Stakeholder Dialogue on Tax at Swedfund, March 13, 2014

Minutes of Meeting

Agenda

- Breakfast and welcome
- Keynote by Alvin Mosioma, Tax Justice Network Africa
- Swedfund's "country by country" tax reporting by Niclas Düring, Swedfund
- Dialogue led by Lars-Olle Larsson, Swedfund
- Next steps?
- Conclusion

Participants

Alvin Mosioma, Executive Director, Tax Justice Network - Africa (TJN-A)

Magnus Walan, Policy Advisor Diakonia

Christine von Sydow, Secretary General, Action Aid

Jenny Engdahl, Head of Communication, Forum Syd

Cecilia Vaverka, Sustainable Business Solutions, PwC (Observer)

Participants representing Swedfund

Niclas Düring, Portfolio Director, Swedfund

Petra Brantmark, Legal, Swedfund

Fredrik Wijkander, Senior Investment Manager, Swedfund

Nina McEvenue, Press Secretary, Swedfund (Notes)

Lars-Olle Larsson, Senior Manager ESG Affairs, Swedfund

Aim of the Stakeholder dialogue

Based on Swedfund's mission to reduce poverty through sustainable business, Swedfund welcomes a constructive dialogue with all stakeholders with a view to improve its transparency with respect to taxes, and create opportunities for further dialogue and discussion on Swedfund's role in private sector development and poverty reduction.

Introductory remarks, Lars-Olle Larsson

Lars-Olle welcomed the attendees and initiated a *tour de table* as there were several new participants that were not present at the last dialogue meeting in October, 2013.

Keynote by Alvin Mosioma, Tax Justice Network Africa

Alvin Mosioma (AM), Director for the Tax Justice Network Africa outlined the focus of the organization and the challenges they address.

AM described the Tax Justice Network Africa, a network of 26 organizations in 18 countries in Africa, noting that several of the members are themselves networks on a more local level. The organization was launched in 2007 and was a key outcome of the World Social Nairobi. With a small staff of 12, Tax Justice Network Africa engages in policy work at different levels including nationally in conjunction with its organizations regionally engaging in African economic organizations such as the African Union, UNECA and Africa Tax Administrators Forum at a global level in partnership with organizations such as Diakonia.

AM outlined the organization's focus which is on budget expenditure and the impact of tax structures on development. The organization addresses the need to influence policy development in this area.

AM noted several factors affecting the taxation system in Africa. On a domestic level many African governments capacity to collect revenue is constrained by structural, policy and capacity challenges. While many governments have also been exploring how to expand their tax base and increase their domestic revenue base and there seems to be a trend towards the development of a very regressive tax system, particularly as a result of expansion of VAT - an approach that is impacting the poor - rather than more progressive tax systems. Due to large informal sectors that are able to avoid taxation the reality is that those with the least ability to pay are carrying the largest tax burden. This situation also undermines the willingness to pay tax resulting in low tax compliance.

AM further noted that tax incentives given by governments through structures such export processing zones erode the tax basis, effectively reducing the amount of tax being paid. It is estimated that Kenya loses 3.1 percent of GDP as a result of tax evasion. In Uganda that number is 2%percent which is roughly twice the country's total health budget.

An additional issue according to AM is the lack of structure in many countries for the granting of tax incentives. These incentives can be offered at several levels and by various officials which makes it difficult to get an overview of the tax incentives given. There is therefore need for a coherent policy framework and the ability to benchmark incentives.

AM pointed out that there are some positive signals, such as recent moratoriums on tax incentives in some countries such as Zambia. There are also efforts being made to map tax incentives in Africa. AM noted that revenue loss as a result of tax dodging by MNCs and wealthy elites present by far the largest source of revenue outflow from Africa

accounting for over 60% of the total illicit flows. Challenges related to illicit financial flows have been identified globally as a major impediment to poverty eradication in poor countries. Despite the general consensus internationally on the need to tackle illicit financial flows it has remained limited largely to political rhetoric but not much action. There is however some traction for these issues in that discussion are taking place in global and regional forums such as the OECD, EU, G8 etc. AM also mentioned the High Level Panel (HLP) on Illicit Financial Flows from Africa led by Thabo Mbeki and Kofi Annan's call in the Africa Progress Panel for the importance of tackling these illicit financial flows. So far, little has trickled down to the domestic level, according to AM.

AM further noted that consultations are taking place, for example recently in Bogotá and in South Africa. But from his organization's perspective this is mostly window dressing with little effective participation of developing countries. There is a need for a broader platform, according to AM, for example a strengthening of the UN tax committee.

