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MASTER'S THESIS

METHODS USED BY MULTINATIONAL ENTITIES FOR AVOIDING THE CORPORATE INCOME TAX

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TABLE OF CONTENTS

INTRODUCTION 1
1 TAXES, TAX AVOIDANCE, TAX EVASION AND TAX DEFERRAL 4
2 INTERNATIONAL CORPORATE TAXATION 8
2.1 Taxation of Cross-Border Income under Domestic Corporate Income Tax Laws 8
2.2 Taxation of Cross-Border Income under Double Tax Treaties 9
2.3 Corporate Income Tax in the Republic of Slovenia 9
2.4 Harmonisation of Direct Taxes in the European Union 10
3 TAX HAVENS 13
4 TAX AVOIDANCE METHODS 14
4.1 Profit Shifting 15
4.1.1 Transfer Price Manipulation 15
4.1.2 Strategic Allocation of Intangibles, Assets and Risks 15
4.1.2.1 The Double Irish with a Dutch Sandwich 15
4.1.2.2 Intellectual Property Holding Structure under the Intellectual Property Box Regime 18
4.1.3 Manipulation of Internal and External Debt Levels 18
4.1.4 Tax Inversion 18
4.1.5 Expatriation 19
4.2 Mismatches among Tax Systems, Preferential Tax Treatment and Negotiated Tax Rates 20
4.2.1 Hybrid Mismatch Arrangements 20
4.2.2 Preferential Tax Treatment 23
4.2.3 Negotiated Tax Rates 23
5 ANTI-AVOIDANCE RULES 23
5.1 Transfer Pricing Rules 25
5.2 Interest Deductibility Rules and Thin Capitalisation Rules 25
5.3 General Anti-avoidance Rules (GAARs) 26
5.4 Controlled Foreign Company (CFC) Rules 26

5.5 Withholding Taxes **26**

6 BEPS ACTION PLAN **26**

6.1 Action 1 – Addressing the Tax Challenges of the Digital Economy **27**

6.2 Action 2 – Neutralising the Effects of Hybrid Mismatch Arrangements **31**

6.3 Action 3 – Designing Effective Controlled Foreign Company Rules **33**

6.4 Action 4 – Limiting Base Erosion via Interest Deductions and Other Financial Payments **34**

6.5 Action 5 – Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance **39**

6.6 Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances **41**

6.7 Action 7 – Preventing the Artificial Avoidance of the PE Status **43**

6.8 Action 8-10 – Aligning Transfer Pricing Outcomes with Value Creation **43**

6.8.1 Intangibles 44

6.8.2 Commodity Transactions 45

6.8.3 The Transactional Profit Split Method 45

6.8.4 Low Value-Adding Intra Group Services 46

6.8.5 Cost Contribution Arrangements 47

6.9 Action 11 – Measuring and Monitoring BEPS **48**

6.10 Action 12 – Mandatory Disclosure Rules **49**

6.10.1 Who Is Obliged to Report 50

6.10.2 What Is Obliged to be Reported 51

6.10.3 When Information is Reported 51

6.10.4 Consequences of Non-compliance 51

6.11 Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting **52**

6.12 Action 14 – Making Dispute Resolution Mechanisms More Effective **53**

6.13 Action 15 – Developing a Multilateral Instrument to Modify Bilateral Tax Treaties **54**

6.13.1 Bilateral Tax Treaties Concluded Prior the Multilateral Instrument Entered into Force 55
6.13.2 Bilateral Tax Treaties Concluded upon the Multilateral Instrument Entered into Force 55
7 INCLUSIVE FRAMEWORK ON BEPS 56
7.1 Progress Report July 2016-June 2017 56
7.2 Progress Report July 2017-June 2018 59
CONCLUSION 62
REFERENCE LIST 64
APPENDIX 71

LIST OF FIGURES

Figure 1: Double Deduction with Hybrid Entity 21
Figure 2: Deduction/no inclusion with Hybrid Instrument 21
Figure 3: FTC Generator with Hybrid Transfer 22
Figure 4: Recommended Exchange Schedule for CbC Reports 57
Figure 5: Status of Peer Review Process 58
Figure 6: Mutual Agreement Procedures (MAP) Jurisdictions 61

LIST OF APPENDICES

Appendix 1: Povzetek (Summary in Slovene language) 1

LIST OF ABBREVIATIONS

MNE – Multinational entities

BEPS – Base Erosion and Profit Shifting

ETR – Effective tax rate

OECD – Organisation for Economic Cooperation and Development

CFC – Controlled foreign-company

GAARs – General anti-avoidance rules

Slovenia – Republic of Slovenia

EU – European Union

VAT – Value added tax

PE – Permanent establishment

ZDDPO-2 – Corporate Income Tax Act

MS – Member State

the I+R Directive – the Interest and Royalties Directive

CCCTB – Common Consolidated CorporateTax Base

CRS – Common reporting standard

IPH – Intellectual property holding

SPV – Special purpose vehicle

CbC – Country-by-Country

TEI – Tax Executives Institute

TFDE – Task Force on the Digital Economy

ECJ – European Court of Justice

APAs – Advance pricing arrangements

LOB – Limitation-on-benefits

PPT – Principle purpose test

CCAs – Cost contribution arrangements

CUP – Comparable uncontrolled price

FDI – Foreign direct investment

MAP – Mutual agreement procedure

INTRODUCTION

Each independent country in the world is fully entitled to choose its own fiscal policies without endorsing any foreign country interference. The main reason for maintaining an autonomous fiscal policy by a government is to control the generating of tax revenues, which of course account for the largest part of government revenues. Hence, the country needs them in order to meet the public needs and to provide all types of public services. When it comes to tailoring a fiscal policy, different countries achieve different goals through its particular design. For instance, developed countries use a specific, mainstream fiscal policy to steer their complex economies. By comparison, transition countries, whose economies follow in developed countries footsteps, tend to attract and anchor foreign investments through a much more favourable i.e. relaxed fiscal policy. The so-called tax havens, due to their small country size, or due to their lack of natural resources, energetically seek out other ways to develop their poor economies i.e. they aspire to attract economic entities, and well-to-do individuals, by promoting very low tax rates, or by promoting non-taxation on certain income, and on acquired wealth. These economic entities and individuals alike take the plunge of a tax haven in order to reduce their momentous tax burden, which would prospectively reach a significantly higher altitude in the countries where they are based in (Bird & Zolt, 2006).

In sole jurisdiction of each economic society is to decide on its tax rates, therefore this difference in the tax rates among distinct jurisdictions may well lead to zero taxation on the one hand, or double taxation on the other hand. In the latter case, when two hierarchically-different tax jurisdictions impose a tax on the same income, due to its toll nature, it is the case of double taxation. The double-taxed entity, however, is legally entitled to take a tax credit so as to reduce the amount of the taxed income. In this regard, multinational entities (hereinafter MNEs) are well-known to exploit the mismatches i.e. disparities amongst corporate tax systems to easily achieve double non-taxation of profit or double deduction of expenses for that matter. Furthermore, they perform an in-depth analysis of the tax regimes preferred when undertaking certain activities, or when making income in dissimilar jurisdictions. At the same time, they meticulously adhere to the positive tax laws, rules and regulations in these jurisdictions of choice, when they use different international tax planning strategies for their targeted tax avoidance. One reliable method of decreasing the tax liability while increasing the profitability of an entity is Base Erosion and Profit Shifting (hereinafter BEPS). This refers to the alternating of an income pattern from a high-tax jurisdiction to a low-tax one with a sole purpose to avoid high tax rates since MNE always aims at holding the lowest possible effective tax rate (hereinafter ETR) i.e. aims at reducing the total amount of taxes it disburses to an revenue service worldwide. Profit shifting is to be achieved by transfer price manipulation, strategic allocation of intangible assets in low-tax jurisdictions, or by locating internal and external debt in countries with observed high-taxation (Johansson, Skeie, Sorbe & Menon, 2017b). By and large, all concerned parties unanimously agree that the issue of profit shifting, especially in connection with the appalling appearance of tax

havens, is becoming an increasingly grave issue at international level. In order to help the monitoring of profit shifting, the Organisation for Economic Cooperation and Development (hereinafter OECD) was established back in 1961. The OECD along with G20 countries and 80 participating developing countries created the BEPS package. Besides the BEPS package, there have been tax anti-avoidance rules which reduce tax planning such as controlled foreign-company rules (hereinafter CFC) which apply to MNEs, a broad spectrum of general anti-avoidance rules (hereinafter GAARs) which allow for tax authorities to question and investigate a large amount of tax-avoidance motivated transactions, transfer pricing rules, interest deductibility rules which in turn restrict debt manipulation, and withholding taxes on interest payments, royalties and dividends (i.e. taxes levied on these payments to non-resident entities) (OECD, n.d.). Most countries, when employing these very effective audits tools, individually or combined, are able to track down the lost sources of tax earnings, yet with varying degrees of success.

Purpose and Goal of the Master Thesis

The foremost scholar purpose of this thesis is to group and thoroughly describe the various international methods for avoidance of the corporate income tax in order to enhance a better understanding of the features, and the way of operating of each and every method used by MNEs, and ultimately to determine whether the BEPS measures achieve their clear goal – to update international tax rules in direction of preventing double taxation and eliminating tax base erosion and profit shifting, by way of neatly closing the gaps-and-bottle necks for double non-taxation.

The scholar goal I have set in this thesis is to gather and elaborate a theoretical corpus of information and practical illustration of the various internationally-developed methods, including the best practices for preventing the corporate income tax avoidance. In the research done, my main focus is on the international tax laws, on the relevant rules and regulations, on the present international corporate income tax avoidance methods, on the effects they produce on the revenues of certain jurisdictions, and last but not least, on the fiscal tools and measures taken to fight and eliminate these harmful phenomena in each developed society.

Research Questions Addressed in the Master Thesis:

1. In which ways the exploiting of mismatches and profit shifting reduce the ETR of MNE?

2. How anti-avoidance rules reduce profit shifting?

3. How the BEPS measures affect the methods of avoiding of the corporate income tax which are used by the MNEs?

Methodology

This thesis comprises an analytical overview of relevant literature, rules and regulations, scientific discussions and scholar research, theoretical findings, as well as experts' articles in the this specific field of research. In my thorough research, I opted for the descriptive approach, namely the classification method, the descriptive method, the comparative method and the compilation method. I applied the common classification method for the classification of tax types, the classification of both legal and illegal tax methods, the classification of international corporate taxes, the classification of the tax avoidance methods and their subdivisions, the classification of the anti-avoidance rules as well as the classification of the Actions of the BEPS Action Plan. I expounded thoroughly the above-mentioned classifications, with a definition or concise explanation, and an example by using the descriptive method. I pinpointed the similarities, differences and the underlining relation among these classifications through the comparative method. Finally, although I used the compilation method for the inclusion of the standpoints, theoretical findings and research done by other scholars with appropriate citations, yet the thesis brings forth my personal scholar signature through my unique approach and way of doing the research.

Structure of the Master Thesis

In the first part of the thesis, different patterns for classification of taxes, tax avoidance, tax evasion and tax deferral are defined whereas in the second part, two principles of corporate taxation - the residence principle and the source principle - are also aptly defined. For illustration, there is a brief description of the corporate income tax in the Republic of Slovenia (hereinafter Slovenia) as well as the harmonisation of the direct taxes in the European Union (hereinafter EU) in the second part. In the third part, the term 'tax haven' is defined, next the OECD's list of tax havens is given, and lastly the Panama Papers Leak Case is presented as well. As for the corporate tax avoidance methods, they are thoroughly described in the fourth part.

The tax avoidance methods are divided into two separate groups. The first group is named 'profit shifting' where transfer price manipulations, strategic allocation of intangibles, assets and risks, shrewd manipulation of both the internal and external debt level amounts, and tax inversion and expatriation shall all be presented in their own right. The second group is named 'mismatches' that happen between any given pair of tax systems, preferential tax treatment and negotiated tax rates. The used term 'mismatches' includes both the hybrid instruments and transfers and the hybrid entities too. Each method is described from both theoretical and practical aspect, with an example included. In the following part, the now-existing anti-avoidance rules shall be explored, in particular their role and their contribution to the event of corporate tax avoidance shall be addressed, so that in the sixth part the focus will be on the BEPS measures singularly. Finally, the thesis shall be rounded off with a conclusion in its last part.

1 TAXES, TAX AVOIDANCE, TAX EVASION AND TAX DEFERRAL

Taxes and the state are inherently interconnected concepts. Since the very appearance of states, taxes have also come into being. Within their conveniently structured framework of taxation system, states use the mechanism of political power and regulation, which is based on the delegation of power in order to meet the growing and painstaking social requirements and deadlines, or to 'correct' market mechanism, so to speak. The management of tax policy and the tax system in modern societies makes it difficult to overcome the basic conflict of interest of citizens who, on the one hand, need to relieve their tax burdens, while at the same time demand that the so far-reached level of public services and social welfare is being satisfactorily-maintained as well.

Taxes are one of the most important forms of fiscal income, both for their aimed purpose and for their portion of contribution in the national income on the whole. Therefore, both fiscal theory and practice pay special attention to the tax system issue. Taxes are only a necessary mean through which the state or the local community collects the income needed to financially cover the public services as well as a broad spectrum of other miscellaneous societal needs that are of special interest for a particular state.

According to Pernek (1997, pp. 105-106), the fundamental characteristics of taxes in the developed countries are as follows:

- Coercion of paying taxes - meaning the tax liability is a legal obligation that the taxpayer must fulfil, otherwise he will be sanctioned;
- Taxes represent state revenues;
- The retention of the collected taxes - the state becomes the sole owner of the resources that it has collected from taxation;
- Taxes paid do not provide a direct compensation to taxpayers - taxes are not compensation for public services provided by the state to its citizens as there is no correlation between the cost to support the government that is exclusively covered by taxes and the actual benefits that citizens would prospectively gain from such tax-covered expenditures;
- The infamous territorial tax principle – people and legal entities who earn income or have assets in a given area are taxpayers regardless of whether they are lawful citizens of that particular state or not;
- Uncertainty of spending the taxes collected – the taxes serve to cover every part of government-born expenses;
- Taxes are always collected in the name of the public interest - taxes serve to meet certain general, common, collective and social needs;
- Taxes, as a common rule, are monetary revenues of the state - only in exceptional cases taxes can be collected in kind.

Expectedly, tax systems of different countries feature a great number of different types of taxes. Some of the mainstream classifications of taxes are as follows:

- According to the taxpayer reference, there are subjective taxes and objective taxes. Subjective taxes are personalized taxes that take into account the subjective characteristics of the taxpayer such as their demonstrated economic power, their age, their health status, their way of earning income, even how often they go on a spending spree, etc. As it is obvious, subjective taxes are much fairer in terms of distribution of the tax burden among taxpayers. Such taxes include the personal income tax, the direct excise duties, the inheritance tax, etc. When it comes to objective taxes, they largely depend on the existence of objective circumstances such as spending, income, belongings, sales and purchase, etc. and they consider the individual tax object only, and not the whole capability of the taxpayer. Objective taxes are always imposed at source. Such taxes are the value added tax (hereinafter VAT), the custom duties, the excise duties, the contributions on salary, certain types of wealth taxes, etc. (Pušnik, 2011, pp. 17-18).
- According to the determination of the tax base amount reference, there are ad valorem taxes and specific taxes. The ad valorem taxes are taxes in values i.e. they draw on a fixed proportion of value whereas the 'tax base' is presented in monetary units only. Instances in this regard are the real estate tax, excise on non-essential goods, etc. The second type of taxes, the specific taxes that is, are taxes that have a tax base presented in other forms as a physical unit of measurement as head/item count, weight, volume or length. A good example of this type of tax is the one imposed on a pack of cigarettes – widely known as excise duty, then tax on fermented liquors, etc. (Pušnik, 2011, p. 18).
- According to the scope or authority-imposing-the-tax reference, there are central taxes and local taxes. It is worth mentioning that the term 'authority' differs significantly among numerous countries around the world, owing to the different financial systems at work in each of them. Lower territorial units are eligible for a part of the central taxes established, apart from their first-established eligibility for local taxes. An example in Slovenia is the personal income tax (Pušnik, 2011, p. 18).
- According to the technical tax proceeding reference, there are cadastral taxes and tariffs. Cadastral taxes are levied on the basis of the data collected from cadaster agencies (for instance land cadaster agencies or real estate cadaster agencies). The tax on agricultural income is calculated in firm agreement with the mathematical principle of cadastral income. Tariffs, on the other hand, are imposed on individual legal actions and facts such as sale, import, manufacturing, etc. according to the tax rates established for certain goods on the list of tariff headings (Pušnik, 2011, p. 19).
- According to the collecting-the-tax reference, there are indirect taxes and direct taxes. Indirect taxes are not imposed directly on the taxpayer since the taxpayer charges them to other people. Common instances of such taxes are the VAT, the excise duties, and the tax charged on motor vehicles sales and transfers. As the name itself implies, direct taxes are imposed directly on the taxpayer, and they have an effect on the income of the

taxpayer. Instances of such taxes include the property tax, the personal income tax, the corporate income tax, the social contributions, and the wealth tax as well (Pušnik, 2011, p. 17).

In line with the previous classifications, there are also two main types of taxes affecting the net profits of an entity operating internationally: they are called personal income tax and corporate income tax. The former of the two is a function of the laws being applied in jurisdictions where workers are employed full-time, and therefore it plays a role in choosing the location of production, distribution and administration. This tax subject has not been addressed in this master's thesis at all. Corporate taxes, the other type of taxation, generally differ inasmuch as they are frequently subject to manipulation, and are not extensively related to the volume of production or other production-related activities in a local jurisdiction. Rather than that, they are influenced by decisions such as place of establishment, transfer pricing policies, repatriation of profits and other stratagem-based decisions. Differences in corporate income tax rates among jurisdictions and other aspects of individual tax systems allow entities to plan their taxes or to decide in which jurisdiction they will locate foreign operating units, including the entity's headquarters itself (Holtzblatt, Jermakowicz & Epstein, 2015). Interestingly enough, the statutory tax rate in a jurisdiction does not reveal anything about the tax burden in a specific jurisdiction for the MNEs as a whole, but the burden depends on the tax reliefs. Here, the catchphrase 'tax relief' essentially refers to all the different methods of reducing the taxpayers' liability permitted by regulations. In fact, the so-called tax reliefs are one of the main tax instruments that enable the country to influence the business operations with this tax. Moreover, with their remarkable economic impact, the country influences investment and employment allocations of the entities while at the same time it is achieving the goals of its economic and social policy. Also, it suffices to say that tax reliefs enable the country to facilitate the development of a myriad of economic activities, branches and disciplines, as well as to direct investments into less developed and bad-off areas. Indeed, a number of renowned economists agree that tax reliefs are applicable means in the following areas:

- investment in research and development,
- investment in equipment and intangible assets,
- employment of people with disabilities,
- implementation of practical work in vocational education,
- voluntary supplementary pension insurance,
- donations (Kostanjevec & Pernek, 2002, p. 8).

Entities and individuals alike make great efforts to reduce their tax burden by employing different methods, which can be considered either legal or illegal. The legal tax evasion i.e. tax planning and tax avoidance is managed through the use of recognised legal methods both by natural and legal persons. However, this type of tax evasion cannot and should not be equated with the illegal tax evasion, which means unlawful and deliberate avoidance of tax

fees. Another legal method of tax evasion is tax deferral which is defined as shifting of the present level of taxable income at high rates, into the future, when it will be taxed at much lower that is at much more favourable rates for the taxpayer.

Tax avoidance is a term that points to an admissible pattern of behaviour of taxpayers utilized to reduce their tax liability, which does not actually violate statutory provisions, yet these actions are contrary to the purpose of the law in their nature, therefore are unacceptable, and are always illegitimate in respect of the general principles of law and justice. Tax avoidance includes tax planning practices such as: transferring assets to countries with a more favourable tax regime, transferring capital gains to countries with lower tax rates, distributing income among different taxpayers that are taxed at lower marginal tax rates, scattering activities throughout different jurisdictional regions so that to avoid VAT eligibility, etc. Legal tax evasion is made possible through the legal gaps in tax laws so it has become 'a type of bylaw.' In other words, legal gaps are set as provisions in the tax laws that rightfully allow individual taxpayers to pay a tax in a decreased total amount, or even to avoid their dues at all times. Most legal gaps have come into existence due to special provisions giving advantage to particular taxpayers or particular activities of the same in terms of tax exemption. In order to prevent legal tax evasion, tax laws of most countries incorporate provisions that define that any legitimate pattern is void from a tax point of view as long as it already has or may have direct or indirect result of avoiding certain tax payment. These provisions are commonly called anti- avoidance rules (Drobnič, 2008).

