



Document Stage: Working Paper
September 2016

Anticorruption Policy: Enhancing the Role of the Asian Development Bank in Relation to Tax Integrity

This document is being disclosed to the public prior to its consideration by ADB's Board of Directors in accordance with ADB's Public Communications Policy 2011.

Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
AEOI	–	automatic exchange of information
BEPS	–	base erosion and profit shifting
DMC	–	developing member country
EOIR	–	exchange of information on request
FATF	–	Financial Action Task Force
IDD	–	integrity due diligence
IFI	–	international financial institution
IMF	–	International Monetary Fund
OAG	–	Office of the Auditor General
OAGA	–	Anticorruption Unit
OAGI	–	Integrity Division
OAI	–	Office of Anticorruption and Integrity
OECD	–	Organisation for Economic Co-operation and Development
OGA	–	Office of the General Auditor
RRP	–	report and recommendation of the President
PSOD	–	Private Sector Operations Department
PSTS	–	Private Sector Transaction Support Division
TA	–	technical assistance
UN	–	United Nations

Head Director	C. Wee, Office of Anticorruption and Integrity (OAI) D. Binns, Investigations Division, OAI
Team members	G. Abel, Senior Transaction Support Specialist (Integrity), Private Sector Operations Department M. Greenhow, Principal Counsel, Office of the General Counsel L. Lahm, Advisor, Strategy and Policy Department Y. Miyaki, Public Management Specialist (Taxation), Sustainable Development and Climate Change Department D. Perez, Integrity Officer, OAI

In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

CONTENTS

Page

I.	INTRODUCTION	1
II.	GLOBAL DEVELOPMENTS	1
III.	ROLE OF ADB	4
IV.	ADB'S EXISTING APPROACH TO TAX INTEGRITY	5
V.	PROPOSED UPDATE	6
IV.	RESOURCES	9
VIII.	REQUEST FOR BOARD GUIDANCE	11

APPENDIXES

1.	Technical Assistance to Developing Member Countries	12
2.	ADB's Anticorruption Policy and the Integrity Principles and Guidelines	13

I. INTRODUCTION

1. This paper sets out the proposed response of the Asian Development Bank (ADB) to global developments in relation to addressing tax secrecy, tax evasion, and legal forms of aggressive tax planning at both the country and project levels. These tax integrity issues are of present and pressing global concern. While these issues adversely affect both developed and developing countries, the effect of lost tax revenues on developing countries in Asia is comparatively more severe.¹

2. In the context of ADB's nonsovereign operations,² tax integrity issues may arise whether the shareholding structure is located onshore (where the project is located) or offshore (in another jurisdiction). Tax integrity issues arise primarily (though not exclusively) through the use of offshore jurisdictions and cross-border structures. ADB acknowledges that there are numerous legitimate reasons for the use of structures involving offshore jurisdictions,³ including tax optimization to eliminate double taxation on income and profits as well as other operational, management, and administrative efficiencies and flexibility, especially where structures involve multiple international investors in numerous jurisdictions. However, ADB also recognizes that offshore structures may pose higher risks because these structures have greater potential to obscure beneficial ownership and sources of funds, and thereby more easily facilitate corruption, tax evasion, money laundering, financing of terrorism, and other illicit purposes.

II. GLOBAL DEVELOPMENTS

3. The global landscape has altered significantly since 2009, as tax secrecy has given way to increasingly strong tax transparency to combat tax evasion. Tremendous progress has been achieved by the widespread implementation of the international tax standard for exchange of information on request (EOIR),⁴ as well as the strong momentum toward universal acceptance of the standard for automatic exchange of information (AEOI).⁵ Together, these two

¹ Developing countries lost \$5.6 trillion in illicit tax flows in 2001–2010, which includes amounts lost through tax evasion; and Asia accounted for 61% of the total. D. Kar and S. Freitas. 2012. *Illicit Financial Outflows from Developing Countries 2001–2010* Washington, DC: *Global Financial Integrity*. Experts speculate that annual revenue losses because of tax evasion are of a magnitude that approximates official development assistance worldwide (more than \$120 billion per year). OECD Development Assistance Committee. 2009. *Investing in Development: A Common Cause in a Changing World*. <http://www.oecd.org/dac/43854787.pdf>. Commentators estimate that offshore tax evasion in the developing world is substantially more extensive, e.g., Global Financial Integrity. 2008. *Illicit Financial Flows from Developing Countries: 2002–2006*. <http://www.gfintegrity.org/storage/gfip/executive%20-%20final%20version%201-5-09.pdf> (illicit financial flows estimated at \$850 billion–\$1 trillion a year). Developing countries are particularly impacted by aggressive tax planning because of their heavy reliance on corporate income tax.

² Nonsovereign operations comprise the provision of any loan, guarantee, equity investment, or other financing arrangement to privately held, state-owned, or subsovereign entities, in each case, (i) without a government guarantee; or (ii) with a government guarantee, under terms that do not allow ADB, upon default by the guarantor, to accelerate, suspend, or cancel any other loan or guarantee between ADB and the related sovereign.

