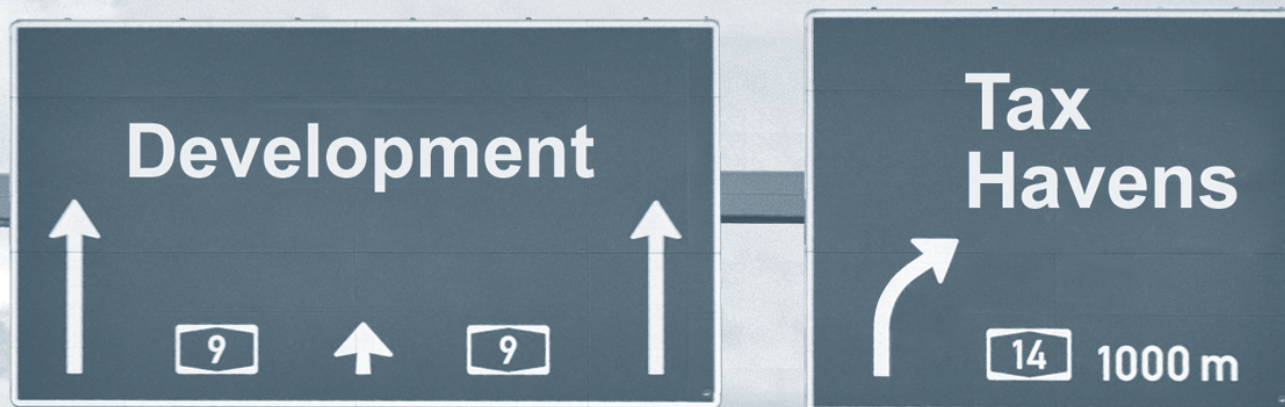


# Going Offshore

How development finance institutions support companies using the world's most secretive financial centres

By Mathieu Vervynckt



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The author believes all the details included in this report to be factually accurate and current as of 15 September 2014.

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Executive summary	04
Introduction	06
<b>1 DFIs and the use of tax havens</b>	<b>08</b>
<b>2 Scope and trends of DFI use of tax havens</b>	<b>10</b>
<b>3 DFI standards regarding tax havens</b>	<b>13</b>
<b>4 A critical analysis of current practices</b>	<b>17</b>
Conclusion and recommendations	19
Annex – Methodology	20
Endnotes	21

## Acronyms

AFD	Agence Française de Développement
AfDB	African Development Bank
AML	Anti-Money Laundering
BEPS	Base Erosion and Profit Shifting
BIO	Belgian Investment Company for Developing Countries
BP	Business Partners
CBCR	Country by country reporting
CDC	The CDC Group plc
CFT	Combating Terrorism Financing
Cofides	Compañía Española de Financiación del Desarrollo (Spanish Development Finance Institution)
CSO	Civil society organisation
DEG	Deutsche Investitions- und Entwicklungsgesellschaft (German Investment Corporation)
DFI	Development Finance Institution
EBRD	European Bank for Reconstruction and Development
EDFI	Association of European Development Finance Institutions
EIB	European Investment Bank
FATF	Financial Action Task Force
FMO	Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden (Dutch Development Finance Institution)
FSI	Financial Secrecy Index
IFC	International Finance Corporation
IFU	Investment Fund for Developing Countries
IMF	International Monetary Fund
KfW	Kreditanstalt für Wiederaufbau (Reconstruction Credit Institute)
LDC	Least developed country
NCJ	Non-cooperative jurisdiction
OECD	Organisation for Economic Co-operation and Development
OeEB	Oesterreichische Entwicklungsbank (Austrian Development Bank)
OFC	Offshore financial centre
Proparco	Promotion et Participation pour la Coopération économique (Investment and Promotion Company for Economic Cooperation, France)
SIFEM	Swiss Investment Fund for Emerging Markets
SIMEST	Società italiana per le imprese all'estero (Italian Company for Enterprises Located Abroad)
SME	Small- and medium-sized enterprises
SOFID	Sociedade para o Financiamento do Desenvolvimento (Portuguese Development Finance Institution)
UNCTAD	United Nations Conference on Trade and Development
UN	United Nations

# Executive summary

Developing countries lose billions of dollars every year through tax avoidance and evasion. Tax havens play a pivotal role in this by providing low or no taxation and by promising secrecy, allowing businesses to dodge taxes and remain largely unaccountable for their actions.

Development Finance Institutions (DFIs) are government-controlled institutions that, as this report shows, often support private sector projects that are routed through tax havens, using scarce public money. By supporting projects in this way, DFIs are helping to reinforce the offshore industry as they are providing income and legitimacy.

This report, which covers three multilateral and 14 bilateral DFIs, looks not only at DFIs' use of tax havens, but also at their standards when deciding where to channel their money. It also looks at the level of due diligence and portfolio transparency of these institutions as a way to assess civil society's ability to hold them to account.

This report finds that:

- **DFIs are still supporting a large amount of investments routed through tax havens.**  
**For example:**
  - At the end of 2013, a massive 118 out of 157 fund investments made by the CDC Group plc (CDC) – the UK's DFI – went through jurisdictions that feature in the top 20 of Tax Justice Network's Financial Secrecy Index (FSI). Between 2000 and 2013, these funds received a total of \$3.8 billion in original CDC commitments, including \$553 million in 2013 alone.
  - As of 4 June 2014, the Belgian Investment Company for Developing Countries (BIO) was involved in a total of 42 investment funds, 30 of which were domiciled in jurisdictions that feature in the FSI's top 20. These investments amounted to \$207 million.
  - At the end of 2013, Norway's Norfund had 46 out of a total of 165 investments that were channelled through jurisdictions that appear on the FSI's top 20. These investments amounted to \$339 million.
  - Of the 46 investment projects involving German DFI Deutsche Investitions- und Entwicklungsgesellschaft (DEG) as of 31 December 2012, at least seven were structured through major tax havens such as the Cayman Islands and the British Virgin Islands.
- Most DFIs have internal standards in place on the use of tax havens. However, **in a few cases, these standards are not publicly available. In most cases they are not part of an explicit policy** to inform a broad range of stakeholders by, for example, making these documents available in the official languages of the developing countries in which they operate.
- **The majority of the publicly disclosed DFI standards are highly dependent on the ratings put forward by the Organisation for Economic Co-operation and Development (OECD) Global Forum on Transparency and Exchange of Information for Tax Purposes.** This forum has severe limitations, as it uses unambitious criteria and excludes many developing countries – the very same countries that face particular difficulties in controlling corporate tax dodging.



The current political momentum towards tax justice presents DFIs with a great opportunity to set an example of best practice in establishing the highest standards of responsible finance.

- **It is not standard practice for DFIs to require the companies they invest in to report on a country by country basis** about the profits, losses, number of employees, taxes paid and other forms of economic performance. If they did, it would allow DFIs to know where their investee companies are making profits and help tax authorities to verify where taxes should be paid.
- **Most DFIs fail to publicly disclose vital portfolio details, such as beneficial ownership of the companies they invest in.** This information would allow for public scrutiny and a reality check in terms of implementation of their policy.

The current political momentum towards tax justice presents DFIs with a great opportunity to set an example of best practice in establishing the highest standards of responsible finance. This is doubly important when considering that DFIs are institutions that aim to reduce poverty and contribute to sustainable development in developing countries.

**Therefore, Eurodad urges DFIs to make the following changes:**

- In order to ensure appropriate implementation of their current and future policy standards, DFIs should only invest in companies and funds that are willing to publicly disclose beneficial ownership information and report back to the DFI their financial accounts on a country by country basis. As an intermediate step, this country by country data should then be forwarded by the DFI to the relevant tax authorities. Ultimately, the data should be placed in the public domain for all stakeholders to access.
- DFIs should ensure that the funds in which they invest are registered in the country of operation. Where that is not possible, DFIs should be explicit about the reasons why a third jurisdiction was preferred over a targeted developing country for domiciliation purposes, and how this, among other things, allowed them to advance towards their development objectives.

- DFIs should be fully accountable for their own operations and those of their clients. In order to do so, DFIs should make their current and future standards easily accessible for all citizens. This means that standards should be available on their respective websites and on request, as well as being translated into the official languages of the targeted developing countries. DFIs should also work towards full portfolio transparency to ensure proper accountability.

**In addition, Eurodad urges national governments to:**

- Establish an intergovernmental tax body under the auspices of the United Nations with the aim of ensuring that developing countries can participate equally in the global reform of existing international tax rules. This forum should take over the role currently played by the OECD to become the main forum for international cooperation in tax matters and related transparency issues.