Illegal tax evasion is a deliberate, unacceptable and unlawful fiscal evasion, where the tax liability is not paid or not determined at all, for the reason that the taxpayer did not pay attention to and did not respect the provisions of the tax law. Undoubtedly, it is an illegal tax reduction achieved by bypassing or by underpayment of taxes, which at times can happen by chance, due to the lack of information, but it can also happen by design. In this regard, tax evasion is listed as a deliberate evasion, which is a criminal offense, and an unintentional evasion, which results in a duty to pay the total tax amount, or it can even be supported by the payment of a fine. This is done in several ways: by not filing a tax return form, or by submitting false information in the filed tax return form, or by committing fraudulent self-taxation, or by presenting a lower tax liability. Therefore, tax evasion, which aims at withdrawal from paying taxes in an unlawful manner, thereby depriving the country of its much needed tax revenues, is regarded as a very serious misdemeanour or a criminal offense adequately sanctioned in numerous countries. The legal implications are mandatory payment of the tax plus the fine, and at worst it is sanctioned by imprisonment of the offender. Which actions can be considered illegal or punishable, however, is determined by the national laws of each country, so the definitions of a lawful / unlawful act, may well differ in different countries (Drobnič, 2008).

To sum up, the essential difference between tax avoidance and tax evasion is legality. Tax avoidance is a legal exploit of the tax system to reduce current or forthcoming tax liabilities

by means not intended by parliament. It often involves artificial transactions which are contrived to produce a tax advantage.

2 INTERNATIONAL CORPORATE TAXATION

The two regular monetary categories i.e. income and consumption are taxed in most countries. Consumption taxes, retail taxes and VAT are all imposed in financial transactions where expenditures are made when acquiring goods and giving or getting services, at the time the transaction is made at either the last point of sale to the consumer or when intermediate transactions are made between two parties or legal entities, at the very place of destination. Income taxes, derived from both personal and corporate income, are imposed on net income over an estimated income period, at the place of source of the income (OECD, 2011).

In this section, I discuss the income tax alone, in particular the corporate income tax, mostly focusing on its treatment in international transactions. To this end, a distinction is made between the taxation of the cross-border income under domestic corporate income tax laws on the one hand and under double tax treaties on the other hand.

2.1 Taxation of Cross-Border Income under Domestic Corporate Income Tax Laws

Here it is important to differentiate two general divisions. The first one is the tax treatment of outbound investments of resident legal entities, and the second one is the tax treatment of inbound investments of non-resident legal entities. Hence, it is required that countries promptly define the category 'residence of the legal entities.' In general, countries adopted different criteria for determining it i.e. some of them use formal criteria (for example place of incorporation), others use factual criteria (for example place of effective management), and the rest use combination of both (Rohatgi, 2005).

Outbound investments of resident legal entities are handled differently for tax purposes, depending on the country's tax system, i.e. whether the country is contingent on the worldwide system or of the territorial system. In the first system, the resident legal entities are taxed on their worldwide income so that the cross-border income is mostly taxed upon repatriation by using the deferral system, and not by using the accrual system/scheme as usual. The tax paid on the cross-border income abroad can be credited in the residence country up to the amount that would have been imposed by the residence country. In the latter system, the territorial one, the resident legal entities are taxed on the local income generated on the territory of the residence country. In practice, most countries use a combination of the two systems to suit their fiscal needs (Rohatgi, 2005).

When it comes to inbound investments of non-resident legal entities both systems impose tax on the income earned within the territorial jurisdiction of the country. Research records show that countries have stipulated multiple domestic rules for determining the source of the corporate income, but their rules are often found to parallel the concept of permanent establishment (hereinafter PE), as it is defined in tax treaties. The PE is either a fixed setting of doing business in another country through which the legal entity operates, or in some cases there is a person which acts on behalf of and in the name of the foreign legal entity. Again, the income of a PE is generally taxed on a net basis. By contrast, the income earned from royalties, interests and dividends is taxed by means of gross-based withholding taxes at a lower rate compared to taxation on a net basis, inasmuch as it is difficult to determine the expenses incurred for generating such income (Rohatgi, 2005).

2.2 Taxation of Cross-Border Income under Double Tax Treaties

Two or more jurisdictions may simultaneously impose tax on the same taxpayer for the same income category, which straightforwardly leads to double taxation. In order to avoid this, so much argued, double taxation, bilateral tax treaties are concluded and finalised. It is conspicuous that most of them show a relatively uniformed structure, based on a model such as the OECD Model Tax Convention or the United Nations Model (OECD, 2015a, pp. 23, 26-27). Bilateral tax treaties allocate the taxing rights to the contracting states by way of ordering rules. When this is the case, there are two possibilities.

By signing a tax treaty, one contracting state obtains the exclusive right to fully uphold its domestic tax laws – corporate income is taxed exclusively by the state of residence unless the legal entity operates in the other state through a PE located therein. If this is the case, then the source state is entitled to tax the income attributable to the PE (Rohatgi, 2005).

One contracting state makes its priority to enforce domestic tax laws while the other has a residual right to tax the income – an illustration are certain payments such as dividends, royalties, interest or technical fees, which allow the source state to impose a withholding tax on a gross basis, as it is mentioned above. The highest rate of the withholding taxes imposed by the source state is defined by the bilateral tax treaties while the residence state has the residual right to tax the payment and at the same time, the resident state, is obliged to provide double taxation relief. Two mechanisms which may be applied for the relief are: the credit method in the destination country and the exemption method, yet in practice countries tend to use a combination of both. The credit method is used for income subject to a withholding whereas the exemption method is used for income generated by a PE (Rohatgi, 2005).

2.3 Corporate Income Tax in the Republic of Slovenia

The corporate income tax in Slovenia is regulated with the following law: Corporate Income Tax Act (ZDDPO-2), O. G. RS, no. 117/2006. A taxable person is the legal person of

domestic and foreign law (resident and non-resident). A resident is taxed on all income that has its source in Slovenia, as well as on all income that has its source outside Slovenia (principle of worldwide system). The taxable person is a resident of Slovenia if he /she meets at least one the following requirements:

- has a headquarter office in Slovenia;
- has a place of effective management in Slovenia.

A non-resident is taxed on all income with a source in Slovenia (the requirement is that he/she does not have a headquarter office in Slovenia, and does not have a place of effective management in Slovenia), namely:

- from the income he/she receives by performing activities in a PE or through a PE in Slovenia;
- from other income source.

The tax base is estimated as the difference between the revenue and the expenditure i.e. outgoings determined on the basis of accounting regulations, specifically Slovenian Accounting Standards and pursuant to the provisions of the ZDDPO-2. The specific rules for the tax recognition of revenue and expenditure are laid out in the ZDDPO-2.

The tax is payable at the level rate of 19 % of the tax base.

A resident may deduct the amount of duty he/she paid on income from sources outside Slovenia, in respect of the obligation to pay the tax for a particular tax period, providing that he /she meets certain criteria for this deduction.

2.4 Harmonisation of Direct Taxes in the European Union

The EU Member States (hereinafter MSs) have their full sovereignty and autonomy in managing their fiscal and tax policies. Under the principle of subsidiarity, decisions should be made by the EU institutions, rather than by a MS itself, only in cases when they are expected to achieve better results and goals than the MS itself. Otherwise, decisions should be made by each MS autonomously, because there are great differences in the social, political and economic development of the MSs. The EU MSs independently, i.e. on a national level, regulate their tax systems, based on the measures taken and the directives given for mutual harmonisation of taxation and avoiding striking discrepancies when imposing taxes. These directives have achieved a minimal harmonisation of tax systems, i.e. partial harmonisation, in the case of direct taxes while the greatest success was achieved in the harmonisation of indirect taxes (Atanasovski & Bogoev, 2004).

When we talk about harmonisation of taxes in the EU, what we have in mind are indirect taxes that are defined by the well-known Treaty of Rome. By contrast, direct taxes are not

foreseen in the provisions of the Treaty, and therefore their harmonisation encounters numerous obstacles. From this prospective, we can say that direct taxes are in a period of incomplete harmonisation – that is approximation. The harmonisation of direct taxes mainly relies on clearing tax evasion and elimination of double taxation. A certain degree of harmonisation of direct taxes is also needed to prevent the distortion of competition, which is an imperative when making investment decisions. In the realm of corporate taxation, the EU has specified two main objectives: the first one is to prevent harmful tax competition amid MSs and to facilitate the free movement of goods, people, services and capital (Atanasovski & Bogoev, 2004). The provisions of the Treaty on the Functioning of the EU state that a MS shall by no means impose on the products imported from other MSs, neither directly or indirectly, any internal taxation that is higher from the taxation of similar domestic products. Also when importing a MS is not allowed to impose countervailing charges. When exporting products in other MSs, Treaty's provisions state that the internal taxation repayment shall not exceed the internal taxation of the same products. Also, while exporting goods to other MSs, turnover taxes, excise duties, and other indirect taxes are allowed, while other repayments may not be allowed. In this way, the anticipated and highly desired free movement of goods, persons, services and capital is ensured. Finally, the EU rarely deals with the personal income tax, and when it does, it is in terms of achieving equality in the working conditions in all MSs.

The system of harmonisation of taxation of entities in the EU includes directives and other tax-law acts and documents, which are sorted out in six areas:

- Taxation of parent companies and their subsidiaries of different EU MSs: The Parent-Subsidiary Directive 2011/96/EU, O. J. L 345/2011, p. 8–16 (hereinafter the Parent-Subsidiary Directive), which refers to the treatment of cross-border dividend payments between the parent company and its subsidiaries, the taxation of the parent company's profits accrued through its subsidiaries, and lastly the taxation of the subsidiaries of subsidiary companies. The Parent-Subsidiary Directive seeks to eliminate double taxation of dividends, i.e. double taxation of distributed profits. The reason for adopting the Parent-Subsidiary Directive is that the event of double taxation to a great extent limits the free movement of capital, which is one of the four fundamental freedoms in the EU. Double taxation of dividends occurs when an associated company in one MS pays dividends to its parent company in another MS in the following manner: the dividend is taxed in the MS where the associated company pays the dividend, and the other way round, the dividend received by the parent company is also taxed in the MS where the parent company is a taxpayer. The Parent-Subsidiary Directive solves the problem of double taxation by exempting withholding taxes on the dividends paid by the associated companies and by imputing against the parent company's tax payable any tax on profits paid by the subsidiaries of the direct subsidiary companies (European Commission, n.d.a).

- Taxation of cross-border restructuring operations involving companies of different EU MSs: The Merger Directive 2009/133/EC, O. J. L 310/2009, p. 34–46, (hereinafter the Merger Directive) aims at eliminating the fiscal obstacles that arise in the event of restructuring operations i.e. mergers, divisions, transfers of assets and share/stock exchanges amongst companies of different EU MSs. The Merger Directive refers to the deferral of the capital gains taxation in the case of cross-border transactions related to the restructuring of groups of entities. When mergers, joint ventures, divisions and reorganisation of related entities take place, there is an increase or a decrease in the tax obligations stipulated by the laws of certain MSs. In order not to come across these differences, the Merger Directive requires the payment of taxes in such situations to be postponed until the sale of the property to a third party takes place (European Commission, n.d.b).
- Taxation of interest and royalties among associated companies in the EU: According to the Interest and Royalties Directive 2003/49/EC, O. J. L 157/2003, p. 49–54 (hereinafter the I+R Directive) interest and royalties are taxed in the MS which is the registered office of the beneficial owner of the interest and the royalties. This means that the country, that is the source of interest and royalties, does not tax them if the beneficial owner is physically located in another EU MSs. The I+R Directive aims at eliminating withholding tax on cross-border interest and royalty payments in the MS providing that the beneficial owner is a company or PE in another MS, so as to facilitate the cross-border interest and royalty payments to be taxed only once in an EU MS (European Commission, n.d.c).
- Prevention of harmful tax competition: The EU model for the prevention of harmful tax competition is described in the Code of Conduct for Business Taxation, which is an integral part of the conclusions of the Economics and Finance Ministers (ECOFIN) of 1 December 1997. It establishes criteria to identify i.e. to detect potentially harmful measures such as tax measures that have an impact on the business location in the EU. The Code of Conduct for Business Taxation obliges the EU MSs not to accept a new tax system that could cause harmful tax competition between them (European Commission, n.d.d).
- The Anti-Tax Avoidance Package: The Anti-Tax Avoidance Directive 2016/1164, O. J. L 193/2016, p. 1–14 (hereinafter the Anti-Tax Avoidance Directive) which sets rules against tax avoidance practices that affect the EU internal market, is a part of the Anti-Tax Avoidance Package. The Anti-Tax Avoidance Directive will be legally binding as from 1 January 2019 and it introduces the scheme of five anti-abuse measures: rule on hybrid mismatches, CFC rule, switchover rule, exit taxation rule, interest limitation rule and GAAR (European Commission, n.d.f). I will explain these rules in greater detail in the chapter which covers the anti-avoidance rules in this thesis.
- Common Consolidated Corporate Tax Base (hereinafter CCCTB): The CCCTB is a single set of rules for computing the taxable income of companies for their EU activities, i.e. in one tax return the companies are able to offset losses from one MS against profits in another MS for their EU activities. An apportionment formula will be used to share

the profits among the MSs, and each share will be taxed by its MS at the MS's national tax rate. The CCCTB will be mandatory for large MNEs as they have the greatest capacity and the greatest potential to use the tax avoidance strategies. The purpose of the CCCTB is to eliminate mismatches between tax systems, preferential regimes and hidden tax rulings, as well as to eliminate the need for using the transfer pricing strategy as a method of profit shifting. At the same time, it will offer incentives for R&D spending and will encourage stable equity financing in order to ensure growth, new investments, employment and economic stability (European Commission, n.d.e).

3 TAX HAVENS

The term 'tax haven' is defined in a different manner by different organisations because it encompasses different methods and indicators, and each approach serves a specific goal. In general, tax havens are defined as low-tax jurisdictions through which businesses and individuals alike grab the opportunity to avoid taxation and to do tax evasion. Tax havens are generally small-sized and politically-stable jurisdictions with effective government and control of corruption (Dharmapala & Hines Jr, 2009). According to the OECD (1998, pp. 22-23) a tax haven is a jurisdiction which has: no taxes at all, or low taxes only; laws and administrative practices which prevent the effective exchange of information; lack of transparency; and the absence of a requirement of substantial activity. The fourth criterion was formally withdrawn from the OECD's 2002 Progress report. This definition, however, excluded some jurisdictions that appeared on the lists of other organisations, such as Ireland, Switzerland, Luxembourg, the City of London, the Netherlands, the United States (Delaware, Nevada and Wyoming), Canada, Costa Rica, Hong Kong, Singapore, Macau, Jordan and Lebanon (Tax Justice Network, 2007).

The OECD came up with three lists of countries in terms of tax havens: a white list of countries implementing an agreed-upon standard, a grey list of countries that have committed to such a standard, and a black list of countries that have not committed at all (Tax Justice Network, 2007). In 2000, OECD identified well over 40 jurisdictions as amazing tax havens. All of these jurisdictions subsequently made commitments to implement the OECD standards of transparency and effective exchange of information, and were agreeably removed from the notorious list, the last being Andorra, Liechtenstein and Monaco in 2009 (OECD, 2000; Gravelle, 2015). Fortunately, at the moment, OECD does not have a record of jurisdictions which stand for an uncooperative tax haven.

One of the most hyped examples of a tax haven is certainly the 'Panama Case,' which was considered a big scandal in 2016, when journalists exposed documents that show that national leaders, politicians, businessmen, lawyers and celebrities have been using tax havens to keep their fortunes safe. The list of tax haven users is actually quite long and impressive: among other entities it lists the United Kingdom ex-prime minister's father Ian Cameron, Pakistan's prime minister Nawaz Sharif, ex-interim prime minister and former

vice-president of Iraq Ayad Allawi, president of Ukraine Petro Poroshenko, former prime minister of Iceland Sigmundur Davio Gunnlaugsson, son of Egypt's former president Alaa Mubarak, Lionel Messi, and Jackie Chan (Wickenden, 2016). The Panama Papers leak of 40-year-period data for 214,488 entities incorporated in 21 tax havens has supplied authorities with a mechanism to obtain secret information, which later on will provide the prosecutors with a road map to the jurisdictions and institutions where clients of Mossack Fonseca, a law firm from Panama engaged in the creation of the renowned 'shell entities,' maintained their accounts and assets. The most popular tax havens from these documents are Panama, the British Virgin Islands, the Seychelles and the Bahamas, while the most popular homes for intermediaries are the United Kingdom, Hong Kong and Switzerland (Carpenter-Holmes & Gazzaway, 2016).

The EU MSs sent letters to 92 Jurisdictions outside the EU with the announcement that they will be screened with a chance of possible inclusion in a future EU blacklist of tax havens, which was ready at the end of 2017. To avoid being on this blacklist, third countries would have to comply with the international tax transparency criteria, fair taxation, and implementation of anti-BEPS measures such as the common reporting standard (hereinafter CRS) (van der Made, 2017). The CRS, published in 2014 by the OECD, requires jurisdictions to obtain and automatically exchange financial account information on tax matters with other jurisdictions on annual basis. The measure resulted in more than 40 jurisdictions adopting the CRS one by one while the reporting started as of 2017. The EU published a black list and a grey list. On 5 December 2017 i.e. the exact time of publishing the list, the black list consisted of 17 countries among which were Panama, Barbados and the United Arab Emirates, which were marked as non-cooperative realms. The grey lists consisted of 47 countries which should have improved their transparency standards, should have introduced fair taxation, substance requirements, and should have implemented the BEPS measures. Among these countries were listed Bosnia & Herzegovina, Hong Kong SAR, Peru, Turkey, Morocco and Switzerland. The eight Caribbean countries that had been struck by a hurricane have not been put on any list, but rather than that they have been given additional time to adopt the EU criteria. A country can be removed from the list given that it satisfies the criteria of the EU. Developed countries have been given one year to catch up with non-listed countries while developing countries have been given two years (European Parliament, 2018).

4 TAX AVOIDANCE METHODS

Tax avoidance can be achieved through profit shifting or through consciously abusing the mismatches of the tax systems in different countries. Legal entities generally use a combination of the two as a means to an end. In this chapter, I describe in greater detail the various profit shifting strategies as well as the patterns of abusing the differences in the tax systems.

4.1 Profit Shifting

Profit shifting means distribution of the taxable income base in different jurisdictions in order to decrease the tax liability as much as possible, and to achieve lower ETR. This results in some income not being taxed or being taxed yet at a lower rate by the destination country. Worldwide fiscal praxis proves that it is possible to achieve profit shifting by transfer price manipulation, strategic allocation of intangibles, assets and risks, manipulation of internal and external debt levels, tax inversion and expatriation, as I describe them right below.

4.1.1 Transfer Price Manipulation

Transfer prices are the prices at which an entity makes transfers of tangibles or intangibles, or the prices at which it provides different services to affiliates (Cazacu (Neamţu), 2015). These prices should be set on the arms-length principle i.e. the prices should be the same as the prices that would be paid by unrelated entities. When this is not the case, they get set at an artificial level, and this convenient set up represents evasion. In practice, setting an appropriate arm's length prices for goods and services for which comparable unrelated transactions are difficult to find, creates an opportunity for shifting income from high-tax jurisdictions to tax haven affiliates (Hines Jr, 2007). This often happens with the transfer of intellectual property rights, or intangibles. Transfers of intangibles, such as new inventions and new drugs, rarely have comparable counterparts, so it is difficult to weigh these royalties against the arms-length principle (Gravelle, 2015).

4.1.2 Strategic Allocation of Intangibles, Assets and Risks

MNEs transfer the ownership of intangibles, assets and risks through intra-group arrangements (such as licensing) from high-tax to low-tax jurisdictions or in jurisdictions with preferential tax treatment for certain intangibles aiming to pay lower taxes on their revenue stream (such as royalties) (Johansson, Skeie, Sorbe & Menon, 2017b). Profit is shifted only if the royalty price is lower than the real value price of the same intellectual property right. In this context, I will present two profit shifting strategies based on intellectual property rights.

4.1.2.1 The Double Irish with a Dutch Sandwich

This strategy is in common use by technology-oriented MNEs, including Google, Apple, Microsoft, Amazon and Facebook. It involves a U.S. parent that owns three entities:

- One intellectual property holding entity (hereinafter IPH) which is a direct subsidiary of the U.S. parent and is incorporated in Ireland. Under the Irish law this entity is considered to be a tax resident in Bermuda in view of the fact that its place of effective management is Bermuda. The same entity is treated as an Irish one by the U.S. since the U.S tax law

considers tax residency in accordance with the place of incorporation and not in accordance with the place of effective management (Fuest, Spengel, Finke, Heckemeyer & Nusser, 2013).

- One operating entity which is also incorporated in Ireland – owned solely by the IPH entity.
- One conduit entity which is incorporated in the Netherlands – owned solely by the IPH entity (Kleinbard, 2011; Sandell, 2012).

The common path is: the U.S. parent confers the intellectual property rights on the IPH entity. But in order to avoid taxation of hidden reserves and future income generated from the intangible, the U.S. parent does not transfer the full-fledged intangible. Instead, the IPH entity makes a buy-in payment, for which the arm's length price is difficult to determine, and also signs a cost-sharing agreement on future improvements and changes of the intangible with the U.S. parent. Hence, the U.S parent reserves the domestic rights to use the fragmented intangible and the IPH entity owns the international rights and has no obligation whatsoever to make periodic payments to the U.S. parent (Fuest, Spengel, Finke, Heckemeyer & Nusser, 2013).