³ Offshore jurisdictions may be referred to as “offshore financial centers,” which refers to jurisdictions that have certain characteristics such as (i) financial centers where a large number of banking activities are performed with nonresident counterparts; (ii) assets and liabilities of the financial system exceeding the needs of the domestic markets; and (iii) specific advantages in relation to taxation or banking secrecy provided. IMF. 2000. *Offshore Financial Centers: IMF Background Paper*. <http://www.imf.org/external/np/mae/oshore/2000/eng/back.htm>.

⁴ EOIR is found in Article 26 of the OECD Model Tax Convention on Income and on Capital as well as the UN Model Double Taxation Convention between Developed and Developing Countries. It requires a tax authority to provide, on request, “foreseeably relevant information” for the administration or enforcement of the domestic tax laws of another tax authority.

⁵ AEOI requires tax authorities to disclose financial account information of nonresidents with the tax authorities of the account holders’ country of residence automatically, under the globally agreed common reporting standard. Thus, tax authorities will send and receive pre-agreed information each year without having to send a specific request.

complementary tax standards (EOIR and AEOI)⁶ will substantially improve the ability of tax authorities to detect tax evasion and ensure that their tax laws are being properly applied. Both standards are promoted by the Global Forum on Transparency and Exchange of Information for Tax Purposes (“Global Forum”),⁷ through its assessments and peer review process.⁸

4. From a practical perspective for many jurisdictions (unless jurisdictions have a sufficiently large treaty network), joining the Multilateral Convention on Mutual Administrative Assistance in Tax Matters is considered by the Organisation for Economic Co-operation and Development (OECD) to be the most efficient and only route to implementing the international standards, especially for AEOI.⁹

5. Jurisdictions, particularly developing ones, face significant resource and capacity challenges in implementing AEOI. It is incumbent on all jurisdictions to (i) enact legislation to facilitate AEOI in accordance with the agreed timetable,¹⁰ and (ii) satisfy confidentiality and data safeguard requirements before another jurisdiction is obliged to disclose to any such jurisdiction any information under AEOI. Once implemented, developing jurisdictions will require increased capacity and resources to enable them to fully use the information they receive under AEOI, as well as to make requests of other jurisdictions under EOIR. In short, developing jurisdictions require assistance both to implement and benefit from AEOI.¹¹

6. In light of these challenges, questions remain on the continued progress of the global tax transparency agenda, including whether jurisdictions will be able to enact the required legislation and satisfy confidentiality and data safeguard requirements within the required timescale and, if they are able to do so, how effectively such jurisdictions will implement AEOI in practice.

7. The global tax landscape is also being transformed by initiatives to reduce opportunities for legal forms of aggressive tax planning by multinational corporations. Such tax planning exploits gaps and mismatches in tax rules to make profits “disappear” for tax purposes, or shifts profits to locations where there is little or no real activity but taxes are low, resulting in little or no overall corporate tax being paid.¹² This form of planning is referred to as base erosion and profit shifting (BEPS), which depletes the tax resources of governments,¹³ distorts competition, and (together with tax evasion) undermines the authority and effectiveness of domestic revenue systems and governments. Countering BEPS is thus not simply a question of raising revenue. It is also about designing a tax system that promotes inclusiveness, encourages good

⁶ The fundamental limitation of EOIR is that the tax authority requesting the information must know enough to make the request and approach the appropriate counterpart jurisdiction. This may not always be the case. However, when AEOI is globally implemented, information brought to light by AEOI may give tax authorities the information they need to enable them to make targeted information requests under EOIR.

⁷ The Global Forum is the largest tax body in the world, whose mandate is to counter tax evasion by increasing (i) global tax transparency, (ii) international cooperation, and (iii) the transparency of corporate bodies, arrangements, and financial information.

⁸ The Global Forum’s peer review process assesses the implementation of EOIR and rates jurisdictions as *compliant*, *largely compliant*, *partially compliant*, or *noncompliant*. Following 2018 when AEOI is scheduled to be implemented, the Global Forum will also assess the implementation of AEOI.

⁹ 96 jurisdictions currently participate in the convention, including 15 jurisdictions covered by territorial extension.

¹⁰ As of June 2016, 101 jurisdictions have committed to implement the AEOI standard in 2017 or 2018.

¹¹ The G8 has proclaimed that “developing countries should have the information and capacity to collect the taxes owed to them—and other countries have a duty to help them.” G8 Lough Erne Declaration, 18 June 2013.

¹² OECD recognizes that low or non-taxation is not itself of concern but becomes a concern when it is achieved by practices that artificially separate taxable income from the activities that generate it.

¹³ The OECD estimates that 4%–10% of global corporate income tax (amounting to \$100–\$240 billion annually) is lost through BEPS.

governance, promotes investments and job creation, matches society's views on reducing inequality, and promotes social justice. This is particularly relevant in developing Asia where many economies have a low tax collection rate, usually 20% or below of GDP.¹⁴

8. The OECD spearheaded an internationally coordinated and comprehensive reform of international tax rules to counter BEPS in the form of an action plan.¹⁵ The plan requires and/or encourages governments to implement substantive measures into domestic law that are designed to increase tax transparency and curtail the ability of multinational corporations to implement BEPS. Developing jurisdictions struggling to fight against the erosion of their domestic tax base can benefit from the BEPS action plan with the support of international and regional organizations. Many developing jurisdictions are seeking technical assistance (TA) in this area.¹⁶

9. The OECD, in 2016, established a new inclusive framework to (i) monitor and support implementation of the BEPS action plan, (ii) review progress on the implementation of the BEPS measures, particularly the minimum standards in the BEPS action plan, and (iii) complete remaining technical work related to BEPS. The United Nations (UN),¹⁷ the International Monetary Fund (IMF), and the World Bank Group are involved in promoting BEPS measures and, together with the OECD, have established the Platform for Collaboration on Tax to better support governments in addressing tax challenges, including BEPS. The platform will develop tool kits aimed at (i) translating certain complex BEPS measures into user-friendly guidance for low-capacity countries, and (ii) addressing international tax issues not included in the BEPS action plan that may be more relevant for developing countries.

