



## The Statens Pensjonsfond Utland and Tax Havens

Sony Kapoor, Managing Director, Re-Define & Linda Zeilina, Special Advisor, Re-Define

*A Report commissioned by Forum for Utvikling og Miljø\**

*\* Report commissioned by ForUM as part of ForUM's search for opinions regarding the SPU's use of so-called tax havens. The views, conclusions and recommendations expressed in this report are all those of Re-Define and not ForUM.*

## **Contents**

List of abbreviations.....	3
Executive Summary.....	4
Background.....	8
Tax havens and their uses.....	11
Tax havens and the three Cs.....	13
Significant development and other impacts.....	16
International efforts to fight tax evasion and avoidance.....	17
1. The European Union (EU).....	17
2. The USA.....	18
3. Norway.....	19
4. The G20.....	21
5. The United Nations.....	22
6. The OECD and international cooperation.....	23
The SPU and tax havens.....	25
1. Direct use of tax havens.....	25
1.1 SPU Subsidiaries in tax havens.....	25
1.2 External Fund Managers in tax havens.....	25
1.3 Companies incorporated in tax havens.....	27
2. Indirect.....	28
2.1 Companies that are heavy users of tax havens .....	28
2.2 Investing in financial institutions facilitating the use of tax havens.....	30
Analysis.....	32
Conclusion.....	39
Policy Recommendations.....	41
List of References.....	44

## List of abbreviations

<b>BEPS</b>	Base Erosion and Profit Shifting
<b>CbC</b>	Country-by-country
<b>DTA</b>	Double Taxation Agreement
<b>FATCA</b>	Foreign Account Tax Compliance Act
<b>FfDO</b>	Financing for Development Office
<b>FFI</b>	Foreign Financial Institution
<b>EC</b>	European Commission
<b>EU</b>	European Union
<b>IMF</b>	International Monetary Fund
<b>MCAA</b>	Multilateral Competent Authority Agreement
<b>MNC</b>	Multinational Company
<b>NBIM</b>	Norges Bank Investment Management
<b>OECD</b>	Organisation for Economic Co-operation and Development
<b>PE</b>	Private Equity
<b>SPU</b>	Statens Pensjonsfond Utland
<b>TIFL</b>	Taskforce on Illicit Financial Flows
<b>UN</b>	United Nations
<b>US</b>	United States
<b>USA</b>	United States of America
<b>WB</b>	World Bank
<b>WBG</b>	World Bank Group

## ***Executive Summary***

The Panama Papers have put tax havens in the news again. The news of secretive companies with hidden beneficial owners, including more than a hundred people in political office, has been front-page news for several weeks now. It has also been revealed that banks, particularly HSBC and UBS, were big users of these offshore structures, buying them en masse for their corporate and retail clients to help them avoid taxes and in some cases hide the proceeds of corruption and launder money.

The biggest exposure Norway has to the international financial system that includes these offshore and tax haven networks is through the Statens Pensjonsfond Utland (SPU)<sup>1</sup>, which invests over NOK 7 trillion in the global financial system. The Panama Papers rightly raised questions about the exposure the SPU has to tax havens and the offshore financial system. It has led to calls for the SPU to withdraw from tax havens altogether. The idea behind these calls is that the SPU's use of tax havens somehow legitimises them.

Those calling for a boycott of these tax havens are right to say that they impose a lot of costs on more legitimate economies. These take the form of lower tax revenues, the flight of capital from poor countries, higher corruption and facilitation of money laundering for criminal and terrorism purposes. In many cases the same infrastructure of havens, accountants, lawyers and bankers that is used primarily by corporations for legitimately reducing their tax burden, is also used for more nefarious purposes. These include aggressive tax avoidance that violates the spirit if not letter of laws, tax evasion, corruption and crime.

---

<sup>1</sup> In this report, the Statens Pensjonsfond Utland will be referred to as the SPU and "the Fund" interchangeably.

Does this mean that all offshore activity is illegitimate and should be banned outright? The answer is no. This report features new original research on the SPU's exposure to tax havens and the ethical, reputational and financial risks it poses. It also discusses the substantial opportunity it offers the SPU and Norway to change and influence international practices that can help mitigate the most egregious uses of tax havens.

In the world of international investments, offshore financial centres (which have spent decades honing legal, financial and treaty infrastructures to attract business) sometimes are the most appropriate way stations for pooling money from various sources in order to make investments across a range of countries and asset classes. They can help minimise unnecessary paperwork and reporting, while minimising the possibility of double taxation. Particularly in the case of investments in illiquid asset classes and in developing economies, the use of tax havens as way stations is very widespread, with both convenience and a predictable legal regime rather than tax avoidance acting as the main motives. So, unless the whole architecture of the global financial system is reset, there are legitimate uses that exist for tax havens.

The SPU is exposed to tax havens through five different channels, of which three are direct and two are indirect. The direct channels are the following:

- 1) the use of a tax haven-based subsidiary for making real estate investments,
- 2) the use of tax haven based funds to invest SPU money through external fund managers,
- 3) the SPU's own direct ownership of companies registered in tax havens.

We estimate that this direct exposure adds up to 7% -10% of the total value of the SPU.

The indirect exposure occurs through:

1) the SPU's ownership of companies such as Apple and Google that are major users of tax havens and

2) the SPU's ownership of large banks such as HSBC and UBS, which are key facilitators of the use of tax havens.

This indirect exposure to aggressive tax haven operations may be as large as 10% of the SPU's value.

So, as much as 20% of the value of the SPU may be exposed to tax havens, but, as we have highlighted in this report, this is not unusual for other funds in the SPU's peer group.

We believe that, while it may be desirable to limit the direct use of tax havens by the SPU from the perspective of public opinion, this may not make financial sense and does not implicate the SPU in the most egregious aspects of tax haven use.

The main moral, reputational and financial risks to the SPU arise from its investments in tax haven-based companies, its investments in companies that are heavy users of tax havens and its ownership of financial institutions that are big facilitators of the use of tax havens. Hence, policymakers must focus on mitigating this risk and using the influence the Fund can exercise as an owner in changing egregious practices.

Thus we recommend that the SPU immediately sell out of the companies it owns that are registered in tax havens, unless there is a strong financial case against such an action. If this is the case, then the SPU needs to justify it to the Norwegian Parliament, which must have the final say on the matter.

We also recommend that the SPU develop a strong expectations strategy for the companies it owns particularly in the IT, pharmaceutical, extractive and financial sectors, where it clearly lays guidelines to minimise the use of

aggressive tax avoidance strategies and tax haven-based legal vehicles.

The SPU should invest resources to also mobilise other institutional investors behind this cause, and aggressively and actively engage with company management by giving them benchmarks for changes with strict timelines. Should these timelines not be met or the management be uncooperative, the SPU should divest from the most aggressive users of tax havens.

The SPU's large stakes in banks such as UBS, HSBC and Credit Suisse, some of which have been implicated in helping enable corruption, bust sanctions, money laundering and tax evasion, are especially risky. The SPU needs to engage aggressively or divest in order to minimise reputational and financial risks and moral complicity.

## **Background**

While tax havens have existed for a very long time (since shortly after World War I), they have seen a major increase since the 1970s<sup>2</sup>. Their proliferation first triggered the attention of national governments only in the 1990s, consequently leading to the OECD involvement and work on the issue. It is estimated that currently the offshore industry consists of approximately 91 havens, with jurisdictions ranging from British Virgin Islands to US states such as Delaware<sup>3</sup> in the United States (or so-called on-shore havens).

### **Features of tax havens**

- Very low or zero taxes for non-residents
- Legal system offers a ring-fenced tax regime
- High levels of secrecy that allow concealing the beneficiaries or real owners of companies, trusts or bank accounts
- No obligations to deliver accounts, meaning no auditing and control, and no preservation of records
- Weak or no legal cooperation with third countries (especially with regard to tax issues)
- No economic substance required to the transactions booked in the jurisdiction

Tax havens are secrecy jurisdictions that enable international companies to avoid double taxation, or in some cases any taxation. Due to the lack of transparency and reliable data on the exact amounts of money stashed away offshore, the current estimates vary wildly, from way below to way above \$20 trillion<sup>4</sup>. A recent paper estimates that a total of 8% of the world's wealth (or USD 7.6 trillion) is kept in tax havens<sup>5</sup>.

---

<sup>2</sup> For a short historical overview of tax havens, please see The Economist (16 February 2013). *Enduring charms: a brief history of tax havens*".

<sup>3</sup> Drucker, J. (27 January 2016). *"The World's Favorite New Tax Haven Is the United States"*.

<sup>4</sup> The Economist (16 February 2013). *"The missing \$20 trillion"*.

<sup>5</sup> Zucman, G. (2013). *"Taxing across Borders: Tracking Personal Wealth and Corporate Profits"*.

### ***The Panama Papers***

- Unprecedented scale: **11.5 million records**, dating back nearly 40 years
- Offers details on more than **214,000 offshore entities** connected to people in more than **200 countries and territories**
- Politically explosive: reveals the offshore holdings of **140 politicians and public officials** around the world – including **12 current and former world leaders**
- Contains names of at least **33 people and companies** blacklisted by the US government
- Facilitation by major banks: more than **500 banks**, their subsidiaries and their branches – including HSBC, UBS and Société Générale – created more than **15,000 offshore companies** through Mossack Fonseca

It is the combination of secrecy and low or no tax rates in particular that makes tax havens so pernicious in the global financial system. The biggest users of tax havens by far are companies that are trying to legitimately and illegitimately reduce tax payments.

