



PAYING TAXES TO ASSIST THE POOR? BALANCING SOCIAL AND FINANCIAL INTERESTS

NpM – Platform for Inclusive Finance



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PREFACE

Paying taxes to assist the poor? is the result of a dialogue among the members of NpM – the Dutch Platform for Inclusive Finance. At the end of May 2013 NpM started a working group to study tax avoidance and the relevance of this issue for microfinance investors as a result of a global discussion. This discussion primarily focuses on tax planning by multinational enterprises (MNEs) investing in developed and emerging economies. By making use of tax treaties between nation states and shifting profits from one country to another MNEs can reduce their effective tax rates considerably and avoid paying taxes. In essence, there is nothing wrong if a company aims to optimise its tax position – for instance by avoiding double taxation – while overall still paying its fair share. A discussion emerges, however, when companies make use of tax treaties to avoid paying taxes. This issue of double non-taxation is even enhanced if MNEs use brass plate or letterbox companies for the sole purpose of avoiding taxation. Since microfinance investors also make use of tax treaties to reduce tax payments the question arises whether they are (not) paying their fair share. The NpM working group is made up of NpM members with a clear interest in acting responsibly, while at the same time making socially and financially sound inclusive finance investments.

NpM is a membership organisation focusing on the promotion of inclusive finance. The platform brings together investors – ranging from impact first to finance first investors –, development organisations, foundations, and policy makers. The members have different financial and non-financial objectives. Most, but not all, aim at making a contribution to the alleviation of poverty in developing countries in general and of the clients for microfinance institutions in particular. What the organisations have in common is their contribution to assisting the poor in getting access to finance. Making direct investments in microfinance institutions is only one way to achieve that objective. In addition, the members can make indirect investments, provide technical assistance or influence the policy environment in ways that are beneficial to the poor. Member organisations may even have policy agendas that go beyond the narrowly defined field of providing access to finance to the poor. Although we recognise the importance of these additional initiatives, they will not be part of the core considerations in this paper. The focus is one what the members have in common: the promotion of microfinance and small and medium-sized enterprise finance in an environment that contributes to improving the situation of poor clients of financial institutions in developing countries – including microfinance institutions.

The paper provides a brief analysis of the issue of efficient tax planning, while at the same time taking issues of fairness and justice into account. The current debate on tax planning is global in nature. In this paper we, however, limit ourselves to discussing only those practices that relate to the issue of inclusive finance in the emerging markets and developing countries. As will be demonstrated we take a pragmatic approach to the issue, taking the consequences of our ideas, suggestions, and proposed actions into account. NpM members, for instance, share a common view on the issue of double non-taxation. Also we believe that the interests of the end consumer of microfinance – the borrower taking up a loan, the client with a savings account, or the uninsured signing a health insurance contract –



should always be at the core of what we do. It is with this focus on the beneficiaries of microfinance in mind that we study the impact of tax treaties – such as double taxation treaties or agreements (DTAs). A question that arises in this context is whether tax treaties are instrumental in channelling capital towards microfinance? Alternatively, one can ask whether ending tax treaties or reducing the financial benefits for investors will negatively impact the flow of capital towards microfinance? Anyone who is familiar with Muhammad Yunus' struggle with established financial and political institutions, as described in *Banker to the Poor*, understands that a potential withdrawal of Foreign Direct Investments (FDI) as a result of increased taxes may not be in the interest of the poor. What is needed is clear helmsmanship to steer foreign microfinance investments between the Scylla of reduced investments and the Charybdis of unfair taxation.

This paper primarily focuses on microfinance investments. Nevertheless, the analysis, discussion, conclusions and recommendations in this paper also apply to investments in Small- and Medium-sized Enterprises (SMEs) in emerging and developing countries. With this paper we hope to contribute to a constructive discussion on fairness and taxation in relation to inclusive finance. NpM is willing to contribute to this discussion and is open to suggestions from investors, investees and other relevant stakeholders.

Prof. Dr. Harry Hummels
Chairman of the NpM Working Group on Tax and Microfinance



EXECUTIVE SUMMARY

The issue of tax avoidance in recent years has emerged as a global issue that affects both developed and developing countries alike and is at present widely being covered by the international press, addressed by supranational bodies like the OECD and UN, and given priority by the leaders of the G8 and G20 nations. A majority seems to purport that concerted action is needed to ensure fair tax outcomes in a world that is characterized by financial interconnectedness. Here, we approach the issue as seen from the perspective of NpM Platform for Inclusive Finance, with a focus on furthering the interests of microfinance clients in developing countries. Despite the fact that this global issue only marginally affects NpM member activities, NpM stimulates further scrutiny – including self-inspection.

Tax avoidance is generally seen as behaviour that might go ‘against the spirit of the law’. As such, tax avoidance is a ‘grey’ area, stuck between the legal practice of tax planning on the one hand, and the illegal practice of tax evasion on the other. Besides large multinational enterprises (MNEs), which have led the way in exploring tax practices that are detrimental to developing nations, more recently also other internationally operating entities including microfinance investors have been accused of avoiding taxes. As a result, important phenomena that deserve attention in this paper are special purpose vehicles or SPVs, tax treaties, profit shifting, and offshore financial centres.

- **Tax treaties and double (non) taxation**

Tax treaties are important instruments to regulate distributive tax issues. They have to prevent that taxpayers are confronted with double taxation and the Internal Revenue Departments of treaty partners with double non-taxation. As a result of the ability of multinational enterprises (MNEs) to shift profits from one country to another – usually the money flows to the country that allows for the largest tax benefits – tax treaties have lost some, if not most, of their initial intent. The treaties have gradually come to be used to avoid taxation. Multinational companies capitalize on their ability to differentiate between tax jurisdictions by shifting profits ‘overseas’. Regarding foreign direct investments (FDI), the OECD and IMF data reveal the itineraries of international investment flows. They show for example that in 2010 Barbados, Bermuda and the British Virgin Islands received more FDIs (combined 5.1% of global FDIs) than Germany (4.8%) or Japan (3.8%). In the Netherlands roughly 80% of its total inward investments of 3,200 billion euro in 2011 entered and subsequently left the country through SPVs.

- **Transfer-pricing and profit shifting.**

Transfer pricing relates to pricing applied by multinational enterprises on intercompany transactions. Transfer pricing regulations require that such transactions take place at an arm’s length basis. In practice the intercompany pricing may still lead to allocating profits to the parent company or subsidiary thereof located in a country with a favourable tax regime with respect to such income. The OECD quotes various studies that find clear evidence of multinational enterprise (MNE) profits appearing on the balance sheet in a country that are not a reflection of the proportional economic activity in that same country. Substantial differences in international tax rates heavily incentivise MNEs to shift their profits across borders.



- **Offshore Financial Centres**

OFCs or tax havens are characterized by offering a combination of tax policies that are devised to offer corporations and investors extensive fiscal advantages – creating an environment for exponential growth of the jurisdiction itself. The combined tax arrangements typically found in tax havens, also individually present themselves outside these jurisdictions, which makes a clear taxonomy of OFCs complicated. For instance, in 2011 13% of the world's total direct investments are invested in Dutch SPVs.

- **Capital flight**

The UN and Tax Justice Network explain that multinational networks of companies enjoy a favourable position vis-à-vis developing nations that have less bargaining power. Some of the capital flight by corporations is unlawful, while some may be questionable but not illegal. It is estimated that for developing nations illegal capital flight represents between 6 and 8.7% of their GDP. Furthermore, it is estimated that illicit capital outflows correspond to about ten times total development assistance going into these countries.

Microfinance and taxation

Microfinance as the provision of financial services to low-income people does not only refer to financial products, such as loans, savings, and insurance. It also relates to the assistance that is provided to microfinance institutions and their clients to get access to these products in a responsible way. With a total of nearly USD 2.1bn the market share of Dutch investors is estimated at some 10 percent. Major contributors include Oikocredit, SNS Impact Investing, Triodos Investment Management, Triple Jump, and FMO, each with Assets under Management that exceed several hundreds of millions of US dollars. The majority of investments by Dutch microfinance investors are made directly in individual microfinance institutions: less than 10 percent of the total of USD 2.1bn is allocated to microfinance holding companies.

Dutch microfinance investors potentially face two issues: the issue of profit shifting by microfinance holding companies, and the use of SPVs. Regarding the first issue there is no evidence that microfinance holding companies shift profits between subsidiaries or between a subsidiary and the parent or holding company in order to avoid taxes. In light of the recent discussion on the use of SPVs domiciled in jurisdictions that are tax friendly to investors the second issue is relevant. Regarding the appropriateness of SPV structures NpM likes to put forward, as a principle, that microfinance funds and MFIs – as well as investors allocating capital to these vehicles – should invest in the country where the activities take place. This results in investees paying taxes locally and stimulating the local economy and society. Second, NpM and its members hold that there is no justification for profit shifting or the deliberate structuring of companies – including the use of SPVs – with the sole purpose to avoid taxation. Whereas microfinance investments are founded on the principle of an empowered private sector, the arm's length bargaining principle is violated if companies avoid taxes on purpose and, consequently, hinder the forming of an empowered private sector. Double non-taxation may contribute to tax base erosion.



This paper argues that, when implementing these two principles, three requirements apply:

- A. the fit for purpose requirement;
- B. the responsibility requirement, and;
- C. the disclosure requirement.

These requirements help to ensure that investors play an important role in realizing the development objectives of microfinance, that the use of an SPV – whenever deemed appropriate – actually contributes to these development objectives, and that a sound and sufficient justification for the use of the SPV can be transparently disclosed. The use of SPVs and tax treaties might, therefore, be permissible if done for the right reasons and in accordance with the requirements mentioned above. NpM welcomes concerted international measures against forms of unfair taxation as promulgated by supranational organizations like the OECD as much as it endorses the allocation of capital to provide better access to finance to the poor.

RECOMMENDATIONS AND CONSIDERATIONS

NpM distinguishes between two types of recommendations: those that apply to its members and those aimed at microfinance investors in general. In addition, we provide some considerations that may be relevant to other stakeholders, including governments, multilateral organisations, NGOs and the media.