# Introduction

Taxation is essential to all countries, rich and poor. However, developing countries urgently need to raise domestic revenues to provide basic services such as healthcare and education. Despite this need, the poorest countries continue to suffer from tax evasion and avoidance by multinational companies.<sup>1</sup>

Tax havens, or secrecy jurisdictions, provide services such as low or no taxation, anonymous company structures and secret bank accounts, and play a major role in facilitating tax evasion (illegal) and avoidance (lawful whilst avoiding the spirit of the law). Secrecy structures are also suitable for laundering the proceeds of criminal activity such as illegal sale of goods, weapons and narcotics, human trafficking, terrorism, corruption, theft and fraud.<sup>2</sup>

In 2013, the fight against tax avoidance and evasion finally gained momentum. This resulted in the introduction of country by country reporting (CBCR) for banks in the European Union, which now have to report their financial accounts (i.e. turnover, taxes paid and number of employees) on a country by country level.<sup>3</sup> In addition, the European Parliament voted in favour of public registries of beneficial ownership<sup>4</sup> and the OECD started its Action Plan on Base Erosion and Profit Shifting (BEPS).<sup>5</sup>

Meanwhile, the role of Development Finance Institutions (DFIs) in the development finance landscape has increased dramatically. They are engaged in supporting the private sector and in mobilising additional private finance through different financial instruments or tools, such as loans, equity and guarantees, among others. Previous Eurodad research found that a significant proportion of support from these institutions is channelled through tax havens.<sup>6</sup> Academic research has shown that by supporting investments routed through secrecy jurisdictions DFIs allow the possibility of a significant loss of tax revenues.<sup>7</sup> More importantly, they are helping to legitimise the offshore industry.

As institutions whose aim is to reduce poverty and contribute to sustainable development in developing countries, DFIs have a significant opportunity to set an example in terms of fair taxation, transparency and accountability. Civil society organisations (CSOs), including Eurodad, have repeatedly urged DFIs to adopt effective policies and to collect and publicly disclose valuable portfolio data in order to make sure citizens can hold them to account.

This report builds on previous Eurodad research and recommendations and presents a mapping exercise of the DFIs that have so far formally adopted internal policy standards on the use of tax havens. It covers three multilateral institutions: the World Bank's International Finance Corporation (IFC); the European Bank for Reconstruction and Development (EBRD); and the EU's European Investment Bank (EIB), and 14 bilateral European-governed DFIs.



By supporting investments routed through secrecy jurisdictions, DFIs allow the possibility of a significant loss of tax revenues. More importantly, they are helping to legitimise the offshore industry.

This report also aims to update CSO analysis of DFI policies in relation to secrecy jurisdictions and the level of transparency of their portfolio. The analysis is also illustrated, when possible, by references to DFIs' support to private sector companies structuring their investments through secrecy jurisdictions. The objective is to inform and support CSOs' tax justice advocacy and campaigns towards multilateral and bilateral DFIs, as well as to contribute to the broader debate on the impacts of private financial flows.

The report is structured as follows:

- The first chapter explains what DFIs are and how they operate, how tax havens or secrecy jurisdictions are being defined, how we analyse the role of tax havens and why they are problematic from a development perspective.
- The second chapter sheds light on the recent and ongoing use of tax havens by selected DFIs, and how DFIs justify this.
- The third chapter screens DFIs on the accessibility of their internal standards regarding secrecy jurisdictions, and further provides an overview of the standards of multilateral and bilateral DFIs where they are available. It goes on to look at the way in which DFIs collect and disclose data from their investee companies as part of due diligence procedures.
- The fourth chapter presents a critical analysis of current practices.

The evidence has been obtained from academic and civil society papers, online portfolios and policy documents from bilateral and multilateral DFIs, documents shared by the DFIs on request, and interviews with experts and officials. A summary of the methodology can be found in the Annex.



As institutions whose aim is to reduce poverty and contribute to sustainable development in developing countries, DFIs have a significant opportunity to set an example in terms of fair taxation, transparency and accountability.

# 1 DFIs and the use of tax havens

## What are DFIs and how do they operate?

### DFIs are government-controlled institutions that invest in private sector projects in developing countries.

There are bilateral and multilateral DFIs; while the former refers to national institutions that serve to implement their government's international development cooperation policies, the latter refer to the private sector arms of the multilateral or regional development banks, such as the World Bank's International Finance Corporation (IFC) and the private sector activities of the EU's European Investment Bank (EIB), and the European Bank for Reconstruction and Development (EBRD), among others. In Europe, 15 bilateral DFIs are members of the Association of European Development Finance Institutions (EDFI).<sup>8</sup>

### The role of DFIs in development finance has increased dramatically.

At the global level, the IFC is the biggest player in this field and its investment commitments have increased by a factor of six since 2002. At the European level, the consolidated portfolio of EDFI members increased between 2003 and 2013 from €10 billion to €28 billion, a 180% increase.<sup>9</sup> This increase is backed by the fact that most DFIs have sovereign guarantees from their governments, who will bail them out – and their creditors – should that prove necessary. In many cases, it is also supported by DFIs' de facto preferred creditor treatment – meaning they will be paid even in the event of a currency crisis in the developing country where they are supporting private investment. In most cases, DFIs are exempt from paying tax on their income and their shareholders will not usually require dividends or to be paid on their investments. This protects DFI investments in a way that no other financial institution can compete with.

Some DFIs are wholly owned by the public sector, while others have mixed public and private ownership. Multilateral institutions are characterised by a completely different ownership structure than bilateral DFIs, as their capital base is supplied by member state governments, who are represented on the institutions' governing boards. Most DFIs are funded by donors' development agencies and can raise additional funds through capital markets.

The objectives of DFIs are often multiple and their mandates vary. Some explicitly include development as their overarching objective, whereas others prioritise support to an efficient private sector as the missing link between development and financial profitability, have mandates that do not explicitly recognise development outcomes, or are directly tied to the interests of national industries (IFU and SIMEST). In practice, DFIs are organised as private corporations with commercial and profitability considerations, which often implies a trade-off between these goals.<sup>10</sup>

DFIs support private sector companies operating in developing countries directly by providing loans or buying shares, or indirectly by supporting financial intermediaries such as commercial banks and private equity funds, which subsequently on-lend or invest in enterprises operating in developing countries.

Eurodad's report *A Private Affair* has shown that the financial sector has been favoured by DFIs in recent years,<sup>11</sup> a trend that has been driven by the IFC, which invests more than 50% through the financial sector. Between July 2009 and June 2013 the IFC invested \$36 billion through the financial sector, namely banks and private equity funds. According to a Bretton Woods Project report, this is three times as much as the rest of the World Bank Group invested directly in education and 50% more than it invested in healthcare.<sup>12</sup> The IFC claims that investments in the financial sector allow the bank to “extend its long-term finance to more companies, in particular to small and medium enterprises (SMEs) and microfinance entrepreneurs”.<sup>13</sup> For similar reasons, the financial sector is the largest sector for EDFI members, with an average of

30% of their total portfolio in 2013, although some European DFIs are more strongly concentrated in this sector than others. For example, in 2013 more than 88% of CDC's total portfolio was committed to the financial sector, accounting for more than \$5 billion.<sup>14</sup>

## What are tax havens?

Although there are no universally accepted criteria for defining “tax havens”, the term is applied to states characterised by the adoption of unusually low tax rates,<sup>15</sup> which also provide secrecy to commercial operators and investee companies, thereby facilitating various kinds of illicit financial flows.<sup>16</sup> They are also widely referred to as “secrecy jurisdictions” or Offshore Financial Centres (OFCs), a term that refers more to “a set of activities than a geographical setting”, as they “sell services (...) to exploit the mechanisms created by the legislation in the tax havens or secrecy jurisdictions”.<sup>17</sup> In practice, however, the three terms are often used as synonyms,<sup>18</sup> also by DFIs.

The current framework used by many DFIs to define tax havens is the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes. This forum was created in the early 2000s to address the risks to tax compliance posed by tax havens. The main activity of the Forum is to conduct peer reviews, in which countries have to undergo detailed assessment against ten evaluation criteria in relation to their willingness to exchange tax-related information as well as the actual implementation of such commitments. The process is broken down into two phases. Phase 1 assesses the quality of a jurisdiction's legal and regulatory information exchange framework. If a country complies with these standards, it moves to Phase 2, where



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**Table 1: Top 20 jurisdictions on the Financial Secrecy Index**

1	Switzerland	12	Malaysia
2	Luxembourg	13	Bahrain
3	Hong Kong	14	Bermuda
4	Cayman Islands	15	Guernsey
5	Singapore	16	United Arab Emirates (Dubai)
6	USA	17	Canada
7	Lebanon	18	Austria
8	Germany	19	Mauritius
9	Jersey	20	British Virgin Islands
10	Japan		
11	Panama		

they are examined on how this exchange of information is being implemented in practice,<sup>19</sup> after which they are rated as “compliant”, “largely compliant”, “partially compliant” or “non-compliant”.<sup>20</sup>

Eurodad believes that the OECD approach is insufficient to identify tax havens because it uses unambitious standards that are mostly focused on banking secrecy instead of corporate tax dodging and country by country reporting, among other issues. Furthermore, many developing countries do not participate in this forum. **Therefore, for the purpose of this report, we use Tax Justice Network’s more comprehensive Financial Secrecy Index (FSI).**<sup>21</sup> This index, which ranks 82 jurisdictions according to their degree of secrecy and their importance in global finance, merited a reference in the 2014 United Nations Conference on Trade and Development (UNCTAD) report on Trade and Development as it “offers an alternative to the OECD approach”.<sup>22</sup> It is based on a secrecy score constructed from 15 indicators, including public availability of beneficial ownership information, compliance with international anti-money laundering standards and full participation in Automatic Information Exchange. Scores range from zero (total financial transparency) to 100

(total financial secrecy). The index shows that some of the biggest tax havens are in fact some of the world’s largest and wealthiest countries, such as Switzerland, Luxembourg and the United States. Table 1 lists the top 20 jurisdictions included in the FSI.

