

Preventing tax loss through offshore financial centres: The EBRD must lead by example

The EBRD has increasingly recognised in recent years that achieving its mission – promoting a transition to a well-functioning market economy - requires building strong institutions and ensuring that all social groups are included in the economy. This has entailed a growing recognition that the state, far from taking a hands-off approach, has an important role to play. For this it needs resources, and taxation is one of the main means to ensure them.

The crucial role of taxation is also recognised publicly by the world's leaders. As the G20 leaders stated in September this year¹, "*In a context of severe fiscal consolidation and social hardship, in many countries ensuring that all taxpayers pay their fair share of taxes is more than ever a priority. Tax avoidance, harmful practices and aggressive tax planning have to be tackled.*"

As the EBRD reviews its policy on the *Domiciliation of EBRD clients*, the bank has an important opportunity to put into practice a number of practices that have been discussed globally in recent years in order to help the bank achieve its mission, to avoid reputational risks and to ensure that its investments bring real tax benefits for the countries of operation.

Below we present several recommendations to make the new policy functional and effective. First though, we lay out why we believe that it is crucial to address this problem at all, especially for a bank like the EBRD which promotes the private sector.

Offshore financial centres – an urgent need for more transparency

Offshore financial centres (OFCs) have a disruptive impact on markets. Their secrecy increases asymmetry of information and reduces the efficiency of international financial markets. They distort competition as their effective use for tax planning requires the use of international structures and arrangements, lawyers and accountants, which are not available to small and medium enterprises, family-run business that operate in domestic markets, or newly established businesses with simple structures, and this prevents the creation of a level playing-field among various types of business. OFCs do not promote greater competition, the expansion of a competitive market or the development of a new private sector.

Currently OFCs have two main features that should be unacceptable for receiving support from public banks such as the EBRD:

1. Current secrecy rules make it easy for criminals to launder their money especially by making use of the anonymous corporate structures and the inability to reveal the beneficial ownership of companies, trusts and other corporate structures. By making it easier to conceal the proceeds of economic crime, OFCs create political incentives to demolish rather than build up institutions, and to weaken rather than strengthen democratic governance.
2. They deprive countries of essential tax revenues that should be used for services and infrastructure. EU Member States are losing around EUR 1 trillion annually to tax evasion and avoidance². The recent revelations about Google, Amazon and Apple's use of tax optimisation³ are just a few high-profile examples. It is estimated that developing countries lose USD 100 billion in tax revenues annually due to insufficient international tax policies.⁴

1 <http://en.g20russia.ru/news/20130906/782776427.html>

2 EC DG Taxation and Customs Union: http://ec.europa.eu/taxation_customs/taxation/tax_fraud_evasion/index_en.htm

3 <http://www.theguardian.com/business/2013/may/30/levy-billions-siphoned-tax-havens>

4 Concord Europe: Spotlight on Policy Coherence for Development 2013, 2013, <http://concordeurope.org/259-spotlight-on-eu->

This undermines democracy, as it is often impossible to identify what taxes are paid by which companies in which countries and therefore how much economic benefit derives from their presence. It is often automatically assumed that foreign direct investment brings benefits in terms of tax revenues but this may not necessarily be the case. This should be important for banks such as the EBRD which need to look at the real benefits of their investments.

The use of OFCs promotes tax competition – effectively, a race to subsidise companies - that deprives citizens of the ability to choose the level of tax rates and of redistribution they would like to see in their country. Such problems need to be seen as faults to be addressed, not unavoidable features of the market.

With the G20's statement and the increased focus on the harmful nature of the existing levels of secrecy and significant loopholes in the international tax regime, a real opportunity for meaningful change now exists. A public bank such as the EBRD should be the first to seize this momentum to ask its clients – the beneficiaries of public money - for higher accountability standards and more transparent access to data about economic operations and taxes paid and contributions to societies in which they are registered.

The EBRD should only accept clients that are willing and able to disclose their beneficial ownership as well as country-by-country reporting on sales, profits, taxes paid, corporate structure, and number of employees in all jurisdictions where they operate⁵.

Is it acceptable for the EBRD to finance companies in offshore jurisdictions?

In a multilateral bank such as the EBRD there need to be appropriate levels of transparency and secondly, the question needs to be asked whether the bank needs to carry out indirect investments at all? If the company or fund that the bank plans to finance is registered neither in the recipient country nor in a country where a substantial amount of the company's real-life activities take place, the bank should refrain from financing it.

The main guiding principle at the EBRD so far has been whether there are 'sound business reasons' for companies to use offshore companies. When asking for these justifications for EBRD projects registered in Luxemburg, Mauritius and Jersey, the Bank responded that these jurisdictions were offering solid, experienced and efficient legal, judicial and advisory structures⁶. It is understandable that project sponsors want to be registered in countries respecting the rule of law and having good judicial systems and corporate laws. However, it bypasses the potential issue of reforming the legal framework of these countries by relocating the companies. In other words, when it finances a company based in an offshore jurisdiction rather than in the jurisdiction where the project itself is due to take place, the EBRD chooses to displace the business location instead of contributing to the improvement of the legislation of the transition states - which is yet necessary to promote an efficient economic system and democracy. But if a public bank like the EBRD will not take the risk and finance the pioneering companies and provide technical assistance to develop the accompanying institutional and legislative framework to solve these problems, it is hard to see how they will ever be solved.

Another reason for using offshore jurisdictions that is often cited is avoiding double taxation. However the problem is rather minor compared to the problem of double non-taxation. For both challenges a significant increase in transparency about corporate structures, operations and taxation levels need to be ensured.

