

INVESTED INTERESTS: THE UK'S OVERSEAS TERRITORIES' HIDDEN ROLE IN DEVELOPING COUNTRIES

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INVESTED INTERESTS

Introduction

The need for developing countries to attract investment from beyond their borders has long been recognised as crucial to their economic growth. Indeed, in today's globalised world, Foreign Direct Investment (FDI) as a prerequisite to prosperity is accepted by countries rich and poor.

Much attention has been focused over the years on understanding the relationship in developing countries between such funding and aid flows, and FDI and poverty alleviation, although analysts have been able to arrive at precious few agreed conclusions.¹

Where the money actually comes from has also excited interest, particularly when it originates from countries listed as developing – China in particular, but also to a lesser extent Brazil, Russia, India and South Africa (collectively known as BRICS).

But whereas Chinese investment in Africa has led to a wealth of articles, reports and even books in recent years, there is one aspect of FDI to the developing world that has barely been mentioned. That is the huge role that British Overseas Territories² (BOT) and Crown Dependencies³ (CD) play in channelling such outside investment to recipient countries.

That is beginning to change, with good reason. While there may be legitimate reasons for using these jurisdictions, there are also potential problems as former UN secretary-general Kofi Annan has highlighted: 'When foreign investors make extensive use of offshore companies, shell companies and tax havens, they weaken disclosure standards and undermine the efforts of reformers in Africa to promote transparency. Such practices also facilitate tax evasion and, in some countries, corruption, draining Africa of resources that should be deployed against poverty and vulnerability'.⁴ The warning, in a recent report on economic progress in Africa, is of global significance.

With tax, trade and transparency the dominant themes at this month's (June 2013) G8 meeting in Northern Ireland, this report attempts, for the first time, to quantify the role that tax havens to which the UK is constitutionally linked play in facilitating the flow of FDI into developing countries, dwarfing that of the BRICS nations.

Three of 14 British Overseas Territories, in particular the British Virgin Islands (BVI), Cayman Islands and Bermuda emerge as among the biggest global sources of FDI. Together with the Crown Dependencies of Jersey, Guernsey and the Isle of Man, they were in 2011 the largest provider of FDI to the developing world, responsible for more than one in every US\$10 that found its way there.

This report presents data from an International Monetary Fund (IMF) survey of developed and developing⁵ countries and their FDI stocks between 2009 and 2011. It shows that the British Overseas Territories and Crown Dependencies provide a share of FDI entirely disproportionate to the size of their economies.

This poses some fundamental questions: why do these offshore jurisdictions play such an important role in foreign direct investment flows? And do they have the regulations in place to ensure the good governance of the money involved? Also, what will the UK government, which has recently committed itself both to transparency and an end to tax dodging, do about the secrecy that these jurisdictions offer? For it is only with transparency about what is really going on with what is claimed to be FDI that investments can be monitored, companies held to account, and the benefits of investment realised.

What the data shows

Establishing exactly where most of the FDI reaching developing countries comes from is problematic. Recognising this, the IMF has in recent years conducted an annual survey which seeks to detail sourcing.⁶ Problems, however, remain. Not every country takes part in the survey, and approximately 6.5 per cent of data that is provided remains confidential and is not attributed to any particular country.

Nonetheless, the data from the 100 or so countries that do take part reveals a pattern.⁷ Table 1 shows which countries provided the most FDI globally between 2009 and 2011, ranked by the average. The first thing to notice is that the top 10 providers of FDI are perhaps not what we would expect – they do not correspond with the ranking of gross domestic product (GDP). And while the United States (US) occupy top spot in both FDI and GDP, that is not the case for the rest of the list.

The top 10

Table 1: Sources of FDI ranked by average⁸

Rank	Investment from:	GDP	2009	2010	2011	Average
1	United States	1	US\$2,490bn	US\$2,872bn	US\$2,845bn	US\$2,736bn
2	Netherlands	17	US\$2,219bn	US\$2,570bn	US\$2,328bn	US\$2,373bn
3	United Kingdom	7	US\$2,344bn	US\$2,365bn	US\$2,202bn	US\$2,304bn
4	Luxembourg	70	US\$1,692bn	US\$1,794bn	US\$1,831bn	US\$1,772bn
5	France	5	US\$1,098bn	US\$1,143bn	US\$1,113bn	US\$1,118bn
6	Germany	4	US\$996bn	US\$1,058bn	US\$1,037bn	US\$1,030bn
7	Switzerland	19	US\$722bn	US\$841bn	US\$944bn	US\$836bn
8	Japan	3	US\$740bn	US\$846bn	US\$904bn	US\$830bn
9	Hong Kong	40	US\$638bn	US\$820bn	US\$978bn	US\$812bn
10	British Virgin Islands	194	US\$603bn	US\$694bn	US\$790bn	US\$696bn

Remarkably, FDI from half the countries in this list – Luxembourg, the Netherlands, Switzerland, Hong Kong and the BVI – is significantly above their GDP rankings. Of particular note is the British Virgin Islands' appearance in the top 10 when it is only 194 on the GDP scale. The role of such tiny jurisdictions becomes even more noticeable when we add in the combined total of the British Overseas Territories and Crown Dependencies. As shown in table 2, this places them as the fifth largest overall source of FDI in the world, providing substantially more than France and Germany.

Their role is also more than twice the size of the BRICS economies⁹ combined, which, as shown in table 2, are the eleventh largest FDI provider. Furthermore, FDI from the BOT and CD is increasing at a faster rate, growing by 21 per cent over the three years compared to 18 per cent from the BRICS economies.