10. Concerted efforts are being made to achieve the global implementation of the BEPS action plan. While certain BEPS measures (such as transparency initiatives¹⁸ and the model treaty-based agreements)¹⁹ are likely to be implemented globally in a relatively short time, questions remain on how other BEPS measures will be enacted and whether such rules will produce a largely consistent international regime, or will be fragmented along national lines.²⁰

¹⁴ *Tax Revenue Trends in Asia and Latin America: A Comparative Analysis*.
<http://www.austaxpolicy.com/1462-2/>

¹⁵ OECD. 2013. *Action Plan on Base Erosion and Profit Shifting*. <https://www.oecd.org/ctp/BEPSActionPlan.pdf>. The BEPS Action Plan equip governments with the domestic and international instruments needed to tackle BEPS. It provides countries with tools to ensure that profits are taxed where economic activities generating the profits are performed and where value is created. These tools also give businesses greater certainty by reducing disputes over the application of international tax rules and standardising compliance requirements. <http://www.oecd.org/ctp/beps-about.htm>

¹⁶ According to the Addis Tax Initiative (footnote 26), developing countries are seeking TA to boost their tax collection, improve their domestic tax compliance, and strengthen tools and procedures to stem both cross-border and domestic tax evasion and avoidance.

¹⁷ In July 2015, the UN Third International Conference on Financing for Development issued the Addis Ababa Action Agenda, which commits countries to substantially reduce illicit financial flows by 2030 by combating tax evasion and corruption, reducing opportunities for aggressive tax avoidance, and scaling up international tax cooperation. 36 conference participants issued the Addis Tax Initiative (footnote 26).

¹⁸ BEPS tax transparency measures comprise country-by-country reporting and mandatory disclosure of private tax rulings. Country-by-country reporting is intended to give tax administrations a picture of where multinational corporation profits are reported and where real activity takes place. Mandatory disclosure of private tax rulings is intended to ensure that low or no tax jurisdictions do not provide arrangements that approach non-taxation to multinational corporations without other jurisdictions being aware of these arrangements.

¹⁹ Model treaty-based agreements apply to treaty abuse, permanent establishment rules, and certain aspects of hybrid mismatch arrangements.

²⁰ For example, national implementation is likely to vary widely in relation to transfer pricing and the controlled foreign company rule.

III. ROLE OF ADB

11. The challenges for ADB's developing member countries (DMCs) in responding to the above global developments are evident:

- (i) As of June 2016, 25 DMCs are not members of the Global Forum on Transparency and Exchange of Information for Tax Purposes. Such DMCs have not committed to promote international tax transparency and cooperation or agreed to adopt and be assessed by EOIR.²¹
- (ii) DMCs assessed by the Global Forum may find it challenging to comply with EOIR because
 - (a) a huge increase in the number of requests for information was received and is forecast to continue, which may impact the ability of tax authorities (particularly those in smaller, under-resourced, developing jurisdictions) to respond in a timely manner; and
 - (b) the Global Forum's next round of reviews (commencing late 2016) will require jurisdictions to implement legislation requiring the disclosure of beneficial ownership information, which even large and well-resourced members may find challenging to implement effectively within the required timescale.
- (iii) As of June 2016, 32 DMCs have not committed to implement AEOI and will therefore not benefit from automatically receiving information from tax authorities of other jurisdictions to ascertain that their residents are paying taxes on income earned offshore in accordance with their tax laws.
- (iv) As of June 2016, 35 DMCs have not yet joined the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.²²
- (v) DMCs that have committed to implement AEOI may have difficulty in enacting the required legislation and satisfying the Global Forum's requirements relating to confidentiality and data safeguards (without which no other jurisdiction is obliged to provide information to them).
- (vi) DMCs implementing both EOIR and AEOI can only truly benefit if they have both the expertise and resources to make use of the information they receive under AEOI, and to make requests of other jurisdictions under EOIR.
- (vii) As of June 2016, 34 DMCs are not participating in the BEPS inclusive framework to tackle BEPS and are therefore not contributing to the international framework that will enable such jurisdictions to protect their domestic tax bases against BEPS.²³
- (viii) The 11 DMCs participating in the BEPS inclusive framework need expertise and resources to consider (a) their priorities for addressing BEPS issues, (b) the extent to which they should implement BEPS measures,²⁴ and (c) whether there

²¹ Participating jurisdictions will be entitled to make requests of other jurisdictions under EOIR. Membership of the Global Forum also entitles jurisdictions to benefit from assistance provided by the Global Forum to enable such jurisdictions to implement EOIR.

