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Towards a Responsible Taxation Policy for the EIB

2015

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1. Introduction: A political momentum for tax justice

Fighting aggressive tax planning and double non-taxation is high on the international and European political agenda.

The financial crisis gave the final push for political leaders to increase their attention on this matter (EU leaders May 2012 summit) and develop action plans (EU action plan from December 2012¹). Following recent revelations on tax practices in Ireland, Luxembourg and Switzerland, taxation has also become an issue undermining fair competition between EU member states in so far that the European Commission has most recently started investigating some of the tax agreements between national governments and multinational corporations – among others Starbucks and Apple – to assess their compliance with EU competition and state aid rules.

In this context it is crucial that the European Investment Bank (EIB), as the 'EU bank', takes serious steps to address the current shortcomings of its policy and practices in order to rule out any support to companies that apply questionable taxation practices. It could be argued that EIB funds ending up in or supporting companies that make use of tax havens would be a violation of its own statutes which require the bank to employ its funds "as rationally as possible in the interests of the Union"².

1 http://ec.europa.eu/taxation_customs/re-sources/documents/taxation/tax_fraud_evasion/com_2012_722_en.pdf

2 The EIB was founded in 1958 under the Treaty of Rome. Its statutes as well as various provisions relating to the EIB taken from the Treaty on European Union and the Treaty on the Functioning of the European Union as well as from Protocols Nos 6, 7 and 28 annexed to these Treaties can be found in this brochure: <http://www.eib.org/infocentre/publications/all/statute.htm>.



image ICIJ

It is logical that the EIB subsidises economic actors operating with a genuine added-value for the EU. However, if this implies further distortion of competition at the cost of small domestic businesses – a key target and engine of economic activity in Europe – EIB subsidies risk undermining EU regulation, its own statutes and the broader public interest.

As a lot of tax issues remain difficult to tackle via purely legal means, public institutions such as the EIB need to go beyond strict obligations and assess all available options to avoid funding and supporting companies with harmful tax practices. This requires a policy framework that allows the bank to take a proactive and responsible approach to tackle abuses wherever they may appear.

In the past the EIB has shown that the political will that would allow such an approach exists within the bank.

In 2009 it was the first international financial institution (IFI) to adopt a policy against "non-cooperative jurisdictions" (NCJ). Despite some shortcomings this was a remarkable step. However, the EIB has failed to

keep up with the political momentum and political developments ever since.

This briefing first examines the flaws in current EIB policies that fail to rule out current tax dodging practices by its beneficiaries and consequently seeks to propose a way forward for the EIB to become a more responsible lender in relation to taxation. This would imply a proactive approach towards a responsible taxation policy, going beyond what is strictly necessary. The components of such a policy include a full implementation of beneficial ownership and country by country reporting requirements for all EIB beneficiaries in all sectors, full transparency in these matters for all stakeholders, improved due diligence and close follow up of ongoing projects and the possibility to take effective measures in the case of abuse by any of the beneficiaries.

The current political climate at EU level is a unique window of opportunity for the EIB to raise its profile and set a precedent among financial institutions. We hope the bank can re-establish the progressive drive on tax issues that was present previously in order to establish a Responsible Tax Policy.

The European Investment Bank

The European Investment Bank (EIB) is the 'EU bank', fully public and controlled by the European Union's 28 Member States and the European Commission. It is the only 100 percent European international financial institution that is policy driven by European laws and regulations.

The EIB operates primarily within the EU and, to a lesser extent, outside the EU under a specific external lending mandate agreed every seven years jointly by the European Commission, Council and Parliament. The bank finances itself on open capital markets by issuing triple-A rated bonds, as well as also managing some of the resources of the European Commission (as in the case of the European Development Fund for African, Caribbean and Pacific countries via the investment facility).

Due to the fact not only that the EIB is a fully European financial institution but also because of its institutional set-up, it is legitimate to expect strict policy coherence between European law and the bank's operations both within and outside the EU, including on taxation.

Taxation matters very much for both the EU and developing countries. The recent – and still unfolding – financial and economic crisis has finally given a wakeup call in this regard to European countries that now find themselves under ever tighter budget constraints and in search of additional resources without increasing their public debt through the fight against tax evasion.

In early 2013, the Organisation for Economic Cooperation and Development – OECD, that sets the rules governing how multinational



European Investment Bank building in Luxembourg, photo Re:Common/2009

companies pay tax – took the unprecedented step of focusing attention on the broader issue of tax avoidance by addressing the problem of tax base erosion and profit shifting by multinational companies³. Companies use a number of schemes to shift profits across borders to take advantage of tax rates that are lower than in the country where they made the profit. According to the OECD some multinationals end up paying as little as five percent in corporate taxes when smaller businesses are paying up to 30 percent. Such tax avoidance schemes are often perfectly legal, and exploit the fact that tax systems are still essentially nation-based and were designed for an economic system that was less internationally integrated.

In recent years, the OECD has also acknowledged that developing countries could be losing far more through tax evasion than they receive in aid. In particular, research by Christian Aid

³ http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/addressing-base-erosion-and-profit-shifting_9789264192744-en#page1

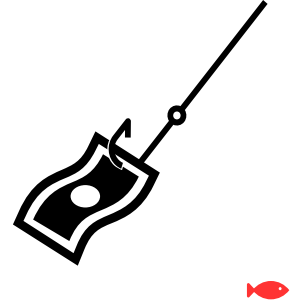
in 2008 estimated that the tax loss to developing countries through tax evasion by multinational companies was USD 160 billion a year⁴. This is significantly more than the total aid provided by developed countries in the global North, which totalled USD 125 billion in 2012⁵. Additionally a 2014 report by Eurodad, a coalition of development NGOs, has calculated that developing countries lose more income through tax evasion than what they gain via aid, remittances and foreign investments combined⁶.

⁴ The USD 160 billion figure was a Christian Aid estimate in the report *Death and Taxes, the true toll of tax dodging*, 2008, based on work on illicit capital flight by Raymond Baker. It was supported by further detailed research on trade mispricing by Professor Simon Pak in the Christian Aid report *False Profits, Robbing the Poor to Keep the Rich Tax Free*, 2009

⁵ <http://www.oecd.org/dac/stats/aidtopoor-countrieslipsfurtherasgovernmentstighten-budgets.htm>

⁶ Eurodad, 2014, 'The state of finance for developing countries, 2014' <http://eurodad.org/files/pdf/549197afa285f.pdf>

2. The EU and tax evasion and avoidance



In Europe, loss of income caused by tax evasion and avoidance is estimated to be around €1 trillion per year.⁷

As a result, in recent years EU governments have beefed up their commitment against tax evasion and avoidance and introduced new legislation at European level.

In particular governments have agreed that mandatory automatic exchange of information among national tax authorities will be implemented from 1st January 2015⁸, as well as some form of automatic exchange of information concerning the taxation of savings income⁹.

Furthermore new provisions have been introduced in European law in order to prevent European multinational companies shifting profits between different branches based in different member states as a means of aggressive tax planning¹⁰.

All of these improvements in European law will make it somewhat easier for national tax authorities to tackle not just tax evasion but also tax avoidance, committed primarily by multinational companies, through cross-border operations. Nonetheless, while better cooperation among EU

7 http://ec.europa.eu/taxation_customs/taxation/tax_fraud_evasion/a_huge_problem/index_en.htm

8 Directive 2011/16/EU on administrative cooperation in the field of taxation.

9 Revised tax savings directive 2014/48 to be transposed by January 2016.

10 Parent subsidiary directive 2011/96/EU as amended in July 2014 to be transposed by Member States by December 2015, concerning the just taxation of savings income in the form of interest payments.

countries is finally welcome on tax matters, improvements in corporate tax transparency remain a key issue in the fight against tax evasion and avoidance.

In this regard, in May 2013 the European Council backed the introduction of a country by country reporting requirement for all large European companies and groups. As explained by former Commissioner Barnier after the Council meeting: "...We must go further now and take measures on more transparency on tax for all large companies and groups – the taxes they pay, how much and to whom. I think it should be possible to introduce rules for the publication of the information on a country by country basis, similar to those approved for banks in [the Capital Requirements Directive]..."¹¹

As a consequence two additional directives were adopted of particular relevance for the country by country reporting obligations for multinational companies and financial institutions: the New Accounting Directive 2013/34 entered into force in July 2013, to be transposed by July 2015, and introduces some obligation for extractive and logging companies to disclose payments made to governments in the countries in which they operate (along the line of provision 1504 included in the Dodd-Frank Wall Street Reform and Consumer Protection Act in the United States); and the Capital Requirements Directive IV, 2013/36 – better known as the new Basel III rules for banks – that introduce country by country reporting for banks and financial institutions from 1st January 2015.

At the same time, last December, as part of the revision of the anti-money laundering directive, the European Council, Commission and

11 http://europa.eu/rapid/press-release_MEMO-13-546_en.htm

Parliament agreed on a historical decision to mandatorily introduce in each EU Member State centralised registries for beneficial ownership (see explanation below) of companies and trusts. As regards companies, new registers shall be accessible in all cases by competent authorities and Financial Intelligence Units without any restriction and obliged entities (such as banks, legal companies and notaries) in the framework of the conduct of customer due diligence. Furthermore, centralised registers shall be accessible to any persons or organisations that can demonstrate a legitimate interest, including investigative journalists and civil society organisations. Concerning trusts, access will be restricted only to competent authorities and obliged entities¹².

A beneficial owner is the real person who ultimately owns, controls or benefits from a company or trust fund and the income it generates. According to Transparency International, "the term beneficial owner is used to contrast with the legal or nominee company owners and with trustees, all of whom might be registered as the legal owners of an asset without actually possessing the right to enjoy its benefits. Complex and opaque corporate structures set up across different jurisdictions, make it easy to hide the beneficial owners, especially when nominees are used in their place and when part of the structure is incorporated in a secrecy jurisdiction"¹³.

