



Tax Haven and Development Partner

Incoherence in Dutch Government Policies?

June 2007

Francis Weyzig & Michiel van Dijk

The Netherlands can be considered as a tax haven for multinational corporations, because it deliberately enables these companies to reduce their tax payments in other countries. As a result, the Netherlands hosts over 10,000 subsidiaries of foreign multinationals, so called Special Financial Institutions, that are used for international tax planning constructions. Together, they control over € 1,000 billion of assets or 13% of global inward FDI stock. This includes € 90 billion in developing countries.

Apart from being a tax haven for multinationals, the Netherlands is also a donor country for international development. As such, it is committed to develop an international financial system that is supportive of poverty reduction. In 2006, the Dutch government provided € 4.3 billion in Official Development Assistance. This report estimates that as a consequence of the tax haven features of the Netherlands, developing countries are missing between € 100 million to € 1 billion in tax revenues each year. One rough estimate yields a figure of € 640 million per year, which is equal to 15% of the Dutch official aid budget.

This raises the question of whether Dutch tax policy is coherent with Dutch policy on development cooperation. It would be in the interest of developing countries to minimise harmful tax planning opportunities. The report presents recommendations to the Dutch government to combat tax havens, end harmful group financing regimes, support tax authorities abroad, and increase disclosure requirements for multinationals.

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Policies?**

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Amsterdam, June 2007

Colophon

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By:
Francis Weyzig & Michiel van Dijk

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SOMO
Sarphatistraat 30
1018 GL Amsterdam
The Netherlands
Phone: + 31 (0)20 6391291
Fax: +31 (0)20 6391321
E-mail: info@somo.nl
Website: www.somo.nl

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Note that those who provided feedback do not necessarily agree with the entire contents of the report. Full responsibility for the report rests with the authors.

¹ See <http://www.taxjustice.nl> for more information on the launch and the network.

1. Introduction

It has increasingly become clear that tax havens have become a global problem, in particular undermining the interests of developing countries. In 2001, Oxfam estimated that developing countries miss out on US\$ 50 billion in tax revenue each year as a consequence of tax evasion and tax avoidance strategies by multinational companies using tax havens in different parts of the world.² The Tax Justice Network (TJN), which is committed to socially just, democratic and progressive tax systems, estimated that worldwide tax revenue lost on the income from assets held by individuals in various tax havens amounts to US\$ 255 billion annually.³ According to most estimates, this amount would be enough to finance the costs of achieving the United Nation's Millennium Development Goals (MDGs) of halving world poverty by 2015.⁴

In November 2006, SOMO published the report: "The Netherlands: A tax haven?" (hereafter "the SOMO report"). The report showed that the Netherlands plays a key role in international tax planning and has done so for more than 30 years.⁵ The report presents empirical evidence on the number of mailbox companies and other vehicles that avoid taxation and on associated financial flows. It also presents an overview of common tax planning structures in which these entities play a prominent role. The report concluded that the Netherlands deliberately and willingly offers companies that would otherwise not be resident within its territory the means to avoid tax in other countries. This in itself does not make a country a tax haven according to OECD criteria.⁶ It should also be emphasised that the Dutch tax regime is very different from - for example - Caribbean tax havens, which offer secrecy and impose low or zero taxes on any type of income. However, the Netherlands would classify as a tax haven for specific activities of multinational corporations, according to the broader definition used by the Tax Justice Network.

The SOMO report also pointed out that, as a consequence of the Dutch tax regime, developing countries are failing to collect important tax revenues which otherwise could have been used to finance health care, education and other essential public goods and services, assuming that these would be government priorities. However due to a lack of data, it was not possible at the time to quantify the negative effects for developing countries. This study follows up on this issue by presenting data of the Dutch Central Bank

² Oxfam, *Tax havens: Releasing the hidden billions for poverty eradication*, 2000.

³ Murphy R, Christensen J, Kimmis K, "Tax Us If You Can", (London: The Tax Justice Network, 2005), p. 13, <http://www.taxjustice.net/cms/upload/pdf/tuiyc_-_eng_-_web_file.pdf> .

⁴ See e.g. S. Devarajan, M. Miller, and E.V. Swanson (2002). "Goals for Development: History, Prospects, and Costs." World Bank Policy Research Working Paper No. 2819; UN Millennium Project (2005). "Investing in Development: A Practical Plan to Achieve the Millennium Development Goals. Overview."

⁵ M. van Dijk, F. Weyzig and R. Murphy, "The Netherlands: A tax Haven?", SOMO, November 2006, <http://www.somo.nl/html/paginas/pdf/netherlands_tax_haven_2006_NL.pdf> (May 2007).

⁶ OECD, "Harmful Tax Competition – an Emerging Global Issue" (Paris: OECD, 1998).

(DNB) on the financial relationships between Dutch tax planning entities and developing countries.

On the basis of this data, it is roughly estimated that as a consequence of the tax haven features of the Netherlands, developing countries are missing € 640 million in tax revenues each year. A precise estimate is not possible, but even if very different assumptions are made about the interpretation of the data and the behaviour of multinational corporations, missed tax revenues must lie somewhere in the range of € 100 million to € 1 billion per year. To put this into perspective, in 2006 the Official Development Assistance (ODA) budget of the Dutch government was € 4.3 billion. This raises the question of whether Dutch tax policy is coherent with Dutch policy on development cooperation.

The structure of this study is as follows. In Section 2 we recap the arguments as to why the Netherlands can be considered a tax haven according to the TJN definition. It briefly summarizes the findings of the previous SOMO report, with new figures on tax planning vehicles and financial flows and an updated overview of harmful tax planning structures. The general costs and benefits of the Netherlands being a tax haven are briefly reviewed. In Section 3 we explore the consequences of tax avoidance via the Netherlands, specifically for developing countries. It discusses both positive and negative effects and provides an overview of past research on this subject, commissioned by the Ministry of Foreign Affairs. Finally, it estimates the tax revenues foregone in developing regions as a consequence of tax avoidance constructions involving Dutch entities. The report ends with conclusions and recommendations.

The aim of this report is to contribute to a more coherent government policy on tax and international development. The recommendations therefore seek to promote a fair and just global economic system in which tax avoidance by multinational corporations is minimised.

2. The Netherlands: a tax haven for multinationals

2.1. Why the Netherlands can be considered as a tax haven

Whether the Netherlands can be considered a tax haven strongly depends on the definition used. We define a tax haven as:

*“any country or territory whose laws may be used to avoid or evade taxes which may be due in another country under that other country’s laws”.*⁷

The Netherlands is definitely not a ‘pure’ tax haven, such as the Cayman islands, the British Virgin Islands or Bermuda, that are characterised by very low levels of corporate tax and a veil of secrecy. Instead, it is a country that exhibits a harmful preferential tax regime by serving as an intermediary or ‘conduit’ country in tax planning structures. It deliberately allows and facilitates multinationals to channel Foreign Direct Investment (FDI) and income flows, via entities in the Netherlands, between a company in one country and subsidiaries or affiliates in other countries, as such considerably reducing their overall tax burden.

These arrangements are harmful because as a result of certain conduit arrangements companies avoid paying taxes elsewhere (see section 2.4). Moreover, by acting as conduit country, the Netherlands plays an important role in routing financial flows to pure tax havens, where many of the licensing and financing subsidiaries and parent companies are located, and no tax is paid. Often the ultimate parent companies of these tax haven entities cannot be easily identified, because of a lack of transparency. Investment statistics, which are discussed in more detail in section 3.7, also suggest that billions of dollars of income channelled to Caribbean tax havens have been reinvested via the Netherlands in other countries. The preferential harmful tax regime of the Netherlands is not a recent phenomenon, but has been in place for at least 30 years.

In response to the SOMO report, some have rejected the idea that the Netherlands is a tax haven. The position of the Dutch Order of Tax advisors (NOB), for example, is that the Netherlands is not a tax haven.⁸ In a previous statement, though, the director of the NOB emphasised the positive aspects of a favourable fiscal regime for multinationals and questioned the negative effects, but not the tax haven qualification itself.⁹ Others have

⁷ Murphy R, Christensen J, Kimmis K, “Tax Us If You Can”, (London: The Tax Justice Network, 2005), p. 67, <http://www.taxjustice.net/cms/upload/pdf/tuyc_-_eng_-_web_file.pdf> .

⁸ I. Damsté, Director NOB, *Jaarrede* [Annual speech] 2007, NOB Annual congress, 7 Jun 2007 in Zeist, <<http://www.nob.net/?q=node/9543>> (Jun 2007).

⁹ I. Damsté, “*Belastingparadijs, nou en? [Tax haven, so what?]*” Reactions of readers, *Het Financieel Dagblad*, 15 Nov 2006, p. 11.

supported our conclusion. In editorial comments in *Vakstudienieuws*, a journal for fiscal specialists, it was confirmed twice that the Netherlands can certainly be considered a tax haven for multinationals. The editorial comments pointed out that Dutch tax policy appears to be inconsistent, because it enables multinationals to avoid taxes abroad, while at the same time it aims to prevent tax avoidance in the Netherlands through tax planning constructions of the same type.¹⁰

The attractiveness of the Netherlands results from several factors:

1. the 'participation exemption', an arrangement which exempts dividends and capital gains from subsidiary companies abroad from corporate income tax in the Netherlands;
2. the large Double Taxation Treaty (DTT) network that substantially reduces withholding taxes on dividend, interest and royalty payments between treaty countries and the Netherlands;
3. the Dutch tax authority grants rulings that gives certainty to multinationals about how the income of their Dutch subsidiaries will be taxed;
4. the special regime for group financing companies which offer very low tax rates on interest received from loans to subsidiaries, while interest payments can be deducted at the normal tax rate abroad of 30% or more;¹¹
5. zero withholding taxes on outgoing interest or royalties;
6. general factors, such as legal security and political and economic stability.

It is the unique combination of these factors that makes Netherlands subsidiaries so useful in tax avoidance constructions. A few other countries have even broader DTT networks, for example, but do not exempt foreign dividend income or do not apply zero withholding taxes on outgoing interest and royalty payments.

2.2. Mailbox companies and SFIs

As a result of facilitating conduit arrangements the Netherlands has attracted a high number of what we have termed 'mailbox' companies. These are companies which have no substantial commercial presence – according to information from the Chambers of Commerce, they mostly employ either zero or one person – and merely perform an administrative function with the overall aim of reducing the tax burden of the multinational that owns it. Trust offices incorporate legal entities on behalf of their clients, mostly multinationals, and provide them with an address, management and administration. These are essential requirements to give the company 'substance', in other words a real presence, in the Netherlands, which are needed in order to be able to exploit certain features of the Dutch tax regime. Consequently, most mailbox companies are located at the same address as the trust office.

Tax planning appears to be the main purpose of Dutch mailbox companies, but not the only one. Other purposes include enhancing legal security, such as foreign investment

¹⁰ *Vakstudienieuws*, Issue 2, 11 Jan 2007, p. 12-3; *Vakstudienieuws*, Issue 11, 1 Mar 2007, p. 32-5.

¹¹ See also note 35 below.

protection under Dutch Bilateral Investment Treaties (BITs). The WTT requires trust offices to identify the ultimate beneficiaries of all companies they administer, and to show on which grounds clients are accepted or refused. According to the Ministry of Finance, this makes the Netherlands a leading country in terms of transparency and makes Dutch mailbox companies unattractive vehicles for illegal transactions such as money laundering.¹²

We estimate that, at present, there are about 20,000 of these companies, and their number is growing over time. We also found that between 27% and 46%, depending on the type of entity, of the mailbox companies has a parent company that is located in a tax haven, mainly the Netherlands Antilles.

Apart from mailbox companies, the Netherlands also hosts a large number of other entities that are used for tax planning purposes but are not managed by a trust office. Most of these are part of very large multinationals that, given the scale and complexity of the transactions, probably do not prefer to contract out their financial management. The size and scope of these entities vary from small units which employ only a handful of administrative staff, to departments of large regional or financial head offices of multinational corporations (MNCs) in the Netherlands.

Under Dutch corporate law, as in most OECD countries, there is no special legal form to distinguish mailbox companies or other tax planning vehicles from genuine types of business entities. This is different from pure tax havens. However, the Dutch Central Bank (DNB) maintains a special register for what it refers to as Special Financial Institutions (SFIs) or, in Dutch, Bijzondere Financiële Instellingen (BFIs). SFIs are defined as:

“Netherlands-based companies or institutions whose shares are held directly or indirectly by non-residents, which specialise in raising funds outside the Netherlands and on-lending or investing them outside the Netherlands. The funds raised by these institutions are onlent or invested almost entirely within the group of which they form part. These institutions are based in the Netherlands partly for fiscal reasons, enjoying tax advantages either in the Netherlands, or in the country where the parent company is established.”¹³

Following the definition, the register of SFIs includes both mailbox companies and other tax planning vehicles. According to DNB about 75% of SFIs are represented by trust offices.¹⁴

In conformance with their purpose, DNB identifies three types of SFIs:¹⁵

- Financing companies: companies whose purpose is to take up and on-lend funds from the parent company or from a financing affiliate in a tax haven, possibly supplemented with funds obtained in the international capital market through the

¹² Ministry of Finance, comments on draft report in meeting with SOMO, 11 Jun 2007, The Hague.

¹³ “Recent developments at special financial institutions,” DNB Statistical Bulletin, 2003, p. 21.

¹⁴ Quarterly Bulletin DNB, March 2007.

¹⁵ “Direct Investment Technical Expert Group: Background paper on Special Purpose Entities,” Background Paper Issues #9 and 11, Prepared by Balance of Payments and Financial Accounts Department, De Nederlandsche Bank, May 2004.

issuance of stocks and bonds, to subsidiaries outside the Netherlands that belong to the same group of companies. Financing companies can therefore be regarded as the internal 'bank' of a multinational enterprise.

