalignment.

In some countries (not only traditional 'tax havens') it is not a requirement that accounts are published, and the amount of information included in them is highly variable between countries. For this reason, the information in this report is far from comprehensive. This would be mitigated by greater corporate transparency. Governments should require publication of OECD standard country by country reporting data – that is, information such as profits made, number of employees and tax paid in each country where a multinational operates. Some anonymised data will be published by the OECD towards the end of 2019[31], which represents a big step forward – although it will still not level the playing field of transparency for individual companies.

**Multinational companies and tax avoidance**

By definition, multinational companies operate as business entities in more than one country. This creates opportunities to avoid corporate tax by shifting profits money around the world. This practice is so ubiquitous that it can be regarded as a normal part of business life. Current data suggests global tax losses of US$500 billion each year due to profit shifting by multinational companies.[32] A recent estimate is that 40 per cent of all foreign-earned corporate profits are shifted to tax havens.[33]

Every country has its own rate of corporate taxation and its own laws governing it. However, because multinational companies operate across many countries, the tax they pay needs to be divided between the countries. Because the tax rates and laws differ, there are multiple opportunities for companies to find ways to reduce their tax bills.

To do this, most multinational companies have complex structures with many subsidiaries which may not have employees and really only exist on paper, and whose function may be unclear. Some of these may be set up in tax havens – jurisdictions with some combination of low tax rates, laws that enable some kind of tax avoidance and little transparency. Many tax havens are small (the classic palm-fringed island) but other jurisdictions with some tax haven features are large countries such as the Netherlands and the UK.

Multinational companies move money around the world through their complex subsidiary structures. Sometimes this will be for purely commercial reasons – such as centralisation of a function – and sometimes it will be done purely in order to minimise tax contributions. And sometimes the two things will coincide.

The corporate income tax paid by multinational companies needs to be divided between the jurisdictions where it operates, but the system designed to do this ends up enabling some income to avoid being taxed altogether, a problem known as double non-taxation.

**Tax evasion and tax avoidance**

Tax evasion relies on deliberate fraud to achieve its outcome of paying less tax and is illegal. Tax avoidance is the use of non-fraudulent mechanisms to seek to reduce tax due. Tax avoidance mechanisms can be found to be lawful or unlawful, when a given scheme is investigated by tax authorities and/or tested in court and found not to achieve the claimed effect. In this report, we discuss tax avoidance only. We do not present evidence of tax evasion by any of the companies named.

The companies claim to be essential revenue providers through duties that are actually being paid by consumers – consumers, whose health is damaged with each puff. But in the same breath, major tobacco companies are using a number of methods to shift profits out of lower income countries to reduce their tax payments in those countries and indeed, in some cases, their tax payments overall.

# 3. CORPORATE TAX AVOIDANCE
## HOW COMPANIES MOVE MONEY OUT OF LOWER INCOME COUNTRIES

In this report we focus on one of the largest exporting multinational tobacco companies – British American Tobacco, a global multinational company, with hundreds of subsidiaries in countries all over the world. We focus on BAT not because it is the only tobacco company that avoids tax, but because of its size: it is the only tobacco company to feature in the top 100 of Forbes' Global 2000 list of the world's largest public companies.[34]

BAT is a publicly traded company based in the UK. It sells its products in over 200 markets around the world and has cigarette factories in 42 countries.[35] Its structure includes more than 100 subsidiaries in tax havens. It has a strong presence in Africa and has had recent growth in sales volume and market share in Bangladesh and Indonesia.[36] It controls an estimated 11.8 per cent of the global cigarette market.[37] The company manufactures and sells tobacco products and 'potentially reduced risk new generation products'. It does not own tobacco farms or employ tobacco farmers – but it does buy hundreds of thousands of tons of tobacco each year. Its brands include Pall Mall, Dunhill, Lucky Strike, Kent and Rothmans.[38]

BAT's revenue in 2016 was US$18.2 billion. Its global pre-tax profits were 42 per cent of revenue[39] – and even after paying corporate income tax, net profit was still 32 per cent of revenue.[40] BAT identifies corporate tax as one of six 'key material issues' in respect of its corporate behaviour, and says this:[41]

> "Companies have a moral as well as a legal obligation to pay all taxes due, and to be transparent about what they pay."

BAT is involved in tax disputes in a range of countries.[42] Per BAT's 2018 report, the aggregate potential liabilities include: in Brazil, US$422 million (corporate income tax and social contribution tax, plus interest and penalties, relating to 2004-2012); in the Netherlands, US$1,155 million (tax, interest and penalties relating to challenged intra-group transactions during 2003-2016); in South Africa, US$148 million (tax and interest relating to challenged debt financing, 2006-2010); plus VAT and duty disputes in Bangladesh (US$218 million) and Egypt (US$131 million). Together, the potential liabilities total some US$2.1 billion were all disputes to go against BAT.

**Tax avoidance methods**

There are a host of methods of moving money around the world which reduce the tax paid in lower income countries. Companies can exploit the differences between national laws and the weakness and gaps in global 'regulation' to reduce their tax bills in the countries where they are invested.

The money that is moved via these methods for various types of intracompany payment is deducted before the pre-tax profit figure is reached (except in the case of dividends). Thus, if the payments were not made the funds would remain part of the profits in the lower income country, increasing the profit on which corporate tax is paid.

## 1 Paying yourself royalties, fees and IT charges

Subsidiaries often pay royalties (a kind of user fee) for the use of brands and trademarks, or for the products of research, to the related company owning these pieces of intellectual property, which may be in the multinational's home country, or elsewhere. While these must abide by the arm's length principle, it is clearly next to impossible to assess the market value of an intangible such as a unique brand, which is why many profit shifting schemes and disputes between multinationals and tax authorities revolve around the placing of intellectual property rights in tax havens.

IT charges and recharges are a more recent category of related party payment, and are similar to royalties, for example for the use of software and IT systems. They may also include a component for staff costs.

### The logic behind royalty payments?

Does it make sense – economic sense, not legal sense – for a multinational company to make ongoing payments to other parts of itself for the ongoing use of its own assets? It may do, for example if there has been extensive recent investment in an asset and the payments are genuinely made at market prices. In practice, there is often no such market because the transactions may only occur within a group, and so the scope for manipulation may be high.  It is also unclear what role international branding plays, compared to domestic advertising, in promoting domestic sales. The UK tax authority identifies offshore royalty payments among its risk indicators for profit shifting.[43]

Subsidiaries also often pay technical or management fees: related party payments for services provided by other parts of the company, often centralised or regionalised. As with royalties, it is often unclear how the arm's length price is assessed. Withholding taxes on these fees, as with royalties, are usually lower than corporate tax rates.

### The logic behind management and technical fees?

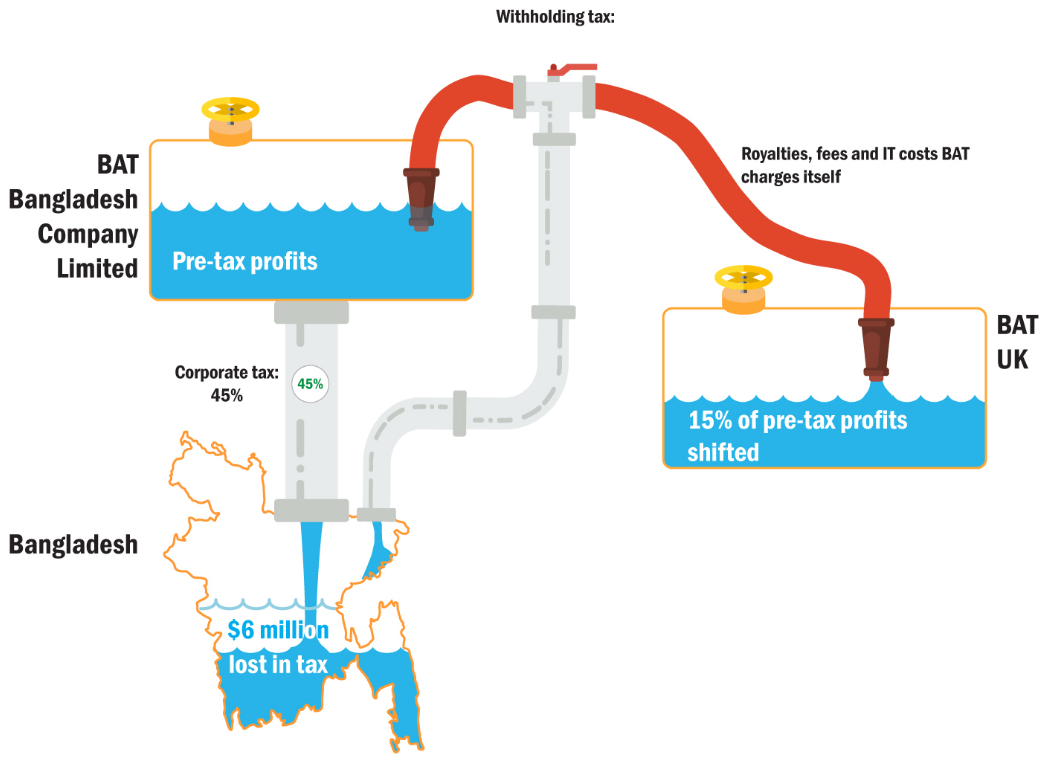
Management and technical services are needed. But economically – not legally – is the profit made from the provision of services in the country where the work takes place, or in the place where the management hub happens to be? The UK's tax authority identifies the payment of significant management or service fees as a key risk indicator for profit shifting.[44]

Furthermore, if multinational companies increasingly sourced managers, IT specialists and technical experts from within their investee countries (often lower income countries), rather than centralising these functions, the companies would contribute more high skilled employment for lower income countries, as well as ensuring more tax revenue for them.[45] Moreover, these costs would usually be much lower, to the benefit of shareholders too.

### An example of royalty, fee and IT charge payments from Bangladesh to the UK

BAT Bangladesh makes payments of all three kinds – royalties, fees and IT charges - to related companies in the UK.[46] From 2014 to 2016, these amounted to an average of US$21 million a year in obligations due from BAT Bangladesh. (Much of this money had not actually been paid by 2016, but presumably will be at some point).[47] The payments were equivalent to nearly 15 per cent of BAT Bangladesh's pre-tax profits.

The corporate tax rate in Bangladesh is 45 per cent, and withholding tax on royalty payments to the UK is a much lower 10 per cent and 20 per cent on fees and IT charges.[48] Assuming the same withholding tax on the other types of payments, Bangladesh will have lost US$5.8 million in tax revenue for 2016.



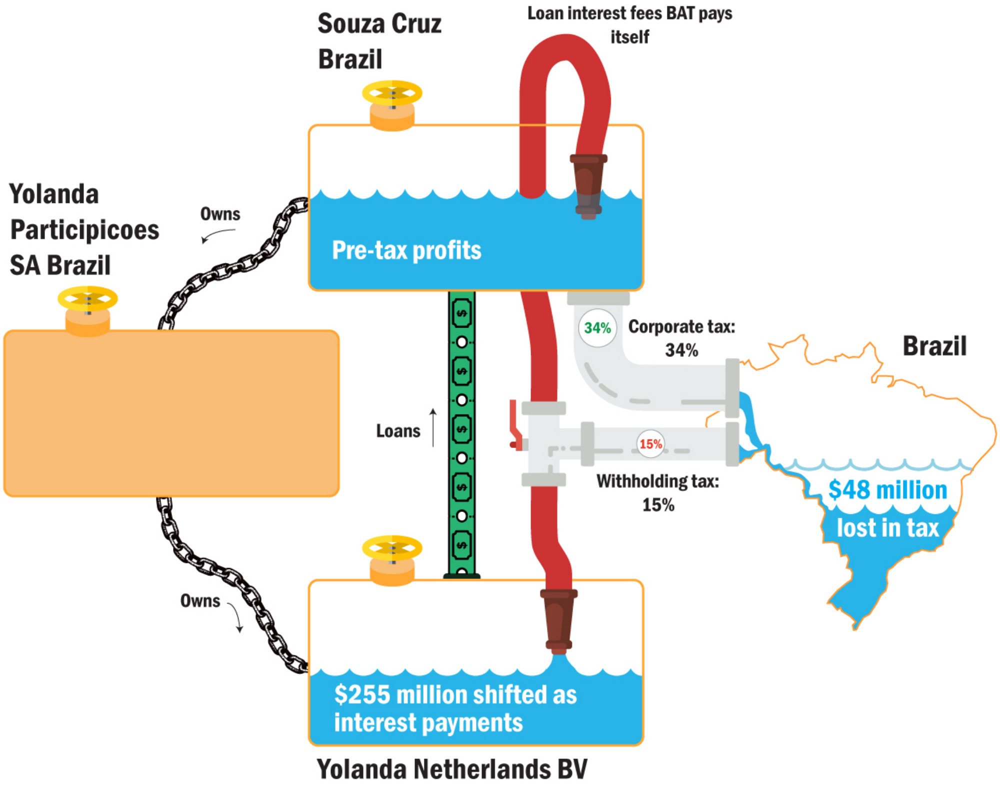

## 2 Lending yourself money

An intracompany loan – between subsidiaries of the same company – typically receives interest, which is paid across borders if the loan comes from an offshore subsidiary. If the withholding tax on the interest is lower than the corporate tax rate in the borrowing subsidiary's country, overall tax revenue there will be lower. Thus, sometimes a loan is made from an offshore subsidiary where this will be the case – perhaps because of a particular tax treaty which reduces withholding tax rates on interest.

Financing can be provided through either loans or through equity issues, although tax rules normally introduce a bias toward loans.