As mentioned above centralised registries, publicly accessible in several cases, of beneficial owners of companies and trusts shall be

12 <http://data.consilium.europa.eu/doc/document/ST-5116-2015-ADD-2/en/pdf>

13 <http://www.transparencyinternational.eu/wp-content/uploads/2014/01/TI-EU-Policy-Paper-Beneficial-Ownership.pdf>

introduced within the EU soon and can make the difference in the fight against money laundering and tax avoidance. In this regard, the EIB should be regarded as an obliged entity under EU anti-money laundering law and thus is entitled to have timely access to all centralised registers in the 28 EU Member States while implementing its due diligence.

Both measures of corporate tax transparency – country by country reporting and public registries of companies' beneficial owners – will greatly help in the fight against tax dodging by exposing in the public domain how much income and profits are produced in each country by multinational companies and usually secret corporate structures and their real owners, as well as the often modest taxes they pay in each country. Recent scandals involving major global tech companies such as Google, Amazon and Apple show that exposing how little tax major corporations pay is the best way to move tax authorities and governments at large to crack down on tax dodging by multinational companies within the EU and in developing countries.

OECD BEPS

In addition to the efforts of the Global Forum, in July 2013 under the mandate of the G20 the OECD also adopted its Action Plan on Base Erosion and Profit Shifting (BEPS)¹⁴, aimed at preventing double non-taxation of trans-national corporations' income.

A significant source of taxable base erosion is the ability of trans-national corporations (TNCs) to shift profits from where businesses perform their activities – and therefore, generate their income – to low- or zero-tax jurisdictions where, very often, little or no substantial business activities are undertaken.

Nowadays roughly 60 per cent of global trade takes place between multinational enterprises¹⁵. The tax avoidance devices used by TNCs to reduce the taxes they pay help to sustain the tax haven and offshore secrecy system – a system that is also used to facilitate illicit capital flight and the laundering of proceeds of crime, including tax evasion, and the proceeds of corruption.

Fifteen specific actions are being developed in the context of the OECD/ G20 BEPS Project to equip governments with the domestic and international instruments needed to address this challenge. The first set of measures and reports were released in September 2014.

Despite the positive political momentum, in civil society's view¹⁶ the

¹⁴ <http://www.oecd.org/tax/beps-about.htm>

¹⁵ <http://www.ranone.com/features/news.asp?ID=4181>

¹⁶ <http://www.eurodad.org/Entries/view/1546260/2014/09/22/OECD-BEPS-process-Minor-victories-in-the-battle-against-tax-dodging-but-we-risk-losing-the-war>

BEPS process has achieved only minor victories so far. Specific weaknesses of the process include:

- A lack of inclusiveness – not all stakeholders have been included, e.g. not all developing countries and their respective concerns are on board;
- More fundamental alternatives to the current international taxation tax system, such as unitary taxation, are not considered. This would mean TNCs are no longer taxed according to the legal forms that their tax advisers create for them, as is currently the case, but according to the genuine economic substance of what they do and where they do it;
- On the other hand problematic existing OECD principles have been reinforced, including the “arm's length” principle (which implies that a transfer price between two subsidiaries of the same company should apply market prices) and more generally a tax treaty system which ultimately favours taxation in residency countries (that means, roughly, OECD countries) over source countries (more likely developing countries);
- Most importantly the information from country by country reporting deemed to be commercially “sensitive” should, according to the OECD outcome of last September, be highly confidential, which would undermine the scrutiny of multinational corporations by the public and concerned citizens, and thus the overall effectiveness of the BEPS measure.

3. The EIB and the fight against tax evasion and aggressive tax planning

The EIB, in 2009, was the first international financial institution (IFI) to adopt a public policy explicitly addressing the issue of offshore financial centres, then referred to as non-cooperative jurisdictions.

A final version of the policy was agreed by the EIB's board in 2010, also in connection to concerns raised by Counter Balance and other European CSOs on the abuse of tax havens by certain companies and financial institutions benefiting from EIB public support¹⁷.

The EIB policy¹⁸ includes a general prohibition on investments linked to non-compliant jurisdictions (NCJs) except in limited circumstances. The EIB has acknowledged that "linked to" means not only companies located in a non-compliant jurisdiction but also companies controlled by NCJ-located companies. The policy also allows the EIB to impose additional tax disclosure obligations for cross-border operations even if none of the jurisdictions involved qualifies as an NCJ.

Notably the EIB policy also includes a relocation clause within a few months, prescribing – according to the policy – a mandatory relocation for an EIB beneficiary if operating in an NCJ. It should be pointed out that at that

¹⁷ http://www.counter-balance.org/wp-content/uploads/2011/01/Tax_Havens_English_web.pdf

¹⁸ <http://www.eib.org/infocentre/publications/all/eib-policy-towards-weakly-regulated-non-transparent-and-uncooperative-jurisdictions.htm>

point in time the introduction of this relocation clause was a significant step forward in terms of assigning a precise role to IFIs in their proactive work to promote responsible taxation by the private sector and to prevent the abuse of tax havens.

Although certain loopholes existed, it was an ambitious decision by EIB management that showed that the bank is able to move beyond the existing international consensus, or even beyond what European law prescribes, when required to send a clear signal concerning the use of European public funding.

However, the policy lost most of its power not long after being adopted. The bank had based its due diligence and compliance on the 'OECD black and grey list' as reviewed under the G20 mandate in 2009. Soon thereafter these lists became empty again as a result of tax havens signing a sufficient number of information exchange agreements among themselves to comply with the G20 commitment. This move undercut all EIB efforts – and the bank was slow to recognise this new reality and to promote a timely review of its policy.

In the meantime other IFIs, such as the International Finance Corporation (IFC) of the World Bank Group and the European Bank for Reconstruction and Development (EBRD) and several bilateral development finance institutions specialised in private sector lending, adopted their own respective policies on tax havens or NCJs.

All of these policies rely on the country ratings put forward by the Global Forum on Transparency and Exchange of Information for Tax Purposes¹⁹ (hereafter the Global Forum). CSOs have repeatedly argued that the Global

¹⁹ <http://www.oecd.org/tax/transparency/>

Forum uses unambitious criteria, as they predominantly focus on banking secrecy instead of corporate tax dodging. In addition, the Global Forum has only 123 members so far and many developing countries are still missing before it can claim to be truly global.

This is a paradox, given that those excluded are often the same countries that the IFIs are trying to target with investments, and also the ones that experience more difficulties to collect their fair share of tax than others. In contrast, seven of the most notorious tax havens that appear in the top 20 of the Financial Secrecy Index (FSI)²⁰, including Switzerland and Luxembourg, are full members of the OECD as well as the Global Forum, and have mostly passed the Global Forum peer review ranking system.

Since the process of the Global Forum – and the subsequent BEPS project – has got under way, few IFI policy developments have taken place, including at the EIB, which has thus retreated from its leading position in tackling tax avoidance to a less proactive role shared by other financial institutions. Despite their commitment, the IFIs are still supporting controversial operations linked to NCJs today²¹.

Concretely, EIB lending and investments have continued to proceed via tax havens for at least two years after the implementation of the EIB's tax haven policy, proving its ineffectiveness.

²⁰ <http://www.financialsecrecyindex.com/> is an index produced by the Tax Justice Network that "ranks jurisdictions according to their secrecy and the scale of their activities".

²¹ <http://www.eurodad.org/Entries/view/1546282/2014/11/03/Going-Offshore-How-development-finance-institutions-support-companies-using-the-world-s-most-secretive-financial-centres>

Table: EIB lending via tax havens – 2011-2013

Project title	Date	Location	Sector	Client	Comment	Amount
DASOS Timerland Fun II	2/01/2013	International	Agriculture	Dasos Capital	HQ: Finland, office Singapore based in Mauritius, recently rebranded to Adenia Partners	EUR 30m
I & P Capital III	29/12/2012	Africa	Services	I&P Management		EUR 12m
Progression Eastern African Microfinance Equity Fund	20/12/2011	East Africa	Services	Progression Eastern African Microfinance Equity Fund	Based in Mauritius	EUR 8m
Investec Climate Action FL	28/10/2011	South Africa	Energy	Investec	London, UK	EUR 50m
Ecoenterprises Fund II	7/12/2011	Latin America	Agriculture	EcoEnterprises	Virginia, US	EUR 5m
Crescent Clean Energy Fund Turkey	5/10/2011	Turkey, Turkmenistan, Bulgaria, Armenia	Energy	Crescent capital	Ireland	EUR 25m
Fund for the Mediterranean Region II	20/12/2012	North Africa	Services	Mediterranea Capital Partners	Management company incorporated in Malta	EUR 20m
Capital North Africa Venture Fund II	21/12/2011	North Africa	Services	Capital Invest (fund manager)	Registered in Luxembourg	EUR 10m
The Palestine & Lebanon Growth Capital Fund	21/12/2010	Gaza/West Bank & Lebanon	Services	Ryada Enterprise Development (Abraaj Capital)	Abraaj based in Dubai	EUR 10m
Euromena III Fund	19/12/2013	North Africa	Services	Capital Trust Group (CTG)	CTG incorporated in Luxembourg	EUR 20m
Badia Impact Fund	18/12/2012	Jordan	Services	Accelerator Technology Holdings	Accelerator Technology Holdings is incorporated in Guernsey and acts through a group of companies established in Bahrain and Jordan	EUR 4m
Leapfrog II	30/08/2013	ACP	Services	Leapfrog Group Ltd	LeapFrog Investments is based in Mauritius	EUR 20m

(This chart is courtesy of an elaboration by Laurens Bielen, CEE Bankwatch Network, based on official data from the EIB. It is not, however, an exhaustive list.)