The Irish operating entity smoothly generates high revenues by taking advantage of the intellectual property, and it only applies the 12.5% Irish corporate tax rate. In turn, the Irish operating entity is allowed to write off its royalty payments on the pretext of trade expenses (Google deducted 5.4 billion dollars in royalties which had an effect of paying a nominal 1% ETR). In other words, the operating entity's tax base is consistently very low because of the high tax-deductible royalty payments it makes to the Dutch conduit entity for the exploitation of its intangible. This unequivocally means that the income from the royalties is not returned directly to IPH entity in Ireland, as Ireland imposes withholding taxes on royalty payments to Bermuda, but in lieu of this they are sent to the Netherlands, which does not impose withholding taxes on any royalty payments, regardless of the jurisdiction of residence. At the same time, because of the EU's I+R Directive, corporations in one MS are exempted from paying any taxes on interest and royalty payments made to subsidiaries of different MSs, provided that the beneficial owner of the payment is a company or PE in another MS (European Commission, n.d.c). Due to this event, the royalty payments from the operating entity are channelled to the Dutch conduit entity which sublicenses the intangible, so they are not paid directly to the IPH entity. Actually, the Dutch conduit entity does not undertake any substantial economic activity, and its tax liability is merely a minute fee paid for using the tax system in the Netherlands (Fuest, Spengel, Finke, Heckemeyer & Nusser, 2013). The income which receives the IPH entity enjoys no corporate tax rate in Bermuda, as Bermuda imposes no taxes on income, capital gain or dividends, until it is repatriated to the U.S. parent through making dividend payments. Then it is a subject to the U.S. dividend rate of taxation, except when the non-U.S. income is not redistributed as dividends or qualified as Subpart F income. So to wisely avoid being taxed, both the Dutch conduit entity and the Irish operating entity file a check-the-box election. This election allows eligible entities (for instance the

Netherlands beslote vennootschap met beperkte aansprakelijkheid, the French societe a responsabilite limitee, the German Gesellschaft mit beschrankter Haftung, etc.) to choose whether they prefer to be categorised as partnerships or as corporations (Carson, Cinnamon & Kronbergs, 1998). This election in the U.S. has no capacity to change the local-law treatment of the entity (Zarin & Zimmerman, 2006). The Irish operating entity and the Dutch conduit entity choose the three entities to be treated as one single Irish corporation, and the royalty payments among each of them are not deemed for tax purposes in the U.S. because they do not constitute Subpart F income, all due to exceptions to the rule included in the Subpart F provisions. Obviously, the income of the three entities is promptly combined, thus only the income from third parties is considered from the U.S. tax perspective (Sokatch, 2011).

Subpart F income consists of various types of income stated below:

- Income earned from the insurance of the U.S. risks;
- Amounts attributable to the international boycott participation or to illegal bribes or kickbacks and
- CFC income. A CFC is a foreign corporation which has more than fifty percent of the total value of the stock, or of the total value of the stock entitled to vote, owned by the U.S. shareholders on any given day during the taxable fiscal year of that corporation. The term 'related entities' includes both entities and individuals that own more than fifty percent of the CFC's stock. Thus, CFC income includes: foreign personal holding company income – passive income as for example interest, royalties and dividend payments between related entities; foreign base company sales of personal property to related entities through CFC which must be available for use or destination outside of the of the CFC country of establishment and the CFC ought not have produced, manufactured or constructed the personal property; foreign base company services income – the CFC performs services outside of the CFC country of establishment for related entities; and foreign base company oil related income (Carson, Cinnamon & Kronbergs, 1998). When these four requirements are met, then the CFC income is referred to as taxable.

The foreign base provision is inapplicable in instances when the personal property is manufactured, produced, or constructed by the CFC. This goal can be achieved through a cost-sharing agreement for joint development, whereby the rights to use the intangible in the U.S. are retained by the U.S. company (i.e. Google), and the rights to use it worldwide belong exclusively to the CFC. In this way, the non-U.S. rights are considered as if they have been gained in the country of establishment of the CFC (Sokatch, 2011).

Due to the international pressure-mechanisms, Ireland introduced formal transfer pricing legislation in 2010, but it is applicable only to transactions agreed on after 1 July 2010, and all of the MNEs which made agreements before 1 July 2010 can still exploit the advantage

of ‘eroding’ the tax base by way of paying extremely high royalties (Fuest, Spengel, Finke, Heckemeyer & Nusser, 2013).

4.1.2.2 Intellectual Property Holding Structure under the Intellectual Property Box Regime

This strategy is devised for the transfer of the intellectual property between two EU resident entities (IPH entity and operating entity). The intellectual property is transferred, while not triggering high exit taxes, to an EU country like the UK, Belgium or Luxembourg, i.e. to IPH entity in countries that have special intellectual property box regime. It is important that no CFC rules apply in the EU parent resident country. Due to the EU’s I+R Directive, royalties are paid directly from the operating entity to the IPH entity, without paying the withholding tax. The royalties are taxed at a very low rate of tax at the IPH entity point because of the special regime, which offers either a reduced tax rate or an exemption of large portion of the royalty income (Fuest, Spengel, Finke, Heckemeyer & Nusser, 2013).

4.1.3 Manipulation of Internal and External Debt Levels

When the debt and the associated interest payments, which are tax deductible, are allocated in high-tax jurisdictions this reduces the tax liability of the MNE. The allocation of debt can be done by not changing the overall debt exposure (i.e. leverage) of the MNE, although certain risks may appear such as the currency exchange rate risk (Johansson, Skeie, Sorbe & Menon, 2017b). One tactic that MNEs use to relieve their tax burden in high-tax jurisdictions is earnings stripping, which is done by interest deductions of either debt associated with affiliates or of unrelated debt. It is often used when entities invert. Jurisdictions take measures against this tactic with the so-called thin capitalisation rules.

4.1.4 Tax Inversion

MNEs invert mostly due to the low corporate tax rate and the territorial tax system of the target country. There are also other reasons for inversion such as avoiding repatriation of foreign-held income and easier access to foreign markets (Marian, 2015). According to some researchers, the inversion does not create a joint value to customers or society, and it is merely a strategy for easing the tax burden (Gomes-Casseres, 2015). Tax inversion enables the U.S. parent to become the U.S. subsidiary to a new foreign parent, in order to avoid paying U.S. taxes on all or on part of the taxable income. This means that a U.S. MNE is relocating its headquarters in lower-tax jurisdiction by merging, or by being taken over by an entity from the same lower-tax jurisdiction. Examples of such jurisdictions are Ireland, the Netherlands, the United Kingdom, Canada and Switzerland. If an entity’s income arises in the U.S., it is subject to U.S. income tax, but the income arisen in other jurisdictions is no longer subject to U.S. income tax. The U.S. taxable income can be additionally reduced by

use of the earnings stripping tactic mentioned in the previous section (Holtzblatt, Jermakowicz & Epstein, 2015). The MNEs that invert use their tax savings to make their prices more competitive or to bring richer dividend pay-outs to the shareholders. In this sense, gains from the difference in prices of the swapped stock have to be recognized by the stockholders who hold stock in the foreign entity as they are subject to tax for the stockholders. Yet, it is up to the management to decide on inversion when the savings on the taxable income are greater than the capital gains that have to be paid by the stockholders (Rosa, 2016). As it is decided internally, this type of inversion is called self-inversion. There is also another type of inversion, called combination migration transaction. This one arises when an entity becomes a subsidiary of a new foreign parent that is not in control of its own management (Oosterhuis, 2015).

Due to the many changes in the U.S. law in order to fight tax inversion, nowadays tax inversions happen in the form of mergers. But in order to invert successfully, the U.S. entities need to merge with a foreign entity in a way that the U.S. entity assets become diluted to forty or to twenty percent. Should the U.S. entity end up with the ownership in the range of sixty to eighty percent of the newly-formed foreign entity, it will be considered as a foreign entity, but it will carry some U.S. tax burdens. In case an entity ends up with an ownership of eighty percent, it will be considered as a domestic U.S. entity for tax purposes. That is why the U.S. entities decrease their relative size, for illustration by paying a 'skinny-down dividend' i.e. they borrow cash to pay out very rich dividends to the shareholders; next by engaging in 'spin versions' when they establish foreign subsidiary and promptly move their assets there, and then spin off only that foreign subsidiary during an inversion (Gupta, 2014); or by using "cash box" where the value of the foreign merging partner is increased by aggregating passive assets in retained earnings (Pauls, 2014). To prevent these tactics, in April 2016, a provision was adopted, that the U.S. entity has to meet the sixty percent or eighty percent thresholds during the thirty-six months before the inversion (Mun, 2017).

4.1.5 Expatriation

This is a strategy of the U.S. entities to shift the ownership on all foreign assets and the business activity in a foreign low-tax jurisdiction in order to earn a foreign income that almost entirely is not taxed and in order to have flexibility to choose where to allocate their taxable assets. There are three chief reasons why entities choose to expatriate. The first reason is to avoid the U.S. rules of taxation of foreign income because there are high taxes on repatriation of the income back in the U.S, so the entity decides to keep its money abroad. The second reason is the tax consequences of the capital gains, and the third one is the tax consequences from the opportunities to reallocate profits in low-tax jurisdictions after the expatriation. In general, the U.S. authorities impose taxes on the dividend payments paid out to shareholders before the ownership transfer takes place (Rosa, 2016).

There are two possibilities to recognize capital gains, which depends on the type of the structure of the expatriation. The first one is when stock transfer is taxed. This happens when there is a swap of the foreign shares into shares of the U.S. entity, a trade which makes the shareholders partial owners of the foreign entity. The second one is when an asset transaction is taxed i.e. when the foreign entity takes over the assets from the U.S. parent entity (Rosa, 2016).

4.2 Mismatches among Tax Systems, Preferential Tax Treatment and Negotiated Tax Rates

Mismatches among different tax systems frequently cause some income not to be taxed in any jurisdiction, or they cause some tax deductions of expenses to be used in two jurisdictions simultaneously, or they cause an asymmetric treatment of a transaction when an expense is deductible in one jurisdiction, but the associated income is not taxable in other jurisdiction (Johansson, Skeie, Sorbe & Menon, 2017b). It is possible to achieve this through an abuse of bilateral tax treaties. MNEs take an advantage of these mismatches and preferential tax treatment to alleviate their tax burden and to present a lower ETR on their corporate income reported.

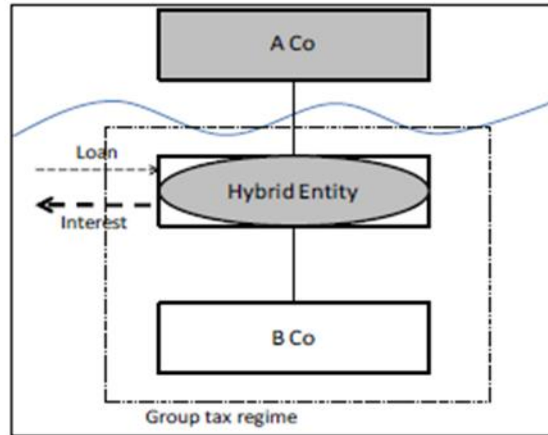
4.2.1 Hybrid Mismatch Arrangements

Hybrid mismatch arrangements generally fall into the category of double deduction, deduction/no inclusion and foreign tax credit generator schemes, which occur due to differences in the tax systems of two or more countries with the help of hybrid entities, hybrid instruments, hybrid transfers or dual residence entities (OECD, 2012, p. 5). Hybrid entities are entities treated as transparent in one country, and as non-transparent in another one. Hybrid instruments have a distinct treatment in different countries, mostly as debt in one country while an equity in another one. Hybrid transfers are treated as a transfer of the ownership of an asset in one country, and as a collateralized loan in another one. Dual resident entities are considered as lawful residents in two countries (OECD, 2012).

Double deduction schemes are crafted to lead to a decrease of the taxable income at the same expense in the two countries of choice. An example, shown in figure 1 below, is when one entity in country A owns indirectly, through a hybrid entity, another entity in country B. The hybrid entity, which is the owner of entity B, is considered to be transparent in country A, but it is considered to be non-transparent in country B, for the same tax purposes of course. The hybrid entity borrows money which, is afterwards injected in entity B as an equity, and at the same time it makes interest expenses on the loan it has previously borrowed. Due to country B group relief regime, and due to the fact that the hybrid entity is treated as non-transparent in country B, entity B is able to offset the interest expenses of the hybrid entity from its taxable income. And vice versa, since the hybrid entity is treated as tax transparent

in country A, the entity in country A is able to offset the interest expenses from the hybrid entity from its taxable income (OECD, 2012, pp. 7-12).

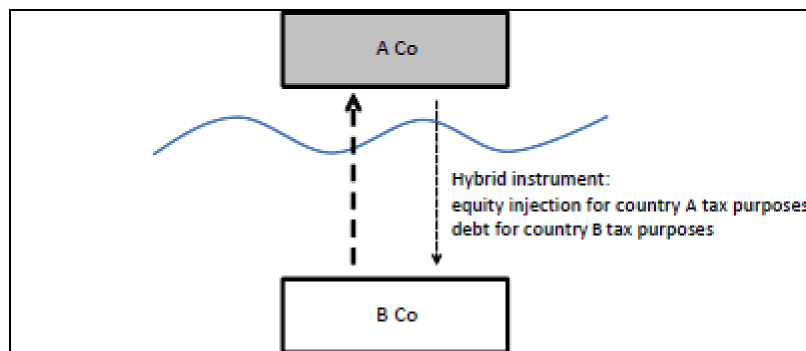
Figure 1: Double Deduction with Hybrid Entity



Source: OECD (2012).

Due to the deduction/no inclusion schemes there is a substantial decrease of the taxable income at a certain expense in one country, while the same expense has not been included in the taxable income in another one. One example, shown graphically in figure 2 below, is when there are two entities, one is made resident in country A, and the other one is made resident in country B. The resident entity from country A funds the entity in country B, with an instrument safely treated as an equity in country A, yet as a debt in country B. In other words, the entity in country B can offset the interest expenses of its taxable income, while in country A the same payment is treated as a tax exempt dividend. Another example is the case of hybrid entity, which is treated as a non-transparent one in the country in which it makes deductible payment to shareholders in a different country in which it is treated as a transparent entity (OECD, 2012, pp. 7-12).

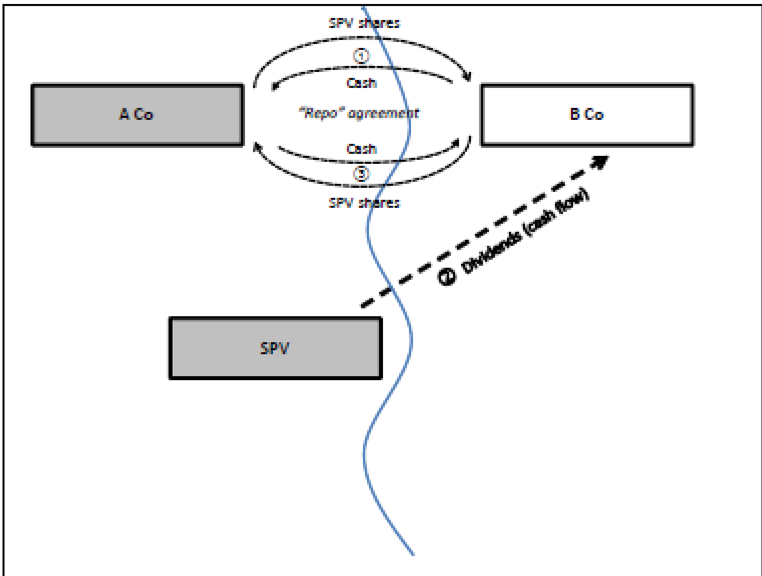
Figure 2: Deduction/no inclusion with Hybrid Instrument



Source: OECD (2012).

Foreign tax credit generators generate additional foreign tax credits. The illustrative example, shown in figure 3 below, is a hybrid transfer of an equity instrument with a sale-and-repurchase agreement over the shares of a special purpose vehicle (hereinafter SPV). The entity in country A establishes a SPV so as to contribute equity, and in return it is allowed to possess preferred shares in the SPV. Ensuing this, an entity in country B, by means of buying the SPV preferred shares, funds the entity in country A. This artificial transaction is treated as a share sale-and-repurchase transaction in country B, and as a loan such that the shares are now seen as collateral in country A. Moreover, both entities have agreed that the shares are to be sold back to the entity A in the future. In the interim, country A imposes taxes on the income generated by the SPV, and the SPV pays dividends to the entity B. Country B sees the entity B as an owner of the shares, and via its indirect foreign tax credit regime the entity B is allowed to claim a foreign tax credit for the corporate income tax that the SPV pays to country A. At the same time, country A sees the entity A both as the owner of the shares and as a recipient of the dividends, so country A automatically applies an exemption for dividends received by the entity B, respecting the fact that the SPV has already paid corporate income taxes to country A, and so via an indirect foreign tax credit regime the entity A receives the dividends, which in effect are not tax-bound. The entity A is allowed to a reduction for the interest expenses incurred by the loan received from the entity B. These interest expenses are treated as dividend payments by the entity B (OECD, 2012, pp. 7-12).

Figure 3: FTC Generator with Hybrid Transfer



Source: OECD (2012).

4.2.2 Preferential Tax Treatment

A number of jurisdictions, or only certain areas within them offer special tax treatments, which are extensively exploited by MNEs. MNEs take advantage of the preferential tax treatment for R&D activities, as they are tax deductible. They also locate all of their patents in jurisdictions with preferential tax treatment for patent revenues (Johansson, Skeie, Sorbe & Menon, 2017b).

Ireland reduced its corporate tax rate to low 12.5% in 2003 so as to attract inward investment, and in 2015 it announced a peculiar 'knowledge development box' when the income generated from intellectual property and patents is taxed at a significantly-lowered rate of 6.25%. Prior to this, in 2008, Luxembourg introduced its patent box-setting an ETR of only 5.84% for income also generated from intellectual property. The Netherlands introduced its own patent box in 2007, and later on revised it in 2010 to set the tax rate at tiny 5%, thus making it the lowest patent box rate in the world ever. The United Kingdom introduced its patent box in 2013, which was phased over a period of five years. In 2017, it was finally set at the level of 10% (Bradley, Ruf & Robinson, 2018).

4.2.3 Negotiated Tax Rates

These tax rates are negotiated between a tax authority and a given large-size MNE.

5 ANTI-AVOIDANCE RULES

All OECD countries, but plenty of countries outside it as well, have set tax anti-avoidance rules in their domestic legislation, but the operational strength of these rules varies, depending on the number of types of anti-avoidance rules countries have set, and depending on whether certain requirements in connection with these rules are met in the countries (Loyens & Loeff, 2016). I listed the types of anti-avoidance rules as separate sections of this chapter.

The application of these anti-avoidance rules could be done through an increased count of audits and higher penalties. A measure that has been taken recently is the adoption of an Anti-Tax Avoidance Package in the EU. This measure includes the adoption of the Anti-Tax Avoidance Directive that will be of great help with the implementation of certain anti-avoidance measures in the EU MSs, among which are also some of the OECD's BEPS measures, coupled with the creation of the EU black list and grey list, already discussed in chapter 3 of this thesis. The provisions of the Anti-Tax Avoidance Directive have to be rendered into national laws and regulations as of 1 January 2019, except for two provisions which will be allowed a longer closing date (Loyens & Loeff, 2016). The provision that refers to anti-hybrid mismatches, which states that it will not be possible to deduct on EU-source for payments made: under hybrid instruments, to reverse hybrids, to disregarded

foreign branch of an EU entity, by a checked EU entity or by an EU branch of a foreign head office, has to be transposed by 1 January 2020. The provision that considers to the taxation of an EU reverse hybrid in an EU MS has to be transposed by 1 January 2022 (de Matos, Semenov & Kuipers, 2018). The Anti-Tax Avoidance Directive is a goal-oriented one towards the six rules I have already mentioned in section 2.4 of this thesis. The rule on hybrid mismatch arrangements aims at the prevention of the exploitation of mismatches of the tax systems (European Council, 2017). For instance, in the United Kingdom, the new rule set out on hybrid mismatch arrangements, which entered into force on 1 January 2017, has an impact on specific Swiss principal entities enjoying tax benefits under the Circular No. 8 regime. If these entities have made arrangements that create deduction/non-inclusion of income, then tax deductions for payments, such as distributor's commissionaire's costs for goods and services, of the United Kingdom resident entities towards non-United Kingdom resident entities, specifically Swiss principal entities, will not be allowed. However, if the income is taxed by Switzerland, proved by an agreement for each tax payer individually, then tax deduction in the United Kingdom will be allowed for these types of payments (Kistler & Zulauf, 2016). The CFC rule aims at the prevention of profit shifting to a country which has low statutory tax rate or has set no tax rate, by taxing the profit in the EU. The switchover rule aims at the prevention of double non-taxation of dividend payments made to the EU-based entities by their existing branches in third countries. The exit taxation rule aims at the prevention of tax avoidance when MNEs are transferring assets such as IP. This is often the case when MNE, which is located in an EU MS, develops a new product, and right before the product is finalised it is transferred into a third country so that the MNE can pay a lessened corporate income tax in the EU. It becomes obvious that the tax will be imposed on the value of the new product before it is moved out of the EU. The measure known as interest limitation rule aims at the prevention of debt arrangements that minimize taxes by limiting the amount of the interest that can be deductible by an entity located in an EU MS. And last but not least, the GAAR is a measure taken against the aggressive tax planning only if other specific rules do not cover the artificial tax arrangements (European Commission, n.d.f).

