Private gain, public loss

Mailbox companies, tax avoidance and human rights

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This paper provides an executive summary of the report *'Private gain, public loss'* (SOMO, july 2013). References are made throughout this summary to the different chapters of the report. For more information on structure, methodology, background, company cases and recommendations, please consult the full report on the SOMO website. For more information, see www.somo.nl or send an e-mail to info@somo.nl.

The Dutch government recognises that multinational corporations (MNCs) impact on human rights in many different ways. This is especially the case for companies that are active in high-risk sectors such as the extractive industry. Oil, gas and mining corporations often operate in fragile states in which human rights are under pressure. Depletion of natural resources, pressure on local communities, security risks for workers and capital flight related to the industry are common problems. This research focuses on human rights, eight large extractive companies and the lack of adequate accountability mechanisms.
All eight corporations are incorporated in the Netherlands with a parent company or important subsidiary.
The research focuses on two important and inter-related human rights dimension, namely, the impact of tax avoidance in host states and of direct human rights violations. Furthermore, this report analyses and highlights the responsibility of the Dutch state therein.

The first human rights issue concerns direct consequences of extractive industry operations of the eight corporations reviewed for this report and the current regime of impunity that prevails. The research finds that subsidiaries of Dutch extractive industry companies are responsible for or associated with serious human rights violations, ranging from environmental pollution damaging the health of local communities to militia violence, killings and displacements.

The second issue dealt with in this report is the link between tax avoidance and human rights; a relatively new issue where the relationship between the fiscal aspect of operational activities, namely revenue losses in host states, and human rights is more indirect than human rights violations directly generated by operational activities. Especially poor countries suffer through massive revenue losses by tax avoidance, and the extractive industry is shown to play a central role in these losses. Capital flight and tax avoidance, as the UN has recently recognised, seriously undermine the ability (and the duty) of governments to mobilise the necessary resources to realise citizens' economic and social human rights. The eight MNCs reviewed here are incorporated in the Netherlands because of the attractive Dutch fiscal climate and their company structures point to the use of tax avoidance techniques in countries of operation. The Netherlands play a central role in international tax competition between jurisdictions, whilst Dutch fiscal policy that facilitates tax avoidance by large multinationals has a negative impact on human rights in countries where extractive industry operations take place.

In both cases, concerning negative human rights impacts as a result of operational activities and as a result of tax avoidance, the Dutch state is bound by international law to take regulatory action to stop companies incorporated in its jurisdiction to violate human rights (see Chapter 2). According to international agreements, the Dutch authorities are also required to provide access to justice for victims of these violations and tackle the prevailing impunity for MNCs.

Governance gap and state duties to protect and fulfill human rights

One of the reasons for businesses-related human rights violations to take place is the so-called governance gap. This gap in regulation is generated by the fact that corporations operate globally, whilst binding regulation is often only applicable at national level. The globalisation of business operations with complex and opaque business structures was insufficiently accompanied in recent decades by an effective domestic and international regulatory human rights framework. There is a growing recognition by civil society, academia and international institutions – such as the OECD[2], the IMF[3] and the United Nations[4] – that some degree of control over the extraterritorial impacts of activities of businesses is necessary. These should complement more effective and binding international regulation (see Chapter 2). While the implementation of extraterritorial jurisdiction is controversially debated, there are numerous uncontroversial and accepted measures states could take that would benefit the human rights conduct of domestically incorporated companies operating abroad.

These measures should apply not only to the parent company of a globally operating business but self-evidently to all legal entities that are related with controversial operations through ownership or financing links.

Tax and human rights

Next to direct human rights violations generated by operational business activities, this report also discusses a research area that is currently developing, namely, the relation between tax (avoidance) and human rights. To be able to realise economic and social human rights, states obviously need sufficient financial and administrative resources. The majority of countries home to extractive industry operations are characterised by poverty and an unequal distribution of wealth. Furthermore, research shows that progressive tax systems contribute to good administration, democratic development and poverty reduction, whilst large-scale tax avoidance by MNCs undermines these developments.