One specific case involves an investment in Qalaa, an African private equity fund which has been benefiting from EIB investments, as recently revealed by the Illicit Finance Journalism Programme²². The fund operates through a network of tax havens, including the British Virgin Islands, in order to channel its investments in African companies. Several development finance institutions, including the EIB, have invested in Qalaa. The British Virgin Islands is a typical example of a non-compliant jurisdiction according to the Global Forum²³.

As a result of pressure by civil society organisations and the European Parliament, in March 2014 the EIB updated its NCJ policy with an

addendum²⁴ that harmonises the EIB's approach with those of the EBRD and the IFC, based on the Global Forum. However this change in the policy is not retroactive and does not compel the EIB to review the due diligence already carried out for its ongoing lending and investments. For instance, in the case of Qalaa, this fund would not comply with the new policy given that the British Virgin Islands is not a fully compliant jurisdiction according to the Global Forum.

The decision to update the NCJ policy was not based on any actual consultation with civil society and other stakeholders and it did not meet requests by civil society for a full revision of the policy taking into account other international processes happening at the time.²⁵ The secretive

and partial review was particularly disappointing because, following the EIB's public annual consultation with civil society in early 2014, the bank's then vice president, Philippe de Fontaine Vive, publicly committed to reform the EIB's outdated policy later in the year. Shortly after, this commitment was pushed back by EIB management, casting further doubts on the bank's intentions.

22 <http://euobserver.com/investigations/126144>

23 <http://www.oecd.org/tax/transparency/GFratings.pdf>

24 <http://www.eib.org/about/documents/ncj-policy-addendum.htm>

25 <http://www.counter-balance.org/wp-content/uploads/2014/01/CSOs-call-for-revising-EIB->

[Tax-havens-policy-January-2014.pdf](#)

4. Major outstanding problems hanging over the EIB's NCJ policy

Although the EIB NCJ policy was ambitious at the time, it included a number of loopholes which would need to be tackled in a Responsible Taxation Policy.

A major problem is that the EIB's policy does not prohibit counter-parties from registering in a country other than in which they are economically active – and produce economic value – because of “other tax burdens that make the structure uneconomic”. This implies that counter-parties are still permitted to move to offshore financial centres to benefit from lower taxation and/or higher secrecy²⁶.

In addition, counter-parties can still operate in a prohibited jurisdiction if this jurisdiction offers a level of “corporate security”. The policy remains unclear about what this can and might entail.

As concerns intermediated lending, contrary to other IFIs the EIB neither publishes the domicile of funds benefiting from EIB support nor those of ultimate beneficiaries supported by financial intermediaries. The EIB website describes only where funds operate with the bank's investments. Civil society and the European Parliament has called on the EIB to improve its transparency in this regard but so far the issue remains unaddressed; this has opened the door for abuses such as in the case of Qalaa (see above) or the Ibori case (see box). Regarding sanctions for those violating the relocation requirement, it remains unclear how possible suspension or cancellation of the financing would be applied, as well as exclusion from future

26 <http://eurodad.org/4380/>

EIB financing.

At the time of the approval of the operation the EIB also does not make public the Integrity Covenant signed by beneficiaries and attached to its lending contracts. Publication of such would be a further deterrent for EIB beneficiaries intending to abuse tax havens. As concerns EIB investments in private equity funds, compliance issues related to harmful tax practices and illicit flows should be included in the legal documentation of such funds, and made public.

More broadly, as concerns the implementation of the policy, currently the public is neither aware of the number of applications turned down by the EIB due to non-compliance with the NCJ Policy nor of the number of relocations requested and implemented as per the policy's stipulations. For the time being there is no detailed reporting made by the EIB to external stakeholders, including the European Parliament, about the implementation of its NCJ policy and the above-mentioned elements.

Main policy features of the EIB addendum to its NCJ policy²⁷

Main policy features:

- No investments through jurisdictions which have:

- i. Following a Phase 1 review, been found unable to proceed to Phase 2.
- ii. Following a Phase 2 review, been determined to be “non-compliant” or “partially compliant”.

- Counter-parties 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.

Key exemptions:

- Jurisdictions which were not allowed to move from Phase 1 to Phase 2, or were determined to be “non-compliant” or “partially compliant” following Phase 2 can benefit from a temporary suspension

27 Courtesy of Eurodad, <http://www.eurodad.org/Entries/view/1546282/2014/11/03/Going-Offshore-How-development-finance-institutions-support-companies-using-the-world-s-most-secretive-financial-centres>

of the relocation requirements of eight months, if the relevant jurisdiction:

- iii. 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;
- iv. 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.

- Counter-parties are still allowed to operate in prohibited jurisdictions if they argue that:

- v. The legal framework and investments climate in the countries of project implementation is inadequate; the counter-party would run the risk of double taxation or suffer from other tax burdens that could make the structure uneconomic.
- vi. The jurisdiction offers a level of corporate security for companies and investors which is not available in their countries of incorporation or residence.

5. A different approach needed to tackle tax avoidance

In order to address the deficiencies contained in the EIB's NCJ policy, three key principles should guide its revision towards a Responsible Taxation Policy.

First, the EIB should rediscover the positive approach that guided the drafting of its first NCJ policy in 2009, in particular as concerns the possibility that, beyond existing policy prescriptions and analysis deriving from the OECD Global Forum and other forums, the EIB should still assess those jurisdictions it judges to be problematic by keeping the possibility of regular country assessment²⁸. In this regard the EIB should produce specific country tax assessments, to be reviewed every three years and published once finalised.

For such analyses the EIB could also make use of the external documents of civil society organisations and researchers who specialise in this area, in particular the Financial Secrecy Index of the Tax Justice Network, "a politically neutral ranking for understanding global financial secrecy, tax havens or secrecy jurisdictions, and illicit financial flows".²⁹ The inclusion of the highly relevant and qualitative work of civil society in the EIB's policies, in parallel to regular consultations between Civil Society Organisations and the EIB, would lead to considerable qualitative improvements in its policy.

Second, the EIB should make pro-active use of its relocation clause, which was one of the main innovative features

²⁸ Paragraph I.3.4) of the NCJ policy www.eib.org/attachments/strategies/ncj_policy_en.pdf

²⁹ <http://www.financialsecrecyindex.com/>



of the policy when adopted in 2009. Through this clause the EIB covenants in financial agreement with the client requesting EIB financial support the obligation to move the company's domicile from a non-cooperative jurisdiction to another deemed appropriate by the bank³⁰.

Finally, and given that the EIB is a public institution, a pro-active approach should be endorsed by the bank's management. This would mean that when it comes to responsible taxation behaviour the EIB should require the private sector interests that benefit from its support to do more than current market practices require.

Moreover, Counter Balance and Re:Common believe that EIB management should concentrate its attention on how to improve corporate transparency, in particular on tax matters. In order to evaluate the effectiveness of the NCJ policy in this regard, it is critical that the EIB requests all necessary data from its clients. This implies that the EIB should prioritise two actions in its corporate

³⁰ Paragraph III.3 of the NCJ policy www.eib.org/attachments/strategies/ncj_policy_en.pdf

due diligence: identify the beneficial owners of all counter-parties, and request all their clients to report on a country-by-country basis.

Identification of beneficial ownership of clients would allow the EIB to know who ultimately owns, controls or benefits from a company or fund that receives its support³¹. Without this kind of due diligence, the EIB cannot guarantee that the use of a prohibited tax regime is fully excluded from its investment activities, or that its clients are not involved in money-laundering or other misconduct. Article 13 of the external lending mandate of the EIB for 2014-2020 formulates such requirement "to take reasonable measures to identify the beneficial owners where applicable"³².

Country-by-country reporting (CBCR) would mean that EIB clients provide relevant data to the EIB about their

³¹ Transparency International's Financial Transparency Glossary.

³² Decision of the European Parliament and of the Council granting an EU guarantee to the European Investment Bank against losses under financing operations supporting investment projects outside the Union, <http://register.consilium.europa.eu/doc/srv?l=EN&f=PE%203%202014%20INIT>

sales and purchases (both within the corporation and externally), 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 especially essential in cases where the EIB engages with multinational corporations, as NGO studies have proven that there is often a complete disconnection between where multinational corporations are economically active and creating value and the stories they tell in their financial accounts³³.

As mentioned above, key developments are occurring in European legislation concerning the disclosure of beneficial ownership of companies and trusts as well as the introduction of mandatory requirements of country by country reporting for multinational companies and financial institutions. It is thus crucial that the EIB, as an EU policy-driven bank, reviews its policy to align it to these important changes in EU law and, in order to regain its position as best in class among IFIs on this matter, goes even beyond these positive developments by setting important concrete precedents on how to implement these across the board as concerns IFI corporate due diligence.