In this context, it is also worth mentioning the fourth Anti-Money Laundering Directive 2015/849, O. J. L 141/2015, p. 73–117 and the fifth Anti-Money Laundering Directive 2018/843 O. J. L 156/2018, p. 43–74. They have provisions on the prevention of the use of the financial system for the purposes of money laundering or even terrorist financing. The fourth Anti-Money Laundering Directive provided the authorities with publicly-accessible registers in the EU MSs. These registers have personal information of individuals, or legal entities for that matter, that are entitled to more than 25% interest in a corporate or other legal entity, or are entitled to a formal or to a de facto control over it (KPMG, 2017). The information in the registers were accessible to law firms, banks and to any person or organisation that could demonstrate a legitimate interest (The VinciWorks Blog, 2017). Due to the terrorist attacks in Paris and Brussels and to the Panama papers affair, the fifth Anti-Money Laundering Directive was adopted in 2018. In terms of tax evasion, it is proposed

that the central registers of beneficial owners of legal entities that operate in the EU have to become publicly-accessible for everyone (European Commission, 2018).

5.1 Transfer Pricing Rules

Transfer pricing rules aim at preventing entities from increasing or decreasing their taxable income with the help of the so called arm's length principle (Tully, 2012). In accordance with this principle, the transactions of related entities should be conducted at a price that is comparable to the prices of transactions among third entities (Johansson, Skeie & Sorbe, 2017a). There are comparable transactions and methods such as the cost plus a mark-up method, which set arm's length prices for many goods and services. But in transactions involving intangibles it is difficult to determine the comparable price. For example, the transfer pricing rules for intellectual property rights are very complex due to the cost sharing agreements concluded amongst the related entities, when each entity contributes to the cost of development of the intangible or contributes to a buy-in payment (Gravelle, 2015).

Transfer pricing rules differ among countries, and their strictness is greater when there are associated documentation requirements as prescribed by the law and also providing that the related entities ought to submit transfer pricing report for the transactions carried out among them in their annual tax return (Johansson, Skeie, Sorbe & Menon, 2017b).

5.2 Interest Deductibility Rules and Thin Capitalisation Rules

The strength of the anti-avoidance rules is greater if the country has drawn up interest deductibility rules and thin capitalisation rules, which also differ among countries. These rules provide control and limit the allocation of debt and are based on interest-to-earnings or debt-to-equity ratios accordingly. The second ones are more often applied in practice, yet some countries like Germany, Portugal and Spain have switched from debt-to-equity to interest-to-earnings rules (Johansson, Skeie & Sorbe, 2017a).

Countries which have debt-to equity rules either target total debt or only related-entities debt. The threshold above which the interest payments on the debt are not allowed for differs among countries, and also either interest payments above the allowed threshold of the debt or interest payments on all of the debt are not allowed (Blouin, Huizinga, Laeven & Nicodème, 2014; Merlo & Wamser, 2014). Countries whose rules apply to total debt have stricter rules than the ones whose rules apply to related entities debt.

Interest-to-earnings rules also differ between countries as countries have different thresholds for deduction of interest (Johansson, Skeie, Sorbe & Menon, 2017b).

5.3 General Anti-avoidance Rules (GAARs)

GAARs are adhered to in several countries, but then again each of these adhering countries implements them differently due to the different abuse provisions, tainted element provisions, etc. (Johansson, Skeie & Sorbe, 2017a). However, there are some common features of GAARs such as how countries identify a scheme, how they quantify the tax benefit associated with a scheme and a purpose test to check whether an entity achieves tax benefit because of a scheme (Johansson, Skeie, Sorbe & Menon, 2017b). The problem with GAARs is that there ought to be a direct link between a certain transaction and associated tax benefit in order that the GAARs are applied, hence they are not always productive in the case of hybrid mismatch arrangements (OECD, 2012, p. 13).

5.4 Controlled Foreign Company (CFC) Rules

The CFC rules differ among countries, and some countries do not even have stated them. In section 4.1.2.1 above, I mentioned the CFC rules in the U.S. There are also CFC rules present in Germany, Denmark, the United Kingdom, Finland, Portugal, Sweden, Spain, France and Italy among the EU countries. CFC rules generally apply to foreign companies that are controlled by shareholders in the parent jurisdiction. These rules aim at prevention of the striping of the tax base in the country of residence by shareholders of a foreign subsidiary. In general, CFC rules are stipulated to tax passive or highly mobile income generated by non-resident entities of resident shareholders in circumstances in which this income would go untaxed (the case of a territorial tax system) or it would be taxed on repatriation in a worldwide tax system. They exclude the taxation of active income of the CFC in order not to discourage genuine investments in foreign countries in a way that the CFC rules do not provide greater tax burden than the one that have the non-resident shareholders in the same foreign country (OECD, 2015a, pp. 22-23). Should the host country impose a tax rate that is closer to the statutory corporate income tax rate in the jurisdiction of residence of the MNE, it makes the CFC rule stricter (Haufler & Runkel, 2012).

5.5 Withholding Taxes

The practice of withholding taxes influences cross-border transactions on interest, royalties and dividend payments even though they are not anti-abuse rules. If a country has signed a small number of bilateral tax treaties and/or has a high standard tax rates, then the country is considered to have stricter rules. I have already discussed withholding taxes in chapter 2 of this thesis in more detail.

6 BEPS ACTION PLAN

OECD has focused on its BEPS action plan, which consists of fifteen actions. The BEPS action plan applies to the issue of exploiting the mismatches among the tax systems of

different countries in order to make a shift of profits to targeted lower-tax jurisdictions, where no substantial activity is taking place. However, the entities should not be hold responsible for taking advantage of the tax rules enforced by the countries, since they have not enforced them on their own, but instead, the countries should evaluate and audit the existing rules and implement new rules in order to combat the BEPS strategies. At the same time, unilateral and isolated measures by countries can lead towards multiple-taxation which makes a negative impact on investments, growth and employment. That is why the BEPS initiative suggests that an internationally coordinated approach be made, which will strengthen the domestic measures for protection of the tax bases, and will also present international solutions to these issues. In order to effectively implement the measures, toolkits for the developing countries developed by OECD, United Nations, International Monetary Fund and World Bank Group are provided. The toolkits have been designed on practical and real-life cases in order to solve the issues these countries encounter with. These toolkits are to be delivered between 2015 and 2018. There was a suggestion to replace the arm's length principle in the developing countries, with a standard that will provide for Global Formulary Apportionment of the profits of the unitary firm, as it may be a simpler standard. However, this suggestion was not accepted on the grounds that it will require an agreement on common tax base and on uniform allocation keys in order to avoid the creation of stateless income, new possibilities for harmful tax practices and/or double taxation. This form of global agreement is difficult to achieve (OECD, n.d.).

The BEPS action plan calls for measures for new minimum standards, for revision of the existing standards, for an approach to convergence of national practices, and for a fiscal guidance based on best practices so far. It is possible to apply some of the measures immediately while others require a change of bilateral contracts or domestic law implementation. The BEPS action plan is a soft law legal instrument, which is not legally binding. However, all of the OECD and G20 countries committed to implement the measures which aim to prevent treaty shopping, to fight harmful tax practices, to improve dispute resolution and to provide a Country-by-Country (hereinafter CbC) report. The implementation of BEPS will be monitored in the areas mentioned above. The countries have agreed that in other areas they would use general tax policy direction, or they would be guided by best practices. In order to see whether BEPS achieved success, it will be checked if a consensus is reached, whether the measures are applied in accordance with the consensus, and whether instances of BEPS are still found after the implementation (OECD, 2015a, pp. 88-93).

6.1 Action 1 – Addressing the Tax Challenges of the Digital Economy

Action 1 addresses the challenges that arise from the digital economy, which should not be put apart from the rest of the non-digital i.e. traditional economy for tax purposes. The digital economy is a result of the transformative process facilitated by information and communication technology (OECD, 2015a). Tax Executives Institute (hereinafter TEI)

(2014a, pp. 143-145) agrees with this standpoint of the OECD, but states that the tax issues in relation to the digital economy can be addressed by the international tax rules applicable to the traditional economy with minute or no modification. It is due to the fact that the business models of digital businesses have the same operational focus as traditional businesses in terms of manufacturing, producing and delivering goods and/or services to customers. The difference is only in the way of receiving the delivery, which is not a reason to formulate new rules of international taxation.

When dealing with digital economy, we have to consider two types of taxes: direct and indirect. The indirect tax is the VAT, which should be paid in the country of consumption, while the direct tax is the corporate income tax which should be imposed on profits made through real economic activities when the value is created. The digital economy is also covered in the case of the transfer pricing issues, the CFC rules and PE, but in the appropriate actions of the BEPS Action Plan (OECD, 2015a).

The Task Force on the Digital Economy (hereinafter TFDE) introduced three options on direct taxes that do not represent internationally agreed standards, but their use in the domestic laws presents a safeguard against BEPS. Still, additional effort will be needed for clarity and consistency with the existing international commitments i.e. how internal standards bilateral tax treaties are based on allocate taxing rights between the source and the residence, as well as for monitoring of the development of the digital economy over time is recommended. The final report on the outcome of Action 1 is expected by 2020 (OECD, 2015a).

The options introduced by TFDE can be used independently or in combination. Taking up these options would generally allow countries to impose a tax in situations when a foreign entity generates significant sales income in the country without a physical presence therein, and/or uses the contributions of in-country users in its value chain, including the collection and monitoring of data (OECD, 2015a). The three options that were introduced by TFDE are as follows:

- The new nexus rule which is based on a significant economic presence. This means that a non-resident entity will be taxed in a country when it has a significant economic presence based on the combination of three types of factors: revenue-based factors, digital factors, and user-based factors. These ones will stand as evidence for a purposeful and sustained interaction with the economy of that country through technology and other automated tools. The revenue-based factor considers gross revenues generated from digital transactions proceeded with in-country customers through an entity's digital platform. A threshold will be introduced, and the level of the threshold would be set at a high enough level to minimalize administrative burden for tax administrations as well as the compliance burden and level of uncertainty for the tax payer. The factor should be operated on a related-group basis rather than on a separate-entity basis to prevent running the risk of artificial fragmentation of distance selling activities with customers of the

same country among a variety of foreign affiliated entities. The revenue factor itself as an appropriate measure of the economic life in a country is not enough, so it could be used with combination with digital (a local domain name, a local digital platform, local payment options) and/or user based (monthly active users on the digital platform who are habitually resident in a given country in a taxable year, online contract conclusion through digital platform with customers or users who are habitually resident in the country in any taxable year, data collected through a digital platform) factors, and a link is to be created between the revenue generating activity of the non-resident entity and its significant economic presence in the country (OECD, 2015a).

Example: If a non-resident entity generates gross revenues above the threshold from transactions with in-country customers effected electronically through a confined digital platform when the customer is required to create a personalised account and to utilize the local payment options offered at the website to make the purchase, it could be considered that there is a link between the revenue generated from that country and the digital and/or user-based factors evidencing a significant economic presence in that country. By contrast, it would be more difficult to find such a link when a non-resident entity generates gross revenues above the threshold from transactions with in-country customers through in-person negotiation taking place outside of the market jurisdiction, if the entity only maintains a passive website that provides product information with no functionalities permitting transactions or intensive interaction with users (including data collection) (OECD, 2015a).

- The withholding tax on certain types of digital transactions that could be imposed as a standalone gross-basis final withholding tax on certain payments made to non-resident providers of goods and services ordered online or, alternatively, as a primary collection mechanism and enforcement tool to support the application of the nexus option i.e. net-basis taxation. The liability to pay a withholding tax on outbound payments is often shifted to a local collecting agent, who must have a free access to information on the transactions sufficient to know when the tax is payable, and who must reasonably comply with his obligation to withhold. In B2B transactions, businesses residents in the source country are expected to assume the withholding obligation. In the B2C context, an intermediary to withhold on the payment would be required. The task of the intermediary could be accomplished only if the collection regime is supplemented by a mandatory registration system for non-resident entities whereby all remote sellers of goods and services have to open a bank account of choice for all payments received from local customers. Assuming that domestic suppliers of similar products are subject to net-basis taxation, the imposition of standalone gross-basis withholding tax on foreign suppliers for remote sales of goods and services is likely to lead to substantial conflicts with trade obligations and the EU laws. Consequently, it is best to use this mechanism as a backup one, and to impose the net-basis taxation on the basis of significant economic presence nexus, rather than as a standalone option. A registration system for taxpayers that agree to file tax return form and to pay tax on their income could be established, coupled with a credit system enabling taxpayers to pay any tax due on net income in addition to the

tax withheld, or in order for taxpayers, who suffered loss on a net basis at the end of the fiscal year, to claim a tax refund. However, such a system would have to consider that taxpayers may have an incentive not to file a return form where their net tax liability would be greater than the amount of withholding tax payable (OECD, 2015a).

- The equalisation levy that could be structured in a variety of ways contingent on its ultimate policy objective. In general, it would be applied only in cases when it is determined that a non-resident entity has a significant economic presence. Imposing an equalisation levy runs the risk of subjecting the same income to both the corporate income tax and the levy. This could happen either in the situation in which a foreign entity is subject to the levy at source and at the same time is subject to corporate income tax in its country of residence, or in the situation when the non-resident is subject to both the levy and the corporate income tax in the country of source. Therefore, it is necessary to structure the levy in such a way that it could be applied equally in all cases when the income would not be taxed, or it would be taxed at a very low rate. Another good approach could be to allow a taxpayer, who is subject to both the corporate income tax and the levy, to credit the levy against its domestic corporate income tax. This will ensure that foreign entities with no nexus for corporate income tax purposes would only be subject to the levy in the source country whereas the tax burden of entities subject to corporate income tax would effectively be limited to either the greater of the corporate income tax or the levy (OECD, 2015a).

TEI (2014a, pp. 143-145) urges the OECD not to encourage MSs to choose from a menu of options, but to promote a uniformed set of international rules. Also TEI (2018, pp. 71-73) does not find clear the addressed problem in terms of the digitalisation of the economy, i.e. whether the income from the digital business is not taxed at all, or whether the income is not taxed in the market country that is the country of consumption. And when the income has already been taxed, the question is whether it should be taxed in addition to or only by the market country as well. TEI (2018, pp. 71-73) opposes the three options presented by OECD in Action 1 and considers them unworkable as well. The withholding tax and the equalisation levy are forms of gross revenue levy, and are represented as a substitute for the corporate income tax, thus it is not clear how it will avoid the risk of double taxation. The EU paper, which was discussed at the ECOFIN meeting in Estonia in September 2017, takes the same attitude towards the withholding tax and the equalisation levy. The EU paper, however, considers the digital nexus rule, i.e. changing the definition of PE in order to accept digital businesses as an appropriate solution, while TEI (2018, pp. 71-73) claims that this will give rise to the uncertainty for businesses. The equalization levy appears similar to VAT, so TEI (2018, pp. 71-73) argues that this will increase the tax costs for local customers only, and in turn will fail to tax non-resident entities. The decision of the OECD to tax the net income of entities when the goods and services are consumed instead of when they are produced and/or the IP is created, seems to replace the income tax with a consumption tax. This could be achieved by increasing tax rates, or by changing the consumption tax regime instead of the proposed solution, as it is much simpler.

6.2 Action 2 – Neutralising the Effects of Hybrid Mismatch Arrangements

Action 2 defines hybrid mismatch arrangements as schemes that are realisable with the help of hybrid financial instruments, hybrid entity payments, and reverse hybrid and imported mismatch arrangements, which is similar to the explanation of hybrid mismatch arrangements, as described in section 4.2.1 of the thesis. Action 2 offers general and specific recommendations that include changes of the domestic law, as well as changes of the OECD Model Tax Convention, with a primary and a secondary defensive rule, which applies automatically to each jurisdiction that will implement them, and will put an end to double non-taxation by neutralising these mismatches. Should one country choose not to implement these changes, it will not affect other country choice to incorporate the rules in its laws. The recommendations have the form of linking rules that align the tax treatment of an instrument or an entity with the tax treatment in the counterpart jurisdiction, but do not disturb commercial outcomes otherwise. The primary rule denies deduction from a payment of a taxpayer in one country when the same payment is not taxable for the recipient in the counterpart jurisdiction. If the taxpayer's country does not apply the primary rule, then the counterpart jurisdiction can opt to apply the defensive rule, i.e. to include the deductible payment in the taxable income, or to deny double deduction depending on the nature of the mismatch. Action 2 also takes into consideration dual resident entities, and recommends a case-by-case solving rather than applying the current rule based on the place of effective management. In general, these rules are drawn up hierarchically so that a jurisdiction does not need to apply the hybrid mismatch rule when there is another rule operating in the counterpart, and it is sufficient to neutralise the mismatch (OECD, 2015b).

Action 2 defines three types of mismatches: double-deduction, deduction/non-inclusion and indirect deduction/non-inclusion and also gives recommendations about them (OECD, 2015b).

The double-deduction rule identifies both the deductible hybrid payment made by a hybrid in the subsidiary jurisdiction and the corresponding duplicate deduction in the investor's jurisdiction. The primary rule denies the deduction in the investor jurisdiction if the deduction is duplicated, i.e. the amount that exceeds the claimant's dual inclusion taxable income. When the primary rule is not applied, then in the subsidiary jurisdiction the secondary rule is applied in order to prevent the benefits of hybrid payment. The taxpayer can carry forward the excess deductions, and can offset them against dual inclusion income in the future for both the primary and the secondary rules, yet to the extent that the deduction cannot be offset against income of any person in the other jurisdiction (Ruchelman, 2014).

The deduction/non-inclusion rule defines a disregarded cross-border, related-party payment if the recipient's resident jurisdiction disregards that payment. According to the primary rule, the hybrid deduction payment cannot be higher than the dual inclusion income while according to the secondary rule the recipient must include the excess deductions in its income (Ruchelman, 2014).

A reverse hybrid (when any person is treated as a separate entity by an investor i.e. foreign owner and as a transparent by the laws of the establishment jurisdiction), is an arrangement when differences in the characterisation of the intermediary result in the payment being disregarded both in the intermediary jurisdiction and in the investor's jurisdiction. In other words, the investor and the intermediary jurisdiction treat the payments as income by a resident of other jurisdiction while the payer jurisdiction allows the deduction (OECD, 2015b). This means that the investor does not a have taxable presence in jurisdiction of the intermediary. Also, the reverse hybrid arrangements are difficult to understand unless they are made within a controlled group. They are typical in the case of widely-held investment vehicles that admit offshore investors (Ruchelman, 2014).

Imported mismatch arrangements include the deductible payment made to a payee that is not bound by hybrid mismatch rules. Moreover, through the use of a hybrid instrument, the income in the jurisdiction of the intermediary is reduced or fully eliminated, upon the lending of the amount raised with the help of the hybrid instrument to a borrower in a third country (Ruchelman, 2014).

Two recommendations have been given in regard of the reverse hybrids and imported mismatch arrangements. One of them is to be in line with rules under which the income or payments related to a reverse hybrid will be included in the income in the jurisdiction of the investor. If they are not to be included in the income of the investor's jurisdiction, then these rules are to be supported by rules which will require the inclusion of the same income or payments in the income in the intermediary's country. The second recommendation is to be in line with rules in jurisdiction of the payer, which deny deductible payments between members of the same controlled group, if the payments are made to an offshore imported mismatch structure, reverse hybrid, or as a part of an avoidance scheme (Ruchelman, 2014).

TEI (2014b, pp. 147-153) advocates that if the Action 2 is uniformly adopted, it might be an effective solution, although it considers that the timing differences, in terms of when countries will implement these recommendations in full, will lead to insecurity. TEI (2014b, pp. 147-153) gives a suggestion that the scope of the recommendations of Action 2 should be imposed on hybrids that are abusive and not in other circumstances. Also, even though OECD assumes that there will be coordination among the countries that will apply the rules, TEI (2014b, pp. 147-153) does not agree as it considers the rules to be too complex to be applied and to be interpreted consistently by all of the countries, and thus they might be leading to double taxation. TEI (2014b, pp. 147-153) commends the OECD for the targeted approach, i.e. targeting of tax effects of the hybrid mismatches instead of re-characterising the hybrids. TEI (2014b, pp. 147-153) also agrees with the OECD's recommendation not to use a general anti-abuse rule for addressing hybrid mismatch issues.