- (Sub-) Holding companies: companies that manage the participations outside the Netherlands, distribute dividend gained from the participations to the parent company and perform acquisitions on behalf of the parent company. Some examples of holding companies in the Netherlands are: Mittal Steel, EADS, ENI, Trafigura, Premier Oil, BHP Billiton and Pirelli. It is very likely that most of these companies also perform financing activities;¹⁶
- Royalty and film right companies: companies that exploit the licences, patents and film rights for their parent companies and shareholders. Well known examples of this type of entities are the company that manages the royalties of U2 and the Rolling Stones.¹⁷

Apart from the three main types, SFIs may also perform any combination of the activities mentioned above. There is no public data on transactions associated with each type of SFI but DNB states that "considering the magnitude of their cross-border transactions, the financing companies are the largest type of SFIs, followed by holding companies".¹⁸ Royalty and film right companies constitute only a limited number of SFIs with a small share in the total volume of transactions.

Figure 1 depicts the number of SFIs for the period 1977-2006. It clearly shows the steady increase of SFIs until the beginning of this century, with a peak in 2002 of 12,500 SFIs. This last figure should be regarded as an overestimation. Due to high turnover rate of SFIs it is very difficult to keep the register up to date. SFIs are required to register with DNB but often fail to cancel their enlisting in case of liquidation or international displacement. As the register is only updated every few years this may result in an overestimation. At present DNB estimates that there are over 10,000 SFIs based on the benchmark of 2004.¹⁹

Apparently a considerable part of mailbox companies falls outside the DNB definition of SFIs, because the estimated number of mailbox companies is about twice as high as DNB estimates. The reasons for this large difference are not completely clear. Possible explanations are that DNB uses a strict definition of SFIs, which excludes certain types of mailbox companies, for instance, mailbox companies which are part of a Dutch group structure or are which serve for other purposes than onlending activities. Further, our estimation of 20,000 mailbox companies probably also includes a number of inactive entities that are not part of the DNB SFI register.

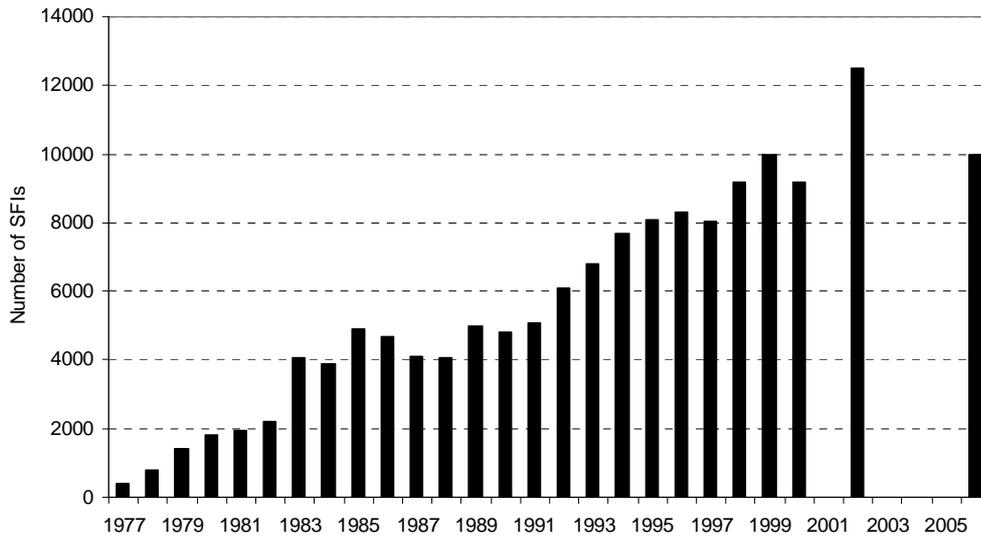
¹⁶ The examples mentioned are based on research by SOMO. They do not represent data of DNB and it is therefore unknown whether these companies are included in the DNB SFI register.

¹⁷ See note 16

¹⁸ "Direct Investment Technical Expert Group: Background paper on Special Purpose Entities," Background Paper Issues #9 and 11, Prepared by Balance of Payments and Financial Accounts Department, DNB, May 2004, p. 4.

¹⁹ E-mail correspondence with DNB 26-04-07.

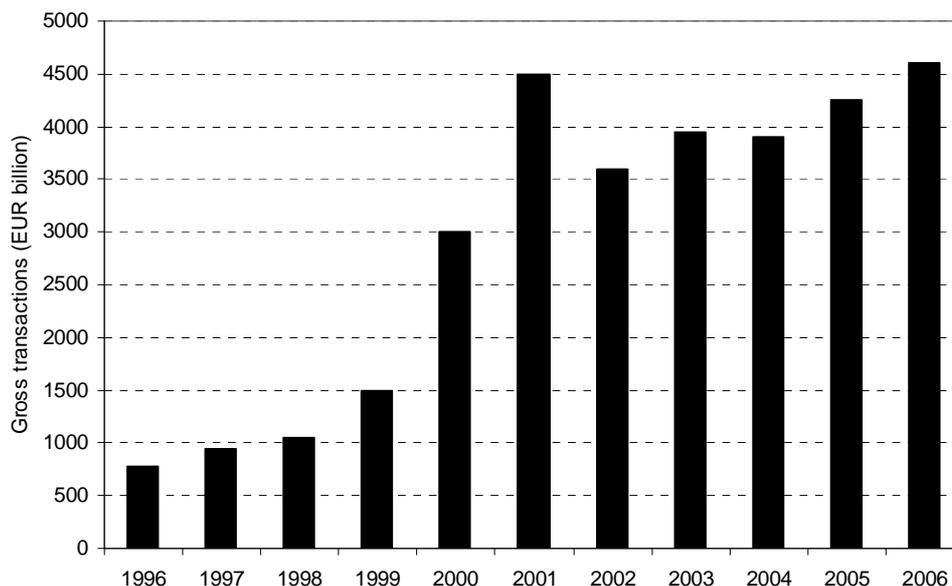
Figure 1: Number of and SFIs, 1977-2006.



Source: DNB Statistical Bulletin, March 2000 and June 2003, and Quarterly Bulletin DNB, March 2007.

Note: The figures presented are based on charts and therefore not exact. There is no data available for 2001 and 2003-2005.

Figure 2 shows the gross transactions involving SFIs between 1996 and 2006. Gross transactions are defined as the sum of total in and outflows and are predominantly made up of payments for dividends, capital endowments, interest and royalties, in line with the SFI classification mentioned above. The figure reveals that the value of gross transactions has increased from EUR 782 billion in 1996 to a staggering EUR 4,600 billion in 2006 – almost nine times Dutch GDP. Although data before and after 2003 is not directly comparable due to a revision of the balance of payments system, the figure suggests substantial and increasing SFI activity over the last ten years.

Figure 2: Gross transactions of SFIs, 1996-2006.

Source: DNB Statistical Bulletin, June 2003, p. 21 and Quarterly Bulletin DNB, March 2007, p. 62.
 Note: The figures presented are based on charts and are therefore not exact. Due to a revision of the balance of payments system the figures before and after 2003 are not directly comparable. In the accounts presented in the annexes, many of the gross transactions in this figure cancel out.

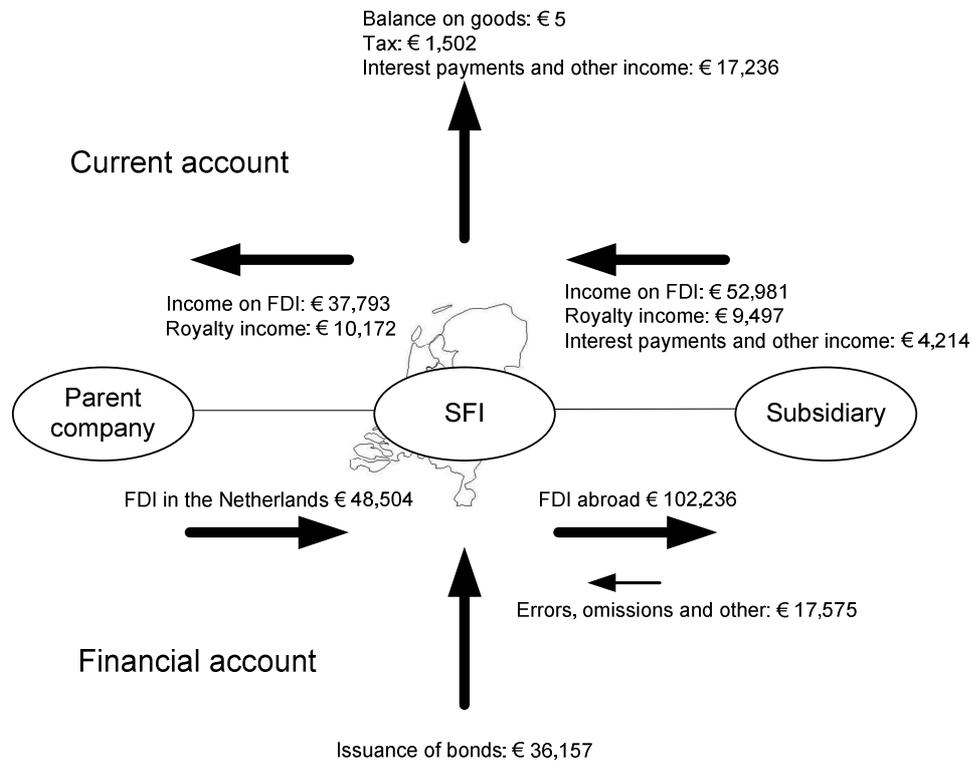
To avoid taxation, multinationals own and finance their subsidiaries through SFIs incorporated in the Netherlands. Figure 3 shows a stylised picture of the financial flows which are annually channelled through Dutch SFIs. The data is computed by taking the difference of balance of payments data including and excluding SFIs (see Annex A). The upper part of the figure shows current account data, which reflects all financial transactions associated with existing FDI, mainly interest on bonds and intra-group royalty, interest and dividend payments. The bottom part of the figure shows information from the financial account, which gives an overview of new investment activities.

It is shown that foreign direct investment (FDI) – the sum of equity capital (shares in subsidiaries), reinvested earnings and inter-company debt transactions – amounted to € 102.2 billion in subsidiaries abroad in 2006.²⁰ In order to finance this, SFIs received € 48,504 million in FDI from parent companies and raised € 36,157 million on the international capital market, mainly by issuing bonds. In the same year, SFI income was composed of € 52,981 million of interest, dividends and retained profits, € 9,497 million of royalty payments and € 4,214 million of other income. Except for about € 1,5 billion in taxes and other expenditures such as payments to tax consultants and trust offices, a minor € 5 million balance on goods and € 17,236 million for interest payments on bonds

²⁰ See Eurostat FDI compilation guide, 2005 edition,
http://forum.europa.eu.int/Public/irc/dsis/bop/library?l=/sdds_bop_metadata/compil_guidepdf/_EN_1.0_&a=d for detailed information on the definition of FDI.

plus other income, the total income of SFIs immediately accrued to their parent companies and other affiliated companies in the form of € 37,793 million in dividends, retained profits and interest, and € 10,172 million in royalties and other services.

Figure 3: SFI capital flows (€ mln) via the Netherlands, 2006



Source: Annex A.

Notes: 'Royalty income' also includes income from other international services; financing and royalty income may also be received from or paid to a group company other than a direct subsidiary or parent; on the current account there is a 'balance on goods' item which should be regarded as 'errors and omissions'; the value for 'tax and expenditures' should be treated as a broad estimate (personal communication DNB 09-05-07).

2.3. Foreign direct investment via SFIs

The balance of payments data provides insights on the annual flows between parent companies and subsidiaries, via the Netherlands. However, due to factors such as business cycle effects, restructuring of companies, mergers and acquisitions, these figures fluctuate from year to year. The international investment position (IIP) statistics provide information on the stock, that is the accumulation of FDI flows, which offer more long term insights into the external financial position of SFIs. It measures the value and composition of a country's external financial assets and liabilities. Assets include FDI

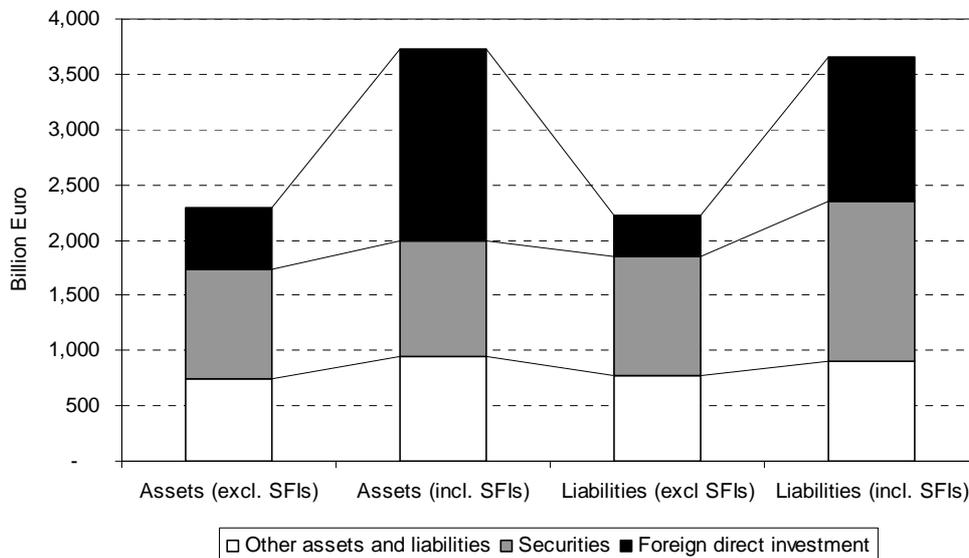
abroad, foreign securities and other assets, and liabilities include FDI in the Netherlands, Dutch securities and other liabilities.

One of the reasons why DNB maintains a register of SFIs is to 'clean' certain statistics. The transactions of SFIs are so enormous that they would blow up the balance of payments and international investment position figures, rendering them useless for the analysis of international financial flows. This is illustrated by Figure 4, which shows IIP statistics including and excluding SFIs.

