Tax Havens and Development

Report by the Independent Norwegian Commission on Capital Flight from Developing Countries

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Mandate

- Assess the magnitude of illicit capital flows and the consequences thereof from a development perspective
- Put forward measures that can curb the harmful effects tax havens may have on development
- Provide recommendations that can be used as operational guidelines for Norfund, the Norwegian Investment Fund for Developing Countries

Unanimous Commission
Illicit capital flows

- Illicit capital flows from developing countries are estimated at USD 641-941 billion
  - Even the lowest estimate exceeds the net legal inflow to poor countries
  - Corresponds roughly to TEN TIMES THE TOTAL DEVELOPMENT ASSISTANCE GIVEN!!

- Rich people hide capital in tax havens corresponding to US GDP
  - Totalled USD 11-12 000 billion in 2004
  - Rich people in developing countries constitute 20% of this number (overrepresented)
  - Only 5% of rich people who place deposits in tax havens declare their deposits
What sets tax havens apart (i): Ring-fenced tax system

1. *One set of laws* for local firms that entails “high” taxation and “normal” regulation

2. *One set of laws* for companies that conduct and manage their business in other states while enjoying “zero” tax conditions, lax (or no) regulation, and secrecy (foreign investor legislation)
   - Business concept is to earn income on registration and administration fees
What sets tax havens apart (ii): Legal system

**Tax havens**
- Ring-fenced tax system
- Absence of public registries or information of any kind
- No obligation to deliver accounts (or no auditing and control)
- No preservation of records
- Legislation favours foreign investors solely (escape clauses)
- Exceptions and lax, if any, enforcement of regulation

**Normal states**
- No ring-fencing: rule of law (equality)
- Public registers and information available
- Mandatory auditing and treasury controls
- Record keeping requirements
- Balanced legislation (public interests, minority owners etc.)
- No exceptions granted, legislation generally enforced

Information exchange tax treaties do not eliminate these harmful structures
“Either this is the largest building in the world or the largest tax scam” (US President Barack Obama, Jan. 5, 2008, debate in Manchester, N.H.)

…..about Ugland House, a small building in Cayman Islands, where 12,748 companies are registered and supposedly conduct their business (among them Coca Cola and Intel Corp.) No real activity is going on!
What sets tax havens apart (iv): artificial structures

- British Virgin Islands (BVI)
  - 19,000 inhabitants/830,000 registered companies; 43 companies pr. capita.
  - Some BVI residents are nominated board members and directors of hundreds (and in some cases even thousands) of companies

  ➔ Real beneficial owners live elsewhere!

  ➔ Illustrative of the lack of activity of substance. These nominee board members and directors are not part of any effective direction or management but make foreign owned companies qualify for domiciliation in tax havens.

  ➔ Tax havens are tiny with huge amounts of capital flowing through them. It is not profitable for them to enforce regulation, keep accounts, do random audits etc. as long as they do not tax capital.
Harmful effects of tax havens are much wider than only losses in tax revenues - a new term captures the characteristics of the problem.

**SECRECY JURISDICTIONS**

1. Part of its regulations is primarily of benefit to those not resident within their territorial domain.

2. Regulations exist that prevent the identification of those who use its regulations and resident outside that jurisdiction.

**HARMFUL EFFECTS**

- Destabilises the financial system by hiding risks
- Facilitates money laundering of the proceeds of drugs and trafficking
- Facilitates financing of terrorism
- Facilitates corruption & economic crime
- Facilitates tax evasion & avoidance
- Destabilises the financial system by hiding risks

**Organizations**

- FATF
- IMF
- FSB
- UNODC
- OECD
- EU
Tax havens and economic development: The seven sins of tax havens hampering development

1. Tax havens encroach heavily on the sovereignty of other countries
2. Tax havens harm the efficiency of financial markets
3. Tax havens undermine national tax systems and increase the costs of taxation
4. Tax havens reduce the efficiency of resource allocation
5. Tax havens make it more profitable and less risky to engage in economic and other crimes
6. Tax havens hurt private income too
7. Tax havens hurt institutional quality (bureaucracy at large) and thereby economic growth (and democratic development in the long run)

The negative impact of these factors may be an insurmountable hindrance to economic development in poor countries
• **International proposals:**
  - Initiate international *convention on transparency* in international economic activity/transactions

• **National proposals:**
  - More legal tools to combat *manipulated transfer pricing*
  - Those who facilitate tax haven registration should *register their activities*
  - Set up a *competence center* in international tax and public finance
  - Multinationals’ annual accounts
    - Must show where they have affiliates (and affiliates of affiliates)
    - Must show how much they pay in tax in percentage of taxable income

• **National development policy:**
  - Help poor countries develop its *revenue side*
  - The Norwegian Investment Fund for Developing Countries has a development perspective and *should not invest* through tax havens
THANK YOU!

To find out more, visit the official website of the Commission Report to download it as a pdf-file or search the document online at:


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