6.3 Action 3 – Designing Effective Controlled Foreign Company Rules

CFC rules first appeared in 1962 as a legal means, and since then the number of countries which conform to them is constantly increasing (OECD, 2015c, pp. 9-10). In fact, CFC rules act as a deterrent. This means that they are primarily designed not to impose tax on the income of the CFC, but rather to retain revenue on the tax base of the parent. In the case of CFC regimes targeted at stripping of the third countries bases i.e. foreign-to-foreign stripping, the objective is to prevent the shifting of income into CFCs. The residence jurisdiction is entitled to secondary taxing rights according to the CFC rules. In general, CFC rules are effective when they impose sufficiently high rate of corporate income tax, or when in the source jurisdictions the tax incentives are reduced or fully eliminated, yet this can make the MNEs shift their profits into their subsidiaries in low-tax jurisdictions (OECD, 2015c, p. 13).

Action 3 of the BEPS Action plan presents recommendations that resemble building blocks, and are revered as best practices. As a rule, they are not obligatory for any jurisdiction i.e. they do not represent the core of minimum standards. Rather, the recommendations suggest that in order to avoid the possibility of producing double taxation, the CFC rules should include provisions such as dividend exemptions or foreign tax credits. For illustration, when attributed CFC income is simultaneously subject to foreign corporate income taxes, or when the count of countries which apply CFC rules on the same CFC income is greater than one, then it is recommended that countries with CFC rules allow credit for foreign taxes actually paid, including any tax put on intermediate parent entities under a CFC regime. On the other hand, it is recommended to implement the dividend or gains exemption in a case when a CFC distributes dividends from already attributed income to resident shareholders, or when the resident shareholder disposes of the shares in the CFC (OECD, 2015c).

CFC rules only apply to foreign entities which are considered a CFC, and whose parents have sufficient influence and control over them. The report is based on recommendations on how to determine if shareholders have sufficient influence on a foreign company in order for that company to become a CFC. It is recommended that CFC rules should at least do both a legal and an economic control test so that the passing of either test results in control. A CFC should be deemed as controlled when residents have at least 50% in their control although countries that want to prevent violation of CFC rules may set their control threshold at a lower level. Additionally, CFC rules should apply when there is either direct or indirect control (OECD, 2015c, p. 33).

Action 3 recommends that CFC rules should be abided only by CFCs that are subject to ETRs momentously lower than those applied to the parent jurisdiction. The recommendation is to include tax rate exemption that would allow entities subject to an ETR, which is sufficiently similar to the tax rate in the parent jurisdiction, not to be subject to CFC taxation (OECD, 2015c).

Computing of the income of a CFC requires making two different definitions. First, it has to be determined which jurisdiction rules should apply to the calculation of CFC's income, so the implementation of the parent jurisdiction rules is recommended as the best option. Second, it has to be determined whether any specific rules are needed for calculating CFC income, for which it is recommended that countries should have specific rules limiting the offset of CFC losses only against the income of the same CFC, or other CFC in the same country (OECD, 2015c, p. 57).

In this regard, jurisdictions are free to choose their rules for defining CFC income, and this choice is likely to be dependent on the degree of BEPS risk a jurisdiction faces. The income that raises BEPS concerns ought to be attributed to controlling shareholders in the parent jurisdiction. The amount of income to be attributed ought to be calculated by reference to the proportionate ownership or influence. The attribution threshold would be tied to the minimum control threshold whenever it is possible although countries can choose to use different attribution and control thresholds depending on the policy considerations underlying CFC rules (OECD, 2015c).

In the EU these recommendations have to be sufficiently adaptable to comply with the EU law. The design of the CFC rules is influenced by whether a country has a worldwide or territorial tax system, and whether the country is a MS of the EU. Provided that a country has a worldwide tax system, then the CFC rules can be applied to any income that is not taxed in the parent jurisdiction. In cases when a country has a territorial tax system, the CFC rules ought to be applied to the income that otherwise should have been taxed in the parent jurisdiction. In practice, the tax systems of jurisdictions are a combination of the two, which can influence the CFC rule policy of each country in terms of how they deal with BEPS and international competitiveness (OECD, 2015c, p. 15).

Since 2006, under the European Court of Justice's (hereinafter ECJ) case law, MNEs located outside the EU MSs can have competitive disadvantage compared to MNEs located in the EU MSs and the European Economic Area, when both the parent and the CFC countries are within the EU and the European Economic Area, due to the fact that to the latter entities less strict CFC rules would be applied. The EU MSs could tax CFC's income provided that the CFC engages in artificial arrangements, and apply equal CFC rules to domestic and cross-border subsidiaries. This would mean that the rules are not discriminatory, and would result in the allocation of the domestic or foreign income to the parent entity jurisdiction (OECD, 2015c, pp. 17-18).

6.4 Action 4 – Limiting Base Erosion via Interest Deductions and Other Financial Payments

BEPS risks in the area of interest deductions, interest income, and debt may be taken in three setups:

- Groups placing higher levels of third party debt in high tax countries;
- Groups using intragroup loans to generate interest deductions in excess of the groups' actual third party interest expense in high tax jurisdictions and interest income in low or no tax jurisdictions;
- Groups using third party or intragroup financing to facilitate the generation of tax exempt or deferred income.

To address these elements of risk countries apply different rules, among which are the following rules that also deal with the BEPS Action plan aims (OECD, 2013):

- Rules limiting the interest expense level or debt level in accordance with a fixed ratio. An instance of a fixed ratio can be the debt to equity ratio, interest to earnings ratio, or interest to total assets ratio. Typical rules of this type are the thin capitalisation rules based on a debt to equity test. These rules are relatively easy to apply and link the level of interest expense to a measure of an entity's economic activity. However, the same ratio is applied to entities in all sectors. These rules are flexible in terms of the applied interest rate but have limitations in the debt amount. Yet, entities with a higher level of equity are also able to deduct a higher amount of interest expense, thus the level of an equity in an entity can be easily manipulated with (Ruchelman & Shah, 2015);
- Rules limiting the interest expense level, or the debt level according to the group's overall position. Existing rules that compare the level of debt of an entity to that of the group often operate by reference to debt to equity ratios, and the amount of equity is not a good measure of its activity level, since equity levels can be easily subject to further manipulation (Ruchelman & Shah, 2015);
- Targeted anti-avoidance rules according to which interest deductions on certain transactions are disallowed (Ruchelman & Shah, 2015).

The best practices recommended in Action 4 are based on these three sets of rules whether as a combination or as a whole. This Action analyses several best practices and recommends an approach which directly deals with the risks of using interest expense, pointed out in the three setups above. The focus is on the level of interest expense in an entity, and not on the level of debt itself. Here, the term 'interest expense' denotes: interest on all types of debt, payments economically equivalent to interest, and expenses incurred in connection with the raising of finance (Ruchelman & Shah, 2015).

Action 4 recommends observing a fixed ratio rule according to which the interest expense should be deducted proportionally with the earnings, assets, or equity of an entity. Since earnings are less stable than the assets, by using the value of the assets compliance costs are reduced, and so the certainty is ensured, yet at the same time they can be artificially inflated, or the cash can be easily manipulated. The recommendation of the Action 4 is to observe the fixed ratio rule that limits net interest deductions of the entity within a 10-30% corridor, and is linked to net interest to EBITDA ratio. This rule is not adaptable to the sectors in which the entities operate, i.e. it is same for each entity, even though entities in different sectors

have different leverage. If this ratio reaches a very high level, it can cause double taxation when groups' leverage exceeds the ratio's level. That is why the best alternative is to combine this rule with a group ratio rule that allows for a higher amount of deductible interest expense in certain situations. Before presenting the group ratio rule, it is important to mention that within a group, the net interest deduction is the difference between the interest expenses to unrelated entities and interest income from unrelated entities, as well as that the interest expense needs to be connected with an economic activity. When these two premises are related, then groups are entitled to tax reliefs in the amount of their third-party interest cost (Ruchelman & Shah, 2015). Two group rules are presented as follows:

- Group-wide interest allocation rule. Two alternative ways are given for the allocation of the worldwide group's net third-party interest expense that ought to be linked to the economic activity among entities of that group. The first group rule is a deemed-interest rule that allocates tax deductible deemed interest expense, in relation to earnings or assets so that in this case the interest of the group as a whole is disregarded. The second group rule is an interest-cap rule, when there is an interest cap for each entity in relation to its allocated earnings or assets. Up to the cap, the whole interest expense would be tax deductible and the interest income would be subject to tax as well (Ruchelman & Shah, 2015).
- Group ratio rule. This rule compares the ratio of an entity with an equivalent ratio of the whole group. If the entity's ratio is equal or smaller than the group ratio, then both the third-party expenses and the intragroup interest expenses are deductible (Ruchelman & Shah, 2015).

These two approaches are differentiated by consistency, i.e. the interest allocation rule is more consistent than the group ratio. The latter is more flexible in terms of being applied by countries that still use existing laws (Ruchelman & Shah, 2015).

There are two alternative methods according to which entities should be included in the scope of the rules of Action 4. The first one is to use the consolidated financial statements of the parent of the entity. If there is a group that does not prepare consolidated financial statements, in order the rule to be applied, the specific entity should provide information on the group. The second one is to use the same definition of an interest limitation group to all entities and it does not take into account their actual composition (Ruchelman & Shah, 2015).

The group ratio rule allows for net interest expense deduction up to the group's net interest to EBITDA ratio of the entity, when this is higher than the benchmark fixed ratio. There is the option for a country to apply uplift to a group's net third party interest expense of up to 10%. The earnings-based worldwide group ratio rule can be also substituted by different group ratio rules, such as the 'equity escape' rule (which compares an entity's level of equity and assets to those held by its group) currently in place in some countries, including Germany and Finland. In Germany for instance, the fixed ratio rule is applied to entities that

have lower equity-to-total-assets ratio than the equivalent ratio of their group, within a two percentage point's tolerance. This means that the highly leveraged entity cannot deduct interest expense up to its group's ratio. Under condition the entity is able to show that its ratio is higher or equal to that of the group, then the fixed ratio rule is not applied (OECD, 2015d, pp. 91-92). It is up to a country not to choose to introduce any group ratio rule, but then it should apply the fixed ratio rule to entities in multinational and domestic groups without improper discrimination (Ruchelman & Shah, 2015).

The recommended approach generally refers to the entities that have a high level of interest expense and high net interest to EBITDA ratio, especially if the entity has a higher ratio than its group ratio. This approach will ensure that an entity's net interest deductions are directly linked to the taxable income generated by its economic activities. It also allows for countries to supplement the fixed ratio rule and the group ratio rule with other provisions that reduce the impact of the rules on entities or situations which entail less BEPS risk (OECD, 2015d):

- A de minimis threshold based on a size (i.e. number of employees, turnover) and on a monetary value (current thresholds range from 0.5 million euros to 3 million euros) of net interest expense, which carves-out entities with low level of net interest expense i.e. entities falling below this threshold, may deduct interest expense without any restriction. If in one country the group has located more than one entity, the total net interest expense of all the entities of the group in that country ought to be summed up. But in case the country decides to apply the rule for each entity separately, then it ought to adopt anti-fragmentation rules in order to prevent the group to establish a lot of entities, and in order to avoid the rule by being below the threshold (Ruchelman & Shah, 2015);
- An exclusion for interest paid to third party lenders on loans used to fund public-benefit projects (Ruchelman & Shah, 2015);
- The carry-forward of disallowed interest expense and/or unused interest capacity (where an entity's actual net interest deductions are below the maximum permitted) for use in future years, and/or carry-back of disallowed interest. The number of years the carry-forward could be applied should be restricted (Ruchelman & Shah, 2015);
- Targeted rules to prevent circumvention may include any provisions which apply to restrict interest deductions on payments made under specific transactions, for example by artificially reducing the level of net interest expense; use of orphan entities or special shares to disguise control of an entity or break a group relationship; arrangements to disguise payments as through back-to-back loans; structures to convert other forms of taxable income into an interest-like return in order to reduce entity's net expense below the level of a limit or a cap; and use of foreign exchange instruments to manipulate the outcome of rules. These rules support the general interest limitation rules and address specific risks (Ruchelman & Shah, 2015);
- Specific rules that address BEPS risks in banking and insurance sectors (Ruchelman & Shah, 2015).

Rules that refer to hybrid mismatch arrangements stated by Action 2, ought to be applied by an entity before the fixed ratio rule and group ratio rule are applied in order to determine an entity's total net interest expense, and next, based on this determination, the amount of the allowed net interest expense should be decided (Ruchelman & Shah, 2015).

The CFC rules recommended in Action 3 can be applied by a country along with the interest limitation rules due to the fact that there are situations when the entity can deduct an interest payment made to a CFC with a low tax rate under both the fixed and the group ratio rules. The taxable CFC income may be included in the EBITDA of the parent when the group and fixed ratio rules are applied. If this CFC income also consists of interest income or expense, then the country ought to include the interest as a part of the net interest expense of the parent and then it ought to exclude the interest from the EBITDA of the parent. The best practice approach intends to diminish the need of CFC rules in a country by distributing the net interest expense among entities of a group, where the economic activity takes place. Along these lines, the CFCs' net interest income would decrease since groups will reduce intragroup interest payments so that net interest expense as well as EBITDA of the entities in the group will be more aligned (OECD, 2015d, pp. 79-83).

It is contingent on countries to decide whether they will apply the recommended interest limitation rules only or a combination of the cited rules along with other rules, in order to target other tax goals or to outweigh other risks. Next, I will present one of the instances given in the Action 4 Report, which represents a combination of the best practices approach and other interest limitation rules. Country A limits the interest deductions of the entities with a four-part approach, three of which address BEPS in connection with interest, and the fourth one addresses other tax goals. The first approach is the introduction of fixed ratio rule, which is applied only to entities which are part of a domestic or multinational group and not to standalone entities. According to the rule, the entity is allowed to deduct net interest up to 20% of EBITDA. The second approach is the introduction of group ratio rule according to which the entity that applies the fixed ratio rule, can deduct more than 20% i.e. it can deduct interest expense up to the group net third party interest to EBITDA. The third approach is the targeted rules which address BEPS in connection with interest posed by standalone entities, or by entities within a domestic or multinational group. The fourth approach aims at reducing debt funding over equity and allows for net interest expense deduction with an upper limit of 30% of EBITDA, both for a standalone entity and for entities within a group. If there is an entity in country A that is part of a multinational group, and the entity is entitled to 100 million dollars of EBITDA, to 15 million dollars of net interest expense, and to group net third party interest to EBITDA ratio of 10%, then the entity is allowed to deduct all of the net interest expense since the entity ratio is below the 20% fixed ratio. If there is an entity in country A, that is part of a multinational group, and the entity is entitled to 100 million dollars of EBITDA, to 28 million dollars of net interest expense, and to group net third party interest to EBITDA ratio of 25%, then the entity is allowed to deduct part of its net interest expense. More specifically, the entity is allowed to deduct 25% (25 million dollars) since it

is part of a group and thus it can apply the group ratio rule. The rest of the interest expense is disallowed. If there is an entity in country A that is part of a domestic group and the entity is entitled to 100 million dollars of EBITDA, to 33 million dollars of net interest expense, and to group net third party interest to EBITDA ratio of 35%, then the entity is also allowed to deduct part of its net interest expense. More specifically, the entity is allowed to deduct up to the upper limit i.e. 30% (30 million dollars) since it is part of a group, and thus it can apply the group ratio rule, which has an upper limit of 30%. The rest of the interest expense is disallowed. If there is a standalone entity in country A, and the entity is entitled to 100 million dollars of EBITDA, to 30 million dollars of net interest expense, and to 5 million dollars paid for an arrangement causing BEPS concerns, then the entity is not subject to the fixed and to the group ratio rules, but it is subject to targeted rules instead. These rules are applied when there is a chance of taking specific BEPS risks by standalone entities, and when they have an upper limit on net interest deductions of 30% of EBITDA. If so, the entity is allowed to deduct 25 million dollars while the 5 million dollars, which cause specific BEPS concerns, are disallowed. If there is a standalone entity in country A, and the entity is entitled to 100 million dollars of EBITDA, to 35 million dollars of net interest expense, and there are no arrangements that cause BEPS concerns, then the entity is not subject to the fixed and to the group ratio rules, but it is subject to targeted rules instead. These rules are applied when there is a possibility of facing specific BEPS risks by standalone entities, and when they have an upper limit on net interest deductions of 30% of EBITDA. But the targeted rules are not applicable in the given situation. Consequently, the entity is allowed to deduct 30 million dollars while the 5 million dollars, which are above the upper limit of 30%, are disallowed to deduct (OECD, 2015d, pp. 94-96).

6.5 Action 5 – Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

In this particular action, the importance of substantial activity on part of the entity as well as the importance of transparency and spontaneous exchange of information on specific tax rulings is stressed out. The Action 5 includes both general rulings and tax-specific rulings, but the framework for compulsory exchange of information applies to taxpayer-specific rulings only. The exchange of information is limited to 6 categories of tax rulings, since tax administrations need to exchange only relevant and useful information with other tax administrations (OECD, n.d.). Taxpayer-specific rulings are understood as any advice, information or undertaking provided by a tax authority to a specific taxpayer, or to a group of taxpayers concerning their tax situation they can rely on. These rulings can be provided prior or after the transaction as a quick response to a specific taxpayer request. General rulings apply to types of taxpayers, rather than to a specific taxpayer, and they are often published, so the taxpayers do not need to request ruling on their part (OECD, 2015e).

The six categories of rulings in Action 5 are: 1) rulings related to preferential regimes, 2) cross-border unilateral advance pricing arrangements (hereinafter APAs) or other unilateral

transfer pricing rulings, 3) rulings giving a downward adjustment to profits, 4) PE rulings, 5) conduit rulings, and 6) any other type of rulings where the OECD Forum on Harmful Tax Practices agrees that the absence of exchange would cause deep BEPS concerns in the future (OECD, 2015e). The exchange of information on tax rulings will be annually reviewed based on 3 categories: the total number of sent spontaneous exchanges, the number of spontaneous exchanges by the category of rulings, and the list of countries the information was exchanged with. The rulings should be exchanged regularly about three months upon they were made available to the relevant authority (OECD, n.d.).

Again, jurisdictions are free to decide whether they will introduce IP regime or not. In case they decide to implement IP regime three different approaches were available. The first approach, which was not supported, is the value creation approach that requires taxpayers to be involved in certain significant developmental activities. The second approach is the transfer pricing approach that allows for benefits to all of the IP's income if the taxpayer does a set of important activities in the jurisdiction providing the regime, and if the taxpayer is the legal owner of the assets and uses these assets that bring tax benefits, but at the same time he is taking the risks of those assets. The third approach, the one that was endorsed, was the nexus approach. A preferential regime in intellectual property boxes is beneficial for stimulating growth and innovation in a jurisdiction, when the income is generated by a real substantial activity of the taxpayer obtaining the benefit. This can be achieved through the nexus approach, which assesses whether the activity in the intellectual property regime is substantial or not, by means of directly relating expenditures to developmental activities (OECD, n.d.). Under the nexus approach, the only IP assets that could qualify for tax benefits under an IP regime are patents and other IP assets, which are functionally equivalent to patents if those IP assets are both legally protected and subject to similar approval and registration processes, if processes are relevant of course. The IP assets that are functionally equivalent to patents are: patents broadly defined, copyrighted software, and in certain circumstances, IP assets that are non-obvious, useful and novel. Marketing-related IP assets such as trademarks can never qualify for tax benefits under an IP regime (OECD, 2015e). Both the preferential intellectual property regimes and the spontaneous exchange of information of specific tax ruling will be monitored and reviewed in terms of their compliance (OECD, n.d.).

The nexus approach uses the equation (1) below in order to calculate the income eligible for tax benefits:

$$\frac{\begin{array}{c}\text{Qualifying expenditures}\\ \text{incurred to develop}\\ \text{IP asset}\end{array}}{\begin{array}{c}\text{Overall expenditures}\\ \text{incurred to develop}\\ \text{IP asset}\end{array}} * \begin{array}{c}\text{Overall income}\\ \text{from}\\ \text{IP asset}\end{array} = \text{Income receiving tax benefits} \qquad (1)$$

Qualifying expenditures have to be incurred by a qualifying tax payer (resident entities, domestic PE of foreign entities, and foreign PEs of domestic entities that are subject to tax in the jurisdiction providing the benefits), and they have to be directly connected to the IP

asset. Qualifying expenditures only include expenditures that are sustained for the purpose of the actual R&D activities. Hence, they do not include interest payments, building costs, acquisition costs, or any other costs that could not be directly linked to a specific IP asset. When calculating qualifying expenditures, jurisdictions may permit taxpayers to apply a 30% up-lift to expenditures that are included in the qualifying expenditures, but only to the extent that it does not exceed taxpayer's overall expenditures (OECD, 2015e).