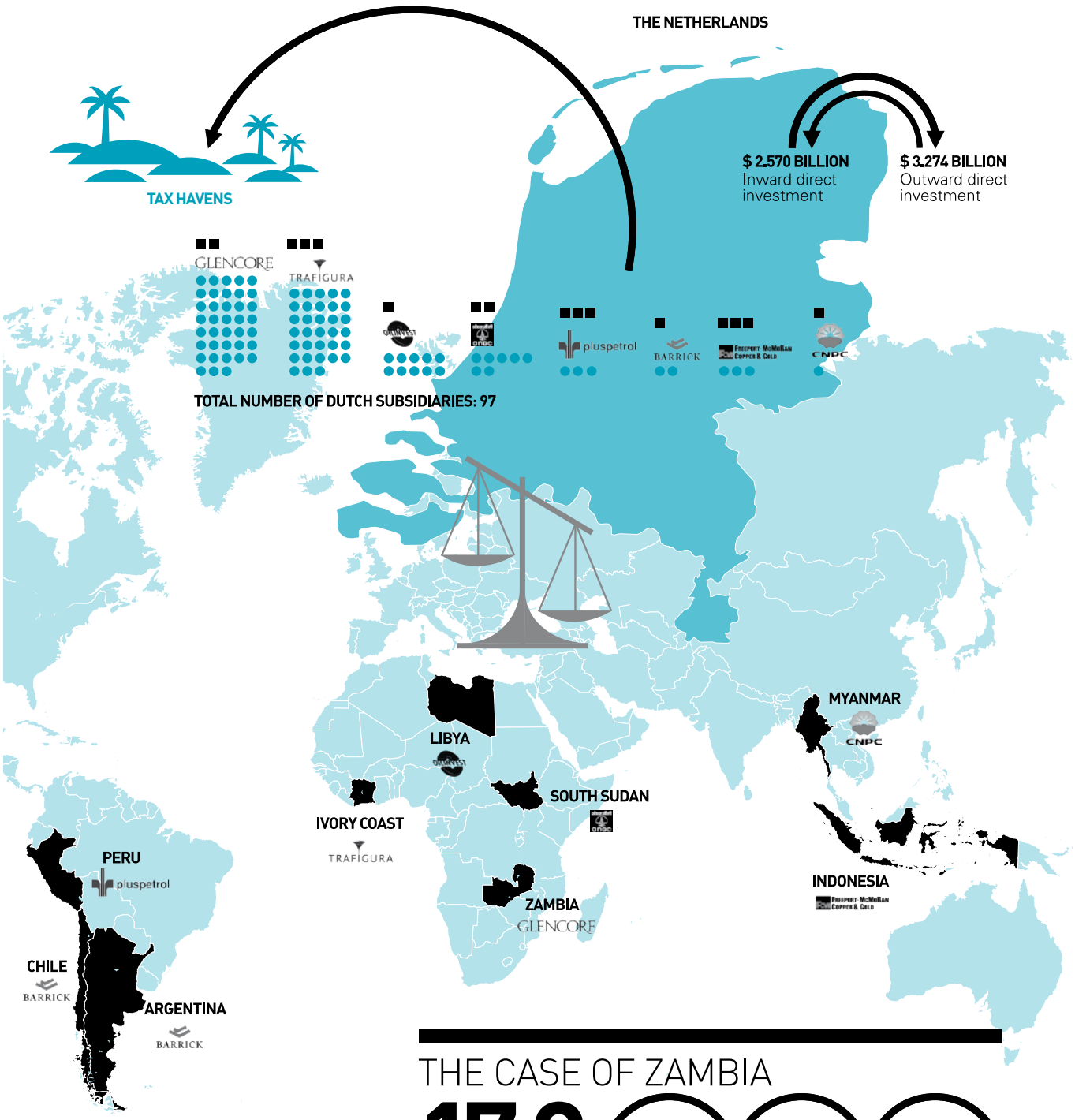
The responsibility for this tax avoidance lies with companies themselves. Whilst violating the principles of solidarity and economic justice, aggressive tax planning techniques are deliberately applied that violate the spirit of international and domestic tax laws. Companies exploit legal loopholes by incorporating subsidiaries in different jurisdictions and lower their tax bill. They shift profits from operating subsidiaries making them appear to make losses, resulting in no of very low corporate income tax being paid in those countries (see the case of Zambia in Chapter 3).

But responsibility also lies with the countries that facilitate tax avoidance with harmful tax regimes, such as the Netherlands. Thus, states that facilitate international tax avoidance hinder other states (where the tax is being avoided) to use their maximum available resources to realise the human rights of their citizens.