Table 2: Sources of FDI including combined totals from BOT and CD,¹⁰ and BRICS, ranked by average

Rank	Investment from:	Total 2009	Total 2010	Total 2011	Average
1	United States	US\$2,490bn	US\$2,872bn	US\$2,845bn	US\$2,736bn
2	Netherlands	US\$2,219bn	US\$2,570bn	US\$2,328bn	US\$2,373bn
3	United Kingdom	US\$2,344bn	US\$2,365bn	US\$2,202bn	US\$2,304bn
4	Luxembourg	US\$1,692bn	US\$1,794bn	US\$1,831bn	US\$1,772bn
5	Combined total from BOT and CD	US\$1,241bn	US\$1,490bn	US\$1,572bn	US\$1,434bn
6	France	US\$1,098bn	US\$1,143bn	US\$1,113bn	US\$1,118bn
7	Germany	US\$996bn	US\$1,058bn	US\$1,037bn	US\$1,030bn
8	Switzerland	US\$722bn	US\$841bn	US\$944bn	US\$836bn
9	Japan	US\$740bn	US\$846bn	US\$904bn	US\$830bn
10	Hong Kong	US\$638bn	US\$820bn	US\$978bn	US\$812bn
11	Total from BRICS ⁹	US\$582bn	US\$693bn	US\$708bn	US\$661bn

Investments in developing countries

Tables 1 and 2 give a picture of FDI into both developed and developing countries. When looking just at the investment being made into developing countries, the picture changes dramatically.

In table 3, some countries which we would expect to see among the top 10, such as France, no longer feature, but Cyprus and Singapore do, and the BVI moves up to fourth place. The picture is also slightly misleading, as much of the FDI from the Chinese Special Administrative Region of Hong Kong goes to mainland China.

In table 4 the FDI from Hong Kong to China has been removed, and the totals for the BOT and CD, and the BRICS have been added. With FDI from Hong Kong to China excluded, the BOT and CD are, on average, the second largest provider of FDI to developing countries after the US, and in both 2009 and 2011 they were the largest provider. The BOT and CD are providing around twice as much FDI as the UK, and over seven times as much as BRICS, which together only rank in seventeenth place.

Table 3: Sources of FDI into developing countries, ranked by average

Rank	Investment from:	2009	2010	2011	Average
1	Hong Kong	US\$567bn	US\$735bn	US\$876bn	US\$726bn
2	United States	US\$340bn	US\$565bn	US\$524bn	US\$476bn
3	Netherlands	US\$230bn	US\$465bn	US\$509bn	US\$401bn
4	British Virgin Islands	US\$247bn	US\$302bn	US\$388bn	US\$312bn
5	Japan	US\$166bn	US\$242bn	US\$270bn	US\$226bn
6	United Kingdom	US\$149bn	US\$232bn	US\$209bn	US\$196bn
7	Cyprus	US\$152bn	US\$208bn	US\$147bn	US\$169bn
8	Singapore	US\$108bn	US\$156bn	US\$189bn	US\$151bn
9	Spain	US\$91bn	US\$170bn	US\$192bn	US\$151bn
10	Germany	US\$91bn	US\$145bn	US\$136bn	US\$124bn

Table 4: Sources of FDI into developing countries including combined totals for BOT and CD, and BRICS, and excluding Hong Kong FDI to mainland China. Ranked by average

Rank	Investment from:	2009	2010	2011	Average
1	United States	US\$340bn	US\$565bn	US\$524bn	US\$476bn
2	Combined total from BOT and CD	US\$360bn	US\$476bn	US\$556bn	US\$464bn
3	Netherlands	US\$230bn	US\$465bn	US\$509bn	US\$401bn
4	Japan	US\$166bn	US\$242bn	US\$270bn	US\$226bn
5	United Kingdom	US\$149bn	US\$232bn	US\$209bn	US\$196bn
6	Cyprus	US\$152bn	US\$208bn	US\$147bn	US\$169bn
7	Singapore	US\$108bn	US\$156bn	US\$189bn	US\$151bn
8	Spain	US\$91bn	US\$170bn	US\$192bn	US\$151bn
9	Germany	US\$91bn	US\$145bn	US\$136bn	US\$124bn
10	France	US\$80bn	US\$119bn	US\$138bn	US\$112bn
17	Total from BRICS	US\$52bn	US\$69bn	US\$65bn	US\$62bn

On average, one in every US\$10 of FDI to developing countries is coming from the British Overseas Territories and Crown Dependencies

To look at this in a slightly different way, in table 5 we can see that the share of FDI being provided by the BOT and CD is significantly greater with respect to developing countries – over 10 per cent in comparison to the developed countries of the Organisation for Economic Co-operation and Development (OECD) where the total is only three per cent. What this means, in effect, is that on average one in every US\$10 of FDI to developing countries is coming from the BOT and CD. This though is only the average; if we look at some specific developing countries, the percentages are even

higher. For example, in 2010 Botswana received 33.2 per cent of its FDI from the BOT and CD, Ghana 31.8 per cent and Nigeria 19.3 per cent.¹¹

The significance of developing countries as an FDI destination for the BOT and CD is also interesting. As table 6 shows, the percentage of FDI to developing countries from the BOT and CD is far greater than FDI from the US and UK. Nearly half the FDI from the BVI goes to developing countries.

Table 5: Comparison of percentage of FDI provided by BOT and CD to the developed countries of OECD and developing countries

	2009	2010	2011	Average
World	7.00%	6.61%	6.41%	6.66%
OECD	2.90%	3.21%	3.00%	3.04%
Developing countries	11.06%	9.70%	11.11%	10.57%

Table 6: Top 10 providers of FDI, showing percentage of FDI going to developing countries with total for BOT and CD added

Rank	Investment from:	2009	2010	2011
1	United States	14%	20%	18%
2	Netherlands	10%	18%	22%
3	United Kingdom	6%	10%	9%
4	Luxembourg	2%	4%	4%
5	France	7%	10%	12%
6	Germany	9%	14%	13%
7	Switzerland	6%	9%	9%
8	Japan	22%	29%	30%
9	Hong Kong	89%	90%	90%
10	British Virgin Islands	41%	43%	49%
	Combined total from BOT and CD	29%	32%	35%

The scale of disproportion

To demonstrate just how disproportionate these figures are, table 7 provides the ratio of how many times greater the volume of FDI provided is than the GDP of the jurisdiction.