Overall expenditures also do not include all expenditures ever incurred in the development of an IP asset, but they do include all qualifying expenditures, acquisition costs, and expenditures for outsourcing that do not count as qualifying expenditures (OECD, 2015e).

Overall income ought to be limited to income that is derived from the IP asset, and ought to be calculated by subtracting IP expenditures, which are allocable to IP income and are incurred in the year, from gross IP income earned in the year (OECD, 2015e).

Taxpayers will have to be able to track down the link between expenditures and income and provide evidence for this link to tax administrations (OECD, 2015e).

I will explain two examples presented in Action 5. The first instance presents a taxpayer who is entitled to 100 units of qualifying expenditures, to 10 units of acquisition costs, and to 40 units for R&D activities of a related entity. The maximum allowed up-lift is 30% of the initial qualifying expenditures, i.e. 100 units x 30% = 30 units, but only if the total amount of the qualifying expenditures, which counts 130 units, is equal to or is less than the overall expenditures. Since the overall expenditures count 150 units in this example, the 130 units of qualifying expenditures is allowed. The IP income will be multiplied by 86.7%, i.e. by 130/150. The second instance presents a taxpayer who is entitled to 100 units of qualifying expenditures, to 5 units of acquisition costs, and to 20 units for R&D activities of a related entity. In this unit count, the maximum allowed up-lift is 30% of the initial qualifying expenditures, i.e. 100 units x 30% = 30 units, but only if the total amount of the qualifying expenditures, which counts 130 units, is equal to or is less than the overall expenditures. Since in this instance the overall expenditures are 125 units, the up-lift can be allowed up to 125 units and the IP income will be multiplied by 100%, i.e. by 125/125 (OECD, 2015e).

6.6 Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

There are tax avoidance strategies such as transfer mispricing, thin capitalisation, arbitrage transactions that take advantage of the domestic law mismatches in one or in two countries, etc. The bulk of these strategies can be addressed by the adoption of anti-abuse rules not only through tax treaties, but also through domestic anti-abuse rules. Such situations are found when domestic anti-abuse rules cannot provide for a treaty abuse such as treaty shopping. Action 6 requires that a minimum standard ought to be reached, and the bilateral treaties ought to be amended with a statement that the jurisdictions that have signed the

bilateral treaty have no intention whatsoever to cause reduced taxation or non-taxation by evasion or avoidance of taxes. Also, the jurisdictions should apply limitation-on-benefits (hereinafter LOB) rule that deals with conduit arrangements, or with principle purpose test (hereinafter PPT) rule, or with the combination of both in bilateral treaties, depending on whether the jurisdiction seeks to issue more certain rules for the smaller amount of already known abusive strategies (LOB), or seeks to issue less certain rules for the greater amount of unknown abusive strategies (PPT). The LOB rule is a specific anti-abuse rule whereas the PPT rule is a general anti-abuse rule (OECD, n.d.).

A number of situations can be regulated by LOB rules as follows:

- Splitting-up of contracts (OECD, 2015f);
- Hiring-out of labour cases (OECD, 2015f);
- Avoidance of dividend characterisation, for example characterising income as capital gain (OECD, 2015f);
- Transfer of dividends - A provision ought to be added by the countries stating that the entity which receives the dividends can be qualified for exemption or relief for the received dividends by 5% of the gross amount of the dividends only if the beneficial owner is an entity other than partnership, and it directly holds at least 25% of the capital of the entity paying the dividends in a 365 day period, including the pay-out day (OECD, 2015f);
- A tie-breaker rule which includes a provision determining that dual-resident persons are residents only in the country being their place of effective management, yet a case-by-case treatment is also allowed (OECD, 2015f);
- An anti-abuse rule for PE located in third countries whose resident country exempts or imposes low rates on the profits of the PE located in third countries, so this rule ought to be included in bilateral treaties in order to protect the source country (OECD, 2015f).

Treaty shopping takes place when an entity which is not a resident in any of the two countries, which have signed a bilateral treaty, attempts to obtain benefits from that treaty by establishing an entity in one of those jurisdictions, which is also called a letterbox, a shell company or a conduit since it only exists on paper while a little or no substantial activity at all is being done by the entity (OECD, 2015f). The issue can be addressed by this set of rules:

- The LOB rule, which denies tax benefits to resident in a country who is not considered a qualified person, but when an agreed portion of the resident entity is owned by certain persons entitled to equivalent benefits as the treaty benefits, then the treaty benefits will be provided to that resident (OECD, 2015f),
- General rules, which regulate arrangements with a purpose to obtain treaty benefits (OECD, 2015f).

According to de Wolf (2017, p. 40), due to the ECJ case law and to the various different tax systems of the EU MSs, taxpayers can benefit from the less restrictive rules within the EU. De Wolf (2017, pp. 50-51) argues that nowadays both the aggressive tax planning and treaty shopping require an innovative coordinated approach, in line with the EU law, between EU MSs and OECD MSs, in order to eliminate legal gaps and mismatches. On the other hand, TEI (2015a, pp. 63-64) recommends that tax authorities adopt a LOB as a primary tool as it is more objective, and on the other hand it considers the PPT as uncertain for deciding whether a taxpayer is entitled to treaty benefits or not.

6.7 Action 7 – Preventing the Artificial Avoidance of the PE Status

The term PE was already cited and explained in some of the previous chapters. Entities successfully avoid the PE status by substitution of their distributor contracts with commissionaire ones, or by a person who concludes contracts on behalf of the foreign entity declaring himself/herself to be an independent agent (OECD, n.d.). Commissionaire contracts are ones through which a person sells goods apparently in their own name, but on behalf of the foreign entity which actually owns the goods. With the commissionaire contracts, the foreign entity sells goods without having the PE status in a country, so as a consequence, the profits from the sale are not taxable in that country. Since the person who sells the goods is not their owner, he/she cannot be taxed on the profits from the sale, but only on the income for his/her services, usually a commission. The abhorred PE status can also be avoided artificially through activities of a preparatory or an auxiliary nature. Activities considered to have a preparatory or an auxiliary nature can in fact be part of the core business activities. For this reason, each case ought to be examined individually. Also, the fragmentation of activities of the entity among many group entities in order for the activity to be considered preparatory or auxiliary is used as an artificial way of avoiding the PE status. To eliminate this, the anti-fragmentation rule proposed that a fixed place of business used by an entity ought not be considered preparatory or auxiliary as long as that entity or related entity does activities in the same country and

- that place is considered a PE for the entity or the related entity, or
- the overall activity as a combination of the activities, done by the two entities in the same country, is not considered a preparatory or an auxiliary one if the activities done within are complementary activities of the overall business operation (OECD, 2015g).

6.8 Action 8-10 – Aligning Transfer Pricing Outcomes with Value Creation

Actions 8-10 have a goal to align transfer pricing outcomes with value creation. The guidance requires analysing of the contractual relation among the affiliates in a combination with the conduct of the affiliates in order to split the profits to the affiliates that conduct the business activities (OECD, n.d.). When a transaction stated in a written contract is in fact inconsistent with the economically-significant characteristics stated, then the actual

transaction will be presented according to its features in terms of the conduct of the parties, or, the transaction may be disregarded on the whole. Also, where appropriate, it may be replaced by an alternative one if the total arrangements of the transaction differ from those that would have been made by independent unrelated entities in comparable circumstances, and not if the transaction could happen among independent unrelated entities. The main point is that the transaction needs to possess the commercial rationality of an arm's length principle between independent unrelated entities in comparable circumstances. Also, if the risks taken by a party stated in a written contract are not actually in control of the same party, or the same party does not have financial capacity to take those risks, the risks will be attributed to the party that has the control or the financial capacity (OECD, 2015h). These actions develop approaches for intangibles, commodity transactions, transactional profit split method, low value adding intra group services and cost contribution arrangements (hereinafter CCAs).

6.8.1 Intangibles

The guidance states that the legal ownership of an intangible is not enough for an affiliate to get the entire profit or portion of the profit generated by the use of intangible, but instead, the value created through business activity done by an affiliate, contributions to assets by an affiliate and the risks, in the development, enhancement, maintenance, protection an exploitation of intangibles, the affiliate considers, are important elements that determine the allocation of profits. It is also important to consider the type of the activity done, as well as the form and the amount of compensation paid in order to avoid the allocation of profits to an entity in a low-tax jurisdiction. Also, the guidance does not allow for special contractual arrangements (OECD, n.d.).

As for the hard-to-value intangibles with no comparable counterparts, a different approach has been developed. The ex post outcomes are to be considered as presumptive evidence for the ex-ante pricing arrangements only in cases when the tax administration cannot check the reliability of the information on which the ex-ante pricing is based. When the reliability can be confirmed, the mentioned approach ought not to be used, and adjustments ought not to be made (OECD, n.d.). If it is highly uncertain to value the intangible, then the tax administration and tax payers ought to take, as a reference, the behaviour of the independent unrelated entities in comparable circumstances. The usual means for handling this type of situations is to use anticipated benefits taking into account the predictability of the future developments, in order to establish the price at the very beginning of the transaction. But when pricing based on anticipated benefits is not adequate as a means of protection against the risks, then clauses in the contracts for price adjustment can be included, such as contingent payments clauses, in order to be protected from not foreseeable future developments, etc. (OECD, 2015h).

When a capital-rich group member funds the activities and takes the financial risks, but it does not do the activities, then it is eligible to receive a risk-adjusted return on its funding. But when a member of the group does not have control over the risks related to its funding, then it is eligible to receive a risk-free return or less when it is a non-commercially rational transaction (OECD, 2015h).

6.8.2 Commodity Transactions

The comparable uncontrolled price method (hereinafter CUP) is appropriate for commodity transactions of associated entities, with quoted prices used as a reference for the arm's length price. However, under the new provision, the tax administration can set the pricing date for commodity transactions such as the shipment date or other date, as evidence for the prevented use of the most advantageous price by the related entities (OECD, 2015h).

TEI (2015b, pp. 47-48) praises the work of OECD stating that the CUP method is a good starting point for the commodity transactions price. At the same time, TEI (2015b, pp. 47-48) expresses concerns and argues that the CUP method is appropriate for commodities that have available quoted prices on an exchange, but it is not appropriate for other types of commodities (bulk traded goods), for which a price is established through pricing agencies. The quoted prices are stable while an entity, which sells the commodity at price for bulk-traded goods, does not have a fast-and-hard guarantee that it will sell the commodity at that price.

6.8.3 The Transactional Profit Split Method

This method is most appropriate one when other methods are difficult to apply. An example is the global trading of financial instruments when the one-sided method is not appropriate, or another example is when both parties make valuable contributions such as unique intangibles (OECD, 2015h).

In addition, TEI (2015c, pp. 51-54) finds the profit split method a very complex one that is less consistent with the arm's length principle, and states that the tax authorities could not be satisfied with its outcome in a number of situations, especially in case their jurisdiction has a lower profit allocation. In general, TEI (2015c, pp. 51-54) considers the profit split method to be more demanding in terms of expertise and international cohesion, and states that not all of the tax authorities are capable of applying the method fairly and efficiently. This concern is especially justified since the use of this method will increase the amount of transfer pricing documentation and compliance costs.

6.8.4 Low Value-Adding Intra Group Services

An elective simplified approach based on the arm's length principle is proposed in the report for the low value-adding intra group services such as accounting and auditing, monitoring and collecting of data on different regulating standards, human resources activities, etc. These services, rendered for the purpose of the simplified approach, are presented as services provided by one or more group members on behalf of one or more other members of the same MNE group that have supportive nature, and do not represent significant or profit-earning activities of the MNE group. These types of services neither create nor require the use of unique and valuable intangibles, and also they neither assume that the service provider is in control of a significant risk nor will the service provider create a significant risk (OECD, 2015h).

This approach lists the types of services which have a limited profit mark-up on costs, it applies allocation key for the recipients of these services, and it also demands specific reporting documentation in order to ensure transparency. The aim of the approach is to provide equal treatment in the payer countries for the associated entities found in similar situations in terms of the allocation of their costs, i.e. to provide a guarantee that there is no overpricing due to the moderate mark-up of 5%, and due to the included categories of costs stated in the general agreement. The approach also shows whether the intermediary companies have low or no functionality at all, and whether their purpose is to merely inflate these charges. By assuming that business incur expenses only if it they are reasonable and necessary for the functioning of the business itself, and only if the simplified approach guarantees an equal treatment of the costs for the associated entities found in similar situations, the benefits test by the payer country is simplified. This is highly beneficial for the tax authorities since they can use the resources intended for the detailed benefit test in other cases when the risk of taking BEPS activities is more substantial (OECD, 2015h).

The elective simplified approach should be adopted in both the payer and the recipient countries. In addition, this approach ought to be made with a threshold, and if the threshold for low-value adding intra-group services is exceeded, then the tax authorities may require a full transfer pricing analysis that includes detailed evidence on the benefits received (OECD, 2015h).

Lastly, the CUP method is the most appropriate one for determining the arm's length transfer pricing for intra-group services, as long as there are comparable services of independent entities in the recipient's country. If the CUP is not available, then the most appropriate method is the cost based one, when the activities, assets and risks are comparable with the ones of independent entities (OECD, 2015h).

6.8.5 Cost Contribution Arrangements

CCAs are used by business entities for sharing risks and for making contributions in the development, manufacturing and obtaining of intangible and tangible assets (development CCAs) or services (services CCAs). It is fairly expected that these assets or services will bring forth benefits for each of the entities takes part in the CCA. What makes the difference between the development CCAs and the services CCAs is that the former are expected to provide future and uncertain benefits associated with significant risks, as opposed to the latter, which are expected to provide current benefits only, considered to be less risky yet more certain. What makes the difference between intra-group transfer and a CCA is that in the first case the participant, for instance a licensor, makes contributions and takes the risks on its own in order to develop an intangible, and then is compensated through the licensing fees of the developed intangible, while in the second case the participants make contributions such as resources and skills and share the development risks, and in return they expect benefits from the anticipated outcome, but the benefits should be proportionate with the costs and risks taken (OECD, 2015h).

As per the arm's length principle, once the participants of the CCA sign the agreement, their share of overall contributions must be proportionate to their share of the overall expected benefits over a time period of several years. Thus, in order to ensure this proportion balancing payments may be needed. When it comes to the balancing payments, they decrease the value of the contributions of the payee, and vice versa, they increase the ones of the payer (OECD, 2015h).

The contributions made under a CCA should be treated with the same general rules that apply for contributions outside of a CCA in terms of taxes. In the case of a services CCAs, the benefits are usually presented as cost savings and usually do not generate income, while in development CCAs the expected benefits appear in later point of time so at the time when contributions are made the income cannot be recognized (OECD, 2015h).

In the event of contributions and benefits not being consistent with the location where the value is created, it leads to profit shifting. The guidance enables to appropriately analyse the CCAs, and to make sure that the outcomes are consistent with the location where the value is created. Even if the agreement is not termed as a CCA, but it still displays similar characteristics with CCA, then the parties ought to receive similar expected returns (OECD, 2015h).

I will discuss one instance from the Action 8-10, referring to the CCAs, which states that the contributions should be priced based on the arm's length principle rule. Two entities (A and B) are members of the same MNE group, and both of them enter into CCA, according to which Entity A provides the Service A, and Entity B provides the Service B, while both entities accrue the benefits of the Services A and B. The costs for providing the Service A are 100 per unit, and the costs for providing Service B are the same i.e. 100 per unit. The

value of the Service A according to the arm's length principle is 120 per unit, while the value of Service B according to the arm's length principle is 105 per unit. Entity A provides 30 units of the Service A and Entity B provides 20 units of the Service B to the group. Under the CCA, Entity A has costs of 3,000, as it provides 30 units, assuming that each unit costs 100. Entity B has costs of 2,100, for providing 20 units, assuming that each unit costs 100. The total costs for the group are 5,100, which demonstrate that Entity A meets 60% of the total costs, while Entity B meets 40% of total costs. The total value of contributions under the CCA is 5,700, of which 3,600 is made by Entity A, as it provides 30 units to the group, assuming that each unit value is 120. This accounts for 63% of the total contributions. Entity B's value of contribution is 2,100, as it provides 20 units, each unit having a value of 105, and this accounts for 37% of the total contributions. Each of the entities consumes 15 units of the Service A and 10 units of the Service B. The benefit of 15 units of the Service A is 1,800, as each unit value is 120, and the benefit of 10 units of the Service B is 1,050, as each unit value is 105. This means that each entity enjoys a 50% benefit of the total value of 5,700 i.e. 2,850 each (OECD, 2015h).

Under the CCA, the value of the both entity contributions ought to be proportionate to the expected benefits i.e. 50%. This means that each entity should contribute 2,850. As Entity A contributes 3,600 and Entity B contributes 2,100, Entity B is supposed to make a balancing payment toward Entity A in the value of 750 (OECD, 2015h).

If contributions were assessed at cost instead of at value, each entity would have to contribute 50% of the total costs, as both of them gain 50% of the total benefit sum. This again means that if CCA was not signed, then under the underlying arm's length principle, Entity A would purchase 10 units of the Service B for 1,050 and Entity B would purchase 15 units of the Service A for 1,800. The net result is 750 in payment from Entity B to Entity A. Undoubtedly, the example shows that the arm's length principle, in terms of the CCA, is applied only when contributions are assessed at value (OECD, 2015h).

6.9 Action 11 – Measuring and Monitoring BEPS

Action 11, with the help of different sources of data, different channels and different metrics, combines six indicators of BEPS activity that confirm that BEPS exists, and is on the rise in the recent years (OECD, 2015i). Some of the conclusions of Action 11 in respect of BEPS behaviour are the following:

- MNE affiliates with offices based in lower-tax countries have higher profit rates than the average worldwide profit rate of their group (OECD, 2015i);
- Large MNEs have approximately 4 to 8½ percentage points lower ETRs than similar domestic entities, which is an inconvenience for the local entities, although lower ETR can be partially due to the use of tax preferences in different countries by the MNEs (OECD, 2015i);

- Foreign direct investment (hereinafter FDI) has increased from 38 in 2005 to 99 times higher in 2012, in countries that have net FDI in relation to GDP of over 200%, compared to the FDI of all other countries. Profits, more often than not, are being taxed in locations where the activity creating value is not present, especially in the case of intangible assets. Such often-quoted example is the six times higher ratio of the received royalties value (in relation to R&D funding) in low-tax countries than the average ratio of received royalties in all other countries. This ratio in lower-tax countries had increased three times between 2009 and 2012. The entities established in the lower-tax countries received royalties that account for 3% of the total royalties, which is an indication of BEPS existence (OECD, 2015i);
- MNE affiliates located in countries that have higher statutory tax rates have higher amounts of incurred debt, both from third parties and from related parties. The affiliates of the largest MNEs founded in higher-tax rate countries have interest-to-income ratio around three times higher compared to their worldwide third-party equivalent ratio (OECD, 2015i).

In actual fact, the BEPS indicators show that profit shifting exists and is likely to increase in the future. That can create an adverse effect on the competition among businesses, distortions of the level and location of debt or intangibles, and can cause inefficient use of tax resources. Based on empirical analysis and on several academic studies, the report states that profit shifting is reduced in the countries that have adopted strict anti-avoidance rules. The BEPS indicators are constrained due to the limited available data that not always include the actual taxes paid, and the data is neither extensive nor thorough across countries or across entities. It is also very difficult to separate the BEPS activities from effects of deliberate governmental policies or from real economic factors. Owing to this, it is important to improve the data accuracy, and the tools necessary to measure BEPS, which will also contribute to the monitoring of the BEPS, and to the evaluation of the impact of the developed measures. Action 11 recommends ways for making the available data analysis better while keeping the taxpayer information confidential. By and large, the recommendations are intended to improve existing data analysis and collect new data in Actions 5, 13 and, if implemented, in Action 12 as well. The report proposes more corporate tax statistics analyses, such as the analyses based on the CbC Report, in order to improve the data availability for governments and researchers alike who will be able to better measure, and to better monitor, both the BEPS and the other developed measures and actions (OECD, 2015i).

6.10 Action 12 – Mandatory Disclosure Rules

The recommendations in Action 12 about the mandatory disclosure regime are not a minimum standard, so each jurisdiction can choose whether to implement them or not. The regime requires from the promoters and/or taxpayers to disclose information in advance about the tax scheme used. Normally, the information is mandatory to disclose in case the

jurisdiction has introduced this regime. Yet, only certain type of information is to be disclosed i.e. the information that is within the hallmarks established in the regime. The hallmarks serve as tools to identify schemes (OECD, n.d.).They can be:

- Specific - specific hallmarks target particular areas such as the use of losses (schemes that provide individual participants with losses in order to reduce the corporate income tax or capital gains tax), leasing (leasing of high value of asset) and income conversion schemes (avoiding higher corporate income tax rate by conversion of the income into gifts or capital) (OECD, n.d.);
- Generic - the generic hallmarks target common features of a promoted scheme, such as the requirement for confidentiality (when the promoter or advisor requires the client to keep the scheme confidential) or the requirement for payment of a premium fee (when the amount which the client pays for the advice given can be attributed to the value of the tax benefits obtained under the same scheme) (OECD, n.d.).