However, this same infrastructure of jurisdictions (lawyers, accountants and banks that facilitate the flow of

money in and out of offshore financial centres) is also used by other actors, amongst which are individuals trying to evade taxes, hide proceeds from corruption and engage in criminal activity and money laundering).

### ***Double taxation***

- Double taxation refers to income taxes that are paid twice on the same source of earned income. Double taxation occurs when a taxpayer (for example, a multinational enterprise) pays tax on the same corporate income earned from economic activity twice, in different countries: once to the tax authorities of the foreign country which is host to the economic activity, and once to the tax authorities of the home country, in which the company is domiciled\*.
- Countries have tried to tackle the issues of double taxation by signing Double Taxation Agreements (DTA), however, these have often been criticised for disadvantaging developing countries by allowing taxation to occur in developed economies where the companies are based.
- Multinational companies have also been accused of treaty shopping – when investment from other (non-DTA) countries that would have taken place anyway is structured via a jurisdiction to take advantage of any new agreements that allow minimising tax payments.
- Due to disagreements between countries and the lack of sufficient international cooperation on tax matters, some companies justify the use of offshore financial centres as the only way of avoiding what is seen as unfair double taxation on the same capital gains. This is a problem that can be tackled by better agreements and cooperation between official authorities.

The illicit capital flows facilitated by this infrastructure violate laws, bend rules and undermine good governance in both the public and private sector. The revelations offered by offshore tax leaks<sup>6</sup> expose how national laws are undermined, resulting in lower confidence in systems of accountability and governance. This in turn has an adverse impact on democratic society.

Moreover, by facilitating capital flight from countries, offshore financial centres also undermine the redistributive efforts of societies and poverty alleviating expenditure in national economies. This increases both income and wealth inequality –an acute problem of our time. In addition, capital flight from developing countries, in particular, contributes to subverting of the international development aid effort and local governments' attempts to improve infrastructure, healthcare and education.

Yet offshore financial centres are likely to remain attractive for large corporations and rich individuals to minimise tax payments and hide the true value of assets. This attraction will only lessen if the reputational and financial risks increase due to whistle-blowers, tax leaks and improved international cooperation on tax matters.

---

<sup>6</sup> For more information on latest tax leaks, please see the website of the International Consortium of Investigative Journalists; on Lux Leaks in 2014: <https://www.icij.org/project/luxembourg-leaks>, on Swiss Leaks: <https://www.icij.org/project/swiss-leaks> and on Panama papers: <https://panamapapers.icij.org/20160403-panama-papers-global-overview.html>

## ***Tax havens and their uses***

Tax havens are in some cases lawfully used to pool investments and reducing tax payments, as the existing international legal system and existing rules allow for that. Consequently, companies and private individuals are able to take advantage of loopholes and imperfections in national tax systems in order to minimise their tax liabilities.

### ***Harmful effects of tax havens***

- Facilitation of money laundering
- Facilitation of corruption and economic crime
- Aiding of large scale tax evasion and avoidance
- Hiding of financial risks and destabilisation of the financial system
- Erosion of countries' tax returns
- Negative development impact on less developed economies
- Undermining of governance structures and confidence in rule of law
- Political disillusionment

### ***The main benefits offered by offshore centres***

- Flexibility of corporate structures and simple incorporations
- Issuance of different share classes
- Reliable legal systems
- Convenience for companies and individuals operating in different jurisdictions, offering centralized, flexible access to funds from various locations
- Multiple saving options in various currencies
- Avoidance of double-taxation (more on this on page 9 above)
- Low or no tax rates
- Secrecy and anonymity for asset owners

Some have argued in favour of the use of tax havens, especially when such jurisdictions are used to avoid double-taxation, or to be used as a “way station” that facilitates complex international trade and investment flows (no or low taxes would be paid in the “way station” due to money being in transit)<sup>7</sup>.

In this way, offshore financial centres allow companies and individuals to manage a multitude of tax issues from various jurisdictions where they

---

<sup>7</sup> Presaud, A. D. (2010). “An economic defense of offshore financial centres - or how to lose your liberal friends in 800 words”.

operate. In addition, they offer reliable and stable legal systems, easy incorporation and allow the issuing of different classes of shares, all very attractive to a variety of investors and companies. Different offshore centres have developed significant niche positions in international financial markets, with Cayman Islands as a leading centre for hedge funds, Luxembourg for fund management and Bermuda specialising in the insurance industry<sup>8</sup>.

As one prominent economist argues, the main culprits to be blamed for the failures and loopholes existing in national tax systems are large developed countries that need to work on improving their own regulation<sup>9</sup>. As a case in point, the City of London working closely with the UK Crown dependencies such as Jersey, Guernsey and the Isle of Man, and the Overseas Territories (including such major offshore centres as the Cayman Islands, the British Virgin Islands and Bermuda) form the largest network of offshore financial centres in the world. While the US has acted stringent action against small island states acting as tax havens, the state of Delaware continues one of the most secretive jurisdictions in the world<sup>10</sup>. In the EU, countries such as the Netherlands and Ireland, which are not regarded as tax havens, have been accused by other Member States of also facilitating large-scale tax avoidance<sup>11</sup>.

This highlights the very important role that large developed countries such as the US, the UK and EU Member States can and need to play to reduce the role of tax havens in the global financial system. However, it goes without saying that other stakeholders, such as large investors can also wield significant influence on the practices of companies in order to minimise their use of offshore centres.

---

<sup>8</sup> Houlder, V. (7 April 2016). *"Tax havens are cog in global economy, say defenders"*.

<sup>9</sup> Presaud, A. D. (2010). "An economic defense of offshore financial centres - or how to lose your liberal friends in 800 words".

<sup>10</sup> The Economist (20 February 2016). *"The biggest loophole of all"*.

<sup>11</sup> For a more in depth exploration of the role of the City of London, Crown dependencies and overseas territories in offshore, please see Tax Justice Network (2015). *"Narrative Report on United Kingdom"*.

## **1. Tax havens and the three Cs**

The legal, financial, jurisdictional and institutional infrastructure that enables huge sums of money to flow through offshore centres for tax avoidance purposes is also used for illegal and unethical practices that include tax evasion, corruption and money laundering.

Since the exact same offshore financial infrastructure is used for both legal and illegal financial activity, it makes it impossible to only address the criminal elements.

When it comes to illicit or illegal financial flows, they fall into three main categories or the three Cs: **c**riminal (when the sources of funds have criminal origins), **c**orrupt (when the funds are linked to proceeds from corruption of public officials), and **c**ommercial (when the flows are driven by profit laundering, tax reduction or other commercial motives).

<b>Rank</b>	<b>Country</b>
1	British Virgin Islands
1	Bermuda
1	Bahamas
2	Cayman Islands
3	UAE
4	Bahrain
5	Guernsey
6	Liechtenstein

The table above lists some of the countries that rank at the top of the Tax Attractiveness Index, a comprehensive index of how favourable the local tax regime is for companies seeking to minimise tax payments, developed by the Ludwig-Maximilians-Universität München<sup>12</sup>.

The criteria for the ranking is listed in the table below, and would be easily recognisable at the OECD, at the Norwegian Tax Authority or at any

---

<sup>12</sup> *Tax Attractiveness Index (2016)*.

organisation working on minimising tax avoidance and evasion by corporations. In short, the index measures the ease with which a jurisdiction can help a company avoid taxes. In the context of this report, it is an index of shame.

***The Criteria used for the Tax Attractiveness Index***

- Anti-avoidance rules
- CFC rules
- Corporate income tax rate
- Depreciations
- EU Member State
- Group taxation regime
- Holding tax climate
- Loss carry-back
- Loss carry-forward
- Patent box regime
- Personal income tax rate
- R&D incentives
- Taxation of capital gains
- Taxation of dividends received
- Thin capitalisation rules
- Transfer pricing rules
- Treaty network
- Withholding tax rate dividends
- Withholding tax rate royalties
- Withholding tax rate interest

Notably, a number of tax haven jurisdictions used by the SPU directly and indirectly appear right at the top of this index.

Tax havens also provide a location for passive investments. Secondly, they provide a location where “paper” profits can be booked, which then permits income shifting and the deferral of residence-country tax by corporations<sup>13</sup>.

Third and most important, they enable the affairs of taxpayers (and their bank accounts in particular) and companies to be shielded from the scrutiny by tax authorities and other countries<sup>14</sup>.

<sup>13</sup> Alm, J. & Martinez-Vazquez, J (29 Nov 2005). *“The Challenges of Tax Reform in a Global Economy”*.

<sup>14</sup> OECD (1998). *“Harmful Tax Competition: An Emerging Global Issue”*.

Intermediaries, such as banks, accounting and law firms, act as drivers of this complex system of financial secrecy, offering a wide selection of services aiding companies and individuals to hide their assets in offshore centres.

#### ***Main mechanisms used for capital flight***

- ***Mis-invoicing of trade transactions:*** 1) under-invoicing the value of exports from the country from which the money is to be expatriated and then selling the goods at full value after expatriation, with the excess amount being paid into an offshore account; 2) the creation of fictitious transactions for which payment is made, but for which the good do not materialise; 3) misreporting the quality or grade of products to over-valuate or under-valuate assets.
- ***Transfer mispricing:*** manipulation of prices of cross-border transactions between related affiliates or subsidiaries of MNCs, which is harder to detect and easier to carry out as transactions occur between related parties.
- ***Mispriced financial transfers:*** intra-corporate financial transactions (such as loans from parent company to a subsidiary company at exaggerated interest rates) in order to shift profit out of a host country. It is possible to misprice real estate, securities and other forms of financial trades to facilitate capital flight; using exaggerated payments for intangible things such as goodwill, royalties, patents etc. are also a channel for capital flight.
- ***Unscrupulous wire transfers:*** occurs when a bank or a non-banking financial institution transfers money out of a country illicitly, sometimes misreporting the source, destination or ownership of funds. While wire transfers are legitimate ways of moving money between countries, they become illicit when used to avoid tax payments or to hide money obtained by illegal activities.
- ***Other mechanisms:*** Smuggling of cash or other high value mobile assets out of the country (such as luxury yachts, diamonds, gold, currencies in shape of bank notes, antiques, works of art and rare coins).