Table 7: Top 10 providers of FDI when ranked by ratio of FDI to size of GDP

Rank	Investment from:	2009	2010	2011
1	British Virgin Islands	688.07	776.09	862.97
2	Cayman Islands	60.92	82.79	83.15
3	Bermuda	59.05	74.98	67.15
4	Cook Islands	42.07	34.85	36.34
5	Samoa	30.98	30.84	32.37
6	Luxembourg	32.58	33.64	30.76
7	Gibraltar	11.95	17.50	13.78
8	Republic of the Marshall Islands	14.57	14.56	12.09
9	Mauritius	4.24	11.10	10.73
10	Jersey	8.98	11.00	10.69
30	United Kingdom	1.07	1.04	0.91
56	United States	0.18	0.20	0.19
	Combined total from BOT and CD	48.71	59.16	58.33

We see that the BVI was a conduit for FDI more than 860 times greater than the size of its domestic economy. This is a clearly disproportionate ratio; more than 10 times the ratio of the next highest country. In the context of this ratio, the significance of the BOT and CD becomes really apparent. Of the top 10 places, the top three are all British Overseas Territories, and five of the top 10 are either BOT or CD. In comparison, the UK has a ratio of around 1:1 and the US around 0.2:1.

To look at this another way, if the FDI from the BOT and CD were to be a country it would be the twelfth largest country in the world, bigger than Australia, Spain and Mexico, and bigger than the entire GDP of Sub-Saharan Africa.¹² The British Virgin Islands' FDI alone would make it the eighteenth largest economy in the world, bigger than both Turkey and Switzerland.

What is going on?

These statistics beg the question as to why small jurisdictions play such a significant role in providing FDI? And why does this excite so little comment?

The fact is that, perhaps unsurprisingly, the investment is not ultimately coming from places like the BVI, but is merely being routed through there from other countries. Indeed this may be why FDI from BRICS is lower than perhaps expected, as BRICS investment may be being channelled through places like the BOT and CD.

There could be a variety of reasons why this is happening, including desire for a stable and reliable legal environment or a politically neutral location for joint venture; but tax, secrecy and the opportunity to shift money are also likely to be top reasons.

Jurisdictions like the BOT and CD, and others that we see at or near the top of the rankings for FDI such as Luxembourg, Cyprus and Singapore, provide a combination of low taxes and secrecy that can facilitate and incentivise a range of activities.

FDI from the British Overseas Territories and Crown Dependencies is larger than the GDP of Sub Saharan Africa

Round tripping

Much of FDI may well originate in the country where it is to be invested. In a practice known as 'round tripping', money that has been either legally or illegally obtained is transferred into an offshore company that hides the identity of the true owner, thus hindering attempts by authorities to trace the source of funds. That secrecy means the offshore company can then return the money to the country where it originated, and where it is to be invested, as 'foreign investment', thereby eligible for various tax incentives. A lawyer with a US firm working in China recently explained to a Hong Kong newspaper: 'If you take the money straight back into China you pay capital gains [or income] tax. If you leave it in the BVI, wait a while then send it back, it can be made to look to the authorities like it is a foreign investment, and you don't pay tax on that.'¹³ He added that in practice: 'It's pretty impossible for the Chinese government to tell whether a BVI company is a Chinese controlled entity or a true foreign investor'.

The exact scale is not known, but estimates of the total amount of Chinese FDI that is round tripped vary from 25 to 50 per cent.¹⁴ In India, the use of Mauritius for round tripping has been widely acknowledged, with a potential cost to the Indian government of US\$600m a year.¹⁵ Recent estimates suggest that round tripping is responsible for over 10 per cent of the most significant FDI investment into India, and that more than 90 per cent of round tripping is conducted via offshore tax jurisdictions.¹⁶

Corruption

In some cases the funds used in such round tripping may have been illegally or corruptly obtained in the original country. Disguising it as foreign investment hides both the original source of the funds as well as the identity of whoever controls the money. In addition, when it re-enters the country where it was originally raised, it is 'clean'. Financial secrecy offered by the BOT and CD facilitates this.

A former Hong Kong-based fraud investigator, who specialised in tracing funds missing from Chinese companies, has contended that it is 'entirely common' to launder money raised in China through offshore jurisdictions with strict secrecy laws.¹⁷

The money corruptly obtained, however, is not always reinvested. Recently the UK Parliament's Great Lakes of Africa Group highlighted the fact that over the previous

four years, at least 45 newly incorporated companies in the BVI had acquired mining assets in the Democratic Republic of Congo (DRC). Committee chair Eric Joyce claimed documents passed to him showed the DRC government had 'sold vast mining assets at knock down prices to various offshore shell companies.' (Shell companies are companies with no assets or employees and usually exist on paper only. Their only recorded 'directors' are nominees such as the lawyers or accountants who set them up on behalf of clients who remain anonymous). The money lost to DRC, he said, amounted to more than US\$5.5bn. The identity of those behind the BVI companies remains a secret.¹⁸

Tax dodging

Round tripping and corruption, however, are not the only reasons why BOT and CD are such popular conduits for FDI flowing into the developing world, especially in regards to countries much poorer than India and China. There are other tax advantages that investors may be seeking to use to their advantage.

The BOT and CD that appear at the top of the FDI tables in this report all offer corporations low or nil tax rates, and most allow the setting up of special corporate entities offering further tax exemptions and fewer regulations, hence the reason such jurisdictions are often referred to as tax havens.

There is evidence that developing countries are not realising the tax returns they may expect from FDI.¹⁹ There are a variety of reasons for this, including the overgenerous granting of tax incentives.²⁰ Multinational corporations (MNCs) may also be seeking to exploit incentives in international tax treaties.