One complication can arise with funds which will operate in several countries. They can only be based in one country and will automatically not be based in all of their countries of

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⁵ See annex 1 for more information

⁶ Exchange of emails with the EBRD, July 2013

operations. But this cannot be an excuse to base them in offshore centres where they have no real activity. Almost all of the private equity funds investments approved by the EBRD during the last three years are based in well-known tax havens such as the Cayman Islands, Guernsey and Luxembourg, even though they have no real operations there. Why are the funds not based in one of the countries where they will operate, or, if the legislation is really too complicated for some reason, Stockholm or Berlin or Madrid, for example?

In a meeting between Bankwatch and EBRD staff in November 2013, it was established that the EBRD has not carried out any assessment of the impact that the use of OFCs in EBRD projects has had on the transition of its countries of operation. Until such an assessment is carried out and an effective tracking system implemented, a precautionary approach needs to be taken and the use of offshore centres avoided.

Conclusions and recommendations

The eight biggest shareholders of the EBRD are precisely the G8 countries that have committed to fight tax avoidance and tackle secrecy jurisdiction. Together with the EU, they hold a large majority of the Bank's shares. These countries can decide to stop these incoherencies. Non-G8 EBRD shareholders, and mainly the recipient countries, would benefit from such a decision as they will gain the ability to collect more taxes instead of seeing profits from operations conducted on their territories syphoned off to offshore centres.

Recommendations:

- **The EBRD needs to make an assessment of the transition impact – positive or negative – that its investments in offshore companies have so far had in its countries of operation.** So far, according to conversations with bank staff, the EBRD has no such thing.
- **The EBRD must ensure that all companies and financial institutions involved in its projects publicly disclose the beneficial ownership of any legal structure directly or indirectly related to the company, including trusts, foundations and bank accounts.** It is unacceptable that public money can still be lent to companies which are essentially anonymous as far as the public is concerned. The European Council already called in May this year for beneficial ownership identification to be introduced on the EU level.⁷
- **In order to be eligible for EBRD financing, all beneficiaries, whether corporations or financial intermediaries, that are incorporated in different jurisdictions must be obliged to disclose country level information about their sales, assets, employees, profits and tax payments in each country in which they operate in their audited annual reports. Beneficiaries must make contracts with host governments public and in particular disclose the fiscal regime in each country in which they operate.** Country-by-country reporting has already been introduced in the EU this year for banks through the Capital Requirements Directive (IV).⁸ They will now be obliged to disclose profits made, taxes paid, subsidies received, turnover and number of employees on a country-by-country basis. The European Council in May this year also backed inclusion of this requirement for large companies in other sectors in the Directive on the disclosure of non-financial and diversity information.⁹ For more information, see Annex 1.
- **The EBRD needs to include projects' tax implications in its transition indicators, with projects generating relatively more tax for country being rated higher than those with lower tax contributions. The bank also needs to indicate the expected and actual tax revenues for the countries of operation in its project summary documents, and make sure the countries receive a fair share of taxes.** In the context of the economic and

7 <http://register.consilium.europa.eu/pdf/en/13/st00/st00075-re01.en13.pdf>

8 <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32013L0036:EN:NOT>

9 <http://register.consilium.europa.eu/pdf/en/13/st00/st00075-re01.en13.pdf>

financial crisis and the continued difficult political situation in North Africa, the EBRD countries are facing severe budget deficits and their governments have to struggle to maintain social services and infrastructure that are necessary to create a favourable business environment and support democracy. The EBRD needs to take this situation into account and provide information about how its investments contribute to national budgets. Even where offshore centres are not used, low levels of tax or tax holidays can diminish the benefits of certain projects.

- **The EBRD must not finance a client which is located in an offshore financial centre if the project is not to be implemented in the OFC and the client does not have substantial operations in the OFC.** This very strict exclusion is necessary to avoid the risk of tax avoidance through offshore centres. Considering the EBRD is investing public money, it cannot accept to take such a risk. With this measure, the EBRD may lose a small number investment projects, but as a public bank with a political mandate, it is not in competition with private banks nor does it need to meet any volume criteria, so this should not be an obstacle to adopting a rigorous policy.
- Given the numerous discussions and proposals on the EU and international level on the issue of tax avoidance and evasion, **the EBRD should review its policy on Domiciliation of EBRD Clients within three years at the latest.** Given the importance and level of interest in the issue as well as ongoing reforms initiated by G20 and others, **there should be a public consultation process for the next review.**

Annex 1: CSO proposal for country-by-country reporting

CSOs in Europe and other regions of the world support the idea of “country-by-country reporting disclosure” of the following information in transnational companies’ annual financial statements:

1. The name of each country in which it operates;
2. The names of all companies belonging to it, trading in each country in which it operates;
3. Its financial performance in each country in which it operates, without exception, including:
 - Its sales, both third party and with other group companies;
 - Purchases, split between third parties and intra-group transactions;
 - Labour costs and employee numbers;
 - Financing costs split between those paid to third parties and to other group members;
 - Its pre-tax profit;
4. The tax charge included in its accounts for the country in question, as indicated below;
5. Details of the cost and net book value of its physical fixed assets located in each country;
6. Details of its gross and net assets in total for each country in which it operates.

Tax information would need to be analysed in more depth, requiring disclosure of the following for each country in which the corporation operates:

1. The tax charge for the year split between current and deferred tax;
2. The actual tax payments made to the government of the country in the period;
3. The liabilities (and assets, if relevant) owing for tax and equivalent charges at the beginning and end of each accounting period;
4. Deferred taxation liabilities for the country at the start and close of each accounting period.