Professionals who are part of the financial infrastructure often actively solicit funds and design elaborate strategies involving manipulated accounts, dubious bank transfers, secretive bank accounts, nominee-run shell companies and other convoluted legal structures to enable the cross-border

transfer of funds, to hide the source and true ownership of funds and to often minimise or altogether eliminate tax liabilities.

### ***Significant development and other impacts***

The outflow of money without any taxation has a variety of financial, development and political consequences.

Oxfam estimates that the world's poorest countries lose approximately USD 170 billion due to the use of tax havens *annually*<sup>15</sup>. Notably, it is also costing developed nations: the European Commission estimates that tax avoidance costs the EU Member States EUR 50 - 70 billion a year in lost tax revenues<sup>16</sup>.

This has a serious impact on the development prospects of many least developed countries, resulting in the erosion of their tax base and thus their ability to invest in infrastructure and public services such as education and healthcare.

Moreover, tax havens, by providing infrastructure for illicit financial flows, allow authoritarian leaders, illegitimate rulers and corrupt governments to transfer their illegitimately obtained assets abroad. In such a way, corrupt behaviour is rewarded, while also enabling corrupt regimes to remain in power for much longer. Every time such unethical behaviour is exposed by tax leaks or other scandals, public confidence in the government and the rule of law is further undermined. Since offshore financial centres directly contribute to the facilitation of corruption, they are a key issue to be addressed in order to improve developmental outcomes, reduce political risks and improve democratic processes.

---

<sup>15</sup>Oxfam America (14 April 2016). *Broken at the Top*.

<sup>16</sup> European Commission (12 April 2016). *“European Commission proposes public tax transparency rules for multinationals”*.

## ***International efforts to fight tax evasion and avoidance***

Over the years, there have been various attempts to tackle the issue of tax haven use. The most prominent initiatives will be shortly examined to show the current state of affairs and to identify the remaining issues. It is important to highlight that often tax leaks have played a key role in creating a momentum helping launch initiatives fighting financial secrecy and forcing countries to sign up to international agreements<sup>17</sup>. While the Panama Papers is a leak on an unprecedented scale, it is not the first leak and is likely not to be the last.

### **1. The European Union (EU)**

In 2015, the European Commission (EC) published a list of top 30 tax havens or non-cooperative tax jurisdictions<sup>18</sup>, amongst which were the British Virgin Islands, Panama, Hong Kong, Andorra and Liechtenstein. However, countries such as Luxembourg, the Netherlands and Ireland were not included, despite major questions about their “sweetheart tax deals”<sup>19</sup> that enable large corporations to evade taxes. The EC list resulted from an aggregation of EU Member States’ own tax blacklists, thus any jurisdiction listed by ten or more states was included in the list. The UK and Germany, for example, do not create such lists, thus the EC list has been heavily criticised for turning out to be selective and not reflective of the main jurisdictions used as tax havens. Calls for improvements of this list have been made, as some of the countries on the list have taken significant steps towards improving their cooperation with other countries’ tax authorities.

---

<sup>17</sup> For more in depth information, please see the website of the International Consortium of Investigative Journalists; on LuxLeaks in 2014: <https://www.icij.org/project/luxembourg-leaks> and on Swiss Leaks: <https://www.icij.org/project/swiss-leaks>.

<sup>18</sup> EUbusiness (18 June 2015). “*EU releases world tax havens blacklist*”.

<sup>19</sup> “*Sweetheart deal*” in finance refers to a merger, a sale or an agreement in which one party in the deal presents the other party with very attractive terms and conditions. In this case, national governments’ tax authorities offer multinational companies special tax deals. For more, see <http://www.investopedia.com/terms/s/sweetheartdeal.asp#ixzz46waZyUVO>.

The LuxLeaks scandal led to the EU boosting automatic information sharing between the Member States without any need to requests, which will finally come into effect in early 2017. The EU's competition commissioner Margrethe Vestager has taken a tough stance on anti-competitive behaviour by MNCs, starting various tax probes to examine the operations of Google, Apple, Starbucks and Fiat amongst others.

## **2. The USA**

The USA has taken tax evasion seriously, introducing its Foreign Account Tax Compliance Act (FATCA) in 2010, which forces foreign financial firms to disclose their US clients. FATCA requires foreign financial institutions (FFIs) to report information about financial accounts held by US taxpayers, or by foreign entities in which US taxpayers hold a substantial ownership interest<sup>20</sup>. This means that non-US banks and financial institutions around the world have to reveal American account details, or risk large penalties (UBS paid USD 780 million and Credit Suisse a record USD 2.6 billion in penalties for violating an earlier requirement for such disclosures). This has acted as a major incentive for governments to sign bilateral agreements with the US in order to comply with FATCA, including even the Russian government despite its hostile rhetoric during the Ukraine crisis in Crimea (the fear of Russian financial institutions being frozen out of the US markets was too large a risk).

FATCA has had some positive impact on the OECD efforts to adopt Common Reporting Standards for global use, and has allowed the OECD to model some of its tax initiatives on it. Large EU countries have signed a reciprocal deal with the US after the FATCA came into force.

---

<sup>20</sup> US Department of the Treasury (2016). *“Foreign Account Tax Compliance Act”*.

### 3. Norway

Norway has played a very important role in putting the issue of illicit financial flows on the international agenda, by establishing a Taskforce on Illicit Financial Flows (TIFL). Several of the final recommendations included in the Taskforce's final report have influenced the work of the G20, the OECD and EU institutions<sup>21</sup>, and have helped set the agenda for the global debate on illicit financial flows.

The country-by-country (CbC) report issued by the Norwegian Ministry of Finance has been deemed to be generally in line with the final report issued by the OECD for implementing action 13 of the BEPS plan, "*Transfer Pricing documentation and country-by-country reporting*"<sup>22</sup>.

It has been proposed that all Norwegian companies of multinational groups with a consolidated turnover of at least NOK 6.5 billion would be required to file a country-by-country report<sup>23</sup>, which means an estimated 70 groups would have to file such report. The aim is to make the country-by-country reports available to all countries where the multinational group operates, whether it is through its permanent or subsidiary establishments.

Confidentiality is also suggested, allowing the submission of the country-by-country reports only to tax authorities in other jurisdictions and only when there is an existing agreement in force pertaining to international law.

It also proposed that subsidiaries in Norway of foreign-based groups would have to submit the country-by-country report if these particular conditions are met:

---

<sup>21</sup> The Task Force on the Development Impact of Illicit Financial Flows (2008). "*Final Report*".

<sup>22</sup> OECD (October 2015). "*Transfer Pricing Documentation and Country-by-Country Reporting, Action 13: Final Report*".

<sup>23</sup> KPMG (5 January 2016). "*Norway: Country-by-country reporting proposal, public consultation*".

- a) the ultimate parent company is not required to file a country-by-country report in the jurisdiction where it is a resident;
- b) the ultimate parent company is a resident in a jurisdiction that has not signed a specific agreement for the automatic exchange of country-by-country reports with Norway; or
- c) there are other measures preventing the automatic exchange of country-by-country reports<sup>24</sup>.

The main task remains for national governments, including the Norwegian one, to sign bilateral agreements with countries (in addition to the already signed international agreements).

In addition to this, the Norwegian Parliament's decision in June 2015 to vote for the introduction of a publicly accessible registry of beneficial owners is a welcome step towards greater transparency.

The CbC reporting standards adopted by Norway have been rightly criticised for important flaws, as they still fail to provide an adequate overview of hidden money flows within companies. For example, allowing companies not to include reporting on certain operations if it is too costly gives them discretion to leave information out. This, however, obfuscates the company structure in its entirety, making it difficult for the authorities to see the full picture. Instead, as argued by Publish What You Pay (PWYP) Norway<sup>25</sup>, companies should be made to report from every country they are registered in without any exceptions (including the number of employees in each subsidiary), ensuring full disclosure. Disclosing transfers and interest payments between different parts of the company would also help determine instances of tax avoidance or evasion. This would enable a closer examination of operations and identifying instances of internal mispricing.

Moreover, requiring companies to report only payments of NOK 800,000 or more is shortsighted. This permits splitting the payments into smaller parts in

---

<sup>24</sup> KPMG (5 January 2016). "*Norway: Country-by-country reporting proposal, public consultation*".

<sup>25</sup> PWYP Norway (30 September 2015).

order to avoid the reporting requirements. This means that only the very largest companies have to report, while in addition, the ones already reporting to the EU are exempt. Since at the moment the EU reporting standards are weaker than the Norwegian ones, this further undermines the efforts for greater transparency.

Also, applying the reporting requirements only to forestry and production is insufficient, as the exclusion of certain sectors such as extractive industries, technology and pharmaceutical and other companies allows them to escape scrutiny. As this report demonstrates, there are plenty of instances showing aggressive tax avoidance and evasion practices by companies in these sectors.

Finally, with no third-party audit of the reports submitted by companies<sup>26</sup>, there is no verification that the information provided is accurate. This is a major shortcoming and should be rectified.