³³ Christian Aid. "FTSEcrecy: the culture of concealment throughout the FTSE"; May 2014. Available at: <http://www.christianaid.org.uk/images/FTSEcrecy-report.pdf>

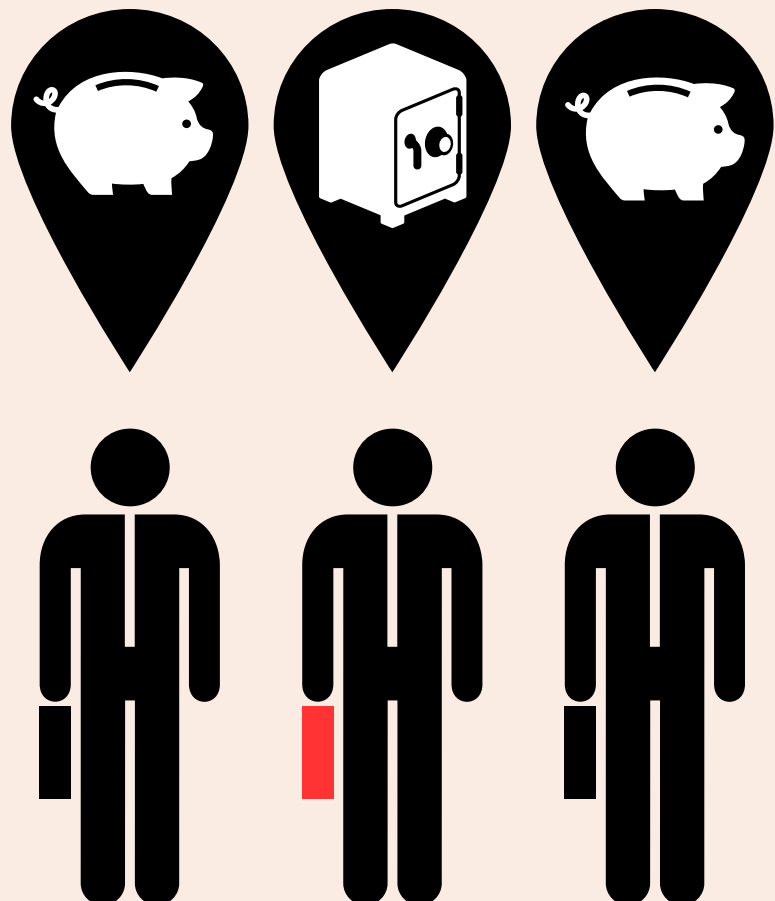
The way towards a Responsible Taxation Policy

By building on urgently needed new measures to be introduced about beneficial ownership and corporate tax transparency, the EIB should create a fully-fledged Responsible Taxation policy by the end of 2016. A first step in this regard should be the revision of its NCJ policy in 2015, as a key component of a broader taxation policy. An open and inclusive public consultation with all stakeholders should take place for both processes.

Thereafter, the EIB should consider the creation of a Working Group on

tax to take stock of the most recent developments at EU level and supervise the creation of an EIB Responsible Taxation policy. In parallel, the EIB should create a separate internal "Tax Unit", possibly as part of its compliance office, with sufficient capacity to implement thorough due diligence on tax issues.

Finally, the EIB should start publishing a yearly "tax report" covering the implementation of its NCJ policy but also providing the European Parliament and general public with precise figures on the tax impact (especially on corporate taxation on profits) of EIB investments and lending.



6. Identification of **beneficial ownership**

What is company beneficial ownership and why it is important to know it

Very often the use of a controversial tax regime or money-laundering activities and other misconduct take place through complex corporate structures linking different companies and investment vehicles incorporated in a large number of jurisdictions, including those that are non-compliant. Several jurisdictions protect the identity of the actual beneficial owner of companies and investment vehicles, while disclosing only the names of legal or nominal shareholders. For a public institution, such as the EIB, lending at international level to multinational companies or financial institutions, or for cross-border investment operations, there is a high risk that the ultimate beneficiary of lending and investment can be associated with tax avoidance and illegal activities.

The EIB claims that, as part of its corporate due diligence, it requests beneficial ownership information from its clients (the so-called “Know Your Client” procedure)³⁴. However simply relying on information provided by the client cannot be sufficient to determine who is the ultimate beneficial owner of the supported entity in reality. As concerns tax matters, it should be noted that a beneficial owner might be anyone who benefits from income streams associated with company operations, and not just those directly involved in company ownership or management.

Therefore the EIB has to perform adequate corporate due diligence

³⁴ Article 15 of the Policy on preventing and deterring prohibited conduct in European Investment Bank activities www.eib.org/attachments/strategies/anti_fraud_policy_20130917_en.pdf

aimed first of all at identifying the true beneficial owners of all of its clients. In cases which raise particular concern the EIB commissions ad hoc investigations to specialised private companies. However, as the Glencore case shows (see box below) such due diligence did not always prove effective.

The EIB’s policy on NCJs, for example, clearly states that “the relevant counterparty/ies and their beneficial owners must always be clearly identified and must not pose any integrity concern”. But when it comes to identifying company beneficial owners most problems emerge with intermediated lending. This is when the EIB lends large funds to other financial institutions which then on-lend it in smaller tranches to several ultimate beneficiaries. The same goes for the EIB’s investments into equity funds which then support ultimate investee companies.

In these cases, EIB due diligence is limited to the financial intermediaries themselves and it is unclear how much the bank screens the beneficial owners of the ultimate beneficiaries of its financing, rather than simply relying on due diligence performed by the financial intermediary. In the case of its investments in a private equity fund managed by Emerging Capital Partners, the lack of proper due diligence by the management company resulted in investments flowing to one of Nigeria’s most corrupt politicians, James Ibori (see box).

Why the EIB should improve its due diligence on client beneficial ownership

Making public the beneficial owners of clients benefiting from EIB support is in line with recent policy developments

at European level³⁵. Even if public disclosure of beneficial ownership will not be implemented by all Member States, it is appropriate when companies and financial institutions benefit from EIB public support that they adhere to the highest standards of disclosure, by making the public interest prevail over commercial privacy.

It should be also noted that making public the beneficial ownership of all EIB clients – including that of ultimate beneficiary companies that receive EIB funding through financial intermediaries – during the initial due diligence process prior to the funding would also be beneficial for the bank’s management itself. This publication would actually allow citizens, whistle blowers and external informants too to support the EIB in its corporate due diligence.

How to improve beneficial ownership due diligence: putting the right questions to the right sources

Corporations, financial institutions and private equity firms

When specific doubts or red flags emerge about the identity of owners of a certain company or financial institutions approaching the EIB for its financial support, EIB management often commissions an ad hoc due diligence report on the ownership and criminal record of the applicant to a limited number of specialised investigative companies. This is standard practice for most public and private financial institutions.

³⁵ <http://www.transparencyinternational.eu/wp-content/uploads/2014/01/TI-EU-Policy-Paper-Beneficial-Ownership.pdf>

The James Ibori case³⁶

The Ibori case illustrates how the outsourcing of due diligence, including the tracking of the beneficial owner, to financial intermediaries makes the EIB's funds more vulnerable to possible abuses. Development Financial Institutions (DFIs) investing through financial intermediaries have a limited say in which companies eventually will be invested. Such a deficiency is still present in the current EIB NCJ policy.

In this specific case, the EIB and other DFIs, including the UK's CDC, supported a private equity firm – Emerging Capital Partners (ECP) – that subsequently invested in three Nigerian companies which served as “fronts” for the laundering of money said to have been obtained by James Ibori, the former Governor of Nigeria's Delta Region.

This was mentioned in an affidavit of the Nigerian anti-crime enforcement agency but went unnoticed by ECP and any of the DFIs involved, calling into question the quality of the due diligence carried out.

Additionally, ECP used an offshore company in Mauritius to invest in one of the companies in Nigeria. This construction increased the secrecy surrounding the investment and may have enabled the directors of the Nigerian company to avoid taxes on their investment³⁷.

It should be noted that in some cases

36 Courtesy of Eurodad, <http://www.eurodad.org/Entries/view/1546282/2014/11/03/Going-Offshore-How-development-finance-institutions-support-companies-using-the-world-s-most-secretive-financial-centres>

37 <http://www.counter-balance.org/counter-balance-eib.org/wp-content/uploads/2011/04/EIB-Memorandum-on-Nigeria.pdf>



James Ibori, Photo: Metropolitan police/PA

the identification of beneficial owners alone is not enough. In the ECP case, for example, beneficial owners turned out to be associates of James Ibori as well and served as fronts shielding the interests of Ibori himself. The only way to prevent this is an in-depth due diligence, including a forensic review of all those associated with project operations performed or commissioned directly by the EIB. However such a requirement is not spelled out in the current EIB NCJ policy.

Since 2009, several CSO groups, including Re:Common and Counter Balance, have accused the ECP and DFIs involved of poor due diligence in identifying beneficial ownership and money laundering schemes. The EIB, as well as the other DFIs involved, shifted the blame to the ECP, while the latter denied the allegations. Both the EIB and the ECP failed to investigate the case and instead simply continued doing business³⁸.

38 <http://www.eurodad.org/files/pdf/52eb71eb-c2a0c.pdf>

The UK parliamentary ombudsman raised serious concerns over the use of intermediary funds as an effective model for channelling development funds. Among other things it questioned the very limited power over investment decisions by CDC and how this limited the oversight of the UK's Department for International Development (DfID)³⁹.

After years of legal trial, Ibori was finally sentenced to a 13 year's jail sentence in April 2012 in London⁴⁰.

It should be stressed that, in its lending through financial intermediaries, the EIB neither makes public the names of the ultimate beneficiaries of its intermediated lending nor their domicile. In this regard the EIB is lagging behind other multilateral institutions, such as the EBRD.

39 <http://www.counter-balance.org/counter-balance-eib.org/?p=2920>

40 <http://www.theguardian.com/global-development/2012/apr/17/nigeria-governor-james-ibori-sentenced>

Although these researches can produce valid and reliable findings in most cases, it is worth considering which other sources the EIB should approach or rely upon in order to perform a comprehensive and enhanced due diligence.

It is unclear how much the EIB itself actively undertakes research into ongoing investigations or convictions that have taken place related to tax, corruption, fraud and money laundering charges concerning clients, the beneficial owners of the client beyond what is declared as shareholding owners, and related companies controlled by the same client and its beneficial owners. In particular the EIB is not entitled to directly approach domestic or home country judiciary authorities to double check such information.

It is also unclear to what extent the EIB will be automatically allowed access to centralised corporate and trust registries likely to be established in all European countries under anti-money laundering laws in the coming years. Given its specific nature as a European institution, the EIB should be allowed by European law to relate directly to national judiciary system and corporate registries in Member States and through ad hoc memorandums of understanding signed with third countries.

Again considering other potential external sources of information, it is unclear how much today the EIB screens media from different countries to acquire information about the criminal and tax behaviour of the client, and, in particular, how much this information eventually gathered is weighted within the due diligence process. When operating outside of the EU, a deepened cooperation with EU

delegations in this matter could be part of the solution.

If not already the case, it is recommended that the EIB includes these information gathering procedures from external sources in its standard due diligence procedures, especially in cases where red flags emerge.