The figure demonstrates that Dutch claims on and liabilities to foreign agents are much higher when SFIs are included. The difference is almost completely caused by the FDI stock component on both sides of the balance. This again illustrates the 'conduit' nature of SFIs, channelling foreign direct investment from one country to another via the Netherlands. On balance SFIs are net foreign investors. The difference is offset by net debts to non-residents as the result of the issuance of bonds in the Netherlands to finance foreign subsidiaries.

A striking result from Figure 4 is that the inward and outward FDI stock from SFIs by far exceed the inward and outward FDI stock of Dutch companies. In 2006, the total FDI stock of Dutch companies abroad amounted to € 554 billion while the corresponding figure for SFIs was € 1,171 billion. In the same year, the FDI stock was € 370 billion in Dutch companies and € 927 billion in SFIs.

Figure 4: International investment position, 2006

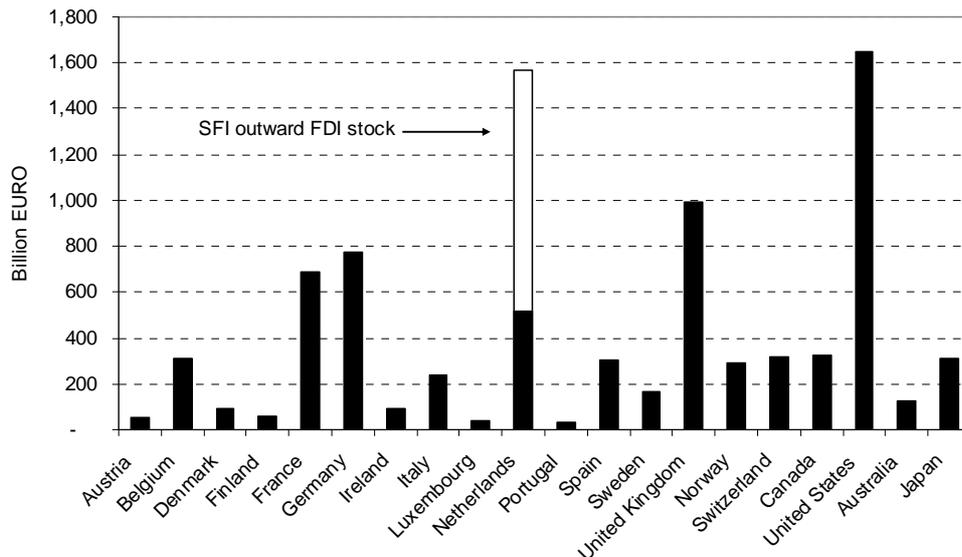


Source: Annex B

Note: Assets are foreign direct investment abroad, foreign securities and other assets. Liabilities are direct investment in the Netherlands, Dutch securities and other liabilities. IIP figures for 2006 are provisional estimates.

SFIs mainly serve to route funds through the Netherlands and therefore have very few relationships with the Dutch economy. Hence, in order to separate FDI related with real operational business from that driven by tax avoidance strategies, DNB has decided to present annual FDI statistics net of SFI transactions. However, in order to obtain a better understanding of the scope of SFI transactions in the global economy, it is interesting to compare the Dutch outward FDI stock including SFIs to the FDI data of some other economies. This is done in Figure 5, with an astonishing outcome.

Figure 5: Outward FDI Stock, selected countries, 2005



Source: FDI stocks from UNCTAD, World Investment Report 2006 and SFI FDI stocks from IIP statistics in- and excluding SFIs, Source: DNB, T5.11 and T5.15, <<http://www.statistics.dnb.nl/index.cgi?lang=uk&todo=Balans>> (04-05-07).

Note: US\$ values in World Investment Report have been exchanged in Euro using average exchange rate € 1 = \$1.24, <<http://www.statistics.dnb.nl/index.cgi?lang=nl&todo=Koersen>> (02-05-007). Outward FDI stock of special entities comparable with SFIs for other countries, such as Luxembourg and Ireland, is not shown due to lack of data.

The figure shows that when SFI transactions are not taken into account, the Netherlands comes fifth in terms of the size of outward FDI stock. However when SFI investments are included the Netherlands is the second largest foreign investor in the world, just behind the USA and far ahead of the UK, the number three largest investor.²¹ Not surprisingly, the

²¹ It is not unlikely that the FDI data of some other countries suffers from the same problems as that of the Netherlands. In Europe, Luxembourg, Ireland, Cyprus and possibly Denmark are frequently mentioned as countries with a favorable tax regime for conduit arrangements similar to those offered by the Netherlands. Outside Europe, Hong Kong is known for being used for round-tripping investments from and to China (UNCTAD, "World Investment Report 2006"; European Central Bank, "FDI task force report", May 2004). Nonetheless, given the longstanding reputation of the Netherlands as suitable for tax planning purposes and the already very high level of FDI stocks controlled by Dutch companies, it is unlikely that other countries' FDI stock including SFIs are higher than that of the Netherlands.

figure for Inward FDI stock (not presented) shows the same pattern as that for outward investment stock. Excluding SFI transactions, the Netherlands is the sixth largest host of FDI while it is second (after the US) including SFIs FDI stock. Note that special entities comparable with SFIs also exist in a few other countries, such as Luxembourg and Ireland. If these were included in the figure, the total outward FDI stocks for these countries might also be substantially higher. However, data on these stocks was not available.

In Table 1, investment via SFIs in a number of large economies is analysis by matching total FDI stocks of these countries with associated FDI stocks held by or in SFIs. To give an example, in 2005 Italy reported a total inward FDI stock of € 177 billion. In the same year SFIs reported a total outward SFI stock in Italy of € 24 billion, implying that 14% of total FDI stock in Italy is controlled by SFIs in the Netherlands. Similarly, the data indicates that 16% of Italian outward FDI stock is hold via SFIs.

Table 1: Inward and outward FDI stocks via SFIs, selected countries, 2005.

	Inward FDI stock			Outward FDI stock		
	FDI via SFIs (€ bn)	Total FDI (€ bn) ^a	Share SFIs (%)	FDI via SFIs (€ bn)	Total FDI (€ bn) ^a	Share SFIs (%)
Italy	24	177	14%	37	236	16%
Germany	78	404	19%	-48	778	-6%
France	50	483	10%	42	686	6%
Belgium	12	396	3%	45	311	14%
Luxembourg	98	56	175%	112	40	280%
United Kingdom	137	656	21%	196	995	20%
Spain	47	296	16%	-20	307	-7%
United States	68	1,307	5%	170	1,649	10%
Japan	27	81	33%	15	311	5%
World excl NL^b	1,033	8,044	13%	833	7,763	11%

Source: FDI stocks from UNCTAD World Investment Report 2006 and SFI FDI stocks from DNB, unpublished data.

Notes: FDI via SFIs for inward FDI stock are outward figures and FDI via SFIs for outward FDI stock are inward figures. ^a US\$ values in World Investment Report have been exchanged in Euro using average exchange rate € 1 = \$ 1.24. ^b Total inward and outward FDI stocks including the Netherlands are € 8,142 and € 8,578, respectively.

The table provides a few very interesting results. Firstly, it appears that SFIs, entities which are created to avoid taxation, control no less than 13% of global inward FDI stock. At the same time, 11% of global outward FDI stock is held via Dutch SFIs. If the regular FDI stocks in and by Dutch companies is added (the black bar in Figure 5), companies incorporated in the Netherlands are responsible for almost one fifth of total global inward FDI stock. Conversely, 14% of total outward FDI stock is controlled by SFIs or Dutch multinationals.

Other figures which stand out are those for Germany, Spain, Luxembourg, Japan and the UK. For the first two countries, the data indicates that the outward stock via SFIs is

negative. This would mean that on a net basis the assets controlled by German and Spanish parent companies in the Dutch SFIs are lower than the assets held by the SFIs in the parent companies. A possible explanation for this phenomenon could be that these SFIs act as group finance companies, offering very high loans to the parent companies – a common financing structure for avoiding taxation. However, it would require detailed information on individual SFI transactions to determine the exact cause of the reported negative FDI stocks.

The table also shows that outward and inward FDI stocks of SFIs related to Luxembourg are more than twice the associated stocks reported by Luxembourg. It is also well known that Luxembourg is frequently used in conduit structures. Official data from Statistics Luxembourg reveals that during 2002-2005 an estimated 95% of FDI inflows left the country again by using tax planning vehicles.²² It therefore seems that just like the Netherlands, Statistics Luxembourg publishes FDI data net of SFIs, resulting in an underestimate of total inward and outward FDI stock. Finally, the relatively high shares of inward FDI stock controlled by SFIs in Japan (33%) and the UK (21%) suggest that tax planning structures involving financial flows between holding companies in the Netherlands and subsidiaries in Japan and the UK are relatively profitable.

2.4. Tax planning

As 13% of all inward FDI stock worldwide is held through Dutch SFIs, it can safely be concluded that Dutch SFIs have a large influence on how the subsidiaries of multinational corporations organise their financial and fiscal matters all over the world. This section briefly reviews some potentially harmful tax planning strategies used by SFIs. The box below explains which types of tax planning are considered.

Which tax planning strategies are considered harmful?

The analysis in this report covers potentially harmful tax planning strategies only. Whether certain forms of tax planning are harmful is to some extent open to discussion. The same applies to the concept of 'fair taxation'. For the purpose of this report, the following basic rule was used.

1. If tax planning is aimed at avoiding double taxation on the same income, it is generally not considered harmful. In particular, strategies to avoid further tax charges on corporate income that has already been subject to corporate tax in the source country is not considered harmful.
2. Other tax planning strategies are considered potentially harmful. In particular, strategies to reallocate pre-tax corporate income to other countries where it is subject to zero or very low corporate tax are considered harmful.

²² UNCTAD, World Investment Report 2006, p. 12.

According to this basic rule, therefore, dividend conduit structures are not considered harmful for the purpose of this report, because dividends are paid out from profits that have already been taxed. Other forms of treaty shopping could be harmful, though, especially in the absence of a real economic substance. Financing conduits to facilitate interest payments to a Caribbean tax haven are considered harmful, because the interest payment reduces pre-tax profits in the source country and the resulting income in the tax haven is not taxed, or is taxed only at a very low rate.

Some of the most important tax planning constructions are summarised below. They correspond closely with the different types of SFIs identified by DNB. The second part of this section addresses a few common questions about substance requirements and profit repatriation.

Royalty and finance conduits

Multinational corporations can use a Dutch subsidiary as a conduit for royalty and interest payments. Such a construction allows to shift income from a subsidiary in another country to a subsidiary in a pure tax haven, such as Bermuda.²³ The latter then holds the intangible property for which it collects the royalties, for example a trade mark or patent, or it provides a loan on which it receives interest. The advantage of a Dutch conduit subsidiary is that withholding taxes at source can be reduced by double taxation treaties, provided certain conditions are met. If royalties or interest were to be paid directly to a subsidiary in a pure tax haven, high withholding taxes would apply, making the transaction unattractive.

Financing conduits may also be used to get untaxed or low taxed income out of pure tax havens. If profits generated in a tax haven are paid out in the form of dividends to a parent company abroad, these dividends are usually taxed in the country of the parent. This would eliminate the benefits of allocating income to a tax haven. By contrast, if the profits of a tax haven entity are reinvested by making loans to other subsidiaries abroad, the funds are effectively transferred out of the tax haven without being taxed elsewhere. It could be attractive to make such loans via a Dutch conduit to reduce or avoid withholding taxes on the interest paid on the loans as well. Note that in this case Dutch SFIs could be used to get profits resulting from any kind of income shifting out of a tax haven, including from transfer pricing and other strategies that do not involve Dutch SFIs to shift the income to the tax haven in the first place. We estimate total loans from Caribbean tax havens to Dutch SFIs in 2005 at approximately € 50 billion, indicating that reinvestment of untaxed or low taxed income via the Netherlands occurs on a large scale. The estimate is explained in more detail in section 3.7.

²³ D.W. Conklin and D.A. Robertson (1999). Tax Havens: Investment Distortions and Policy Options. Canadian Public Policy/Analyse de Politiques, 25(3), p. 333-44.

Participating loans

The participating loan (deelnemerschapslening) is a hybrid security that may also be used for avoiding taxes. According to Dutch case law, a loan is deemed to be a participating loan if it meets the following criteria:²⁴

1. no (or very low) fixed interest is charged, compensation is (mainly) dependent on profits;
2. the loan is subordinated to other loans;
3. the period of the loan is indefinite (or at least 50 years).

In such cases, the Dutch tax authorities treat the loan as informal capital and the income associated with the loan as if it were dividends from a participation in a subsidiary. The participation exemption therefore applies to such loans to foreign subsidiaries. If the loan is treated in the same way by the host country, the payments associated with the loan are not deductible, because they are treated as dividends. The participation exemption then prevents double taxation.

In 2005, however, the Dutch Supreme Court decided that a certain loan to a French subsidiary qualified as a participating loan, exempting the income received on the loan from tax in the Netherlands, while the payment of this income was (partly) tax deductible in France.²⁵ In this case, therefore, and up to a certain maximum, the income was not taxed anywhere. The changes in Dutch corporate tax law that came into effect in 2007 further endorsed such constructions by dropping the condition that payments associated with hybrid loans should be non-deductible abroad. This has created a possibility to avoid taxation by arranging loans that qualify as informal capital in the Netherlands and as real loans in the host country.²⁶ The Ministry of Finance notes that in the past there have been attempts to coordinate the qualification of loans and equity participations with other countries, but international support was insufficient.²⁷

Tax avoidance constructions involving the proposed group interest box and participating loans have in common that income is effectively shifted to the Netherlands, where it is taxed at 5%, or is tax exempt. Furthermore, both use unique opportunities for arbitration between different tax systems that are not offered by other countries.

BV1/BV2 construction

This is a construction used by US-based parent companies. Under the US 'check the box' system of tax regulations, a parent company can indicate that a subsidiary, such as an LP or LLC, should be regarded as a transparent entity. In that case, the income of the entity is attributed to its participants for US tax purposes. However, due to arbitration between tax systems, this can also be applied to a Dutch BV. US parents have been using structures in which they provide a loan to a Dutch fully owned subsidiary, BV1, which uses these

²⁴ Dutch Supreme Court, Judgement 11 Mar 1998, no. 32.240, BNB 1998/208.