#### **4. The G20**

The G20 has been playing an active role in exploring the best ways to increase transparency and tackle tax evasion and avoidance issues. It has made commitments to tackle the beneficial ownership issues and has distributed a set of principles to guide governments when drafting national rules. The G20 has also published a set of principles for national governments, aiming to make it easier to identify the beneficial owners of shell companies, which, according to the US and the UK, were among the jurisdictions used most frequently to incorporate legal entities that hold the proceeds of corruption<sup>27</sup>.

At the recent IMF and World Bank spring meetings in beginning of April this year, the finance ministers of the G20 warned the tax havens that they are

---

<sup>26</sup> Tax Justice Network Norge (13 January 2014).

<sup>27</sup> Smyth, J & Parker, G. (16 November 2016). "G20 leaders back drive to unmask shell companies".

prepared to look into using “defensive measures”<sup>28</sup>. The secretive jurisdictions are urged to sign up to the internationally agreed standards on transparency, with particular pressure put on Panama that finds itself in the middle of the controversies created by the Panama Papers leak. Panama has up until now refused to commit to the new standards, along with Bahrain. The harsher rhetoric is in line with the public mood of outrage over the revelations of tax evasion schemes.

The UK is planning to host a major summit on tackling corruption in May 2016, which is likely to see extra pressure on offshore centres to share beneficial ownership information, something that the offshore centres that are UK dependencies still refuse to do.

## **5. The United Nations**

The United Nations (UN) have played a key role in promoting the developing countries’ perspectives on taxation, and working on their capacity building for improved taxation.

The UN’s Financing for Development Office (FfDO) has carried out substantial work on strengthening the developing countries’ capacity to protect and broaden their tax base. In 2015, the FfDO published a publicly accessible Handbook on the matter, offering an in-depth overview of main issues and ways to tackle them<sup>29</sup>.

The UN’s Committee of Experts on International Cooperation in Tax Matters and various sub-committees complement the OECD’s BEPS work from a capacity development angle and have the advantage, over the OECD, of universal representation.

---

<sup>28</sup> Giles, C. & Houlder, V. (15 April 2016). *“G20 threatens tax havens over standards”*.

<sup>29</sup> United Nations (2015). *“United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries”*.

Moreover, the UN has argued that illicit financial flows, as well as tax evasion and avoidance all contribute to inequality and undermine development, and should thus be seen as issues to be tackled as part of the Sustainable Development Goals (SDGs)<sup>30</sup>.

## 6. The OECD and international cooperation

The OECD has played a major role in Europe and worldwide with its attempts to tackle capital flight and tax evasion and avoidance.

Its main initiative, the Base Erosion and Profit Shifting (BEPS), refers to tax planning strategies that exploit the gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid<sup>31</sup>. The OECD deems BEPS to be of major significance for developing countries, as they rely heavily on corporate income tax, particularly from multinational companies (MNCs).

The OECD research estimates that annual losses arising from BEPS come to between 4% - 10% of global corporate income tax revenues or between USD 100 to 240 billion annually<sup>32</sup>.

The BEPS initiative gained a lot of interest from developing countries, but was met with refusal by the US to participate, as it maintains a preference for bilateral agreements with countries. In practice this has meant that the US provides very little information to other countries, becoming a tax haven of choice. However, the framework provided by the OECD offers guidelines for national authorities to address taxation shortcomings and loopholes. Recent

---

<sup>30</sup> UN News Centre. (30 March 2016). *“UN calls for political will to overcome inequality hindering sustainable development for all”*.

<sup>31</sup> OECD. *“About Base Erosion and Profit Shifting (BEPS)”*.

<sup>32</sup> [OECD \(October 2015\). “OECD Secretary-general Report to G20 Finance Ministers”](#).

developments, such as Australia and Germany signing a new double tax agreement, show active use of the OECD BEPS Report<sup>33</sup>.

On the 27<sup>th</sup> of January 2016, 31 countries signed the Multilateral Competent Authority Agreement (MCAA), which provides for the automatic exchange of country-by-country (CbC) reports. The intention of this is to enable a consistent and swift implementation of the new transfer pricing reporting standards by requiring the signatories to:

- i) establish the infrastructure for an effective exchange relationship;
- ii) provide for the necessary legislation to require companies to file a CbC report; and
- iii) safeguard that the information received remains confidential and is only used for purposes of the assessment of transfer pricing risks<sup>34</sup>.

The OECD, seen as a club of rich countries, has been criticised for the exclusion of developing countries from its work on BEPS. The 34 member countries set the OECD agenda on the global tax rules and tax cooperation. Eurodad, a development NGO, has argued that the existing rules disadvantage developing countries, as in the case when an MNC operating in multiple countries is to mainly pay taxes in the country where it has its headquarters, which in most cases is an OECD member state (despite substantial operations in developing countries)<sup>35</sup>.

The Panama Papers leak has further reinvigorated the international efforts to fight tax evasion and avoidance. In mid-April, the IMF, the OECD, the UN and the World Bank Group (WBG) all formed a joint platform to intensify their cooperation on tax issues and to develop new tools and standards for tackling tax base erosion and evasion<sup>36</sup>. Also, some of the secretive jurisdictions have

---

<sup>33</sup> Hall & Wilcox (22 April 2016). *"Australia and Germany sign new Double Tax Agreement"*.

<sup>34</sup> [Theiss, W. \(31 March 2016\). "Thirty-one countries sign automatic information sharing agreement for country-by-country reporting"](#).

<sup>35</sup> Rowlands, L. (19 April 2016). *"Developing countries left out of global tax decisions"*.

<sup>36</sup> [Economia \(20 April 2016\). "IMF, OECD, UN and World Bank join forces to tackle tax evasion"](#).

come under increasing pressure to join international efforts. Bermuda, previously criticised for lack of cooperation<sup>37</sup> on tax matters, signed the OECD's Multilateral Competent Authority Agreement for the Automatic Exchange of Country-by-Country reports in mid-April this year.

## ***The SPU and tax havens***

The SPU is a direct and indirect user of tax havens through five different channels, all of which we discuss below.

### ***1. Direct use of tax havens***

#### **1.1 SPU Subsidiaries in tax havens**

The SPU invests in real estate through a subsidiary it has established in Luxembourg<sup>38</sup>, one of the world's largest offshore financial centres and tax havens. LuxLeaks showed that Luxembourg has been implicated in helping companies avoid billions of dollars of tax payments in other economies<sup>39</sup>.

The Fund states the following: "NBIM S.à r.l. is a fully-owned subsidiary of the Norwegian central bank (Norges Bank). It was set up in May 2011 to oversee direct and indirect real estate investments in mainland Europe for the Government Pension Fund Global. The company is located in Luxembourg."

The investments of NBIM S.à r.l, the SPU's subsidiary fund in Luxembourg, were worth NOK 232 bn or 3.1% of the SPU's overall value at the end of 2015. The Fund is targeting a 5% share of total investments to be in real

---

<sup>37</sup> MNE Tax (20 April 2016). "*Bermuda signs agreement for exchange of country-by-country tax reports*".

<sup>38</sup> NBIM (2016e). "*NBIM S.À. R. L*

<sup>39</sup> The International Consortium of Investigative Journalists. "*Luxembourg Leaks: Global companies' secrets exposed*".

estate, so the expected value of the Fund's investments through its Luxembourg subsidiary is expected to rise to above NOK 350 billion over the next couple of years.

## **1.2 External fund managers in tax havens**

The SPU makes most of its investments on its own, but sometimes it uses external fund managers for geographic locations or investment strategies where it lacks internal capacity. At present, the SPU has 297 billion kroner, or 4 percent of its capital, under external management. A total of 84 mandates were managed externally by 70 organisations<sup>40</sup>.

While the SPU discloses the full list of external managers used, the managers themselves often have poor disclosures when it comes to their legal structures, ownership and place of incorporation. From the limited information available, it is easy to see that at least 4 of the 70 managers are based in known tax havens, three in the Cayman Islands and one in the Isle of Man. Those that appear to be in the Cayman Islands are 3G Radar, Prosperity Capital Management and Ion Value Management. Capital International Limited is based in the Isle of Man. In addition to this, several other managers are based in other jurisdictions known as havens, including Hong Kong, Singapore and Switzerland.

However, in reality the percentage of external investments being channelled through tax havens is likely to be much higher, as most external managers operate through funds incorporated in offshore financial centres. It is reasonable to expect that at least half of the SPU funds that are externally managed are invested through funds incorporated in offshore financial centres or tax havens. This would put the figure at upwards of 2% of the total value of the SPU.

---

<sup>40</sup> NBIM (2016c). "*External Managers*".

### 1.3 Companies incorporated in tax havens

The SPU invests in over 9,000 companies in 75 countries<sup>41</sup>. A number of these companies are based in tax havens that feature on the European Commission's list of 30 non-cooperative jurisdictions<sup>42</sup>. Bloomberg have calculated that the SPU has invested \$15.8 billion or over 2% of the total value of the SPU in companies that are incorporated in these jurisdictions<sup>43</sup>.

The most commonly used jurisdictions are the Cayman Islands and Hong Kong, with Bermuda also featuring heavily.

A direct search in the NBIM database for each of these jurisdictions only gives a very partial picture, and shows only a few corporate entities in Hong Kong, Cayman Islands, Bermuda and Guernsey amounting to only 0.138% of the SPU's overall holdings<sup>44</sup>.

This picture is very incomplete. For example, fully 70 equity investments in China have been made through the Cayman Islands (54) and Bermuda (17) amounting already to 0.141% of the overall size of the SPU. Bloomberg's calculation of over 2% of the total value of the SPU invested in firms incorporated in non-cooperative jurisdictions is more painstaking and comprehensive.