Countries develop hallmarks for schemes that include cross-border BEPS outcomes that affect them, in order that this sort of schemes is disclosed. These schemes are to be disclosed only if the scheme includes a transaction of a domestic taxpayer, who was aware, or else ought to have been aware, of these outcomes with tax consequences ensuing in the same country (OECD, 2015j).

As for the purpose of collecting this information, jurisdictions can later use it to change their malfunctioning tax laws, and to assess risks taken in relation to tax avoidance schemes (OECD, n.d.).

The principal difference between mandatory disclosure regimes and other optional disclosure stimuli such as rulings regimes, additional reporting obligations, surveys and questionnaires, voluntary disclosure and co-operative compliance programs, is that a mandatory disclosure provides crucial information on the scheme, users and suppliers, and that this information is provided timely in the tax compliance process (OECD, n.d.). A successfully designed mandatory disclosure regime takes into account components such as who is obliged to report, what is obliged to be reported, when information is reported, and the consequences to which non-compliance leads (OECD, 2015j).

6.10.1 Who Is Obliged to Report

Two options are offered in terms of who has the obligation to disclose the information:

- Both the promoter and the taxpayer, or
- Either the promoter or the tax payer (OECD, 2015j).

6.10.2 What Is Obliged to be Reported

Countries are offered two options in order to define the extent of a disclosure regime:

- Multi-step approach i.e. threshold approach – all schemes ought to fulfil a threshold condition, which is recommended for domestic schemes exclusively, but not for international ones;
- Single step approach – without the threshold condition (OECD, 2015j).

It is recommended that the regimes include a combination of both generic and specific hallmarks. Thus, countries are given two options to choose from if they decide to implement them:

- Adopt hypothetical/subjective hallmarks;
- Adopt objective hallmarks (OECD, 2015j).

The specific hallmarks target particular risks in individual countries, and it is up to them to choose if they want to link the specific hallmarks to a de-minimis amount to limit the number of disclosures (OECD, 2015j).

6.10.3 When Information is Reported

There are two options for the timing of the disclosure so that it is disclosed in time:

- Timeframe linked to the availability of a scheme, which is recommended when the promoter has the obligation to disclose the scheme. The tax administration is expected to set a short timescale in order to be able to react quickly to the tax scheme (OECD, 2015j);
- Timeframe linked to implementation, which is recommended when the taxpayer has the obligation to disclose the scheme. And only if the taxpayer has the obligation to disclose the information, then the tax administration in charge should set a short timescale in order to be able to react quickly to the tax scheme (OECD, 2015j).

In addition there are two options for identifying scheme users:

- Through scheme number and clients list;
- Through clients list only (OECD, 2015j).

6.10.4 Consequences of Non-compliance

It is recommended to impose either financial penalties or non-monetary ones if the obligation is not disclosed as recommended (OECD, 2015j).

6.11 Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting

The new guidance includes a standardised approach based at three distinct levels that give explanations and guidelines on the documenting process, the burden of proof, and the penalties for the transfer pricing documentation package for the MNEs (OECD, 2015k). At the first level, information on the transfer pricing policies and the business activities done on a global scale are required to be documented by the MNE in a master file, which will be made available to the tax authorities of relevant jurisdictions. At the second level, transfer pricing documentation which identifies transactions among relevant affiliates, the total amount of the transactions, and the transfer pricing guidelines are ordered to be placed in a local file, available for each jurisdiction. At the last third level, a CbC report on annual aggregate information related to the global allocation of the income of the MNE, on the related taxes paid, on the activities each entity does including the location of economic activity, is required (OECD, n.d.).

The CbC report is required to be mandatory only for the MNEs that annually generate EUR 750 million revenue, or even greater revenue at a consolidated group level. This threshold precludes approximately 85 to 90 percent of MNE groups, but MNE groups that control around 90 percent of corporate revenues are within the scope of the threshold. The report on the fiscal years as of 1 January 2016, or upon this date, needs to be provided to tax authorities of the parent entity until the end of 2017, and needs to be automatically exchanged with other jurisdictions in 2018. It is also understandable that some developing jurisdictions will take more time in order to provide the information needed. Some jurisdictions will oppose the obligation to implement the CbC report. So for the last two scenarios, i.e. when the parent entity is not bound by its jurisdiction to file the report, there is a solution. The MNE's group can choose a group entity in a jurisdiction that has adopted the legislation and make it a surrogate parent. The surrogate parent will provide the information requested by the CbC report, which afterwards will be automatically shared with other jurisdictions (OECD, n.d.).

In order to ensure compliance with the guidance, two options are available:

- Tax administrations can require an annual update of the master file, the local file and the CbC Report, and the transfer pricing documentation will have to be prepared at the time of transaction, or no later than the time of filing the tax return form in the fiscal year when that transaction happened;
- Tax administrations can install penalty regimes or rewards for the accurateness and timeliness of the transfer pricing documentation, for example in a way that the taxpayer would receive lower penalty rate if there has to be made some transfer pricing adjustment, or for example the burden of proof about transfer pricing matters can be shifted from the taxpayer to the tax administration. These regimes can be different for each country and could make non-compliance more costly than compliance (OECD, 2015k).

It is decided the information will not be made open to the public. The master and the local file will be delivered straightforwardly to the tax authorities. The CbC approach will be adopted in the jurisdiction of tax residence of the parent entity and shared automatically among jurisdictions through the Competent Authority Arrangements based on legal instruments, such as the Multilateral Convention on Mutual Administrative Assistance on Tax Matters, bilateral tax treaties, or Tax Information Exchange Agreements. This information will contribute towards the assessment and evaluation of the transfer pricing risk and other related BEPS risks, and also will help determine where audit resources is advisable to be allocated. If a breach is made while keeping the information by a certain jurisdiction, that jurisdiction can be denied a future exchange (OECD, n.d.).

The implementation and the compliance will be monitored, and upon it the standard will be reviewed in 2020 (OECD, 2015k).

6.12 Action 14 – Making Dispute Resolution Mechanisms More Effective

The mutual agreement procedure (hereinafter MAP) is a mechanism which can resolve, on a mutually-agreed basis, the difficulties in relation to the proper interpretation and application of the OECD Model Tax Convention, i.e. tax treaties. Action 14 goal is to make the MAP more efficient and effective (OECD, 2015l).

In relation to dispute resolution jurisdictions decided on implementing the minimum standard and on the 11 best practices. The minimum standard is intended to ensure that the treaty obligations, related to the MAP, are implemented in good faith, and that the dispute is resolved within the average time period of 24 months, in token of prevention and timely resolution of these disputes. The minimum standard is complemented by a set of best practices. The best practices are more subjective and qualitative, hence not all OECD and G20 countries will adopt them. A choice of two of the eleven best practices is presented below (OECD, 2015l).

Best practice 2: Countries should implement appropriate procedures related to publishing agreements that provide guidelines for the application of a treaty. It refers either to all taxpayers or to a specific category of taxpayers, which will result in fewer disputes in the future (OECD, 2015l).

Best practice 5: Countries should implement appropriate procedures that in certain cases permit the verification of facts to resolve some issue of the taxpayer in a specific fiscal year. This should be allowed for when a case is not corresponding to the Convention, and that case was reported within three years of the first notification of the action with respect to that fiscal year (OECD, 2015l).

The compliance will be monitored through a monitoring mechanism and through evaluating the framework of the tax treaties and the domestic tax rules and regulations of the

jurisdictions (OECD, n.d.). Countries should provide MAP access in transfer pricing cases, along with the cases when there is a disagreement between the tax authorities and the taxpayer, i.e. there is a conflict between an anti-abuse provision in a domestic law and a provision in a treaty. Furthermore, countries should publish guidelines related to MAP, and should make them readily available to the taxpayers, who will have no choice other than to comply with them. The tax authorities should work collectively through a membership in the Tax Administration MAP Forum (OECD, 2015l).

Also, a mandatory binding arbitration as a part of the negotiations of the multilateral instrument will be introduced, with an aim to resolve the disputes that prevent the resolution of cases through the mutual agreement procedure (OECD, n.d.). Regrettably, only a group of the OECD and G20 countries agreed to adopt the mandatory binding arbitration (OECD, 2015l).

6.13 Action 15 – Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

The multilateral instrument is an innovative approach that will modify existing bilateral treaties in order to implement the measures of the BEPS Package, much like those measures on hybrid mismatch arrangements, on treaty abuse, on mutual agreements procedures, and on PE in a reasonably-short period, at the same time respecting the sovereign tax autonomy and the tax treaties bilateral nature (OECD, n.d.). The multilateral instrument has no precedent in the tax area heretofore, but there are existing bilateral treaties which include a multilateral instrument that acts as a precedent in other international law areas. It offers an array of advantages, among which the following three are crucial (OECD, 2015m):

- It is highly target-oriented (OECD, 2015m);
- 3,000+ bilateral tax treaties will be modified in order to implement the measures of the BEPS Package, without addressing individually each tax (OECD, 2015m);
- It decreases BEPS abuses, so the governments are doing better at achieving their tax policy goals without breaching existing bilateral treaties, the case of using unilateral measures being one of them (OECD, 2015m).

The multilateral instrument makes the international tax treaty network more reliable by ensuring transparency and certainty for businesses. It ought to be implemented by countries following the ratification, following other domestic procedures, and according to the country national laws, while providing flexibility at the commitment level, and quietly coexisting with the existing bilateral tax treaties. It will regulate only the relationship of parties which have signed a bilateral tax treaty among themselves, while other parties would not be affected in general. An example of exception to the rule is the multilateral dispute resolution mechanism that refers to all parties subject to the multilateral instrument, including those parties that have not concluded bilateral treaty among themselves (OECD, 2015m).

In regard of the level of commitment, and in relation to the substance of specific provisions, parties will be allowed to exclude the whole or part of the application of certain provisions; parties could also choose from offered alternative measures; parties could take on additional commitments when they are not coupled with the main treaty (OECD, 2015m).

The level of commitment of the parties is affected by:

- The binding wording, which can be very strong (will, must, undertakes, shall) or can be more flexible (should, take steps, including by, may, as necessary/appropriate, with a view to) (OECD, 2015m);
- The type of obligations, which can be obligations of result, obligations of means/conduct, or both of them at times. The first type means that the parties are obliged to achieve a particular outcome by all means. The second type means that parties are obliged to strive to achieve an outcome. In case both of the obligations are required, then parties are obliged to achieve a particular outcome in a particular way (OECD, 2015m).

In the following sections, the relationship between bilateral tax treaties and the multilateral instrument is described.

6.13.1 Bilateral Tax Treaties Concluded Prior the Multilateral Instrument Entered into Force

Bilateral tax treaties previously concluded will be applicable to the degree to which their provisions are compatible with the multilateral instrument that is by inserting compatibility clauses in the multilateral instrument to address the relationship among the treaties in greater detail. Well-known types of the compatibility clauses are the following: 1) the multilateral instrument supersedes all of the bilateral treaties provisions which are within the same scope; 2) if the pre-existing provisions of the bilateral treaties differ from the ones of the multilateral instrument, then the multilateral instrument modifies the bilateral treaties provisions; 3) if the pre-existing provisions of the bilateral treaties are compatible with the ones of the multilateral instrument, then they are not affected; 4) there is an exception to the previous two clauses, i.e. the previously-concluded bilateral treaty supersedes the multilateral instrument when the bilateral treaty provides more favourable provisions. In certain situations, the multilateral treaty explains which provisions are modified or added to the bilateral treaties (OECD, 2015m).

6.13.2 Bilateral Tax Treaties Concluded upon the Multilateral Instrument Entered into Force

Compatibility or obedience clauses have already been included in many treaties, which state that parties shall not be part of subsequent contracts incompatible with the main treaty.

Subsequent contract may be allowed by these clauses only if they confirm, supplement, extend or amplify the provisions of the main multilateral treaty (OECD, 2015m).

When a jurisdiction becomes a party upon the multilateral instrument entered into force, then the jurisdiction will need to ratify the instrument, but a certain time period is allowed for the procedure due to the potential difficulties (OECD, 2015m).

7 INCLUSIVE FRAMEWORK ON BEPS

The measures taken to realign the profit taxation with the substance of economic activity and value creation, to increase transparency and consistency among the tax systems of countries and/or jurisdictions, and also to decrease BEPS and their effects, are presented in the two progress reports issued by the Inclusive Framework (OECD, 2017). The first progress report covers the period from July 2016 to June 2017, while the second one covers the period from July 2017 to June 2018. The two reports are presented in the sections bellow.

7.1 Progress Report July 2016-June 2017

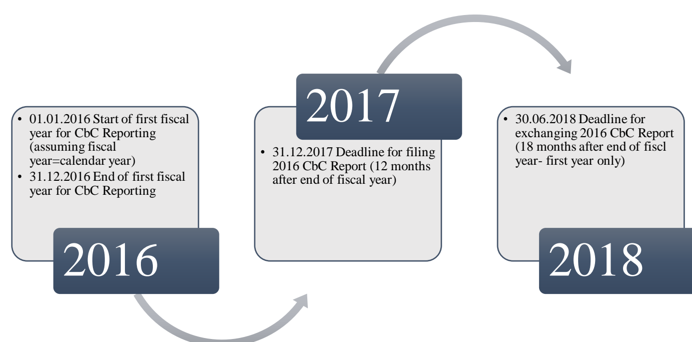
100 countries and jurisdictions of different fiscal profiles, accounting for more than 93% of the global GDP, became members of the Inclusive Framework established in the month of June 2016, as a response to the consistent implementation of the BEPS measure package. The Inclusive Framework presents the progress along the BEPS minimum standards with the help of peer reviews (OECD, 2017).

Due to the date of the report 9,000 tax rulings are considered as relevant, out of which more than 6,000 have already been exchanged as a result of Action 5. For the exchange of information on tax rulings, the 28 EU MSs amended the Council Directive 2011/16/EU, O. J. L 64/2011, p. 1-12 on administrative cooperation in the field of taxation. Under Action 5, 125 preferential tax regimes were reviewed, while 10 regimes were abolished, or are being amended in an ongoing process, in order to grant tax benefits depending on the place where the substance of economic activity is carried out, which shows that harmful tax practices are on the decrease. IP regimes ought to comply with the nexus approach, i.e. benefits will be provided only when the entity undertakes substantive R&D activity (OECD, 2017).

Due to Action 6, over 67 countries are in the process of signing the Multilateral Convention on Tax Treaty Related Measures (the MLI) while others are negotiating the modification of bilateral tax treaties to avoid treaty-shopping abuse, to improve dispute resolution (under Action 14), to implement mandatory binding arbitration (under Action 14), and finally to prevent artificial avoidance of the PE status (under Action 7). This action shall update over 1,100 bilateral tax treaties made worldwide. The jurisdictions having signed this Convention are preparing for the MLI ratification in line with their domestic procedures (OECD, 2017).

Moreover, over 50 jurisdictions have obliged more than 95% of the MNEs to provide CbC report to the jurisdiction of the parent entity as a result of Action 13. The 28 EU MSs are obliged to make the CbC report by Council Directive 2016/881/EU, O. J. L 146/2016, p. 8-21 amending Directive 2011/16/EU, 38 jurisdictions are dedicated to meeting the Master and the Local File requirement, and 30 out of these 50 jurisdictions have met the legal framework requirements. This Progress Report recommends an exchange schedule for the CbC Reports, and is shown in figure 4 below. Also, 64 jurisdictions have signed the CbC Multilateral Competent Authority Agreement, which regulates the exchange of the CbC reports among the parties of this Agreement while some jurisdictions have signed bilateral Competent Authority Agreements for the purpose of exchange of the CbC reports. The data collected from the CbC reports will be aggregated and anonymized, and they are expected to be available in 2019/2020. These data will be used in the new Corporate Tax Statistics dataset, which shall be released in 2018 (OECD, 2017).

Figure 4: Recommended Exchange Schedule for CbC Reports



Source: OECD (2017).

In addition to the minimum standards, there has been an update of the provisions of the OECD Model Tax Convention through the MLI, and an update of the provisions of the OECD Transfer Pricing Guidelines. These changes put an end to arrangements such as the "cash box" that will be entitled to no more than a risk-free return on invested funds (OECD, 2017).

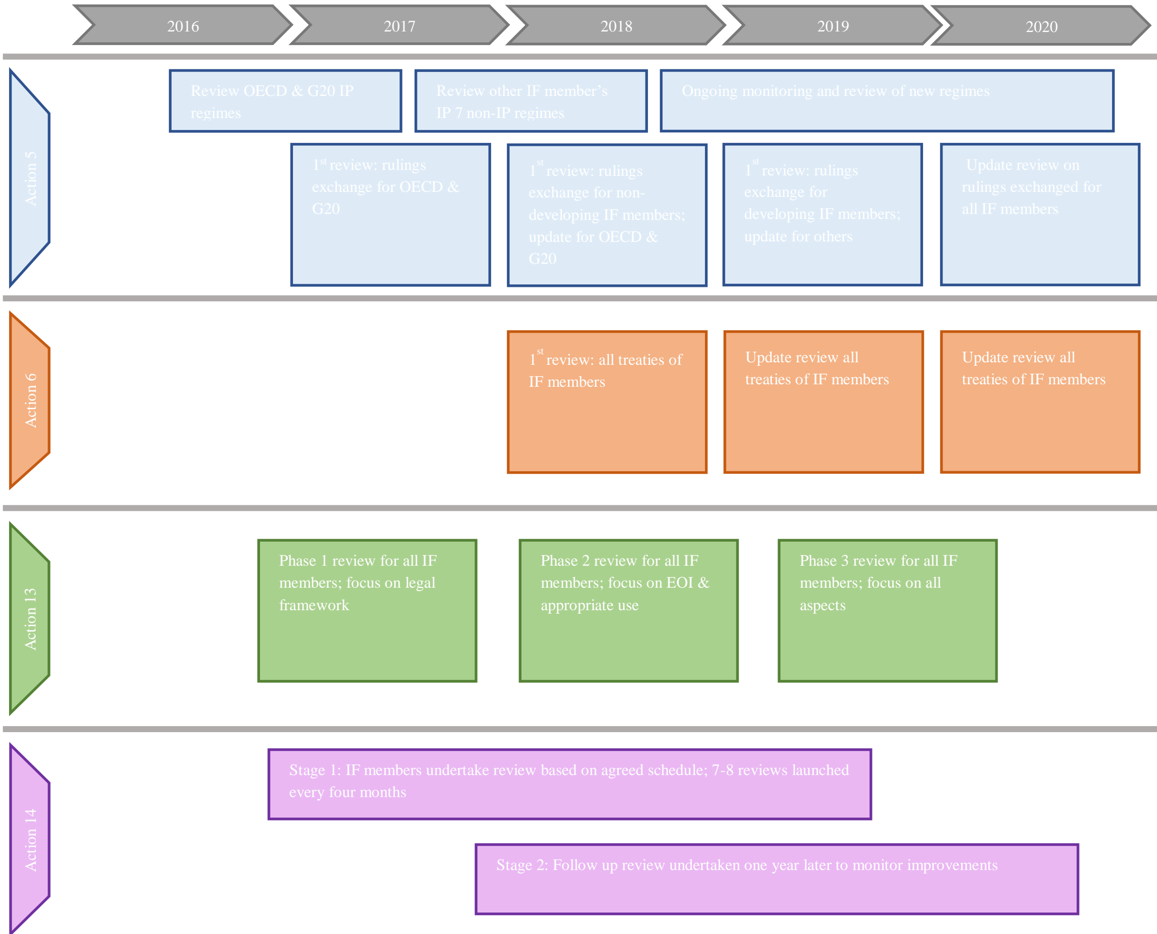
Action 2, Action 3, Action 4 and Action 12 can be enforced through the domestic law of a country. Since they are not minimum standards, countries have an interest in implementing them. For example, the 28 EU MSs are obliged to implement the rules under Action 2, Action 3 and Action 4 under the Anti-Tax Avoidance Directive. Vietnam introduced the rules on third party and related party debt under Action 4 while New Zealand and Australia proposed the implementation of Action 2 in their domestic laws. Five more countries adopted partially the rules under Action 2, and many other countries consider adopting all of the rules under Acton 2. Another 35 countries have already incorporated the hybrid mismatch and branch mismatch rules in their domestic laws, under Action 2 (OECD, 2017).

Data on the effect of the BEPS measures is not available as yet, while data collected by use of the updated BEPS indicators in Action 11 have already become available. Nonetheless, the available data confirms the trends seen in Action 11 (OECD, 2017). Guidance and toolkits are provided for the developing countries as a support during the implementation of the BEPS package. The toolkits shall be delivered between 2015 and 2018 for tax incentives, for lack of comparable data, for mineral product pricing, for indirect transfers of assets, for tax treaty negotiation, for base-eroding payments, for transfer pricing documentation, for BEPS risk assessment, and for supply chain restructuring (OECD, 2017).

