



DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT
ECONOMIC AND SCIENTIFIC POLICY **A**



Economic and Monetary Affairs

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Internal Market and Consumer Protection

Tax Challenges in the Digital Economy

Study for the TAXE 2 Committee



DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

TAX CHALLENGES IN THE DIGITAL ECONOMY

STUDY

Abstract

This paper analyses direct and indirect tax challenges in the digital economy in light of the conclusions of the OECD's BEPS (Base Erosion and Profit Shifting) Project. While assessing the recent reforms in the area of taxation within the EU and third countries, it revisits the question of whether or not specific measures are needed for the digital sector. Taking into account the recent scandals involving big digital companies and their aggressive tax planning practices in the EU, the specificities of the digital sector and the legal landscape in the 28 Member States, the paper makes policy recommendations for further tax reforms in order to tackle tax avoidance and harmful competition.

This document was provided/prepared by Policy Department A at the request of the TAXE2 Committee.

This document was requested by the European Parliament's Special Committee on Tax Rulings

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Original: EN

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Manuscript completed in April 2016

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LIST OF ABBREVIATIONS

Anti-BEPS	The Anti-Tax Avoidance Directive
APA	Advanced Pricing Agreement
ATAD	Anti-Tax Avoidance Directive
B2B	Business to Business
B2C	Business to Consumer
BEPS	Base Erosion and Profit Shifting
BIAC	Business and Industry Advisory Committee to the OECD
CBCR	Country-By-Country Reporting
CCA	Cost Contribution Arrangement
CCCTB	Common Consolidated Corporate Tax Base
CEO	Chief Executive Officer
CFC	Controlled Foreign Capital
CIR	Crédit d'Impôt Recherche
CJEU	Court of Justice of the European Union
CUP	Comparable Uncontrolled Price
DAC	Directive on Administrative Cooperation
DG FISMA	Directorate-General for Financial Stability, Financial Services and Capital Markets Union
DG TAXUD	Directorate General for Taxation and Customs Union
ECOFIN	Economic and Financial Affairs Council
EBITDA	Earnings Before Interest, Tax, Depreciation, and Amortization
EEA	European Economic Area
EC	European Commission
ECIPE	European Centre for International Political Economy
EP	European Parliament
EPSU	European Public Service Union
EU	European Union

GAAR	General Anti Abuse Rule
GDP	Gross Domestic Product
GRR	Group Ratio Rule
FATCA	Foreign Account Tax Compliance Act
FDI	Foreign Direct Investment
ICT	Information and Communication Technology
IMF	International Monetary Fund
IP	Intellectual Property
ISP	Internet Service Provider
GDP	Gross Domestic Product
OECD	Organisation for Economic Co-operation and Development
MNE	Multinational Enterprise
MOSS	Mini One Stop Shop
NGO	Non-Governmental Organisation
PE	Permanent Establishment
PwC	PricewaterhouseCoopers
R&D	Research and Development
SME	Small and Medium Enterprises
SPE	Special Purpose Entity
TFDE	Task Force on the Digital Economy
TFEU	Treaty on the Functioning of the European Union
UK	United Kingdom
UN	United Nations
US	United States
VAT	Value Added Tax
WWW	World Wide Web

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EXECUTIVE SUMMARY

As the scandals keep multiplying with Lux Leaks, Swiss Leaks and Panama Leaks, public cries increase calling governments to stop tax avoidance, as a result of which EUR 50-70 billion¹ of tax revenue is being annually lost by the Member States of the European Union (EU).

The increasing number of EU and Member State investigations against digital companies such as Google, Amazon, Apple and Facebook show that the digital sector is highly involved in aggressive tax planning practices, which permits the biggest companies of the world to get away with the payment of close to zero taxes. Although the European Commission shall be commended for its proactiveness, the investigations are seen as a temporary solution to tax avoidance and are being constrained by the EU case law, the four fundamental freedoms as well as lengthy investigation processes.

While the digital economy does not create Base Erosion and Profit Shifting (BEPS) issues, it 'exacerbates the existing ones'.² Digital goods are highly mobile or intangible, physical presence of a company in the market country is often not needed in the digital sector, rendering it substantially different from traditional brick-and mortar businesses. New digital business models (subscription, access or advertisement models) and new technologies such as robotics or 3D printing are not confined by national boundaries and can easily escape their tax liabilities by channelling their royalty payments towards a tax haven, for instance.