²² Jurisdictions that have committed to implement AEOI are expected to join the convention (if they have not already done so), because this is the most practical way to implement AEOI (para. 4).

²³ As of 15 July 2016, 85 jurisdictions are part of the BEPS inclusive framework, including 11 DMCs. <http://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf>. 19 other jurisdictions are expected to join the framework in the coming months. <http://www.oecd.org/ctp/first-meeting-of-the-new-inclusive-framework-to-tackle-base-erosion-and-profit-shifting-marks-a-new-era-in-international-tax-co-operation.htm>.

²⁴ Jurisdictions are required to commit to implement certain standards in specified key areas, which must be implemented in totality (such as country-by-country reporting and treaty abuse), but have discretion as to the extent to which they wish to implement other measures (such as the guidance for the application of transfer pricing rules

are tax issues that are more pressing for them than those set out in the BEPS action plan.²⁵

12. ADB recognizes that, as an international financial institution (IFI) with a mandate to foster the economic growth, cooperation, and development of its DMCs, it has a role to play in assisting its DMCs to stem tax evasion and the erosion of their domestic tax bases. ADB fulfills its role primarily by providing TA to enhance the capacity and regional cooperation of tax authorities to enable DMCs to meet these challenges.

13. ADB supports leading organizations working in this area and participates as an observer in the Global Forum. ADB welcomes the Addis Tax Initiative and collaborates with development partners to achieve the objectives of the initiative.²⁶ Pursuant to ADB's Policy on Combating Money Laundering and the Financing of Terrorism (2003), ADB also commits to strengthen its cooperation with the Financial Action Task Force (FATF).²⁷ ADB's Sustainable Development and Climate Change Department is in coordination with the platform leaders, who coordinate their activities and share information with regional tax organizations and MDBs.

14. At the project level, ADB is committed to conduct due diligence to obtain reasonable assurance that the projects it finances do not facilitate tax evasion. While ADB recognizes that its role in relation to BEPS issues is primarily at the country level, since taxation issues are within the sovereignty of its DMCs, ADB will take steps to ensure that the projects in which it invests do not involve material related-party contracts that inappropriately transfer income to a group company or related persons and entities in an offshore jurisdiction (para. 26 [iv]).

15. In addressing tax integrity issues as described in this paper, ADB seeks to demonstrate in a practical and effective way its support for and promotion of global tax integrity.

IV. ADB'S EXISTING APPROACH TO TAX INTEGRITY

16. ADB's provision of recent TA to its DMCs is detailed in Appendix 1.

17. ADB adopts a risk-based approach to assessing integrity risks, including tax evasion. This approach, which is in line with international best practices,²⁸ means that project teams are required to focus their efforts on projects where integrity and reputational risks to ADB are significant, while limiting their integrity checks where integrity and reputational risks are considered to be low. A risk-based approach means ADB will always assess risks and determine the extent to which they can be mitigated. If perceptions of risk change, a risk-based approach requires internal processes to be modified to take this into account. It is thus a dynamic and proportionate approach to addressing risk.²⁹

and provisions to eliminate the "mismatch" effect of hybrid arrangements). Developing jurisdictions may consider that, while they face the same challenges as developed jurisdictions, their priorities and requirements differ.

²⁵ As noted in para. 9, the platform (established by the UN, IMF, World Bank Group, and OECD) recognizes the particular challenges faced by developing countries when addressing BEPS issues.

²⁶ The Addis Tax Initiative was launched at the 2015 Finance for Development Conference (footnote 16). It is designed to dramatically increase donor support for building tax capacity in poorer countries, step up domestic resource mobilization, and promote policy coherence.

²⁷ The FATF recommendations include tax evasion as a predicate offense for money laundering and the FATF standard for disclosure of beneficial ownership information represents the international standard adopted by the Global Forum.

²⁸ See for example the FATF recommendations, which adopt a risk-based approach.

²⁹ ADB's internal procedures for the conduct of integrity due diligence (IDD) have been regularly updated since 2012 to take account of lessons learned and IFI best practices.

18. ADB's existing risk-based approach means that project teams are required to (i) identify the ultimate beneficial owners of ADB's client; and (ii) satisfy themselves regarding the transparency of the clients' shareholding structure, the business reasons for any complex ownership structure, and the use of offshore jurisdictions in the shareholding structure. Adopting a risk-based approach also requires ADB to (i) take into account the ratings of relevant jurisdictions provided by lead organizations (e.g., Global Forum, FATF, and the UN), international sanctions, and considerations of violations of law (including tax laws); and (ii) disclose relevant information to ADB's Board of Directors.

19. ADB's risk-based approach seeks to address the risks identified in each project, including secrecy risks associated with the use of offshore jurisdictions. It does not automatically prevent ADB from considering a project because a jurisdiction involved in the project was given a certain rating or classification by a lead organization. However, if ADB's risk assessment identifies integrity concerns (which could relate to any of the issues mentioned in para. 18), ADB will only proceed once it is satisfied that the risks have been appropriately mitigated.³⁰

20. ADB considers its risk-based approach to assessing integrity risks (including tax evasion) to be appropriate since, as an IFI, ADB seeks to manage its relationships with any members that are noncompliant with international standards. At the project level, ADB seeks to address and mitigate risk, rather than to "de-risk,"³¹ by conducting due diligence and being satisfied that the risks of proceeding with the project and sponsors in question are acceptable.