The role of the Netherlands

The Netherlands plays a crucial role in international tax avoidance. The country hosts some 23.000 mailbox companies. In 2009, the total of incoming investment was as much as 3.000 billion US dollars, while outgoing investment amounted to 3.700 billion US dollars. This is an equivalent of 377% and 465% of Dutch GNP, respectively. In comparison, the United States foreign investment flows amounted to 16% and 25% of the country's GNP in 2009. Thus, the ratio of foreign direct investment to total GNP in the Netherlands is 20 times larger than in the US.

PRIVATE GAIN, PUBLIC LOSS



- Identified human rights violations with link to Dutch mailbox companies
- Dutch subsidiaries
- Tax haven subsidiaries in the ownership structure above Dutch mailbox company
- Accountability gap

THE CASE OF ZAMBIA

17.9 BILLION $ TOTAL VALUE OF GLENCORE'S ASSETS IN THE NETHERLANDS.

6885 X DUTCH AID TO ZAMBIA (2.6 MILLION USD)

9 X REVENUE LOSS (2 BILLION USD)

0.93 X GDP (19.2 BILLION USD)

Sources: Annual accounts of Glencore's subsidiaries retrieved from the Dutch Chamber of Commerce; GDP Zambia is 19.2 billion USD, source: Global Financial Integrity, 'Zambia Lost $8.8 Billion in Illicit Outflows from 2001-2010', 13 December 2012; Annual revenue loss through tax avoidance in Zambia is 2 billion USD, source: Bloomberg, 'Zambia Says Tax Avoidance Led by Miners Costs $2 Billion a Year', 25 November 2012; 2.6 million USD (€2 million) is the amount the Dutch government spends on improving health conditions in Zambia, source: Dutch Government, 'Zambia resulaten ontwikkelingssamenwerking 2009-2010'

The Netherlands is a conduit country for investments of most of the world's extractive industry companies. After the US state of Delaware, the Netherlands is the second favourite home of incorporation of subsidiaries for ten of the largest corporations in this sector. The large number of incorporations in the Netherlands are the result of the country's active pursuit of a business-friendly fiscal and investment policy. The Netherlands has long been recognised by investors and tax and investment consultancy firms as a legitimate home for tax treaty shopping.[5] The country has faced criticism by the OECD[6], the European Union[7] and the United States[8] for a fiscal climate that allows for an erosion of other countries' tax bases through harmful tax competition and conduit structures. The active and successful enticement for foreign business incorporations and related investment flows by the Dutch government carries with it the responsibility to monitor the impact of these companies abroad.

The role of the Netherlands in the regulation of businesses operating abroad is two-fold. On the one hand, as a home state for internationally operating businesses the country should regulate the human rights policies and conduct of these businesses. This can take the form of financial and non-financial reporting but also by guaranteeing access to justice for victims. The current practice amounts to the exact opposite: not only is there no oversight worth mentioning, the Dutch state goes to great pains to provide arguments that present effective and binding regulation as unfeasible or undesirable. The Netherlands should make sure that companies do not avoid tax with the result that other states are unable or less able to realise their citizens' human rights.

Business impact on human rights

Eight multinational extractive companies with either their parent company or important subsidiaries incorporated in the Netherlands were reviewed for this report. First, it was researched whether these companies were involved in human rights controversies in countries of operation and whether their Dutch subsidiaries had included meaningful corporate social responsibility provisions in their annual reports. Secondly, the Dutch company structure was analysed with regard to its substance in the Netherlands and the potential Dutch tax and investment benefits resulting from this incorporation. The structures of Oil and Natural Gas Corporation Limited (ONGC), Barrick Gold, Trafigura and Glencore illustrate the (financial) holding structures commonly used by multinational corporations (MNCs) in the Netherlands to benefit from the country's tax and investment climate (Chapter 3).

Next to these financial constructions, five cases (China National Petroleum Corporation (CNPC), Oilinvest, Freeport-McMoran Copper & Gold, Barrick Gold and Pluspetrol) provide insight into common direct human rights violations occurring in the context of operational extractive activities. The link between the operations of this sector abroad and the Netherlands is discussed. CNPC and Oilinvest illustrate the politically volatile situations in which extractive companies operate in conflict-affected or repressive states (Chapter 4). Two companies, Trafigura and ONGC, are outlined in more detail as separate case studies to provide deeper insight into human rights issues in the extractive industry. Finally, an analysis of Dutch policy and legislation pertaining to business and human rights highlight weaknesses of the current system, such as lack of reporting obligations of very limited and expensive access to company information. The report provides specific examples of the failure of the Dutch state and lack of political will to provide victims of business-related human rights abuses with access to justice.