Taxation of e-commerce is problematic due to anonymity, difficulty to determine the amount of tax, lack of paper trail, tax havens, companies incurring liability in multiple countries, tax administration's lack of capacity to identify companies and to manage VAT. These factors render it difficult for tax administrations to collect Value-Added Tax (VAT), especially due to BEPS risks stemming from exemptions for imports of low valued goods and remote digital supplies to consumers.

Tax challenges arise from nexus, data and characterisation in the digital sector. These concepts relate to the difficulty to define tax jurisdiction, the problem of attributing value to data created by users free of charge and the dilemma on whether or not e-commerce transactions fall under the category of royalties. To give a few examples, MNEs usually often rely on the exceptions under the Organisation for Co-operation and Development's (OECD) Model Tax Convention to circumvent Permanent Establishment (PE) status, use tax incentives such as patent boxes for tax purposes rather than for their intended purpose of promoting Research and Development (R&D) activities, engage in treaty shopping to shift taxable revenue to tax havens or negotiate sweetheart deals with governments willing to attract Foreign Direct Investment (FDI).

Thin capitalisation, transfer pricing, hybrid mismatches, circumvention of Controlled Foreign Capital (CFC) rules, preferential tax regimes and artificial contractual agreements are commonly used methods to eliminate tax base by Multinational Enterprises (MNEs) in the digital sector.

Especially, the OECD / G20 BEPS measures related to Permanent Establishment, CFC rules and transfer pricing are designed to address the BEPS issues in the digital economy.

These include addressing the exceptions included in the definition of the Permanent Establishment status, eliminating artificial arrangements or contracts, regulating transfer pricing of intangibles and modifying the definition of CFC rules.

¹ European Commission (2016) European Commission proposes tax transparency rules (http://europa.eu/rapid/press-release_IP-16-1349_en.htm).

² OECD BEPS Frequently Asked Questions (<http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm>).

Although the OECD / G20 recommendations in 15 different action fields constitute a step in the right direction, their adoption is left at its Member States' discretion, as OECD is a soft-law Organisation and often comes up with minimalist and multiple-option solutions to facilitate consensus building among its Members. BEPS Action 1 on the digital sector fails to come up with short-term solutions, as it fiercely defends the idea that ring-fencing the digital economy would not be feasible as 'the digital economy is increasingly becoming the economy itself'.³ Moreover, concerns about productivity losses and deviation from the OECD's neutrality principle and breach of the EU's four fundamental freedoms, such as the movement of services, also justify that isolation of the digital sector would not be an optimum solution.

Notwithstanding this, some EU Member States and some third countries experimenting with or flirting with the idea of the introduction of specific taxes on the digital economy. The European Commission raised doubts about these specific measures because of their impractical, irrational or temporary nature while highlighting the need for some out-of-the box thinking within the boundaries of the existing system.

In this framework, it is worthwhile to keep a vigilant eye on the reform process within the US tax system, as the Obama administration proposed a minimum tax of 19 % on global earnings of US companies, 'regardless of whether the income is repatriated to the US and imposed 'limits on deferral of overseas income and use of corporate structures that leave some income untaxed by any country.'

The overall analysis on the OECD/ G20 BEPS measures relevant to the digital sector reveals that some measures fail to address the core of the problem. This may stem from the OECD's being a soft-law organisation and its efforts to reach consensus by offering de minimis solutions and multiple options. Yet, the OECD does not exclude the future possibility of engaging in far-reaching reforms relevant to the digital sector, referred to as 'Beyond BEPS strategy', such as the conception of a single firm, modification of source and residence and deemed PE, while providing several possibilities, including fractional apportionment, deemed profit methods, withholding tax on digital transactions and equalisation levy. The unitary approach is seen by many as the ultimate solution to the tax problems in the digital sector, especially those related to transfer pricing, suggesting that the OECD's arm's length principle is untenable.

Going beyond the recommendations of the OECD, the EU has recently proposed an Anti-Tax Avoidance Directive (ATAD), which goes further than the OECD recommendations. The Directive suggests the following three actions, which were also recommended by the OECD / G20 BEPS project: Hybrid mismatches (Action 2), interest limitations (Action 4) and CFCs (Action 3). Moreover, the Commission proposes three additional actions, which were not covered by BEPS: General Anti-Avoidance Rule (GAAR), switch-over clauses and exit taxation.