21. However, in light of global developments promoting tax transparency and addressing aggressive tax planning, ADB recognizes that its existing approach in relation to addressing tax secrecy and tax evasion needs to be strengthened and that ADB's existing approach must evolve to reflect lessons learned and future global developments. As such, ADB accepts that it should seek to avoid financing projects where its client is either established in an intermediate jurisdiction or controlled by an entity established in an intermediate jurisdiction (footnote 43) which (in either case) is classified by the Global Forum³² as noncompliant for EOIR unless ADB is satisfied that (i) the project's tax integrity risks are low and acceptable to ADB (ii) and that there is a sound business or policy reason to finance such project that takes priority over the rationale for not financing in such jurisdiction.³³ Irrespective of whether a project involves a noncompliant, partially compliant, largely compliant or compliant jurisdiction, ADB will conduct integrity and tax integrity due diligence, as further described in para 26 (iii) to (iv).

V. PROPOSED UPDATE

22. ADB proposes to update its Anticorruption Policy (1998, as amended to date) to take into account issues of tax integrity at the country and project levels.³⁴

³⁰ For example, if a jurisdiction's disclosure of beneficial ownership information raises concerns at a country level, ADB will satisfy itself in this regard at a project level (para. 18).

³¹ De-risking refers to the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk. De-risking is contrary to the FATF's risk-based approach.

³² See Footnote 7.

³³ ADB's assessment and findings will be duly disclosed to the Board.

³⁴ The Anticorruption Policy is implemented in accordance with ADB's Integrity Principles and Guidelines 2015, as amended from time to time (Appendix 2). This update to the Anticorruption Policy is intended to address tax integrity issues and is not intended to be a comprehensive review of the implementation of the Anticorruption Policy.

23. The rationale for updating ADB's Anticorruption Policy is as follows:
- (i) ADB is mandated to support competitive markets and efficient, accountable, and transparent public administration as part of its broader work on good governance and capacity building.³⁵
 - (ii) A lack of tax integrity and a culture of low tax compliance increase the risk of corruption. Corruption, money laundering, and financing of terrorism damage financial sector institutions and—together with tax evasion and aggressive forms of tax planning—(a) distort competitive markets; (b) hinder efficient, accountable, and transparent public administration; and (c) adversely impact the domestic resources of DMCs.
 - (iii) ADB is mandated to seek to ensure that projects financed and administered by ADB comply with the highest ethical standards and are not used for the purposes of corruption, tax evasion, money laundering, financing of terrorism, or other illicit purposes.³⁶ A lack of tax transparency at the project level increases the risk of tax evasion, corruption, money laundering, and financing of terrorism.
24. As with previous updates to the Anticorruption Policy,³⁷ no changes will be made to the existing provisions of the Anticorruption Policy.³⁸
25. Recognizing that ADB has a role to play in promoting global tax integrity while pursuing its vision of an Asia and Pacific region free of poverty, ADB proposes the following:
- (i) ADB will adopt the approach and recommendations contained within this document as a policy paper and as a Management directive in the form of staff instructions.³⁹
 - (ii) ADB will support and promote international tax integrity, including the work of lead organizations (including Global Forum, FATF, and the UN) in this area.
 - (iii) ADB will support tax integrity initiatives in the Asia and Pacific region by providing TA to (a) assist DMCs in protecting themselves against tax evasion and BEPS, (b) develop the capacity of DMCs to become members of and participate in the work of the Global Forum, and (c) support DMC participation in BEPS initiatives promoted by lead organizations.⁴⁰
 - (iv) ADB will encourage the inclusion of tax integrity issues in the policy dialogue with DMCs, where necessary and appropriate, particularly when DMCs request ADB's assistance in this area. In such cases, these issues should be explicitly incorporated into the country partnership strategies and its update (CPS/CPSU), country operations business plan (COBP), regional cooperation strategy and programs (RCSP), and relevant sector and aid agency consultations.
26. ADB proposes to implement new internal procedures for the conduct of integrity due diligence (IDD) in relation to tax integrity for nonsovereign transactions. Such procedures will

³⁵ Anticorruption Policy, para. 14 (i).

³⁶ Anticorruption Policy, para. 14 (iii).

³⁷ ADB. 2004. *Anticorruption Policy: Proposed Clarifications and Related Changes to Consulting and Procurement Guidelines*. Manila; ADB. 2006. *Anticorruption Policy: Harmonized Definitions of Corrupt and Fraudulent Practices*. Manila (August and October); and ADB. 2010. *Anticorruption Policy: Harmonization of Debarments*. Manila.

³⁸ ADB's response to tax evasion and BEPS issues will be addressed in an update to ADB's Anticorruption Policy for the reasons set out in para. 23. This does not imply that legal forms of tax planning by multinational corporations constitute illegal activity or corruption.

³⁹ For clarity, "document" refers to the main text and the appendixes, as appropriate.