### An example of an intracompany loan from the Netherlands to Brazil

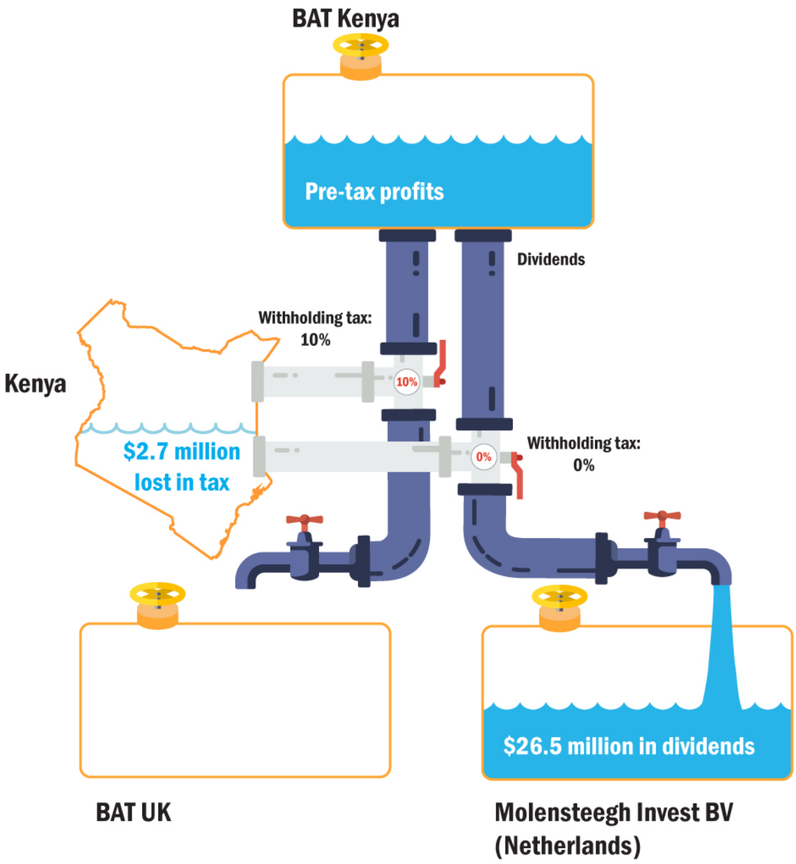
Souza Cruz is BAT's subsidiary in Brazil. Between 2007 and 2014 Souza Cruz financed its exports with loans from its own subsidiary company Yolanda Netherlands BV. In total over the period, Souza Cruz paid US$255 million in interest on these loans.[49] The Brazilian corporate tax rate through the period was 34 per cent, while the withholding tax rate stipulated in the Netherlands-Brazil tax treaty on loan interest was only 15 per cent.[50] The difference between the two rates could have allowed Souza Cruz to pay on average roughly US$6 million a year less in Brazilian taxes over those years.




## 3 Sending profits back home to investors

Dividends are corporate profits paid to investors. When the investors are in a different country (often a multinational company's home country) dividend payments will be made across borders. This is a different type of profit shift from the others, because dividends are paid from post-tax profits. However, withholding taxes are often levied on dividends. The rates at which these can be set are often stipulated in tax treaties. So dividends may be sent via a jurisdiction where withholding tax is low, rather than directly back to the multinational's home country.

BAT has sent US$26.5 million in dividends from Kenya to the Netherlands in 2015 and 2016 [51], rather than directly to the UK. The relevant domestic rate of Kenyan withholding tax is assumed to be 10 per cent[52], and the Netherlands-Kenya treaty, has since 2015 reduced the withholding tax on dividends to zero.[53] This therefore represents a tax loss to Kenya of US$2.7 million a year. However, this arrangement was not set up with the purpose of avoiding the withholding tax on the dividends, since BAT Kenya's dividends have been sent via the Netherlands for many years. This example illustrates the importance of the regulatory environment that surrounds corporate taxation.




## 4 Procurement

Multinational companies' procurement functions are often centralised. This may make business sense, but it also enables profits to be shifted around the world and booked in larger centres rather than investee countries. These centres may often have lower tax rates than the investee countries.

For example, BAT Bangladesh buys and sells tobacco products from BAT GLP Ltd[54], a UK company which 'procures and trades in tobacco leaf and semi-finished tobacco product, as a member of the BAT group'.[55] BAT GLP trades with all four of BAT's global regions, suggesting that it acts as a hub.[56] However, from publicly available information it is not possible to quantify the tax impacts of this centralised procurement.

### Tax in the destination country?

In any of these cases, tax may be paid in the destination country – in which case, revenue is reduced for the investee country but the multinational's overall tax bill may not be reduced. However, sometimes a range of mechanisms mean that little or no tax is paid in the destination country. If it is paid, the corporate tax rate is often lower in the destination country, so less is paid. If it is a tax haven, the tax rate is likely to be low, and it is also likely that the transactions will be opaque, making it challenging to assess exactly what is going on. This issue is explored in more detail in Section 5.

### The bill for the lower income countries

For this report, we looked at countries in which British American Tobacco is invested in Asia (Bangladesh and Indonesia), Africa (Kenya, Uganda and Zambia), and Latin American and the Caribbean (Brazil, Guyana and Trinidad & Tobago). The countries were chosen to ensure geographical spread. They also reflect public availability of financial information, which varies between countries.

The research was done through examination of transactions in the corporate accounts published in the company audited financial reports to shareholders for BAT in the relevant country. The financial reports show where and how profits are shifted to other companies in the same group. The exact steps taken to estimate tax losses are laid out in this report's Appendix.

The financial reports for each country have differing formats and show different information. In some cases, profits are shifted but the available information is not sufficient to allow a calculation of tax losses. For this reason, some of the countries and examples in the detailed country case studies in the appendix are not featured in the table below. Thus, the total in the table below is likely to be an underestimate.

In some countries (not only tax havens), companies are not required to publish their audited financial reports to shareholders, and even where audited accounts are published the amount of information included in them varies between countries. For this reason the information in this report is far from comprehensive.

The estimates are based on different years, in some cases reflecting the availability of information and in others the timing and duration of the transactions. Their basis also differs in nature, hence there are different caveats for each example. Nevertheless, the examples taken together provide a rough estimate of the widespread nature and scale of these tax practices for British American Tobacco. Just for these countries, and just for one company, the estimated tax loss reached a total of US$58 million per year.

*Payments leaving the lower income countries and the estimated tax losses that result*[57]

| | **Type of profit shift** | **Profit shift amount per year**<br>**US$ million** | **Estimated tax loss per year**<br>**US$ million** | **Years** | **Notes (where applicable)** |
|---|---|---|---|---|---|
| Bangladesh | Royalties, fees and IT charges | 21 | 5.8 | 2014-2016 (tax loss for 2016) | Some payments accrued in the accounts but not yet made |
| Indonesia | Loan interest | 54.7 | 11 | 2013-2015 | Payments uneven between different years and some made later |
| | Royalties, fees and IT charges | 19.7 | 2.7 | 2010-2016 | *Potential* loss - offset against future profits |
| Brazil | Profits booked in Madeira | 78.3 | 27 | 2009-2011 | |
| | Loan interest | 31.9 | 6 | 2007-2014 | |
| Guyana | Royalties, fees and IT charges | 3.4 | 1.1 | 2009-2012 | Assumption that related party payments made to the UK |
| Trinidad and Tobago | Royalties, fees and IT charges | 12.6 | 1.9 | 2010-2017 | Assumption that related party payments made to the UK |
| Kenya | Dividends | 26.5 | 2.7 | 2015-2016 | Relevant treaty came into force in 2015 and arrangement pre-dates this, so not *motivated* by avoiding this tax. BAT says that according to its sources, the Kenya/ Netherlands Double Tax Agreement treaty does not yet apply. |
| **Total** | | | **58.2 million** | | |

### The human and economic costs of smoking

A staggering 5.4 trillion cigarettes were sold in 2016. Between 2003 and 2017, cigarette volume sales decreased by 1.3 per cent - although real retail values increased by 26.5 per cent. However, while cigarette consumption is declining in high income countries, it is growing in lower income countries. About 80 per cent of the world's smokers live in low and middle income countries, and the tobacco industry is increasingly targeting these markets.[58]

In the countries we have looked at for this report, smoking levels are high, particularly among men in the Asian countries: 76 per cent of Indonesian men, and 40 per cent of Bangladeshi men smoke.[59] Around a quarter of male Bangladeshi deaths, and over a fifth of Indonesian male deaths, are attributed to smoking.[60] The associated economic costs – both the direct costs of healthcare and the indirect costs of lost productivity – are high. Clearly, the damage caused by smoking is an important component holding back human and economic development.

| | **% men over 15 using tobacco daily %** | **% women over 15 using tobacco daily** | **% deaths caused by tobacco - men** | **%** | **Estimated economic cost of smoking - (direct health costs and lost productivity due to early mortality and morbidity)** |
|---|---|---|---|---|---|
| Bangladesh | 39.8 | 0.7 | 25.5 | 9.7 | 158578 million taka (US$1.8 billion) |
| Indonesia | 76.2 | 3.5 | 21.4 | 7 | 639173131 million rupiah (US$42 billion) |
| Brazil | 19.3 | 11.3 | 12.4 | 10.5 | 73031 million real (US$19.7 billion) |
| Guyana | 17.4 | 2.3 | 11.4 | 4.7 | 3409 million dollar (US$15 million) |
| Trinidad and Tobago | 26.1 | 5.8 | 12.4 | 4.5 | 1858 million dollar (US$0.3 billion) |
| Kenya | 24.6 | 2.1 | 4.2 | 1.6 | 2978 million shilling (US$29 million) |
| Uganda | 16.4 | 2.9 | 4.3 | 2.6 | N/A |
| Zambia | 26.5 | 4.6 | 6.6 | 3.6 | N/A |

*Source: tobaccoatlas.org (accessed 20 October 2018). Exchange rates using [https://oanda.com/currency/converter/](https://oanda.com/currency/converter/) on 20 October 2018*

### Corporate tax and the costs of smoking

While the multinational tobacco companies are highly profitable, as we have seen in this report, the amounts of profit generated and the corporate income tax paid on them is relatively small in comparison with the scale of the economic damage caused by smoking. For example, in 2016 BAT Bangladesh made a net profit of around 7.6 billion BDT[61] (US$88.9 million) – much less than the estimated 158 billion BDT (US$1.9 billion) of economic damage caused by smoking. Yet, even though the corporate income tax they pay is a relatively small potential recompense, the companies still avoid making the full corporate income tax contribution that would be expected. Rather, they should pay a higher distribution from profit towards mitigating the damage.

### Contributing to the Sustainable Development Goals

As of 2015, the global community – centring on the UN - has adopted a comprehensive framework to guide sustainable development, known as the Sustainable Development Goals or SDGs. These 17 goals set aspirational targets for the year 2030 in many areas of development, and provide a framework for action and accountability for all the world's countries. Goal number 3 focuses on health and states an aspiration to "ensure healthy lives and promote well-being for all at all ages." One of the indicators under the goal is to reduce the prevalence of tobacco use.[62] The overall cost of implementing this goal is estimated at an average annual US$69-89 billion in new public investment in low- and lower middle income countries.[63]

Just for the few countries and the one company we have studied, the estimated tax loss in a year is US$58 million. Between now (2018) and 2030, a tax loss each year of this size would mean an estimated US$700 million less in public finance for these countries to spend on work towards the health SDG (not allowing for inflation). By avoiding taxes in lower income countries, the multinational tobacco companies are effectively undermining efforts to mitigate the human and economic damage that their products cause. It's a small proportion of the costs of smoking, but still big enough to be worth governments asking the companies to pay their fair share.

# 5. TAX AVOIDANCE IN THE DESTINATION COUNTRIES?

So far, we have looked at how companies arrange their tax affairs to reduce the tax paid in lower income countries. This in itself merits examination, because lower income countries are the current growth areas for cigarettes for multinational tobacco companies, and also where tax revenue is most needed to mitigate the negative health impacts of smoking. Furthermore, as we saw in Section 1, taxation should be aligned with the location of economic activity.

However, it is also relevant to ask what tax is paid in the shifted profits' destination country. It is likely to be less – perhaps much less – than would have been paid in the source country, as this provides one of the incentives for the profit shifting to happen, allowing the company to reduce its overall global tax bill, as well as its bill in the lower income countries where it operates.

Looking at this also allows us to discern the global patterns of profit shifting favoured by a company.

**How much corporate tax does BAT pay globally?**

Globally, BAT has paid tax on its profits at an average cash tax rate of just under 26 per cent in the decade from 2007 to 2016.[64] This rate is not particularly low by global standards. It does not mean that BAT is not avoiding tax, however. The headline corporate income tax rates in some of BAT's key markets are considerably higher than this. This suggests that BAT may be paying a rate of tax in some of these key markets which is much lower than the headline rates, although it is not possible to confirm this without a country by country breakdown of BAT's profits and tax payments, which the company does not publish.

Like many other multinationals, BAT has been paying steadily less tax on its profits. Its average tax rate in the decade to 2016 (26 per cent) compares to an average of 37 per cent in the previous decade.[65] This falling tax rate reflects the trend for countries around the world to cut their tax rates in an attempt to lure investment away from each other: the widely recognised "race to the bottom."

BAT states that its tax strategy is, while complying with all laws in countries where it operates, to be open and transparent with tax authorities and to use arm's length pricing, to "support the business strategy of the Group by undertaking efficient management of our tax affairs in line with the Group's commercial activity" and "engage in proactive discussion with tax authorities on occasions or differing legal interpretation."[66] Tax is not mentioned in the pages of BAT's Annual Report 2017 that deal with corporate social responsibility. It is mentioned as one of five or six risk factors for the company – in relation to excise duty increases and to unfavourable tax rulings.