Regarding the actual involvement of third parties in the due diligence process and project monitoring, the EIB should also adopt a more pro-active stance by making more information public ex-ante before project approval in order to trigger more interest and cooperation from whistle blowers and external informants. At present it is unclear how information provided by whistle blowers and external informants is considered within the due diligence process and project monitoring after approval, and whether clients are informed or not when information is received from whistle blowers or external informants.

It would also be important that, regardless of a client's counter-arguments, allegations from whistle blowers and external informants be investigated without the involvement of the client. It should be pointed out that the current EIB whistle blowing policy⁴¹ does not cover external informants but rather the EIB staff.

In any case the EIB should maintain the right – eventually to be explicitly covenanted in financial agreements with its clients – to intervene and review its client due diligence during project implementation as well, although this could lead to eventually halting and slowing down project financing and generating some financial losses for the client.

⁴¹ <http://www.eib.org/infocentre/publications/all/eib-s-whistleblowing-policy.htm>

The ultimate beneficiaries of the EIB's intermediated lending

Regarding intermediate lending through commercial banks, the EIB is required to check which due diligence system these financial institutions have in place in order to detect the beneficial ownership of ultimate beneficiaries to which banks on-lend EIB funding and thus prevent tax evasion, corruption, fraud and money laundering.

This is particularly important in the case of institutions operating in countries that are not implementing the recommendations of the inter-government Financial Action Task Force for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system⁴². However it is unclear which precise safeguards the EIB has in place in order to be sure that partner financial institutions implement an in-depth due diligence of all their clients.

It is also not so clear at what stage the EIB is informed by the financial intermediary about the company to which it on-lends, whether the EIB has a say before funding is disbursed, and more importantly whether the financial intermediary shares with the EIB its due diligence of the identified beneficiary company or which proof of evidence that this due diligence has been properly performed.

The EIB Environmental and Social Practices Handbook provides a description of the EIB's responsibilities in approving allocations to SMEs, however the specific issue of beneficial ownership is not detailed there⁴³.

⁴² <http://www.fatf-gafi.org/topics/fatfrecommendations/documents/fatf-recommendations.html>

⁴³ See articles 305, 307 and 309 of the EIB

It would appear to be absolutely necessary for an adequate and effective system to be in place allowing the bank to intervene in a timely fashion if red flags emerge⁴⁴.

Investee companies

The EIB's involvement in investment funds or investee companies is set down in partnership agreements that are signed with all limited partners of the fund. An analysis⁴⁵ of these types of agreements suggests that the power and involvement of DFIs participating in such funds is very limited.

These agreements tend to shield the responsibilities of the investors and at the same time limit the rights of DFIs to intervene in the investment choices by the fund managers. The information they require does not go beyond the general financial performance of the investments made. It is unclear if, according to partnership agreements, the EIB has even the right to formally acquire the due diligence documentation about each investee company upon request, and at which stage of the process.

Handbook of December 2013, http://www.eib.org/attachments/strategies/environmental_and_social_practices_handbook_en.pdf

44 The colloquial term 'red flag' is operationally defined in ex-ante screening and due diligence procedures implemented by financiers according to their anti-fraud and corruption policies. Red flags include specific typologies of information (or lack of) and facts raising well-grounded suspicions which when present should trigger an in-depth, enhanced due diligence of the proposed operations. The same concept of red flags applies to ex-post monitoring of financed operations, in particular as concerns evidence deemed 'sufficient' to trigger an internal investigation (or by external supervising bodies) on alleged fraud and corruption. The definition of what constitutes 'sufficient evidence' has always been a controversial issue – according to some implemented in a discretionary manner – in any judiciary or soft-law accountability system.

45 <http://www.nakedcapitalism.com/2014/05/surprising-missing-sections-private-equity-limited-partnership-agreements.html>

“Not acting openly and accountably” – the failure of due diligence in the ECP/Ibori case

Due to the seriousness of the allegations concerning the Emerging Capital Partners (ECP) case mentioned above, the case was brought to the UK parliamentary ombudsman who investigated how the Department for International Development (DfID) handled this case.

In February 2014 the ombudsman presented its sometimes devastating conclusions⁴⁶. The report accused DfID of maladministration for handling the case. The ombudsman also concluded that CDC failed to “act openly and accountably” and did not deal with the case in a transparent way. The report was critical of the handling of the case by DfID given the “uncertainties” over the quality of the due diligence.

More specifically the ombudsman's report reveals that:

46 <http://www.ombudsman.org.uk/reports-and-consultations/reports/parliamentary/handling-allegations-of-corruption>

- Many fund managers have simply refused to implement CDC's Business Principles, without CDC being able to take any action against them.
- Even after CDC made it a contractual obligation for fund managers to sign up to their new investment code, CDC has only “limited rights” to the accounts and records of fund managers.
- CDC has no rights whatsoever to force a fund manager to withdraw from an investee company.

Before this report very little was known about the relationship between an investor in a private equity fund and the manager of that fund. The ombudsman warned especially about these types of intermediated lending and the related risks to corruption.

As an investor in the same fund using the same instruments, these problems also apply to the EIB and other public investors investing in private equity.



Niger Delta, Nigeria, 2010, Photo Luca Tommasini/Re:Common

7. Country by country reporting (CBCR)

Country-by-country reporting (CBCR) is a very important tool in civil society's view and possibly the most powerful deterrent for the abuse of tax havens by multinational companies and financial institutions.

CBCR is a key tool to assess whether tax payments in each country by multinational companies are fair and correspond to their actual real economic activity in those countries. Making public this information will not have any negative impacts on companies' business and would be a major deterrent to engage in offensive tax planning and abuse of tax havens. It will even help the economy, says a recently published PriceWaterhouseCooper report⁴⁷.

CBCR refers to companies providing relevant data on their sales and purchases within the corporation and externally, profits, losses, number of employees, taxes paid and other forms of economic performance in each country where they have some kind of activity. NGO studies have proven that there is often a complete disconnection between where multinational corporations are economically active and creating value and what is being reported in their financial accounts⁴⁸. Concerning tax matters and the risks of tax evasion and avoidance by companies

⁴⁷ <http://www.euractiv.com/sections/euro-finance/publishing-banks-taxes-and-turnover-will-help-economy-says-pwc-308902>

⁴⁸ Christian Aid. "FTSEcrecy: the culture of concealment throughout the FTSE"; May 2014. Available at: <http://www.christianaid.org.uk/images/FTSEcrecy-report.pdf>



and financial institutions benefiting from EIB support, whether direct or intermediated, the EIB claims to pay sufficient attention to this issue in its own due diligence. However it is unclear which specific information is assessed within available clients' accounts, in particular in the case of multinational companies or transnational operations for which only aggregated accounts, without country breakdowns, are usually available – it is thus hard to detect income, profits and taxes paid in particular within NCJs.

Despite EIB commitment on this matter, and growing interest from most of the bank's shareholders, it is legitimate to wonder how effectively the EIB can today analyse the risk of profit shifting and base erosion from the information provided by its clients.

In particular, the EIB faces some institutional hurdles in acquiring information directly from tax authorities in domestic and home countries. Only tax authorities in the end can authoritatively certify tax information, so that, as with the judicial system, the EIB too should be entitled to relate directly with these authorities.

However, in the case of domestic tax authorities, problems may arise if these are not so open and supportive (such as in the case of NCJs). Similar problems would of course emerge too concerning information about beneficial



owners from authorities from the same jurisdictions. Therefore the EIB, beyond asking the client, should adopt a strategy to acquire this information from other channels, including on tax matters – for example, by requesting ex-ante and directly to its clients to publish certified CBCR.

Aggressive tax planning and profit shifting can happen in different forms and concerns corporations as well as banks and investee companies which are able to operate in more than one jurisdiction. The easiest way is that a company which the EIB finances – either directly or indirectly – pays service commissions to a subsidiary or parent company located in an NCJ. This would increase its costs and reduce profits and taxes to pay in the jurisdiction where the EIB is interested to finance the operation.

More sophisticated forms of profit shifting can take place, even through the use of commodity derivative contracts (as allegedly done by Glencore in the case of the EIB funded Mopani copper mine in Zambia – see box below). A whole range of tax planning strategies are seeking to exploit gaps and mismatches in tax rules to make profits "disappear" for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid⁴⁹.

⁴⁹ www.oecd.org/ctp/beps-frequentlyasked-



Mopani copper mine, photo CEE Bankwatch Network

The Mopani Copper Mines case⁵⁰

In 2005, the EIB loaned USD 50 million to Mopani Copper Mines in Zambia, which was largely owned by GlencoreXstrata, for the renovation of a smelter. Mopani Copper Mines are controlled through the British Virgin Islands, while GlencoreXstrata is officially headquartered in Jersey, but operates from Switzerland.

In 2011, a leaked audit report found that Mopani had sold copper to Glencore at 25 percent of the international price, depriving Zambia of much needed tax revenue. The report also found that Mopani had inflated costs between 2006 and 2008 to further reduce its tax bill.

The EIB started an investigation in 2011, but kept the findings secret despite numerous requests by civil society organisations to reveal them⁵¹.

questions.htm

50 Courtesy of Eurodad, <http://www.eurodad.org/Entries/view/1546282/2014/11/03/Going-Offshore-How-development-finance-institutions-support-companies-using-the-world-s-most-secretive-financial-centres>

51 <http://eurodad.org/Entries/view/1546188/2014/04/10/CSO-letter-to-EIB->

Only following a recommendation by the European Ombudsman, the EIB released a two page summary of its investigative report in early 2015, more than three years after the investigation was concluded.