⁴⁰ In determining appropriate TA, ADB will consider (i) the DMC's request and commitment, (ii) ADB's relative strengths and focus areas, and (iii) existing support provided by other development partners.

include the following requirements, which reflect both the prohibitive⁴¹ as well as risk-based approaches⁴². ADB will:

- (i) (a) seek to avoid financing projects where its client is either established in an intermediate jurisdiction or controlled by an entity established in an intermediate jurisdiction (footnote 43), which (in either case) is classified by the Global Forum as a noncompliant jurisdiction for EOIR unless (b) ADB is satisfied that the project's tax integrity risks are low and acceptable to ADB and that there is a sound business or policy reason to finance such project that takes priority over the rationale for not financing in such jurisdiction;⁴³
- (ii) consider the classifications and ratings issued by the Global Forum and FATF to ascertain levels of risk of tax secrecy and money laundering. In line with its risk-based approach to IDD, ADB will give the matter heightened scrutiny if ADB's client or any of its significant direct or indirect shareholders are established in a jurisdiction that is either rated as noncompliant or partially compliant by the Global Forum for EOIR or is otherwise classified as an uncooperative jurisdiction by the OECD;
- (iii) require IDD to be conducted on significant direct and indirect shareholders of ADB clients⁴⁴ established in an intermediate jurisdiction;⁴⁵
- (iv) review and assess material related-party contracts from an integrity perspective, to ensure they are entered into on an arm's length basis, consistent with the current practice of the Private Sector Operations Department (PSOD) relating to material related-party contracts in its commercial due diligence; this introduces a new requirement since ADB's existing IDD procedures do not address any BEPS issues;
- (v) make appropriate revisions that may be recommended by the tax expert (see para. 28 [iv]) upon the conclusion of its review;
- (vi) include provisions on identified tax integrity risks in ADB's legal documentation for nonsovereign transactions, where appropriate;
- (vii) enhance its focus on integrity (including tax integrity) issues through requiring such issues to be addressed at key project processing stages. ADB will make consequential revisions to its internal procedures, processes, and templates to ensure that tax integrity issues are addressed at each key project processing stage;⁴⁶ and
- (viii) disclose tax integrity issues at each key stage in project approval, including to the Board of Directors in a new integrity annex to the report and recommendation of

⁴¹ See para. 26 (i). If ADB should decide that the conditions set out in para. 26 (i) (b) are met (which it is envisaged would be exceptional), ADB will apply the risk-based approach as set out in para. 26 (ii) to (viii),

⁴² See para. 26 (ii) to (viii).

⁴³ While this is similar to a prohibitive approach, ADB considers that such a deterrent is necessary given the risks and lack of transparency associated with non-complaint jurisdictions.

⁴⁴ This will include, in the case of an ADB investment in a private equity fund, the general partner and fund manager, as well as any carry vehicle.

⁴⁵ For tax integrity due diligence, ADB will expand the current definition of an intermediate jurisdiction. The intention is to capture entities established in jurisdictions in-between ADB's client (at the bottom of the shareholding structure) and its ultimate beneficial owners (at the top of the shareholding structure). Due diligence in relation to tax integrity is not required in relation to an entity established in an intermediate jurisdiction that is the same as the jurisdiction of its ultimate beneficial owner.

⁴⁶ Revisions will be required to (i) ADB's procedures for the general conduct of IDD for nonsovereign operations; (ii) ADB's staff instructions in relation to credit and other processes for nonsovereign operations; and (iii) ADB's document templates, including the RRP.

the President (RRP) for nonsovereign operations; this integrity annex will need to be cleared by the Office of Anticorruption and Integrity (OAI).⁴⁷

27. With the objective of ensuring that ADB's procedures and processes in relation to integrity (including tax integrity) remain up to date, ADB proposes the following:

- (i) ADB will update its internal procedures for the conduct of IDD to incorporate revisions that may be recommended upon the conclusion of the tax expert's review (para. 28 [iv]).
- (ii) ADB will update its internal procedures for the conduct of IDD as required to consider global developments and lessons learned, and adopt appropriate approaches and strengthen its ability to identify and mitigate tax integrity risks.
- (iii) ADB will allocate the resource needs as will be described in paras. 29 to 37.

28. ADB also proposes the following at the department and/or office levels:

- (i) OAI to effect changes to ADB's internal procedures as required to implement the recommendations set out in para. 26 (i)–(viii) and, including clearing the integrity annex to be attached to each RRP for nonsovereign operations.
- (ii) OAI and the Budget, Personnel, and Management Systems Department to collaborate in providing training in tax integrity due diligence to staff involved in nonsovereign operations, financial analysts, and project implementation officers.
- (iii) OAI and staff involved in nonsovereign operations to keep up with the latest developments and maintain working contacts with multilateral and bilateral agencies engaged in tax integrity issues through participating in meetings and workshops of key organizations and agencies such as the Global Forum, OECD, and the UN.
- (iv) OAI, PSOD, and departments involved in nonsovereign operations to strengthen their understanding on the indicators of tax evasion and BEPS issues which are relevant for ADB's nonsovereign operations (such as material party contracts) by engaging (a) an international tax expert to assess ADB's exposure to such issues in PSOD's portfolio; recommend ways to mitigate such concerns; advise on best practice ways to obtain assurance of actual tax transparency in different project structures and strengthen ADB's IDD procedures where gaps are identified; and (b) an international tax expert to provide ongoing tax integrity advice to PSOD and departments involved in nonsovereign operations, as required.
- (v) OAI will monitor the implementation of the policies contained in this paper and will report to the Board 3 years after the policy becomes effective and thereafter as appropriate, in light of international developments.