²⁵ Dutch Supreme Court, Judgements 25 Mar 2005, nos. 40.989 and 40.990, BNB 2006/82-83; .H.M. Arts, *Deelnemerschapsleningen*, Maas & Roer, *Fiscale berichten uit de Euregio*, Feb 2006(11), p 6-8.

²⁶ E.J.W. Heithuis, *Werken aan de deelnemingsvrijstelling*, Tijdschrift Fiscaal Ondernemingsrecht 2006/169 <http://folders.sinoonline.nl/6816/31981/TFO%202006_169_%20Heithuis_Werken%20aan%20de%20deelnemingsvrijstelling.pdf> (Apr 2007).

²⁷ Ministry of Finance, comments on draft report in meeting with SOMO, 11 Jun 2007, The Hague.

funds to make an equity capital contribution to its fully owned subsidiary BV2. The latter then uses the capital to provide loans to other subsidiaries abroad. The two BVs form a fiscal unity for Dutch tax purposes and BV1 is chosen to be regarded as a transparent entity for US tax purposes. In the end, the effect is that the interest paid for the loans provided by BV2 is deductible abroad, while the interest income received by BV2 is not taxed anywhere.²⁸ The possibility for such arbitration was discontinued in 2003, when the Dutch law on fiscal unity was revised,²⁹ to level the playing field for US-based and Netherlands-based companies. After that, however, such constructions also became possible with Luxembourg as the intermediary country, and therefore in 2007 the new tax law 'Working on Profit' allowed the construction via The Netherlands again.³⁰ The situation in the Netherlands is therefore not unique and has been influenced by tax competition with another EU member state. The US must be aware of the possibility of BV1/BV2 constructions,³¹ but may be unwilling to address this and prefer to allow US-based multinationals this special tax advantage.

Proposed group interest box and historical CFA regime

Under the proposed group interest box, it can be very attractive for a multinational corporation to increase loans from a Dutch group financing company to a subsidiary in another country (the host country). If certain conditions are satisfied, the intra-group interest income is taxed in the Netherlands at 5%.³² This appears to be one of the lowest tax rates among OECD countries on a certain type of corporate income. Initially, a rate of 10% was proposed, but this was considered not competitive enough because other countries inside and outside the EU offer rates substantially lower than 10% on the same type of activities.³³ These include Switzerland with a tax rate of 2-5%³⁴ (depending on the Canton), Belgium, where an effective rate of 2.5% may be reached under the notional interest deduction rule (depending on the financing structure), and Luxembourg. The effective tax rate on group financing activities in Luxembourg is not publicly known, but may be about 2-5% as well. There appears to be active competition for hosting group financing operations between the Netherlands, Belgium, Luxembourg, Switzerland and a few other countries, including by offering very low effective tax rates on this type of activities.

²⁸ M. Vrouwenvelder, "Tax planning to reduce foreign taxes for U.S. multinationals – an EU and Netherlands tax update," *Tax Management International Journal*, Vol. 30, Issue 9 (7 Sep 2001), p. 403-14; Deputy Minister of Finance, *Voorstel van wet houdende wijziging van de Wet op de vennootschapsbelasting 1969 c.a. (herziening regime fiscale eenheid)*, no. 26 854, 17 Aug 2001, <http://www.minfin.nl/nl/actueel/kamerstukken_en_besluiten,2001/08/wdb01_499.html> (Apr 2007).

²⁹ *Wijzigingswet Wet op de vennootschapsbelasting 1969 c.a. (herziening regime fiscale eenheid)*, Dec 2002.

³⁰ *Vakstudienieuws*, Issue 2, 11 Jan 2007, p. 12-3; Minister of Finance, 13 Feb 2007, *Beantwoording kamervragen Nederlandse belastingstelsel E. Irrgang*, No. 2060705950.

³¹ Ministry of Finance, comments on draft report in meeting with SOMO, 11 Jun 2007, The Hague.

³² Law "Working on Profit", Section 2.4, unofficial translation available at <http://www.somo.nl/html/paginas/pdf/Group_interest_box_NL_EN_ES.pdf> (Apr 2007).

³³ *Wijziging van belastingwetten ter realisering van de doelstelling uit de nota «Werken aan winst» (Wet werken aan winst)*, *Memorie van toelichting*, 2005, 30572 Nr. 3, p.11.

³⁴ *Fiscaal vestigingsklimaat, brief van de staatssecretaris van Financiën*, 23 Sep 2005, 30107 Nr. 4, p. 8.

Under the EU Interest and Royalties Directive, no withholding tax applies for qualifying intra-group interest payments between EU countries. For most countries outside the EU, a withholding tax on outgoing interest is charged by the host country. Under double taxation treaties with developing countries, this withholding tax is reduced to some 10%. At the same time, for the subsidiary in the host country, the interest payments are deductible from corporate income, which is taxed at the host country's national corporate tax rate that may be 30%³⁵ or more. Income is effectively shifted to the Netherlands.

The group interest box is the successor to the regime on Group Financing Activities (Concernfinancieringsactiviteiten, CFA; also Concernfinancieringsmaatschappij, CFM). Like the group interest box, the CFA regime offered a very low effective tax rate on interest received on loans to foreign subsidiary companies. In 2003, the CFA regime was found to be in breach of the EU competition law and was discontinued. Companies can no longer apply for the CFA regime, but it will remain in force until 2011 for companies that were already using the arrangement. However, for most multinationals using the regime, possibly accounting for over three quarters of the financial flows, it will end in 2007 or 2008 already. The group interest box is currently being investigated by the EU in the context of state aid.³⁶

Substance requirements

There have been some questions regarding substance requirements and other anti-abuse criteria that need to be met in order to benefit from the participation exemption, double taxation treaties, and other aspects of the Dutch tax system. It seems odd that foreign corporations can use mailbox companies in the Netherlands to reduce their tax burden while at the same time complying with such requirements. For group financing companies, this is not relevant, as these usually have some real presence in the form of a regional or global financial head office. According to records of the Dutch Chamber of Commerce, however, many conduit entities managed by trust offices employ not even a single employee, which seems to conflict with the most basic substance requirements.

The Ministry of Finance has also drawn up a list of substance criteria for financing and royalty conduit companies that want to obtain certainty in advance about the tax treatment of their operations through an Advance Tax Ruling (ATR) or Advance Pricing Agreement (APA). The criteria include, for example, that decisions of the board of directors need to be taken in the Netherlands and that the administration of the company is kept in the Netherlands.³⁷ Note that these criteria do not apply to dividend conduit companies, though, which probably make up the largest part of all mailbox companies. Furthermore, not all SFIs seek advance certainty of tax treatment. The number of APAs and ATRs

³⁵ 30% is the average statutory corporate rate in EU-15 countries in 2005, see Ministry of Finance, 'Tabel 1: Statutaire Vpb-tarieven EU-lidstaten periode 1995-2005,' <<http://www.expatax.nl/Documents/corporate%20tax%20rates%20EU.pdf>> (Jun 2007)..

³⁶ Raad voor Economische en Financiële Zaken, Nieuwe Commissievoorstellen en initiatieven van de lidstaten van de Europese Unie, 22 Mar 2007, 21507-07 & 22112 Nr. 557,

³⁷ Ministry of Finance, Decision of 11 Aug 2004 no. IFZ2004/126M & *Vraag en antwoordbesluit dienstverleningslichamen*, 11 Aug 2004.

currently in force should be some somewhere between 500 and 2,500, depending on the average duration of the agreements, while there are currently at least 10,000 SFIs.

Some substance criteria have been determined by case law and by legislation. Substance requirements for financing and royalty conduit companies were strengthened in 2001, with an interim period until the end of 2005.³⁸ However, trends like the rising numbers of mailbox companies in the Netherlands and rising royalty flows through Dutch SFIs have steadily continued during this period and after it. Mailbox companies are apparently managing to formally comply with the criteria. It is also possible that the number of mailbox companies will start to decrease in the near future. Rulings are normally awarded for four years, which implies that there is a certain time lag between the implementation of the stricter ruling policy and its impact on the number of mailbox companies.

There have also been questions regarding the accumulation of profits in the Netherlands or in pure tax havens. If such profits were simply distributed to the ultimate parent company, in most cases residual taxes would apply, which would eliminate the gains from tax planning. Some home countries of multinational corporations also have Controlled Foreign Corporations (CFC) rules, which apply residual taxation even if the income from tax haven or conduit subsidiaries is not distributed from abroad. CFC legislation is very complex, though, and usually contains loopholes. The existence of tax planning structures indicates that multinational corporations manage to get around this in some way. Subsidiaries in pure tax havens might use their interest or royalty income to make new loans to subsidiaries, for example, or make loans to the parent company, so that the income is not distributed to the parent in the form of internal dividends. The same applies to Dutch group financing companies. The precise constructions will probably differ from case to case.

2.5. Benefits and Costs

The SOMO report pointed out several costs and benefits of maintaining a conduit-friendly tax regime that fosters SFIs and mailbox companies. The main points are briefly repeated below.

Benefits:

- ❑ Employment: Acting as a tax haven generates employment for financial experts, accountants and fiscal consultants. The trust sector provides direct employment to around 2500 people, and if indirect employment is also taken into account this figure may be higher.³⁹
- ❑ Tax income and other revenue: SFIs and mailbox companies pay a very limited amount of tax to justify the commercial nature of the transaction. In 2001, the most recent data available, the total direct revenue for the Netherlands as a

³⁸ J. Peters (2005). The need to restructure Dutch conduit entities. *International Tax Review*, Mar 2005, p. 23-5.

³⁹ VIMS website, "*Wat betekent de trust branche voor de Nederlandse werkgelegenheid, economie?*" <<http://www.vims.nl/?pageID=59&languageID=1>> (25-09-06).

consequence of SFI activity was € 1.7 billion (about 0.3% of gross domestic product). Of this amount, approximately € 1.2 billion (0.8% of total expected tax revenue in the Netherlands)⁴⁰ is made up of taxes while the remainder constitutes payments to trust offices, payments for banking services, contributions to the Chamber of Commerce and personnel and accommodation costs incurred in undertaking self-funded activities.

- ❑ Amsterdam as financial centre: As most mailbox companies are established in Amsterdam, they contribute to Amsterdam's position as a financial centre.
- ❑ Stimulation of other activities: SFIs stimulate the establishment of primary group activities in the Netherlands, such as production, research and development, and trade.

Costs:

- ❑ Presence of socially irresponsible companies: Serving as a tax haven for conduit structures attracts a high number of companies, which would otherwise not have engaged in any activity in the Netherlands. It is unavoidable that among them there are also a number of companies with a dubious reputation. Striking examples of this are the financial activities of the children of former president Suharto in the Netherlands during the 1990s and the movement of the headquarters of James Hardie from Australia to the Netherlands in 1998.⁴¹ Furthermore, it is well known that besides avoiding tax, mailbox companies (and hence also SFIs) may also be used to evade tax, cover up fraud, hide losses or launder money (see below). Enron, who operated dozens of mailbox companies in the Netherlands is a notorious example of such practices.
- ❑ Damage to the Netherlands' reputation: A related problem is that a company's socially irresponsible behaviour will be linked to the Netherlands, although often the head office is nothing more than a mailbox company and the actual management, administration and legal department are located in a third country. This is underlined by the fact that two out of the three nominees for the Public Eye Award, the prize for the world's most irresponsible corporations, are 'Dutch' enterprises (Trafigura and Ikea) because their main office is located in the Netherlands for tax reasons.
- ❑ Money laundering: A recent study commissioned by the Dutch Ministry of Finance, which analysed the extent of money laundering in the Netherlands, pointed out that "some of the experts expressed that they would not be surprised if 1% of SFI transactions are used for money laundering" and concluded that "the Netherlands is a tax haven and this makes it vulnerable to money laundering".⁴² Nonetheless, it should also be noted that the Dutch government has recently implemented strict regulation to prevent money laundering or other criminal activities via mailbox companies. On the first of March, 2004, the Dutch

⁴⁰ The expected total tax revenue in 2007 is € 157.5 billion, Ministry of Finance, "Inkomsten van het Rijk," <http://www.minfin.nl/nl/onderwerpen,begroting/inkomsten_x_uitgaven/inkomsten_van_het_rijk_2006.html> (01-05-07).

⁴¹ See M. van Dijk, F. Weyzig and R. Murphy, "The Netherlands: A tax Haven?", for more information.

⁴² B. Unger *et al*, "The amounts and the effects of money laundering", report for the Ministry of Finance, 16 Feb 2006, p. 11, p. 77.

government adopted the Act on the Supervision of Trust Offices (Wet Toezicht Trustkantoren, WTT). As of this date, the trust sector has been supervised by the Dutch Central Bank, and only companies with a license are allowed to offer trust services. Furthermore, trust offices must be managed by a natural person (instead of a company) and are required to show on which grounds clients are accepted or refused.

- Tax revenue foregone by other countries: As a consequence of Dutch conduit structures to avoid taxation, other countries miss out on tax income which would have been collected if the transaction had been routed through the Netherlands. As will be elaborated on in the next section, the data suggests that developing countries are also disadvantaged by the Dutch fiscal regime.

3. Consequences for developing countries

3.1. Exploring the issue

The broad network of double taxation treaties, zero withholding tax on outgoing royalties and interest, the proposed group interest box and other features of the Dutch tax system have important consequences for developing countries. There are several reasons why these may have received relatively little attention so far. In absolute terms, the effects for other high income countries are much larger, for instance, because these have much higher stocks of foreign direct investment. Furthermore, the consequences for developing countries may not be obvious and many donor agencies and development organisations are still unfamiliar with international tax issues. The effects are also difficult to quantify due to a lack of available data. However, the Dutch tax system is likely to have a significant impact on tax revenues in developing countries and financing for development.