Another prime explanation is profit shifting; using techniques such as transfer mispricing, taxable profits are shifted overseas, especially to tax havens. Such techniques mean the lost revenues to the country can ultimately far exceed the value of the FDI coming in.

The cost to developing countries is enormous. Christian Aid research in 2008 estimated that mispriced international trade alone cost developing countries US\$160bn annually.²¹ In a study for the European Commission, the accountancy firm Pricewaterhouse Coopers (PwC) estimated that tackling transfer mispricing in four developing countries could increase corporation tax from MNCs by more than 40 per cent over five years.²²

Tax avoidance facilitated by offshore jurisdictions clearly gives MNCs making use of their services an unfair competitive edge. Recent Christian Aid research on MNCs operating in India showed that those with subsidiaries and/or shareholders in tax havens could have paid 30 per cent less in tax per unit of profit, compared to those without such links.²³

The OECD in its recent report *Addressing Base Erosion and Profit Shifting* listed some of the tax advantages other than transfer mispricing that might persuade a multinational to make use of a tax haven. They included reducing both source and residence country taxation of dividends and interest during the course of the investment, and capital gains upon exit from a country.²⁴

Noting as remarkable the high levels of FDI from jurisdictions including the BVI and Bermuda, the report said the figures gave useful indications about the extent of base erosion and profit shifting.²⁵

Corruption and tax dodging, including round tripping, cost developing countries billions of dollars a year and undermine the value of investments. Not only is there the loss of revenue, depriving developing countries of vital funds for public services, but the financial secrecy offered by tax havens means there is also a lack of transparency and accountability. This allows corruption to go unchallenged, and prevents those responsible being held to account.

What are the solutions? The first five steps

It has been accepted by the OECD and the G20 that the international tax system has not kept pace with globalisation and needs reform.²⁶ In their analysis the OECD has acknowledged that 'out of the box' thinking is required.²⁷ This reform should seek to align taxing rights closer to real economic activity, and to enable MNCs to be seen as integrated entities, rather than artificially dividing them into separate entities.²⁸ Ensuring that developing countries needs are included in these reforms is critical [see box below].

Developing countries need to be included in international tax reform

The OECD in its *Addressing Base Erosion Profit Shifting* report, acknowledged the problems of FDI being routed through tax havens. Given that the data shows OECD countries have around three per cent of their FDI coming from the BOT and CD, while developing countries have 11 per cent, it is clear that the risks are greater for developing countries.

While the scale of the problem developing countries are facing is bigger, their role in devising solutions is small. The OECD, to which developing countries do not belong, is leading the process along with working groups led by the UK, France, Germany and the US. While some of the BRICS economies are involved to some degree, there is little sign of other developing countries being actively engaged.

Christian Aid believes this needs to change; solutions are required that work for all. The current approach to meeting the needs of developing countries appears to be focused on capacity building, in the belief that solutions that work for the OECD will also work for

developing countries. It's argued that by providing the expertise and resources to tackle tax dodging, the problem will disappear.²⁹

This approach, however, ignores the fact that the sheer scale of the problem confronting developing countries is far greater than that faced by OECD countries. It also fails to take account of what happens while capacity is built. The capacity gap is significant and will not be bridged quickly (eg Sub-Saharan Africa has one-twentieth of the world average ratio of tax officials,³⁰ a shortfall of over 650,000). Developing countries therefore need tax rules and norms that address their current circumstances. This is not to say that capacity building should not be rigorously pursued, but to warn that alone it will not be enough to counter the problems that developing countries currently face. Only by including developing countries in helping reform international tax rules and norms, for example through the UN Tax Committee, will the challenges they face be properly addressed.

In addition to the reform of the international system, there are also some more obvious remedies that could be implemented immediately.

This report shows that – whatever the reason – jurisdictions such as the BOT and CD are significant actors in FDI, particularly for developing countries. They are the conduit for, on average, more than one in every US\$10 of FDI to developing countries. This raises a fundamental question – is the governance exercised by such jurisdictions adequate to the role they perform?

1. Collecting data

Unlike the UK, the BOT and CD do not take part in the IMF's annual FDI survey, so provide no detailed figures of their involvement. Instead, all the data available comes from the countries receiving the investment. Given the extent of the role of BOT and CD in the world of FDI, this must change as soon as possible.

Beyond the data, there are questions on the regulatory environment in these jurisdictions. It has been noted repeatedly that the combination of low taxes and financial secrecy provides incentives for a range of undesirable activities that drain resources from developing countries. We see many of these features in the BOT and CD.

2. Special corporate entities

To attract offshore funds, BOT and CD have created a range of special corporate entities of types that are not available in the UK. They include, in the British Virgin Islands, an entity called the BVI International Business Company, while in the Cayman Islands and Bermuda the term used is 'exempted companies'. These entities often have laxer regulations than ordinary companies. There is no requirement for BVI International Business Companies, for example, to keep accounts or provide returns, and they are exempt from BVI taxes. In the Crown Dependencies, the existence of Protected Cell Companies (PCC) is common. These companies allow cells to be created within the company, with the assets of each cell ring-fenced so they cannot be claimed by another cell in the case, for instance, of insolvency. This allows a high level of secrecy regarding the assets, activities and owners of each cell, which although not treated legally as separate companies, effectively function as separate entities.

These low transparency regulations, combined with the lack of transparency in certain types of companies, makes it difficult enough for the authorities – and virtually impossible for civil society organisations – to find out who is behind them.

3. Transparency of ownership

It is also far too easy for criminals and the corrupt to hide their money in shell companies. A recent World Bank study revealed that 70 per cent of large-scale corruption cases involved the use of such shells.³¹ While many such companies are based in tax havens, offshore jurisdictions are not alone in failing to regulate against such entities – there is much that the UK and other G8 countries should also be doing.