---

<sup>41</sup> NBIM (2016a). *Government Pension Fund Global: The Fund*.

<sup>42</sup> Eubusiness (18 June 2015). "EU releases world tax havens blacklist".

<sup>43</sup> Holter, M. (11 April 2016). *Norway's Wealth Fund Faces Demonstration Over Tax Havens*.

<sup>44</sup> NBIM (2016b). *Holdings*.

## **2. Indirect**

### **2.1 Companies that are heavy users of tax havens**

The vast majority of the 9,000 companies the SPU invests in are not incorporated in tax havens. However, a significant number of them, particularly the largest Multi National Corporations (MNCs) have subsidiaries in tax havens. Companies vary widely in how intensively they use tax havens, but as a rule of thumb companies that operate in the IT, pharmaceutical, financial and extractive sectors are particularly heavy users of offshore centres.

The intellectual property-heavy regimes within the first two sectors make it relatively easy to manipulate the share of earnings across various jurisdictions, so the biggest chunk of profits can be reported to be arising in low tax jurisdictions. In the financial sector, the free flow of capital across borders, combined with the use of complex intra company loans and derivatives, makes it relatively easy to engage in tax avoidance. The extractive sector is notorious for mis-invoicing the amount and value of natural resource exports, so as to book the largest share of profits in offshore jurisdictions.

One of the SPU's largest investments is in Apple Inc, the total investment in both its bonds and equities totalling NOK 44 463 million, with a vote share of 0.81%. Yet Apple has been subject to increasing criticism by the European Commission and other institutions over its use of the "sweetheart tax deals" with Ireland, allowing it to avoid paying a fair share of tax on its profits. This means that Apple is now accused of having USD 8 billion in unpaid taxes in Europe<sup>45</sup>.

---

<sup>45</sup> Satariano, A. (15 January 2016). "Apple May Be on Hook for \$8 Billion in Taxes in Europe Probe".

Apple had also been accused of booking a EUR 879 million profit that was generated in Italy through a subsidiary in Ireland, in a bid to lower its taxable income base. To settle the claim Apple had to pay EUR 318 million to the Italian authorities<sup>46</sup>.

The SPU has invested NOK 32 980 million invested in Microsoft. Yet in 2014 the company admitted to Securities and Exchange Commission that it was keeping a record USD 92.9 billion of earnings stored offshore, which means it would have owed the US government USD 29.6 billion in Taxes if the earnings were to be repatriated<sup>47</sup>. It has also come under fire in Europe for aggressive tax avoidance.

The current standard of disclosure by large companies is insufficient and often poor. As a Wall Street report on subsidiaries observed in 2012, companies often rapidly reduce the number of subsidiaries they disclose<sup>48</sup>. Microsoft had initially disclosed more than a hundred subsidiaries, but in 2003 it reported only 13 and in 2012 it was down to 11.

A similar pattern was identified in other disclosures, with Google reporting more than 100 subsidiaries in 2009 (some located in Delaware, but also 81 located overseas in Bermuda, Hong Kong etc.), but by 2013 the number had dropped to just two, both located in Ireland. Google has also been accused of aggressive tax avoidance, with the actions of a whistle blower in London having resulted in a GBP 130 million settlement with the UK Tax Authority<sup>49</sup>.

Google, now called Alphabet, Microsoft and Apple all feature in the SPU's list of the biggest investments highlighted on its home page<sup>50</sup>.

---

<sup>46</sup> Yalburgi, V. (16 January 2016). *"Apple accused of \$8bn tax evasion in European Commission probe"*.

<sup>47</sup> Sirota, D. (22 August 2014). *"Microsoft Admits Keeping \$92 Billion Offshore to Avoid Paying \$29 Billion in U.S. Taxes"*.

<sup>48</sup> Holzer, J. (22 May 2013). *"From Google to FedEx: The Incredible Vanishing Subsidiary"*.

<sup>49</sup> Connett, D. (29 January 2016). *"Barney Jones: Meet the whistleblower who helped expose Google's tax avoidance"*.

<sup>50</sup> NBIM (2016d). *"Investments"*.

Many of the other firms the Fund has significant investments in have also been accused of aggressive tax avoidance, and in some cases tax evasion.

## **2.2 Investing in Financial Institutions facilitating the use of Tax Havens**

As discussed in a previous section of this report, the use of tax havens is facilitated by a number of intermediaries that includes corporate formation agents such as Mossack Fonseca, the company at the centre of Panama Leaks, accounting firms and lawyers and banks such as UBS and Credit Suisse, both of which have been implicated in helping facilitate clients evade taxes and circumvent rules<sup>51</sup>.

The SPU has large stakes in a number of banks such as BNP Paribas, UBS, Credit Suisse and HSBC, which have been fined not just for facilitating tax evasion but also for helping clients launder money. For example, BNP Paribas was fined a whopping USD 8.9 billion for its role in laundering money and sanctions busting<sup>52</sup>. Credit Suisse and HSBC were also fined for these offences.

Credit Suisse has paid a fine of USD 2.6 billion for its role in tax evasion, and UBS has been fined \$780 million with further action possible.

The SPU owns 4.94% of Credit Suisse, 3.08% of UBS, 2.07% of BNP Paribas and 1.98% of HSBC<sup>53</sup>. This makes it the largest or one of the largest shareholders in these banks that have actively promoted the use of tax havens. These four banks already constitute about 1.3% of the SPU's total investments. Adding in other holdings from firms that have actively facilitated the use of tax havens would possibly double the number, but we can conservatively estimate that the SPU invests 2% of its size in such investments.

---

<sup>51</sup> Thomson Reuters (2015). *"Banking misconduct bill"*.

<sup>52</sup> BBC News. (1 July 2014). *"BNP Paribas to pay \$9bn to settle sanctions violations"*.

<sup>53</sup> NBIM (2016b). *"Holdings"*.

In order to calculate the indirect exposure, through the use of tax havens by onshore companies the SPU invests in, the focus was on four main sectors.

These are:

- 1) financials,
- 2) healthcare (which includes large pharmaceutical companies)
- 3) the technology sector and
- 4) the oil and gas industry.

These sectors were chosen because companies in these industries are, on average, the biggest users of tax havens and aggressive tax avoidance strategies. In case of the financial sector, as discussed previously in the report, many of the large banks such as BNP Paribas and UBS the SPU owns significant shares in, are not just big users of havens themselves, but have also been implicated in promoting aggressive tax avoidance and the use of tax havens.

The total equity share of these sectors, as recorded in the 2015 Annual Report of the SPU, comes to 48.5%. Based on our knowledge and understanding of these sectors and on conversations with expert analysts who cover these sectors<sup>54</sup>, it is reasonable to assume that about a third of the share of SPU investments in these sectors are significantly exposed to tax havens and aggressive tax avoidance. We also assume that the same proportion, namely 48.5%, of the SPU's corporate bond holdings belong to these sectors. This means that a third of the 48.5% of the equity and corporate bond holdings of the SPU are heavily exposed to tax havens. Taken together, the equity and corporate bond holdings amount to just over 70% of the whole SPU, which means that a third of 48.5% of 70% of the SPU, amounting to just above 10% of the total, is heavily exposed to tax havens and aggressive tax avoidance strategies.

---

<sup>54</sup> Due to various concerns including confidentiality clauses, the officials interviewed for this report wished to remain anonymous.

## Analysis

In summary, the SPU's direct exposure to tax havens and / or offshore financial centres amounts to between 7% and 10% of the total value of the Fund depending on various assumptions. This may look like a high number to some. However, a quick look at other comparable funds shows that this is not that high. Using similar criteria to calculate direct exposure to tax havens as we have used for the SPU, some other funds will have higher exposures<sup>55</sup>.

The biggest determinant of this indirect exposure would be how much of its assets a fund manages externally vs. internally. Investments in emerging economies are also more likely to be channelled through tax havens, as are investments in illiquid assets such as private equity and infrastructure, since the fund managers specialising in these areas often operate through funds based in tax havens.

Because the SPU does most of its investment in house, it invests far less than other similar funds in emerging economies and does not invest in illiquid assets outside of property, thus its direct use of tax havens is rather modest compared to some within its peer group. Most other funds manage a higher proportion of their funds externally, and have a much larger share in emerging markets and invest in illiquid assets<sup>56</sup>.

Like the SPU, these too have come under criticism. For example, the Australia Future Fund, Australia Super and the New Zealand Superannuation Fund

---

<sup>55</sup> Due to space constraints, this Report will not be discussing the SPU's mandate and the Ethical Council. However, the authors would like to note that if the SPU's mandate is to make largest possible return on its investments and to reach the 4% return, the SPU may need to use offshore centres for its investments. This issue could be addressed by ethical guidelines forbidding use of secrecy jurisdictions or third parties based in or using offshore centres.

<sup>56</sup> Kapoor, S. (2013). "*Investing for the future.*"

have come under scrutiny for using the Cayman Islands<sup>57</sup>. Other large sovereign wealth funds also use offshore financial centres<sup>58</sup>.

Does this somehow legitimise the use of tax havens? Can these direct uses of tax havens be banned without undue harm to financial returns for the SPU and other funds?

Offshore financial centres have spent decades honing their legal regime, treaty network and financial infrastructure to cater to the needs of a growing financial industry, which is driven by globalisation and the liberalisation of capital accounts. As discussed in a previous section in this report, they do confer specific advantages for companies and investors, such as avoidance of double taxation, reducing onerous reporting burdens and a convenient place to pool funds from various sources and jurisdictions in order to make investments, particularly in many developing economies with poorly developed legal and financial infrastructure. A submission from the Australian and New Zealand Funds highlights some of these issues<sup>59</sup>.