1. Recommendations for NpM members

Generally speaking, NpM urges its members to accept a leadership role by expressing that:

- they do not deliberately seek to let fiscal considerations determine their investment policies and their microfinance investments,
- they pay their fair share of taxation in the developing countries in which they invest, and
- they are accountable to their investors, their investees and society at large about their investments through microfinance holding companies and SPVs.

In addition, members adopting a leadership role will stimulate the microfinance institutions – including microfinance holding companies – in which they invest to do the same and adhere to the principles above.

2. Recommendations for microfinance investors

NpM calls on all microfinance investors:

1. to adopt and disclose their policy on development and on the use of microfinance holding companies and SPVs in relation to achieving that development;
2. to avoid investments in SPVs and microfinance holding companies that are domiciled in tax havens or other investor-friendly jurisdictions, with the sole purpose of shifting profits and avoiding taxation; and
3. to subscribe to the three requirements for microfinance investments in developing countries and apply these requirements in the decision-making processes of the investors. NpM distinguishes:
 - a. the fit for purpose requirement
 - b. the responsibility requirement
 - c. the disclosure requirement.



Considerations for multilateral organisations

NpM recognises and endorses the role of governments and multilateral organisations to create a level playing field for investments in developing countries – enabling developing countries to attract capital for development under conditions that are just and fair.

NpM calls upon governments and multilateral organisations to continue their concerted efforts to stimulate an open and critical discussion on the development and implementation of a globally applicable legal and moral framework for fairness in taxation. To that extent, the requirements mentioned in this paper could provide relevant guidance.

In developing a global framework and applying it in their respective jurisdictions, we urge governments and multilateral organisations to acknowledge the distinction between multinational companies and investors and the motives they have for investing in SPVs and holding companies. In order to stimulate investors to take their responsibility in this area, NpM would welcome a case-study book with best practices that can easily be applied across the globe.

Considerations for the Dutch government

NpM welcomes the initiative of the Dutch government to engage with a wide variety of national and international stakeholders on the topic of fairness and taxation. In order to stimulate mutual understanding between relevant stakeholders and promote a dialogue between them, the Dutch government could make use of its convening power.

NpM believes that, while being critical of investors using investment structures with the sole purpose of avoiding taxation, general legislation prohibiting all investors to use tax friendly jurisdictions is not recommendable.



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1. INTRODUCTION

“Developing countries should have the information and capacity to collect the taxes owed them – and other countries have a duty to help them.”

This recommendation comes from the G8 Lough Erne Declaration that was issued on 18 June 2013. Actually, it is one of four recommendations focusing on curtailing tax avoidance and tax evasion, most notably by multinational corporations. The rules should be adapted to prevent companies shifting their profits across borders to avoid taxes, while tax authorities are called upon to work together more closely in their fight against the evasion or avoidance of taxes.

Even though the issue particularly concerns the policies and the behaviour of MNEs it is not limited to multinational companies. Already in 2008 the Norwegian government instated a commission on capital flight. In its preliminary report, issued in 2009, the commission critically discussed the pros and cons of investments in developing countries through offshore investment vehicles. In Belgium, Minister Jean-Pascal Labille announced that BIO, the Belgium Investment Company for Development Cooperation, is no longer allowed to make use of tax havens for allocating and disbursing money to stimulate economic development in emerging economies. The Belgium minister took this decision following a public debate that called for public organisations like BIO to take the moral high ground. In the UK, the Guardian recently disclosed that CDC, the private investment branch of the UK Department for International Development (DFID), deployed nearly half of its investments through jurisdictions like Jersey, Guernsey, Mauritius, the Cayman Islands, Luxembourg, and Vanuatu. This news was sensitive – if not embarrassing – for UK Prime Minister, David Cameron. He very much promoted and endorsed the G8 Lough Erne Declaration that calls for a change in the use of tax havens.

In The Netherlands *OneWorld Magazine*, a periodical financed by the Dutch government through NCDOⁱ, accused Microfinance Investment Vehicles (MIVs) in March 2013 of avoiding taxes. In the article ProCredit, one of the largest providers of finance for microfinance institutions (MFIs) in the world, was portrayed as a brass plate company. Also, FINCA, Goodwell and Catalyst Microfinance Investors (CMI) were accused of avoiding taxes through the use of SPVsⁱⁱ. In addition, the magazine suggests that because the majority of Foreign Direct Investments in microfinance is coming from Luxembourg, the Netherlands, the US (Delaware), Mauritius and the Cayman Islands the rich become richer by investing in microfinance. Although *OneWorld Magazine* did not claim that microfinance investors make high returns at the expense of the poor, it is at least implied by the authors. As a result, Dutch members of parliament turned to the Minister of Foreign Trade and Development Cooperation with a wide range of questions.

NpM, the Dutch Platform for Inclusive Finance, which represents some of the largest players in the area of microfinance in the Netherlands, would like to provide a nuanced view on the role of microfinance investors in stimulating economic development in developing economies and their use of SPVs and tax treaties to reduce tax payments. This paper starts with a short exploration of the issue of tax avoidanceⁱⁱⁱ. We will briefly touch upon the origin of the debate: the practice of MNE tax



planning with the intention to pay as few taxes as possible. Companies like Starbucks, Apple, Google and Microsoft, just to mention a few, are registered in the Netherlands for reasons of tax efficiency. It has made The Netherlands top the Foreign Direct Investing stock tables with a total of US\$3 trillion of incoming and US\$3.7 trillion of outgoing investments in 2009 (SOMO, 2013:4).

At the outset of this paper we would like to point out that Dutch microfinance investors take the issue of fair taxation and paying taxes in the emerging economies in which they operate serious. Following the outline of the issue in section 2, we will show that microfinance institutions do pay taxes, whether or not they receive funding from abroad. No tax breaks apply to foreign MIVs with regard to the provision of financial products and services of the MFIs they financially support. The discussion focuses on paying additional withholding taxes when foreign investors try to retrieve their investment – usually at the time when the investment period comes to an end – or the capital gains related to the investment. An important issue that needs to be addressed is the impact withholding taxes on interest, dividends, and capital growth may have on the willingness of foreign investors to remain involved in microfinance. A potential withdrawal of foreign direct microfinance investments (FDI) may not necessarily impact the willingness of ‘impact first’ investors like foundations or Development Finance Institutions (DFIs). It may have consequences, however, for the ability of MFIs to attract capital from commercial investors – which may ultimately impact the financial sustainability of MFIs and their capacity to offer financial services to the poor. This paper ends with drawing conclusions and presenting recommendations for the Dutch microfinance sector and for other stakeholders involved in this debate.



2. WHAT IS THE ISSUE?

2.1 The debate on taxation and multinational enterprises

According to a recently published report by SEO Economisch Onderzoek, 12,000 so-called Special Financial Institutions are located in the Netherlands, 9,000 of which are managed by trust firms and have the character of a brass plate or letterbox company. The companies have little or no substance in terms of business activities. The Financial Times reports that 8500 international corporations use these letterbox companies as conduit structures. Allegedly, these companies serve only one purpose, namely transferring revenues across different tax jurisdictions to minimise their tax bill.

Across the globe, the avoidance of paying one's fair share of taxes causes public outrage. In a 2011 hearing by the UK public accounts committee, large corporations such as Starbucks and Google have been publicly held accountable for using tax constructions to circumvent taxes in the countries where they do business. They in fact are accused of manipulating the level playing field that contributes to a healthy economy. The companies make use of all the available public and private facilities in the countries in which they operate without contributing their fair share to the development and maintenance of these public infrastructures. What makes it somewhat more complicated is that they do so while acting within the boundaries of the law. In their rebuttal the companies argue that they behave like lawful corporate citizens simply making use of the opportunities the law provides. In the public eye, however, they fail to live up to their civil responsibilities.

Tax Justice as fairness

In the debate the notion of 'a fair share' has been introduced but immediately calls for an informed explanation. What is fairness and what does it require in this specific case?

In his seminal work 'A Theory of Justice' John Rawls (1971) introduced the notion of Justice as Fairness. He argues that justice has at least two aspects: a procedural and a distributive aspect. Both aspects can also be applied to the discussion on tax justice as fairness. The distributive aspect deals with the question 'Who gets what?' The procedural aspect refers to the question: 'Who has something to say about the decision-making process and what procedure will be applied to decide on the division of costs and benefits?' Rawls argues that a fair arrangement is the one that allows each person to enjoy the most extensive basic liberty compatible with a similar liberty for others. In addition, he argues that social and economic inequalities are to be arranged that they "are to be of the greatest benefit to the least-advantaged members of society".



Tax Justice as Fairness in this respect means that microfinance investors have a clear eye for the distribution of benefits and burdens associated with their investments. They will take into account the direct impact of their investments on the provision of access to financial services to the poor, while at the same time being open to the indirect consequences to secondary stakeholders. In the view of NpM a 'fair share' can be defined as that share that is:

- proportional to the amount of economic activities of the entity in the country, and
- comparable with the tax payments of investors that invest directly into the country without the use of holding companies or SPVs in the sense that it does not add additional layers of taxation or leads to double taxation of the activities.

With regard to the procedural aspect of their investments microfinance investors will engage with microfinance institutions, microfinance holding companies or SPVs on the nature and appropriateness of the investment vehicle, while being responsive to those who are negatively impacted by the investments.

The problem is not new. Already for more than one decade, development organisations, trade unions, academics, faith based organisations and others have tried to get the issue of global fairness in taxation on the political agenda. Until recently these attempts were to no avail, but that is changing rapidly. International reports by the OECD and Tax Justice Network and Dutch reports by SOE Economisch Onderzoek and SOMO have attracted substantial public attention^{iv}. The reports on tax justice are picked up by the popular media and have become headline news. The Financial Times, for instance, spoke of 'the great tax race' in its report on corporate tax breaks and offshore tax havens. In this environment the G8 Lough Erne Declaration only confirms the importance of the issue is acknowledged by the world's leading nations. In order to shed some light on this discussion we will subsequently pay attention to some of the relevant concepts and issues that frequently pop up in the discourse on (the acceptability of) tax avoidance. Among others, the debate is about the content of tax treaties, profit shifting, transfer pricing, tax havens and the legal measures aimed at countering their adverse effects. Some clarification of these concepts and issues is usually helpful in this respect.