In 2017 BAT acquired Reynolds American Incorporated, a significant acquisition which altered its overall global tax position.[67]

**Tax in the destination countries**

BAT has a complex group structure with hundreds of subsidiaries in dozens of countries. Billions of dollars flow between these companies each year in the normal course of its business. The company is not required to publish very specific information about most of these transactions. As a result, it is hard to see from the outside how BAT's tax affairs are run. However, there are strong indications that BAT may be using financial engineering to avoid some taxes in the group as a whole.

One indication is that in 2015 BAT had more than a hundred offshore subsidiaries in 19 tax havens. For example, it had 37 subsidiaries in the Netherlands, a favoured tax haven for multinationals. Most of these are holding companies which own investments in other countries. There were also 12 companies in the British tax haven of Jersey.[68] Some of BAT's tax practices appear to have been too aggressive for Dutch tax officials, who have demanded an extra €235 million in tax for the years from 2008 to 2013 in respect of "a number of intra-group transactions, including guarantee and factoring fees, loan interest and product pricing". BAT is contesting the claim and says that it believes it has a strong case in law.[69]

British American Tobacco's home and headquarters is in the UK and it has many subsidiaries there. The UK's corporate income tax rate is 19 per cent[70] –lower than any of the lower income countries where BAT has subsidiaries that we have looked at in this report. This alone provides a tax-related incentive to shift profits to the UK. Yet the accounts of the group's parent company, BAT plc, show that it pays almost no corporate income tax in the UK, and paid none at all between 2011 and 2014.[71]

BAT's major income stream is dividends paid by its subsidiaries around the world. The UK has not taxed foreign dividends since 2009, in order to make overseas investment by its corporations more "competitive", so BAT does not have to pay UK tax on this form of income. Where dividends are received in other countries, some tax may be paid on them there.

In addition to foreign dividends, however, BAT's companies in the UK also receive hundreds of millions of dollars a year in royalties, fees and charges from subsidiaries, including those looked at in this report. Payments featured in this report are made to BAT (Holdings) Ltd, BAT Investments Ltd and British American Shared Services (GSD) Ltd – which are among BAT's many UK companies.

**The scale of BAT's income shifting through royalties, fees and charges**

Global payments to BAT (Holdings) Ltd, one of the main holding companies and the principal group head office operating company, were, in 2016, £325 million (US$400 million) in royalties, £214 million (US$263 million) in technical and advisory fees and IT recharges of £226 million (US$278 million) – a total of £765 million (US$941 million).[72] BAT's global pre-tax profits in that year were £6245 million (US$7682 million).[73] So income shifted from around the world to BAT Holdings alone, using just one method, constituted 12.3 per cent of pre-tax profits - nearly one in eight of every pound BAT makes. This picture was similar in 2015, when the total of royalty, fee and IT recharge payments to BAT was £668 million (US$990 million) and global pre-tax profits were £5855 million (US$8679 million): in this year, income equivalent to 11.4 per cent of pre-tax profits was shifted to BAT Holdings.

These types of payments are more problematic from the point of view of tax avoidance because they are deductible from taxable profits in the countries of the subsidiaries, and if BAT can also avoid tax on them in the UK then it has an incentive to extract as much as it can.

Some of the income that flows into the UK is offset by the costs of BAT's staff, buildings and other assets of the group headquarters. But large sums – running to hundreds of millions of dollars a year – are booked to "other operating charges"[74] which are not further explained in the accounts, and whose nature is therefore not possible to explain. Overall, BAT's intra-group dealings in the UK are complex and opaque. BAT stated that: "The charges referred to include costs for services provided within the Group which are calculated on an arm's length basis. These are mostly provided from UK companies."[75]

It is reasonable to be concerned that BAT may be avoiding tax in countries where these fees originate (though some withholding tax may be paid as the money leaves these countries) and not paying tax on them in the UK either. The process by which this occurs is opaque – and opacity is one of the hallmarks of a tax haven. In this regard, the UK's rules allow it to be used like a tax haven.

Another method of shifting profits is via procurement from related parties. BAT appears to have centralised some of its procurement on a UK company called British American Tobacco GLP Limited ('GLP' stands for "Global Leaf Processing").[76] This company makes substantial profits by buying tobacco from BAT subsidiaries around the world and selling it to other subsidiaries at a mark-up. This profit is barely taxed because of 'group relief', meaning that profit is offset against losses elsewhere in the group.[77] Where these losses arise is unclear.

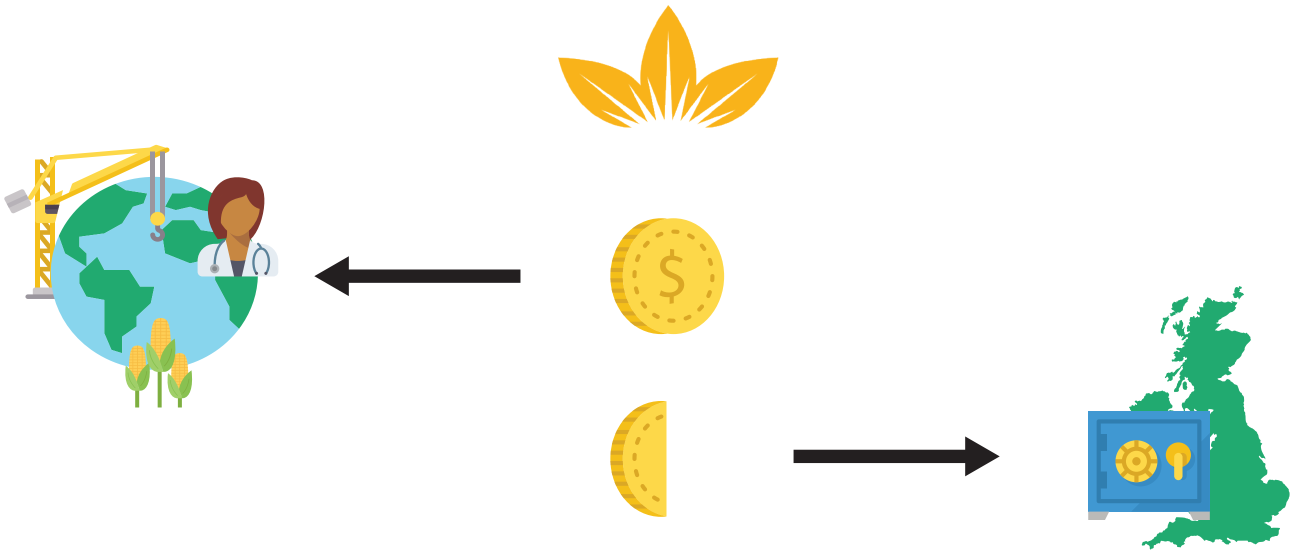
There are borrowing and lending arrangements within the BAT group. Tens of billions of dollars move around between the subsidiaries of BAT as loans and interest payments, and money can be lent out by the group to its own subsidiaries at a profit, in such a way that the profit ends up in a tax haven – and this is allowed by the arm's length principle. For example, profits of BAT's Dutch subsidiary Yolanda Netherlands, which received interest on BAT's Brazilian loan, was taxed in the Netherlands at an average of just 2.32 per cent.[78]

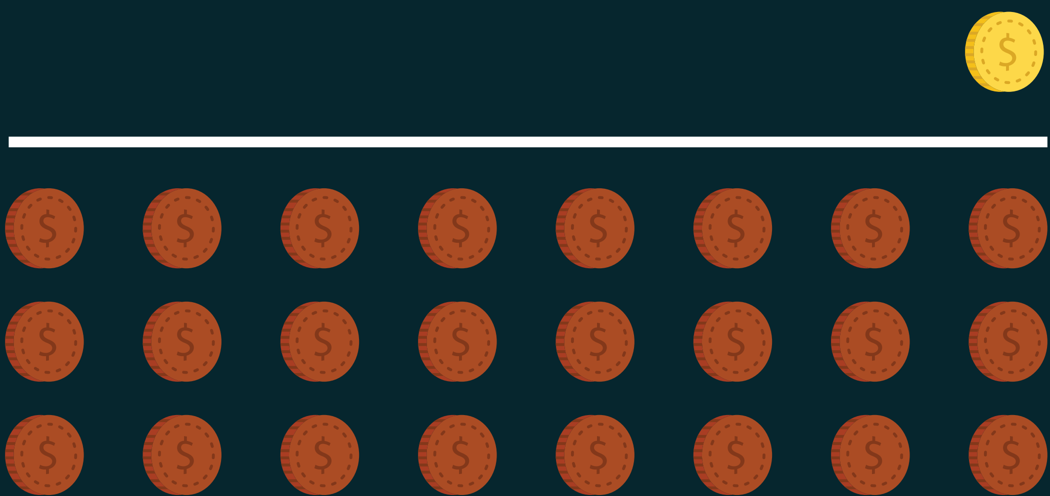
**BAT response to this report**

We shared the report with BAT and asked for their response. They told us that the group fully complies with all applicable tax legislation where it does business, and is a significant tax contributor to governments worldwide; and that all the transactions highlighted within the report fully comply with relevant tax legislation and have been transacted on an arm's length basis. They state that the transactions of group companies are frequently subject to detailed external scrutiny. (BAT statements with further detail are included in the relevant country sections of the Appendix.)

BAT also dispute our characterisation of the UK and the Netherlands as offering tax haven conditions. They state that there are genuine costs associated with the intra-group services provided by the UK companies, and therefore that the tax loss identified by the report simply does not arise. BAT denies that their intra-group UK transactions are opaque, saying that UK legislation requires the appropriate recharge of employment costs between the group's different UK entities, and therefore the group did not comment further on this. Overall, "the Group does not accept that there is any avoidance or loss of tax to the countries concerned in the manner contended by the report."

For every dollar BAT paid in tax globally, BAT shifted over half a dollar that would have been taxed locally in the countries where it operates into a London office where it paid almost no corporate income tax.





For every dollar Bangladesh raised in income tax from BAT

Bangladesh lost 24 dollars in economic damage caused by smoking

# 6. CONCLUSIONS AND RECOMMENDATIONS

The deadly health impacts of tobacco are now so well known that tobacco companies justify their business in a range of ways. One of these is the tax revenue they contribute to lower income countries. These countries certainly need tax revenue – not least to fund mitigation of the health impacts of smoking.

Yet, far from maximising this, British American Tobacco is reducing its tax contribution by shifting its profits out of lower income countries using a range of methods. The companies use their complex structures, their tax haven subsidiaries and their multinational nature to move money around the world and contribute less tax revenue in lower income countries.

These practices are not particularly extreme – quite the opposite, they are one of an infinite number of variations on normal business practice. And this is the point. This report provides an exposition of the kinds of techniques that virtually all multinational companies use. Multinational tobacco companies are profitable yet they impose massive public health costs on lower income countries. The least they should do is make a fair tax contribution in these countries.

If this practice continues, just the few countries studied in this report will lose nearly US$700 million in revenue between now (2018) and 2030 – the date by which the world aspires to achieve the Sustainable Development Goals. One of these is "to ensure healthy lives and promote wellbeing for all at all ages."

To make this happen, we need concerted international action – firstly, to increase transparency of multinational tobacco companies' activities and, secondly, to redress the balance of global tax treaties in favour of lower income countries. Increasing transparency would allow citizens to pinpoint tobacco companies' tax affairs in more depth and detail than is currently possible, increasing pressure on companies to shift fewer profits around the world. Tax treaties more favourable to lower income countries would mean these countries could increase the amount of tax due to them even if profits are shifted. However, this will take some time. Individual governments can also act unilaterally, requiring increased transparency, reviewing treaties and scrutinising and regulating companies' activities. This last point would help to prevent companies from avoiding tax in the first place.

Governments must take action immediately to stem the flow of much-needed funds from their countries by an industry already exacting a heavy toll in terms of lives lost to tobacco use.

# Recommendations

### Governments

- Prioritise regulation and administration that enables the maximisation of corporate tax revenue from tobacco companies (to be spent on essential public services)
- Ensure public accountability of tobacco companies by requiring publication of country by country reporting alongside company accounts – a measure which has been shown to cut tax avoidance immediately and also provides insights into where tax authorities should challenge abuse
- Closely scrutinise the tax affairs of tobacco companies, to reduce or eliminate profit shifting, with particular attention to crossborder related party royalty fees and IT recharge payments, financing, routing of dividend payments and procurement
- Review and renegotiate tax treaties that are excessively disadvantageous to lower income countries
- Assess the overall level of tobacco related revenues, and the share that is accounted for by spending to reduce health and other costs of tobacco consumption

### International community

- Require multilaterally the publication of multinational companies' country by country reporting to ensure accountability for mechanisms that shift taxable profits away from the location of real economic activity
- Support tax treaty standards more beneficial to lower income countries.

## Methodology

### Country selection

We looked at countries in which British American Tobacco is invested in Asia (Bangladesh and Indonesia), Africa (Kenya, Uganda and Zambia) and Latin American and the Caribbean (Brazil, Guyana and Trinidad & Tobago). The countries were chosen to ensure geographical spread. They also reflect public availability of financial information, which is highly variable between countries.

### Information sources

The research was done through examination of transactions in the corporate accounts published in the company audited financial reports to shareholders for BAT in the relevant countries (in some of the following we refer to these as 'the accounts' for brevity). The financial reports show where and how profits are shifted to other companies in the same group.