We have chosen to analyse the portfolios of DFIs based on this limited set of secrecy jurisdictions, as the FSI identifies them as the worst examples: if DFIs support companies that use them, then it is fair to say they are providing legitimacy to the tax havens that are at the heart of the global problems of illicit financial flows and tax dodging, which are so damaging for developing countries.

### **Why DFI use of tax havens is problematic from a development perspective**

#### **Taxation has an essential role in society. It allows states to raise domestic resources and provide public goods such as education, infrastructure and healthcare.**

Nonetheless, in Europe alone, tax evasion and avoidance cause an estimated €1 trillion loss of income each year.<sup>23</sup> Yet it is the developing countries that are highly vulnerable. In 2008, Christian Aid estimated that developing countries lost around \$160 billion per year in corporate tax revenues due to transnational enterprises and other trading entities illegally manipulating their profits to shift them into tax havens, where they face little or no tax. They estimated that this would be enough to substantially address infant mortality and save the lives of 350,000 children aged five or under every year.<sup>24</sup> While these estimates are imprecise owing to the illicit nature of the flows they are trying to track, according to the UNCTAD “their magnitude is in line with that of national tax authorities or other official sources”.<sup>25</sup>

Tax havens play a systemically important role in this global trend of wealth transfer. In 2009, it was estimated that two million international business companies and hundreds of thousands of trusts, mutual funds, hedge funds and captive insurance companies are located in tax havens. In addition, about half of all international bank lending is routed through tax havens and 30-40% of the world’s stock of Foreign Direct Investments is accounted as assets of firms registered in these jurisdictions.<sup>26</sup>

Furthermore, Tax Justice Network reports that “an estimated \$21 to \$32 trillion of private financial wealth is located, untaxed or lightly taxed, in secrecy jurisdictions around the world”.<sup>27</sup>

There are several reasons why DFIs’ use of tax havens are problematic from a development and an economic global justice perspective. They include:

- **Legitimising a structural problem of the economy:** By supporting investments routed through tax havens, DFIs essentially legitimise a perverse and damaging industry and contribute to a status quo in which developing countries continue to suffer from the damaging structures in tax havens that generate tax evasion, avoidance and other damaging activities.<sup>28</sup>
- **Taxes lost due to routing investments through tax havens:** By supporting private sector companies that route their investments through tax havens, DFIs allow the possibility of a significant loss of tax revenues to developing countries. According to a study by the University of Manchester, Norfund underpaid more than \$14.6 million (gross) in tax for 2008.<sup>29</sup> This is tax that Norfund would have paid for 29 investee companies if these companies had been domiciled in the same jurisdictions as their operations, rather than in a tax haven.<sup>30</sup>
- **Lack of transparency:** Many tax havens have strict secrecy regulations. These are often reinforced by the absence of public registries containing significant information about companies and other legal entities conducting economic activity. As a result, stakeholders located where the actual economic activities of companies take place have few opportunities to know who the “brains” behind the companies are (beneficial owners) and to hold them to account.<sup>31</sup> Although DFIs have due diligence procedures to ensure that they are in no way supporting criminal or unethical activities, several cases<sup>32</sup> in the past have shown that these procedures are not always successfully enforced (see Chapter 3, Box 2).

# 2 Scope and trends of DFI use of tax havens

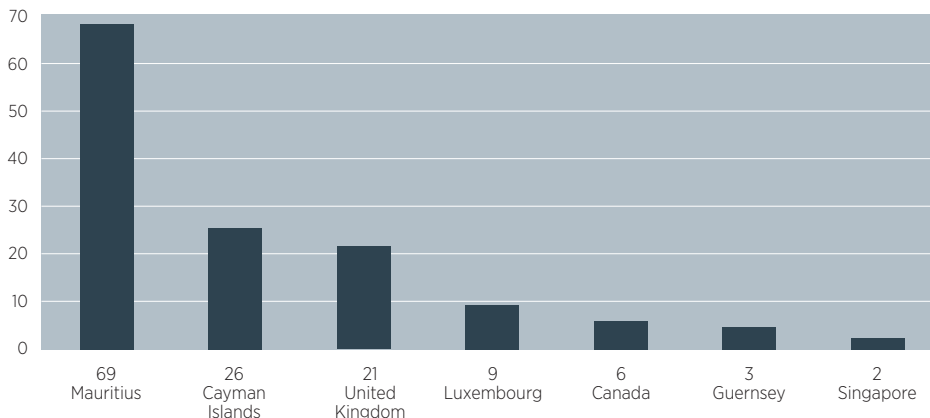
## Recent DFI use of tax havens

To give some indication of the ongoing trend of DFI support being routed through tax havens and the need to monitor this investment model with firm standards, we screened the latest portfolio data from CDC, BIO, Norfund and DEG, as these were available online and largely consistent, in contrast with many other DFI portfolios. Our research shows that a large portion of DFI money is still being channelled through funds registered in secrecy jurisdictions that feature in the top 20 of Tax Justice Network's FSI.

### CDC (UK)

CDC's portfolio as of 31 December 2013 shows that both its direct and its indirect investment model rely heavily on secrecy jurisdictions. A massive 118 out of a total of 157 fund investments go through secrecy jurisdictions. Between 2000 and 2013, these funds received a total of \$3.8 billion in CDC commitments. Graph 1 shows that 69 of these funds are registered in Mauritius (\$1.8 billion), while 26 funds are registered in the Cayman Islands (\$909 million). In addition, of the 21 funds registered in the United Kingdom, 15 are domiciled in the City of London through CDC's largest spin-off, Actis. Between 2000 and 2013, these 15 funds received \$2.3 billion in original CDC commitments.

**Graph 1: CDC's fund investments channelled through top 20 jurisdictions of FSI**



Source: CDC portfolio at the end of 2013

The use of secrecy jurisdictions is less prominent in the case of direct investments: six of the 19 direct investments (\$194 million) have a routing pattern through Mauritius.

In 2013, the CDC invested in nine funds, of which six were structured through major secrecy jurisdictions: two were domiciled in Mauritius, two in Singapore, one in Guernsey and one in Luxembourg. These six funds received a total of \$553 million.

### BIO (Belgium)

In 2012, a critical report by the Belgian organisation 11.11.11<sup>33</sup> revealed that nearly €111 million (\$144 million) of BIO's investments were structured through secrecy jurisdictions such as the Cayman Islands and Mauritius. In addition, Eurodad found that, as of 4 June 2014, BIO was engaged in a total of 42 investment funds, 30 of which were domiciled in jurisdictions that feature in the FSI's top 20, in which BIO invested a total of \$207 million.

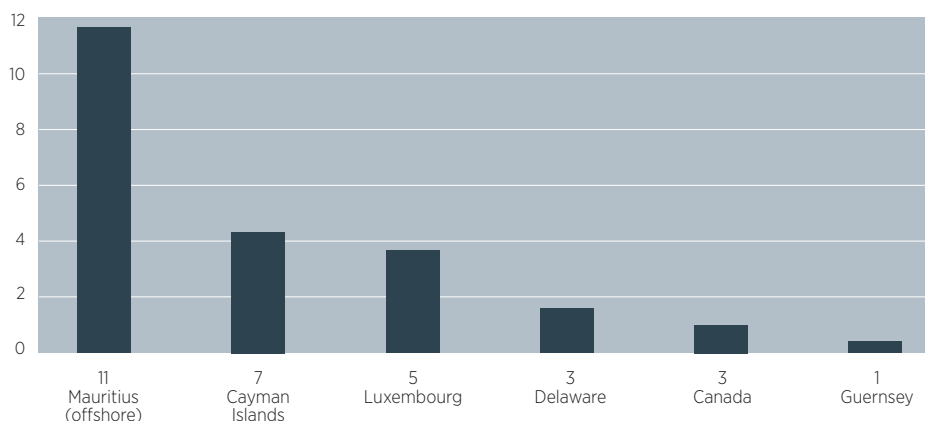
### Norfund (Norway)

At the end of 2013, 46 of Norfund's 165 active investments were channelled through jurisdictions that appear on the FSI's top 20 (see Graph 3). Between 1999 and 2013, Norfund committed a total of \$339.43 million to these companies.<sup>34</sup>

### DEG (Germany)

DEG's latest portfolio figures show that a significant proportion of its investment holding operates through secrecy jurisdictions. Of DEG's 46 investment projects as of 31 December 2012, at least seven were structured offshore through major tax havens

**Graph 2: BIO's fund investments channelled through top 20 jurisdictions of FSI**



Source: BIO online portfolio at 4 June 2014



In 2013, the CDC invested in nine funds, of which six were structured through major secrecy jurisdictions: two were domiciled in Mauritius, two in Singapore, one in Guernsey and one in Luxembourg.