2.2 Tax treaties and double (non) taxation

"When a person or legal entity invests in another jurisdictions than its own and earns income there, the question arises as to which jurisdiction gets to tax which bits of the income".

This is how Tax Justice Network introduces the discussion on a fair division of tax revenues between countries and a fair taxation of the person or entity having to pay those taxes. Tax treaties are important instruments to regulate distributive tax issues. They have to prevent that taxpayers are confronted with double taxation and the Internal Revenue Departments of treaty partners with double non-taxation. According to a recent SOMO report double taxation agreements (DTA) find their origin in the shared



belief of the contracting countries that both partners to the treaty benefit as a result of increased trade between their nations. The treaty simply divides taxing rights between the signatory states. In addition, they define who is entitled to enjoy treaty benefits and avoid double taxation by agreeing on exemption, credit or tax sparing methods and defining tax-relevant principles for both jurisdictions.

As a result of the ability of multinational enterprises (MNEs) to shift profits from one country to another – usually the money flows to the country that allows for the largest tax benefits – tax treaties have lost some, if not most, of their initial intent. The treaties have gradually come to be used to avoid taxation altogether. Multinational companies capitalize on their ability to differentiate between tax jurisdictions by shifting profits ‘overseas’. Economics Nobel laureate Joseph Stiglitz reflects on the issue:

“It’s no surprise that a company with the resources and ingenuity of Apple would do what it could to avoid paying as much tax as it could within the law. While the supreme court [...] seems to have said that corporations are people, with all the rights attendant thereto, this legal fiction didn’t endow corporations with a sense of moral responsibility; and they have the “Plastic Man” capacity to be everywhere and nowhere at the same time – to be everywhere when it comes to selling products, and nowhere when it comes to reporting the profits derived from those sales.”

Regarding foreign direct investments (FDIs), the OECD and IMF data reveal the itineraries of international investment flows. They show for example that in 2010 Barbados, Bermuda and the British Virgin Islands received more FDIs (combined 5.1% of global FDIs) than Germany (4.8%) or Japan (3.8%). Mauritius, the data show, is the top investor into India (24%).^{vi} The OECD database also reveals that FDI stock is held in so-called Special Purpose Entities (SPEs) or Special Purpose Vehicles (SPVs) – investor lingo for brass plate or letterbox companies – that hardly have a substantial presence in the host economy. Indeed, SEO concurs with findings of the OECD and reports that in the Netherlands roughly 80% of its total inward investments of 3,200 billion euro in 2011 entered and subsequently left the country through these SPVs (OECD, 2013a: p.18).

It is important to note, as the OECD does, that the instalment of SPVs for holding or intra-group financing purposes in the Netherlands (cf. SOMO, 2013) does not necessarily imply – nor deny – that they are used for base erosion and profit shifting. As will be discussed in the next section microfinance investors may have sound reasons for using SPVs. One reason, for instance, to use a SPV is the inability to invest directly in a country.

There is another angle to the discussion that receives attention. A recent report by the International Tax and Investment Center (ITIC), carried out by the Institute for Austrian and International Tax Law, and supported by the Qatar Financial Center Authority (QFCA), posits that “the problems affecting developing countries lie not with double tax treaties but rather in weak domestic tax legislation.” An elaboration of this issue is beyond the scope of this paper.



2.3 Transfer-pricing and profit shifting

Transfer pricing relates to pricing applied by multinational corporations on intercompany transactions. Transfer pricing regulations require that such transactions take place at an arm's length basis. In practice the intercompany pricing may still lead to allocating profits to the parent company or subsidiary thereof located in a country with a favourable tax regime with respect to such income. When subsidiary branches of an international parent company generate profits, it must be determined what share of these profits gets taxed where and under which rules. The OECD^{vii} quotes various studies that find clear evidence of multinational enterprise (MNE) profits appearing on the balance sheet in a country that are not a reflection of the proportional economic activity in that same country. Substantial differences in international tax rates heavily incentivise MNEs to shift their profits across borders. Oxfam Novib^{viii} remarks in this respect that 60% of international trade occurs within, rather than among, multinational companies. As a result of these collective transfer-pricing practices substantial amounts of capital may escape appropriate taxation.

2.4 Offshore financial centres or tax havens

The terms tax haven, low tax jurisdiction, secrecy jurisdiction or offshore financial centre are often used interchangeably and all denote locations to which profits may be shifted for tax optimisation purposes. There is no generally accepted definition available of what constitutes a tax haven, even though the OECD has listed a few common characteristics of tax havens: no or low taxes, lack of effective exchange of information, lack of transparency, and no requirement of substantial activity^{ix}. According to the Dutch government, a tax jurisdiction qualifies as a low tax jurisdiction when it levies income at less than 10%^x. The Tax Justice Network sees the ability to evade or avoid the legal systems of other jurisdictions as the central feature of a haven^{xi}.

SEO underlines the reputational risk the Netherlands faces should it receive the label 'tax haven' (SEO: p.148) and quotes Gravelle (2013: p.14) who states that the Netherlands does not explicitly appear on tax haven lists or classifications, but is widely considered a tax conduit for US multinationals. The conduit metaphor refers to the ability to transfer intra-group financing from one country to another through conduit structures. According to the OECD, these structures serve – amongst others – to reduce source and residence country taxation of dividend and interest during the investment period, and the taxation of capital gains upon exit (2013a: p.18).

2.5 Legal measures

Making use of brass plate companies does not in itself constitute an illegal act. On the contrary, making use of the opportunities tax treaties offer to reduce tax payments can be perfectly legitimate. According to SEO (2013) a difference must be made between tax planning on the one hand and tax avoidance or even tax evasion on the other. Whereas tax planning refers to acting in line with the letter and the spirit of the law, tax avoidance might go 'against the spirit of the law'. As such, SEO concludes that tax avoidance is a 'grey' area, stuck between the legal practice of tax planning on the one hand, and the illegal practice of tax evasion on the other. Note that because tax regulation differs substantially among jurisdictions, there is hitherto no international consensus of what constitutes tax avoidance.



Various legal measures are in place to curb the negative implications of tax avoidance. An early example of action against circumventing payable taxes comes from the US Supreme Court in 1935. The Supreme Court interpreted the corporate restructuring efforts of the defendant as follows:

“The whole undertaking, though conducted according to the terms of subdivision (B), was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else.”^{xii}

Similarly, in current times, international constellations may be set in place with the sole purpose of avoiding payable taxes. One of the most recent measures that have been taken to curb the tax benefits related to individuals avoiding taxation is the US Foreign Account Tax Compliance Act (FATCA) that as of 2014 will also apply to the Netherlands. FATCA demands US taxpayers to be transparent about their foreign accounts, while demanding foreign financial institutions to disclose accounts held – or entities owned – by US taxpayers.^{xiv}

In the Netherlands, according to the Financial Times, the government has stopped further growth of letterbox companies in 2009, particularly via imposing additional requirements regarding material business presence, also known as ‘substance requirements’.^{xv} Other efforts in individual countries include the enactment of so-called General Anti Avoidance Rules (GAAR’s). A 2012 PWC report^{xvi} describes GAAR’s as statutory rules that provide revenue authorities with effective means to control tax avoidance. India and the UK are in the process of enacting such GAAR’s in the foreseeable future. Finally, at the international level there is an increased call for supranational institutions like the OECD and the UN^{xvii} to come up with additional measures, as their member countries believe that concerted international action is needed to tackle this principally international issue and be able to promote good tax practices.

2.6 Who pays the bill and why is that unfair?

Due to constructs like profit shifting and the accompanied routing via tax havens, money leaves one jurisdiction and gets taxed in another. As the UN and Tax Justice Network explain, multinational networks of companies enjoy a favourable position vis-à-vis particularly developing nations that have less bargaining power. Some of this capital leaving developing countries is unlawful, while some may be questionable but certainly not illegal. It is estimated that for developing nations illegal capital flight represents between 6 and 8.7% of their GDP^{xviii}. Furthermore, it is estimated that illicit capital outflows correspond to about ten times the total development assistance going into these countries.

According to NpM and its member there is no justification for the deliberate structuring of companies – including the use of SPVs – with the sole purpose to avoid taxes. Making use of legal SPVs and tax treaties, as will be shown in section 3, is, however, permissible. Whereas microfinance investments are founded on the principle of an empowered private sector, the arm’s length bargaining principle is violated if companies avoid taxes on purpose and, consequently, hinder the forming of an empowered private sector. Double non-taxation may contribute to tax base erosion and the NpM welcomes



concerted international measures against forms of unfair taxation as promulgated by supranational organizations like the OECD.

As mentioned, tax havens are characterized by offering a combination of tax policies that are devised to offer corporations and investors extensive fiscal advantages – creating an environment for exponential growth of the jurisdiction itself^{xix}. Individually, these tax policies also present themselves outside of tax havens, which makes a clear taxonomy of tax havens particularly complicated. For instance, The Netherlands serves as a conduit country where in 2011 roughly 80% of its total inward investments entered and subsequently left the country through SPVs. From a different angle, of the world's total direct investments, 13% is invested in Dutch SPVs. Other countries have other allegedly impactful elements, like the banking secrecy in Switzerland and Liechtenstein for example. Nevertheless, Switzerland does not qualify as a typical tax haven. Again, it is the combination of tax arrangements in tax havens that impacts the sovereignty and tax bases of other countries.

The Norwegian government commission on capital flight from poor countries^{xx} comes to the conclusion that tax havens result in an inequitable distribution of tax revenues. Even though developing countries are a consenting party in every tax treaty they underwrite, there is clearly no equilibrium in the power balance between the contracting partners. Tax havens seem to stimulate opportunistic behaviour of powerful elites (so-called “rent-seeking”) at the expense of advancements towards a democratic and sustainable tax administration. Indirectly, therefore, they hamper the development of strong tax administrations in developing countries. In addition, it is argued that many developing nations with less efficient tax administrations than developed nations are – as a result – prone to attract proceeds from criminal activities, such as money laundering or illegal trade.