The SOMO report did not deal with the consequences for developing countries in much detail, and several questions have been raised about the precise impacts since the report was issued. The discussion below addresses some of the main questions, taking into account negative as well as positive impacts. The issue is also further analysed using new data on the geographical composition of investment through SFIs, which was made available by DNB in April 2007. On the basis of this data, the corporate tax revenues that are missed by developing countries due to tax avoidance via Dutch SFIs are estimated in the range of € 100 to € 1 billion per year. This section also presents an analysis of the coherence between Dutch government policy on tax and on development cooperation, and discusses the findings from two relevant studies commissioned by the Ministry of Foreign Affairs in 2003.

3.2. Overview of negative effects

The main direct negative effects for developing countries of tax avoidance constructions involving Dutch subsidiaries are summarised below.

Conduit constructions and treaty shopping

The large and growing number of SFIs indicates that multinational companies increasingly use the Netherlands to plan their group tax structures. Channelling intra-group income and capital flows through Dutch finance, holding and royalty companies, in order to make use of the beneficial Dutch tax regime, suggests that tax is avoided in other countries. This tax would have been paid if the Netherlands had not been used as a conduit country to decrease withholding tax on interest and royalty payments. Through such constructions, income is sometimes shifted from a subsidiary in a developing country to a subsidiary in a pure tax haven in the form of royalties or interest. The direct result is a lower total tax

burden for the multinational corporation, no or very low tax revenues on the income shifted to the pure tax haven, and some tax revenue on the operational margin in the Netherlands, at the expense of the developing country.

Group interest box, hybrid securities and hybrid entities

As explained above, multinational corporations can increase loans from a Dutch group financing company to a subsidiary in a developing country to avoid taxation by using the CFA regime or, if approved, the group interest box. The direct result is a lower total tax burden for the multinational corporation and a higher tax revenue in the Netherlands at the expense of the developing country. Other constructions, such as those involving hybrid participating loans or hybrid BV1/BV2 entities with a US parent, have similar effects for a developing country. They do not generate any tax revenues in the Netherlands, however.

Competition

The Dutch tax system provides opportunities for multinational corporations to reduce their tax burden, as described above. This provides them with a competitive advantage over smaller and less internationalised companies, including domestic competitors in developing countries. As the competitive advantage from tax avoidance is unrelated to operational performance, it is likely to distort market efficiency and does not contribute to economic development.

Facilitation of money laundering

As mentioned above, the existence of a large number of mailbox companies and SFIs, supported by the Dutch tax system, may facilitate money laundering. This could indirectly support undesirable activities in developing countries as well, such as corruption and illegal arms and drugs trade.

3.3. Discussion of negative effects

The first two types of negative effects will be discussed here in some more detail. Regarding the undesirable effects of the group interest box, former finance minister Zalm has clearly stated: "There will by itself be no disadvantages for developing countries."⁴³ As the group interest box has not yet come into force, one can only try to predict its effects. However, it seems unlikely that the group interest box would not be used to avoid taxation in developing countries. Unlike the CFA regime, the group interest box is open to all companies, so any multinational corporation could establish a financing subsidiary in the Netherlands to take advantage of the 5% tax rate. This suggests that the disadvantage generated by the CFA regime would not only be continued, it would even increase. There is some evidence from recent academic studies as well⁴⁴ that multinational corporations

⁴³ Minutes of 9th Dutch Senate meeting, 21 Nov 2006.

⁴⁴ J. Mintz, and A.J. Weichenrieder (2005). Taxation and the Financial Structure of German Outbound FDI. CESifo Working Paper Series No. 1612; H. Grubert (2003). Intangible income, intercompany transactions, income shifting, and the choice of location. National Tax Journal 56, p. 221-42; M. Riesco, G. Lagos, and M. Lima (2005). The "Pay Your Taxes" Debate: Perspectives on Corporate Taxation and Social Responsibility in the Chilean Mining Industry. UNRISD Technology, Business and Society Programme Paper No. 16.

indeed use intra-group financing strategies to reduce their total tax burden. These studies are based on detailed financial data from individual subsidiary and parent companies.

Regarding conduit constructions, there could be differences between industries. To shift income in the form of royalties, multinational corporations require intangible property, such as a registered trademark, brand name or patent, for which substantial royalties can be charged. It therefore seems that relatively R&D intensive multinational corporations, which generate more intangible property, have more opportunities for income shifting.⁴⁵ This includes the pharmaceutical and electronics industry. However, there are also indications that royalties and interest are to some extent substitutes for income shifting.⁴⁶ If a multinational corporation does not hold substantial intangible property in pure tax havens, it might therefore use financing strategies to achieve tax avoidance instead.

The size of the income shifted through Dutch conduit subsidiaries and the associated negative consequences for developing countries are not known. The data required for such an analysis are not available. However, the SOMO report provides strong indications that such structures are used in practice. These indications include supporting data on the operations of SFIs, references to promotion of such constructions by tax advisors, and a few case studies of MNCs.

There have been questions as to whether the strategies mentioned above would make sense for operations in developing countries, because many multinational corporations obtain tax holidays or other tax incentives when they invest in these countries. As a consequence, subsidiaries in developing countries are exempt from corporate tax and pay withholding taxes only, so there would be no corporate tax to avoid in the first place. However, even though many foreign investors do enjoy generous tax incentives in developing countries, this does not mean that all foreign investment is completely exempt from corporate tax for an indefinite period. Academic studies using micro data show that some multinational corporations do pay corporate taxes in developing countries.⁴⁷ A loss of corporate tax revenues is therefore still possible. It should also be recognised that corporate income taxes constitute a much larger proportion of total tax revenues in developing countries than in developed countries.⁴⁸

If tax avoidance strategies lower the tax burden on the operations of MNCs in developing countries, this could make it more attractive to invest in these countries. Thus, apart from income shifting effects, there may also be an effect on real business operations, and there is some evidence for this from actual behaviour of MNCs.⁴⁹ Higher levels of investment

⁴⁵ H. Grubert, *op. cit.*

⁴⁶ H. Grubert (1998). Taxes and the division of foreign operating income among royalties, interest, dividends and retained earnings. *Journal of Public Economics* 68, p. 269-90.

⁴⁷ J. Mintz, and A.J. Weichenrieder, *op. cit.*; H. Grubert (2003), *op. cit.*; M.A. Desai, C.F. Foley, and J.R. Hines Jr. (2003). Chains of Ownership, Regional Tax Competition, and Foreign Direct Investment. In: H. Herrmann and R. Lipsey (Eds.) *Foreign Direct Investment in the Real and Financial Sector of Industrial Countries*. Springer Verlag, Heidelberg, pp. 61-98.

⁴⁸ V. Tanzi & H.H. Zee (2000). Tax policy for emerging markets: developing countries. IMF working paper WP/00/35.

⁴⁹ H. Grubert (2003), *op. cit.*

would mitigate the negative consequences of tax avoidance. It is unlikely that this would fully compensate for the loss of tax revenues, though, because tax avoidance would have similar effects as formal tax incentives and these effects are generally limited. This will be discussed in the section on coherence with development policy.

3.4. Positive effects

In response to the SOMO report, some have pointed out that Dutch tax policy also has some positive aspects for developing countries. These would include the following:⁵⁰

- the participation exemption;
- tax sparing credits;
- DTTs based on the UN model convention;
- higher withholding taxes allowed under DTTs.

The participation exemption, instead of a credit system, encourages investment in countries with a corporate tax rate lower than that in the Netherlands. Tax sparing credits encourage investment by allowing MNCs to benefit from tax holidays in developing countries without residual taxes applying in the Netherlands. Offering tax holidays is not always in a country's own interest, though. This will be explained in the next section. The DTTs concluded between the Netherlands and developing countries all use the UN model convention for tax treaties. In contrast to the OECD model treaty, they generally do not reduce withholding taxes on royalties and interest to zero but to some 10%. This is relatively favourable.

Apart from these specific aspects of the Dutch tax regime, it has been pointed out that the most important positive effect of signing a DTT is that it will help developing countries to attract more foreign investment. Although there are some studies which demonstrate a positive impact of tax treaties on FDI in rich countries, only very limited research on this topic has been undertaken with respect to developing countries. A recent study did find a positive relation between signing a tax treaty and FDI in developing countries, but noted that this finding only applied to middle income countries and not to lower income countries.⁵¹ Hence, there is no conclusive evidence that the overall effect of concluding a DTT with the Netherlands is positive for a developing country.

Even if it is assumed that DTTs will lead to more investment in developing countries, this does not automatically mean that they can be considered as positive. Economists have pointed out that FDI can positively affect economic growth and development, but only when it improves the balance of payments and generates technology spillovers,

⁵⁰ Summary of meeting between SOMO and the Ministry of Finance (in Dutch), 11 Jan 2007, <http://www.somo.nl/html/paginas/pdf/Samenvatting_gesprek_SOMO_Minfin_20070111_NL.pdf> (Apr 2007).

⁵¹ E. Neumayer (2006). Do double taxation treaties increase foreign direct investment to developing countries? SSRN, <<http://ssrn.com/abstract=766064>> (Apr 2007).

employment and linkages with the local economy.⁵² However, the most recent UNCTAD World Investment Report shows that FDI in developing countries is heavily tilted towards primary production, primary oil and gas exploration, and mining.⁵³ And precisely these sectors can be classified as industries with little integration into the domestic economy, because they employ relatively few people, technology spillovers are limited and there are few backward and forward linkages with local business. It therefore seems that the main positive contribution of this type of FDI to developing countries must come from additional tax revenue. Unfortunately, as this report shows, this has become increasingly difficult, partly as a consequence of the Dutch tax regime.

While recognising the positive effects of the Dutch tax system for developing countries, it is not possible to determine if these more than compensate the negative effects, because the data required for such an analysis are not available. As a consequence, the Ministry of Finance cannot assess all consequences of the Dutch tax system for developing countries.⁵⁴

3.5. Coherence with development policy

The Netherlands aims to enhance coherence of government policy in other areas with its policy on development cooperation. Tax policy is highly relevant in this respect. The Dutch government is committed to providing high levels of donor financing, and its ODA expenditures have been fixed at 0.8% of GNP. Part of this sum is directly provided to governments of developing countries as bilateral budget support and as debt relief. Enabling multinational corporations to avoid taxes in developing countries, which lowers government revenues in these countries, therefore seems inconsistent with high levels of ODA to raise these budgets. There is also a more direct link between tax policy and the UN Millennium Development Goals (MDGs), aimed at halving extreme poverty by 2015. Tax issues related to MDG 8, which is supportive of the other seven MDGs, and more specifically to two of the seven more concrete targets that have been set for MDG 8 (see box). Almost by definition, international tax issues form an integral part of a financial system that is supportive of development and of a comprehensive solution for the debt problems of developing countries.

⁵² See e.g. A. Summer, "Is foreign direct investment good for the poor? A review and stocktake," *Development in Practice*, Vol. 15, Nos. 3 & 4, Jun 2005, p. 269-85.

⁵³ UNCTAD World Investment Report 2006.

⁵⁴ Summary of meeting between SOMO and the Ministry of Finance (in Dutch), 11 Jan 2007, <http://www.somo.nl/html/paginas/pdf/Samenvatting_gesprek_SOMO_Minfin_20070111_NL.pdf> (Apr 2007).

Excerpt from the Millennium Development Goals⁵⁵

MDG 8: Develop a global partnership for development

Target 12: Further develop an open trading and financial system that is rule-based, predictable and non-discriminatory (includes a commitment to good governance, development and poverty reduction – both nationally and internationally).

Target 15: Deal comprehensively with developing countries' debt problems through national and international measures in order to make debt sustainable in the long term.

There has already been some attention paid to tax issues in Dutch development policy, especially from 2001 to 2004. In 2001, the Erasmus University Rotterdam (EUR) prepared a position paper on tax competition among developing countries for the Ministry of Foreign Affairs.⁵⁶ The main conclusion of the paper is that tax incentives are not usually a decisive factor for MNCs when deciding whether or not to invest in a certain developing country, so they are usually ineffective. In January 2002, two months before the Financing for Development Conference in Monterrey, Mexico, former minister for development cooperation Herfkens referred to this in a speech:

“More state financing – ODA – cannot be the only response. We also need to work out more incentives for the middle income countries.[MICs] (...) But the MICs also have to do their own homework and revise present practices. I recently learned from an Oxfam report that development countries lose large amounts of income because of the so called fiscal measures (tax holiday). (...) The developing countries should realize that foreign investors first of all consider the enabling environment before deciding on investment. They will not deny the fiscal advantages but this is not what will attract them.”⁵⁷

At the Financing for Development Conference itself, the delegation of the Netherlands organised a side event together with Oxfam GB on the relationship between tax and foreign direct investment in developing countries. Studies show that the costs of tax incentives are often high compared to the benefits in practice and other factors, such as stable and predictable taxation, are more important to investors. The discussion raised attention for this issue and the analysis was generally confirmed by all members of the discussion panel, including industry, IMF and World Bank representatives. At that time,

⁵⁵ See e.g. UNDP, MDGs, “MDG Targets and Indicators,” <<http://www.undp.org/mdg/goallist.shtml>> (Apr 2007).

⁵⁶ D. Bols, D. Frans, D. van den Berghe, and R. van Tulder, *Fiscaliteit, Locatieconcurrentie en Eerlijke Belastingafdracht [Fiscality, Location Competition and Fair Taxation]*, Position Paper for Ministry of Foreign Affairs (Rotterdam: Erasmus University Rotterdam, 15 Nov 2001).

⁵⁷ E. Herfkens, Minister for Development Cooperation, “Monterrey: Harvest the seeds we have sown,” Speech, 28 Jan 2002, <http://www.minbuza.nl/nl/actueel/speeches,2002/01/monterreyx_harvest_the_seeds_we_have_sown.html> (Apr 2007).

three central themes in Dutch development policy were ODA, policy coherence, and partnership. The discussion was linked to partnership, and the Netherlands announced that it would consider intensifying cooperation with tax authorities in developing countries.⁵⁸

The consensus among heads of state and governments that was reached at the Financing for Development Conference did not address tax issues in detail. However, it recognised that equitable tax systems are important for raising domestic resources and enhancing the coherence of the international financial system in support of development (see box).