VI. RESOURCES

29. To properly implement the tax due diligence required under the proposed policy, ADB will need to supplement OAI and PSOD staff resources. The additional resource allocations anticipated in this paper take into account that ADB previously allocated considerable staff resources for IDD.⁴⁸

⁴⁷ The integrity annex will comprise a linked document to the RRP. References to an RRP also refer to a report to the President.

⁴⁸ IDD would cover, for example, ascertaining the ultimate beneficial ownership of ADB's client, which is relevant and necessary when assessing tax integrity risks.

A. Office of Anticorruption and Integrity

30. In 2016, ADB allocated to OAI one additional national staff position for IDD. Upon approval of the policy, it is envisaged that resources to engage two tax experts (one international and one national consultant) will be required. OAI will ascertain the most cost effective ways to ensure that it has appropriate access to tax integrity research and information, and also anticipates that a modest increase in administrative resources will be required for these purposes.

31. For 2018, it is anticipated that two additional staff positions (one international and one national) will be required, as well as a modest increase in administrative and consulting resources.

B. Private Sector Operations Department

32. Since PSOD has taken significant steps to improve its IDD processes and procedures, it is well on its way to establishing an efficient and targeted IDD unit that conducts targeted reviews of key risks. PSOD currently has two international positions (one is under recruitment) and 0.8 administrative positions allocated to IDD.⁴⁹ PSOD's IDD staff members are supported by 14 national consultants.

33. Nevertheless, the IDD outputs currently expected from the Private Sector Transaction Support Division (PSTS) will require more than the existing staff resources. The proposed policy changes will further stretch limited resources and require PSTS to engage specialized assistance to address tax transparency.

34. In 2017, PSTS seeks to enhance its staff resources by adding two national staff members to meet current and new task requirements. A modest increase in administrative resources to cover tax expert and retainer fees is also envisaged.

35. For 2018, two additional staff positions (one international and one national) may be required as well as an increase in administrative and consulting resources.

C. Technical Assistance

36. Where assistance through TA is appropriate, TA resources will also be required. The decision on whether assistance should be provided through loans, TA loans, or TA grants will be judged taking into account the overall context of the DMC.⁵⁰

37. To enable ADB to increase country and regional support to DMCs through TA, ADB will require an increase in its TA allocation. Whether assistance should be provided through loans or grants will be judged taking into account the overall context of the DMC.

⁴⁹ While preliminary IDD is conducted by PSOD project officers on their projects, the Private Sector Transaction Support Division (PSTS) conducts searches, completes required checklists, and advises and supports the PSOD project officers throughout project processing and administration. PSTS shares one associate project analyst (0.5%) and one operations assistant (0.3%) with other units in PSOD.

⁵⁰ For 2016, ADB already received one request for assistance from a DMC with regard to membership of the Global Forum. Another DMC that is a member of the Global Forum requested assistance in relation to the peer review process.

VII. REQUEST FOR BOARD GUIDANCE

38. The Board's guidance is sought on the Proposed Update (Section V) and Resources (Section VI) to the Anticorruption Policy as described in paras. 22 – 37 above.

TECHNICAL ASSISTANCE TO DEVELOPING MEMBER COUNTRIES

1. ADB has undertaken a program of technical assistance (TA) to assist developing member countries (DMCs) in (i) combating money laundering and the financing of terrorism; and (ii) improving their tax collection capacity fairly and effectively through broadening and protecting their domestic tax base, enhancing the capacity of tax administrations, improving domestic tax compliance, and improving tools and procedures to stem both cross-border and domestic tax evasion and avoidance.

2. To enhance the capacity and regional cooperation of tax authorities in DMCs, ADB conducted the following regional conferences and training seminars on tax issues to identify challenges these authorities face:

- (i) Cooperating to Combat Tax Evasion: Strategy, Policy, and Legislation (Tokyo, February 2015).
- (ii) Fundamentals of Effective Exchange of Information (Phnom Penh, August 2015).
- (iii) Enhancing Effective Exchange of Information (Manila, September 2015).
- (iv) Detecting Cross-Border Tax Evasion (Tokyo, November 2015).
- (v) Tax Evasion: Investigation and Compliance Strategies (Tokyo, March 2016).

3. ADB, OECD, and the Global Forum jointly organized the following regional conferences on implementing exchange of information for tax purposes:

- (i) A Regional Training Seminar on Exchange of Information for Tax Purposes (Manila, September 2013).
- (ii) Global Forum: Automatic Exchange of Information Training Seminar (Manila, April 2015).

4. ADB supported the following diagnostic assessments of the capacity of tax administrations to protect and increase tax revenues in DMCs and to identify key areas where capacity building and reform measures will be most effective:

- (i) Capacity development needs assessment for Cambodia, People's Republic of China, Indonesia, Malaysia, Mongolia, Papua New Guinea, Philippines, Thailand and Viet Nam.
- (ii) Recommendation report based on the assessment above to Strengthen International Cooperation and Exchange of Information for Tax Purposes (expected to be produced by July 2016).
- (iii) Report on a Comparative Analysis of Tax Administration in Asia and the Pacific (2014, updated 2015).
- (iv) Workshop on Revenue Statistics in Asia jointly organized with OECD (Seoul, October 2015).