Even though jurisdictions offering a favourable environment to corporations and investors for setting up SPVs and reducing their taxable income the transactions they facilitate may be perfectly legitimate. It is only when transactions are facilitated with the sole purpose of avoiding or evading taxes in other countries that these transactions become questionable. As we will come to see in section 3 SPVs that are structured in Mauritius, the Caymans, Guernsey, Luxembourg or The Netherlands can be perfectly acceptable to serve the needs of, for instance, poor people in emerging and developing countries. Nevertheless, as we have demonstrated in this section, tax friendly jurisdictions – and those who make use of them – have something to explain. This gets even more relevant when the offering and behaviour of these countries – and that of the corporations and investors exploiting the wealth of fiscal facilities – negatively impacts the developing countries. They are less able to shield themselves from harmful tax practices than developed countries, and moreover pay a price for failing to construct an effective and resilient tax infrastructure.



3. MICROFINANCE INVESTORS AND TAXATION

3.1 Microfinance as access to finance for poor people

Microfinance is the provision of financial services to low-income people. These services not only refer to financial products, such as loans, savings, insurance. They also relate to the assistance that is provided to microfinance institutions and their clients to provide these products in a responsible way. Since 2004 the microfinance industry started growing at an unprecedented rate. Both donors and investors began channelling large amounts of funding to microfinance institutions (MFIs) across the globe – mostly via microfinance investment vehicles (MIVs). This trend brought benefits to the underserved poor in the form of getting wider access to financial services. As of 2011, more than 205 million microfinance clients, of whom 82% are female, have been reached in more than 85 countries. The number of clients grew in the last decade some 20 percent per year. Even though the financial crisis has caused a slowdown of the growth of microfinance, the sector still shows impressive growth figures. Currently, the financial size of the global market of cross-border microfinance funding is estimated at USD 21bn . With a total of nearly USD 2.1bn^{xxi} the market share of Dutch investors is estimated at some 10 percent. Major contributors in this respect are Oikocredit, SNS Impact Investing, Triodos Investment Management, Triple Jump, and FMO – each with Assets under Management that exceed several hundreds of millions US dollars.

Dutch investors investing in microfinance holding companies

The three largest Dutch microfinance investors allocate 99.2%, 92% and 97.8% of their funds respectively, directly without the intervening of holding companies. In assets, these three investors make up almost 75% of the entire NpM portfolio of €2.1 bn. Smaller investors, which dispose of fewer direct investment expertise, seem to make use of holding or fund structures more often: of the three smallest NpM investors, 8%, 30% and 100% of their portfolios respectively, were invested via holding companies (most notably ProCredit). These smallest three portfolios make up 7% of NpM's total funds invested.

3.2 Microfinance institutions paying taxes

NpM members find common ground in the belief that microfinance investors and the institutions they invest in should pay their fair share in taxes. This means that they will not deliberately seek opportunities to use SPVs for the purpose of avoiding tax payments. In addition, the members acknowledge that the primate for deciding on (the acceptability of) tax treaties lies with the governments of the contracting countries. Obviously, governments are influenced by the international discussion on fair taxation and as such, it is the right of every stakeholder to contribute to that discussion. For the purpose of this paper, we believe that some instruments, like profit shifting or SPVs that are set up to avoid taxation, are irresponsible. The proof of the pudding for an MFI or an investor in deciding on the appropriateness of the instrument is in demonstrating its appropriateness.



There is an important difference between a company being able to shift profits from one jurisdiction to another and an investor investing in microfinance. Just like other legal entities subject to paying taxes microfinance institutions – the entities invested in by the investors – in developing countries pay their dues to the Internal Revenue Departments of their respective countries. They are subject to paying (corporate) tax. Now microfinance investors can make their investments – in terms of loans or equity participations – directly into individual microfinance institutions or alternatively in funds or holding companies. The most important holding companies are ProCredit, FINCA, Access Holding, Pro Mujer, MicroCred, and Opportunity International. The majority of investments by Dutch microfinance investors are made directly in individual microfinance institutions: less than 10 percent of the total of USD 2.1bn in Dutch microfinance investments is allocated to microfinance holding companies.

With regard to their investments in microfinance entities investors are potentially facing two issues, which may be relevant for our discussion in this paper: the issue of profit-shifting by microfinance holding companies, and the use of SPVs by microfinance institutions like brass plate companies. Regarding the first issue there is no evidence that microfinance holding companies shift profits between subsidiaries or between a subsidiary and the parent or holding company in order to avoid paying taxes. In light of the recent discussion on the use of SPVs domiciled in jurisdictions that are tax friendly to investors the second issue is relevant and will be dealt with in the remainder of this paper.

3.3 The use of special purpose vehicles in microfinance

Dutch microfinance investors are bound by a common interest to provide access to finance to poor people and to add value for microfinance clients. Sometimes that requires making investments in microfinance holding companies that have a less than substantial presence in the country out of which the investments are made. As *OneWorld Magazine* points out, both FINCA Holding and ProCredit Holding operate out of Amsterdam, without having a substantial presence in the Dutch capital – thereby implying that both organisations overstep the moral boundary. The underlying assumption in the article is that both organisations based their investment decision mainly on tax considerations. That is, however, not a *conditio sine qua non*. On the contrary, we would argue. Both ProCredit and FINCA may have had justifiable reasons to take their decision of using a Dutch SPV. In fact, as we will show, the considerations that influenced the acceptability – and ultimately fairness – of their decision were not only related to taxation. More in general, we would argue that various reasons could apply to decide whether or not the use of a special purpose vehicle is justified. Inter alia, these reasons relate to:

1) Operational considerations

Sometimes a jurisdiction is very suitable for setting up an investment vehicle, like for instance a Private Equity investment fund, because of the availability of an infrastructure, in terms of legal, financial, and other professional services that the developing countries in which the investments are to be made simply lacks.



2) Legal considerations

In some cases direct investments are legally not possible or very difficult, like in the case of FINCA Holdings investments in Afghanistan. FINCA Holding is domiciled in the state of Delaware in the US which – certainly in the past – made it difficult for the organisation to raise capital for its subsidiary in Afghanistan.

3) Cost considerations

In case direct investments are not possible an investor, willing to invest in a certain developing country, has to find an alternative route to make the investment in the country. In deciding on the best domicile cost considerations can play a role. It will depend on the profile of the investor to what extent these considerations are an issue of considerable or only of minor importance.

4) Political considerations

The stability of a regime and of the attractiveness, the quality of the governance and the investment climate in general can also be important considerations for deciding where to set up a SPV.

5) Pragmatic considerations

Finally, pragmatic considerations, like the region or country where the investors are or where the fund manager is located, can be relevant for deciding which jurisdiction to select.

Therefore, in order to pass judgement on ProCredit and FINCA additional information is required.

What is, for instance, the reason why a fund or a holding company makes use of a Special Purpose Vehicle to structure its development related investments? Three questions will be raised to assess the appropriateness of the structure:

- A. What is the development objective the microfinance investor wants to achieve?
- B. Is the SPV fit for purpose in achieving the development objective and to what extent does it negatively impact the interests of other stakeholders than the microfinance clientele?
- C. Does the investee provide a sound and a sufficient justification for structuring an investment through a SPV?

A. The development objective of microfinance

The OECD introduced the notion of policy coherence for development (PCD) to clarify whether investors are acting in line with their development objectives. The OECD explains PCD as the way in which wider policy tools can be used to support common development objectives, such as inclusive sustainable growth^{xxii}. For instance, when investors avoid taxes in developing countries, while at the same time aiming to financially support these same countries, one could speak of a breach of policy coherence for development. In this sense the Guardian observation that “CDC’s use of tax havens undermined the UK’s efforts to help poor countries”^{xxiii} is quite telling. What The Guardian appears to forget is that CDC, when investing in developing and emerging economies, may actually contribute to the wellbeing of individuals and small communities in those countries. Microfinance has – and has always had – the primary objective of serving individuals and small communities. In Banker to the Poor Muhammad Yunus argued forcefully that there is need for access to finance for individuals and communities that



have been denied access to finance by the traditional banking system – including those banks supported by the governments of the developing countries. It was not the government of Bangladesh that saw the need for and developed a system to assist the poor that have no collateral in getting access to financial services. On the contrary, it needed an enlightened university professor being faced with the everyday challenges around Chittagong to create a tremendous shift^{xxiv}.

Looking at the stated policy objective of the Dutch microfinance sector – associated in NpM, the platform for inclusive finance, microfinance investors share:

“a commitment to expanding access to finance in underserved regions and anticipate the changing need in the sector to grow towards a responsible industry.”^{xxv}

This objective does not necessarily imply a commitment to alleviate poverty in developing countries. NpM members differ in their view on the contribution of microfinance to the alleviation of poverty. In line with Yunus’ philosophy the Dutch microfinance sector intends – and has always intended – to provide access to finance to poor people. Recently, a range of microfinance evaluations demonstrated that microfinance is an important tool to provide access to finance to the poor. In addition, it provides microfinance clients with an ability to gain increased control over their own financial future. So far the literature shows that microfinance has not succeeded in alleviating microfinance entrepreneurs out of poverty^{xxvi} – even though many investors still have an (implicit) desire to lift the poor out of poverty. Recognising the differences between the members in terms of development objectives NpM members will define their policies differently. Whereas Oxfam Novib explicitly endeavours to alleviate poverty through the provision of access to finance to the poor, others may have more modestly defined development objectives. SNS Impact Investing, for instance, refers to improving financial access to poor people across the world and to contribute to a professionalization of the microfinance practice in emerging and developing economies. With a view on overall development objectives NpM calls on its members to minimally:

- 1) use legal structures such as SPVs that are instrumental in serving the needs of (potential) microfinance clients (fit for purpose requirement);
- 2) use legal structures that are responsible in the sense that the structure does not violate the interests of other primary (and secondary) stakeholders (responsibility requirement). If the structure negatively impacts other primary (and secondary) stakeholders the member should
- 3) investigate the availability and applicability of alternative structures that are not in conflict with the interests of other primary (and secondary) stakeholders and is able and willing to disclose the result of the assessment (disclosure requirement).