Excerpts from Monterrey Consensus on Financing for Development⁵⁹

A. Mobilizing domestic financial resources for development

15. An effective, efficient, transparent and accountable system for mobilizing public resources and managing their use by Governments is essential. We recognize the need to secure fiscal sustainability, along with equitable and efficient tax systems and administration, as well as improvements in public spending that do not crowd out productive private investment. (...).

F. Addressing systemic issues: enhancing the coherence and consistency of the international monetary, financial and trading systems in support of development

64. To strengthen the effectiveness of the global economic system's support for development, we encourage the following actions:

- (...)
- Strengthen international tax cooperation, through enhanced dialogue among national tax authorities and greater coordination of the work of the concerned multilateral bodies and relevant regional organizations, giving special attention to the needs of developing countries and countries with economies in transition;
- (...).

3.6. Previous studies on tax and development

With tax issues firmly on the agenda, the largest initiative on taxation from the Ministry of Foreign Affairs came in 2003, when it commissioned two major studies on tax policy and Dutch relations with developing countries. One study was conducted by the International Bureau on Fiscal Documentation (IBFD) and focussed on DTTs and tax administrations in developing countries. The conclusions of the study included the following.⁶⁰

⁵⁸ Ministry of Foreign Affairs, *Verslag internationale conferentie* [report international conference] Financing for Development, 15 Apr 2002, <http://www.minbuza.nl/nl/actueel/brievenparlement,2002/04/verslag_internationale_conferentie_financing_for_development.html> (Apr 2007).

⁵⁹ UN, Monterrey Consensus on Financing for Development: final text of agreements and commitments adopted at the International Conference on Financing for Development, Monterrey, Mexico, 18-22 Mar 2002 (underlining by SOMO).

⁶⁰ J.J.P. de Goede *et al.*, *Tax Systems and Tax Treaties: A study assigned by the Dutch Ministry of Foreign Affairs and Development Co-operation* (Amsterdam: IBFD, 6 May 2004), p. 30.

- ❑ “Generally the attribution of taxing rights in a tax treaty will limit the taxing rights of developing countries (...) and may thus lead to (...) a short-term budgetary loss.(...)”
- ❑ A tax treaty can be viewed by the developing country as an important tool to promote its investment climate by providing foreign investors with more certainty about the tax consequences of their investment (...). Such improvements may generate additional foreign investment and employment and thus lead to increased tax revenue by way of additional corporate taxes, wage taxes, and sales taxes;
- ❑ Tax treaties are important instruments for tax administrations to counter tax avoidance and evasion through exchange of information and mutual assistance in the collection of taxes;
- ❑ Finally, it may be important from a political point of view for developing countries to conclude tax treaties (...) to strengthen international co-operation.”

The study also notes that in view of the lack of quantitative data, it is difficult to draw a definitive conclusion from the qualitative analysis, but it can safely be assumed that the hundreds of tax treaties that developing countries have concluded with developed countries indicate that many developing countries on balance attribute positive effects to these treaties.

The other study was again conducted by the EUR, and focussed on tax incentives offered by developing countries and income shifting through transfer pricing in trade with the Netherlands. With regard to tax competition, the study concludes that tax incentives might in theory be effective in attracting certain types of valuable FDI that are relatively tax sensitive, but in practice such considerations are not taken into account by developing countries when granting tax incentives, which makes them largely ineffective.⁶¹ The effect of tax avoidance on the size of foreign investment is similar to the effect of tax incentives.

The research finds little evidence of transfer pricing manipulation in trade with the Netherlands at the expense of developing countries.⁶² Although worldwide transfer pricing is one of most important mechanisms for income shifting and tax avoidance and evasion, this result might have been expected, because the relatively small differences in statutory tax rates do not allow large gains from transfer pricing in trade with the Netherlands.

With hindsight, it is striking that the Ministry of Foreign Affairs commissioned elaborated studies on all main tax issues relevant to developing countries, except tax avoidance through financing and royalty constructions. It is remarkable that even the IBFD study on tax treaties left out these issues, while they may be the single largest source of concern with regard to the coherence of Dutch government policy on tax and development. Other

⁶¹ A. Muller, D. Frans, and R. van Tulder, *Assessing the Development Squeeze: The impact of tax incentives, tax evasion and tax avoidance on Less Developed Countries (LDCs)* (Rotterdam: SCOPE Expert Centre/Ministry of Foreign Affairs, Jul 2004).

⁶² A. Muller, D. Frans, and R. van Tulder, *op cit.*

studies on tax and financing for development tend to overlook these particular issues as well.⁶³

It seems that since 2004, the Ministry of Foreign Affairs has not been considering Dutch tax policy and tax issues in general as a priority. Apparently, this is partly a result of the findings from the two studies conducted by the IBFD and EUR, which did not indicate any inconsistency between tax and development policy. In its MDG 8 progress reports of 2004 and 2006, the Ministry did not mention Dutch policy on tax issues at all.⁶⁴ Thus, it seems that the main coherence issue between Dutch tax and development policy has escaped all attention so far.

3.7. Estimates of missed tax revenues

Data on investment via SFIs in developing regions

In order to illustrate the magnitude of consequences for developing countries, a rough estimate can be made of the missed tax revenues in those countries due to tax avoidance constructions involving Dutch SFIs. DNB has made available new data on the geographical composition of SFI inward and outward investment stocks and flows. This data confirms that SFIs are also used as vehicles for investment in developing regions. Estimates of missed tax revenues still involve many assumptions, however, because the calculations require other data as well, for example about the composition of SFI income, that is not readily available. The estimates are therefore necessarily imprecise. Furthermore, the DNB data distinguishes continents and geographical regions rather than groups of developing countries or low income countries. The regions below include important middle income countries according to the World Bank classification, such as South Africa, Brazil, China, as well as low income emerging economies, notably India. Only corrections made for high income countries are excluded these from the regional data.

The first three data columns in the table below, labelled 'FDI via SFIs', present investment positions of SFIs in the main developing regions of Africa, Latin America, and Asia, for the years 2003 to 2005. These investment positions are the total outward FDI stocks of SFIs, including equity investment as well as loans and other financial transactions to subsidiaries, parents, and other related companies that are part of the same group. SFI investments in Central America have been corrected to exclude tax havens in the Caribbean.⁶⁵ Total inward FDI stocks in mainland Central America and in the Caribbean,

⁶³ See e.g. J. Martens, "What if Developing Countries could Finance Poverty Eradication from their own Public Resources?" Global Policy Forum, 2006

<<http://www.globalpolicy.org/soecon/ffd/domestic/2006/jensmartens.htm>> (May 2007).

⁶⁴ Ministry of Foreign Affairs, MDG 8: Progress Report 2006 (OSDR0564/E), Jul 2006

<<http://www.minbuza.nl/binaries/en-pdf/mdg-8-rapport-2006-engels.pdf>> (Apr 2007); Ministry of Foreign Affairs, MDG 8: Progress Report by the Netherlands 2006 (OSDR0526/E), May 2004 <http://www.undg.org/archive_docs/4532-Netherlands_-_MDG_8_Develop_a_Global_Partnership_for_Development_-_Report.pdf> (Apr 2007).

⁶⁵ See Annex C for the country classification.

from all sources worldwide, are roughly of the same size.⁶⁶ However, it may be expected that SFIs have relatively large investments in tax havens, and therefore it has been conservatively assumed that only 20% of SFI investment in the region is in mainland Central America, where it is strongly concentrated in Mexico. SFI investments in Asia, excluding the Middle East and Japan, have been corrected to exclude Singapore, Republic of Korea, Taiwan and Hong Kong. Inward FDI stocks in these four countries account for 59% of global investment of the region⁶⁷ and for 68% of Dutch investments by non-SFI companies.⁶⁸ Using these benchmarks, it has been conservatively assumed that the other countries in the region, including China and India, receive only 35% of total SFI investment in the region.

Table 2: Inward FDI stocks via SFIs and estimates of tax missed for 2005

Region	FDI via SFIs			Total FDI 2005 (€ bn) ^c	Share SFIs (%)	Tax missed	
	2003 (€ bn)	2004 (€ bn)	2005 (€ bn)			Est. 1 ^d (€ bn)	Est. 2 ^e (€ bn)
Total Africa	10	10	13	213	6%	0.098	.. ⁿ
Latin America excl Caribbean	32	40	46	555	8%	0.342	0.039
<i>Central America excl Caribbean^a</i>	13	18	21	192	11%	0.155	0.009
<i>South America</i>	19	23	25	363	7%	0.186	0.030
Asia excl Middle East, JP, SG, KR, TW, and HK ^b	28	28	30	462	7%	0.199	0.062
Total developing regions	≈ 70	≈ 80	≈ 90	≈ 1,200	7%	≈ 0.64	≈ 0.11
Total all countries	919	946	1,033	≈ 7,800^f	13%	≈ 6.8^g	≈ 1.8

Source: DNB, unpublished data on SFIs, UNCTAD World Investment Report 2006, calculations by SOMO.

Note: See Annex C for country classification. ^a 20% of total Central America to correct for the Caribbean; ^b 35% of total Asia excl Middle East and Japan (JP) to correct for Singapore (SG), Rep. of Korea (KR), Taiwan (TW), and Hong Kong (HK); ^c using average exchange rate € 1 = \$ 1.24; ^d Estimate 1: assuming 5% -point of taxes missed on 15% return on investment on inward FDI stocks; ^e Estimate 2: assuming € 1 bn missed through financing constructions, proportional to non-equity stocks per region, and € 0.8 bn through royalties, proportional to total royalty payments per region; ^f excl SFIs and other FDI in the Netherlands; ^g based on all countries excl the Caribbean and Luxembourg; ^h estimate cannot be calculated due to data problems.

It is interesting to compare the investments of SFIs in developing countries with the total inward FDI stocks in these countries as reported in the UNCTAD World Investment Report 2006. The total stocks are shown in the column 'Total FDI 2005' and the proportion of total investment for each region that is channelled through SFIs is shown in the column 'Share SFIs'. This proportion ranges from 4% for North Africa to 11% for Central America. On average, some 7% of all foreign investments in the main developing regions is held through Dutch SFIs. As a point of reference, the bottom row of the table shows the total for all countries worldwide, similar to the total in table 1, but excluding the Netherlands itself.

⁶⁶ UNCTAD World Investment Report 2006.

⁶⁷ UNCTAD World Investment Report 2006.

⁶⁸ DNB statistics, Table 5.6d, Direct investment abroad (stocks), last updated 12 Oct 2006.

Estimate 1: Relatively simple assumptions and calculations

Estimating missed tax revenues requires a few further assumptions. For a relatively simple estimate, it is assumed that the pre-tax return on investment on operations in developing countries is 15%. This is in line with historical data.⁶⁹ Note that total income on FDI received by SFIs was approximately 5% (€ 53 billion of income on FDI over € 1,033 billion of total FDI stocks abroad). The income reported by Dutch SFIs does not consist of pre-tax profits, however, but of interest payments and of dividends and capital gains from after-tax profits. There could also be a significant effect from errors and omissions in the data. Still, it cannot be fully explained why total income on FDI received by SFIs is relatively low compared to their total investment stocks abroad. Therefore it might be safer to use the more robust rate of 15% pre-tax return on investment.

It is further assumed that missed tax revenues amount to 5% of this pre-tax income, which is the same as assuming that on average the effective corporate tax rate abroad is lowered by 5 percentage points. This percentage can only be estimated. In reality, it may be lower, for example because SFIs are not that effective or because tax savings may be unevenly distributed among regions. SFI subsidiaries may also benefit from local tax breaks that should not be attributed to the SFIs or may use other tax avoidance mechanisms too, such as transfer pricing, that do not necessarily involve Dutch SFIs. However, as the main purpose of SFIs is to reduce the tax burden of multinational corporations, the percentage may be much higher as well. It is also possible that investments through SFIs in some developing regions are underestimated because they may sometimes be channelled via other developed countries, such as Hong Kong, Singapore, or Cyprus. Any estimate for missed tax between 1% and 10% of pre-tax income can probably be defended.

Note that the net gain to multinationals is always lower than the taxes missed in developing countries, due to the costs of tax planning and the lower tax charges that arise in other countries to which income is shifted. The latter include tax on the operational margins of SFIs in the Netherlands, which is more than € 1 billion. The total missed tax revenues in all other countries worldwide must therefore be assumed to be at least as large as this, and probably several times as large. The simple estimate described above implies total missed tax revenues worldwide of € 6.8 billion, of which some € 640 million in developing regions and roughly € 76 million in Sub-Saharan Africa. The estimate is shown in the table as 'Tax missed, Est. 1'. Note that it is also assumed here that the revenue effect of lower effective taxes is not substantially offset by increased foreign investment, as discussed in the previous section.

Estimate 2: More conservative assumptions and more complex calculations

A more careful estimate would distinguish different tax avoidance strategies and their relation to the financing structure of subsidiaries. One tax avoidance strategy is the use of royalties and license fees to shift income to tax havens. In 2005, total receipts of SFIs for exports of services were € 9.5 billion and total expenditures for imports of services were €

⁶⁹ UNCTAD, FDI in Africa: Performance and Potential, UNCTAD/ITE/IIT/Misc. 15 (Geneva:UNCTAD, 1999), p. 18.

10.2 billion.⁷⁰ It may be assumed that some € 8 billion, the largest part of these flows, reflects conduit activities for royalties and license fees. It is further assumed that some € 4 billion of these flows is paid onwards to 'pure' tax havens, and the rest to non-havens. If royalties are paid to a foreign affiliate to shift income out of a country, the payment is tax deductible, but additional withholding taxes may arise. Assuming a statutory corporate tax rate of 30% and a withholding tax of 10%, missed tax revenues would amount to 20% of the flows to 'pure' tax havens. This results in an estimate of missed tax revenues of € 0.8 billion. The use of Dutch royalty conduits need not be related to investment positions of Dutch SFIs, because payments for the use of intangible property can also be collected from companies that are not owned or financed by Dutch SFIs. It would therefore be more appropriate to assume that missed taxes per country due to royalty conduit structures are proportional to a country's total payments of royalties and license fees to foreign countries. To calculate these proportions, statistics on national payments for royalties and license fees in 2003 are used. These are taken from the balance of payment data in the UNCTAD Handbook of Statistics.⁷¹ 2003 is the latest year for which more or less comprehensive data was available.