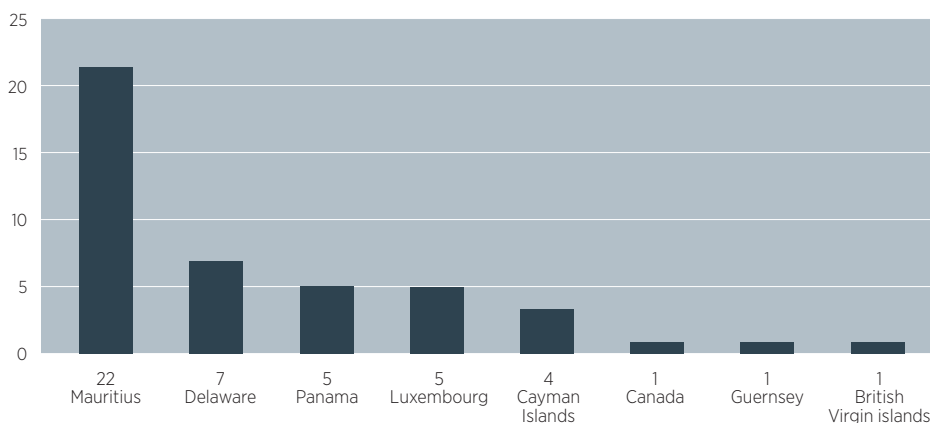
such as the Cayman Islands, St Kitts and Nevis and British Virgin Islands. At least two of DEG's eight investments in Africa were registered offshore in Mauritius.<sup>35</sup>

### Demystifying why DFIs use tax havens

Most DFIs argue that secrecy and low taxation are not the reasons why the funds in which they invest are domiciled in tax havens. In several reports and public statements, DFIs generally claim that tax havens offer the kind of services that are important to make their activities possible in specific countries.

According to a report from the Norwegian Commission on Capital Flight and Developing Countries,<sup>36</sup> Norfund argues that tax havens prove to be particularly advantageous as they offer "a good and stable legal framework specially tailored to the requirements of the financial sector", "arrangements which avoid unnecessary taxation in third countries" and "political stability". CDC states that tax havens can provide "straightforward and stable financial, judiciary and legal systems which facilitate investment",<sup>37</sup> while the EBRD claims that "the choice of the jurisdiction may be influenced by the desire to avoid double taxation".<sup>38</sup> According to the Swiss Investment Fund for Emerging Markets (SIFEM), tax havens "make [it] possible to set-up investment funds with a regional scope which can thus invest in multiple countries".<sup>39</sup>

### Graph 3: Norfund's investments channelled through top 20 jurisdictions of FSI



Source: Norfund's portfolio as at the end of 2013

#### Eurodad questions these arguments:

**1. A stable financial, judiciary and legal framework:** While it is partly true that tax havens provide better legal structures for the use of investment funds than many developing countries, a key part of the role of DFIs' is to promote private sector development at the local level, thus it is possible to think that this implies helping create structures that allow for direct investments. Furthermore, in most cases DFIs invest in funds that other investors have already set-up in a specific jurisdiction. Since many of these

jurisdictions are tax havens, there is a higher risk that investors simply use what has already been established to start shifting profits and as such avoid taxation.

**2. Avoidance of double taxation:** Double taxation occurs when a company is taxed twice on the same income, both in its home country, say the UK, and in the country in which it invests, say Nigeria.<sup>51</sup> For years, developing countries have been pressured to sign double taxation treaties that generally lower or remove taxation of outgoing flows of capital with the aim of avoiding double taxation. However,

### Box 1: Use of tax havens by IFC, FMO and Proparco

Because portfolio data from the IFC, The Netherlands Development Finance Company (FMO) and Promotion et Participation pour la Coopération économique (Proparco) were unavailable or incomplete, the following examples and figures are based on partner and corporate reports, or portfolios from co-investing DFIs. However, the use of tax havens will likely reach further than available evidence suggests.

**IFC:** Between July 2009 and June 2013, the IFC supported financial intermediaries registered in tax havens listed in the top 20 FSI amounting to \$2.2 billion of public money.<sup>40</sup> In addition, between January and June 2013, the IFC disclosed 94 summaries of proposed investments through financial intermediaries. At least eight of these projects were intended for other developing countries but were channelled through corporate vehicles registered in one of the following jurisdictions: Cayman Islands (4), Mauritius (2), Delaware (1) and Guernsey (1). These projects received

a total amount of \$195 million in IFC commitments. Even some of the domestic financial institutions channelled their investments through tax havens. For example, in 2013 the IFC approved an investment in India 2020 Fund II, a domestic fund with a destination in India, but structured through a Mauritius-domiciled subsidiary.<sup>41</sup> By doing so, the IFC follows a widely-popular investment route that many foreign investors use to earn tax-favoured profits when investing in India.<sup>42</sup>

**FMO:** In July 2012, FMO invested \$8.5 million in the Leopard Haiti Fund, a private equity fund focusing on the reconstruction of the Haitian economy. The fund is managed by the Cayman-domiciled fund management company Leopard Capital.<sup>43</sup>

In December 2012, FMO agreed to invest \$6 million in the Business Partners International Southern African SME Fund (BPI SA), a Mauritius-based fund managed by Business Partners International, a subsidiary of Business Partners (BP). The fund was established with the purpose of replicating BP's model of SME support in South Africa

in other countries including Namibia, Zimbabwe, Zambia and Malawi. Other DFIs, such as CDC and the African Development Bank (AfDB), are involved in the fund as well.<sup>44</sup>

In December 2013, FMO invested \$6 million in SFC Finance Limited, a company established by FMO's strategic partner AfricInvest to support SMEs.<sup>45</sup> Throughout the years, several other DFIs have actively participated in AfricInvest's investment strategy as well, such as BIO, Finnfund and the EIB. AfricInvest's office is registered in Mauritius.<sup>46</sup>

**Proparco:** Between 2007 and 2013, Proparco channelled more than \$505 million intended for developing countries through tax havens,<sup>47</sup> none of which, however, were considered as "non-cooperative jurisdictions," according to Proparco's policy. As of 31 December 2012, Proparco had investments in place in funds such as Cauris Croissance II (Mauritius),<sup>48</sup> I&P Capital II (Cayman Islands)<sup>49</sup> and Development Principles Fund II (Cayman Islands),<sup>50</sup> among many others.

these treaties, and in particular the treaties signed with tax havens, have become a key part of the structure that allows companies to avoid or evade taxation altogether (“double-non-taxation”). The double taxation treaty system is therefore now under heavy criticism, for example from the International Monetary Fund (IMF), which has recommended that “[developing countries] would be well-advised to sign treaties only with considerable caution.”<sup>52</sup> If DFIs want to support investments routed through tax havens to avoid double taxation, they should firstly prove that this does not lead to lower taxation in the developing country where the economic activity has taken place. Secondly, they should explain why a tax haven structure – rather than the structures of countries with ordinary tax and transparency laws – is necessary. In general, DFIs should also demonstrate what they are doing in order

to ensure that each developing country gets its fair share of tax. As institutions that “enter markets where few others dare to tread”,<sup>53</sup> DFIs should respect the tax system in the developing countries in which they – or their clients – operate, and accept that this might result in a lower return on their investments.

**3. Political stability:** The argument that tax havens and other well-resourced countries offer more political stability than some of the targeted developing countries is invalid unless DFIs clarify what kind of political instability in the specific developing country prevented them from investing directly. This is crucial, since a significant number of developing countries that receive indirect DFI support via tax havens have become relatively stable democracies. Furthermore, tax havens can also be vulnerable to political

instability. In the last couple of years, tax havens have experienced shockwaves as a result of several high-ranking politicians condemning tax avoidance and evasion,<sup>54</sup> and initiatives taken by investigative journalists, such as *Offshore Leaks*.<sup>55</sup>

**4. Possibility to set up funds with a regional scope that can be used to invest in multiple countries:**

DFIs should explain more clearly what the costs and benefits are of investing in each country directly versus the indirect alternative of investing in a fund with a regional scope. Moreover, if such a cost-benefit analysis concludes that an indirect investment is the better option to finance SMEs, for example, then DFIs can still decide to only invest in funds that are set up in states that offer similar financial services, but that do not have the traits of tax havens.

# 3 DFI standards regarding tax havens

This chapter examines the extent to which DFIs have adopted standards on the use of tax havens. The chapter provides an overview of all the available multilateral and bilateral DFI standards in order to identify key trends and whether they are accessible to the general public. It also focuses on the kind of data DFIs require from their investee companies as part of their due diligence procedures and the level of portfolio transparency.

## Accessibility of DFI standards regarding tax havens

This report ranks DFIs on the level of accessibility of their tax haven standards. In practice, this relates to DFIs' transparency and access to information policy. According to CSOs, this policy should be based on a presumption of full disclosure (with a limited list of exceptions), particularly in relation to their standards as a broad range of stakeholders should be able to hold them to account for any possible breach of them.