Even though this paper explicitly focuses on the role of microfinance investors, NpM recognises that microfinance institutions can play an important role in this discussion as well. Particularly in situations in which direct investments are not possible because of legal or operational impediments, a microfinance holding company may be legitimised to use alternative routes to attract foreign investments. Again, we like to emphasise that the overriding majority of investments is made directly into microfinance institutions in developing countries. They do not make use of SPVs.



B. Negatively impacting other stakeholders than microfinance clients?

To assess whether microfinance investments negatively impact emerging and developing countries through the use of SPVs we will start with the description of a concrete case. *OneWorld Magazine* refers to an investment in ProCredit Bank Bulgaria and one in ProCredit Bank Serbia through a Dutch SPV. The volume of funds originated in the Netherlands amounted at most to about EUR 250 million i.e. about 4% of total assets of ProCredit Group. Regarding the Bulgarian SPV ProCredit remarks^{xxvii}:

“This structure (an innovative, much-lauded construct at the time) was set up to receive affordable, collateralized funding for SME loans and manage particular National Bank regulations, which prevailed at the time. Without the structure the bank would not have been able to grow its loan portfolio. The National Bank of Bulgaria did not have any objections to this form of funding. Tax considerations played no role in our decision to choose this form of international funding. (...)

In addition ProCredit Bank Serbia issued a EUR 125 million bond in the Netherlands in 2007. This was fully repaid in 2012. This bond was simply a vehicle to enable international investors to provide long-term funds to the bank. At that time, local regulations made direct international investment into securities issued by ProCredit Bank A.D. Serbia difficult. The National Bank of Serbia did not have any objections to this form of funding. Tax considerations played no role in our decision to choose this form of international funding.”

As the letter continues ProCredit explains that the SPVs were not set up to avoid taxes. On the contrary, they did not generate tax savings for the ProCredit group. Mobilizing these funds for investments in Bulgaria and Serbia actually led to an increase in taxable income in Bulgaria and Serbia as it helped to generate taxable profit in its respective countries. Hence, the letter concludes:

“it is a misleading statement that the governments of Bulgaria and Serbia lost Euro 7.5m in taxes over the past 6 years. (...) ProCredit Holding AG & Co. KGaA is a company registered in Germany where it pays taxes in the normal way. All ProCredit banks are regulated banks, which also pay local taxes in the normal way. ProCredit Holding has invested very considerable resources to ensure that the ProCredit group is supervised by the German regulatory authorities (BaFin and Bundesbank) and that each ProCredit bank operates in line with German banking regulations and standards”.

The case of impact first investors

ProCredit explains in the letter that the SPVs used in this case were fit for purpose. Moreover, the structures were not only in the interests of potential microfinance clients but were actually serving the needs of the microfinance clientele better than alternative structures. At the time the SPV structures were developed there was no opportunity for ProCredit Bank Bulgaria to attract foreign investment capital directly and grow its microfinance portfolio. The example demonstrates that the microfinance holding company intended primarily – if not exclusively – to use the vehicle for legal and operational purposes and not for fiscal reasons. This does not mean that fiscal considerations are not relevant at all for impact first investors. On the contrary, but they don't constitute an argument in itself for making use of the SPV or the holding company structure.



Nevertheless, ProCredit made use of a SPV in the Netherlands – a country known for its tax friendly environment. Was this necessary or could the vehicle have been set up in other jurisdictions as well? Two elements are important in determining the appropriateness of the jurisdiction. The first is technical, the second economic. Technically speaking, the structure could have been set up in other jurisdictions like in Germany the US, the UK, Mauritius, or elsewhere across the globe. The reason why ProCredit has chosen The Netherlands as a domicile for the SPV relates to operational issues. Regarding the economic justification for using SPVs domiciled in The Netherlands, ProCredit confirms that the SPVs did not result in a financial advantage for the Group thereby harming the financial interests of the Serbian and Bulgarian authorities. This means that if NpM and its members were to be confronted with the same case today, they would probably not object to an investment in the SPV.

The case of finance first investors

It is not always the case that tax considerations are of such little importance that they hardly play a role in the decision-making process. Take the example of SNS Impact Investing investing in Indian microfinance institutions. Due to the Indian regulatory environment making investments in Indian MFIs directly was – and still is – rather difficult for foreign investors. SNS, therefore, required the use of a foreign SPV. Reasons of tax efficiency SNS did play a role in using of a Cyprian SPV even though these reasons were secondary. Just like in the case of ProCredit SNS only made use of a foreign SPV because direct investments were not an alternative. The use of the Cyprian SPV resulted in a reduction of the Indian withholding tax on dividends and interest of 10 percent. The rationale behind this is that SNS Impact Investing operates with the capital of “finance first” impact investors^{xxviii}. SNS has a fiduciary responsibility towards the participants in its microfinance funds. The beneficiaries of the fund participants – mostly pension funds – count on the asset manager to realize market-rate returns. They want to receive a reasonable, market-based return for the investment risk they take relating to various risk factors. Among others, risk factors relate to: credit risks, interest rate risks, financial counterparty risks, governance risks, operational risks, currency risks, liquidity risks, regulatory risks, political risks, including corruption, and reputation risks.

Finance-first investors want to be adequately compensated for the risks related to their emerging and developing market investments. They have a vast amount of investment opportunities across the world. Even though tax considerations are usually of minor importance to investors their effect on the financial performance of an investment can become a relevant argument if its impact becomes material. By using the Cyprian SPV structure SNS investors receive a tax benefit of 10 percent on the income received through their interest-based income (reducing it from 20 percent to 10 percent). As Luuk Zonneveld, the managing director of the Belgian Investment Company for Development Cooperation BIO, has argued, the inability to use tax efficient fund domiciles leads to a significant increase in the costs of the microfinance and other development funds^{xxix}. We should not forget that microfinance is a relatively expensive investment compared to other types of private debt and private equity investments in emerging market^{xxx}. Someone has to pay for those extra costs. Either the microfinance borrower has to pay more for a loan, a savings or an insurance product, or the investor will have to settle for a lower return. Due to their fiduciary responsibility professional investors such as pension funds, insurance companies and professional asset managers are not likely to accept significant reductions on their returns. They will simply seek alternative investments. In both cases microfinance clients will carry the burden.



The potential consequences

There is, however, another important angle to this issue. In an era in which the budgets of governments and government-sponsored NGOs are significantly under pressure, microfinance institutions become increasingly dependent for their funding on private capital. During the first years of the new millennium DFIs and multilateral organizations, like the World Bank, IFC and EBRD, provided more than half of all foreign investments. In the last few years, institutional investors, including international banks, pension funds, and insurance companies, contributed significantly to the growth of microfinance – particularly in the area of private equity investments (El-Zoghbi, et al., 2011:10). The growth of microfinance (debt) funding from public sources, El-Zoghbi, et al. continue, was minimal in 2008 and 2009^{xxxi}. The impressive growth figures of private investments have sometimes been interpreted as a sign that the microfinance industry is maturing. As De Sousa-Shields and Frankiewicz (2004:vii) argue, microfinance has gone through a “process of transformation from a sector dominated by a mission-driven ethos to one responding to the needs and interests of private capital”.^{xxxii} This has led to an increased market-share of private microfinance investments over time. MicroRate’s latest report shows a growth of 11 percent of the private Microfinance Investment Vehicles market in 2011, while a growth of 14 percent is expected for 2012 (see Table 1).

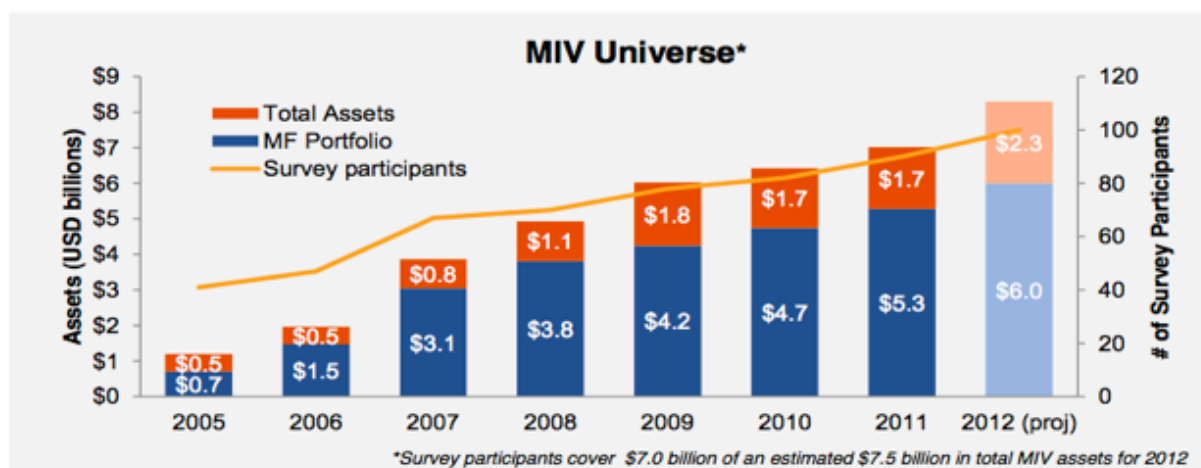


Table 1 Market development of microfinance assets by MIVs (MicroRate, 2012)

If governments prohibit the allocation of microfinance investments across the board through tax efficient routings, like the Belgian government has done recently with regard to public funding^{xxxiii}, they may jeopardize the future development of private investments in microfinance. Institutional capital may be withdrawn from the market, leading to a reduction in the access to finance for the clients of microfinance institutions.

In conclusion, we would like to make two observations. In the first place, in light of the policy objective of most Dutch microfinance investors to provide access to finance to poor people the interests of microfinance clients comes first. They are primary stakeholders, while countries are secondary stakeholders. Second, it is not immediately clear that governments and Internal Revenue Departments



are negatively impacted by the use of SPV structures – as was the case with the investments in ProCredit Serbia and Bulgaria. That would only be the case if there would be proof of microfinance holding companies shifting profits from one subsidiary to another or between a subsidiary and the parent company to deliberately avoid taxation. There is no evidence – nor is it claimed by critics of the use of SPVs – that microfinance holding companies shift profits to avoid taxes. It is merely implied by *OneWorld Magazine* without providing any evidence for its claim. In section 4 we will provide some examples of the responsible use of SPVs and investments in microfinance holding companies.