ADB'S ANTICORRUPTION POLICY AND THE INTEGRITY PRINCIPLES AND GUIDELINES

1. The Anticorruption Policy (1998, as amended to date) designated the then Office of the General Auditor (OGA)¹ as the initial point of contact for alleged incidents of corruption among Asian Development Bank (ADB) projects and staff, and instructed OGA to work out appropriate procedures for performing this function. The Anticorruption Policy provided for changes in the Procurement Guidelines and the Guidelines on the Use of Consultants, establishing the principle of declaration of ineligibility (sanctions)² along the same lines as the World Bank,³ i.e., allowing ADB to declare a firm or an individual ineligible (either indefinitely or for a stated period of time) to participate in ADB-financed activities if ADB determines that the firm or individual has engaged in corrupt and fraudulent practices in executing or competing for an ADB-financed contract.
2. In September 1999, ADB established an Anticorruption Unit (OAGA) within the Office of the Auditor General (OAG) to focus on activities relating to the implementation of the Anticorruption Policy and to handle matters related to such allegations.⁴
3. OAG's investigation procedures were then governed by ADB's Guidelines on Operational Procedures, Section 55 (GP 55) issued in July 2000. In conjunction with ADB's revision of its *Operations Manual* in 2003, OAG revised its audit manual and incorporated anticorruption procedures into chapter 800. The procedures applying to ADB's handling of allegations of fraud and corruption (GP 55) became obsolete upon ADB's issuance of its new *Operations Manual* in 2003. In December 2003, the ADB President approved OAG's new audit manual.
4. In November 2004, ADB's Board of Directors approved the clarification of certain aspects of the Anticorruption Policy (primarily terms and definitions related to corruption and fraud) to address critical issues that affect OAGA's activities and ability to assure and promote the ethical standards required by the Anticorruption Policy.⁵
5. In view of the Board approved policy update, in September 2005 ADB approved revised anticorruption investigation guidelines and procedures⁶, which incorporated Anticorruption Policy clarifications and the scope of work of the Integrity Division (OAGI).⁷ This replaces ADB's anticorruption procedures (formerly chapter 800 of the audit manual).
6. In February 2006, the presidents of ADB, African Development Bank, European Bank for Reconstruction and Development, European Investment Bank, Inter-American Development Bank, International Monetary Fund, and the World Bank, recognizing that a unified and coordinated approach is critical to the success of a shared effort to fight corruption, agreed to establish a joint international financial institution (IFI) anticorruption task force to work toward a

¹ Later renamed to Office of the Auditor General (OAG).

² Debarments are also referred to as sanctions.

³ Anticorruption Policy, para. 60.

⁴ In December 2004, OAGA was upgraded to an Integrity Division (OAGI) with expanded functions to cope with the growth in volume and complexity in investigations of fraud and corruption.

⁵ ADB. 2004. *Anticorruption Policy: Proposed Clarifications and Related Changes to Consulting and Procurement Guidelines*. Manila.

⁶ ADB. 2005. *Integrity Guidelines and Procedures*. Manila

⁷ In October 2009, OAGI became the Office of Anticorruption and Integrity (OAI) when the Integrity Division was separated from OAG.

consistent and harmonized approach to combat fraud and corruption, including developing common principles and guidelines for investigations.

7. Following a recommendation by the task force to their respective institutions, ADB's Board of Directors approved the harmonized definitions on fraudulent and corrupt practices in late 2006.⁸ In line with the Board approval of the harmonized definitions, the President, on 7 November 2006, approved the revised Integrity Principles and Guidelines⁹, which incorporated the common principles and guidelines for investigations endorsed by the IFI task force

8. The endorsement by the IFIs of common guidelines and principles laid the groundwork for the potential harmonization of other aspects of each IFI's anticorruption efforts. To enable a coordinated approach among the IFIs and strengthen the fight against corruption, the IFIs signed the Agreement for Mutual Enforcement of Debarment Decisions in 2010¹⁰. Under the agreement, entities sanctioned by one IFI may be ineligible to do business with another IFI. ADB revised implementing documents including the Integrity Principles and Guidelines, the Procurement Guidelines, and the Guidelines on the Use of Consultants to reflect the agreement.

9. The current Integrity Principles and Guidelines,¹¹ which is consistent with the harmonized framework, contain provisions relating to the investigation process, sanctions, remedial actions for violations of the Anticorruption Policy,¹² procedures for appeal and reinstatement, disclosure of sanctions, and cross debarment.

⁸ ADB. 2006. *Anticorruption Policy: Harmonized Definitions of Corrupt and Fraudulent Practices*. Manila (August and October).

⁹ ADB. 2006. *Integrity Principles and Guidelines*. Manila.

¹⁰ As approved by the Board, the ADB President signed the agreement. ADB. 2010. *Anticorruption Policy: Harmonization of Debarments*. Manila.

¹¹ ADB. 2015. *Integrity Principles and Guidelines*. Manila.

¹² Sanctions and remedial actions that may be imposed include debarments, reprimands, restitution and remedies, as well as cautions.