### Eurodad argues that a high level of accessibility exists when the DFI:

- Explicitly discloses its internal standards in a specifically dedicated section on its website and, for people with limited internet access, on request.
- Makes additional efforts to ensure that affected people can actually access information regarding its internal standards. To judge this, we use as an indicator whether key documents are translated into the official language of the targeted country. This would increase the level of accountability of DFI operations vis-à-vis the general public, as it would allow for effective communication with the following stakeholders, in addition to DFI clients: national tax payers and local stakeholders in partner countries, including local parliamentarians, trade unions, CSOs and representatives of local communities.

Graph 4 indicates that none of the selected DFI adhere to the high level of accessibility, or transparency in relation to this particular policy. The three multilateral DFIs – IFC, EBRD and EIB – make their standards accessible on their respective websites, each in the shape of a formal document. However, these documents are only available in English (or in the case of the EIB, also in French) and are not translated into the official languages of the affected people that live in the countries that are targeted. This is particularly problematic since these

are the very people that are most affected by tax dodging activities. Therefore they have a legitimate interest in increasing their understanding of DFI attitudes towards tax havens.

At the bilateral level, five of the 14 bilateral European DFIs fail to disclose any standards online and on request. In addition, it is apparent that the two bilateral European DFIs with respectively the largest and second largest portfolio in 2012 – FMO and DEG – are seriously failing to lead by example. Whereas FMO does not disclose any internal standards, DEG states that it follows the “Guidelines of KfW for Dealing with Financing Transactions in Intransparent Countries and Territories”, which are not publicly disclosed.

## State of play of multilateral and bilateral DFI standards

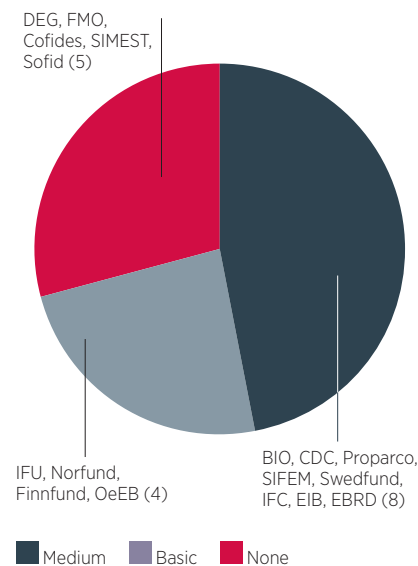
This section presents an overview of the main features of the multilateral and bilateral DFI standards towards the use of tax havens. As a result of our analysis of accessibility, the following DFIs have been excluded from an in-depth screening because they either do not have standards in place, or because their standards are not publicly available: DEG, the Portuguese Development Finance Institution (Sofid), the Spanish Development Finance Institution (Cofides),<sup>56</sup> the Italian Company for Enterprises Located Abroad (SIMEST) and FMO.

Table 2 presents information on the three multilateral institutions in our sample: IFC, EIB and EBRD, while Table 3 includes relevant information on selected European bilateral DFIs, taking into account national legislation. Both tables only include statements made in the specific policies, and as such do not analyse them here or their actual implementation.

The three multilateral DFIs in our sample have undertaken a process to harmonise their policies. As Table 2 clearly shows, the three DFI policies have a lot in common, with adherence to the OECD Global Forum standards as the most prevalent reoccurring pattern. In addition, in cases where the Global Forum identifies deficiencies, the three DFIs allow for the suspension of the policy if the jurisdictions makes a commitment, within three months, to correct these deficiencies.

A similar pattern emerges at the European bilateral level. As members of EDFI, DFIs

**Graph 4: Level of accessibility of DFI standards regarding tax havens**



undertook efforts to harmonise their practices on the use of tax havens by adopting the non-binding “EDFI guidelines for Offshore Financial Centres”.<sup>57</sup> These guidelines leave it up to each member DFI to adopt binding standards. Table 3 (overleaf) indicates that all European bilateral DFIs that have done so follow the OECD Global Forum standards (also mentioned in their national legislation). However, in the case of Proparco and the Austrian Development Bank (OeEB), they just partially take into account the OECD Global Forum standards. Proparco takes just Phase 1 ratings while the OeEB states that it ultimately decides on a project by project basis. Moreover, some DFIs also have additional national standards in place that are uniquely applicable to them when excluding certain tax havens, for example in the case of BIO, Proparco or OeEB.

## Due diligence procedures

In order to evaluate policy effectiveness, it is critical that DFIs have strict due diligence procedures in place, and request all necessary data from their investee companies. DFIs should also have in place full transparency requirements in relation to their portfolio. This will allow for proper accountability – particularly to a broad range of stakeholders – in relation to their due diligence procedures and the implementation of their standards.

**Table 2: Multilateral DFI standards regarding tax havens**

IFC	EIB	EBRD
<b>Ownership:</b> owned by 184 member states	<b>Ownership:</b> owned by 28 EU member states	<b>Ownership:</b> owned by 64 states and the EU and EIB
<b>Date of issue:</b> 11 October 2011 (last updated on 26 June 2014) <sup>58</sup> <b>Latest update:</b> 26 June 2014 <sup>58</sup>	<b>Date of issue:</b> 15 December 2010 <sup>59</sup> <b>Latest update:</b> 13 March 2014 <sup>60</sup>	<b>Date of issue:</b> 17 December 2013 <sup>61</sup>
<b>Main policy features:</b> <ul style="list-style-type: none"> <li>● No Investments through intermediate jurisdictions which have: <ul style="list-style-type: none"> <li>i. Following a Phase 1 review, been found unable to proceed to Phase 2</li> <li>ii. Following a Phase 2 review, been determined to be "non-compliant" or "partially compliant".</li> </ul> </li> <li>● Intermediate jurisdictions which are not meeting Global Forum standards must make a commitment to correct deficiencies within 3 months. Excluded intermediate jurisdictions will have a transition period of 8 (when failed to move to Phase 2) or 14 months (when failed to pass Phase 2) to address the deficiencies. If the jurisdictions file a request for a Supplementary Peer Review Report, the transition period will be extended to the date of the publication of this report.</li> </ul>	<b>Main policy features:</b> <ul style="list-style-type: none"> <li>● No investments through jurisdictions which have: <ul style="list-style-type: none"> <li>i. Following a Phase 1 review, been found unable to proceed to Phase 2.</li> <li>ii. Following a Phase 2 review, been determined to be "non-compliant" or "partially compliant".</li> </ul> </li> <li>● Counterparties located in these jurisdictions should disclose information on their beneficial owners, the economic rationale of the structure and the economic requirements that make the use of the jurisdictions necessary, and a description of the tax regime applicable.</li> <li>● Relocation requirements for relevant cross-border operations with counterparties incorporated in "grey-listed" or equivalent jurisdictions.</li> <li>● A temporary suspension of the relocation requirements of 8 months can be granted, if the relevant jurisdiction: <ul style="list-style-type: none"> <li>i. Sends to the EIB a written high-level commitment and outline of an action plan to redress the deficiencies identified by the Global Forum, within 3 months after the publication of the relevant country report;</li> <li>ii. Submits to the Global Forum a request for a reassessment together with a follow-up report indicating progress made, within 8 months from the publication of the relevant country report.</li> </ul> </li> </ul>	<b>Main policy features:</b> <ul style="list-style-type: none"> <li>● No investments through third jurisdictions which have: <ul style="list-style-type: none"> <li>i. not undergone any peer review as part of the OECD Global Forum and have not substantially implemented the internationally agreed tax standard.</li> <li>ii. been found unable to proceed from Phase 1 to 2.</li> <li>iii. been determined "non-compliant" or "partially compliant" in Phase 2.</li> <li>iv. been subject to a public statement by the Financial Action Task Force (FATF) calling for specific countermeasures by its members and others.</li> </ul> </li> <li>● The EBRD must be satisfied in any event that there are sound business reasons for the use and selection of jurisdictions.</li> <li>● Third jurisdictions which are not meeting Global Forum standards must make a commitment to correct deficiencies within 3 months. When it comes to CBCR, Eurodad found that none of the DFIs requires financial information reported on a country by country basis by all their investee companies. The only exception is Swedfund, who stated they do this. Thus, if the jurisdictions file a request for a Supplementary Peer Review Report, the suspension period can be extended to the publication of this report.</li> </ul>

In terms of **requesting information** from their clients, DFIs should a) identify the beneficial owners of all counterparties, and b) request all their investee companies to report on a country by country basis:

**a) Identification of beneficial ownership** would allow the DFIs to know who ultimately owns, controls or benefits from a company or fund that receives their support. Without this kind of due diligence, DFIs cannot guarantee that the use of a prohibited tax regime is fully excluded from its investment activities. Not knowing the real owners of the companies or funds will also make it impossible to ensure that these companies or funds are not involved in any other types of misconduct.