In effect, as the cases of ProCredit and SNS show, in the short term governments benefit from using SPVs that are set up to channel microfinance to their respective countries. Without the SPVs no investment in the respective MFIs would have been possible. So not only do the investments result in tax revenues, the governments also benefit indirectly from an increased financial sustainability of the microfinance sector. If, on the other hand and as a result of the increased cost of the investments, commercial investors would turn away from microfinance this could result in a situation in which everyone pays a price. There is a risk of an emerging downward spiral. In light of the increased need for private capital investments in microfinance MFI clients will be impacted if a decreasing amount of private capital is not compensated by increased public funding from governments, multilaterals like the World Bank, the IFC, EBRD and other Development Finance Institutions or NGOs. As El-Zoghbi demonstrated, the growth of microfinance investments coming from public sources was minimal in 2008 and 2009. As a result of the financial crisis in the developed economies the chances are quite minimal that this trend has shifted in a positive way since 2010. The opposite is more likely to be the case. But the governments (and the Internal Revenue Departments) of the developing countries would also suffer the negative consequences of a retreat of private investors in microfinance. In order to become sustainable financial institutions MFIs need commercial funding (Hummels and Millone, 2013). If commercial investors withdraw their capital or if the cost of capital increases for the MFIs it increasingly becomes difficult for them to become financially (and socially) sustainable. In the end that even might result in declining corporate tax revenues received by the government of the developing country.

C. Does the MFI or MIV provide a sound and a sufficient justification?

NpM recognizes the dilemma its members face when using tax efficient routings to deploy the private microfinance investments. With their investments they clearly have the intention of serving the poor by lending money to microfinance institutions or providing equity capital to reinforce the capital structure of the MFI. As such, their intent is to stimulate economic activity in the country they invest in – whether or not they make use of a SPV domiciled in a third country. They are not the ‘plastic men’ Joseph Stiglitz refers to when talking about companies that are “*everywhere when it comes to selling their products, and nowhere when it comes to reporting the profits derived from those sales*”.

Nevertheless, NpM recognizes that at face value it may not always be immediately clear to investors and beneficiaries – or to secondary stakeholders like relevant authorities and the general public – why fund managers or MFIs structure their funds in domiciles that appear to be particularly beneficial to investors. There may be sound reasons for setting up an SPV in countries like Mauritius, Luxembourg, The Netherlands, Guernsey or the Cayman Islands. What is needed, however, is that the initiating fund manager or MFI ex ante investigates the availability and applicability of alternative structures that are



not in conflict with the interests of other primary (and secondary) stakeholders and – when asked for – is able and willing to disclose the result of the assessment (disclosure requirement). In other words, the fund manager or MFI should be able to explain to what extent the structure is fit for purpose^{xxxiv}. NpM explicitly opposes the use of any legal and financial structure that only serves the purpose of avoiding taxes in targeted developing countries. Fairness requires that no SPV structures be deployed that intentionally result in double non-taxation. At the same time, when SPVs are fit for purpose and have been structured responsibly, the question remains whether investors have sufficiently disclosed their reasons for using the structure? Looking at some of the cases mentioned by *OneWorld Magazine* it becomes clear that with regard to this issue there is room for improvement.



4. CASE STUDIES

In this section we present some examples of microfinance SPVs that were set up in jurisdictions with a tax regime that is favourable to microfinance investors, like the Netherlands, Luxembourg or Mauritius. Unlike the allegations in *OneWorld Magazine* that were based on insufficient information or understanding of the practice, the case studies show that fund managers and MFIs – as well as microfinance investors – often have good reasons for using or investing in holding structures or SPVs.

4.1 FINCA^{xxxv}

FINCA Microfinance Holding (FMH) was established in 2010 as a limited liability company (LLC) in the State of Delaware (US) to further the mission of FINCA International. FMH provides financial services to the world's lowest-income entrepreneurs so they can create jobs, build assets and improve their standard of living. FMH also was created as a vehicle to raise additional equity to broaden and accompany the growth of FINCA's international subsidiaries. In addition, a cooperative was set up under Dutch law.

In 2013, the Dutch Coop owns 6 of FINCA's 23 subsidiaries. Just like any other company each subsidiary pays corporate income tax on its audited gross income in the respective country it operates in. When these subsidiaries remit payments like dividends or royalties to the Coop, each is required to withhold local country withholding taxes on these remittances according to the Dutch Tax Treaty with that country – if there is a treaty at all. In fact, FINCA Afghanistan has no treaty with The Netherlands and thus pays the withholding tax assessed by the Government of Afghanistan. In the case of the other 5 subsidiaries there is a tax benefit for dividend withholding taxes ranging from zero (Azerbaijan and Malawi), to 3% (Georgia), to 5% (Armenia), and to 15% (Uganda). For royalty withholding taxes the tax benefits range from 4% to 15%. For services withholding taxes there are no tax benefits. The lower withholding taxes “allow for more income to remain at the subsidiary level which we see as contributing to our overall mission of serving our low-income clients. There is no effort to avoid taxes. We see the Dutch tax regime as aiding a number of developing countries”.

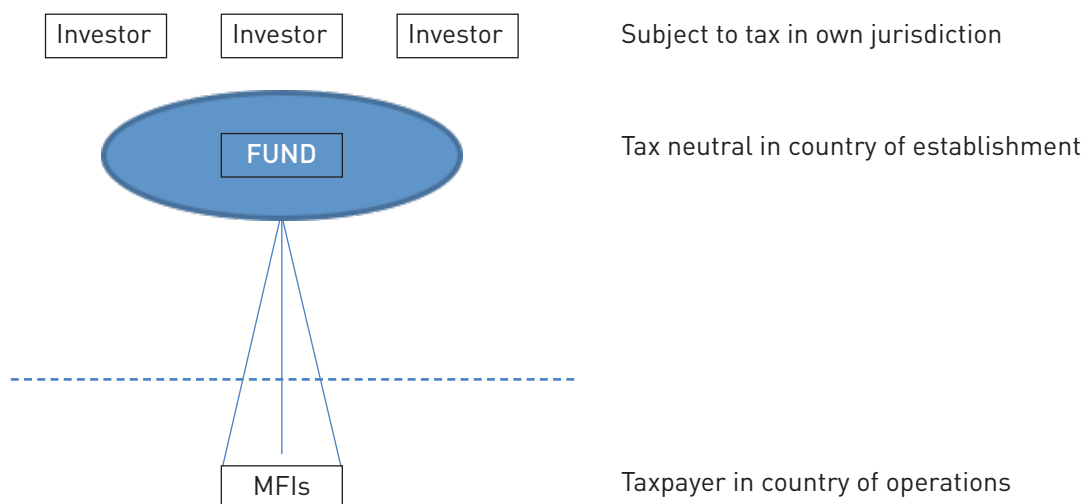
4.2 FMO Private Equity Fund Investments

Throughout its history FMO has invested capital through Private Equity (PE) Funds because of the geographical remoteness from its targeted MFIs. In addition, by using these structures it can tap into the local market expertise of associated fund managers. PE funds collect capital from different investors in a variety of jurisdictions that aim to collectively invest in pre-described targets through equity investments or subordinated loans. For the MFI sector, these targets would concern MFI's located in developing countries. The chosen legal structure of a PE Fund is rather an organisation tool than a tax planning tool. Nevertheless, such vehicles are often found in low or zero tax jurisdictions. This can be explained by the conviction that the mere act of organising funds should not lead to an additional layer of payable taxes. In addition, these jurisdictions offer relevant regulatory facilities and services, such as fund management services and compliance activities, which developing countries typically lack. In brief, for FMO the decision to invest in a PE fund is based on:



- a) The ability to inject a target MFI with equity, such that it can grow and reach those in need of financial services,
- b) The belief that a soundly operating MFI will effectively contribute to the economy and therefore pay its shares of taxes, and
- c) The assurance that the investor understands the legal framework of the fund structure together with its own legal and fiscal position.

This can be illustrated in the figure below.



Possible cash flows include:

- 1) interest or dividend payments from the MFI to the fund^{xxxvi}, and;
- 2) third-party payments to the fund in case it sells (part of) its shares in the MFI^{xxxvii}.

4.3 Triodos Investment Management

Triodos Investment Management BV (TIM) is the manager of four funds that invest in inclusive finance globally. The objective of the funds is to contribute to access to sustainable financial services to those traditionally excluded in general as a basis for social and economic development while generating a fair return to our investors and partners. TIM and its partners Stichting DOEN and Stichting HIVOS carry the responsibility to act transparently with the objective to contribute to building sustainable societies. Paying taxes is an integral part of that responsibility. Assessment of the local tax structures and the investee's morale in this respect forms an important part of the decision whether or not to enter into a relationship with a respective investee. In principle, TIM provides finance directly to investees in the countries of their operations. Those investee companies pay taxes according to local tax legislation. In these circumstances there is no avoidance of taxes and hence no controversy in that respect. Direct



finance accounts for 97.8% of the total portfolio outstanding in inclusive finance. Nevertheless, TIM is frequently confronted with situations requiring specific analysis or decision-making in holding companies or off shore SPVs. Two examples illustrate the legitimacy of a divergent approach.

The first example comes from a leading microfinance organization in the Indian subcontinent, known for its lean operations and wide focus on society development, has expanded activities towards various African countries. TIM supports this initiative as an effective manner to widen the range of financial services in particular to the low-income communities in Africa. Given the size and scale of operations and the activities in various African jurisdictions, a joint funding platform has been created. It pools lenders and investors globally together into one vehicle – the SPV – that serves the various African operations with funding in the local currency of that country. The rationale behind the SPV is the opportunity to attract funding at adequate scale, the diversification of risk and the reduction of foreign exchange (FX) risk. Investors in the vehicle are found around the globe. Operations take place in several countries. In this example Cayman Islands was selected as the most suitable location to set up the SPV because of the suitability of the legislation and the availability of a supporting infrastructure to manage the fund. Tax legislation, including tax treaties between the Cayman Islands, the African countries and the domiciles of the investors, was taken into consideration. It was not a main driver for the decision. TIM decided to invest in the SPV because the choice for domicile was deemed logical, transparent and ethical.