Yet, the package including six legally binding anti-abuse measures is far from being inked as consensus could not be reached due to three controversial issues: the switch-over clause, CFC rules and provisions on hybrid mismatches. For instance, usefulness of the switch-over clause is being questioned, as the 40 % relative threshold may lead to a race to the bottom and would not apply to low tax Member States. As for the nominal threshold proposed for the CFC rules, they may limit tax administrations to tax foreign based subsidiaries if the tax rate paid there is lower than 40 % of the home country tax rate.

Separately, the Commission announced the relaunch of the Common Consolidated Corporate Tax Base (CCCTB) based on two important changes: A compulsory CCCTB to

³ OECD Final Report (2015) Addressing the Tax Challenges of the Digital Economy, Action 1.

combat BEPS risks, and a two-step approach to harmonise tax base across the EU and consolidation.⁴ Furthermore, a Directive on the reporting rules by MNEs was adopted on May 25 May 2016 in the Council to implement the OECD's BEPS Action 13 on Country-by-Country Reporting (CBCR).⁵ However, there is much criticism on both measures concerning the size of companies held accountable for reporting as a minimum threshold was set at USD 750 million. The OECD findings show that this would exclude more than 85 % of MNEs while limiting tax administrations' investigative powers.

The EU adopted regulations on money laundering (Anti-Money Laundering Directive) in 2015 to increase transparency and to address the problems posed by shell companies, foundations and trusts. Accordingly, companies in EU Member States are expected to declare the real owner of such entities but countries differ in their level of ambition when it comes to its implementation. At the same time, only persons having a 'legitimate interest' are granted access to the registers of real owners and it is not clearly defined who these real owners are.⁶

To tackle harmful tax practices, EU Member States endorsed the OECD's Modified Nexus Approach, according to which a criterion of substantial activity with regards to IP Box regime was adopted. It is expected to will the scope of eligible IP to patents and comparable intangibles while rendering IP Box relevant to net instead of gross income. Thanks to a grandfathering rule, companies having obtained advantages under the existing IP regimes until June 2016, will be able to fully benefit from them until the end of June 2021.

In order to address problems arising from the localisation of businesses and conceptualisation of taxable person, new rules regarding the destination principle and the Mini One Stop Shop (MOSS) entered into force in January 2015. There is a shift in the EU to use more and more the principle of destination for VAT purposes. The VAT Action Plan Agenda, proposed under the Better Regulation Agenda by the Commission on 7 April 2016, is the first step towards a single EU VAT area, which is equipped to tackle fraud, to support business and to help the digital economy and e-commerce. It is yet to be seen whether the EU will do away with an updated list of goods and products, which can be taxed at a minimum of 15 % rate or rather keep a regularly updated version of the list.

⁴ European Commission, Common Consolidated Corporate Tax Base (CCCTB). (http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm#practical).

⁵ Council of the European Union (2016) Corporate tax avoidance: Council adopts rules on the exchange of tax-related information on multinationals (<http://www.consilium.europa.eu/en/press/press-releases/2016/05/25-exchange-tax-related-information-multinationals/>).

⁶ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.26.

1. INTRODUCTION

The recent Panama Leaks in addition to earlier revelations referred to Swiss Leaks and Lux Leaks remind us of the large scale of aggressive tax planning practices, which siphon off tax revenues, when they are more than ever needed in the aftermath of the financial crisis⁷

Tax avoidance, tax fraud and tax evasion amount to annual tax revenue losses of EUR 1000 billion, EUR 150 billion of which can be attributed to tax evasion.⁸ Offshore tax havens continue to be a major concern despite several attempts to curb them and offshore assets are estimated between USD 21 and USD 32 trillion⁹. Some of the above-mentioned scandals and ensuing investigations revolving around big tech giants such as Google, Apple and Amazon demonstrate that tax avoidance is a recurrent issue in the digital sector. This can be attributed to its 'unparalleled reliance on intangible assets, massive use of data (notably personal data), widespread adoption of multi-sided business models capturing value from externalities generated by free products, and the difficulty of determining the jurisdiction, in which value creation occurs.'¹⁰

Furthermore, the mass adoption of connected digital services by consumers, enterprises and governments, which can be defined as digitisation, is stimulating economic growth.¹¹ This factor makes it rather challenging for governments to impose balanced taxes on the digital sector as they may fear hampering growth and curbing investment flows.

BEPS Project initiated by the G20 and the OECD is an important step to tackle major tax challenges arising from the permanent establishment status, tax treaties or hybrid mismatches but they fail to address the fundamental deficiencies in the tax system and leave the question of transfer pricing at the OECD's arm's length principle intact, for instance.