Exchange rates are taken from O and A Currency Converter[79], for the end of the relevant year or years, unless otherwise stated.

Estimation of revenue losses due to profit shifting

The tax losses were estimated as follows. The steps vary slightly for the different tax avoidance methods but are always similar to the following.

### Step 1 – what funds were shifted out of the countries?

The volume of profits shifted was found from company audited financial reports to shareholders of the company in the relevant country or countries. The accounts were also examined to look for any factors complicating the situation – where this is the case it is stated in the text. In some cases, the destination of the funds, or detail of the nature of the payments has needed to be assumed, based on the information that is given. Where this is the case it is stated.

### Step 2 – what corporate tax would have been due on the funds?

The statutory corporate tax rate was applied to the funded shifted.

### Step 3 – what is the estimated withholding tax that would have been due on the funds?

The withholding tax on the type of profit shift was estimated from the treaty between the source and destination country, the laws of the source country or (in a few cases) the accounts. In some cases, the withholding tax paid, or lack of it, needs to be assumed, based on surrounding evidence.

### Step 4 – what is the estimated tax loss to the country?

The revenue lost was estimated, based on the difference between the expected revenue on the volume of profits shifted at the statutory corporate tax rate and the expected revenue from withholding tax on the same volume of profits.

An assumption was made that, had the profit shift not occurred, these funds would not have been spent on the purpose within the source country.

**Limitations of research**

The financial reports for each country are in a different format and show different information. In some cases, profits are shifted but the available information is not sufficient to allow a calculation of tax losses. For this reason, some of the countries and examples in the detailed country case studies in the appendix are not featured. Thus, the total is likely to be an underestimate.

In some countries (not only tax havens) it is not a requirement that company audited financial reports to shareholders are published, and where they are, the amount of information included in them is varies between countries. For this reason, the information in this report is far from comprehensive.

The estimates are based on different years, in some cases reflecting the availability of information and in others the timing and duration of the transactions. Their basis also differs in nature, and so there are different caveats for each example. Nevertheless, the examples taken together provide a rough estimate of the widespread nature and scale of these tax practices for these multinational tobacco companies. Just for these countries, and just for one tobacco company, the estimated tax loss reaches a total of US$58 million per year.

# Asia

## Bangladesh

### Summary

From 2014 to 2016 BAT Bangladesh shifted some profits by paying royalties, fees, and IT charges to related companies in the UK. In this way, the company in 2016 reduced its Bangladeshi tax bill by an estimated US$5.8 million.

### BAT in Bangladesh

There are two major tobacco companies in Bangladesh[80], one being British American Tobacco Bangladesh, which has been in the country since 1910. BAT Bangladesh makes and sells cigarettes, and is 72.9 per cent owned by the British American Tobacco Group.[81]

Bangladesh is the second largest market of BAT in the world.

Tobacco companies have a statutory corporate tax rate of 45 per cent in Bangladesh[82], which was brought into force in 2016. Other listed companies enjoy a lower rate. BAT Bangladesh claimed in 2016 that its 45 per cent tax rate was "arbitrary" and "unjustified from the shareholders' point of view."[83] It describes itself as the "largest taxpayer in the country" – including in this the indirect taxes (VAT and excise duty) that it pays.[84] It complains that government taxation policies 'negatively impact not only BATB but also government revenue earning capacity from the industry' and wants the government to "reinstate investment-friendly corporate tax rate structures.” [85]

After paying excise and value added taxes and corporate income tax, BAT’s net profit margin in 2016 was 17.3 per cent.[86]

**BAT and tax avoidance in Bangladesh**

**Royalties, fees and charges**

**Step 1 – what funds due to be shifted out of Bangladesh?**

BAT Bangladesh’s payments due to related companies in the UK from 2014 to 2016 have included:

- Royalties of just over US$5 million a year to British American Tobacco (Holdings) Limited
- Technical and advisory fees of US$10-12 million a year to BAT Investments Limited
- More than US$5 million a year of payments for IT services to BASS GSD Limited.[87]

These three types of payment amounted to approximately US$21 million a year in obligations due from BAT Bangladesh to other BAT companies in the UK. (Much of this money had not actually been paid by 2016 but will be paid at some time in the future).[88];[89]

These payment obligations are equivalent to, on average, 14.8 per cent of BAT Bangladesh’s pre-tax profits over the three years.

**Step 2 – what corporate tax would have been paid on these funds?[90]**

The Bangladeshi corporate tax rate of 45 per cent in 2016 (for tobacco companies) on US$21 million would have yielded around US$9.5 million in each year, on average.

**Step 3 – what is the withholding tax on the payments?**

Royalty payments incur a withholding tax of 10 per cent under the Bangladesh-UK tax treaty.[91] According to BAT, technical and advisory fees and IT charges incur Bangladesh’s domestic withholding tax at a rate of 20 per cent.

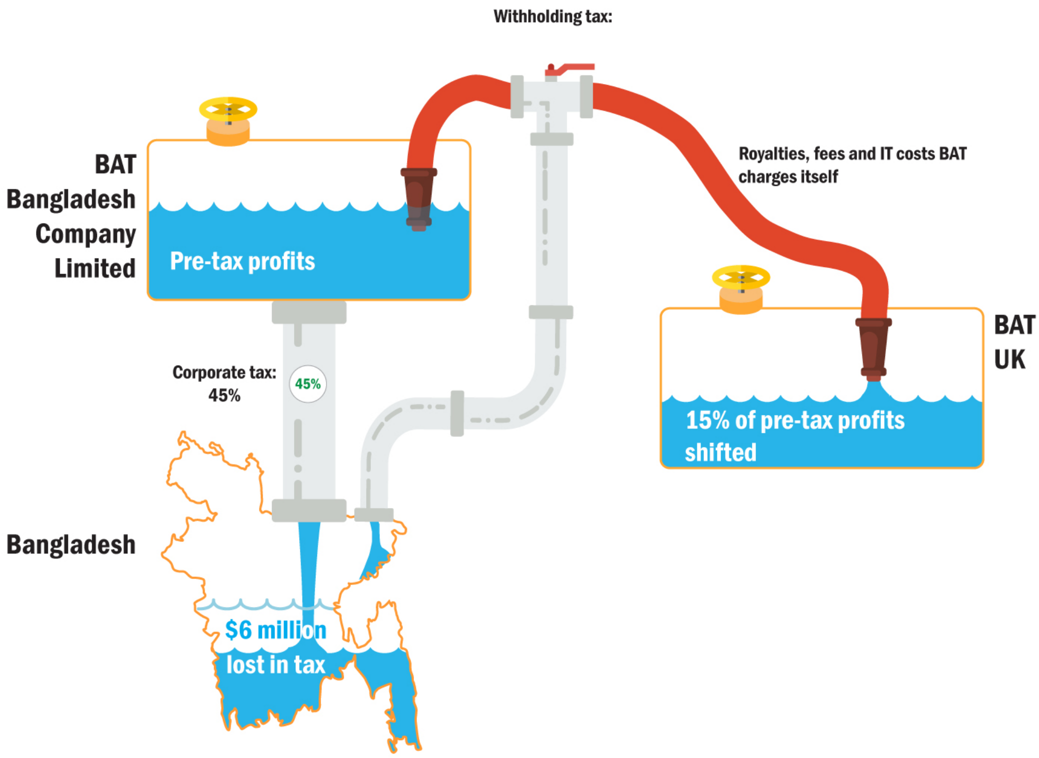
Therefore, in 2016, withholding tax on royalties at 10 per cent would have been US$0.6 million. Withholding tax on fees at 20 per cent would have been US$2.1 million. And withholding tax on IT charges at 20 per cent would have been US$1 million. So the total withholding tax due would have amounted to US$3.7 million.

**Step 4 – what is the estimated lost tax revenue to Bangladesh?**

Subtracting the US$3.7 million in withholding tax due from the lost US$9.5 million in corporate tax revenue gives US$5.8 million – the estimated lost revenue to Bangladesh in 2016.

*Tax on royalties, fees and IT recharges payable by BAT Bangladesh, 2016*[92]

| | 2016 US$ | Withholding tax payable | Corporate tax payable (45%) | Difference |
|---|---|---|---|---|
| Royalties | 5,529,058 | 552,906 (10%) | 2,488,076 | 1,935,170 |
| Fees | 10,403,249 | 2,080,650 (20%) | 4,681,462 | 2,600,812 |
| IT services | 5,110,602 | 1,022,120 (20%) | 2,299,770 | 1,277,650 |
| **Total** | **21,042,908** | **3,655,676** | **9,469,308** | **5,813,632** |




**BAT response:** "As a listed company BAT Bangladesh is also regulated by the Bangladesh Securities and Exchange Commission Act. The local Board of directors are required to approve all royalties and T&A fees before these can be remitted.  Post Board approval, invoices and detailed calculations are provided to the Central Bank for review and approval and on top of this, before remittance an application is made to Bangladesh Investment Development Authority (BIDA) for approval."

## Indonesia

### Summary

In total, Indonesia may lose nearly US$14 million in revenue per year as a result of BAT's tax avoidance, as a result of loan interest payments (2013-2015) and royalty, fee and IT charge payments (2010-2016). (Because BAT's company in Indonesia has made losses in recent years, some of these actual revenue losses may occur in the future, rather than being current.)

### British American Tobacco in Indonesia

British American Tobacco's main subsidiary in Indonesia is PT Bentoel Internasional Investama, which owns a number of cigarette production and distribution companies in the country. Bentoel is a longstanding Indonesian cigarette company, which BAT bought in 2009. It is owned (92.5 per cent) by British American Tobacco (2009 PCA) Ltd in the UK. Its market share in Indonesia is 7 per cent. [93]

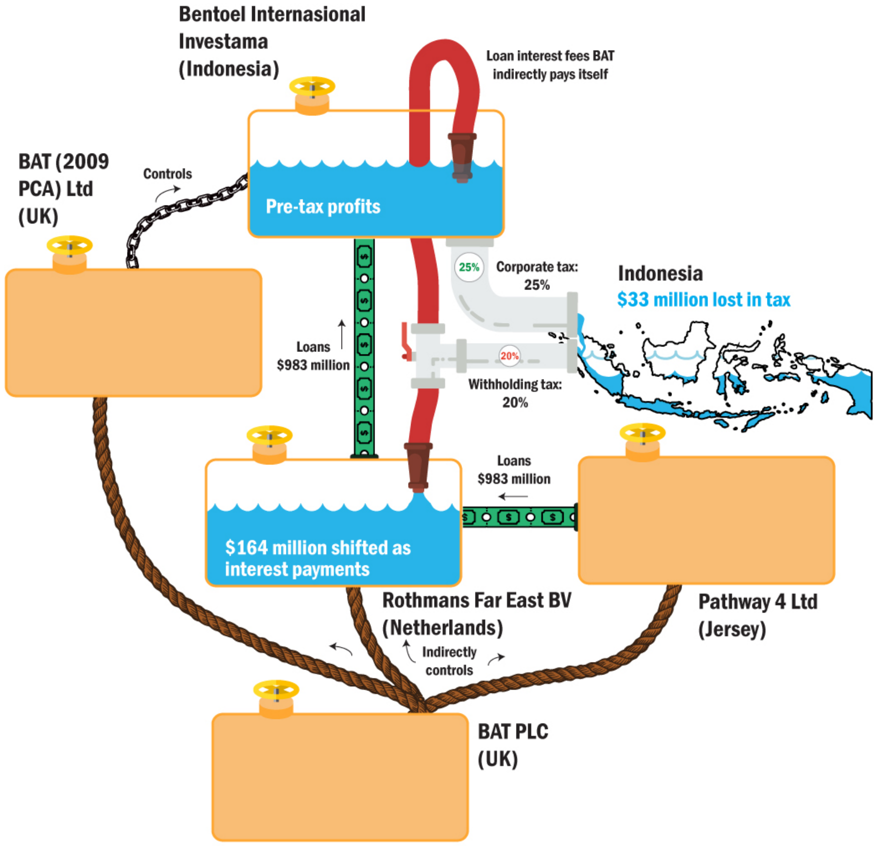
Bentoel has been troubled: it made a loss each year since 2012 and has paid minimal or no dividends since 2011. Because of these recorded losses it has paid little corporate tax.[94]

### BAT and tax avoidance in Indonesia

British American Tobacco appears to have shifted some of its earnings out of Indonesia in two ways. The first and larger method was an intra-company loan between 2013 and 2015. The smaller was via payments back home to Britain for royalties, fees and services.

Because Bentoel was loss-making, the losses – which were much larger than they would have been without the profit shifts – may end up being offset against tax on future profits. So some of the revenue losses to Indonesia may occur in the future, if or when Bentoel goes back into profit, rather than being current.

## The loan




Bentoel borrowed heavily between 2013 and 2015 from a related company in the Netherlands, Rothmans Far East BV, to refinance its bank debt and pay for machinery and equipment. The interest payments on the loan were deductible from the company's taxable income in Indonesia.