The second example comes from Asia. In the past the government of Mongolia has signed an Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with several Western countries. As of 2014 the agreement with, for instance, the Netherlands and Luxembourg will be cancelled. Mongolian companies receiving funding from investors from these countries will be subject to 20% withholding tax on foreign interest charges, making borrowing more expensive. Investors will be subject to 20% capital gains tax, reducing the attractiveness to invest in Mongolia. TIM funds have been lending to, and investing in, Mongolia since 2002. Whether its funds can maintain their relationship with Mongolian counterparts remains an open question as the additional taxes make funding expensive. While Mongolia ends the tax treaty with 4 countries, the treaty remains in place for 24 other countries. This results in uneven competition between providers of finance operating from different jurisdictions. Furthermore, it enhances the sensitive topic of crowding out by multilateral organisations such as IFC, ADB, and EBRD. The organisations find themselves in a favourable position over private capital investors. This enhances dependency for countries such as Mongolia on Development Finance Institutions (DFI) funding. In cases like this, alternative routes for funding may become important to avoid selective or double taxation and an unlevelled playing field.



4.4 Triple Jump

Triple Jump manages and advises funds that aim to make responsible investments in developing countries. It provides finance to 170 investees in almost 60 countries on behalf of, inter alia, ASN Bank, Oxfam Novib, Habitat for Humanity and SNS Impact Investing. Typically Triple Jump seeks to fund the local operating companies (MFIs) directly – accounting for 98% of the total investment portfolio outstanding.

In case investments are made at the holding level, this occurs with MFI networks based in Western Europe or the United States where they have their origin. Before considering to investing in a holding company Triple Jump assures itself of the following:

- the local operating companies pay their taxes due on corporate income;
- channeling an investment through a holding should not change its purpose, which is to enable the underlying MFIs to grow their portfolio and broaden their outreach;
- the holding is transparent about fees and interest rates it charges to its affiliates and these fees and rates should be reasonable and justifiable in order to avoid base erosion.

The majority of MFI networks prefer to receive investments at the holding level for reasons of cost efficiency. Holdings are set up to support their affiliates in developing countries, inter alia, by attracting equity and/or debt from both domestic and international investors. Attracting equity investments, for instance, is a time consuming process. MFI networks rather attract larger amounts at holding level then discussing each investment at affiliate level. This way the MFI network also assures to have full control and uniformity at affiliate level. Within its own jurisdiction the MFI network may choose the most favorable legal structure/jurisdiction from a tax perspective. This may lead to tax reduction in the home country of the network; in itself this does not constitute a practice of tax avoidance in developing countries in which the affiliates operate. Similar to SPV investments, interest and dividend payments to holdings are likely to be subject to withholding tax in the country of the MFI. Reduction of withholding tax may occur if the holding can benefit from a tax treaty between the holding jurisdiction and MFI jurisdiction. That is, in itself, not illegitimate. Triple Jump believes – and is supported in that belief by other NpM members – that tax treaties are the responsibility of the government taking into account the interests of investors and investees.



5. CONCLUSIONS

This paper is about tax justice and fairness with regard to microfinance investments – while also being applicable to SME Finance and other types of inclusive finance. The focus of the paper is on the possibility of investing in microfinance – both directly and indirectly via microfinance holding companies and SPV – while paying a fair share in taxes. We have defined a ‘fair share’ as a share that is:

- proportional to the amount of activities of the entity in the country, and;
- comparable with the tax payments of investors that invest directly into the country without the use of holding companies or SPVs in the sense that it does not add additional layers of taxation or leads to double taxation of the activities.

Tax justice as fairness means that microfinance investors have a clear eye for the distribution of benefits and burdens associated with their investments. They will take into account the direct impact of their investments on the provision of access to financial services to the poor, while at the same time being open to the indirect consequences to secondary stakeholders. With regard to the procedural aspect of their investments, microfinance investors will engage with direct stakeholders – being the microfinance institutions, microfinance holding companies or SPVs – while being responsive to the representatives of those who are negatively impacted by the investments and the way in which these are structured.

In the paper NpM has tried to explain the relevance of tax related issues for the microfinance investments of its members. We have made clear that Dutch microfinance investors invest in vehicles that are domiciled in jurisdictions with favourable investment conditions – including tax benefits. In addition, they invest in microfinance holding companies that can be involved in reducing taxes by setting up Special Purpose Vehicles (SPVs) in jurisdictions that are known to have tax treaties with the developing countries they ultimately invest in. To this extent NpM and its members believe that the international discussion on tax avoidance is relevant and should be taken serious. NpM experienced that the discussion is often based on sentiments and on poor quality of the information and argumentation applied in the public debate on taxation and microfinance. Inter alia it is for this reason that the Dutch microfinance sector presents this paper, which aims to contribute to an improved quality of the debate and a better understanding of the motives of microfinance investors and the consequences of their investment behaviour.

With regard to the members’ involvement with microfinance holding companies and SPVs that trigger a potential discussion on tax avoidance – because of favourable tax treaties between the countries in which they are domiciled and developing countries – we showed the issue to be relatively small. The largest microfinance investors in the Netherlands with USD 1.6bn out of USD 2.1bn of all Dutch microfinance investments, invest more than 95 percent of this capital directly into microfinance institutions in developing countries. For the small part of their investment portfolios that Dutch microfinance investors use SPVs the examples indicate that the investors had sound reasons for these investments beyond the potential tax benefits that were or were not related to these investments.

Even though this may seem to be a relatively small issue for the Dutch microfinance sector, there is sufficient reason to take the involvement in potential tax avoidance seriously. In section 2 we have argued that tax avoidance, as distinguished from legitimate forms of tax planning, may have a serious



impact on the development of developing countries. The issue relates mostly, but not exclusively, to the practices deployed by Multinational Enterprises being able to shift their profits from one subsidiary to another or from a subsidiary with the parent company with the sole purpose of reducing its tax payments. This may lead to double non-taxation, meaning that the company makes use of the present public infrastructure of a country – in terms of the financial, human, intellectual, natural and other infrastructures – without contributing its fair share. NpM welcomes concerted international measures against forms of unfair taxation as promulgated by supranational organizations like the OECD. In principle, also microfinance holding companies may have an ability to shift profits in order to obtain tax credits. We have not found any examples of microfinance holding companies deploying these practices. In case we would encounter such a microfinance holding company shifting its profits we urge microfinance investors to abstain from investing in the holding company – while being supportive of investments in the individual subsidiaries.

Regarding the appropriateness of SPV structures NpM put forward in this paper that microfinance funds and MFIs – as well as investors allocating capital to these vehicles – should, in principle, invest in the country where the activities take place. Second, NpM and its members hold that there is no justification for profit shifting or the deliberate structuring of companies – *including the use of SPVs – with the sole purpose to avoid taxation*. Nevertheless, NpM acknowledges that investors may have sound reasons for investing in developing countries through SPVs set up in jurisdictions that are particularly apt for attracting and transferring capital to microfinance entities in developing countries. These reasons vary from operational to legal and cost considerations, while political and pragmatic issues may also influence the decision-making process legitimately. The examples of FMO, Triodos Investment Management, Triple Jump, and FINCA illustrate the importance of having alternative investment routes whenever that is appropriate. This paper argues that the appropriateness of alternative routes depends on the investor applying three requirements:

- 1) the fit for purpose requirement,
- 2) the responsibility requirement, and
- 3) the disclosure requirement.

The *fit for purpose requirement* points to the development objective the investment aims to realise. We argued that there might be an important distinction between the development objective of governments and multilateral organisations and those of microfinance investors. While governments in both developed and developing nations focus on the contribution of tax payments to the development of the economy and the public infrastructure, microfinance investors specifically target the development and wellbeing of the beneficiaries of their investees. The purpose of microfinance is to improve the situation of MFI clients in getting access to the financial services they need. The proof of the microfinance pudding is therefore in the increased wellbeing of the microfinance borrowers, the micro-savers, or the micro-insured in an improved control of their financial situation.

The *responsibility* requirement refers to use legal structures that are responsible in the sense that they do not violate the interests of other primary (and secondary) stakeholders. Referring to the examples of ProCredit Bank in Bulgaria and Serbia we showed that the SPVs were responsible in the sense that



they did not violate the interest of the Bulgarian and Serbian governments. Using the example of SNS Impact Investing we also argued that microfinance investments domiciled in tax friendly jurisdictions could negatively impact the inland revenues of developing countries. Does this mean that the Cyprian investment structure is illegitimate or even illegal? We argued that this is not the case. Without a foreign SPV the investment in Indian MFIs would not have occurred – leaving all stakeholders worse off with regard to the direct consequences of the investment. These stakeholders include Indian MFIs, foreign investors, and the Indian Revenue Service (IRS). At this point in time it is not clear whether the investment will trigger secondary or long-term consequences that might be harmful to one or more stakeholders. NpM believes that microfinance clients are best off if investors continue to allocate capital to microfinance institutions and remain focused on the needs of poor citizens in developing countries.

Also we argued that the fund managers and MFIs using a SPV should be accountable towards their stakeholders. That also counts for microfinance investors making use of special vehicles to deploy capital. This is the *disclosure requirement* urging microfinance investors and MFIs – when called upon by a relevant stakeholder – to disclose the reasons for using a SPV. With the benefit of hindsight NpM comes to the conclusion that there is room for improvement among the members about their reasons to invest in SPVs. NpM hopes to have made a meaningful contribution to the discussion on fair taxation in the area of microfinance investments. In the process of engaging members and outside stakeholders we have come to appreciate the relevance of the issue of avoiding tax avoidance. To stimulate an investment practice that meets the responsibility criteria for investors, MFIs and society at large, and make a contribution to the discussion on tax and fairness, NpM wants to end this paper with a set of recommendations.

Finally it became clear – as was addressed in some of the cases presented – that tax treaties serve a purpose for microfinance investors and investees. Without exception NpM members oppose the abuse of tax treaties and are in favour of anti-abuse provisions as part of current and future tax treaties. At the same time NpM believes that tax treaties do not damage the interests of the developing countries per se. NpM, therefore, calls upon relevant authorities to create a level playing field and take into account the potentially negative consequences of a retreat of private capital if governments one-sidedly end tax treaties with a select number of countries – while upholding treaties with other countries.