Looking back, AM sees a huge momentum that should be taken advantage of at both a national and international level. A few years ago some of the demands made by civil society such as country by country reporting were perceived to be unrealistic and not viable by bodies such as the OECD. Global pressure has led to the point where the OECD admits that their models need to be changed. AM emphasized the need to move away from political rhetoric and start looking at actual legislation and policy-making.

AM further noted that another important issue is taxation agreements such as the double taxation agreements between governments. When asking why these agreements are being reached, the response according to AM has been that it is in part due to restrictions made by DFI banks which encourage channeling investments via Mauritius. Many older agreements need to be reviewed so that they follow the current development agenda. At the same time there is need to ensure policy coherency between economic policy choices including bilateral agreements and the development policy agenda. We are concerned some of the double taxation agreements signed particularly between Mauritius and other African countries are opening a flood gate for the development of tax avoidance schemes.

Magnus Walan (MW) added that Sweden's Prime Minister Fredrik Reinfeldt has spoken about financial flows, money laundering etc. and its link to organized crime. Leaders in the EU have also promised action. In addition there have been processes taking place and directives in the EU related to these issues. Most significantly, there have been discussions on account directives on country-by-country reporting. This issue was tabled in the bank sector but we have not seen any further discussions in other areas, according to MW.

MW further noted that the Swedish government and EU backtracked on this issue recently by referring to the OECD. Swedish officials have also stated that they lacked knowledge of pricing as a problem and have also emphasized the heavy burden that reporting puts on companies. In addition, we are looking at beneficial ownership and money laundering. We have not yet found the government's position on these issues.

Christine von Sydow (CvS) asked AM if the study was able to show that Kenya has more tax incentives than Uganda and that despite this Uganda managed to attract more investments.

In response to the question posed, AM mentioned that incentives are more prevalent in certain industries. There have been discussions about creating regions for investments in certain industries, for example the apparel sector. Local producers cannot compete in terms of price with those not paying tax, which results in unfair competition. In the report "Tax competition in East Africa: A race to the bottom?" it's been described how countries in the east Africa region in their efforts to attract FDI's are engaged in a harmful race which is significantly eroding their tax bases.

Petra Brantmark (PB) noted that Swedfund does currently invest in funds through Mauritius which has been approved in the OECD Global Forum Peer Review and noted that Swedfund is aware of problems associated with companies establishing a holding company there for the purpose of tax evasion. PB also noted that the treaty between for example Mauritius and Kenya is not necessarily always more beneficial for the country in which the investment is made than the treaty between Sweden and Kenya from a tax perspective and added that there are also other reasons than tax to invest via Mauritius, for example if the tax system in the country is not sufficiently robust. PB emphasized however that Swedfund would not set up a holding company in Mauritius direct investments for tax reasons.

In response AM noted that there are a myriad of arguments such as red tape etc. made by companies as to why they go through Mauritius. It is difficult to rule out these arguments but Action Aid's study shows however that it does open an opportunity for profit shifting. AM emphasized further that the potential for revenue loss is more important from his organization's perspective, noting that it is not just double taxation that is the problem. Due diligence is also very important to ensure that this practice is not taking advantage and that round-tripping is not taking place.

In response, PB mentioned that due diligence is exactly what Swedfund does. When making an investment Swedfund looks at why the structure has been set up the way it has and ensures that it is not purely for tax reasons. For example, sometimes the domestic legislation in a country is not rigorous enough for Swedfund to ensure shareholder rights which are very important for Swedfund in order to be a responsible investor. There may also be other reasons for having holding companies noted PB.

Niclas Düring (ND) described Swedfund's role as a DFI and MFI that provides support and investments as well as loans and credit to banks. Swedfund supports commercial, sustainable companies and strives to have a positive impact on society. ND explained that Swedfund exits investments and reinvests profits in new companies. Taking an example from his previous employer CDC Group – the UK Development Finance Institution - their average growth for the 2004-09 period was 18 % year-on-year, effectively enabling them to scale up the number of companies they support with capital through funds and direct investments from a few hundred to more than a thousand companies. ND emphasized that Swedfund is very small compared to other DFI's,

having currently about 90 investments, both directly and through funds and loans, but that the same principles hold, just on a smaller scale.

Fredrik Wijkander (FW) added that Swedfund requires a seat on the boards of the investee company in order to have an active influence and do what is possible to ensure compliance as well as work to develop the companies in these aspects. Swedfund helps companies understand that being a good Corporate Citizen benefits the business.