Still, there are great challenges in the case of transfer pricing technical issues and BEPS issues related to the digital economy. The Inclusive Framework will deliver an interim report on the latter issue in 2018, and a final report in 2020 (OECD, 2017).

To make sure that the members of the Inclusive Framework are consistently implementing the minimum standards, each of them will be subject to a peer review process for the period from 2016 to 2020. Each review will be delivered in relation to the deadlines for each minimum standard, as shown below in the figure 5.

Figure 5: Status of Peer Review Process



Source: OECD (2017).

7.2 Progress Report July 2017-June 2018

According to the second Progress report, the Inclusive Framework now has 116 members, number which accounts for 95% of global GDP (OECD, 2018).

The MLI, according to the report date, reads 82 jurisdictions, following ratification by five countries where the MLI entered into force on 1 July 2018, but will be put into effect as of 1 January 2019. Among these five countries was Slovenia, which ratified the MLI on 22 March 2018. The MLI modifies more than 1,360 tax agreements while it is expected to influence more than 2,500 bilateral agreements, thus accounting for one third of the existing tax agreements worldwide as soon as all signatories ratify the MLI. The effect of treaty modification will take place as of 2019 and 2020. The effects of the MLI provisions that refer to a specific bilateral tax treaty can be analysed through the MLI Matching Database. This database allows users to search through data from the list of reservations and Covered Tax Agreements, i.e. MLI positions provided by the MLI parties, in order to analyse possible matching outcomes among jurisdictions. All of these Covered Tax Agreements will at least include the new preamble language and the PPT provisions, bringing the already modified agreements up to the Action 6 minimum standard. The first annual report of the Action 6 peer monitoring process will refer to the implementation of the minimum standard on treaty shopping, and shall be finalised in January 2019 (OECD, 2018).

In order to address the challenges related to the digital economy issues, and to urge for a consensus-based long-term agreement, in March 2018, the Tax Challenges Arising from Digitalisation – Interim Report 2018 was delivered by the Inclusive Framework, while the final report is expected to be filed in 2020. The Interim Report 2018 reads that the members of the Inclusive Framework ought to review the nexus and the profit allocation rules that impact the digitalisation of the economy, yet in relation to the aligning profit rule in regard of the place where there is the substance of economic activity and value creation. The main characteristics of the digital markets as well as the 3 frequent characteristics, i.e. 1) heavy reliance on intangibles, 2) data and user participation and 3) scale without mass, of some highly-digitalised business models are described in the Interim Report 2018 (OECD, 2018).

The Progress Report presented the first outcomes of the peer reviews. In relation to Action 5, two peer review reports titled Harmful Tax Practices – 2017 Progress Report on Preferential Regimes and Harmful Tax Practices – Peer Review Reports on the Exchange of Information on Tax Rulings were published in October 2017 and in December 2017, respectively. A count of 175 regimes was taken into consideration under the rules of Action 5, out of which 31 have already been changed, and 81 are in the process of changing. Next, a count of 47 regimes does not pose risks of BEPS activities, 4 regimes are found to be harmful, and 12 regimes are still under review. Up to the date of the report, part of 112 regimes have already been modified, part are still being modified, and part have been abolished with the result that only three harmful IP regimes remained in existence. These harmful regimes still exist in France, Italy and Turkey. Italy and Turkey have already made

amendments related to the harmful elements and features of their regimes, i.e. the customised grandfathering of the regimes. France regime is considered harmful as a whole, so France has intentions to amend it in compliance with Action 5's nexus approach. The process of identifying harmful regimes shall continue in the future. Jurisdictions have to amend, or abolish, the harmful features of their regimes reviewed in 2017 within 12 months, i.e. by October 2018. The existing non-IP regimes considered to have harmful features will be closed off to new entrants by October 2017, or by 30 June 2018 for the non-nexus IP regimes, while grandfathering for old-type regimes will be allowed only by 30 June 2021. A review of the new and ongoing regimes will be done in 2019 and 2020. Under Action 5 over 17,000 rulings have been identified and exchanged, which ensures transparency in a way that the ruling regimes will not be able to function non-transparently and secretively (OECD, 2018).

Over 60 jurisdictions already have a domestic legal framework for the CbC reports. The first exchange of the CbC reports started in June 2018, and resulted in over 1,400 exchange relationships. The first peer review report, released in May 2018, contains data about the implementation of the rules of Action 13 by 95 jurisdictions. The second peer review report, written under the same action, was released in April 2018, and it focuses both on the exchange of CbC reports and on keeping this information confidential (OECD, 2018).

A count of 21 jurisdictions has been included in the peer review reports under Action 14, a next count of 16 jurisdictions are currently subject to peer reviews, while 35 jurisdictions are scheduled to be peer reviewed by December 2019. The list of these jurisdictions is presented below in figure 6. MAP country profiles, i.e. public information on competent authority details, domestic MAP guidelines, and other information according to an agreed template for over 80 countries, have been published under the Action 14 requirements. It was done so as to increase transparency of the MAP processes in those countries. Additionally, MAP statistics for 2016, under the new MAP Statistics Reporting Framework, have been published. Almost 25% of approximately 8,000 cases as of 1 January 2016 were closed during 2016 while almost 25% of approximately 1,500 cases that started on, or after 1 January 2016 were closed during 2016. Over 85% of these cases were resolved. More than half of the MAP cases were transfer pricing cases, and these cases took 30 months to be resolved, unlike the other half of the cases which took 17 months to be solved. The MAP statistics for 2017 will be published in the second semester of 2018 (OECD, 2018).

Figure 6: Mutual Agreement Procedures (MAP) Jurisdictions

Published			Ongoing		Not yet started				
1st batch 3 December 2016	2nd batch 7 March 2017	3rd batch 7 July 217	4th batch December 2017	5th batch April 2018	6th batch by August 2018	7th batch by December 2018	8th batch by April 2019	9th batch by August 2019	10th batch by December 2019
Belgium	Austria	Czech Republic	Australia	Estonia	Argentina	Brazil	Brunei	Andorra	Barbados
Canada	France	Denmark	Ireland	Greece	Chile	Bulgaria	Curacao	Bermuda	Kazakhstan
Netherlands	Germany	Finland	Israel	Hungary	Colombia	China	Guernsey	British Virgin Islands	Oman
Switzerland	Italy	Korea	Japan	Iceland	Croatia	Hong Kong (China)	Isle of Man	Cayman Islands	Qatar
United Kingdom	Lichtenstein	Norway	Malta	Romania	India	Indonesia	Jersey	Macau (China)	Saint Kitts and Nevis
United States	Luxembourg	Poland	Mexico	Slovak Republic	Latvia	Papua New Guinea	Monaco	Turks and Caicos Islands	Thailand
	Sweden	Singapore	New Zealand	Slovenia	Lithuania	Russia	San Marino		
		Spain	Portugal	Turkey	South Africa	Saudi Arabia			

Source: OECD (2018).

In July 2017, the Inclusive Framework published a report on Neutralising the Effect of Branch Mismatch Arrangements in order to align the tax treatment of branch mismatch arrangements with the rules in the report on Action 2. The goal is to prevent taxpayers from switching from hybrid to branch mismatch arrangements, due to their similar structure and outcomes (OECD, 2018).

Numerous members of the Inclusive Framework took tax reform measures which included provisions under Action 2, Action 3 and Action 4. For illustration, under the new CFC rules in accordance with Action 3, the US MNEs will pay tax on excess foreign profits, i.e. they will pay at least 13,125% combined US and foreign tax rate on the foreign profits. The Netherlands proposed a reform for implementing BEPS measures, even beyond the minimum standards in some situations. The EU incorporates BEPS measures, like branch mismatch arrangements and limitation to interest deductibility rules, with the help of the Anti-tax avoidance Directive that will be effective in all EU MSs with deadlines starting in 2019. According to the Anti-tax avoidance Directive, EU MSs will adopt an interest cap that restricts the deductible related borrowing costs, including third party borrowing costs of the taxpayers, up to 30% of their EBITDA. Rules on hybrid mismatches were included in the US tax reform at the end of 2017. Proposals according to Action 2 for hybrid and branch mismatch rules were introduced in Australia and New Zealand. Under Action 4, now the US taxpayers will be allowed for deduction of net interest expense from total debt up to 30% of their adjusted taxable income (OECD, 2018).

The new Corporate Tax Statistics data set is expected to be released in November 2018. Initially, it will contain 3 main categories of data i.e. 1) corporate tax rates, 2) corporate tax revenues, and 3) corporate tax incentives, while from 2019 onwards it will also contain anonymised and aggregated data, gathered from the CbC reports (OECD, 2018).

In the category of corporate tax rates, the current statutory tax rates of the members of the Inclusive Framework, which are currently being collected through surveys, will be included. Also, corporate ETRs will be included as they are a more accurate measure of the tax systems which allows for cross-country comparisons and for specific analyses of industries and businesses. Effective marginal tax rates, effective average tax rates, net present value of capital allowances as a percentage of investment, and the cost of capital will be included in the same category. The effective marginal tax rates show how taxes make an influence on investment decisions as they measure the effect which taxation has on the pre-tax rate of return, i.e. the rate which is required by investors to break even. The effective average tax rates show the entity location choice, or their technology choice, as they measure the taxation effect on the economic rents of investments (OECD, 2018).

In the category of corporate tax revenues, it is expected that it will contain data on 90 countries, which will be gathered from the OECD's Global Revenue Statistics Database. The indicators in this category are corporate tax revenue as a percentage of GDP, or as a percentage of total tax revenue and level of corporate tax revenue in local currency (OECD, 2018).

The corporate tax incentives category will include two indicators on R&D tax incentives, on the members of the Inclusive Framework which would take part in it. Tax subsidy rates on R&D expenditures are the first set of indicators, and they measure notional tax support level, such as social security contributions, accelerated depreciation of assets etc., per additional unit of R&D expenditures. The second set of these indicators refer to tax expenditures for R&D (OECD, 2018).

The Council Directive (EU) 2018/822, O. J. L 139/2018, p. 1-13 amending Directive 2011/16/EU, which requires that mandatory disclosure rules for CRS avoidance schemes, cross-border aggressive tax planning and offshore structures be introduced in the EU MSs, was adopted by the European Council in May 2018. Promoters and service providers are obliged to inform the tax authorities about their designed or marketed schemes. As more than 100 jurisdictions in 2018 started the reporting and automatic exchange on offshore financial accounts pursuant to the CRS, the tax authorities have already identified around 85 billion euros (OECD, 2018).

CONCLUSION

When MNEs are shifting their taxable income among different jurisdictions through various profit shifting methods, their taxable income is not taxed, or is taxed at a lower tax rate.

Consequently, their ETR decreases. Another method used by the MNEs to lower their ETR is to have a preferential tax treatment or to exploit the mismatches of tax systems of different jurisdictions since the MNEs avoid taxation of some of their taxable income, or deduct twice the same tax deductible expense in two jurisdictions, or deduct an expense in one jurisdiction, although they do not have an associated income with it in another jurisdiction. This is primarily achieved by abuse of bilateral tax treaties.

In order to decrease the use of profit shifting strategies, and the exploitation of the mismatches of the tax systems of different jurisdictions, jurisdictions worldwide introduce anti-avoidance rules. The type of anti-avoidance rules, as well as their strictness, differs amongst jurisdictions. Certain type of measures, which target hybrids, aim at preventing the exploitation of mismatches in different tax systems. It is done by denying an entity in one jurisdiction the right to tax deduction in cases when the associated income with it is not taxable in the counterpart jurisdiction. Other set of measures aims at preventing tax avoidance when MNEs are transferring assets, such as IP, to another country right before the new product is developed, done by means of imposing tax on the value of the new product prior to its moving out of the country. Interest limitation rules and thin capitalisation rules aim at preventing debt arrangements that minimize taxes by limiting the amount of the interest deductible by an entity via setting a threshold, which is differently set in countries. CFC rules provide for taxing the passive, or the highly mobile income, generated by non-resident entities of resident shareholders, in situations when otherwise this income would be untaxed in a territorial tax system, or would be taxed on repatriation in a worldwide tax system. The transfer pricing rules prevent related entities from increasing or decreasing their taxable income with the help of the so-called arm’s length principle, i.e. the transaction between related entities has to have a commercial rationality of the arm’s length principle between two or more independent unrelated entities in comparable circumstances.

The BEPS action plan containing 15 actions also targets the methods of avoiding the corporate income tax. Action 1 addresses the challenges associated with the digital economy era, and offers three options to be applied individually or combined, in order for the jurisdictions to tax the non-resident entities when these entities have a significant economic presence in that jurisdiction. Action 2 gives recommendations for the hybrid mismatches and branch mismatches. The recommendations align the tax treatment of an instrument or an entity with the tax treatment in the counterpart jurisdiction, yet otherwise they do not disturb commercial outcomes. Action 3 recommends the application of CFC rules only to the CFCs subject to ETRs, which are meaningfully lower than those applied to the parent jurisdiction, and whose ‘parents’ have sufficient influence and control over them. The use of the parent jurisdiction rules is recommended as the best way for calculation of the CFC’s income. Action 4 directly addresses the risks of using interest expense by use of a combination of a fixed ratio rule, linked to the net interest to EBITDA ratio, that limits net interest deductions of the entity within a 10-30% corridor, and a group ratio rule that allows for a higher amount of deductible interest expense in certain situations. A count of 175 regimes was taken into

consideration under the rules of Action 5 in order to grant tax benefits according to the place where the bulk of economic activity happens. Also, over 17,000 rulings have been identified and mutually exchanged, hence this ensures transparency of the functioning of the ruling regimes. Due to Action 6, countries are modifying bilateral tax treaties in order to avoid treaty-shopping abuse, to improve dispute resolution, to implement mandatory binding arbitration, and to prevent artificial avoidance of the PE status. Action 7 implements changes in the definition of the PE, in order to tax entities trying to avoid the PE status artificially. Actions 8-10 align transfer pricing outcomes with value creation, by analysing the contractual relation between the affiliates in a combination with the conduct of the affiliates, all in order to split the profits to the affiliates doing the actual business activities. The main point is that the transaction ought to have the commercial rationality of an arm's length principle among independent unrelated entities in comparable circumstances. Action 11 proposes more corporate tax statistics analyses to be done in order to gather data for measuring and monitoring BEPS and the developed measures as well. The recommendations in Action 12 are about the mandatory disclosure regime, under which the promoters and/or taxpayers of a scheme are expected to disclose information about the tax scheme used. The information disclosed falls within the hallmarks defined in the regime. Action 13 includes a three level standardised approach for the transfer pricing documentation package applying to the MNEs which will contribute to transfer pricing risk assessment and evaluation, and will contribute to other related BEPS risk assessment and evaluation, and will also help determine where audit resources should be allocated. Action 14 ensures that MAP is more efficient and effective by resolving the difficulties in relation to the proper interpretation and adhering to tax treaties while at the same time promoting prevention and timely resolution of the disputes. The multilateral instrument, presented in Action 15, will modify existing bilateral treaties in order to implement the measures of the BEPS Package, by respecting the sovereign tax autonomy and by respecting the bilateral nature of the tax treaties. Finally, the multilateral instrument makes the international tax treaty network more reliable via ensuring transparency and certainty for businesses.

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APPENDIX

Appendix 1: Povzetek (Summary in Slovene language)

Vsaka država ima temeljno pravico do izbire svoje fiskalne politike brez zunanjega vmešavanja. Glavni razlog, da si države prizadevajo za ohranitev avtonomne fiskalne politike, je nadzor nad ustvarjanjem davčnih prihodkov, ki predstavljajo največji del državnih prihodkov, država pa jih potrebuje za zadovoljevanje javnih potreb in zagotavljanje vseh vrst javnih storitev (Bird & Zolt, 2006). Vsaka država odloča o svoji davčni stopnji in davčnem sistemu. Razlika v davčnih stopnjah in sistemih med državami lahko privede do ne obdavčevanja ali dvojnega obdavčevanja poslovnega subjekta. Večnacionalni subjekti (v nadaljnjem besedilu: VNS) izkoriščajo neusklajenost med davčnimi sistemi, da bi dosegli dvojno izogibanje davku od dohodkov pravnih oseb in uporabijo preferencialne davčne režime za določene dejavnosti ali dohodke, ki obstajajo v različnih državah. To je mogoče storiti z zlorabo dvostranskih davčnih pogodb. Hkrati VNS spremljajo davčno zakonodajo in predpise v teh državah pri izvajanju različnih mednarodnih strategij davčnega načrtovanja, da bi se izognili davkom in dosegli nižjo efektivno davčno stopnjo (v nadaljnjem besedilu: EDS) na prijavljene dohodke (Johansson, Skeie, Sorbe & Menon, 2017b).

Subjekti zmanjšujejo svojo davčno obveznost in povečujejo svojo dobičkonosnost z zmanjševanjem davčne osnove in preusmerjanjem dobička (v nadaljevanju: BEPS). To pomeni preusmerjanje prihodkov iz držav z visokimi davki v države z nizkimi davki, da bi se izognili visokim davčnim stopnjam, ker je cilj VNS najnižja možna EDS, o.z. zmanjšanje skupnega zneska davkov, ki jih plačujejo kot skupina. Posledica tega je, da nekateri dohodki niso obdavčeni ali so obdavčeni na nižji ravni glede na ciljno državo. Preusmerjanje dobička je mogoče doseči z manipulacijo transfernih cen, strateško porazdelitvijo neopredmetenih sredstev, sredstev in tveganj, manipulacijo ravni notranjega in zunanjega dolga, davčno inverzijo in izseljevanjem (Johansson, Skeie, Sorbe & Menon, 2017b).

Problem preusmerjanja dobička, zlasti v povezavi s pojavom davčnih oaz, je še večji na mednarodni ravni. Organizacija za ekonomsko sodelovanje in razvoj (v nadaljevanju: OECD) je skupaj z državami G20 in 80 sodelujočimi državami v razvoju, ustvarila paket BEPS. Akcijski načrt BEPS z ukrepi je sestavljen iz petnajstih ukrepov in se nanaša na vprašanje izkoriščanja razlik med davčnimi sistemi različnih držav, da bi se dobički prenesli na države z nižjimi davki, kjer VNS ne opravljajo pomembne dejavnosti. Enostranski in izolirani ukrepi držav lahko privedejo do večje obdavčitve, kar negativno vpliva na naložbe, rast in zaposlovanje. Zato pobuda BEPS predlaga mednarodno usklajen pristop, ki bo okrepil domače ukrepe za zaščito davčnih osnov in predstavil mednarodne rešitve za ta vprašanja (OECD, n.d.). Akcijski načrt BEPS vsebuje ukrepe za nove minimalne standarde, za revizijo obstoječih standardov, za pristop k konvergenci nacionalnih praks in za usmerjanje na podlagi najboljših praks. Nekatere ukrepe je mogoče uporabiti takoj, drugi pa zahtevajo spremembo dvostranskih pogodb ali izvajanje v domači zakonodaji. Akcijski načrt BEPS je pravni instrument, ki ni pravno zavezujoč. Vendar pa so se vse države OECD in G20 zavezale, da bodo izvajale ukrepe za preprečevanje izkoriščanja ugodnosti, ki izhajajo iz pogodb (“treaty shopping”) , boj proti škodljivim davčnim praksam, izboljšanje reševanja

sporov in zagotavljanje CbC poročila po državah. Izvajanje BEPS se bo spremljalo na zgoraj navedenih področjih, oziroma vsako področje bo predmet postopka medsebojnega pregleda za obdobje od 2016 do 2020. Vsak pregled bo opravljen v zvezi z roki za vsak minimalni standard (OECD, 2017). Države so se strinjale, da bodo na drugih področjih uporabljale splošne smernice ali smernice o najboljših praksah. Sprejeti so ukrepi za izravnavo obdavčitve dobičkov s poudarkom na gospodarski dejavnosti in kraju ustvarjanja vrednosti, za povečanje preglednosti in usklajenosti med davčnimi sistemi držav, da bi zmanjšali BEPS in njihove učinke (OECD, 2017). Da bi ugotovili, ali je BEPS dosegel uspeh, se bo preverilo, ali je bilo doseženo soglasje, ali se ukrepi izvajajo v skladu s konsenzom, in ali obstajajo primeri BEPS po izvedbi le-tega (OECD, 2015a, pp. 88-93).

Poleg paketa BEPS obstajajo tudi pravila za preprečevanje izogibanja obdavčevanja, ki zmanjšujejo davčno načrtovanje, kot so CFC pravila o nadzorovanih tujih podjetjih, ki veljajo za večnacionalne družbe, splošna pravila za izogibanje davka, ki davčnim organom omogočajo, preglede davčno motiviranih transakcij, pravila o višini obresti za davčne cilje, pravila o odbitku obresti, ki omejujejo manipulacijo z dolgom, in odbitje davka na plačila obresti, licenc in dividend (OECD, n.d.). Moč predpisov proti izogibanju davka se giblje in razlikuje glede na to, koliko držav imajo pravila proti izogibanju, in če so v državah izpolnjene določene zahteve v zvezi s temi pravili (Loyens & Loeff, 2016).