The EU has developed its own instruments, such as the Anti-Tax Avoidance Directive to fight against these challenges, sometimes taking a step further than the OECD. Yet, it is constrained by the unanimity obligation in the tax matters as well as by legal limitations related to its competition rules and its four fundamental freedoms.

It is worrying to witness that while loopholes such as the double Irish scheme are being closed, others are being created (i.e. pattern boxes). Acknowledging that it is essential to give incentives for R&D activities, policymakers need to put a system in place with assurances that MNEs would not make use of these incentives solely by fiscal motivations.

The EU could reap the benefits of instruments such as Country-By-Country Reporting to the fullest, which could provide tax administrations with sufficient instruments to reclaim public money from tax havens, including the ones within the European Union (EU) and European Economic Area (EEA).

In parallel, it is worthwhile to take stock of the reform processes in countries such as the US since it would enable the EU to spot general tendencies and to develop more targeted policies.

Finally, it is important to adhere to the principle of tax neutrality but this should not be done at the expense of democracy and general public interest. Some say it is time for digital tech giants to start paying taxes such as bandwidth tax or equalisation levy to offset for the losses

⁷ BBC, Panama Papers: Mossack Fonseca leak reveals elite's tax havens, 4 April 2016.

⁸ Somo, Tax-Free Profits: Welcome to the Geography of Tax Avoidance, December 2015.

⁹ Global Alliance for Tax Justice, Open Data for Tax Justice Launches, March 2016.

¹⁰ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 2.

¹¹ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, June 2014, p. 9.

incurred by the free use of data of end-consumers or to compensate for missing advertising revenues.

The following analysis will evaluate the specificities of the digital sector, specify general tax avoidance practices in the sector; take stock of recent reform processes in the framework of BEPS measures and their repercussions in the EU legislative landscape as well as third countries; and finally make recommendations for possible future measures in the area of direct and indirect taxation, which are relevant to the digital sector.

2. KEY FEATURES OF THE DIGITAL ECONOMY

KEY FINDINGS

- The digital economy is expanding at a tremendous pace while the entire economy is being digitalised. This occurs thanks to dropping prices of Information and Communication Technologies (ICTs) and a constant drive for innovation.
- As digital goods are highly mobile or intangible, the physical presence of a company in the market country is often not needed in the digital sector, rendering it substantially different from traditional brick-and mortar businesses.
- The boundary between consumer and producer in the digital economy is thin, which results in the new concept of 'prosumer'.
- Due to new information goods and the Internet, it has become possible to create product bundles, which serve as price discriminating tools, often put into question by the EU's competition law.
- Value is created by subscription fees paid by users, advertisement fees generated by users and access fees paid by third parties to take hold of user's data in digital business models.
- Digital businesses are easily contestable and barriers of entry are low, which makes companies innovate seamlessly in order to stop disruptive innovators. Digital companies have a tendency towards monopoly due to 'network effects, scale effects, restrictions of use, potential to differentiate and possibility for users to use several platforms.'
- As it is a sui generis sector, some think that specific measures shall apply to the digital sector regarding taxation. Yet, the general consensus is not to isolate the sector as it is a major driver of growth.

As the Internet 'is at once intangible and in a constant state of mutation, growing larger and more complex with each passing second'¹², it increasingly leads to the digitalisation of the entire economy. As digital goods are highly mobile or intangible, the physical presence of a company in the market country is often not needed in the digital sector, rendering it substantially different from traditional brick-and mortar businesses.

The rise of the digital economy is largely due to the decreasing Information and Communication Technology (ICT) prices and a constant drive for innovation. The spread of ICT tools such as Laptops, smart mobile phones and tablets as well as telecommunications networks such as the World Wide Web (WWW) indicates that the digital products are becoming increasingly part of our daily lives.

The digital economy can be defined as 'the global network of economic and social activities that are enabled by platforms such as the Internet, mobile and sensor networks.'¹³

¹² Schmidt, p. 3.

¹³ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 5.

Value creation online can be referred to as virtual or digital labour. There are 'blurred boundaries' between production and consumption in the digital age. This is exemplified by the amalgam 'prosumer', showcasing the weak distinction between consumer and producer.¹⁴

Although one can not clearly define the boundaries of the digital economy, the transactions in the digital economy can be categorised as follows: 'electronic services, supply over the Internet of services other than electronic services and supply of goods ordered online.'