In the context of tax and human rights, the company structures identified point to fiscal planning and therefore tax avoidance:

- all the companies in this report use the Netherlands for intermediate holding activities using conduit entities that have no material substance (such as sales, workforce or fixed assets) in the Netherlands;
- all companies researched invest in subsidiaries abroad in which material activities take place or finance these activities, which allows for returns on these investments or interest income to remain untaxed or taxed at a very low rate;
- the Dutch holdings all have links with tax haven subsidiaries, either through financing activities or by being directly owned by subsidiaries located in tax havens.

This structure allows for profit shifting to low-tax jurisdictions, indicating that the eight companies researched use the Netherlands for tax planning purposes. By actively facilitating and attracting these companies, the Dutch state contributes to the loss of revenue that is economically destructive to poor countries and undermines obligations of these states in protecting and fulfilling human rights.

In the context of human rights impacts resulting from operation activities, all researched MNCs have been associated with human rights controversies in countries of operation, ranging from Peru and Argentina to Indonesia and Côte d'Ivoire. To name a few examples:

- CNPC develops a gas pipeline in Burma, a country known for its human rights violations, whilst no human rights reporting takes place on this project.

- Freeport operates in a remote region in Indonesia characterised by conflict. The company harbours close relationships with military, police and other security forces that are regularly accused of human rights violations.
- Pluspetrol's operations in Peru illustrate how the livelihoods and health of local communities are negatively affected by a company's oil operations: after decennia of oil spills exacerbated by corroding pipelines and lack of clean-up operations, the region has been declared an environmental state of emergency by the Peruvian government in March 2013 due to high levels of barium, lead, chrome and petroleum-related compounds.
- The case of Oilinvest, the oil and gas company of the late Libyan leader Muammar Gaddafi, is a striking example of how multinationals encounter no scrutiny for compatibility with foreign policy objectives or human rights considerations before or after registering in the Netherlands for tax purposes.

An analysis of the annual reports deposited at the Dutch Chamber of Commerce shows that a human rights policy is absent in most cases and when human rights commitments are made, they are by and large not specifically defined and non-enforceable, because based on voluntary commitment.

High human rights risks, yet no effective regulatory framework

All these cases show that the Dutch government takes enormous human rights risks by actively attracting global corporations to incorporate in its jurisdiction. This is because the Netherlands offers companies fiscal benefits without linking these benefits to any form of regulation or responsibilities. The Netherlands thereby contributes to a culture of impunity. As a home state that offers many advantages to multinational corporations, the Netherlands has a responsibility to address human rights violations. It should do this by taking appropriate measures to solve this structural problem and provide access to justice for its victims. In the words of Human Rights Watch:

"At a minimum, governments should take it upon themselves to proactively monitor the conduct of their companies when they work in other countries and to investigate credible allegations of human rights abuse linked to those operations. Doing so would still leave hard questions on the table – like how governments should articulate and enforce extraterritorial human rights obligations for companies. But it would at least end an indefensible status quo where governments refuse to find out whether their corporate citizens are credibly implicated in serious human rights abuses abroad."[9]

This research shows that the Dutch state facilitates tax avoidance whilst neglecting the potential negative impact this avoidance has on human rights. the Netherlands also fail to effectively regulate multinational companies that contribute to human rights violations abroad. For example:

- Supervision of compliance with key CSR standards is absent.
- Lack of transparency surrounding the operations of MNCs is hardly addressed. This creates ample scope to manipulate ownership and financial structures and thereby avoid accountability and escape states' regulatory efforts.
- When human rights abuses take place in a host state several obstacles hinder effective access to justice to judicial and non-judicial mechanisms.

Conclusion

The report concludes that the Netherlands, despite being bound by international human rights obligations, fails or shows insufficient political will to regulate the human rights impact of MNCs incorporated in its territory. There is urgency for the government of the Netherlands to proactively introduce (legal) measures to prevent and reduce the negative footprint of these companies abroad, and provide remedy to victims of corporate-related abuses. Whilst states eschew regulation of businesses with regard to their human rights conduct, they often grant investors extensive extraterritorial tax and investment rights and entitlements. It is unacceptable that corporations profit from far-reaching privileges whilst these being balanced with responsibilities.