Rothmans Far East BV provides financing to several BAT subsidiaries and is also involved in marketing cigarettes in Japan and Korea. Rothmans Far East is not purely a paper company, but is very small in terms of employment: it has employed three people outside the Netherlands and some of its work is done by staff at other BAT companies.[95]

The loan facility was Rp 5.3 trillion[96] (US$434 million[97]) in August 2013 and another Rp 6.7 trillion (US$549 million) in 2015.[98]

The Dutch company's accounts show that the funds lent to Bentoel came from another BAT group company, Pathway 4 (Jersey) Limited, which is based in the British tax haven of Jersey. The loan from Jersey to the Netherlands was denominated in Indonesian rupiah, making it clear that the money was intended to be lent on to Bentoel.[99]

**How much revenue did Indonesia lose as a result of the loan?**

**Step 1 – what funds were shifted out of Indonesia?**

Bentoel paid a total of Rp 2.25 trillion (US$164 million) in interest on the loan.[100] This interest would have been deductible from its taxable income in Indonesia. Broken down, the interest payments were as follows[101]:

| 2016 | 2015 | 2014 | 2013 | Total |
|---|---|---|---|---|
| US$45.8m | US$68.8 | US$43.0m | US$6.3 m | US$163.9 |

The loan was so large that the interest payments were a significant burden on Bentoel's earnings. The company acknowledged this in its 2016 annual report, saying that its net losses increased by 27.3 per cent that year, despite losing less money on its operations than in the previous year. This was partly because of "interest expenses relating to inter-company loans, which were subsequently paid off later in the year."[102]

**Step 2 – what is the withholding tax on these payments?**

The Indonesia-Netherlands tax treaty, which was signed in 2002, did not empower Indonesia to charge any withholding tax on interest payments paid on long-term loans from the Netherlands.[103] Indonesia normally applies a domestic withholding tax of 20 per cent on interest payments to non-residents.[104] There is no tax treaty between Indonesia and Jersey (where the BAT loan originated), meaning that the higher Indonesian rate of 20 per cent rate would have applied.[105]

Withholding tax of 20 per cent on US$164 million is US$33 million, or an average of US$11 million per year.

**Step 3 – what is the revenue loss to Indonesia?**

This US$11 million per year is also the revenue loss to Indonesia. (It should be noted that the payments were not equal in different years and some were paid later).

Furthermore, Indonesia has tax treaties with several other countries – including the UK - which set the rate of withholding tax on interest at 10 per cent.[106] So even if the Dutch tax treaty had not been available, BAT could have routed the loan via one of these countries: in this case, the tax foregone by Indonesia would have been just under US$17 million over the period of the loan. This illustrates the problem of competing tax treaties: if one is reformed, companies may be able to use another to reduce withholding taxes instead.

## Other questions arising

### Why was the loan routed via the Netherlands?

Given that the loan funds originated in Jersey, there is no obvious reason for the loans to Bentoel to have been routed via the Netherlands, other than to take advantage of the Indonesia-Netherlands tax treaty and thus avoid withholding tax. Because the treaty cancels out Indonesia's withholding tax on interest, it has been common both for foreign investors in Indonesia and Indonesian conglomerates borrowing on the international market to route loans via holding companies in the Netherlands, even if they have no substantial operations there.

### What will happen in future?

The Dutch-Indonesian tax treaty was revised in 2015, and the revised treaty empowers Indonesia to charge a withholding tax of 5 per cent on interest. This new provision came into effect in October 2017, meaning that some of the previous tax advantage of loans such as Bentoel's being routed via the Netherlands has disappeared.[107]

### Why did BAT charge interest to Bentoel at all?

It is clear that Bentoel genuinely needed finance during the period we are looking at, but this does not explain why the finance could not have been provided by BAT in the form of equity or interest-free loans, either of which would have had less effect on Bentoel's income.

The loans were made interest-free at the end of 2015, then paid off altogether in mid-2016, although Bentoel continued to pay interest in 2016, presumably on the previous year. At this point, Bentoel issued shares – in fact, the proceeds of the share issue paid off the loan.

The new shares appear to have been bought entirely or mostly by BAT itself, whose shareholding in Bentoel rose to 92.48 per cent after the rights issue, compared to 85.55 per cent at the end of 2015. The holding of the other major shareholder, the Swiss bank UBS, shrank to 7.29 per cent from 13.41 per cent. The holdings of the Indonesian public almost vanished to 0.23 per cent from 1.04 per cent.[108] This implies that other investors were not keen to buy Bentoel's shares, which would not be surprising, given that the company had been making losses for several years.

In effect, BAT injected equity into Bentoel in order to pay off Bentoel's loan to BAT itself. This raises the question: why did BAT provide capital to Bentoel in the form of expensive interest-bearing loans, at a time when Bentoel was already losing money? BAT could have provided the funds in the form of an interest-free loan, as it did from the end of 2015 onwards, or in the form of equity as it did in mid-2016.

When asked, BAT said "The financing provided to Indonesia to meet the requirements of the commercial business was provided on arm's length terms. The nature of the financing provided on an arm's length basis would take into consideration the underlying performance of the business. Indonesia is a challenging commercial market and the changes made to the financing appropriately reflects this fact."[109] What this actually shows, however, is BAT using the arm's length principle to charge one of its subsidiaries far more for credit than the BAT Group would have had to pay for the same credit. BAT has not explained why it foisted this expensive loan on Bentoel when it had other options which would have had less effect on Bentoel's finances. Nor did BAT explain why it changed its mind at the end of 2015 and removed the interest burden from Bentoel.

If Bentoel had not had to pay out US$164 million in interest, these funds would have added to its income in Indonesia. This would not have immediately increased Indonesia's tax revenue, since Bentoel was not making any profits. But it would have reduced the amount of losses which Bentoel could carry forward and use to reduce tax payments on its profits in future. The potential tax loss to Indonesia from this perspective can be calculated by applying the corporate tax rate of 25 per cent to the US$164 million of interest payments, which gives US$41 million, or an average of US$13.7 million a year.

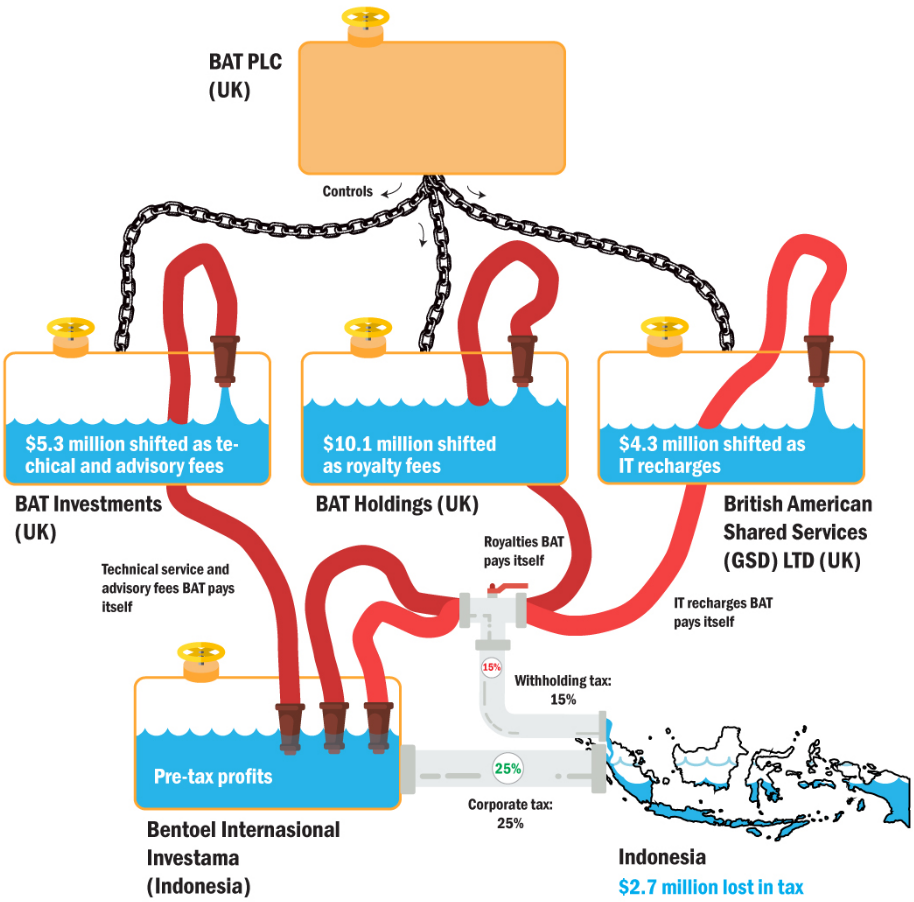
Within a year of the treaty being revised, the loan had been replaced with equity. The timing of these events suggests that BAT lent the money to Bentoel via the Netherlands because it was a profitable and "tax efficient" way to make use of its own funds, even though Bentoel itself was losing money. But once the treaty was revised, the tax advantage to BAT in lending its own money in this way was reduced.

**Why was the interest rate high?**

BAT charged Bentoel an interest rate of around 10-12 per cent.[110] During the same period, however, BAT's own global cost of borrowing averaged just under 4 per cent.[111] These figures imply that if Bentoel had been able to borrow at the same rate as BAT itself, then it might have saved as much as two-thirds of the US$164 million in interest payments, with the money going towards its taxable income in Indonesia.

The pricing of the loan to Bentoel was benchmarked against the cost of domestic interbank borrowing in Indonesia, so it is consistent with the arm's length principle. This pricing difference is a good example of the flaws of the principle, which work to the advantage of multinationals lending their own funds to their subsidiaries in countries with relatively high interest rates and tax rates.

## Royalties, fees and charges




### Step 1 – what funds were shifted out of Indonesia?

Bentoel makes payments for royalties, fees and IT charges, including to several BAT companies in the UK. From 2010 to 2016, these have included:

- US$10.1 million a year (on average) paid in royalties to British American Tobacco (Holdings) Ltd[112] (for the use of the Dunhill and Lucky Strike brands: the former of these accounted for a third of Bentoel's sales by volume in 2015).[113]
- US$5.3 million paid per year in technical and advisory fees to British American Tobacco (Investments) Ltd.[114]
- US$4.3 million paid per year in IT recharges British American Shared Services (GSD) Limited.[115]

The total payment was thus US$19.7 million per year.

In recent years these have significantly exacerbated Bentoel's losses in Indonesia. The combined cost of these payments was equivalent to 80 per cent of the company's pre-tax loss in 2016.[116]

**Step 2 – what is the corporate tax on the payments?**

The average corporate tax on the payments each year, at the Indonesian rate of 25 per cent[117], would have been:

- US$2.5 million on the royalties
- US$1.3 million on the fees
- US$1.1 million on the IT recharges

**Step 3 – what was the withholding tax due?**

- Royalties on trademarks, under the UK-Indonesia tax treaty, pay Indonesian withholding tax at 15 per cent.[118] 15 per cent of US$10.1 million is US$1.5 million
- It appears that fees for technical services are not subject to withholding tax.[119]
- IT recharges are not mentioned in the treaty[120], probably because it dates back to 1995. As IT recharges are similar to royalties, we make an assumption that a withholding tax of 15 per cent was paid on the IT recharges. 15 per cent of US$4.3 million is US$0.7 million

**Step 4 – how much revenue did Indonesia lose?**

- On royalties, Indonesia lost the corporate tax of US$2.5 million, minus the withholding tax of US$1.5 million, which is US$1 million a year.
- On fees, Indonesia lost the whole amount of corporate tax – US$1.3 million a year.
- On IT recharges, Indonesia lost the corporate tax of US$1.1 million, minus the assumed withholding tax of US$0.7 million, which is US$0.4 million.

So the total loss of potential future revenue to Indonesia from BAT's royalty, fee and IT recharge payments to UK BAT companies was up to US$2.7 million a year. This will apply if or when Bentoel makes profits in the future.

**BAT response:** "As Bentoel is a listed company there is a requirement to also secure a "Fairness opinion" from an independent appraiser for certain non-routine transactions to protect minorities. The introduction of the inter-company loan was supported by a fairness opinion and approved by the local Board."

## Latin American and the Caribbean

### Brazil

### Summary

BAT's Brazilian operation Souza Cruz appeared to have had at least two different arrangements that reduced the tax it paid in Brazil. In total these enabled it to reduce tax paid in a year in Brazil by an estimated US$33 million.

### BAT in Brazil

BAT's subsidiary in Brazil is called Souza Cruz. Founded in 1903, it has been controlled by BAT since 1914 and is now Brazil's largest tobacco company, with about four-fifths of the domestic cigarette market as of 2015.[121] Souza Cruz was restructured into a private company in 2014.