Particularly in the world of fund management, the use of offshore financial centres does seem to offer a convenient “way station” that can help offer legal certainty. Their use is not strictly necessary, as investments can be routed differently, but there is a financial cost to this, which can be significant in certain instances.

In this case, we defend the SPU’s decision to base its real estate subsidiary in Luxembourg, although it would be prudent to explore alternative locations that are not tax havens and to explicitly highlight additional costs if there are any, ultimately letting the parliament decide if it is ready to bear additional costs in order to be not seen to be legitimising the use of tax havens.

---

<sup>57</sup> The Australian. (2016). *“Industry super funds pouring into Cayman Islands.”*

<sup>58</sup> McLaren, J. & Passant, J. (2010). *“Tax havens: do they have a future providing banking and financial services?”*

<sup>59</sup> The Australian. (2016). *“Super wealth funds plead to OECD for tax rule exemption.”*

The SPU cannot be held responsible for the fact that much of the world's fund management infrastructure is legally based out of tax havens. If the SPU needs to use external managers, it will in most cases not be in a position to decide what the legal jurisdiction of their operation should be. This will be the hardest part to change. Nevertheless, given that Norwegian public opinion is against any use of tax havens, it would be prudent for the Fund to do a public report on the exact use of tax havens by the external fund managers it uses and to explore whether there are possible alternatives. If not, it would be sensible to highlight what the financial costs of discontinuing the use of fund managers who run funds out of tax havens would be and let the Norwegian Parliament decide.

The direct investments by the SPU in companies registered in tax havens such as the Cayman Islands etc. is less defensible and the Fund should issue a full public report explaining the size, scope and justification for these investments. The default position of the Parliament in this case should be that the Fund should not be making these investments unless it can make a strong case for why these may be necessary.

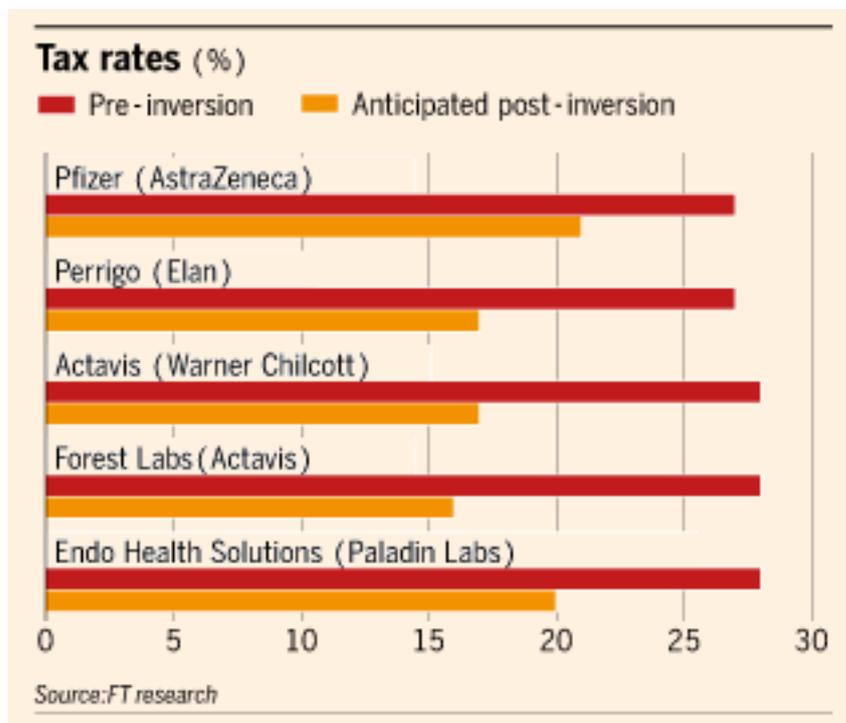
While a lot of attention is focused on the direct use of tax havens by the SPU, one of the more pertinent questions is the extensive use of tax havens and aggressive tax avoidance strategies by the companies that the SPU invests in. Of equal concern are the SPU's large investments in financial institutions and other actors that facilitate the web of offshore financial flows, both legal and illegal.

The most serious misuse of tax havens is not by funds trying to pool and invest money using such jurisdictions as way stations, but by corporations such as Apple, Google, Microsoft, Pfizer and others (that the SPU holds significant stakes in) using aggressive tactics, complex restructurings<sup>60</sup> and

---

<sup>60</sup> The Financial Times (29 April 2014). *"Tax Avoidance" The Irish Inversion*".

mispricing the value attached to intellectual property<sup>61</sup>. As the following graph from the Financial Times shows, these tactics can significantly reduce the tax payable in onshore economies both in the OECD and in the developing world.



This raises three main questions.

The first is whether this is morally acceptable and whether the SPU and Norwegian citizens should benefit from large corporations seeking to minimise the payment of taxes in other economies by bending rules and violating the spirit, if not the letter of the law. This is for Norwegian citizens and their Parliament to decide.

The second is whether the SPU as a financial investor should not be more concerned about the reputational risks associated with such aggressive tax avoidance strategies. Amazon, Starbucks, Google and a host of other companies the SPU owns significant shares in have suffered serious

<sup>61</sup> Hickey, W. (21 May 2013). *“It’s not just Apple: The Ultra-Complicated Tax Measures That Microsoft Uses To Avoid \$2.4 Billion In U.S. Taxes”*.

reputational damage because of such tax avoidance. There is also a second order reputational risk of the SPU and, hence, the Norwegian government being a significant owner of companies that indulge in shady practices, which are socially unacceptable and go against the zeitgeist. The SPU suffered some serious reputational damage and came under fire for its investments in Formula 1 and may face similar reputational risks in the future<sup>62</sup>. The reputational risks can also have financial consequences as loss of reputation can damage the brand value, cause customers to take their business elsewhere and can result in voluntary payments (by Starbucks in the UK) and settlements (by Google in the UK) that have a financial cost.

The third is whether the SPU should be concerned about the financial risks arising from such aggressive tax avoidance. The recent crackdown on corporate inversion by the Obama administration instantly wiped billions off the market value of Pfizer and Allergan, resulting in a planned merger, designed specifically to avoid taxes, getting called off<sup>63</sup>. Other instances, for example, of Glaxo being slapped with back taxes<sup>64</sup>, of firms having to pay huge fines and settle with tax authorities abound and are getting more frequent as the aftermath of the financial crisis turns citizens and governments against such taxes. The general direction of policy is very clear, as highlighted in a previous section in this report. The G-20, the OECD, the UN, the EU and national governments are all closing loopholes that allow aggressive tax avoidance and the patience of tax authorities is wearing thin. This means that corporations where aggressive tax avoidance strategies help inflate profits in the short-term pose a serious risk to investors. Changes to policy and action against particular companies by tax authorities can wipe off billions off the market value of these firms, delivering large losses to investors such as the SPU.

---

<sup>62</sup> Reuters (11 March 2014). *“Norway wealth fund made mistakes when buying F1 stake – CEO”*.

<sup>63</sup> The Financial Express (6 April 2016). *“Obama’s inversion curbs kill Pfizer’s \$160 billion Allergan deal”*

<sup>64</sup> Reuters (22 May 2009). *“Glaxo in potential \$1.9 billion tax battle with IRS”*.

So far, the SPU has no proper strategy to manage these moral, reputational and financial risks posed by the use of tax havens by many of the firms it invests in. It needs to develop such a strategy with great urgency, given the pace of policy change, the scale of risks posed and the zeitgeist turning against the use of tax havens.

We firmly believe that it is in this area that the SPU needs to act most urgently rather than on its direct use of tax havens as a way station. The scale of the problem, risks to the SPU and the negative impact of such use of tax havens is an order of magnitude bigger than with the direct use of such havens. Also, the scope for corrective action by the SPU acting unilaterally is much greater, given the very significant size of its stake in many of these corporations, where it is often the largest or one of the largest investors. This would involve a combination of engagement, issuing clear expectation documents and public divestment from the most egregious offenders.

Last but not least, we come to the SPU's substantial investments in financial institutions that have often been implicated in facilitating the use of tax havens for corruption, tax evasion and money laundering. As discussed earlier, the SPU has significant stakes of between 2% and 5% in banks such as UBS, BNP Paribas, HSBC and Credit Suisse that have already paid tens of billions of dollars of fines. It is likely that others might follow.

An investigation of the Panama Papers has revealed "that major banks are big drivers behind the creation of hard-to-trace companies in the British Virgin Islands, Panama and other offshore havens. The files list nearly 15,600 paper companies that banks set up for clients who want keep their finances under wraps, including thousands created by international giants UBS and HSBC. An ICIJ analysis of the leaked files found that more than 500 banks, their subsidiaries and branches have worked with Mossack Fonseca since the 1970s to help clients manage offshore companies. UBS set up more than

1,100 offshore companies through Mossack Fonseca. HSBC and its affiliates created more than 2,300<sup>65</sup>.”

The SPU owns 2% of HSBC and 3% of UBS, which have been the two banks most active in promoting the use of tax havens by their clients, as exposed by Panama Papers.

Being such a large shareholder in institutions that are deeply implicated in promoting the use of tax havens for both legal and illegal purposes poses substantial financial and reputational risks for the SPU and the Norwegian government. The moral risks of complicity in helping promote behaviour that is at best immoral, and at worst downright illegal and criminal are even greater.

The SPU needs to address these risks with the greatest urgency and find a way of mitigating them. This could involve a mix of aggressively using its influence as a large shareholder to change management behaviour, setting explicit guidelines for reducing the role these institutions play in the offshore system, and use public divestment from the worst offenders.