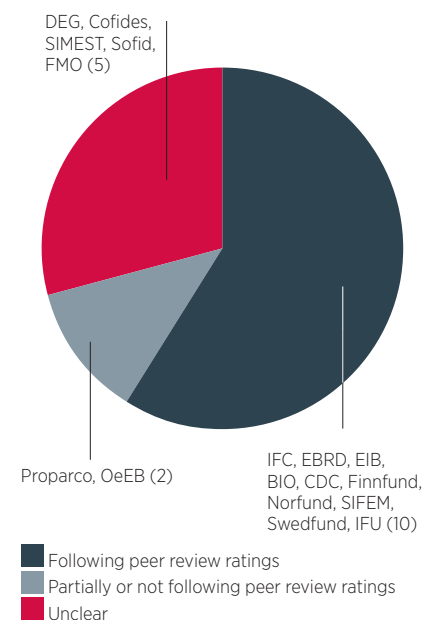
Eurodad analysis of DFIs' internal standards found that all DFIs in our sample, either multilateral or European bilateral, require their private sector clients to identify beneficial owners as part of their screening process, which is in itself a good starting point.

**b) Country by country reporting (CBCR)** is an essential instrument for DFIs to find out where their investee companies are economically active and creating value, compared to where they are booking profits and paying their taxes.<sup>62</sup> In practice, it would mean that investee

companies provide the DFI with relevant data about their economic activities, profits, losses, number of employees, taxes paid and other forms of economic performance in each country where they have some kind of activity. CBCR is in itself a powerful due diligence tool in order to safeguard DFIs against supporting tax dodging activities. It is even more powerful if this information is publicly disclosed, as this has the potential to raise red flags in order to examine dubious corporate tax practices.

When it comes to CBCR, Eurodad found that none of the DFIs requires financial information reported on a country by country basis by all their investee companies. The only exception is Swedfund, who stated they do this. Thus, there is insufficient information to identify where DFI client companies and financial intermediaries are making profits and where taxes should be paid.

At the multilateral level, the IFC, EIB and EBRD collect information from their client companies on their corporate taxes paid, profits and losses and number of employees and staffing costs. However, this is not being done on a country by country basis. At the bilateral level, only Swedfund claims that "if a company has operations in different countries these operations are usually accounted for country by country, following the accounting standard and tax

**Graph 5: DFI dependency on OECD Global Forum peer reviews**

**Table 3. European bilateral DFI standards regarding tax havens**

DFI	Ownership	Format	Main policy features
<b>BIO</b> (Belgium)	100% state owned	Articles in legal provisions, agreement with Belgian government, and a circular letter	<ul style="list-style-type: none"> <li>No investments through jurisdictions which:               <ol style="list-style-type: none"> <li>refuse to negotiate automatic information exchange agreements with Belgium after 2015</li> <li>have not successfully passed Phase 1 and Phase 2 peer reviews and labelled as “non-cooperative for more than one year”, and</li> <li>are listed by Art. 307, § 1 of Belgian Income Tax Code 1992 . This includes jurisdictions which levy corporation tax at a nominal rate of less than 10%.</li> </ol> </li> <li>BIO will take measures to avoid practices of transfer pricing in cases where the (potential) beneficiary is not located in a prohibited jurisdiction, but is being controlled for at least 25% by an entity domiciled in a prohibited jurisdiction.</li> </ul>
<b>CDC</b> (UK)	100% state owned	Document “Policy on the payment of taxes and the use of offshore financial centres” <sup>64</sup>	<ul style="list-style-type: none"> <li>No investments through jurisdictions which have:               <ol style="list-style-type: none"> <li>Not undergone any peer review as part of the OECD Global Forum</li> <li>Following a Phase 1 review, found unable to proceed to Phase 2</li> <li>Following a Phase 2 review, and determined to be “non-compliant” or “partially compliant”.</li> </ol> </li> <li>CDC will only invest in any of these jurisdictions if it considers that the “development benefits justify the use of an intermediary located in such a jurisdictions”.<sup>65</sup></li> </ul>
<b>Finnfund</b> (Finland)	92.1% state owned, 7.8% Finnvera, 0.1% confederation of Finnish Industries.	Standards in annual report 2013 <sup>66</sup>	<ul style="list-style-type: none"> <li>Finnfund follows guidelines given by the Ministry of Foreign Affairs.</li> <li>No investments through jurisdictions which have been deemed ineligible to move from Phase 1 to Phase 2, or labelled as “non-compliant” or “partially compliant” in Phase 2 of the OECD Global Forum.</li> <li>Background checks on fellow investors and fund management companies and heightened due diligence on taxes paid.</li> </ul>
<b>IFU</b> (Denmark)	100% state owned	Document “IFU’s policy regarding offshore financial centres”	<ul style="list-style-type: none"> <li>IFU may only invest in sound and transparent company structures, that do not contribute to tax evasion or money laundering.</li> <li>No Investments through jurisdictions which have:               <ol style="list-style-type: none"> <li>Not undergone any peer review as part of the OECD Global Forum</li> <li>Following a Phase 1 review, been found unable to proceed to Phase 2</li> <li>Following a Phase 2 review, been determined to be “non-compliant” or “partially compliant”.</li> </ol> </li> <li>IFU can use OFCs when there is “a clear business or development rationale”.</li> <li>IFU may discuss the Global Forum’s opinion and assessment with relevant Danish authorities. The Ministry of Foreign Affairs will assist in these discussions.</li> </ul>
<b>Norfund</b> (Norway)	100% state owned	Standards accessible on request	<ul style="list-style-type: none"> <li>Norfund’s use of a third jurisdiction should be in accordance with international guidelines put forward by the OECD Global Forum and the FATF, and in accordance with the rules that also apply to other public companies and funds.</li> </ul>
<b>OeEB</b> (Austria)	100% private, Oesterreichische Kontrollbank, though backed by Austrian Sovereign Guarantee	Standards accessible on request	<ul style="list-style-type: none"> <li>Due to the limited number of transactions, OeEB decides on a project by project basis, factoring not only OECD Global Forum ratings, but the entire project structure and possible indicators that jurisdiction is planning to take measures to address deficiencies.</li> <li>OeEB takes into account EBRD and EIB practices under their respective policies.</li> </ul>
<b>Proparco</b> (France)	57% state owned, 43% private.	Document “Policy with regard to Non-Cooperative Jurisdictions (NCJs)” <sup>67</sup>	<ul style="list-style-type: none"> <li>Prohibition from using vehicles registered in NCJs or from financing investment vehicles registered in NCJs that have no real business activity there (e.g. investment funds).</li> <li>Prohibition from financing artificially structured projects involving counterparties whose shareholders are controlled by entities registered in NCJs, unless that registration is warranted by sound business reasons in those jurisdictions.</li> </ul> <p>Proparco considers as NCJs all countries which are on the French list of NCJs as stated in the French General Tax Code (Botswana, Brunei, Guatemala, Marshall Islands, British Virgin Islands, Montserrat, Nauru and Niue) and countries that failed to pass Phase I of the OECD Global Forum peer review process.</p> <p>Proparco has a banking licence and is subject to the French Banking Law, which include Anti-Money Laundering and Combating Terrorism Financing (AML/CFT) requirements. This includes:</p> <ul style="list-style-type: none"> <li>An identification threshold for shareholders of a company located in NCJs set at 5%, which also applies to other type of counterparties deemed as highly risky under the Proparco AML/CFT internal procedure.</li> <li>Projects registered in NCJs will be stopped in cases where Proparco cannot identify beneficial owners, where the counterparty cannot sufficiently justify companies registered in NCJs, or where there are signs that the company is being artificially structured or used for unlawful purposes.</li> </ul>
<b>SIFEM</b> (Switzerland)	100% state owned	Viewpoint “Why does SIFEM invest through Offshore Financial Centres?” <sup>68</sup>	<ul style="list-style-type: none"> <li>SIFEM constantly reviews its policy in light of the work of the Global Forum and seeks to follow internationally agreed standards. Currently no Investments through jurisdictions which have:               <ol style="list-style-type: none"> <li>Not undergone any peer review as part of the OECD Global Forum</li> <li>Following a Phase 1 review, been found unable to proceed to Phase 2</li> <li>Following a Phase 2 review, been determined to be “non-compliant” or “partially compliant”.</li> </ol> </li> <li>Abidance to the Swiss Anti-Money Laundering Act, which entered into force in 1998 and imposes on all financial intermediaries the identification of beneficial owners.</li> </ul>
<b>Swedfund</b> (Sweden)	100% state owned	Standards online on the Corporate Governance <sup>69</sup> section and in the Sustainability Report 2012 <sup>70</sup>	<ul style="list-style-type: none"> <li>No investments through intermediate jurisdictions which have:               <ol style="list-style-type: none"> <li>Following a Phase 1 review, been found unable to proceed to Phase 2</li> <li>Following a Phase 2 review, been determined to be “non-compliant” or “partially compliant”.</li> </ol> </li> </ul>

## Box 2: the case for identification of beneficial ownership and CBCR

### Beneficial ownership: the James Ibori case

In 2006, the EIB and other DFIs, including the CDC, started to support a private equity firm – Emerging Capital Partners (ECP) – which subsequently invested in three Nigerian companies: Oando, Notore and Intercontinental Bank. These companies were alleged by Nigeria’s financial crimes investigation agency to have served as “fronts” for laundering money, said to have been obtained by James Ibori, the former Governor of Nigeria’s Delta state. ECP also used an offshore shell company, Notore Mauritius, to invest in Notore. This increased the secrecy surrounding the investment, which may have enabled Notore’s directors to avoid paying taxes in Nigeria on their investment<sup>71</sup>.