The summary reveals how hard it is for the EIB to obtain the necessary information from its own beneficiaries:

“The work of the EIB Review Team was non-conclusive due to the difficulties faced in the investigation of the case. As not all of the necessary information could be obtained, it was not possible to comprehensively prove or disprove the allegations raised in the Leaked Draft Report regarding Mopani’s costs, revenues, transfer pricing, employee expenses and overheads.”⁵²

More importantly, none of this would have been necessary had the EIB forced its client to report on a country-by-country basis.

In 2012, Glencore Xstrata made a net profit of USD 7.9 billion⁵³.

calling-for-publication-Mopani-Glencore-report

52 http://www.eib.org/attachments/press/mopani-copper-mines-summary-of-the-main-findings_en.pdf

53 <http://publiceye.ch/en/case/glencore-xstra->

As noted above, today multinational companies’ accounts do not include any breakdown on a country by country basis. As defined in the “CBCR template”⁵⁴ adopted by the BEPS project in 2014, multinational companies should report on a country by country basis information on revenue, profit before income tax, income tax paid and accrued, the location of the economic activity, all the constituent entities, and the nature of the main business activities.

So far the agreement in the BEPS process does not require that the CBCR information be subject to independent verification and the same legal obligations relating to the statutory accounts of the companies⁵⁵. Civil society hopes that this decision will soon be reviewed for obvious reasons related to the risk of falsification and the difficulty of verifying statements produced by transnational companies.

It is crucial that the EIB makes public CBCR a mandatory eligibility criteria for any company or financial institution approaching the bank to benefit from its financing (whether lending or investment).

In March 2014, the European Parliament, in its resolution on the EIB (2013/2131(INI)), called for “the EIB to follow the country-by-country reporting in order to combat the financing of illegal activities; considers that, in order to be eligible for EIB financing, all beneficiaries, whether corporations or financial intermediaries, that are incorporated in different jurisdictions must be obliged to disclose country-level information about

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54 <http://www.oecd.org/ctp/transfer-pricing/discussion-draft-transfer-pricing-documentation.pdf>

55 <http://www.taxresearch.org.uk/Blog/author/admin/page/24/>



their sales, assets, employees, profits and tax payments in each country in which they operate in their audited annual reports; considers also that beneficiaries must make contracts with host governments public and, in particular, disclose the fiscal regime in each country in which they operate”.

Counter Balance and Re:Common support the European Parliament’s request that CBCR should be requested by the EIB from all companies and financial institutions benefiting from its financing, in any sector of operation, even though – as we will see below – this requirement has so far only been introduced for some specific sectors under European legislation. An extension to all sectors – as suggested by the European Council in May 2013⁵⁶ and foreseen by a European Commission proposal within the negotiations on the Non-Financial Reporting Directive in 2014⁵⁷ – is justified by the fact that the EIB is a public financial institution that should condition its support to requirements that are stricter than market practices.

This briefing now articulates a proposal on how CBCR should be implemented by the EIB for all its financial instruments (lending to multinational companies, lending to financial intermediaries, investment in private equity funds), and based on

⁵⁶ See footnote 8

⁵⁷ http://ec.europa.eu/finance/accounting/non-financial_reporting/index_en.htm

information provided by clients, which measures the bank should eventually put in place to reduce and progressively eliminate the risk of profit shifting and tax base erosion and being supportive of aggressive tax planning.

a. EIB lending to multinational companies

The new Accounting Directive imposed in article 41-48 a new obligation on European companies operating in the extractive and logging sector to disclose their payments to governments and other public entities in any single country where they operate as well as for any single project they are involved in. This decision is a major step forward in terms of making host governments more responsible for how royalties and taxes paid by multinational companies will be used. At the same time it will make evident to both host countries’ and European citizens how much in tax the extractive and logging multinationals pay per project.

However the modalities regarding the publication of this information will be defined in the transposition process of the new directive into national laws at Member State level. It is crucial that governments introduce such a level of transparency.

Only knowing about a company’s tax payments in each country is not enough to assess whether those payments are fair and correspond to actual real economic activity. A figure on payments

to governments does not reveal where the real economic activity takes place and gives no benchmark to assess the tax payments against. Importantly it does not reveal how some companies move profits from the place where production takes place, where work is done and where pollution is produced to countries where taxes are low but no real activity takes place, hence lowering tax revenues for host countries.

Thus it is crucial that the EIB soon makes public CBCR a mandatory eligibility criteria for any company approaching the bank to benefit from its direct financing – therefore expanding the requirements in EU law on the extractive and forestry sectors to all economic sectors it finances. In order to reduce transaction costs for the EIB, CBCR accounts should be subject to independent verification and the same legal obligations relating to the statutory accounts of the companies.

Once this information is made public and thus becomes available to the EIB, the bank’s services would analyse the presence in NCJs of subsidiaries of the multinational company. Based on the relocation clause provision of the NCJ policy, the EIB would ask the company to relocate away from NCJs within eight months. This requirement will be covenanted in financial agreements, including a clause of suspension and restitution of the loan if not properly implemented. The EIB should also consider the possibility to apply this clause to other jurisdictions even though these are deemed compliant according to the Global Forum standards and reviews.

b. EIB lending through financial intermediaries

It is very welcome that the EU has agreed that Capital Requirement

Directive (CDR IV) at art. 89 will require banks and financial institutions to disclose profits made, taxes paid, subsidies received, turnover and number of employees on a country by country basis.

It should be noted that recently the assessment of economic impacts associated with the implementation of this norm commissioned by the European Commission to PriceWaterHouseCoopers made it clear that “the public country-by-country reporting of information under Article 89 of Directive 2013/36/EU is not expected to have significant negative economic impact, in particular on competitiveness, investment, credit availability or the stability of the financial system. On the contrary, it seems that there could be some limited positive impact.”⁵⁸ Thus the Commission has decided to start the implementation of this norm from 1st January 2015.

The EIB has a quite close and structured relationship with the commercial banking system. Not just as concerns the systematic use of so-called “global loans” to commercial banks which then on-lend to SMEs, but most importantly because the EIB finances itself on open capital markets by issuing its bonds through major commercial banks.

The example of France, where a law on CBCR for French banks has already been implemented in 2014 – so that the first reports have been made available by the banks – will allow us to define how the EIB should act when a certain large bank – either issuing EIB bonds, or benefiting from EIB financing – operates to a certain extent through NCJs.

⁵⁸ http://ec.europa.eu/internal_market/company/docs/modern/141030-cbcr-crd-report_en.pdf

The example of French banks and how CBCR becomes a realistic practice

A recent report from the French “Plateforme Paradis Fiscaux et Judiciaires” draws the first lessons from the transposition in French law of the CRD IV directive⁵⁹. Among the conclusions of this report there are striking features, including the fact that one third of the foreign subsidiaries of the five largest French banks are located in tax havens (with a preference for Luxembourg, Belgium, Hong Kong and Switzerland), 26 percent of French banks’ international turnover is located in tax havens, and tax havens are more attractive than emerging countries (the turnover of French banks in emerging countries is five times less important in the BRICS than in tax havens).

Another worrying lesson drawn is that figures provided by the banks show that employees of banks located in tax havens are two times more productive than employees located in other countries, which questions the real nature of banking activities in tax havens and the specialisation of these subsidiaries.

Overall, this recent exercise shows that transparency is possible and that even if the CBCR is not yet complete (French banks will only publish in 2015 their profits and taxes paid, and the methodologies used for CBCR remain to be improved), it already raises some important questions on why French banks have a significant level of activity in tax havens.

⁵⁹ <http://www.stopparadisfiscaux.fr/que-font-les-etats/la-france/article/que-font-les-plus-grandes-banques#cle1>

In the case of intermediate lending, the public CBCR requirement should apply to both the bank and companies that onlend EIB funds.

Regarding intermediary banks, in the case of financial intermediaries operating through NCJs, the EIB should agree and covenant in financial agreements a “progressive relocation clause”, that means the phase out of these institutions from those jurisdictions within five years (20 percent each year to reduce both income and profits) up to the closure of its presence there. Should financial institutions not comply with this clause, loans will be suspended and then withdrawn, and administrative sanctions applied as described in financial covenants.

In the case that a certain NCJ acquire a compliance status in the making this will be taken into account in the reduction target. However, the EIB will retain its right to include in the progressive relocation clause also some other jurisdictions which are regarded by the bank as non-compliant and not adequate for bank investment beyond what is reviewed within the Global Forum process.

Concerning companies to which the intermediary bank onlends EIB funds, only a limited number of such companies is supposed to be multinational. In these cases the intermediary bank should request CBCR to be made public as a pre-condition for receiving financing. Based on these reports, the intermediary bank should perform a tax due diligence, analysing the presence of the company in NCJs or other jurisdictions that might be deemed problematic and not justifiable by the EIB. This due diligence should be communicated to the EIB before any financing decision is taken.

In the spirit of supporting domestic companies for development purposes, in cases where planned beneficiary companies operate through NCJs and other jurisdictions deemed problematic or in a not justifiable manner, the intermediary bank should deny support for these companies.

The EIB should then make public on its website the list of beneficiary companies for each intermediated loan every six months as well as related CBCR of those companies when available.

c. EIB investments in private equity funds

In the case of EIB investment in private equity funds, the bank should pay specific attention to different actors, including the fund itself, the private equity firm managing it and the investee companies benefiting from the fund equity participation.

Regarding where the fund is incorporated, the EIB should carefully analyse why a certain jurisdiction is chosen. This could happen in terms of rule of law certainty that investors would want to get secured, but also because of the layer of corporate secrecy that some jurisdictions offer. In most jurisdictions the fund is not taxed, when in theory investors' dividends should be taxed in their own home country. This approach could be accepted if the highest level of transparency is guaranteed and if investors are based in jurisdictions where this occurs.

In all cases, as a minimum, the EIB should make publicly explicit – in a project's description and in a detailed manner – why it tolerates that the fund is domiciled in an NCJ or in a jurisdiction which might raise concerns

despite being compliant according to the Global Forum standards. Similarly these justifications should be included in a yearly report to the European Parliament concerning the implementation of the NCJ policy.