The active fiscal policy of the Dutch state should go hand in hand with the effective protection and regulation of human rights. the report concludes with a number of concrete recommendations to the Dutch government. These include:

- Conduct a human rights impact assessment of the current fiscal and investment policies in countries where extractive industry operations of subsidiaries of Dutch incorporated businesses take place.
- Policies and laws that allows companies to avoid tax should be abolished, for instance by introducing stricter substance rules and the inclusion of (more effective) anti-abuse clauses and human rights in tax and investment treaties.
- Take a pro-active stance and transparently and publicly communicate Dutch positions in internationally initiatives of the G20, the OECD and the EU to tackle tax avoidance and evasion.

- Introduce and make explicit human rights obligations for internationally operating businesses incorporated in the Netherlands. At a minimum, this should include reporting obligations with regard to human rights conduct abroad, full disclosure of corporate structures, shareholders and beneficial owners of all subsidiaries. The Netherlands should also implement country-by-country-reporting, starting with extractive industry companies.
- Improve access to judicial and non-judicial remedies for victims of business-related human rights abuses, amongst others, by providing financial means to victims to take legal action, by improving access to information and by defining the accountability of mailbox companies of businesses incorporated in the Netherlands. Further, the mandate of the National Contact Point of the OECD should be extended to allow it to initiate independent investigations and monitor business activities.

Endnotes

1 Barrick Gold, China National Petroleum Corporation (CNPC), Freeport-McMoran Copper & Gold, Glencore, Oil and Natural Gas Corporation Limited (ONGC), Oilinvest, Pluspetrol, Trafigura.

2 Report on implementing the OECD Anti-Bribery Convention in the Netherlands, OECD, December 2012, p. 19.

3 Kingdom of the Netherlands – Netherlands: Detailed Assessment Report on Anti-Money Laundering and Combating the Financing of Terrorism, IMF Country Report No. 11/92, (Washington, DC: International Monetary Fund, April 2011).

4 Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework. UN doc. A/HRC/17/31, available at http://www.business-humanrights.org/media/documents/ruggie/ruggie-guiding-principles-21-mar-2011.pdf

5 'Treaty shopping' generally refers to a situation where a person, who is resident in one country (say the "home" country) and who earns income or capital gains from another country (say the 'source' country), is able to benefit from a tax treaty between the source country and yet another country (say the 'third' country). This situation often arises where a person is resident in the home country but the home country does not have a tax treaty with the source country. See http://intltax.typepad.com/intltax_blog/2008/05/treaty-shopping.html

6 The OECD ranked the Netherlands as one of the top five industrialised countries that supported harmful tax competition. It identified 9 potentially harmful tax practices in Dutch law, excluding holding company regimes and similar provisions: because of the 'complexities raised by such regimes, including their possible interaction with tax treaties', the Forum decided further research was needed to assess the effect of holding company structures (OECD 2000).

7 The EU Code of Conduct Group on Business Taxation (Primarolo Group) was designed to detect measures constituting harmful tax competition, i.e. measures which 'unduly affect the location of business activity in the Community by being targeted merely at non-residents and by providing them with a more favourable tax treatment than that which is generally available in the Member State'. In a 1999 report the Group identified 66 tax measures with harmful features, of which 40 in EU Member States, 15 in Dutch Law and 7 in the Netherlands Antilles.

8 US Commerce data show that US businesses kept $118 bn of income in Dutch holding companies between 2006 and 2009 ('Tax wars: the accidental billion-dollar break', Financial Times, 27.9.2011, http://www.ft.com/cms/s/0/69703dfe-e82e-11e0-9fc7-00144feab49a.html#axzz1fTOPnukW) and U.S. President Barack Obama famously named the Netherlands a tax haven in May 2009 ('Netherlands surprised at Obama tax haven slur', NRC.nl, 5.5.2009, http://vorige.nrc.nl/international/article2232958.ece)

9 See Human Rights Watch, 'Without Rules: A Failed Approach to Corporate Accountability' in World Report 2013, available at http://www.hrw.org/world-report/2013/essays/112459?page=3.

Colophon

By: Roos van Os, Katrin McGauran and Indra Römgens
Layout: Frans Schupp
Graphic: Femke Herregraven
Print: Drukkerij Raddraaier

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Stichting Onderzoek Multinationale Ondernemingen
Centre for Research on Multinational Corporations

Sarphatistraat 30
1018 GL Amsterdam
The Netherlands
T: +31 (0)20 639 12 91
F: +31 (0)20 639 13 21
info@somo.nl
www.somo.nl

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