In a letter to the European Council, Prime Minister David Cameron stated his commitment to 'ensure full transparency in beneficial ownership'.³² That commitment must be extended to BOT and CD, and lead to public registries of the real (beneficial) owners of companies, trusts and other legal entities. Some jurisdictions, such as Jersey, have a non-public registry already and should quickly be able to make this public. Currently, although companies play a significant role in our societies as institutions that we buy from, sell to, partner with, invest in and work for, we have no legal right to determine their ownership from public registries. Detailing true ownership would be a strong deterrent to those seeking to cloak their criminal activities in secrecy.

4. Public availability of accounts

In addition, while David Cameron talks of the need for a new mechanism to track where multinationals make their money and pay their taxes,³³ none of the BOT or CD, bar Gibraltar, oblige both public and private companies to publish their accounts. Moreover, the requirement to file accounts is often minimal, making public scrutiny of their activities, including the channelling of FDI, impossible. Even Gibraltar, which does provide for public access to some accounts, makes it both difficult and expensive to exercise that right.³⁴

Making such information publicly available not only provides the transparency to help to hold companies and governments to account, it would also help revenue authorities to piece together a picture of a company's activities and identify where tax dodging has occurred.

“ We need a new mechanism to track where multinationals make their money, and where they pay their taxes, so we can stop those that are manipulating the system unfairly

UK Prime Minister David Cameron, May 2013

The UK House of Commons' International Development Committee (IDC) has recommended that the UK should advocate for an international standard requiring statutory filing of accounts, including in the CD.³⁵ This was agreed in principle by the UK government, only then to claim that an international standard would be too difficult to achieve. The CD asserted that they meet current, and would meet any future, international standards.³⁶

Making information about a company's beneficial ownership and its accounts publicly available should be complemented by full country-by-country reporting for multinational companies – providing details of their activities in every country where they operate. All of this will go part of the way in preventing malfeasance. There is also the need for authorities to access confidential information.

5. Exchange of information

For a country to enforce its tax laws effectively, it often needs information about a corporation or company's activities and finances abroad, as well as within its borders. The secrecy that tax havens offer means those details are often difficult, if not impossible, to acquire. As well as the need for new regulations and accounting standards to oblige businesses to put more information into the public domain, far greater cooperation between governments over the exchange of information is also required. This exchange should, when it comes to tax matters, be automatic.

The G20 has already stated that they expect to see automatic information exchange become the international standard.³⁷ Countries such as the US and the UK are already increasingly able to benefit from automatic information exchange. Developing countries, however, which lack both the political and economic power to enforce compliance with their wishes, face a far more difficult task in prising the information they want out of tax havens.

The OECD-linked Global Forum on Transparency and Exchange of Information for Tax Purposes assesses jurisdictions on their international cooperation on tax matters. One criterion it uses is the extent to which a country is prepared to exchange information on request as determined by their willingness to sign Transfer of Information Exchange Agreements (TIEA). While the BOT and CD have signed such agreements with a range of developed countries (including the UK and USA

as well as places such as Greenland and the Faeroe Islands), few developing countries and no countries among the ranks of the least developed have been afforded such access by the major FDI-providing BOT and CD, as can be seen in table 8.

The willingness of a number of offshore jurisdictions to sign such agreements with richer countries has nonetheless been deemed sufficient for the OECD Global Forum to declare them cooperative. In particular, the BVI, which is by far the most important in terms of FDI to the developing world, has only signed two TIEA with poorer countries, and the Turks and Caicos have signed none. This is a situation that needs urgent change. To regulate FDI effectively, developing countries need support and information from the jurisdictions involved in its transfer, including BOT and CD, which as we have seen will be the first (and potentially only) port of call for assistance for over 10 per cent of their FDI. At present they receive little or none.

There are signs that some of the BOT and CD are moving towards this, Juliana O'Connor-Connolly, Premier of the Cayman Islands, recently said: 'We welcome these efforts to promote an effective global mechanism for automatic exchange of information for tax purposes, in which all jurisdictions participate',³⁸ and the Isle of Man has made similar comments,³⁹ as have other BOT and CD. The challenge is to turn this into reality.

The most effective way forward on this would be for the BOT and CD to sign up to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, where all signatories agree to share information with each other, at a minimum on request. In addition, the BOT and CD as well as the UK should commit to agreeing to all requests from Convention signatories for automatic information exchange. They should also recognise that much of the information traffic will initially flow one way – from them to developing countries, which will need time to develop the resources and expertise to reciprocate in full.

Progress so far

Table 8 summarises the differences between the UK and the BOT and CD in the key areas discussed above. In most areas, the BOT and CD require much lower levels of transparency and have much lower requirements for information to be filed. From the information the authorities do have, they have far fewer commitments to sharing this with others that may

Table 8⁴⁰

	GDP ranking	FDI ranking global/developing countries	Requirements for companies to prepare accounts ⁴¹	Public access of accounts for registered companies	Beneficial ownership information publicly available	Special corporate entities ⁴²	Signed Multilateral Convention on Mutual Administrative Assistance in Tax Matters	Information exchange agreements	Information exchange agreements with developing countries	Financial Secrecy Index score
UK	7	3/6	Yes	Yes	No	No	Yes	147	75	45
Guernsey	171	51/101	Yes	No	No	Yes	No	49	13	65
Jersey	157	36/50	Yes	No	No	Yes	No	41	9	78
Isle of Man	160	80/88	Yes	No	No	Yes	No	39	6	65
Cayman Islands	170	21/15	Partial	No	No	Yes	No	31	5	77
British Virgin Islands	194	10/4	Partial	No	No	Yes	No	24	2	81
Bermuda	153	15/13	Yes	No	No	Yes	No	38	9	85
Anguilla	206	140/128	Partial	No	No	Yes	No	17	0	79
Turks and Caicos	193	145/139	Partial	No	No	Yes	No	16	0	90
Gibraltar	184	47/42	Partial	Yes (but difficult to access)	No	Yes	No	26	4	78

require it. The table also includes the Financial Secrecy Index (FSI) score for all the jurisdictions. The FSI, devised by the Tax Justice Network and Christian Aid, looks at a range of factors that determine the level of secrecy provided by a jurisdiction; the higher the score, the more secretive the economy. The gap in score between the UK and the BOT and CD is significant, a minimum of 20 points, with the Turks and Caicos twice that of the UK, illustrating the size of the regulatory gap between the UK and the BOT and CD.