Several CSOs have accused the DFIs of failing to address these risks. When the

issue was raised, the DFIs referred the allegations to the accused firm, ECP, who denied them. They then continued doing business with ECP despite publicly available information showing that some of ECP’s assurances had to be false<sup>72</sup>.

In the case of CDC, the UK parliamentary ombudsman noted that the UK’s Department for International Development (DFID) and the CDC attributed their inability to independently assess compliance with their ethical business principles to the limited contractual rights and obligations that CDC had entered into with the fund manager<sup>73</sup>.

Following a long trial, Ibori pleaded guilty to charges of fraud amounting to nearly \$80 million and received a 13-year jail sentence in April 2012<sup>74</sup>.

### CBCR: the Mopani Copper Mines case

In 2005, the EIB loaned \$50 million to Mopani Copper Mines for the renovation of a smelter. Although the company is

physically located in Zambia, one of the least-developed countries, it is largely owned by GlencoreXstrata, which is officially headquartered in Jersey, but operates from Switzerland. Mopani Copper Mines are controlled through the British Virgin Islands.

In 2011, a leaked audit report commissioned by the Zambian government<sup>75</sup> found that Mopani had sold copper to Glencore at 25% of the international price, keeping the profits in Zambia low and depriving Zambia of much-needed tax revenue. The report also found that Mopani had inflated costs between 2006 and 2008 to further reduce its profits and consequently its tax bill. The EIB started an investigation in 2011, but has failed to share its findings so far.<sup>76</sup> More importantly, had the EIB forced its client to report on a country by country basis, it would have been possible to identify profit shifting even without investigations.

legislation of the country in question”.<sup>63</sup> Proparco, on the other hand, does not require its client companies to report on a country by country basis. This is particularly surprising, since Chapter III, Article 8 of France’s new development law, which was adopted on 7 July 2014, clearly states that the Agence Française de Développement (AFD) Group, and as such also Proparco, should promote financial transparency on a country by country basis for companies operating with them.<sup>77</sup> This amendment, which follows strong CSO pressure, builds on France’s banking reform law from July 2013, which made it mandatory for French banks to report on a country by country basis. While this law does not yet include CBCR requirements for companies in other sectors, it is clear that France’s new development law calls on the AFD Group to set an example in anticipation of more substantial reform.

**Portfolio transparency:** DFIs should put in the public domain relevant information about their portfolio to assure citizens that none of their client companies are involved in any tax dodging activities. This report ranks all European bilateral DFIs and selected multilateral DFIs on their level of portfolio transparency. To be considered with a “high” level of portfolio transparency, a DFI should publicly disclose all of the following essential data:

1. All **fund** and **direct investment domiciles**;
2. All investee companies’ **beneficial owners**; and

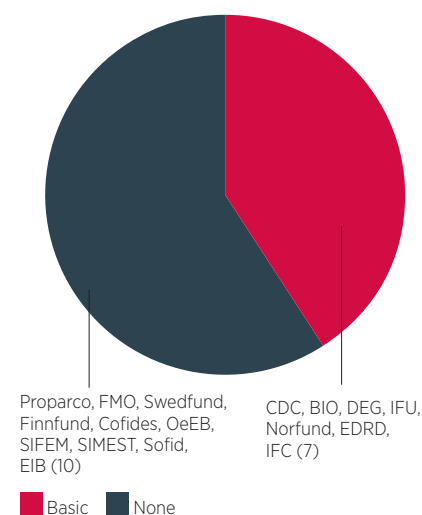
3. **Country by country** information on each investee company, namely: profits, losses, number of employees, taxes paid and other forms of economic performance in each country where they have some kind of activity. As UNCTAD clearly states, “making firms pay taxes in the countries where they actually conduct their activities and generate their profits” would not only “require the implementation of country by country reporting employing an international standard”, but also by “ensuring that these data are placed in the public domain for all stakeholders to access”.<sup>78</sup>

DFIs that only disclose all fund and/or direct investment domiciles and all investee companies’ beneficial owners will be rated as “medium”. In cases where a DFI only publishes one or the other, its level of portfolio transparency will be determined as “basic”, whereas in cases where a DFI fails to disclose any of the aforementioned data, its commitment will be rated as “none”.

As Graph 6 shows there is a very low level of portfolio transparency in most of the cases. 10 out of 17 DFIs fails to publish fund and/or direct investment domiciles, let alone any of the other essential data. Only CDC, BIO, DEG, the Danish Investment Fund for Developing Countries (IFU), Norfund, EBRD and IFC show a basic form of portfolio transparency on their use of tax havens by disclosing the domiciles of the funds in which they invest and in some cases direct investment domiciles. Swedfund has not been rated “basic” because it fails to share

fund or direct investment domiciles, and its public country by country information only covers the DFI itself, and not each individual investee company, although it claims that it requests this information. The level of portfolio transparency for EBRD<sup>79</sup> and IFC has been rated as “basic” although in a small number of cases both banks still fail to disclose fund and direct investment domiciles. Nonetheless, EIB’s level of portfolio transparency is significantly poorer. The bank is currently in the middle of a review of its transparency policy, in which CSOs are actively engaged.<sup>80</sup>

**Graph 6: DFI level of portfolio transparency**





# 4 A critical analysis of current practices

## The OECD Global Forum

As previously indicated, DFIs are highly dependent on the OECD Global Forum peer review process. Although the current peer review process offers an overview of commitments along several dimensions – such as ownership, accounting, rights and safeguards, network of agreements and confidentiality – it is insufficient in defining and listing harmful tax regimes, and has proven to be an unreliable tool to stop tax dodging activities and enhance domestic resource mobilisation.

The **current Global Forum peer review process is not fit for purpose** for several reasons, including:<sup>81</sup>

- **Unambitious standards:** The standards used are mainly focused on exchange of bank account information and, to a much smaller extent, on who owns which company. The Forum fails to address issues such as public disclosure of beneficial ownership and CBCR, and is thus not well placed to radically address corporate tax dodging. According to UNCTAD: “the [Forum] has been criticized for its bias towards standards that aligned with the interest of OECD Member States and for giving notorious tax havens a full seat at the table from the very beginning”.<sup>82</sup>
- **Lack of developing country representation in the Global Forum:** The OECD Global Forum is open to developing country participation and currently has 122 members and the European Union.<sup>83</sup>

However, the Forum is still predominantly led by developed economies,<sup>84</sup> and while the OECD claims that the Global Forum serves as a “dedicated self-standing secretariat”,<sup>85</sup> its employees ultimately remain “subject to the authority of the Secretary General”<sup>86</sup> and should “carry out their duties and regulate their conduct always bearing in mind the interests of the Organisation”.<sup>87</sup> The developing countries that are allowed to participate in the Global Forum do not have any voting rights in the OECD. Furthermore, as Figure 7 shows, a large number of developing countries – in particular least developed countries (LDCs) – are not members of the Global Forum, which is illustrative of their lack of representation on this body. During the World Bank and IMF’s annual meetings in October 2014, Ministers of Finance of Francophone LDCs stated that the cause of the ongoing problem of tax avoidance and evasion in their countries is their lack of decision-making power in global tax discussions, such as at the OECD level. They therefore called for “an equal seat at the table, which would best be provided by a high-level meeting under UN auspices, as part of the Financing for Development conference in July 2015”.<sup>88</sup>

- **“Upon request” information exchange:** This standard is based on governments sending specific case-by-case requests for information to each other. Until now, this system has been widely used internationally, but it has also been strongly criticised for being ineffective, especially when it comes to obtaining

information from countries with strong financial secrecy regulation such as Switzerland. In many cases, it has proven very difficult, and often impossible, for governments to obtain information, not least due to the fact that information requests often have to be very specific.<sup>89</sup>

In February 2014, the OECD presented a new global standard on Automatic Information Exchange. While this new system represents an advance towards transparency, UNCTAD argues that “the lack of inclusion of developing countries in the design phase of the new system and the premature inclusion of countries known as tax havens risk weakening the new system”.<sup>90</sup> In addition, tax havens can still exclude developing countries or refuse to sign multilateral agreements with them. For example, Switzerland issued a statement saying that it will only automatically exchange information with “countries with which there are close economic and political ties” and that “information should be reciprocal, i.e. should flow in both directions”.<sup>91</sup>

- **Costly with limited added value:** For developing countries that are members of the Global Forum, the costs of the peer reviews are out of proportion to their usefulness. The current standards focus on the legal and administrative infrastructure in a given country for non-residents investing there, and to what extent information is available to tax administrations for exchange purposes. This means that developing countries that do not yet have a system for collecting, processing and exchanging bank account information (many of these being LDCs) are obliged to prioritise policies designed for a hypothetical situation in which a non-resident is using the developing country’s bank account for dodging taxes in their home country.<sup>92</sup>

- **Conflict of interest:** The peer reviews are not impartial, as major OECD and G20 member states have been selected for a combined Phase 1 and Phase 2 review. According to the Tax Justice Network, such a review excludes any potential for political pressure for reform.<sup>93</sup> So far, 22 of the 26 countries that were selected for a combined review are OECD members or dependent territories (Jersey and Isle of Man).<sup>94</sup>

**Figure 7: Members of the OECD Global Forum**



■ Members of the OECD Global Forum



To ensure that the needs and views of developing countries are fully taken into account, it is necessary for all countries, including Least Developed Countries, to be able to participate on an equal footing in the setting of global standards on tax matters.