6. RECOMMENDATIONS AND CONSIDERATIONS

At the outset of this section NpM would like to clarify that the rationale for microfinance lies in the creation of a financial infrastructure that provides or improves access to financial services to poor people. As such, NpM members invest to contribute to an improved situation of poor people through the creation of financial access and, as a result, to the macro-economy of the developing countries in which the investments are made. The focus is primarily on creating access to financial services of poor people who were denied access in the past – and improve the control of their current and future financial situation. Secondly, NpM endorses a dialogue between all relevant stakeholders based on solid and robust information relating to all relevant aspects of this complex topic. NpM is willing to promote and contribute to that dialogue to improve the opportunities to get access to finance for those who need it.

NpM distinguishes between two types of recommendations: those that apply to its members and those aimed at microfinance investors in general. In addition, we provide some considerations that may be relevant to other stakeholders, including governments, multilateral organisations, NGOs and the media.

6.1 Recommendations for NpM Members

Generally speaking, NpM urges its members to accept a leadership role by expressing that:

- they do not deliberately seek to let fiscal considerations determine their investment policies and their microfinance investments,
- they pay their fair share of taxation in the developing countries in which they invest, and
- they are accountable to their investors, their investees and society at large about their investments through microfinance holding companies and SPVs.

In addition, members adopting a leadership role will stimulate the microfinance institutions – including microfinance holding companies – in which they invest to do the same.

6.2 Recommendations for microfinance investors

NpM calls on all microfinance investors:

- 1) to adopt and disclose their policy on development and on the use of microfinance holding companies and SPVs in relation to achieving that development;
- 2) to avoid investments in SPVs and microfinance holding companies that are domiciled in tax havens or other investor-friendly jurisdictions, with the sole purpose of shifting profits and avoiding taxation;
- 3) to subscribe to the three requirements for microfinance investments in developing countries and apply these requirements in the decision-making processes of the investors.

NpM distinguishes:

- a. the fit for purpose requirement
- b. the responsibility requirement
- c. the disclosure requirement.



6.3 Considerations regarding the role of external stakeholders

Multilateral organisations

NpM recognises and endorses the role of governments and multilateral organisations to create a level playing field for investments in developing countries – enabling developing countries to attract capital for development under conditions that are just and fair.

NpM calls upon governments and multilateral organisations to continue their concerted efforts to stimulate an open and critical discussion on the development and implementation of a globally applicable legal and moral framework for fairness in taxation. To that extent, the requirements mentioned in this paper could provide relevant guidance.

In developing a global framework and applying it in their respective jurisdictions, we urge governments and multilateral organisations to acknowledge the distinction between multinational companies and investors and the motives they have for investing in SPVs and holding companies. In order to stimulate investors to take their responsibility in this area, NpM would welcome a case study book with easily applicable best practices across the globe.

The Dutch government

NpM welcomes the initiative of the Dutch government to engage with a wide variety of national and international stakeholders on the topic of fairness and taxation. In order to stimulate mutual understanding between relevant stakeholders and promote a dialogue between them, the Dutch government could make use of its convening power.

NpM believes that, while being critical of investors using investment structures with the sole purpose of avoiding taxation, general legislation prohibiting all investors to use tax friendly jurisdictions is not recommendable.



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Footnotes

ⁱ NCDO is a Dutch expertise and advisory centre for citizenship and international cooperation.

ⁱⁱ Without providing any proof for its claim *OneWorld Magazine*, for instance, accused MIVs of “wanting to cash like Compartamos” – the Mexican MFI that was quite successful in raising money through an Initial Public Offering (IPO).

ⁱⁱⁱ We restrict ourselves to discussing tax avoidance since there has been no mentioning of tax evasion in relation to microfinance. As NpM we are not aware of any practice of deliberately evading taxes. NpM does acknowledge, however, that microfinance investment vehicles sometimes make use of tax treaties that provide them tax benefits. In this paper we will try to demonstrate, however, that making use of these favourable tax regimes is not primarily done with the primary objective to avoid paying taxes to the host countries.

^{iv} Bloomberg, Guardian, FT, and New York Times among others, provided prominent coverage on the topic.

^v <http://www.guardian.co.uk/commentisfree/2013/may/27/globalisation-is-about-taxes-too>

^{vi} OECD (2013a: p.17)

^{vii} OECD (2013a: p.65)

^{viii} Berkhout, E. (2013) De Nederlandse route: Hoe arme landen inkomsten mislopen via belastinglek Nederland. Oxfam Novib beleidsrapport, 20 mei 2013.

^{ix} Organization for Economic Development and Cooperation, Harmful Tax Competition: An Emerging Global Issue, 1998, p. 23.

^x SEO p.93. Please note that a country like Mauritius has a corporate tax rate of 15% and would, therefore, not be excluded according to this indicator.

^{xi} Tax Justice Network (2007) Identifying Tax Havens and Offshore Finance Centers www.taxjustice.net/cms/upload/pdf/Identifying_Tax_Havens_Jul_07.pdf

^{xii} <http://supreme.justia.com/cases/federal/us/293/465/case.html>

^{xiii} Fernandez, R. (2013) Follow the money <http://www.ftm.nl/column/wat-is-de-toekomst-van-nl-als-financieel-centrum/>

^{xiv} US Internal Revenue Service: <http://www.irs.gov>

^{xv} Financial Times, 28 April 2013 <http://www.ft.com/cms/s/2/5a9f0780-a6bc-11e2-885b-00144feabdc0.html#ixzz2W5NW5zR6>

^{xvi} http://www.pwc.com/en_GX/gx/tax/newsletters/tax-controversy-dispute-resolution/assets/pwc-general-anti-avoidance-rules.pdf

^{xvii} UN Handbook on selected issues in administration of double tax treaties for developing countries (2013)

^{xviii} Norway p.86

^{xix} This paragraph borrows from insights derived from the Report from the Norwegian Government Commission on Capital Flight from Poor Countries. 2009

^{xx} Report from the Norwegian Government Commission on Capital Flight from Poor Countries. 2009: p.11

^{xxi} NpM and ING, A billion to gain, Dutch contributions to the microfinance sector, Amsterdam, 2012. It is



particularly this amount of cross-border funding that is relevant for our discussion regarding the use of tax treaties in foreign direct and indirect investments.

^{xxii} OECD (2011), “Better policies for development: Recommendations for policy coherence”.

^{xxiii} <http://www.theguardian.com/global-development/2013/aug/14/cdc-aid-tax-havens>

^{xxiv} Yunus actually argues in *Banker to the Poor* that the interests of the government are opposing those of the microfinance sector in Bangladesh. Illustrative for this clash of interests is the example Yunus gives of the conversation he had with his friend, the minister of Finance in 1996. Bangladesh could receive soft loan from the World Bank of USD 175mn. One of the conditions was, however, that Grameen Bank would receive part of the loan – something, which Yunus refused to accept. He even saw it as ‘a death verdict’. When the minister said: ‘Well, our country really needs the money’, Yunus simply replied: ‘We at Grameen, we don’t’.

^{xxv} NpM (2013) <http://www.inclusivefinanceplatform.nl/about-NpM/about-NpM>

^{xxvi} For an elaboration of this argument the reader is referred to the explanation given by SNS Impact Investing: <http://www.snsimpactinvesting.com/wp-content/uploads/2013/06/Social-value-of-MF1.pdf>

^{xxvii} This information comes from a letter from ProCredit Director, Helen Alexander, on 4 April 2013 to the management of SNS Impact Investing.

^{xxviii} Freireich and Fulton (2009) made a distinction between finance first and impact first investors. The first group aims at realizing a market-rate return while doing good for society. The second group first and foremost aims at realizing the social or environmental objectives of the investment. It is not relevant that the achievement of impact results in a financial trade-off and to lower than market-rate returns.

^{xxix} <http://www.deredactie.be/cm/vrtnieuws/politiek/1.1598389>. If other development banks follow suit, this will mean a substantial decrease in funding for recipient countries: European DFI’s alone already represent combined funds of about €16.7 billion.

^{xxx} The higher expense-ratio for microfinance investments relates to, for instance, the cost of sourcing the investments, the additional social and environmental requirements, the increased amount of investments made in local currencies, and the illiquidity of many investments schemes. Because most microfinance investors want to be responsible investors they are willing to accept a longer duration of their investment – without being able to retrieve their investment – and a higher exposure in local currencies. These are, however, rather costly commitments.

^{xxxi} While debt financing grew only with 3 percent to US\$ 10.6 bn in 2008 and 2009, equity investments grew at a pace of 60 percent to US\$ 6.4 bn (El-Zoghbi, et al, 2010:10).

^{xxxii} The authors create a false dichotomy between mission-driven and commercial microfinance. Investors with a focus on commercializing microfinance can have a clear eye for the mission of a microfinance institution (MFI).

^{xxxiii} Private investments are not impacted by this measure of the Belgian government.

^{xxxiv} Obviously, it is up to the MFI or the fund manager to decide who it considers to be a relevant stakeholder having a legitimate interest in demanding an answer.

^{xxxv} The information in this paragraph comes from a letter by the CFO of FINCA Microfinance Holding, Mr. Steve McGuire, to the management of SNS Impact Investing.

^{xxxvi} Cash flows to purposely shift profits of the MFI ‘offshore’ are uncommon in MFI PE fund structures. Interest payments are likely to be subject to withholding tax in the country of the MFI. Reduction of withholding tax may occur if the fund can benefit from a tax treaty between fund jurisdiction and MFI



jurisdiction. However, often such treaty is not available. Withholding taxes mostly lead to cost increases for the MFI. Dividend withholding taxes decrease the return for the investor if they cannot be offset against home taxes.

^{xxxvii} When the fund realises a gain on the sale of MFI-shares, the MFI jurisdiction may levy taxes, also when the third party buyer is NOT a resident of the MFI country. Investors experience such taxes as double taxation, as the price the buyer pays for the shares, in general reflects expected future profits of the MFI, which will be paying taxes over these profits as well when realised.



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