The digital economy is driven by 'content production, consumption and indexation'. The monetisation of personal data plays a key role in the digital sector.¹⁵ At the same time, it is a challenge to calculate the value creation in the digital sector as consumers receive services free of charge in exchange for providing data.¹⁶

The use of big data is another key characteristic of the digital sector, which is now incorporated in every level of international economy. It is a pool of data collected, diffused, aggregated, stored and analysed, which creates value by increasing transparency, improving performance management and decision-making, and by developing tailored products or services or even new business models.¹⁷

Digital businesses can be easily contestable 'as market power can be challenged by entrants more easily and often faster than in more traditional fields of the economy.'¹⁸

The digital sector is more dependent on intellectual property than traditional brick-and-mortar business.¹⁹ The creation of a dominant or 'gatekeeper' position (usually through patents, which grant control over access to technology and standards) makes it challenging to survive or to grow for new entrants in the market although entry barriers are low. Hence, to avoid disruptive innovators, companies have to engage seamlessly in innovation, in other words, new techniques, products, sales channels, customers etc.²⁰

These key distinctive features in the digital sector make it easier for digital companies to engage in tax avoidance practices.

2.1. Digital Business Models

Digital business models can be categorised as follows:

- the subscription model, in which users pay a subscription fee to have access to a service or content on a website such as Amazon or Netflix;
- the advertisement model, in which the end-users generate revenue by being exposed to advertising in platforms provided by companies such as YouTube or Yahoo; and

¹⁴ Huws, p. 50.

¹⁵ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 5.

¹⁶ European Parliament Directorate General for Internal Policies. Policy Department A. Economic and Scientific Policy. In-depth Analysis for the ECON Committee (2015) Presentation: Challenges for Competition Policy in a Digitalised Economy, p.21.

¹⁷ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 26.

¹⁸ European Parliament Directorate General for Internal Policies. Policy Department A. Economic and Scientific Policy In-depth Analysis for the ECON Committee (2015) Presentation: Challenges for Competition Policy in a Digitalised Economy, p.23.

¹⁹ Tax Executives Institute, BEPS Action 1 Digital Economy, 13 April 2014.

²⁰ European Parliament Directorate General for Internal Policies. Policy Department A. Economic and Scientific Policy In-depth Analysis for the ECON Committee (2015) Presentation: Challenges for Competition Policy in a Digitalised Economy, pp. 6-7.

- the access model, in which content and app developers (Internet Service Providers, data brokers and data analysts) pay to have access to end-users' data such as App store.²¹

Online marketplaces, such as eBay, dating sites such as Tinder.Com, online employment agencies such as Upwork, price comparison sites, online travel sites such as Skyscanner or Expedia, or accommodation sites such as Booking.Com, peer to peer services such as Airbnb and transport services such as Uber are equivalents of offline businesses. Payments, media, auctions, logistical solutions have nowadays all their online versions. Profit is created by charging usage or commission fees to service providers, service users and advertisers.²²

New business models generated by the digital sector are electronic commerce, app stores, online advertising, cloud computing, payment services, high frequency trading and participative networked platforms.

The digital economy allows for a highly mobile allocation of tasks among various branches of one company in different countries.²³

The unique nature of digital business models helps digital companies to engage in tax avoidance practices, which will be analysed in the next section.

²¹ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 13.

²² Huws (2014), pp. 163-164.

²³ OECD Final Report (2015) Addressing the Tax Challenges of the Digital Economy, Action 1.