If the absence of regulation and oversight in the BOT and CD pertained only to business entities operating within their borders, this might be justifiable. However, these are jurisdictions that together were the largest provider of FDI to developing countries in 2011. They are a conduit for, and on paper the source of, assets – tens, and in the British Virgin Islands' case, hundreds of times

the size of their economy. In such a role, there should be an obligation to ensure effective governance of the funding flowing from their jurisdictions, and the sharing of information with countries receiving such investment.

The BOT, in particular, offer statutory exemptions for businesses that purportedly do not undertake any economic activity within their jurisdiction. But funds will still flow through them, and profits are potentially booked. Surely, at a minimum, they should ensure that other countries are not disadvantaged by their laxity. The United Nations, World Bank, IMF and OECD together in a report to the G20 in Cannes in 2011 recommended that countries undertake 'spillover' analysis to assess the impact that the tax policy in developed countries could have on developing countries.⁴³ In the UK, the IDC also recommended that such analysis was carried out.⁴⁴ Given the degree to which the BOT and CD economies

“ The governance vacuum surrounding companies operating from offshore centres is undermining reform in Africa itself

The Africa Progress Panel

are geared towards other countries, particularly in the developing world, it is vital that they undertake a baseline analysis of the impact their tax and financial regulations are having on poorer nations.

The lack of publicly available information, and the refusal of such jurisdictions to share confidential information means effective oversight of companies operating from these jurisdictions is not possible. The Africa Progress Panel notes that: ‘The governance vacuum surrounding companies operating from offshore centres is undermining reform in Africa itself’, and that ‘African governments and citizens...have no recourse to information about the operations of these companies’.⁴⁵

The BOT and CD assert that they meet current international standards, as seen in their response to the UK’s IDC.⁴⁶ However, as also seen in the UK Government response to the IDC, there are significant difficulties in both developing and changing international standards.⁴⁷ Furthermore, there are difficulties in defining what meeting the international standard means. Whilst all the jurisdictions claim to meet the standard in the OECD Global Forum peer review process, the reality is almost all the BOT and CD do not meet the standard in all areas. All the BOT and CD, and the UK, have had areas for improvement identified.⁴⁸ The commitment of such jurisdictions to minimising the harmful impact of their present policies must therefore go beyond getting away with what they can. Clear commitment is needed on their part to going further than present accounting standards require to help counter the damage they currently cause.

The UK’s role

The fact that the BOT and CD are jurisdictions that are constitutionally linked to the UK also raises the question of what role the UK government should have in seeking to improve this situation.

The British Overseas Territories and Crown Dependencies have slightly different relationships with the UK. The Crown Dependencies’ relationship is managed through the Ministry of Justice, while the British Overseas Territories’ relationship is through the Foreign and Commonwealth Office.

The BOT vary in the degree of self-government permitted in their constitutions, though in most the Governor (appointed by the Queen and reporting to the UK’s Foreign Secretary) has responsibility for defence, external affairs, internal security, public service and the administration of justice, and often has certain reserve powers (eg to disallow legislation). In the most recent White Paper on the BOT it was confirmed that ‘[As] a matter of constitutional law the UK Parliament has unlimited power to legislate for the territories’.⁴⁹

In the CD, the role of the lieutenant governor (appointed by the Queen) has increasingly become more formal than substantive.⁵⁰

There therefore seems to be greater scope for the UK to engage directly in the affairs of the BOT than the CD, and in practice this appears to have been the case. For example, in 2009 following a corruption scandal in the Turks and Caicos Islands, ministerial government and the House of Assembly were suspended, and direct rule was imposed from the UK. There have also been calls from the UK Parliament for the governor to use his reserve powers in respect to the financial sector, especially where the constitution places greater financial liabilities on the UK.⁵¹ The situation in Turks and Caicos was exceptional. However it is clear that in both the BOT and CD the UK has a responsibility to intervene on issues of good governance.

Forty years ago, a Royal Commission on the Constitution (also referred to as the *Kilbrandon report*,⁵² which is considered the most authoritative report on the relationship between the UK and Crown Dependencies) stated:

*There is room for difference of opinion on the circumstances in which it would be proper to exercise that power. Intervention would certainly be justifiable to preserve law and order in the event of grave internal disruption. Whether there are other circumstances in which it would be justified is a question which is so hypothetical as in our view not to be worth pursuing. We think that the United Kingdom Government and Parliament ought to be very slow to seek to impose their will on the islands merely on the grounds that they know better than the islands what is good for them.*⁵³

However, it went on to note:

*It is nevertheless highly desirable that the institutions and the practices of the Islands should not differ beyond recognition from those of the United Kingdom.*⁵⁴

To clarify the UK government's position, Justice Secretary Jack Straw in 2008 said: 'Briefly, the conclusion of the *Kilbrandon report* is that the United Kingdom Government are responsible for the defence and international relations of the islands, and the Crown is ultimately responsible for their good government. It falls to the Home Secretary to advise the Crown on the exercise of those duties and responsibilities. The United Kingdom Parliament has the power to legislate for the islands, but it would exercise that power without their agreement in relation to domestic matters only in the most exceptional circumstances...United Kingdom laws are sometimes extended to the islands with their agreement.'⁵⁵

The UK has, however, extended laws to the CD against their will. Notably in 1967 an anti pirate radio act was imposed against the Isle of Man's wishes.⁵⁶

With regards to the BOT, the UK's ability to intervene is also clear – it used Orders in Council to outlaw the death penalty in 1991, and to decriminalise homosexual acts between consenting adults in private in 2000.⁵⁷

The UK has made clear its responsibility and its willingness to act on issues of good governance that directly affect those living in the BOT and CD. This report, however, together with others such as *Tax havens and development*⁵⁸ (from the Norwegian government in 2009), takes the question further. Should the UK not extend its responsibility for good governance towards the impact that the BOT and CD have beyond their borders?