---

<sup>65</sup> The International Consortium of Investigative Journalists (3 April 2016). *“Giant Leak of Offshore Financial Records Exposes Global Array of Crime and Corruption”*.

## ***Conclusion***

In this report we have estimated that the SPU has a 7% - 10% direct exposure to tax havens through:

- 1) the use of an offshore subsidiary,
- 2) the use of external fund managers who invest through tax havens and
- 3) through direct investments in tax havens.

In addition to this, given the SPU's large exposure to the financial, technology, pharmaceutical and extractive sectors, as much as 10% of the SPU may be indirectly exposed to the operations that the companies the SPU owns engage in through an extensive and aggressive use of tax havens.

This total exposure of up to 20%, while substantial, is not unusual amongst the Fund's peer group. In fact, other sovereign wealth funds (SWFs) may have exposures that are significantly higher. This is because most have a higher share of external manager run investments, invest more in emerging and developing economies and allocate larger shares to illiquid assets such as infrastructure and private equity, all of which are more likely to be channelled through tax havens.

Given the present state of the global financial, legal and institutional infrastructure, using offshore financial centres merely as way stations to pool and channel investments in a cost effective manner can be seen to be ethically and morally acceptable, as well as financially prudent in at least a few cases. Also, there is a limit to what the SPU can unilaterally do to change the way the global financial system works.

As discussed in the previous section, the most pernicious aspect of the use of these tax havens the SPU is involved in is not so much their direct use as way stations, but the following:

- 1) the direct investments in companies registered in such havens,
- 2) the large investments the SPU has in companies that aggressively use tax havens and
- 3) the SPU's significant share in financial institutions that facilitate the aggressive use of tax havens by individuals and firms.

It is these activities that generate the most harm in terms of lost tax revenues, enabling of capital flight, facilitation of corruption and smoothing the flow of laundered money. Coincidentally, this is also where the SPU can have the most influence while acting unilaterally.

## ***Policy recommendations***

- The SPU should disclose the full extent of its direct use of tax havens via the three channels it uses (as highlighted in this report), namely:
  - 1) any use of the NBIM's own subsidiaries located in a tax haven,
  - 2) those external funds that channel the SPU's money through legal vehicles domiciled in tax havens,
  - 3) the SPU's direct investments in companies registered in a tax haven.
- The SPU should quantify the financial advantage, if any, of channelling its real estate investments through Luxembourg and report on what alternative arrangements could be, and how much they might cost. The decision on whether to discontinue the use of this subsidiary should be left to the parliament in 2017. Our recommendation is that, if the cost of alternatives is substantial, the SPU should be allowed to continue to use tax haven subsidiaries.
- The SPU should report on how much of its funds managed through external managers are actually invested through legal structures incorporated in tax havens. It should also report on whether it might be possible to make those same investments without using tax havens. If this were possible, then what the additional cost, if any, would be. Once again, the decision on whether to continue to allow this practice or to disallow it altogether should be left to the Parliament in 2017. Given our deep knowledge of the fund management landscape, our recommendation would be to allow the SPU to continue to have the flexibility to use external managers that channel funds through offshore financial centres.
- The SPU should quantify and give a detailed breakdown of its direct investments in companies registered in tax havens. It is hard for us to see a justification for the continuation of such investments and our

recommendation to the Norwegian finance ministry and the Parliament would be to forbid such investments. If the SPU feels that this will have serious financial consequences, it must explain these clearly in a report to the Parliament. The Parliament should have the final say.

- The SPU should develop a clear policy towards the aggressive use of tax havens by the companies it invests in. We suggest that this should include the following:

- 1) an expectation document that highlights the SPU's expectation that companies follow not just the letter, but also the spirit of tax laws; that they do not engage in unethical or aggressive tax practices, do not use tax havens unless strictly justifiable; that they follow full disclosure and country-by-country reporting and also do a risk analysis that takes into account changes in tax policy, reputational risk and the risk of fines and financial losses,

- 2) a policy of active engagement with the worst offenders, with the SPU putting substantial governance resources into this and prioritising the discouragement of the use of tax havens. It should also actively mobilise other large institutional investors on this issue.

- 3) a policy of disinvestment from the worst offenders,

- 4) a regular report of the use of tax havens by the companies it invests in and the reputational and financial risks this pose for the SPU,

- 5) a regular report that also lists corrective actions undertaken by the SPU to minimise the ethical, reputational and financial risks posed by the use of tax havens by companies it invests in. It can take the form of an annual "Actions taken to minimise the role of tax havens" report,

- 6) The SPU should have additional disclosures and policies particularly for the IT, pharmaceutical and extractive sectors, which are the heaviest users of tax havens.

- The SPU needs to urgently put in place a clear and strong policy on the use of tax havens in the financial sector. In particular, a number of the banks the SPU has substantial investments of as much as to 5% in, have been deeply implicated in the active promotion of tax havens for both legal and illegal purposes. This means the SPU is morally complicit and faces serious reputational and financial risks from these exposures.
- It needs to actively engage with these financial institutions as a priority, and use the substantial influence that its role as one of the largest shareholders offers to issue a cease and desist policy on the promotion of tax havens, aggressive tax avoidance and tax evasion by these institutions.
- It should actively invest resources to mobilise other large shareholders on this issue to force change globally.
- If the direction and pace of change does not conform with the SPU's expectations, then the SPU should divest from companies that fail to meet certain standards.
- The SPU should have a proper policy to report on and mitigate the financial and reputational risks posed by its investments in the financial sector.

## List of References

Action Aid. (2013). “*Policy Brief on Double Taxation Agreements*”. Available at:

[http://actionaid.org/sites/files/actionaid/policy\\_brief\\_on\\_double\\_taxation\\_agreements.pdf](http://actionaid.org/sites/files/actionaid/policy_brief_on_double_taxation_agreements.pdf)

Alm, J. & Martinez-Vazquez, J (29 Nov 2005). “*The Challenges of Tax Reform in a Global Economy*”.

Asia Asset Management (20 April 2016). “*NZ Super sells three offshore PE funds*”. Available at:

[http://www.asiaasset.com/news/NZ\\_Super\\_CH1904\\_FS\\_DM.aspx](http://www.asiaasset.com/news/NZ_Super_CH1904_FS_DM.aspx)

BBC News. (1 July 2014). “*BNP Paribas to pay \$9bn to settle sanctions violations*”. Available at: <http://www.bbc.co.uk/news/business-28099694>

Connett, D. (29 January 2016). “*Barney Jones: Meet the whistleblower who helped expose Google's tax avoidance*”. The Independent. Available at:

<http://www.independent.co.uk/news/business/barney-jones-meet-the-whistleblower-who-helped-expose-googles-tax-avoidance-a6842586.html>

Drucker, J. (27 January 2016). “*The World's Favorite New Tax Haven Is the United States*”. Bloomberg. Available at:

<http://www.bloomberg.com/news/articles/2016-01-27/the-world-s-favorite-new-tax-haven-is-the-united-states>

Economia (20 April 2016). “*IMF, OECD, UN and World Bank join forces to tackle tax evasion*”. Available at: <http://economia.icaew.com/news/april-2016/imf-oecd-un-and-world-bank-join-forces-to-tackle-tax-evasion>

EUBusiness (18 June 2015). “*EU releases world tax havens blacklist*”.

Available at: <http://www.eubusiness.com/news-eu/economy-politics.120n>

European Commission (12 April 2016). “*European Commission proposes public tax transparency rules for multinationals*”. Available at:

[http://europa.eu/rapid/press-release\\_IP-16-1349\\_en.htm](http://europa.eu/rapid/press-release_IP-16-1349_en.htm)

Eubusiness (18 June 2015). “*EU releases world tax havens blacklist*”.

Available at: <http://www.eubusiness.com/news-eu/economy-politics.120n>

Giles, C. & Houlder, V. (15 April 2016). “*G20 threatens tax havens over standards*”. The Financial Times. Available at:

<https://next.ft.com/content/39e2eeb4-030a-11e6-af1d-c47326021344>

Hall & Wilcox (22 April 2016). “*Australia and Germany sign new Double Tax Agreement*”. Lexology. Available at:

<http://www.lexology.com/library/detail.aspx?g=0ed43ecf-87cd-4d52-91dd-6097b52dce78>

Holter, M. (11 April 2016). "Norway's Wealth Fund Faces Demonstration Over Tax Havens". Available at: <http://www.bloomberg.com/news/articles/2016-04-11/norway-wealth-fund-faces-demonstration-over-tax-haven-holdings>

Holzer, J. (22 May 2013). "From Google to FedEx: The Incredible Vanishing Subsidiary". The Wall Street Journal. Available at: <http://www.wsj.com/news/articles/SB10001424127887323463704578497290099032374>

Houlder, V. (7 April 2016). "Tax havens are cog in global economy, say defenders". The Financial Times. Available at: <https://next.ft.com/content/7fe30aa0-fcd6-11e5-b3f6-11d5706b613b>

Hickey, W. (21 May 2013). "It's not just Apple: The Ultra-Complicated Tax Measures That Microsoft Uses To Avoid \$2.4 Billion In U.S. Taxes". Business Insider. Available at: <http://www.businessinsider.com/apple-microsoft-avoids-taxes-loopholes-irs-2013-1?IR=T>

Investopedia. "Sweetheart Deal". Available at: <http://www.investopedia.com/terms/s/sweetheartdeal.asp#ixzz46waZyUVO>

Kapoor, S. (2013). "Investing for the future." Available at: [http://www.redefine.org/sites/default/files/images/SWF-Report\\_Final.pdf](http://www.redefine.org/sites/default/files/images/SWF-Report_Final.pdf)

