EDFI European Development Finance Institutions

EDFI Principles for Responsible Tax in Developing Countries

EDFI is the Association of European Development Finance Institutions ("EDFIs"), a group of 15 institutions that provide financing to private sector enterprises in emerging and frontier markets. Responsible tax is important for sovereign governments, DFIs and other actors in their efforts to contribute to the Sustainable Development Goals.

EDFIs often operate in challenging institutional environments, where investment risk is substantially increased by inadequate foreign investment protection laws, dispute resolution mechanisms, judicial enforcement and regulation of foreign exchange transactions. DFIs must take appropriate actions to mitigate these risks in a responsible manner that respects the sovereignty of countries to decide on their tax policies and regimes.

Offshore financial centres (OFCs) offer stable jurisdictions that can mitigate many of the most concerning investment risks, such as by having clear legislation covering investment activities and proven, stable dispute resolution mechanisms, including through the courts. EDFIs have been following international discussions on tax and a permanent EDFI working group was established in 2011 to develop and maintain shared guidelines for transactions involving EDFIs and entities domiciled in OFCs[*]. The working group concluded that EDFIs commonly participate in investment structures involving OFCs when this fits the purpose of mobilising private finance towards developing countries and thereby helps to fulfil the DFIs' development mandates.

Responsible tax practices of course extend beyond the appropriate use of OFCs and, therefore, the EDFIs have agreed that a more holistic approach is needed. EDFIs are ready to lead by example and as financial institutions, EDFIs are instrumental in encouraging clients to respect their share of the "social contract", namely to comply with tax laws and to refrain from engaging in inappropriate and artificial, but nevertheless legal, shifting of taxable profits from the developing countries in which they operate. At the same time, EDFIs also face limitations. They are not legislators, regulators, auditors or tax inspectors. This means they can neither assume the role of tax authorities in sovereign jurisdictions, nor can they assume responsibility for the tax compliance of third party investors.

As a result, the EDFI member institutions endorse a set of principles for their approach to responsible tax practices.

[*] The working group noted that while there is no single definition, "OFCs" are typically characterised by financial assets and liabilities disproportionate to intermediation needed to finance the domestic economy; by low taxation of non-residents with limited or no activities "onshore"; and by legal and regulatory infrastructures that meet the requirements of institutional investors seeking to invest in the private sector in developing countries.

EDFI principles for responsible tax in developing countries:

1. **Adopt and publish a tax policy.**

2. **Seek to prevent participating in potentially harmful tax situations,** where there is a significant risk of tax evasion by the client or an unfair tax treatment towards the client, and **require client compliance with tax law in the developing countries in which business is conducted.**

3. **Avoid participating in corporate structures created for the sole purpose of shifting taxable profits away from the developing countries in which business is conducted**. DFIs participate in transactions involving intermediary jurisdictions or holding company structures outside host countries when such structures are deemed necessary to mobilise financial resources and to fulfil development objectives. The use of OFCs should be limited to jurisdictions that are committed to the internationally accepted standards defined by the Global Forum on Transparency and Exchange of Information for Tax Purposes, which include the automatic exchange of tax information (AEOI), and at least largely compliant with them.

4. **Promote transparency** by disclosing, to the extent possible and within the legal limits of client protection, project specific information. Due to legitimate expectations of privacy this would not usually extend to disclosure of beneficial ownership of investees unless such disclosure is already required by law.

5. **Recognise the role of tax in development effectiveness reports** by including information collected on taxes paid by clients at an aggregate level. This would complement other development indicators and help position the role of development finance in reaching the Sustainable Development Goals (SDGs).

The EDFI working group will periodically exchange experiences among DFIs, monitor activities and reports of the OECD, EU and other international institutions, and engage in dialogue with relevant stakeholders on these principles.

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