As seen, the BOT and CD are responsible for one in US\$10 of FDI to developing countries, with the BVI the claimed source of FDI worth over 860 times the size of its economy. Given the size of the influence such jurisdictions wield beyond their borders through the policies they adopt, especially on developing countries, it is vital they implement good governance to counter the abuses the secrecy they offer facilitates, such as corruption, round-tripping and tax dodging.

As table 8 shows, regulations in the BOT and CD are different to those in the UK. Christian Aid argues that in fact the business practices they allow differ 'beyond recognition' from those of the UK – something which the *Kilbrandon report* identified as a potential threshold for action. Today, concern about the lack of oversight exercised by the UK over the tax havens to which it is linked, is spreading. Austria, which is under pressure to reform banking secrecy, has made it clear it won't take such demands seriously until it sees similar action from the UK over the BOT and CD.⁵⁹ Especially with respect to the BOT where the data shows they are the more significant jurisdictions for FDI to developing countries, and where the UK appears to have greater capacity and willingness to act, the UK needs to think about how it uses the full range of its influence and powers over these jurisdictions.

This year (2013) the UK holds the Presidency of the G8. The Government has said the themes of the June summit will be trade, tax and transparency. If that is not to be seen as empty rhetoric, there must be recognition of the damage caused to the developing world by the secrecy offered by tax havens – including those linked to the UK. That recognition must go hand in hand with a firm commitment to hold to account those who seek to profit off the backs of the world's poor. There is an urgent need for investment in developing countries, that is obvious, but it must be real investment, bringing real benefits, not money disguised for tax purposes to enrich the already wealthy, illicit money laundered to bestow legitimacy on the corrupt, or investments set up to artificially shift profits out of developing countries.

“ A lack of knowledge about who ultimately controls, owns and profits from companies leads to aggressive tax avoidance, tax evasion and money laundering, undermining tax bases and fuelling corruption across the world

UK Prime Minister David Cameron, May 2013

Policy recommendations

The following policies are recommended by Christian Aid:

For the British Overseas Territories and Crown Dependencies

- British Overseas Territories and Crown Dependencies to participate in annual FDI survey.
 - This would provide a much more comprehensive picture of the role the BOT and CD play in FDI globally, and in developing countries.
- BOT and CD to sign up to the Multilateral Convention on Mutual Administrative Assistance in tax matters.
 - This would provide immediate access to information for all other convention signatories.
 - Access to information from the BOT and CD would increase the benefits of joining the convention for developing countries.
- BOT and CD to improve standards in key areas such as public availability of accounts, to meet, as a minimum, those of the UK.
 - The BOT, CD and the UK should also seek together to improve standards even further, including through support for an international convention on financial transparency to establish an international 'gold standard'.

This will provide vital information about the activities of companies, enabling the quick spotting of malfeasance.

For the UK and British Overseas Territories and Crown Dependencies

- The UK, the BOT and CD should offer automatic information exchange to developing countries with asymmetric reciprocity.
 - This will allow developing countries to benefit from receiving information automatically, without the immediate burden of providing full reciprocity of information.
 - The UK should provide assistance both to build the capacity to utilise information received, and to move towards full reciprocity of information exchange.
- UK and BOT and CD to commit to establishing public registries of the beneficial ownership of companies and trusts.
 - The UK should be willing to provide financial and logistical support for this.
 - Transparency of ownership is vital for identifying both corruption and tax dodging.
- UK and BOT and CD to introduce full country-by-country reporting requirements for MNCs.
 - Country-by-country reporting, by showing the activities of multinationals in every country where they operate, makes it both easier to detect artificial profit shifting, and to see the full picture of the impact and contribution multinationals make to the societies they operate in.
- UK and BOT and CD to work together on assessing the use and potential for abuse of the BOT and CD as a conduit for FDI.
 - This should include assessing the regulations around the various types of corporate entities allowed in the BOT and CD.
 - This is necessary to understand both how and by whom the BOT and CD are being used to channel FDI to developing countries, and where further reforms may be necessary.

For the UK

- If the CD, and especially the BOT, are unwilling to implement the above policies, the UK should seek to use its influence and powers over these jurisdictions to produce the necessary changes.

For the international community

- Inclusion of developing countries in the reform of international tax rules and norms. For example, making the UN Tax Committee a key part of the Base Erosion Profit Shifting project:
 - This will allow developing countries to be able to shape the international environment to match both their current and future capacities.
- Further research to determine what 'good' FDI looks like.
 - The role FDI has in development is still subject to much debate. Part of the problem may be a lack of research on the variety of FDI (eg composition, source and longevity of investment). Further research in this area could help determine what makes some FDI 'good' and how 'good' FDI can be nurtured and encouraged.