Kikuchi, T. (29 October 2014). "Ho Ching upbeat as Temasek's portfolio expands offshore". Available at: <http://asia.nikkei.com/Business/Asean-Business-File/Ho-Ching-upbeat-as-Temasek-s-portfolio-expands-offshore>

KPMG (5 January 2016). "Norway: Country-by-country reporting proposal, public consultation". Available at: <https://home.kpmg.com/xx/en/home/insights/2016/01/tnf-norway-country-by-country-reporting-proposal-public-consultation.html>

McLaren, J. & Passant, J. (2010). "Tax havens: do they have a future providing banking and financial services?". Canberra Law Review, 1 1-23. Available at: <http://ro.uow.edu.au/cgi/viewcontent.cgi?article=1053&context=buspapers>

MNE Tax (20 April 2016). "Bermuda signs agreement for exchange of country-by-country tax reports". Available at: <http://mnetax.com/bermuda-signs-agreement-exchange-country-country-tax-reports-multinationals-14687>

NBIM (2016a). “*Government Pension Fund Global: The Fund*”. Available at: <http://www.nbim.no/en/the-fund/>

NBIM (2016b). “*Holdings*”. Available at: <http://www.nbim.no/en/the-fund/holdings/>

NBIM (2016c). “*External Managers*”. Available at: <http://www.nbim.no/en/investments/external-mandates/external-managers/>

NBIM (2016d). “*Investments*”. Available at: <http://www.nbim.no/en/investments/>

NBIM (2016e). “*NBIM S.Å. R. L*”. Available at: <http://www.nbim.no/en/investments/real-estate-management/nbim-sarl/>

OECD. “*About Base Erosion and Profit Shifting (BEPS)*”. Available at: <http://www.oecd.org/ctp/beps-about.htm>

OECD (1998). “*Harmful Tax Competition: An Emerging Global Issue*”. Available at: <http://www.oecd.org/tax/transparency/44430243.pdf>

OECD (October 2015). “*OECD Secretary-general Report to G20 Finance Ministers*”. Available at: <https://www.oecd.org/g20/topics/taxation/oecd-secretary-general-tax-report-g20-finance-ministers-october-2015.pdf>

OECD (October 2015). “*Transfer Pricing Documentation and Country-by-Country Reporting, Action 13: Final Report*”. Available at: <https://www.oecd.org/ctp/transfer-pricing-documentation-and-country-by-country-reporting-action-13-2015-final-report-9789264241480-en.htm>

Oxfam America (14 April 2016). *Broken at the Top*. Available at: [http://www.oxfamamerica.org/static/media/files/Broken\\_at\\_the\\_Top\\_FINAL\\_E\\_MBARGOED\\_4.12.2016.pdf](http://www.oxfamamerica.org/static/media/files/Broken_at_the_Top_FINAL_E_MBARGOED_4.12.2016.pdf)

Presaud, A. D. (2010). “*An economic defense of offshore financial centres - or how to lose your liberal friends in 800 words*”. VoxEU. Available at: <http://voxeu.org/debates/commentaries/economic-defense-offshore-financial-centres-or-how-lose-your-liberal-friends-800-words>

Publish What You Pay. (30 September 2015). “*Strengthening country-by-country reporting regulations in Norway. What next?*”. Available at: <http://www.publishwhatyoupay.org/strengthening-country-by-country-reporting-regulations-in-norway-what-next/>

Reuters (22 May 2009). “*Glaxo in potential \$1.9 billion tax battle with IRS*”. Available at: <http://www.reuters.com/article/us-glaxo-irs-idUSTRE54L1P520090522>

Reuters (11 March 2014). “*Norway wealth fund made mistakes when buying F1 stake – CEO*”. Available at: <http://www.reuters.com/article/us-norwaywealthfund-formula-idUSBREA2A0HG20140311>

Rowlands, L. (19 April 2016). “*Developing countries left out of global tax decisions*”. Inter Press Service. Available at: <http://www.ipsnews.net/2016/04/developing-countries-left-out-of-global-tax-decisions/>

Satariano, A. (15 January 2016). “*Apple May Be on Hook for \$8 Billion in Taxes in Europe Probe*”. Bloomberg. Available at: <http://www.bloomberg.com/news/articles/2016-01-15/apple-may-be-on-hook-for-8-billion-in-taxes-after-europe-probe>

Sirota, D. (22 August 2014). “*Microsoft Admits Keeping \$92 Billion Offshore to Avoid Paying \$29 Billion in U.S. Taxes*”. International Business Times. Available at: <http://www.ibtimes.com/microsoft-admits-keeping-92-billion-offshore-avoid-paying-29-billion-us-taxes-1665938>

Smyth, J & Parker, G. (16 November 2016). “*G20 leaders back drive to unmask shell companies*”. The Financial Times. Available at: <https://next.ft.com/content/25ae632e-6d60-11e4-8f96-00144feabdc0>

*Tax Attractiveness Index (2016)*. Available at: <http://www.taxindex.de/>

Tax Justice Network Norge. (13 January 2014). “*Land-for-land har landet*”. Available at: <http://taxjustice.no/ressurser/land-for-land-har-landet>

Tax Justice Network (2015). “*Narrative Report on United Kingdom*”. Available at: <http://www.financialsecrecyindex.com/PDF/UnitedKingdom.pdf>

Temasek (5 July 2012). “*Temasek portfolio at a resilient S\$ 198 billion*”. Available at: <http://www.temasek.com.sg/mediacentre/newsreleases?detailid=17723>

The Australian. (2016). “*Super wealth funds please to OECD for tax rule exemption*.” Available at: <http://www.theaustralian.com.au/business/wealth/super-wealth-funds-plead-to-oecd-for-tax-rule-exemption/news-story/082b56f7791e10d3257ddcc8eda6aa1c>

The Australians. (2016). “*Industry super funds pouring into Cayman Islands*.” Available from: <http://www.theaustralian.com.au/national-affairs/industrial-relations/industry-super-funds-pouring-into-cayman-islands/news-story/790efe7948bc5aa0484377bbc2282b12>

The Task Force on the Development Impact of Illicit Financial Flows (2008). *"Final Report"*. Available at:  
[http://www.leadinggroup.org/IMG/pdf\\_Final\\_report\\_Task\\_Force\\_EN.pdf](http://www.leadinggroup.org/IMG/pdf_Final_report_Task_Force_EN.pdf)

The Economist (16 February 2013). *"The missing \$20 trillion"*. Available at:  
<http://www.economist.com/news/leaders/21571873-how-stop-companies-and-people-dodging-tax-delaware-well-grand-cayman-missing-20>

The Economist (16 February 2013). *Enduring charms: a brief history of tax havens*". Available at: <http://www.economist.com/news/special-report/21571550-brief-history-tax-havens-enduring-charms>

The Economist (20 February 2016). *"The biggest loophole of all"*. Available at:  
<http://www.economist.com/news/international/21693219-having-launched-and-led-battle-against-offshore-tax-evasion-america-now-part>

The Financial Express (6 April 2016). *"Obama's inversion curbs kill Pfizer's \$160 billion Allergan deal"*. Available at:  
<http://www.financialexpress.com/article/industry/companies/obamas-inversion-curbs-kill-pfizers-160-billion-allergan-deal/233130/>

The Financial Times (29 April 2014). *"Tax Avoidance" The Irish Inversion*". Available at: <https://next.ft.com/content/d9b4fd34-ca3f-11e3-8a31-00144feabdc0#axzz46pwTqCwp>

The International Consortium of Investigative Journalists. *"Luxembourg Leaks: Global companies' secrets exposed"*. Available at:  
<https://www.icij.org/project/luxembourg-leaks>

The International Consortium of Investigative Journalists. *"Swiss Leaks: Murky Cash Sheltered by Bank Secrecy"*. Available at:  
<https://www.icij.org/project/swiss-leaks>

The International Consortium of Investigative Journalists (3 April 2016). *"Giant Leak of Offshore Financial Records Exposes Global Array of Crime and Corruption"*. Available at: <https://panamapapers.icij.org/20160403-panama-papers-global-overview.html>

Theiss, W. (31 March 2016). *"Thirty-one countries sign automatic information sharing agreement for country-by-country reporting"*. Lexology. Available at:  
<http://www.lexology.com/library/detail.aspx?g=df3ccd3b-3d81-46cd-b492-3f992dafd9e0>

Thomson Reuters (2015). *"Banking misconduct bill"*. Reuters Graphics. Available at:  
[http://graphics.thomsonreuters.com/15/bankfines/index.html?utm\\_source=twitter](http://graphics.thomsonreuters.com/15/bankfines/index.html?utm_source=twitter)

United Nations (2015). *“United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries”*. Available at: <http://www.un.org/esa/ffd/wp-content/uploads/2015/07/handbook-tb.pdf>

UN News Centre. (30 March 2016). *“UN calls for political will to overcome inequality hindering sustainable development for all”*. <http://www.un.org/apps/news/story.asp?NewsID=53576#.VyC-7pMrLUo>

US Department of the Treasury (2016). *“Foreign Account Tax Compliance Act”*. Available at: <https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx>

Yalburgi, V. (16 January 2016). *“Apple accused of \$8bn tax evasion in European Commission probe”*. Available at: <http://www.ibtimes.co.uk/apple-accused-8bn-tax-evasion-european-commission-probe-1538299>

Zucman, G. (2013). *“Taxing across Borders: Tracking Personal Wealth and Corporate Profits”*. *Journal of Economic Perspectives*, Vol 28: 4, pp. 121–148. Available at: <http://gabriel-zucman.eu/files/Zucman2014JEP.pdf>