There will be more taxes missed due to financing constructions. The size of flows associated with financing conduits may be derived from the loans from tax havens to Dutch SFIs, which are then lent to subsidiaries worldwide. Direct data on interest income of SFIs is not available, because it is included in the same item on the balance of payments with SFIs as dividends and capital gains. Debt financing from companies in Central America and the Caribbean to Dutch SFIs was € 59 billion in 2005. However, part of these stocks may reflect investments from mainland Central America.⁷² This share is unlikely to be large, given the size of total outward FDI stocks from Mexico and Panama and the negligible outward FDI stocks of other mainland countries.⁷³ Therefore it can be conservatively assumed that loans from Caribbean tax havens to Dutch SFIs were € 50 billion. Assuming 6% interest on these loans when they are lent onwards, and missed tax revenues amounting to 20% of these flows (similar to royalty flows), the missed tax revenues due to financing conduits would be € 0.6 billion.

There will be similar financing effects from other tax havens, such as the Channel Islands that are grouped together with Russia and Eastern Europe in 'other Europe' in the DNB data, and from the Dutch CFA regime. Together, these are estimated at € 0.4 billion. This is again a rather conservative estimate. According to the Dutch government, the additional government revenues from the CFA regime were € 225 million per year.⁷⁴ These are the revenues from tax on the interest income of group financing companies using the CFA regime that would otherwise not be present in the Netherlands. The effective tax rate on this income must be between 5% and 10%, depending on the use of certain reserves.

⁷⁰ Data from DNB, T5.1 and T5.14, IIP statistics in- and excluding SFIs, [http://www.statistics.dnb.nl/index.cgi?lang=uk&todo=Balans \(04-05-07\)](http://www.statistics.dnb.nl/index.cgi?lang=uk&todo=Balans (04-05-07)) .

⁷¹ UNCTAD Handbook of Statistics On-line, International trade in services, "5.2 Trade in services by sector and country," <<http://www.unctad.org/Templates/Page.asp?intItemID=1890>> (May 2007).

⁷² UNCTAD World Investment Report 2006, p. 304.

⁷³ UNCTAD World Investment Report 2006, p. 304.

⁷⁴ Kamerstuk 30 107 No. 2, Fiscaal Vestigingsklimaat, Nota Werken aan winst: Naar een laag tarief en een brede grondslag, 29 Apr 2005, p. 22

Thus, if the additional tax revenue for the Dutch government is € 225 million per year, the interest income must be at least € 2.25 billion per year. The missed tax revenues elsewhere due to the CFA regime alone might therefore well be higher than the conservative estimate of € 0.4 billion mentioned above.

Note that loans to subsidiaries via Dutch SFIs could be used to obtain profits resulting from any kind of income shifting out of a tax haven, including from transfer pricing and other strategies. Any indirect impact of Dutch financing conduits by enabling such uses of tax havens is disregarded here.

It is assumed that missed tax due to financing constructions is proportional to SFI debt financing stocks in a region instead of total SFI investment stocks. Adding these royalty and financing constructions yields a second estimate, shown in the table as 'Tax missed, Est. 2'. This estimate is more conservative with total tax avoidance of € 1.8 billion, and taking into account that total missed taxes worldwide must be well over € 1 billion, it is in fact a minimum estimate. It also yields a more conservative distribution over regions, with developing regions carrying a smaller proportion of the burden. Developing regions are therefore missing out on at least € 100 million of tax revenues.

Putting the estimates into perspective

Both estimates above attribute missed tax revenues to the host countries where the subsidiaries of multinational corporations are located, not to the home countries where the ultimate parent company is based. This implicitly assumes that the interest and royalty payments, resulting in a reduced tax base in host countries, would have been much lower if no tax planning schemes were used. The following is an example of a scenario where this assumption does not hold.

- ❑ The patent rights of a multinational corporation are held by a subsidiary in a Caribbean tax haven instead of a subsidiary in the multinational's home country where the R&D was performed.
- ❑ The subsidiary in the developing country pays royalties to the subsidiary in the Caribbean for the use of the patent rights. The payments are made via a conduit subsidiary in the Netherlands to reduce withholding taxes.
- ❑ However, the royalty payments are the same amounts that would have been paid had the patent been held by a subsidiary in the multinational's home country.

In this case, the same royalty payment would have been made anyway, only now the royalty income ends up in a tax haven instead of the home country of the multinational. As a consequence, tax revenues are foregone in the home country, but the tax base in a host country is not reduced. In practice, though, the correct market price for the use of intangible property rights is very hard to determine and multinationals have considerable flexibility in determining intra-group royalty payments.⁷⁵ The same applies to intra-group financing structures. As long as a company does not breach thin capitalisation rules, a

⁷⁵ See e.g. H. Grubert (2003). Intangible income, intercompany transactions, income shifting, and the choice of location. National Tax Journal 56, p. 221-42

multinational is free to decide on the combination of equity and internal debt financing of a subsidiary. If the use of tax planning schemes makes internal loans more attractive, then it is likely that a multinational will increase such internal loans. The implicit assumption that missed taxes should in general be attributed to host countries therefore seems reasonable.

It should be remembered that the estimates presented here are not very precise, however. It might therefore be better to assume a range that indicates the possible amounts of corporate tax revenues missed by governments of developing countries due to tax avoidance via Dutch SFIs. Combining the results from above, and taking account of the fact that most assumptions are fairly conservative, tax revenues missed by developing countries should be in the range of € 100 million to € 1 billion per year.

Only part of these missed tax revenues would be recovered were the Netherlands to take effective measures to eliminate possibilities for international tax avoidance. There are two reasons for this. Firstly, it is sometimes argued that without the international tax avoidance opportunities offered by the Netherlands, the investments in developing countries would not have taken place in the first place. However, we expect that this only has a marginal effect because tax considerations are usually of secondary importance in international investment decisions, especially for production or sales locations. The second reason is more important. If harmful conduit and group financing structures would no longer be possible via the Netherlands, many multinationals using these would change their tax planning strategies and use subsidiaries in other countries to achieve the same effect. The alternative strategies will probably be somewhat less attractive and less tax would therefore be avoided in developing countries. However, tax avoidance will continue via other countries. Therefore international cooperation to fight harmful tax avoidance is essential.

4. Conclusions and recommendations

4.1. Conclusions

The main aim of this study has been to analyse the consequences for developing countries of the tax haven features of the Netherlands. It builds on the previous SOMO report: "The Netherlands: A tax haven?" That report concluded that the Netherlands is a tax haven for multinational corporations (MNCs), because it deliberately enables them to reduce their tax payments in other countries via constructions involving subsidiaries in the Netherlands. This study has taken into account several comments and questions that have emerged after the first report. It confirms the conclusion that the Netherlands is a tax haven for MNCs.

The study presented new data and calculations on the operations of Special Financial Institutions (SFIs). These are Dutch subsidiaries of foreign multinationals used for international tax planning constructions. At present, the Netherlands hosts over 10,000 SFIs. The amount of foreign direct investment (FDI) that is channelled through these SFIs is enormous. Together, they control over € 1,000 billion of assets or 13% of global inward FDI stock. In international FDI statistics, the assets and liabilities of SFI are usually left out. If they would be included, the Netherlands would be the second largest investor worldwide, just after the US and far ahead of the UK, the third largest investor.

SFIs can be divided into financing companies, holding companies, and royalty companies. The financing companies generate the largest volume of transactions. Some of the most important potentially harmful tax avoidance constructions used by SFIs are royalty and financing conduits and the Dutch Group Financing Activities (CFA) regime, which is being phased out. It has been replaced by a new 'group interest box' that is currently being investigated by the European Commission and has not yet entered into force. Some of these regulations, such as the previous CFA regime and a future group interest box, are unique for the Netherlands. Other constructions, such as royalty and financing conduits, could in principle use alternative conduit countries as well.

In 2005, SFIs had invested approximately € 90 billion in developing countries. This was 7% of total FDI in these countries. Tax avoidance via SFIs therefore also results in missed tax revenues for governments of developing countries. In addition, it causes a market distorting tax advantage for MNCs over smaller domestic competitors. It should be noted that Dutch tax policy also has some positive aspects for developing countries. However, there is insufficient data available to substantiate the positive effects, let alone to sustain claims that these would compensate for the negative effects.

Apart from being a tax haven for MNCs, the Netherlands is also a donor country for international development. As such, it supports the UN Millennium Development Goals (MDGs) of halving world poverty by 2015, including the instrumental MDG 8 to develop an international financial system that is supportive of poverty reduction. In 2006, the Dutch

government provided € 4.3 billion in Official Development Assistance (ODA). This report has estimated that as a consequence of the tax haven features of the Netherlands, developing countries are missing between € 100 million to € 1 billion in tax revenues each year. One rough estimate yields a figure of € 640 million per year, for example. This equals 15% of the Dutch official aid budget. A more precise estimate would require more detailed data on the composition of SFI income.

The Netherlands being a tax haven for multinationals therefore has important negative consequences for developing countries. This raises the question of whether Dutch tax policy is coherent with Dutch policy on development cooperation. The Ministry of Foreign Affairs already recognised the coherence aspect of tax policy and development policy in the past. However, it appears that the large role of SFIs in tax avoidance and the associated amount of missed tax revenues in developing countries have largely escaped attention until recently.

Finally, it should be recognised that tax avoidance is an international problem. If the Netherlands were to eliminate opportunities for harmful tax avoidance while other countries, such as Luxembourg and Switzerland, continue to offer this type of construction, a large part of the missed tax revenues would not be recovered. It is likely that many multinationals would simply continue avoiding taxes using constructions via those countries instead. On the other hand, Dutch financing conduits may also facilitate tax avoidance via other countries as they can be used as a conduit to reinvest the untaxed income. Ending such structures could have a broader impact beyond the use of Dutch SFIs as well.

4.2. Recommendations

The conclusions above are based on an analysis of the empirical data gathered during the study. This study has attempted to provide an objective reflection and interpretation of this data. In this paragraph, we present a set of recommendations to the Dutch government. In contrast to the rest of the report, these are not intended to be neutral, but seek to promote a fair and just global economic system in which tax avoidance by multinational corporations is minimised. We already made a number of recommendations in our previous report.⁷⁶ Some of these are specified in greater detail below, and linked to recent developments and some new, additional recommendations are presented.

Combating tax havens in general

- **At the international level, the Dutch government should take a pro-active position to combating tax havens and harmful preferential tax regimes.** In addition to the initiatives of the EU, OECD and UN, the Netherlands should support the recent initiative of the Leading Group on Solidarity Levies to Fund Development – a group of 24 countries with a particular focus on finance for

⁷⁶ M. van Dijk, F. Weyzig and R. Murphy, "The Netherlands: A tax Haven?", SOMO, November 2006, <http://www.somo.nl/html/paginas/pdf/netherlands_tax_haven_2006_NL.pdf> (May 2007), p. 62-5.

development. The Leading Group emphasises combating tax havens as a major contribution to achieve its goal. Tax havens should therefore be also a priority issue for the Financing for Development conference in Doha in 2008.⁷⁷

- **At the national level, the Netherlands should introduce a withholding tax on interest and royalty payments to tax havens.** For application of the participation exemption, comparable anti-avoidance clauses already exist. These disqualify foreign dividends received from low-taxed financing companies. The threshold for low-taxed companies has been set at 10%.⁷⁸ A substantial withholding tax on interest and royalty payments to the same class of companies could strongly discourage harmful conduit structures via the Netherlands without affecting real economic activity. A second effect of such a measure is that it would reduce the attractiveness of reinvesting income from tax havens entities via the Netherlands into other countries. At present, Caribbean tax haven entities alone have invested some € 50 billion via loans to Dutch SFIs. Introducing a withholding tax on associated interest payments could therefore make a major difference. The measure needs to be designed in such a way that it does not breach EC law. It should therefore be explicitly justified on the grounds of public policy, and not involve arbitrary discrimination or disguised restrictions on payments to third countries.⁷⁹

Ending harmful group financing regimes

- **At the international level, tax competition between the Netherlands, Luxembourg, Switzerland, Belgium and a few other countries to attract group financing activities must be stopped.** This requires a coordinated effort. The major tax benefits for income from financing activities are harmful for third countries, because they create incentives for tax avoidance abroad via intra-group financing structures. This contrasts with tax competition for manufacturing locations, which is usually harmful for competing countries and the country that offers the benefits itself, but not for third countries.
- **At the national level, the Dutch government should not allow the group interest box to enter into force.** In addition, no alternative regime of a similar nature should be introduced, for example in case the European Commission, which is currently investigating the group interest box, qualifies it as illegal state aid. The withdrawal of the group interest box could be part of an internationally

⁷⁷ Erik Solheim, Minister of International Development, "Opening Statement"; Morten Eriksen, Managing Director Norwegian NGO Forum, "NGO Remarks on the agenda of innovative finance," Leading Group on Solidarity Levies to Fund Development, Second Plenary Meeting, 6-7 Feb 2007, <<http://www.innovativefinance-oslo.no/statements.cfm>> (June 2007).

⁷⁸ *Wet op de VpB* [Law on corporate tax] 1969, Section 2.5, Art. 13 (*Deelnemingen en deelnemingsvrijstelling*), No. 9-11.

⁷⁹ Consolidated version of the treaty establishing the European Community, Official Journal of the European Communities, C 325, 24 Dec 2002, Art. 58 (previously Art. 73d), p. 56.

coordinated effort as mentioned above, in which other countries also abolish their preferential tax regimes for group financing activities.