FW noted further that established discussions always involve tax and that it is not a deal-breaker from his perspective and experience. Tax incentives are not a necessity; people will invest despite a lack of such incentives. This is something that must be better understood by the governments.

CvS noted that Action Aid often hears from companies that it is not about the level but about the fair competition. It is more important there is a standard and level playing field. There is a risk that by conducting investments where double taxation agreements come into play, Swedfund to some extent contributes to the existing system.

FW emphasized that Swedfund's aim is to ensure fairness in the application of transfer pricing practices/rules (when applicable), thereby enabling the parent company as well as the local company to share profits in a reasonable way. FW noted that Swedfund is after all an owner locally and wants a reasonable part of the profits to be realized locally – they want the company to grow.

Regarding the private sector, AM noted that companies say that if they are offered tax incentives they cannot say no, though this is not the main driver for investment. But looking at what happens on the ground AM:s organization has seen that companies do get these incentives and that it makes a difference for competition on the ground. AM asked: how do you see your influence in promoting tax transparency – nobody seems to be willing to take lead on this issue and set benchmarks for due diligence etc.?

Lars-Olle Larsson (LOL) noted in response that in the previous dialogue the draft principles for corporate responsibility on tax were discussed and how Swedfund can facilitate this effort in Sweden and help finalize the draft.

Swedfund's "country by country" tax reporting by Niclas Düring, Swedfund

ND: described Swedfund's view of taxes and why they matter as well as what can be done and what is currently being done.

ND described Swedfund's three pillars, each of which is essential: Society Development, Financial Viability and Sustainability. Swedfund looks at investments collectively. We can shift funds between commercially successful companies to those with maybe less profit but more impact. It is a balance where we have to weigh helping more people today and not as many tomorrow or none today but many in the future.

ND further explained that Swedfund's pillar "societal development" encompassed taxes, jobs and knowledge transfer. Thus, tax features prominently as one of our nine key performance indicators. Our investments should create jobs that create trickle down

effects. They should also provide products needed locally. It is important to balance both the income and non-income side of poverty. Do people have money to spend (income side of poverty) and are there products and services available to them (non-income side of poverty)? In order to create lasting impacts our investments need to generate a return on investment. The profit is important for a range of reasons – it means a company is financially viable and therefore will be able to provide lasting employment to their employees, enabling a more long-term outlook on life and investments in housing and education for their children. A profitable investment also enables Swedfund to invest more and support more companies in subsequent years, thereby increasing its impact on livelihoods, societal development and ESG matters, and even locally the company can invest and buy more.

ND noted that Swedfund does not conduct dialogue on regulatory reform as it is not the organization's mandate. Swedfund does however insist on tax payments and compliance on several issues. We are currently the only DFI that pays taxes domestically to the Swedish government, which unfortunately has the obvious consequence of reducing Swedfund's capital and ability to support even more companies with investments.

ND explained further that Swedfund's portfolio companies pay taxes where they domicile. Swedfund has reached out to other DFI's on OECD peer review findings to ensure a common interpretation. Otherwise we run the risk of being either too risk-taking or too cautious. We are settling key questions, such as if we can invest in red-listed countries. Ambiguity on these issues can have negative impacts. We have also heard some indications that some African companies that were reviewed early on with little support in the processes. This resulted in some cases to passing judgments rather than supporting change. In some instances comparison are being made between tax havens and some of these countries. There are big differences and we are clumping these countries together too much.

ND noted that in Swedfund's country-by-country reporting primarily taxes payable figures are used – although taxes paid is actually a better measure. Taxes payable is the data Swedfund currently receives from their investment companies and it would entail more work on their part to get these figures as taxes paid.

ND cautions that the same behavior will lead to the same results. Either Swedfund or someone else has to do something differently. National governments must have a better overview of their tax treatment. There is also a need for a similar regional overview and coordination. They either need to invite themselves at an international level or conduct regional discussion on these issues.

ND explained that when it comes to Swedfund's portfolio, Swedfund ensures that taxes are paid and that they increase through higher profitability as well as ensuring that tax avoidance is not exercised. Tax levels should not have impact on our investments. We influence board seats etc. and aim to be as transparent as possible so long as information is not commercially sensitive. Swedfund is able to publish country-by-country numbers where we have several company investments.

ND explained that there is a "Corporate Governance Development Framework" signed by 33 Development Finance Institutions (DFIs) for use in their investment processes.