As concerns the private equity management firm, a specific tax due diligence should be applied and CBCR requested, given that in most cases these firms operate in several jurisdictions.

Once this information is made public and thus available to the bank, EIB staff would analyse the presence of subsidiaries of the management firm in the particular NCJ. Based on the relocation clause provision of the NCJ policy, the EIB would ask the management firm of the private equity firm it invests in to relocate away from NCJs within eight months. This requirement will be covenanted in financial agreements, including a clause of suspension and restitution of the loan if not properly implemented.

The EIB should also consider the possibility to apply this clause to other jurisdictions even though these are deemed compliant according to the Global Forum standards and reviews. For instance, the EIB could also make use of the external documents of civil society organisations and researchers who specialise in this area, in particular the Financial Secrecy Index of the Tax Justice Network.

Finally, regarding the investee companies, most of these are supposed to be just domestic companies so that CBCR already exists in their annual reports as they operate in a single country. However there have been cases where investee companies are directly related or controlled by other companies located in other jurisdictions, so that the fund manager

should require ex-ante to make public CBCR in order to check whether these companies are eligible.

In the spirit of supporting domestic companies for development purposes, and as requested under the External Lending Mandate of the EIB, the fund should not invest in companies that operate through NCJs and other jurisdictions deemed problematic or in a not justifiable manner.

The EIB should be informed in advance by fund managers about their intention to invest in a specific company which has been found in compliance with the NCJ policy. The EIB should then make public on its website the list of investee companies every six months and related CBCR of those when available.

8. It is not just a matter of **ex-ante** due diligence

The EIB's efforts to curb the abuse of tax havens should not stop just at the ex-ante due diligence to be performed on each of its clients and operations.

It is essential that the bank's board of directors be adequately informed and pro-actively monitor management's tax due diligence. Furthermore, ex-post monitoring by the bank's management and staff should mainstream taxation issues and in particular the abuse of tax havens.

A pro-active board on tax matters

Currently it is unclear how tax and corporate transparency due diligence is communicated to board members before project approval, in particular what kind of information is highlighted in project descriptions for internal purposes. It is also not possible to know how many projects have been turned down on concerns related to the use of tax havens or other taxation issues by EIB management – and thus quite likely not taken for discussion at board level – given that the bank does not keep that information in case of project proposal rejection and claims that it can't publicly report on it.

In order to overcome these limitations, it is important that the board exerts its leadership on taxation issues and mainstream this matter in all its decisions, both at project and policy level. It would thus be necessary for the board to report annually to all stakeholders in its annual consultation meeting at the beginning of the year

in Luxembourg on how taxation issues have been dealt with in the year just past.

Tax clauses in project financial covenants

However more can be achieved also after project approval if the right tax conditions are inserted in project financial agreements. In particular financial covenants should include specific clauses concerning tax evasion and avoidance and related fraud, corruption and money laundering. Given the confidentiality of these agreements, it is not possible to know what is already covenanted on this matter as standard practice by EIB management.

For instance, is the integrity statement covenanted as an integral part of the entire project financial agreement? In which specific form? And what power does the EIB have to activate clauses and interrupt the financing based on allegations of tax evasion and avoidance without incurring any sanction? And, in the specific case of private equity funds, which tax clauses are specifically negotiated in partnership agreements? More generally concerning lending through financial intermediaries, which legal obligations are imposed on these as concerns the need to covenant specific tax clauses with beneficiary companies to which they onlend EIB financing?

Regular monitoring and possible due diligence revision

Monitoring is also central in order to prevent tax evasion and avoidance by beneficiaries of EIB financing. It is unclear whether a procedure exists that allows the bank to re-assess the



corporate transparency and tax due diligence after project approval. If such a procedure exists, neither is it clear under which circumstances it can be applied.

For instance, if some red flags have been raised during the due diligence process before the approval and then processed and overcome thus leading to project approval, how the same concerns are regularly screened and monitored after the approval is unclear to European citizens and all concerned parties to the deal, despite the requirements from article 9.2 of the EIB external lending mandate⁶⁰.

As already suggested, in order to overcome the fact that the compliance of NCJ with the Global Forum standards or EIB own criteria might change overtime, a regular country tax assessment by the EIB every three years would automatically trigger the need to eventually revise some specific client due diligence already performed at the time of project approval.

⁶⁰ Article 9.2 of the EIB external lending mandate requires the bank to "monitor the implementation of financing operations. In particular, it shall require the project promoters to carry out thorough monitoring during project implementation until completion, inter alia, on the economic, development, social, environmental and human rights impact of the investment project. The EIB shall verify on a regular basis the information provided by the project promoters and make it publicly available if the project promoter agrees

9. Conclusions

This briefing seeks to propose a way forward for the EIB to become a more responsible lender in relation to taxation by adopting an ambitious Responsible Taxation Policy –indeed to become a model in this field.

The current political climate at EU level is a unique window of opportunity for the EIB to raise its profile and set a precedent among financial institutions. Below are summarised our main proposals for this change to happen.

Principles for a Responsible Taxation Policy

- A pro-active approach should be endorsed by EIB management. The EIB should request the private sector benefiting from its support to do more than current market practice in terms of responsible taxation behaviour.
- The EIB should rediscover the positive approach that guided the drafting of its first NCJ policy in 2009, in particular through the possibility to go beyond existing policy prescription and analysis from the OECD Global Forum. The EIB should keep the possibility of regular country assessment to identify problematic jurisdictions via the production of country tax assessments to be reviewed every three years. To this end the bank could use assessments from civil society organisations and specialist researchers.
- The EIB should make a more pro-active use of its relocation clause.

Further clarifications in the NCJ policy are needed

- Counter-parties can still operate in a prohibited jurisdiction if this jurisdiction offers a level of “corporate security”. The policy remains unclear about what this would entail.
- The EIB should systematically publish the domicile of funds benefiting from EIB support, as well as those of ultimate beneficiaries supported by financial intermediaries.
- In case of a violation of the relocation requirement, more details are needed on the suspension or cancellation of the financing, as well as exclusion from future financing.
- When approving an operation the EIB should make public the Integrity Covenant signed by beneficiaries and attached to its lending contracts. Regarding investments in private equity funds, compliance issues related to harmful tax practices and illicit flows should be included in the legal documentation of the fund and possibly made public.
- More detailed reporting to the European Parliament and external stakeholders on the implementation of the NCJ policy should include the number of applications turned down by the bank for non-compliance with the NCJ Policy, as well as the number of relocations requested and implemented.
- It is crucial that the board of directors of the EIB exerts its leadership on taxation issues and mainstreams this matter in all its decisions, both at project and policy level.
- Regular monitoring and due diligence revision would be a step forward.

In particular the EIB should make public in its NCJ policy which allegations and evidence are sufficient to trigger a review of the already performed due diligence of a certain client that was granted EIB financing.

Improving beneficial ownership due diligence: putting the right questions to the right sources

For corporations, financial institutions and private equity firms, the EIB should approach new sources in order to perform a comprehensive and enhanced due diligence. The EIB should be allowed by European law to relate directly to national judiciary system and corporate registries in Member States and through ad hoc memorandums of understanding signed with third countries. Further media analysis and deepened cooperation with EU delegations outside of the EU could also be part of the solution.

By making more information public before project approval, the EIB would trigger more interest and cooperation from whistle blowers and external informants. Information provided by third parties should be strongly considered within the due diligence process and project monitoring after approval. The EIB should review its current whistle blowing policy which does not cover external informants, but rather the EIB staff. In any case the EIB should uphold the right to review its client due diligence during project implementation, even though this could lead to the eventual halting and slowing down of project financing and generate financial losses for the client.

For ultimate beneficiaries of the EIB's lending through financial intermediaries,

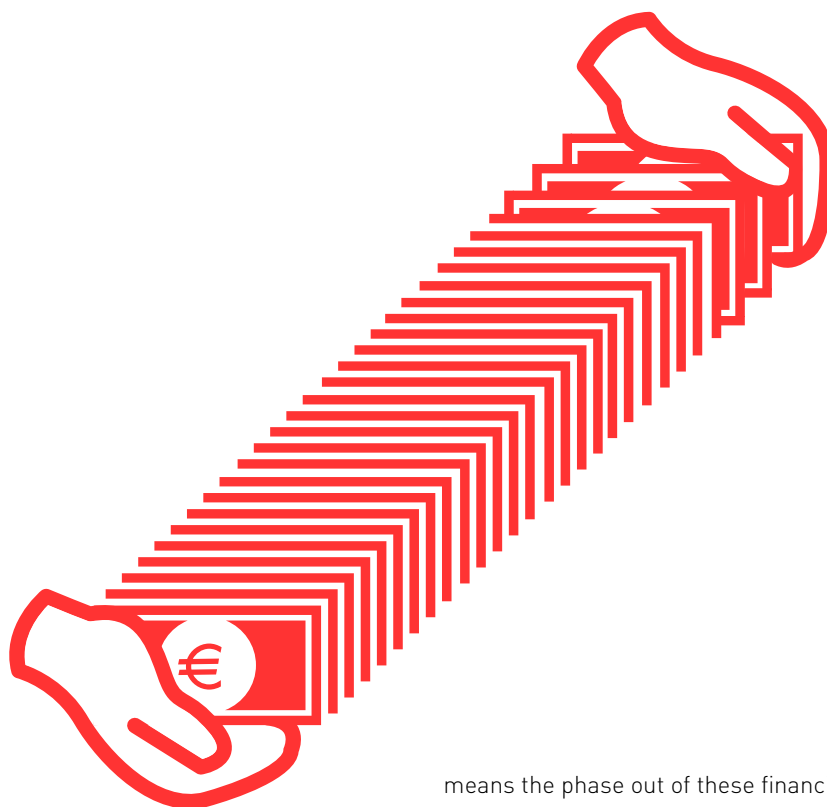
the EIB should clarify which precise safeguards are in place to ensure that partner financial institutions implement an in-depth due diligence of all their clients. Even if financial intermediaries are used to reduce transaction costs, it is still essential that an adequate and effective system is in place allowing the bank to intervene in timely fashion if red flags emerge.