Brazil's tax authority has reassessed the profits of Souza Cruz' overseas subsidiaries and has demanded another US$320 million from 2004 to 2012 from the company in tax, interest and penalties. The two sides are currently disputing the issue.[122]

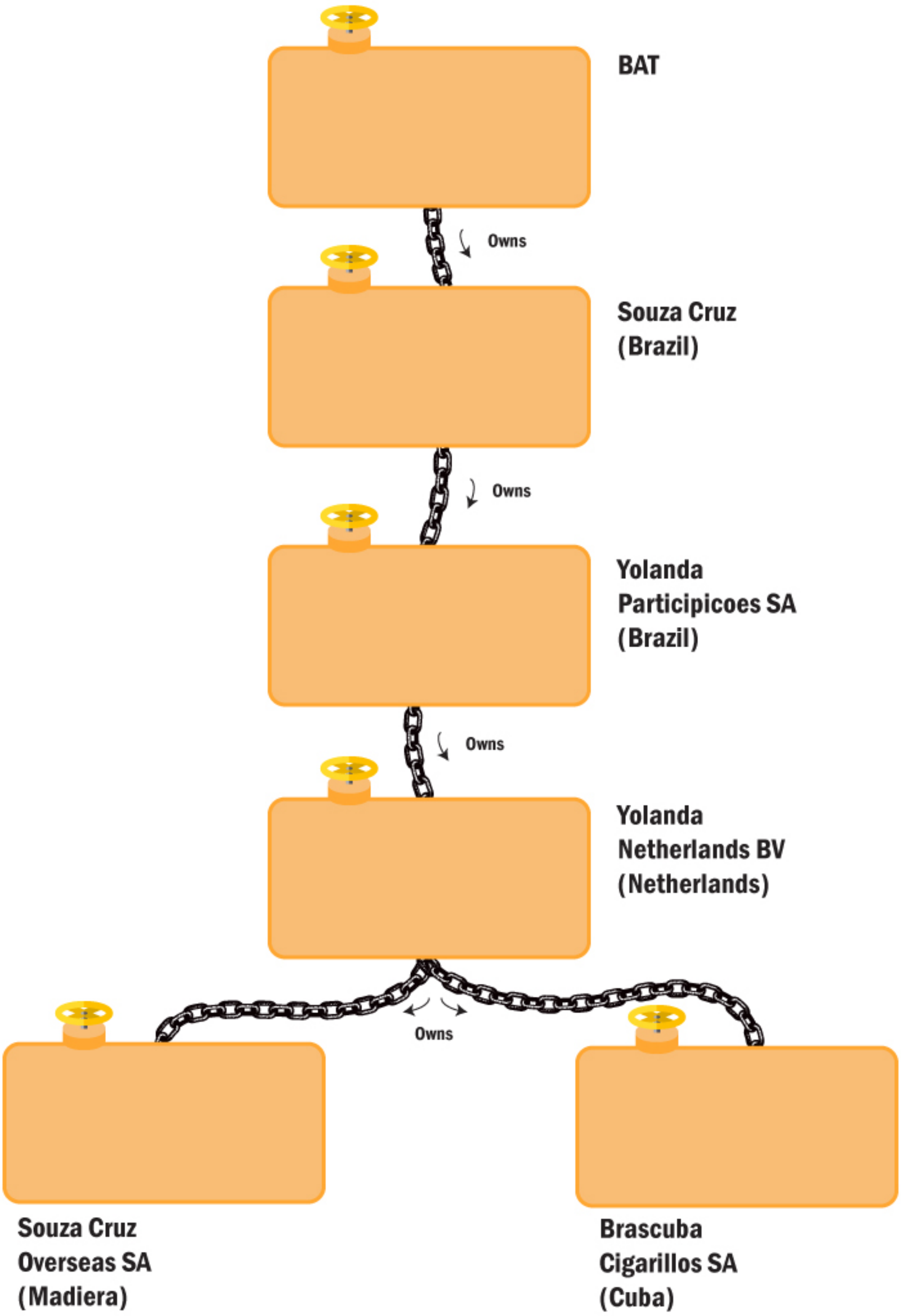
### Profitability

In 2014, Souza Cruz made a net profit margin of 25.8 per cent (calculated on the basis of net sales revenues).[123]

### BAT and tax avoidance in Brazil

Souza Cruz had a wholly-owned subsidiary called Yolanda Participacoes SA, which had a subsidiary called Yolanda Netherlands BV.[124] This Dutch company had no employees, indicating that it was a holding company used purely for financial transactions.[125] Until mid-2011, Yolanda Netherlands had two subsidiaries: Souza Cruz Overseas SA, in the Portuguese tax haven of Madeira, and a small Cuban company.[126]

**Souza Cruz and Yolanda Netherlands (prior to April 2011)**




Souza Cruz became a private company in 2014, which is therefore the last year for which accounts are available.

### Loan interest

#### Step 1 – what funds were shifted out of Brazil?

Between 2007 and 2013, Souza Cruz financed its exports of tobacco products with loans from Yolanda Netherlands BV. The size of these loans peaked at US$602 million. Souza Cruz paid approximately US$255 million in interest on them between 2007 and 2014.[127] This averages US$32 million a year leaving Brazil for the Netherlands in interest payments. It is a relatively small but still significant proportion of Souza Cruz's pre-tax profits, which were over US$900 million in 2014.[128]

#### Step 2 – what corporate tax was due in Brazil?

The Brazilian tax rate throughout the period of the loans was 34 per cent.[129] So if Souza Cruz had not had to pay interest on the loan, and had booked an equivalent sum as income instead, then the corporate tax due on this US$255 million in interest would have been US$86.7 million.

#### Step 3 – what was the withholding tax due?

The withholding tax rate on interest payments from Brazil to the Netherlands was 15 per cent.[130] So withholding tax due would have been US$38.3 million.

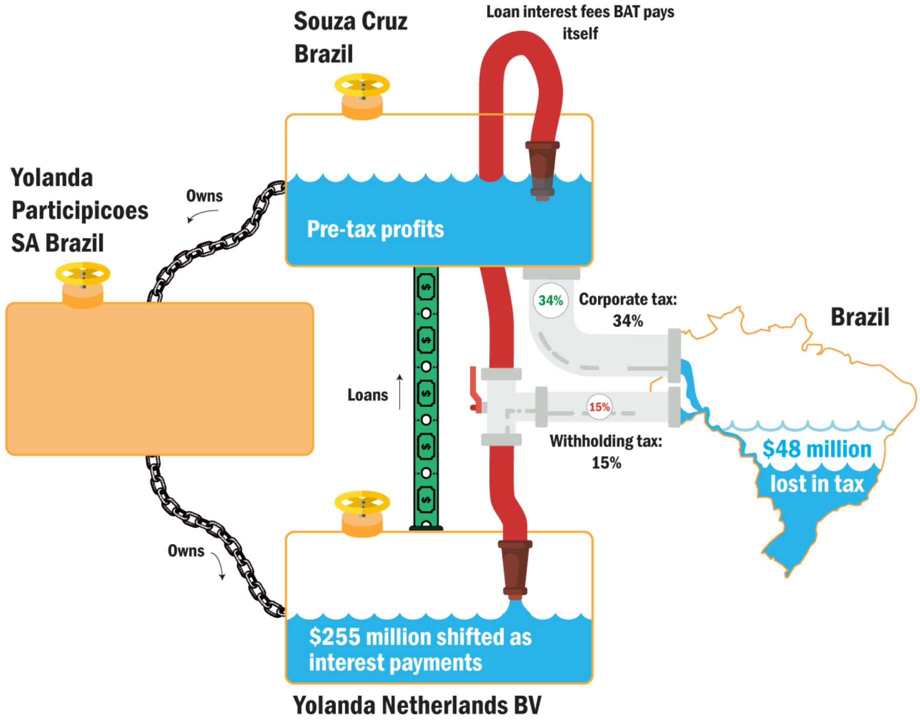
#### Step 4 – what was the revenue loss to Brazil?

It appears that Souza Cruz was in a position to deduct this US$255 million in interest from its profits in Brazil, taxable at 34 per cent, and pay this sum to its own subsidiary in the Netherlands, paying only a Brazilian withholding tax of 15 per cent. The difference between the two rates, applied to this US$255 million, would be US$48 million over the period or roughly US$6 million a year.

| Value of interest payments 2007-2014 | Tax collected if taxed as profit in Brazil at 34% | Tax withheld at 15% if paid to Netherlands as interest | Difference in value: revenue loss to Brazil over period | Average estimated revenue loss to Brazil, per year |
|---|---|---|---|---|
| US$255 million | US$86.7 million | US$38.3 million | US$48.4 million | US$6 million |

#### Other issues – a circular loan?

Yolanda Netherlands' only source of finance (apart from its own retained earnings) was equity from its parent, Yolanda Participacoes SA, which in turn was wholly owned by Souza Cruz. In effect, this makes it likely that the Brazilian tobacco company Souza Cruz was lending its own money to itself via the Netherlands. This point was put to BAT, which did not respond.




### Profits from Madeira

### Step 1 – funds shifted out of Brazil?

Between 2009 and 2011, Yolanda Netherlands received US$235 million in dividends from its subsidiaries, or an average US$78 million in each of the years. The accounts do not say exactly which subsidiary paid how much in dividends, but it is likely that most or all of the money came out of the profits of Souza Cruz Overseas SA in the Portuguese tax haven of Madeira, which traded tobacco products on behalf of Souza Cruz in Brazil, since Yolanda Netherlands' only other subsidiary was a small Cuban company.  This sum may mainly represent profits booked in Madeira rather than Brazil.

### Step 2 – what corporate tax would have been due in Brazil?

The Brazilian corporate tax rate was 34 per cent. Applied to the US$235 million, this would have been US$79.9 million. In comparison, the corporate income tax rate in Madeira at the time was 4 per cent.

### Step 3 – what was the revenue loss to Brazil?

If tax had been paid on the US$235 million at the Brazilian rate of 34 per cent, this would have come to US$79.9 million. This is the estimated sum of tax lost to Brazil - an average US$26.6 million a year between 2009 and 2011.

The Brazilian tax authority evidently did suspect that BAT was shifting profits out of Brazil via Madeira and the Netherlands. It filed claims against Souza Cruz for tax, interest and penalties totalling US$320 million between 2004 and 2012. Souza Cruz lost its appeals at the tax tribunal for some of these claims and successfully appealed against others. All these claims are now moving through the Brazilian legal process for tax disputes, according to BAT.[131] When asked about this matter, BAT said, "the nature and matter of the ongoing historical tax dispute between the Brazilian Federal Tax Authority and Souza Cruz relates to historically whether and how the profits of overseas Brazilian subsidiaries are subject to Brazilian taxation."[132]

### Royalties, fees and charges

Throughout recent years there have been numerous other transactions between Souza Cruz and other members of the BAT group, including payments to Souza Cruz as well as payments from the Brazilian company. For example in 2014, the last year for which Souza Cruz published accounts before it went private (see below), the company reported payable expenses totalling US$23 million in royalties, technical advisory fees, cost-sharing for research and IT charges to various BAT companies in the UK.[133] This is a pattern commonly seen in BAT subsidiaries. However, Souza Cruz also received significant payments from related parties, including in the UK. Therefore it is not possible to estimate the tax effects of these payments.

### Reshuffling the Brazilian operations

In 2011, Madeira trading company Souza Cruz Overseas was shut down by its parent company Yolanda Netherlands. The next year, Yolanda Netherlands itself was sold by Souza Cruz to another BAT subsidiary, British American Tobacco GLP Limited in the UK. Yolanda Netherlands had ceased trading by 2015.[134] That same year, BAT bought out the minority shareholders of Souza Cruz in Brazil and took complete control of it.[135]

The tax effects of this complex series of transactions is hard to assess, and Souza Cruz stopped publishing its own accounts after the takeover by BAT.  Souza Cruz now appears to be exporting much of its tobacco via BAT GLP Limited.[136]

**BAT response:** "The former subsidiary of Souza Cruz in Madeira was established to enhance Brazilian leaf exports by giving Souza Cruz a presence closer to the European and Asian markets it sold leaf to. From 2011 Brazilian leaf exports were brought within the scope of BAT's centralised global leaf business in the UK. Loan Interest: The purpose of these loans was to refinance Souza Cruz's leaf growing funding requirements with internal instead of external financing on comparable arms-length terms. Brazilian tax audits have covered the tax deductibility of the interest with no challenges made."

## Guyana

### Summary

From 2009 and 2012, BAT in Guyana shifted profits out of that country by paying royalties and fees to BAT companies in other countries. This resulted in Guyana losing out on an estimated US$1.1 million a year.

### BAT in Guyana

Demerara Tobacco Ltd is BAT's marketing subsidiary in Guyana, where BAT started operations in 1928. The company is small by global standards but also very profitable, reporting a net profit margin of 40 per cent.[137]

### BAT and tax avoidance in Guyana

Step 1 – what funds were shifted out of Guyana?

From 2009 to 2012, Demerara Tobacco paid US$13.5 million in royalties, and technical, advisory and management fees to BAT companies in other countries.[138] These averaged US$3.4 million a year.[139] These payments amounted to an average of 30 per cent of Demerara Tobacco's pre-tax profits.

### Step 2 – what corporate tax would have been due?

The corporate tax rate in Guyana was 45 per cent for 2009 and 2010 and 40 per cent in 2011 and 2012. [140] The latter rate is used for these calculations, meaning that the totals are a slight underestimate. The corporate tax due on US$3.4 million at 40 per cent would have been US$1.4 million per year,

### Step 3 – what withholding tax was due?

For the sake of estimation, we calculate the tax that would have been lost to Guyana if the payments were made to the UK (a pattern seen in other BAT subsidiaries). The UK-Guyana tax treaty of 1992[141] sets a maximum withholding tax of 10 per cent on royalties and technical fees. Thus, US$0.3 million a year would have been due on the US$3.4 million.

### Step 4 – what tax was lost to Guyana?

Corporate tax paid on the US$3.4 million a year at 40 per cent would have been US$1.4 million a year. The withholding tax at 10 per cent would have been US$0.3 million. So the tax loss to Guyana in each year is estimated at the difference between these: US$1.1 million.

## Trinidad and Tobago

### Summary

Between 2010 and 2017, BAT in Trinidad and Tobago made royalty and fee payments to BAT subsidiaries in other countries, resulting in an estimated tax loss in each year to Trinidad and Tobago of US$1.9 million.

### BAT in Trinidad and Tobago

West Indian Tobacco is the Trinidad and Tobago-based subsidiary of BAT, which sells cigarettes in the domestic market and the region. BAT owns just over half of the company's shares, via British American Tobacco (Investments) Ltd.[142] Between 2010 and 2017, the company made an average net profit margin of 44 per cent.[143]

### BAT and tax avoidance in Trinidad and Tobago

### Step 1 – what funds were shifted out of Trinidad and Tobago?

Between 2010 and 2017, West Indian Tobacco made a total of US$101 million in royalty and advisory fee payments to related parties or to its parent company in the UK, an average of US$12.6 million a year.[144] These royalty and fee payments have been equivalent to just over 16 per cent of West Indian Tobacco's pre-tax profits since 2010.[145]

### Step 2 – what corporate tax would have been due?

The corporate tax rate in Trinidad and Tobago was 25 per cent[146]. Therefore the corporate tax due on the royalty and fee payments would have been US$25.3 million.