Swedfund took an initiative last week with the CDC on the anti-corruption framework to address this issue. We are very ambitious in this area and even though we are small we are also loud.

ND added that based on financial statements from each company and compiled by region and by country Swedfund will have a tax report for 2012. This will reflect taxes payable for the most part. Since Swedfund is expected to deliver the Annual Report in the spring, at the same time as most of the investment companies, Swedfund will not be able to include the figures for 2013 in the report.

ND remarked that a lot of current investments are Greenfields that are pre-revenue and pre-profit as well as struggling companies so the tax payment levels are lower than ideal. It's not an average and the figures are very influenced by individual companies.

FW emphasized that Swedfund investments are often early on in the company's development and that these types of investments often take longer and then expected to reach a profit. It therefore takes time for these companies to reach a level where they can pay local income tax.

Dialogue led by Lars-Olle Larsson, Swedfund

AM emphasized that his organization has concerns about the Global Forum as a clearing house for defining tax havens. From experience, the effectiveness of OECD can be questioned and it is not adequate noting that countries in that process have not done anything on the ground.

AM asked about Swedfund's internal capacity to ensure a company is above board when it comes to tax. Swedfund invests taxpayer's money and how they are used will impact Swedfund's credibility. How certain can Swedfund be on its DD?

FW responded that Swedfund does have the internal capacity to an extent, and if not uses external third parties to assist, both locally in the destination country and here in Sweden. Swedfund also does integrity checks where the ownership structures as well as individuals are thoroughly checked. Swedfund goes back through structures and has declined interesting opportunities based on information showing ownership higher up the chain that was red listed. We do decline those investments that do not comply with our policies. Swedfund is as sure as we can be when we invest although there is always a risk. We are constantly improving and our last investment is always our best investment.

LOL emphasized that it has not always been this way. While policies continuously are improving, Swedfund does have an issue with older investments. Investments made 12 years ago did not adhere to the same standards in terms of due diligence and contracts were not as demanding in these aspects as they are today.

ND noted that Swedfund's investments are long-term private investments and loans. There is a possibility for influence but Swedfund needs to be committed for a long time and it is difficult to include a contractual clause for policy changes over time. It is therefore a challenge to evolve older investments.

MW noted the need to also embrace progressively handling risk and its evolution. These things are moving targets and are they themselves evolving.

FW responded that it is not possible to contract this at the entering stage. But companies are also realizing the benefits more progressive policies. Swedfund is influencing where we can.

MW mentioned that Diakonia is currently having dialog with the UN on the principles on tax as well as with the Gates Foundation, also on tax policy. Henrik von Sydow is in dialog on the future with the OECD.

CvS noted that Action Aid is looking at fair taxation standards as a start.

LOL noted that Swedfund hopes to see an update at our next dialog this spring.

Next steps & conclusion

Regarding the next steps LOL mentioned that MW and Swedfund's Managing Director Anna Ryott would like to do something together on this issue, maybe in conjunction with Swedfund issuing the country-by-country report.

AM noted that what is going to be interesting is the the possibility of building change into contracts. The profit shifting action plan from the OECD is very interesting as well as how this could be translated into the principles. The question is also how much leadership Swedfund can have in the DFI network and in pushing anti-corruption.

ND responded that Swedfund is the smallest dog with biggest bark in the European DFI network and that it therefore is difficult to impose standards and practices on others. The best thing Swedfund can do is to lead by example and to engage in dialogue with other DFIs and investors to try and raise the bar and efforts to address tax matters.

MW noted that Diakonia can help find relevant platforms.

ND said that Swedfund can also promote the issue in the EDFI - the European DFI network. That is a forum where there is a possibility to influence and raise the discussion. (In discussions right after the meeting between ND and the chief legal counsel, it turns out the network of lawyers among European DFI already discusses tax matters in great depth).

ND added that the IFC has published a Doing Business survey over the past 11-12 years. One of the 10 areas covered in the survey is 'Paying taxes'. You look at the data and compare figures such as total tax rates etc., which also points to that there are measures governments can take to improve and facilitate the business environment also with regard to taxes. All these numbers shift around a lot and do impact the setup of businesses and are therefore interesting to look at.

MW concluded that there is potential for future cooperation and discussion.

LOL thanked everyone for participating in the dialog and concluded the meeting.

Links:

Africa rising? Inequalities and the essential role of fair taxation.

Corporate Governance Development Framework

Tax competition in East Africa: A race to the bottom? Tax incentives and revenue losses in Kenya

IFC Doing Business survey