For investee companies, the EIB currently has limited power to know in advance which investee companies fund managers select and based on which due diligence. According to the signed partnership agreements, the EIB should formalise its right to acquire the due diligence documentation of each investee company and at various stages of the process.

Introducing a stringent system of country-by-country reporting (CBCR)

The EIB faces some institutional hurdles in acquiring information directly from tax authorities in domestic and home countries, therefore it should be entitled to relate directly with these authorities. The EIB, beyond asking the client, should adopt a strategy to acquire information through other channels. For example by requesting its clients to publish certified CBCR prior to the signing of an agreement.

For EIB lending to multinational companies, the EIB should make public CBCR a mandatory eligibility criteria for any company approaching the bank to benefit from its direct financing – therefore expanding the requirements in EU law on the



extractive and forestry sectors to all economic sectors it finances, as requested by the European Parliament in March 2014. In order to reduce transaction costs for the EIB, CBCR accounts should be subject to independent verification and the same legal obligations relating to the statutory accounts of the companies.

Once this information is made public and thus available to the Bank, the EIB services would analyse the presence in NCJs of subsidiaries of the multinational company. Based on its relocation clause, the EIB would ask the company to relocate away from NCJs within eight months. This requirement will be covenanted in financial agreements, including a clause of suspension and restitution of the loan if not properly implemented.

For EIB lending through financial intermediaries, public CBCR requirements should apply to both the banks and companies which onlend EIB funds. The EIB should agree and covenant in financial agreements a “progressive relocation clause”, that

means the phase out of these financial intermediaries from NCJs within five years (20 percent each year to reduce both income and profits) up to the closure of its presence there. Should financial institutions fail to comply with this clause, loans will be suspended and then withdrawn and administrative sanctions applied as described in financial covenants.

Concerning companies to which the intermediary on-lends EIB funds, the intermediary should request CBCR to be made public as a pre-condition to receive finance. Based on these reports, the intermediary should perform a tax due diligence analysing the presence of the company in NCJs or other jurisdictions which might be deemed problematic by the EIB. This due diligence should be communicated to the EIB before any financing decision is taken. In cases where planned beneficiary companies operate through NCJs and other jurisdictions deemed problematic, the intermediary bank should deny support to these companies. The EIB should then make public on its website the list of beneficiary companies for each intermediated loan every six months and related CBCR of those companies when available.

When considering EIB investments in private equity funds,

the EIB should pay specific attention to the fund itself, the private equity firm managing it and the investee companies. For all those different actors, CBCR requirements should be applied as described above for intermediated loans.

In all those cases, the CBCR exercise should be a prominent feature of the project analysis made by the EIB under its 3PA (“3 pillars assessment” for projects inside the EU) and REM (Results Measurement Framework for projects outside the EU).

Towards the creation of an EIB Responsible Taxation Policy

In order to operationalise some of the proposals formulated in this briefing and live up to EU citizens’ expectations, the EIB should create a fully-fledged Responsible Taxation Policy by the end of 2016. A first step in this regard should be the revision of its NCJ policy in 2015, as a key component of a broader taxation policy. An open and inclusive public consultation with all stakeholders should take place for both processes.

Thereafter, the EIB should consider the creation of a Working Group on tax to take stock of the most recent developments at EU level and supervise the creation of an EIB Responsible Taxation policy. In parallel, the EIB should create a separate internal “Tax Unit”, possibly as part of its compliance office, with sufficient capacity to

implement thorough due diligence on tax issues.

Finally, the EIB should start publishing a yearly “tax report” covering the implementation of its NCJ policy but also providing the European Parliament and general public with precise figures on the tax impact (especially on corporate taxation on profits) of EIB investments and lending.

Annex

We have given the European Investment Bank the opportunity to share their views on this report prior to publication and we thank them for their input which is available below. We applaud the bank's commitment for further improvements but as outlined in the text we believe there is space to take a more active approach soon. The cases mentioned in the report are still relevant in our view. They are still ongoing and according to our analysis would not have been avoided with the current NCJ policy.



Европейска инвестиционна банка
Evropská investiční banka
Den Europæiske Investeringsbank
Europäische Investitionsbank
Euroopa Investeeringispank
Ευρωπαϊκή Τράπεζα Επενδύσεων
European Investment Bank
Banco Europeo de Inversiones
Banque européenne d'investissement
Banca europea per gli investimenti
Eiropas Investīciju banka

Europos investicijų bankas
Európai Beruházási Bank
Bank Ewropew tal-Investment
Europese Investeringsbank
Europejski Bank Inwestycyjny
Banca Europeana de Investiții
Európska investičná banka
Evropska Investicijska banka
Euroopan Investointipankki
Europeiska investeringsbanken

Mr Xavier Sol
Director
Counter Balance

Via e-mail: xavier.sol@counter-balance.org

Luxembourg, 29th January 2015

Ref.SG/CR/CS/JSB/vk

Dear Sir,

We thank you for giving to the EIB the opportunity to review the Counter Balance draft briefing on "The EIB and the fight against tax evasion and avoidance" prior to release.

While the Bank shares your general concerns on these important matters, and is constantly monitoring major developments at EU and international level in order to maintain its leading role amongst International Financial Institutions in the fight against tax fraud, tax evasion and harmful tax practices, we regret noticing that, notwithstanding the clarifications already provided by the Bank on several occasions, the draft contains numerous inaccurate and misleading statements such as, just to mention a few examples:

- the usual references to old ECP and Mopani cases used to corroborate alleged deficiencies in the EIB Policy on non-compliant jurisdictions (NCJ Policy), despite both operations largely pre-dating the NCJ Policy itself; and
- allegations on EIB management "pushing back" and "casting further doubts on the Bank's intentions" are totally unfounded since just about one month after the statement the Bank stakeholders approved - after intense debate on most key features of the NCJ Policy - the Addendum published on the EIB website, to take into account the new OECD Global Forum country rating process and methodology.

Also the repeated statements on the allegedly "non-ambitious" and "non-inclusive" OECD Global Forum achievements, appear questionable given OECD's and the Global Forum's impressive progress under the G20 mandate in the fight against tax secrecy and for the establishment of appropriate tax governance standards.

These achievements and ongoing developments appear well beyond those of any national authority, lead organisation or NGOs worldwide and could only be possible thanks to the unconditional support and coordination of i) all Global Forum members, which include the European Union and most EU Member States, and ii) all others participating to the Global Forum activities as observers - such as most IFIs including the EIB - and scrupulously endorsing the Global Forum standards and country listings.



The EIB therefore confirms its long-standing support to the OECD and to the Global Forum: the OECD standards greatly contributed to the harmonisation of more transparent and increasingly responsible tax practices for the IFIs offshore activities and should not be hastily dismissed without an equally effective and reputable alternative, which is currently not available.

Without prejudice to the above, there is certainly room for further improvement in the existing NCJ Policy and related processes to take into account ongoing tax-related developments and enhance transparency of EIB activities in line with its Transparency Policy, and we remain available to discuss with all interested stakeholders any such possible improvement.

In particular, as already discussed with Counter Balance and other NGOs during the workshop held in Brussels in October 2014 and the Eurodad roundtable in November 2014, we agree that all key actors of the international community will have to increasingly focus on country-by-country reporting (CBCR) and beneficial ownership transparency as fundamental instruments to end secrecy and harmful tax practices.

Key actors include, for activities within their respective remits and mandates, EU and national institutions in charge with establishing the necessary legal framework, national tax authorities in charge with supervision and enforcement and, of course, IFIs within the terms of their mandates and pursuant to applicable legal and administrative regimes.

In particular the EIB welcomes and monitors with extreme attention the efforts made under the Draft 4th AML-CFT Directive to establish beneficial ownership registries: these will indeed constitute a material progress to corroborate beneficial ownership (BO) records usually available to financial intermediaries including the EIB, i.e. counterparts declarations and state-of-the-art specialist providers' data.

However, the Bank would like to point out that the timeframe for the implementation of BO registries across Europe is still unclear and the existence of such registries is hardly predictable outside Europe.

Likewise, the country-by-country reporting (CBCR) standards are currently limited to EU credit institutions and other specific, and very limited, sectors, and could not be unilaterally extended by the EIB beyond the existing legal framework only by contractual remedies: the EIB is certainly cognisant of EU policy priorities but cannot replace and step into the role and prerogatives of EU and national institutions in charge of the legislation process.

Also, it should be pointed out that, while beneficial ownership registries would be an immediate advantage, when available, for financial institutions and the public at large, by enhancing the certainty and reliability of beneficial ownership in general, CBCR is not intended to benefit financial institutions but rather national tax authorities, who are the sole entities with necessary powers and capacity to impose remedial action.

Even under the hypothesis of your proposed progressive extension of CBCR legal obligations to all EIB counterparts it has to be kept in mind that financial institutions, including the EIB, would not have the authority and capacity to elaborate the related data and tax due diligence worldwide.

We would therefore caution against evoking beneficial ownership transparency and country-by-country reporting as the sole, future cornerstones of an updated EIB NCJ Policy.



Current ongoing developments certainly need to be considered to anticipate possible evolving trends, but the very limited legal framework currently available does not allow, at this stage, for a realistic implementation timeframe.

We reiterate our commitment to continue the fruitful dialogue started last October through dedicated workshops on both beneficial ownership transparency and country-by-country reporting, in order to identify possible concrete measures realistically transposable in daily EIB policies and processes despite the limited legislation framework currently available.

Yours Sincerely,
EUROPEAN INVESTMENT BANK

Gerhard Hütz
Chief Compliance Officer

Hakan Lucius
Head of Division



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