In general, Eurodad also believes that the OECD is not suited to being global standard setter either way, since its guidelines are non-binding and a vast majority of its members are developed countries, some of which are tax havens themselves. To ensure that the needs and views of developing countries are fully taken into account, it is necessary for all countries, including LDCs, to be able to participate on an equal footing in the setting of global standards on tax matters. Eurodad therefore believes that a more prominent role should be given to the UN, and an intergovernmental body on tax matters should be established under its auspices.

### Loopholes, exemptions and other limitations

Several of the multilateral and bilateral DFI standards include significant loopholes or exemptions, allowing DFIs to continue using ineligible jurisdictions in specific cases or casting doubt on how the standards will be enforced.

#### At the multilateral level:

- The IFC's updated policy extended the transition period to make the necessary adjustments: from six to eight months for intermediate jurisdictions that did not pass Phase 1, and from six to 14 months for the ones not passing Phase 2. Furthermore, in exceptional circumstances the Board can grant a request by the IFC for a "waiver" of the application of the usual standards, including the transition period, to transactions that involve such jurisdictions.
- The EIB's policy does not prohibit counterparties from registering in a

different country from where they are economically active, because of "other tax burdens that make the structure uneconomical". This implies that counterparties are still allowed to move to tax havens to benefit from lower taxation and/or higher secrecy.<sup>95</sup> In addition, counterparties can still operate in a prohibited jurisdiction if this jurisdiction offers a level of "corporate security". The policy also remains unclear about what this would entail.

- The EBRD's policy prevents the bank from investing through jurisdictions if there are no "sound business" reasons for the use and selection of such jurisdictions. The EBRD considers that tax planning may be a legitimate reason, if it uses lawful practices and double taxation treaties, and provided it does not involve the (near) elimination of taxation.

#### At the bilateral level, the picture is more mixed:

- BIO is still allowed to support private sector companies routing investments through Mauritius, because the jurisdiction has an advertised tax rate of 15%<sup>96</sup> and is therefore not mentioned in the list of countries stipulated in the Belgian Income Tax Code. However, according to commercial tax consultants – aiming to minimise companies' tax bills – through several provisions in Mauritius' tax regime, the country's rate of taxation can be reduced from 15% to an effective rate of 3%.<sup>97</sup> In addition, the current list of countries mentioned in the Belgian Income Tax Code has been adopted in 2010 and does not include major tax havens such as

Luxembourg or Delaware.<sup>98</sup>

- Proparco's current list of non-cooperative jurisdictions and territories, as stated in the French General Tax Code, has been reduced by more than half in the past four years, from 18 in 2010 to just eight in 2014.<sup>99</sup> Since Proparco's current definition of NCJs also does not include jurisdictions that are rated "non-compliant" or "partially compliant" following a Phase 2 review by the OECD Global Forum, Proparco is still allowed to use counterparties or finance investment vehicles registered in the following jurisdictions: Austria, Cyprus, Luxembourg, the Seychelles and Turkey.<sup>100</sup> This explains why Proparco channelled \$6.3 million to the Luxembourg-domiciled Moringa Fund in 2013,<sup>101</sup> despite the fact that Luxembourg was rated as "non-compliant" by the OECD Global Forum in 2013.<sup>102</sup>
- CDC's policy stresses that "CDC would only invest through a jurisdiction that is not successfully participating in the Global Forum in exceptional cases, and only if we consider that the developmental benefits of the investment justify the use of an intermediary located in such a jurisdiction". However, the policy does not elaborate on how CDC determines these development benefits.
- IFU's policy explicitly states that it "can use offshore financial centres in deal structuring in cases where there is a clear business or development rationale". However, there is little evidence available regarding the way IFU determines this business rationale.

The annual commitments of DFIs have risen sharply in recent years as part of increased interest in, and funding for, private sector development by most donors. Thus these institutions are playing an increasingly dominant role in development finance. At the same time, they are relying heavily on financial intermediaries that are domiciled in tax havens, and that play a crucial role in upholding an environment in which developing countries continue to suffer from tax dodging and lose out on much-needed domestic resources. By supporting investment routed through tax havens, DFIs help to legitimise, and in some cases reinforce, the damaging effects of the offshore industry, and operate against their public obligation to uphold a high level of transparency and promote development.

In order to better ensure their development objectives, DFIs need to show more effectively that they are engaging exclusively in pro-poor and sustainable investments. However, this report shows that DFIs generally fail to take an investment approach that fully reflects such a commitment. Although most DFIs have adopted internal policies on the use of tax havens, they are not ambitious enough, as they are highly dependent on the country ratings put forward by the OECD Global Forum. This forum fails to focus on decisive criteria such as CBCR and lacks the participation of many developing countries. Likewise, DFIs' due diligence procedures also generally do not include requirements for their investee companies to report on a country by country basis and most DFIs demonstrate a severe lack of portfolio transparency.

The current political momentum on tax justice presents DFIs with a great opportunity to **set an example of best practice in establishing the highest standards of responsible financing**. In practice, this means that DFIs should make sure they are closer to their development mandate rather than to a pure business approach as a financial institution.

## Therefore, DFIs should make the following changes:

- In order to ensure appropriate implementation of their current and future policy standards, DFIs should only invest in companies and funds that are willing to publicly disclose beneficial ownership information and report back their financial accounts on a country by country basis to the DFI. As an intermediate step, these country by country data should then be forwarded by the DFI to the relevant tax authorities. Ultimately, the data should be placed in the public domain for all stakeholders to access.
- DFIs should, wherever and whenever possible, ensure that the funds in which they invest are registered in the country of operation. Where that is not possible, DFIs should be explicit about the reasons why a third jurisdiction was preferred over a targeted developing country for domiciliation purposes, and how this, among other things, allowed them to advance towards their development objectives.
- DFIs should be fully accountable for their operations and those of their clients. In order to facilitate this, DFIs should make their current and future standards easily accessible for all citizens, in both the global north and global south. This means that standards should be available on their respective websites as well as on request, and should be translated into the official languages of the targeted developing countries. DFIs should also work towards full portfolio transparency to ensure proper accountability.

## In addition, Eurodad urges national governments to:

- Establish an intergovernmental tax body under the auspices of the United Nations with the aim of ensuring that developing countries can participate equally in the global reform of existing international tax rules. This forum should take over the role currently played by the OECD to become the main forum for international cooperation in tax matters and related transparency issues.

# Annex

## Methodology

### DFIs included in sample portfolio analysis:

Full portfolios were provided by CDC, Norfund, BIO and DEG. In the case of CDC, Norfund and BIO, it was possible to retrieve their portfolios as of the end of 2013. DEG's latest available portfolio dates back to the end of 2012. Other DFIs did not provide full portfolio data, and it was therefore not possible to produce comparative figures.

In the case of the IFC, FMO and Proparco, partial portfolio data and examples were obtained by screening partner and corporate reports, portfolios from co-investing DFIs and leaked information.

### Involvement of DFIs:

The following DFIs provided comments on a draft of the report: IFC, EBRD, EIB, Swedfund, CDC, Proparco, Norfund and IFU. During the research, a questionnaire was also sent to three multilateral DFIs (IFC, EBRD and EIB) and 14 European bilateral DFIs to check on factual information. The IFC, EBRD, EIB,

Swedfund, CDC, Proparco and Norfund responded to the questionnaire, while OeEB, Finnfund and SIFEM provided a more general response to our requests. BIO, IFU, FMO, Cofides, Sofid and DEG did not respond.

The questionnaire included the following questions, as well as others:

- 1 Do you request all your clients to provide beneficial ownership information in order to identify who ultimately owns, controls or benefits from your support?
  - a. If yes, which steps do you take to ensure the general public that the requirement for beneficial ownership identification is being implemented?
  - b. If not, please explain.
- 2 Are all your client companies required to report back to you on a country by country basis?
  - a. If yes, do you request your clients to

provide the following data:

- i. corporate taxes paid;
  - ii. profits and losses;
  - iii. number of employees and staffing costs;
  - iv. sales and purchases within the corporation and externally;
  - v. turnover figures?
- b. If yes, which steps do you take to ensure the general public that the requirement for country by country reporting is being implemented?

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## Eurodad

The European Network on Debt and Development is a specialist network analysing and advocating on official development finance policies. It has 47 member groups in 19 countries. Its roles are to:

- research complex development finance policy issues
- synthesise and exchange NGO and official information and intelligence
- facilitate meetings and processes which improve concerted advocacy action by NGOs across Europe and in the South.

Eurodad pushes for policies that support pro-poor and democratically-defined sustainable development strategies. We support the empowerment of Southern people to chart their own path towards development and ending poverty. We seek appropriate development financing, a lasting and sustainable solution to the debt crisis and a stable international financial system conducive to development.

**[www.eurodad.org](http://www.eurodad.org)**

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