Supporting developing countries

- **At the international level, the Dutch government should take a lead in international programmes to increase the capacity of tax authorities in developing countries.** One of the reasons why the Netherlands has developed into a tax haven for multinational corporations, is the presence of highly qualified and knowledgeable experts in the field of tax planning.⁸⁰ As such, the Netherlands is in an excellent position to develop a comprehensive international capacity building programme to train tax officials in developing countries. As part of the International Tax Dialogue (ITD) programme, the OECD already organises training weeks in developing countries on various tax issues.⁸¹ The number of workshops on international tax avoidance and evasion could be increased and the Netherlands should also consider bilateral technical assistance programmes of a more structural nature.
- At the national level, the Dutch government should actively exchange information with developing countries on potentially harmful tax structures via entities in the Netherlands. The Netherlands should contact governments of developing countries that have a tax treaty with the Netherlands and investigate in detail whether multinationals may be avoiding taxes in that country through investment structures or transactions involving Dutch subsidiaries. In addition to sharing the information, the Dutch government should provide training and support to the tax authorities to interpret the data and help implement measures to stop such harmful structures and prevent them from happening in the future. Such a programme should be a joint effort by the Dutch Ministry of Foreign Affairs, the Ministry of Finance and the Dutch tax authority, in order to be effective.

Increasing transparency and disclosure

- **At the international level, the Dutch government should support the development of a mandatory accounting standard that includes country-by-country reporting of corporate tax payments.**⁸² The International Accounting Standards Board (IASB) has proposed International Financial Reporting Standards (IFRS) 8, a new standard on segment reporting, which is to replace International Accounting Standard (IAS) 14. The European Commission has

⁸⁰ See M. van Dijk, F. Weyzig and R. Murphy, "The Netherlands: A tax Haven?", SOMO, November 2006.

⁸¹ International Tax Dialogue website, www.itdweb.org (Jun 2007).

⁸² Global Witness, Care, Save the Children, Open Society Institute, Transparency International (UK), Cafod & Publish What You Pay, International Accounting Standard 14 Segment Reporting, 2005 Update: Submission to the IASB, <<http://www.taxresearch.org.uk/Documents/IAS14Final.pdf>> (Jun 2007).

agreed to undertake an impact assessment of IFRS 8 before it is adopted. In order to enhance disclosure, IFRS 8 should be modified to include country-by-country reporting of tax payments. This would be in line with the Global Reporting Initiative (GRI) protocol on economic indicators, the leading global standard for sustainability reporting.⁸³

- At the national level, The Dutch government could increase transparency about corporate structures and tax payments, by requiring all companies resident in the Netherlands to file annual accounts at the Chamber of Commerce. At present, the subsidiaries of a multinational corporation are exempted from the obligation to publish (unconsolidated) annual accounts if the parent publishes consolidated accounts and has filed liability statements for the subsidiaries.⁸⁴ The UK is an example of a country where such an exemption does not exist. As a consequence, access to data on UK companies, via the UK Companies House, is much greater than access to information on Dutch companies.

⁸³ GRI, Indicator Protocol Set: Economic Performance Indicators, Version 3.0, 2006, <http://www.globalreporting.org/NR/rdonlyres/A4C5FA04-3BD3-4A02-B083-6B3B00DEAF61/0/G3_IP_Economic.pdf> (Jun 2007), p. 5.

⁸⁴ BW 2 [Dutch Civil Code, Book 2] Art. 403.

Annex A: Balance of Payments, 2006

	Current account	Non SFI (€ mln)	SFI (€ mln)	Total (€ mln)	Non SFI (%)	SFI (%)	Total (%)
	Goods account						
1.1	Balance on goods	38,305	5	38,310	100%	0%	100%
	Services account						
1.2.1	Exports of services	67,248	9,497	76,745	88%	12%	100%
1.2.2	Imports of services	62,783	10,172	72,955	86%	14%	100%
1.2	Balance on services	4,465	-676	3,789	118%	-18%	100%
	Income account						
	Receipts						
1.3.1.1	Income on direct investment	38,169	52,981	91,150	42%	58%	100%
1.3.1.2	Income on portfolio investment	26,671	631	27,302	98%	2%	100%
1.3.1.3	Income on compensation of employees and other investment	20,999	3,583	24,582	85%	15%	100%
1.3.1	Receipts	85,835	57,199	143,034	60%	40%	100%
	Expenditures						
1.3.1.1	Income on direct investment	10,903	37,793	48,696	22%	78%	100%
1.3.1.2	Income on portfolio investment	35,162	14,447	49,609	71%	29%	100%
1.3.1.3	Income on compensation of employees and other investment	27,628	2,789	30,417	91%	9%	100%
1.3.2	Expenditures	73,694	55,026	128,720	57%	43%	100%
1.3	Balance on income	12,141	2,173	14,314	85%	15%	100%
1.4	Net current transfers	-9,103	0	-9,103	100%	0%	100%
1	Balance on current account	45,808	1,502	47,310	97%	3%	100%
2	Net capital transfers	-1,100	-1	-1,101	100%	0%	100%

	Financial account	Non SFI (€ mln)	SFI (€ mln)	Total (€ mln)	Non SFI (%)	SFI (%)	Total (%)
	Direct investment						
	<i>Direct investment abroad</i>						
3.1.1.1	<i>Equity capital including reinvested earnings</i>	-10,205	-100,769	-110,974	9%	91%	100%
3.1.1.2	<i>Other capital</i>	-7,882	-1,470	-9,352	84%	16%	100%
3.1.1	<i>Direct investment abroad</i>	-18,089	-102,236	-120,325	15%	85%	100%
	<i>Direct investment in the Netherlands</i>						
3.1.2.1	<i>Equity capital including reinvested earnings</i>	4,956	86,854	91,810	5%	95%	100%
3.1.2.2	<i>Other capital</i>	-1,475	-38,345	-39,820	4%	96%	100%
3.1.2	<i>Direct investment in the Netherlands</i>	3,484	48,504	51,988	7%	93%	100%
3.1	Net direct investment	-14,605	-53,732	-68,337	21%	79%	100%
	Portfolio investment						
	<i>Foreign securities</i>						
3.2.1.1	<i>Equity</i>	-8,517	-2,060	-10,577	81%	19%	100%
3.2.1.2	<i>Debt securities</i>	-33,625	362	-33,263	101%	-1%	100%
3.2.1	<i>Foreign securities</i>	-42,141	-1,702	-43,843	96%	4%	100%
	<i>Dutch securities</i>						
3.2.2.1	<i>Equity</i>	16,227	8,864	25,091	65%	35%	100%
3.2.2.2	<i>Debt securities</i>	33,637	28,994	62,631	54%	46%	100%
3.2.2	<i>Dutch securities</i>	49,865	37,859	87,724	57%	43%	100%
3.2	Net portfolio investment	7,724	36,160	43,884	18%	82%	100%
3.3	Net financial derivatives	-5,610	-2,845	-8,455	66%	34%	100%
3.4	Net other investment	-20,020	9,456	-10,564	190%	-90%	100%
3	Net financial account excluding Financial reserves	-32,511	-10,961	-43,472	75%	25%	100%
4	Total increase (-) in official reserves	-826	0	-826	100%	0%	100%
5	Net financial account (3+4)	-33,337	-10,961	-44,298	75%	25%	100%
6	Errors and omissions	-11,368	9,458	-1,910	595%	-495%	100%

Source: DNB, T5.1 and T5.14, <http://www.statistics.dnb.nl/index.cgi?lang=uk&todo=Balans> (04-05-07).

Annex B: International Investment Position, 2006

External assets		Non SFI (€ mln)	SFI (€ mln)	Total (€ mln)	Non SFI (%)	SFI (%)	Total (%)
	Direct investment abroad						
1.1	Equity capital	372,442	936,831	1,309,273	28%	72%	100%
1.2	Other capital	181,599	234,506	416,105	44%	56%	100%
1	Total direct investment abroad	554,041	1,171,337	1,725,378	32%	68%	100%
	Foreign securities						
2.1	Equity securities	448,053	6,971	455,024	98%	2%	100%
	Debt securities						
2.2.1	<i>Bonds</i>	<i>546,093</i>	<i>39,911</i>	<i>586,004</i>	<i>93%</i>	<i>7%</i>	<i>100%</i>
2.2.2	<i>Money market instruments</i>	<i>7,629</i>	<i>7,070</i>	<i>14,699</i>	<i>52%</i>	<i>48%</i>	<i>100%</i>
2.2	Total debt securities	553,722	46,981	600,703	92%	8%	100%
2	Total foreign securities	1,001,775	53,952	1,055,727	95%	5%	100%
3	Financial derivatives	62,186	31,008	93,194	67%	33%	100%
	Other investment						
4.1	Trade credits	29,751	0	29,751	100%	0%	100%
4.2	Loans	115,235	124,598	239,833	48%	52%	100%
4.3	Currency and deposits	473,916	35,239	509,155	93%	7%	100%
4.4	Other assets	39,832	10,156	49,988	80%	20%	100%
4	Total other investment	658,733	169,995	828,728	79%	21%	100%
5	Total official reserves	18,151	0	18,151	100%	0%	100%
6	Total assets (1-5)	2,294,886	1,426,292	3,721,178	62%	38%	100%

	External liabilities	Non SFI (€ mln)	SFI (€ mln)	Total (€ mln)	Non SFI (%)	SFI (%)	Total (%)
	Direct investment in the Netherlands						
7.1	Equity capital	200,394	786,828	987,222	20%	80%	100%
7.2	Other capital	169,747	140,386	310,133	55%	45%	100%
7	Total direct investment in the Netherlands	370,141	927,214	1,297,355	29%	71%	100%
	Dutch securities						
8.1	Equity securities	468,785	22,400	491,185	95%	5%	100%
	Debt securities						
8.2.1	<i>Bonds</i>	582,163	332,538	914,701	64%	36%	100%
8.2.2	<i>Money market instruments</i>	24,566	14,455	39,021	63%	37%	100%
8.2	Total debt securities	606,729	346,993	953,722	64%	36%	100%
8	Total Dutch securities	1,075,514	369,393	1,444,907	74%	26%	100%
9	Financial derivatives	66,144	25,413	91,557	72%	28%	100%
	Other investment						
10.1	Trade credits	19,837	0	19,837	100%	0%	100%
10.2	Loans	149,984	81,448	231,432	65%	35%	100%
10.3	Currency and deposits	509,272	4,037	513,309	99%	1%	100%
10.4	Other liabilities	34,455	18,787	53,242	65%	35%	100%
10	Total other investment	713,548	104,272	817,820	87%	13%	100%
11	Total liabilities (7- 10)	2,225,347	1,426,293	3,651,640	61%	39%	100%
12.1	Net direct investment (1-7)	183,899	244,124	428,023	43%	57%	100%
12.2	Net portfolio investment (2-8)	-73,738	-315,442	-389,180	19%	81%	100%
12.3	Net financial derivatives (3-9)	-3,958	5,595	1,637	- 242%	342 %	100%
12.4	Net other investment (4-10)	-54,815	65,723	10,908	- 503%	603 %	100%
12.5	Net official reserves (5)	18,151	0	18,151	100%	0%	100%
12	Net Dutch external assets (12.1-12.5)	69,539	0	69,539	100%	0%	100%

Source: DNB, T5.11 and T5.15, <http://www.statistics.dnb.nl/index.cgi?lang=uk&todo=Balans> (04-05-07).

Note: IIP data for 2006 are provisional.

Annex C: DNB country classification

EU: Austria, Belgium, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Latvia, Lithuania, Malta, Netherlands, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, United Kingdom.

EFTA countries: Iceland, Liechtenstein, Norway, Switzerland.

Other Europe: Albania, Andorra, Belarus, Bosnia and Herzegovina, Bulgaria (up to 2005), Cyprus, Gibraltar, Guernsey, Jersey, Macedonia, Isle of Man, Moldavia, Malta, Romania (up to 2005), Russian Federation, San Marino, Serbia and Montenegro, Turkey, Ukraine, Vatican.

North Africa: Algeria, Egypt, Libya, Morocco, Tunisia.

Rest of Africa: Angola, Benin, Botswana, Burkina Faso, Burundi, Cape Verde, Comoros, Cameroon, Central African Republic, Chad, Congo, Congo Democratic Republic of, Côte d'Ivoire, Djibouti, Eritrea, Ethiopia, Equatorial Guinea, Gabon, Gambia, Ghana, Guinea, Guinea-Bissau, Kenya, Lesotho, Liberia, Mali, Mauritania, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Niger, Nigeria, Rwanda, Senegal, Sierra Leone, Sudan, Seychelles, Somalia, South Africa, Swaziland, Sao Tome and Principe, Togo, Uganda, United Republic of Tanzania, Zambia, Zimbabwe.

Central America: Anguilla, Antigua and Barbuda, Aruba, Bahamas, Barbados,

Belize, Bermuda, British Virgin Islands, Cayman Islands, Costa Rica, Cuba, Dominica, Dominican Republic, El Salvador, Grenada, Guatemala, Haiti, Honduras, Jamaica, Montserrat, Mexico, Netherlands Antilles, Nicaragua, Panama, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Trinidad and Tobago, Turks and Caicos Islands.

South America: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Falkland Islands, Guyana, Paraguay, Peru, Suriname, Uruguay, Venezuela.

Middle East: Armenia, Azerbaijan, Bahrain, Georgia, Iran, Islamic Republic of, Iraq, Jordan, Kuwait, Lebanon, Oman, Palestinian Territory, Qatar, Saudi Arabia, Syrian Arab Republic, United Arab Emirates, Yemen.

(Rest of) Asia: Afghanistan, Bangladesh, Bhutan, India, Japan, Kazakhstan, Kyrgyzstan, Maldives, Nepal, Pakistan, Sri Lanka, Hong Kong, Korea Democratic People's Republic of, Korea, Republic of, Macao, China, Mongolia, Taiwan, Brunei, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste, Tajikistan, Turkmenistan, Uzbekistan, Viet Nam.

Oceania: Australia, Cook Islands, Fiji, French Polynesia, Kiribati, New Caledonia, New Zealand, Niue, Northern Mariana, Islands, Palau, Papua New Guinea, Samoa, Solomon Islands, Tokelau, Tonga, Tuvalu, Vanuatu.