ENDNOTES

- 1 For a useful summary see Reiter, S.L. and Steensma, H. Kevin (2010) *Human Development and Foreign Direct Investment in Developing Countries: The Influence of FDI Policy and Corruption in World Development* Vol 38 No. 12, pp1678-1691.
- 2 Akrotiri and Dhekelia, Anguilla, Bermuda, British Antarctic Territory, British Indian Ocean Territory, British Virgin Islands, Cayman Islands, Falkland Islands, Gibraltar, Montserrat, Pitcairn Islands, Saint Helena, Ascension and Tristan da Cunha, South Georgia and the South Sandwich Islands, Turks and Caicos Islands.
- 3 Jersey, Guernsey, Isle of Man.
- 4 *Africa Progress Panel Report 2013*, p7.
- 5 Developing countries are defined and classified as either upper middle income, low middle income or low income countries by the World Bank.
- 6 <http://cdis.imf.org>
- 7 101 countries provide some data for some years, but not all provide all data for all years.
- 8 FDI data in all tables from <http://cdis.imf.org> and refer to stocks of FDI, not flows. GDP data from the UN (<http://unstats.un.org/unsd/snaama/dnltransfer.asp?fID=2>) except for Jersey, Guernsey, Isle of Man and Gibraltar which were not included. Data for these are from the official statistics of each jurisdiction.
- 9 BRICS does not include Hong Kong and Macau which are treated separately in FDI statistics.
- 10 British Overseas Territories and Crown Dependencies used for all combined totals are Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Gibraltar, Guernsey, Jersey, Isle of Man and Turks and Caicos which are the only ones with significant FDI data.
- 11 See note 6.
- 12 The 47 countries of SSA had a combined GDP of 1,282,074,141,071 in 2011 compared to FDI from the BOT and CDs of 1,572,454,231,513.
- 13 'Sun, Sand and Lots of Hot Money', *South China Morning Post*, Aug 14 2012 www.scmp.com/article/968175/sun-sand-and-lots-hot-money
- 14 See http://unctad.org/en/Docs/iteiamic20075_en.pdf and Shollapur, M, Maheswari, S and Tate, U (2010) *FDI Accounting in India and China: A Need for Harmonization DIAS Technology Review*, Vol 6. No. 2, for estimates.
- 15 <http://blogs.reuters.com/david-cay-johnston/2011/08/09/tax-gateways-to-india>
- 16 Rao, K.S. and Dhar, B. India's FDI Inflows: Trends and Concepts, 2011.
- 17 See note 13.
- 18 <http://ericjoyce.co.uk/wp-content/uploads/2011/11/summary-5-5m-loss-to-congolese-people-through-questionable-mining-deals.pdf>
- 19 For an example, see Goodspeed, T. (2004) *Taxation and FDI in Developed and Developing Countries*.
- 20 Recent research in East Africa found that four countries in the East African Community were forgoing US\$2.8bn of tax revenues every year due to tax incentives. See Action Aid and TJN-Africa (2012) *Tax Competition in East Africa: A race to the bottom?*
- 21 www.christianaid.org.uk/images/deathandtaxes.pdf and www.christianaid.org.uk/images/false-profits.pdf
- 22 Transfer pricing and developing countries: Final report (http://ec.europa.eu/europeaid/what/economic-support/documents/transfer-pricing-study_en.pdf) Appendix I – Estimated impact on tax collection from Transfer Pricing reform (pp76-88).
- 23 Prats, A and Jansky, P (2013) *Multinational corporations and the profit-shifting lure of tax havens*.
- 24 *Addressing Base Erosion and Profit Shifting*, OECD Publishing, 2013, p17.
- 25 *Ibid*, p18.
- 26 *Ibid*, p5, and www.bbc.co.uk/news/uk-21482242
- 27 *Ibid* p9.
- 28 christianaid.org.uk/Images/No-more-shifty-business-response-to-OECD_tcm15-68250.pdf
- 29 See note 24, p87.
- 30 Fjeldstad, O. and Heggstad, K. (2011) *The tax systems in Mozambique, Tanzania and Zambia: Capacity and Constraints*, pX.
- 31 Sharman, J, Park, J, Harrison, R, Halter, E and Willebois, E (2011) *The Puppet Masters: How the corrupt use legal structures to hide stolen assets and what to do about it*.
- 32 <https://www.gov.uk/government/news/pm-letter-to-the-eu-on-tax-evasion>
- 33 Prime Minister David Cameron and President Obama Press Conference, 13 May 2013.
- 34 See note 155 at www.secrecyjurisdictions.com/sj_database/Gibraltar.xml#b155
- 35 International Development Committee (2012a). *Tax in Developing Countries: Increasing Resources for Development*. Vol 1, p12.
- 36 International Development Committee (2012b) *Tax in Developing Countries: Increasing Resources for Development: Governments Response to the Committee's Fourth Report of Session 2012–13*, p5 and p14.
- 37 See paragraph 14 at <http://en.g20russia.ru/load/781302507>
- 38 <http://tinyurl.com/nqua7o8>
- 39 www.isleofman.com/News/details/54780/isle-of-man-welcomes-developments-in-international-taxation
- 40 Data from a range of sources including the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes (www.oecd.org/tax/transparency), commissioned legal research and www.financialsecrecyindex.com
- 41 This refers to a requirement for all companies to prepare accounts in a minimum prescribed way. In some jurisdictions there are exemptions from the requirements to prepare accounts or there is no prescribed content for accounts, these are recorded as partial.
- 42 This refers to either to special provisions for 'international' companies or protected cell companies.
- 43 *Supporting the Development of More Effective Tax Systems: A report to the G-20 development working group by the IMF, OECD, UN and World Bank*. pp27-28.
- 44 See note 35, pp20-21.
- 45 See note 4, p60.
- 46 See note 36, p14.
- 47 See note 36, p5.
- 48 See www.oecd.org/tax/transparency for peer review reports for each jurisdiction.
- 49 The Overseas Territories: Security, Success and Sustainability, FCO 2012, p14.
- 50 www.publications.parliament.uk/pa/cm200910/cmselect/cmjust/56/5610.htm

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- 53 Part XI of Volume 1 of *The Report of the Royal Commission on the Constitution 1969-1973*, Cmnd 5460, paragraph 1, 502.
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- 55 Hansard, House of Commons debates, 3 June 1998, Column 471.
- 56 Marine etc. Broadcasting (Offences) Act 1967.
- 57 See note 51, p83, paragraph 254.
- 58 Official Norwegian Reports, 2009. *Tax havens and development: status, analyses and measures*.
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