### Step 3 – what withholding tax was due?

In order to make an estimate, we calculate revenue lost if the payments were made to the UK – a pattern seen in other BAT subsidiaries. The UK-Trinidad tax treaty of 1982[147] provides that royalties and technical fees can be taxed in Trinidad and Tobago at 10 per cent, which would have meant US$10.1 million in withholding tax.

### Step 4 – what tax was lost to Trinidad and Tobago?

The difference between the corporate tax of US$25.3 million and the withholding tax of US$10.1 million is US$15.2 million. The lost revenue is estimated at the difference between these, which is US$15.2 million, or an average US$1.9 million in each year.

# Africa

## BAT in Africa

BAT's audited financial reports are available for Kenya, Uganda and Zambia. Yet, the accounts include less information than those of the other continents – so the picture is less clear.

## Kenya

### Summary

In 2015 and 2016, the Kenyan revenue authority may have received US$2.7 million less in revenue per year, due to BAT's routing of dividend payments via the Netherlands – although this arrangement cannot have been motivated by the tax saving.

### BAT in Kenya

BAT Kenya plc is a producer and distributor of cigarettes, just under half of whose production is exported. It has one subsidiary, BAT Kenya Tobacco Company Ltd, which sells cigarettes. BAT Kenya is a "strategic manufacturing hub" for cigarettes sold by other parts of the global group.[148] The company has been manufacturing and distributing cigarettes for over a century.[149]

The company has been fighting in the courts against tougher anti-smoking regulation and BAT is under investigation by the UK Serious Fraud Office for various allegations, including that it paid bribes to the Kenya Revenue Authority for information on a competitor.[150]

BAT Kenya's net profit margin averaged 19.2 per cent of its revenue between 2010 and 2016.[151]

### BAT and tax avoidance in Kenya

#### Rerouting dividends

BAT Kenya is 60 per cent owned by a Dutch subsidiary of the BAT group called Molensteegh Invest BV.[152]

#### Step 1 – what funds are shifted out of Kenya?

In the two years 2015 and 2016, US$53 million - 60 per cent of BAT Kenya's dividends - would have been paid to the Dutch company. [153] This is an average of US$26.5 million a year.

As BAT is a UK company, however, it would be expected that the dividends would be paid to the UK.

#### Step 2 – what corporate tax would have been due?

Corporate tax would have been paid before the dividends left Kenya.

#### Step 3 – what withholding tax was due?

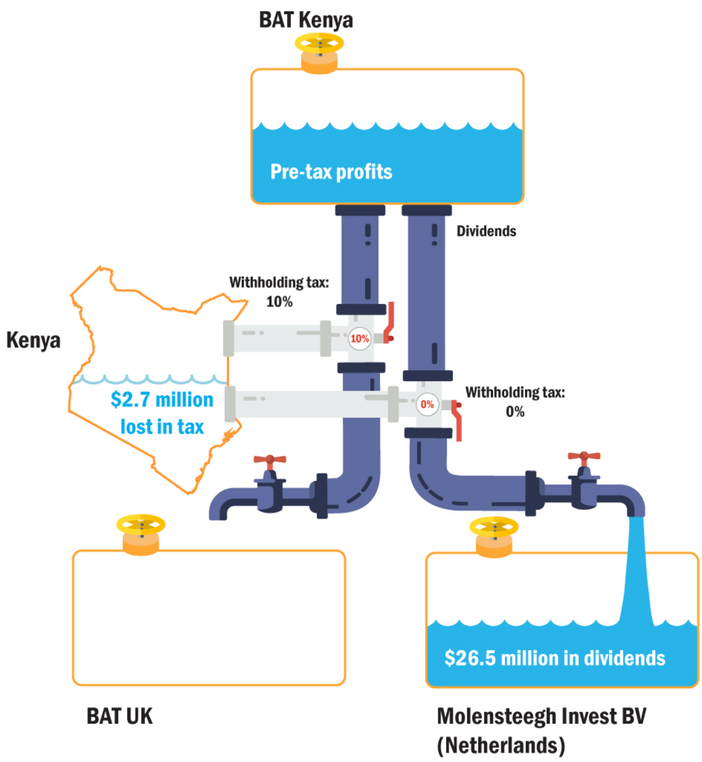
Since 2015 there has been a Netherlands-Kenya tax treaty which reduces withholding tax on dividends to zero. [154] The withholding tax due according to the decades-old UK-Kenya treaty is not clear, as the rate applies only if dividends are taxed in the UK, which foreign dividends no longer are.[155] The Kenyan domestic rate of withholding tax on dividends is 10 per cent for non-residents outside the East Africa Community[156], and this rate is also mentioned in the BAT Kenya 2016 annual report.[157] So this is the rate assumed.

**Step 4 – what tax was lost to Kenya?**

If 10 per cent withholding tax had been paid, this would have amounted to US$5.3 million or, US$2.65 million a year. The Kenya-Netherlands treaty reduces this to zero, so the tax loss to Kenya would be estimated at US$2.7 million a year. However, BAT says that according to its sources, the treaty does not yet apply.

However, this arrangement cannot originally have been motivated by this tax saving, because Molensteegh Invest BV has held BAT's shares in Kenya since at least 2005 - before the treaty was signed - and before 2015, the dividend payments to the Netherlands holding company were presumably subject to the 10 per cent withholding tax.

It is possible to speculate that the dividends may originally have been paid via the Netherlands, where they are not taxed, in order to avoid paying them to the UK which up until 2009 did tax foreign dividends.




**Related party transactions**

BAT Kenya reports very little detail on its related party transactions and there is no record of royalties, technical fees or IT recharges. A general item for "recharges and other expenses" was US$7.04 million in 2016 and US$8.7 million in 2015. Although recharges are related party transactions, the lack of disaggregated detail make it impossible to assess the Kenyan tax effects of this item.

## Uganda

### BAT in Uganda

BAT Uganda is 70 per cent owned by British American Tobacco Investments Ltd, a UK registered subsidiary of British American Tobacco. It markets cigarettes in Uganda, and until 2015 also traded in tobacco leaf.

BAT Uganda discontinued its tobacco leaf business in 2014; before this, it sold large volumes of tobacco leaf via BAT GLP in the UK. This meant a sharp drop in the size of the business. The corporate income tax paid fluctuated significantly in the last three years. This is likely to be explained by fluctuation in deferred tax liabilities on assets, related to the sale of the tobacco leaf business – rather than tax avoidance issues.[158]

In 2016 its net profit was 12 per cent – low in comparison to other BAT companies, although still a sizable profit margin.[159]

### BAT Uganda and tax avoidance

Like many BAT companies, BAT Uganda makes related party payments to the UK (and also to other countries, including Romania and Kenya). These include payments to UK companies BAT Investments Ltd, its parent company, and to BASS GSD. The accounts do not say what the payments are for – however they may be payments for royalties, technical and advisory fees and/or IT recharges, analogous to the payments made from other BAT companies around the world to these UK BAT companies.

They are small in absolute terms - US$0.82m in 2016 and US$0.92 in 2015[160]– but BAT Uganda's business is also relatively small in absolute terms. The 2016 related party payment, just to BAT Investments and BASS GSD in the UK, is 27 per cent of pre-tax profit and the 2015 payment is 21 per cent. It is likely that the payments generated tax losses in Uganda analogous to others in the report, but they cannot be quantified since the accounts do not specify what the payments relate to.

## Zambia

### BAT in Zambia

BAT Zambia is 78 per cent owned by BAT International Holdings (UK).

In 2016 its sales volume dropped by 42 per cent, according to the annual report owing to a price increase of BAT Zambia's products of up to 100 per cent, following a hike in excise tax. [161] This led to a drop in revenue of 14 per cent, to US$17.1 million. Despite the hike, the absolute payment of excise duty fell.[162] Notwithstanding the turbulence, BAT Zambia's net profit in 2016 was still 12 per cent.[163]

### BAT Zambia and tax avoidance

Despite all this, BAT Zambia still shifted some profits to the UK. It paid US$1.05 million to UK companies in 2016 in related party payments (to British American Shared Services GSD and BAT Investments). Together, these related party payments comprise 30 per cent of the 2016 profits, and in 2015 they totalled US$0.83 million, which was 15 per cent of pre-tax profits.[164] There were also many other related party payments to various companies in various countries. It is likely that the payments generated tax losses in Zambia analogous to others in the report, but they cannot be quantified as we do not know what they were for.[165]

**BAT response on Guyana, Trinidad and Tobago, Uganda and Zambia:** "the payment by BAT's subsidiaries in these locations for services including royalties, technical & advisory and IT recharges is on arms-length terms.  As the companies in these jurisdictions are listed on local stock exchanges with significant minorities, the entering into such inter-company arrangements is subject to significant scrutiny by the board of directors, who have additional fiduciary duties to safeguard the interests of the minorities. In addition, local tax audits have not resulted in any of these payments being non-deductible."

**Arm's length principle**
The rule that transactions between companies which are part of the same overall multinational company (related parties) must be priced as they would be on the open market – as if the parties to the transaction were separate from each other.

**Corporate income tax**
The tax a company pays on its profits

**Country by country reporting**
The reporting by a multinational company of information such as profits made, number of employees and tax paid in every country where it operates. Country by country reporting is now mandated by the OECD, although the reports are yet required to be published.

**Lower income countries**
Includes low and middle income countries

**Profit shifting**
The process of moving profits from one country where a multinational company is present to another – usually from a higher tax to a lower tax jurisdiction

**Related parties**
Companies within the same overall multinational company

**Royalty**
A kind of user fee for the use of brands and trademarks, or for the products of research, paid to the related company owning these pieces of intellectual property, which may be in the multinational's home country, or elsewhere.

**Subsidiary**
A company that is part of a multinational group, because at least 50 per cent of it is owned by the ultimate parent, which therefore controls it.

**Tax haven**
A jurisdiction with some combination of low tax rates, laws that enable some kind of tax avoidance and little transparency.

**Tax treaty or double taxation agreement**
A bilateral, legally binding agreement between countries, which aims to divide up taxing rights between countries where corporations are resident and those where they invest

**Transfer pricing**
Pricing of trades between related parties

**Withholding tax**
Tax that is taken from an individual's or a company's income before it reaches them. In this report, the term is used for tax that is levied on funds shifted out of a country by a multinational company to its other subsidiaries.

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26 Hearson M (2016), Measuring tax treaty negotiation outcomes – the ActionAid tax treaties dataset, ICTD Working Paper 47, and ActionAid (2016) *Mistreated – the tax treaties that are depriving the world's poorest countries of vital revenue*

27 http://www.oecd.org/tax/treaties/1914467.pdf (accessed 24 October 2018)

28 http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm (accessed 24 October 2018)

29 http://www.un.org/esa/ffd/tax/unmodel.htm (accessed 24 October 2018)

30 Eg Picciotio S (2012) *Towards unitary taxation of transnational corporations,* Tax Justice Network

31 OECD (2018) *Secretary General Report to G20 Finance Ministers and*

*Central Bank Governors*, http://www.oecd.org/tax/oecd-secretary-general-tax-report-g20-finance-ministers-july-2018.pdf (accessed 17 December 2018)

32 Cobham A (2017) *Tax avoidance and evasion – the scale of the problem*, Tax Justice Network Briefing, p1

33 Torslov T, Wier L and Zucman G (2018) *The missing profits of nations*, National Bureau of Economic Research Working Paper 24701, p3

34 https://www.forbes.com/global2000/list/#industry:Tobacco (accessed 12 December 2018).

35 BAT plc Annual Report 2017 p16. In a private communication with TJN on 19/10/18, BAT said it operates in 180 markets around the world.

36 BAT plc Annual Report 2016 p19

37 Campaign for Tobacco Free Kids (2018), *The Global Cigarette Industry*, Briefing, p2

38 BAT plc Annual Report 2016, p2

39 Calculated using pre-tax profits as a proportion of net revenue (which BAT calls 'revenue')

40 Calculated using net profits as a proportion of net revenue (which BAT calls 'revenue)

41 BAT Sustainability Report 2018, p.22

42 BAT Annual Report 2017, p187-88

43 https://www.gov.uk/hmrc-internal-manuals/international-manual/intm482100

44 https://www.gov.uk/hmrc-internal-manuals/international-manual/intm482090

45 ActionAid International, Christian Aid and Oxfam International (2015), *Getting to good – towards responsible corporate tax behaviour*

46 BAT Bangladesh. Annual report for 2016. Note 37. Annual report for 2015. Note 34. Related Party Disclosures.

47 Ibid.

48 UK Bangladesh double taxation convention 1979. Article 12. Royalties.

49 Souza Cruz S.A. e Sociedades Controladas. Demonstrações financeiras em 31 de dezembro de 2007 e de 2006 e parecer dos auditores independentes. P.28. Demonstrações financeiras em 31 de dezembro de 2008 e de 2007 e parecer dos auditores independentes. P.64. Yolanda Netherlands BV financial statements for 2009 to 2014.

50 Netherlands Brazil double taxation convention 1991. Article 11. Interest. KPMG Corporate Tax Rates table. 2003 to 2018. KPMG says the Brazilian tax rate includes a basic rate of 15 per cent, a 10 per cent surtax on corporate profits and a 9 per cent social contribution on net profits, giving a headline rate of 34 per cent.

51 BAT Kenya Annual Report 2016. Consolidated statement of cash flows. Dividends paid to the Company shareholders.

52 Deloitte – International Tax Kenya Highlights 2018,

53 Convention between the Kingdom of the Netherlands and the Republic of Kenya for the avoidance of double taxation. 22nd July 2015. Article 10. Dividends

54 BAT Bangladesh. Annual reports for 2016. Note 37. Annual report for 2015. Note 34. Related party disclosures

55 BAT GLP Annual Report 2016, p2

56 BAT GLP Annual Report 2016, p13

57 All sources for figures in this summary table are included in the detailed exposition of the calculations in the Appendix

58 Campaign for Tobacco Free Kids (2018), *The Global Cigarette Industry*, Briefing, p1

59 www.tobaccoatlas.org (accessed 20 October 2018)

60 www.tobaccoatlas.org (accessed 20 October 2018)

61 BAT Bangladesh Annual Report 2016, p143

62 https://sustainabledevelopment.un.org/sdg3 (accessed 20 October 2018)

63 Schmidt-Traub G (2015) *Investment needs to achieve the Sustainable Development Goals – understanding the billions and trillions*, Sustainable Development Solutions Network, p10

64 BAT plc Annual reports from 2008 to 2016. This figure is a cash tax rate, calculated by dividing the amount of tax paid each year (from the Group Cashflow Statement) by the pre-tax profit (from the Group Income Statement). The cash tax rate is used here because it reflects the amount of tax revenue actually received by governments in a given year rather than the total amount which is owed, but may not be paid that year. BAT prefers to cite its effective tax rate – that is, tax paid and tax owed – which is legitimate, but is not as useful as the cash tax rate for understanding the effect of a company's tax practices on the public finances. In a private communication to TJN on 19/10/18, BAT said "the BAT Group's underlying effective tax rate for subsidiaries, excluding the impact of adjusting items, associates and joint ventures post tax profit in the Group's pre-tax results, was 29.7%. In 2016 the comparable figure was 29.8%."

65 BAT plc Annual reports from 1997 to 2016

66 BAT plc Annual Report 2017, p36

67 BAT plc Annual Report 2017

68 British American Tobacco plc. Form AR01. List of subsidiaries 2015.

69 British American Tobacco International Holdings BV. 2016 summary financial statements.

70 https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html (accessed 25 October 2018)

71 British American Tobacco plc. Annual reports for 2011 to 2016. Notes to the financial statements. Taxation on ordinary activities. UK corporation tax.

72 British American Tobacco (Holdings) Ltd – Annual Report and Financial Statements (2016) p13

73 British American Tobacco plc Annual Report 2017. p106

74 British American Tobacco (Holdings) Ltd – Annual Report and Financial Statements (2016) p13

75 Private communication, 26/10/18

76 British American Tobacco (GLP) Ltd Annual Report 2016, p2 and 13

77 British American Tobacco (GLP) Ltd, Annual Report and Financial Statements 2016. P16.

78 Yolanda Netherlands BV financial statements for the years 2009 to 2014. The tax rate is calculated by dividing tax paid from the cashflow statement by pre-tax profit.

79 https://www.oanda.com/currency/converter/

80 https://www.tobaccofreekids.org/problem/toll-global/asia/bangladesh (accessed 26 October 2018)

81 BAT Bangladesh Annual Report 2016, p4

82 https://home.kpmg.com/xx/en/home/insights/2018/02/bangladesh-vat-law-tax-holidays-corporate-tax-rate-changes.html. In 2017 the rate was increased by a further 2.5%. (accessed 24 October 2018)

83 BAT Bangladesh Annual Report for 2016, p18. Corporate Tax Rate.

84 British American Tobacco Bangladesh. Annual Report 2016, p18 and p73

85 BAT Bangladesh Annual Report for 2016, p14

86 BAT Bangladesh Annual Report for 2016, p143

87 BAT Bangladesh Annual report for 2016, note 37. Annual report for 2015, note 34. Related Party Disclosures.

88 BAT Bangladesh Annual report for 2016, note 37. Annual report for 2015, note 34. Related Party Disclosures.

89 BAT Bangladesh has sometimes received fees from other BAT subsidiaries in Asia. Their value has been tiny in comparison to the value of its payments to the UK. For example, the total value of fees received from related parties in 2016 was less than US$200,000. BAT Bangladesh Annual Report for 2016, note 37.ii.b. Other fee.

90 The tax calculation is done for 2016 only, as the corporate tax rate increased between 2015 and 2016.

91 UK-Bangladesh double taxation convention of 1979. Article 12. Royalties.

92 BAT Bangladesh Annual Report 2016, note 37

93 PT Bentoel Internasional Investama Tbk Annual Report 2016. The figure for market share is on Page 25. The company's subsidiaries are on Page 13 and its ownership on Page 58.

94 Bentoel Annual Reports for the years 2012 to 2016.

95 Rothmans Far East BV. Financial statements for 2016. Principal activities. Results for the year.

96 Bentoel. Annual report for 2016. Note 12. Long-term loans.

97 All values taken from Bentoel's accounts in rupiah (Indonesian currency) and converted to dollars at the exchange rate at the end of the relevant year, from www.oanda.com. There were large exchange rate fluctuations during the period, so dollar values are approximate.

98 Bentoel. Annual report for 2015. Note 12. Long-term loans.

99 Rothmans Far East BV. Financial statements for 2016. Market risk. Currency risk.

100 Bentoel. Annual reports for 2013 to 2016. Notes to the financial statements. Significant transactions with related parties. The US dollar-rupiah exchange rate has been averaged over the period of the loan. It may not correspond exactly to exchange rates used in the accounts of BAT subsidiaries.

101 Bentoel annual reports for 2013 to 2016 Figures in USD million, converted from Indonesian rupiah at year-end exchange rates for each year. The exchange rates used here may be different from those used in Bentoel's accounts, resulting in different US dollar totals.

102 Bentoel annual report 2016. P53.

103 https://www.loyensloeff.com/en-us/news-events/news/revised-netherlands-indonesia-tax-treaty-becomes-effective-on-1-october-2017 (accessed 26 October 2018)

104 Deloitte. Indonesia Taxation and Investment 2018 (Updated December 2017). 4.0 Withholding Tax, p21

105 Government of Jersey. Double taxation agreements. https://www.gov.je/TaxesMoney/InternationalTaxAgreements/DoubleTaxation/Pages/index.aspx

106 UK/Indonesia double taxation agreement. 14th April 1994. Article 11. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/498367/indonesia-dtc_-_in_force.pdf

107 https://www.loyensloeff.com/en-us/news-events/news/revised-netherlands-indonesia-tax-treaty-becomes-effective-on-1-october-2017 (accessed 26 October 2018)

108 Bentoel Annual Report 2016. Composition of shareholders. P58. Bentoel financial statements 2015. Note 15. Share capital.

109 Private communication with TJN, 26/10/18

110 The pricing of BAT's loan to Bentoel is set out in Rothmans Far East BV. Annual report for 2016. Note 3. Long-term loans. The first loan was priced at the six-month Jakarta interbank (Jibor) rupiah lending rate plus 2.75 per cent and the second loan at six-month Jibor plus 3.75 per cent. This rate averaged around 7-8 per cent during the period of the loan. See http://www.bi.go.id/en/moneter/jibor/data-historis/Default.aspx

111 BAT plc annual reports 2013-2015. The cost of borrowing has been calculated by dividing BAT's total borrowings, as reported on its balance sheet, by its finance costs as reported in its income statement.

112 Bentoel Annual Reports 2011-2016. Each type of payment has been converted from Indonesian rupiah into US dollars at the year-end exchange rate for that year as given by www.oanda.com. The royalty rate itself has

increased from 5 per cent of total sales of the brand concerned in 2010, to 5-7 per cent in 2011, to 8 per cent in 2015.

113 Bentoel Annual Report 2015, p2

114 Bentoel Annual Reports 2011-2016

115 Bentoel Annual Reports 2011-2016

116 Bentoel Annual Report for 2016. Profit and loss statement and Note 26c. Significant transactions with related parties.

117 https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html (accessed 26 October 2018)

118 UK-Indonesia double taxation agreement. 1st January 1995. Article 12. Royalties. http://taxsummaries.pwc.com/uk/taxsummaries/wwts.nsf/ID/Indonesia-Corporate-Taxes-on-corporate-income

119 UK-Indonesia double taxation agreement. 1st January 1995.

120 UK-Indonesia double taxation agreement. 1st January 1995.

121 Reuters. British American Tobacco mulls $3.5bn buyout of Brazil unit stake. 23rd February 2015. https://uk.reuters.com/article/uk-souza-cruz-m-a-brit-am-tobacco-idUKKBN0LR14I20150223 (accessed 26 October 2018)

122 British American Tobacco plc. Annual report 2017. P. 187.

123 Souza Cruz SA. Relatório da Administração (Management report). Year to 31st December 2014. The last published accounts for Souza Cruz, before it was wholly taken over by BAT, are for 2014. In this year the company reported net profits of 1,714 million reals (US$638 million) on net sales revenues of 6,624 million reals (US$2.47 billion), giving a net profit margin of 25.8 per cent

124 Souza Cruz SA. Relatório da Administração. Exercíco findo em 31 de Dezembro de 2014.

125 Yolanda Netherlands BV. FInancial statements for the years 2010 to 2014. Note 10.

126 Souza Cruz SA. Relatório da Administração. Exercíco findo em 31 de Dezembro de 2014.

127 Souza Cruz S.A. e Sociedades Controladas. Demonstrações financeiras em 31 de dezembro de 2007 e de 2006 e parecer dos auditores independentes. P.28. Demonstrações financeiras em 31 de dezembro de 2008 e de 2007 e parecer dos auditores independentes. P.64. Yolanda Netherlands BV financial statements for 2009 to 2014. Some figures in Brazilian reals have been converted into US dollars at the year-end exchange rate for the year concerned, as given on www.oanda.com.

128 Sousa Cruz SA. Relatório da Administração. Exercíco findo em 31 de Dezembro de 2014.

129 https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html (accessed 26 October 2018) This is a compound rate consisting of the basic corporate income tax rate, a surtax on profits and a social contribution levied on

profits.

130 Netherlands Brazil tax treaty 1991. Article 11. Interest http://www.itc-leiden.nl/UserFiles/Documents/Brazil%20ENG.pdf (accessed 26 October 2018)

131 British American Tobacco plc. Annual report 2017, p187.

132 Private communication with TJN, 26/10/18

133 Souza Cruz. Relatório da administração – Exercício findo em 31 de Dezembro de 2014. Note 31b

134 Yolanda Netherlands. Financial statements for 2014. Outlook.

135 BAT plc. Annual report for 2015. Note 26c.

136 British American Tobacco (GLP) Limited. Financial statements for 2016. Note 4.

137 DemeraraTobacco Annual Report 2012, p 7 and 8. Revenue calculated by subtracting excise duty paid from gross turnover, as a figure for revenue is not given in the accounts.

138 Demerara Tobacco. Annual reports for 2009 to 2012. It is not specified in the accounts to which countries the payments went.

139 dfd

140 Demerara Tobacco. Annual report for 2011, p38 Annual report for 2012, p38..

141 UK-Guyana Double Taxation Convention. December 1992. Articles 13 and 14.

142 West Indian Tobacco. Annual Report 2017, p8

143 West Indian Tobacco. Annual reports for 2010 to 2017. Statement of profit or loss.

144 West Indian Tobacco. Annual reports for 2010 to 2017. Notes to the financial statements. Related party transactjons and balances. The related parties are not identified.

145 Payments to related parties and parent company as a percentage of pre-tax profits, taken from West Indian Tobacco annual reports from 2010 to 2017, Statement of profit or loss and Note on related party transactions and balances.

146 https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html (accessed 27 October 2018)

147 UK-Trinidad and Tobago Double Taxation Convention, 1984. Article 12. Royalties. Article 13. Technical fees.

148 BAT Kenya Annual Report 2016, p11.

149 BAT Kenya Annual Report 2016 p19

150 Sarah Boseley and Julia Kollewe, The Guardian 1 August 2017, Serious Fraud Office opens investigation into BAT bribery claims;, https://www.sfo.gov.uk/cases/british-american-tobacco/ (accessed 26 October 2018)

151 BAT Kenya. Annual reports 2011-2016. Consolidated statement of profit

or loss. Consolidated statement of cashflows. The tax rate is calculated by dividing cash tax paid by pre-tax profits.

152 BAT Kenya Annual Report 2016, p92

153 BAT Kenya Annual Report 2016. Consolidated statement of cash flows. Dividends paid to the Company shareholders.

154 Convention between the Kingdom of the Netherlands and the Republic of Kenya for the avoidance of double taxation. 22nd July 2015. Article 10. Dividends

155 UK-Kenya Double Taxation Agreement, 1977.

156 Deloitte – International Tax Kenya Highlights 2018,

157 British American Tobacco Kenya Annual Report 2016, p86

158 BAT Uganda Annual Reports 2014, 2015 and 2016

159 BAT Uganda Annual Report 2016 p40

160 BAT Uganda Annual Report 2016, p 68. Figures for 2015 have been adjusted in the 2016 Annual Report to reflect only the non-leaf business side of BAT Uganda, to make them comparable with the 2016 figures.

161 BAT Zambia Annual Report 2016 p13

162 BAT Zambia Annual Report 2016 p25

163 BAT Zambia Annual Report 2016 p25

164 BAT Zambia Annual Report 2016 p48

165 The BAT Zambia Annual Report does include payments for royalties and technical fees (p39), but these are not specified to be related party transaction.