3. TAX CHALLENGES, TAX-RELATED INVESTIGATIONS AND COMMON TAX AVOIDANCE PRACTICES IN THE DIGITAL SECTOR

KEY FINDINGS

- Tax challenges arise from nexus, data and characterisation in the digital sector. These concepts relate to the difficulty to define tax jurisdiction, the problem of attributing value to data created by users free of charge and the dilemma on whether or not e-commerce transactions fall under the category of royalties.
- BEPS in the digital sector mainly occurs to avoid Permanent Establishment status in the market country, to escape withholding tax and to eliminate tax in various jurisdictions.
- MNEs use complex mechanisms such as the Double Irish scheme to achieve double non-taxation and to generate the so-called stateless income within a multinational group in onshore or offshore low tax jurisdictions.
- The EU and Member States' investigations on tech giants for abuse of dominant position and state aid under the guise of tax rulings or transfer pricing illustrate only the tip of the iceberg regarding anomalies in the digital sector.
- The European Commission shall be commended by its proactive approach on state aid investigations targeting the largest tech companies. As the investigations on state aid are done case by case, they have both their limitations and attractions. The Commission itself admits they only provide a rather temporary and small scale solution to the problem of taxation in the digital sector. Yet, Member States shall also assume responsibility in tackling this issue by adapting existing tax laws. For instance, as a result of The UK's new tax laws aimed at forcing companies to pay more tax on revenue generated in the UK, Facebook changed its tax structure. Another solution could be the introduction of deadlines to make the investigation processes more efficient.
- MNEs often take advantage of the exceptions provided in Article 5 of the the OECD's Model Tax Conventions to avoid PE status. Tax treaties between jurisdictions of the payer and recipient may be abused by treaty shopping to avoid the payment of withholding taxes in the high-tax jurisdiction by means of establishing shell companies in tax havens.
- Thin capitalisation, transfer pricing, hybrid mismatches, circumvention of CFC rules, preferential tax regimes and artificial contractual agreements are commonly used methods to eliminate tax base in the intermediary jurisdiction or in the jurisdiction of residence.
- Regarding VAT collection, BEPS risks stem from exemptions for imports of low valued goods and remote digital supplies to consumers.
- Taxation of e-commerce is problematic due to anonymity, difficulty to determine the amount of tax, lack of paper trail, tax havens, companies incurring liability in multiple countries, tax administration's lack of capacity to identify companies and to manage VAT.

3.1. Nexus, Data and Characterisation at the Heart of the Tax Challenges in the Digital Sector

Income tax base in the digital economy is endangered by the fact that the MNEs are increasingly providing goods and services in countries without a physical or legal presence; by situations where customers pay for certain digital services by providing their personal data free of charge, thus generating visibility and customers in the market country without a value being attributed to it; by artificial contracts created for shifting profits; by circumvention of withholding tax using transfer pricing practices such as converting royalties into services.²⁴ The current tax system privileges the jurisdictions where functions, assets and risks of MNEs are located but large markets are increasingly voicing that profits shall be taxable in the market country, where labour and business factors are located.²⁵

The OECD categorises tax challenges arising from the digital sector as follows:

- Nexus: The possibility to conduct business without physical presence thanks to technological advancements.
- Data: The difficulty to attribute value to data generated by using personal information of end-users.
- Characterisation: The creation of new products and new ways of delivery, which make the characterisation of payments uncertain in new digital business models, such as cloud computing, which facilitates storage of data and programmes at external services, and thus saves space on the consumer's own computer.²⁶

Most of the digital products such as intellectual properties or patents are of an intangible character, hence it is difficult to calculate their value in comparison with physical goods. Moreover, unlike physical goods, they can travel easily across borders. This makes it easy for companies to set up a business far away from their consumers, where the actual economic activity takes place. This can be exemplified by the wide use of mailbox or shell companies established in tax havens.²⁷

Traditionally, companies have a physical presence or a nexus in a given jurisdiction, where they are obliged to pay their taxes. E-commerce eliminates the need for a physical presence or nexus of a company in order to have access to its customers there.

Value generated by using personal data in online digital giants such as Google and Facebook are 'hugely profitable'. Because there is no commodity being produced but the profits are made by advertising as these companies have access to data of their users and can analyse it.²⁸ Advertisers, who want to sell their commodities, use social media or search engines to advertise them, and this is how value creation occurs.

Characterisation issues arise from online payments made in e-commerce transactions, for instance. As there is no intermediary involved, it is difficult to decide whether a company received payments while carrying on business. In some cases, the payer may be the person, who carried on business.

²⁴ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 3.

²⁵ U.S. Department of the Treasury (2025) Testimony of Robert B. Stack, Deputy Assistant Secretary (International Tax Affairs) Before the Senate Finance Committee.

²⁶ OECD Final Report (2015) Addressing the Tax Challenges of the Digital Economy, Action 1, p. 99.

²⁷ Arbeiterkammer, Tax Avoidance, Tax Evasion, Tax Havens, 14 May 2015.

²⁸ Huws, 159.

As a result, a blurry situation may occur to identify whether these payments fall under Article 7 of the OECD Model Tax Convention²⁹, which deals with business profits or under Article 12 of the Convention, which deals with royalties.

The term 'royalties' is defined by the OECD as 'payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work'.³⁰

The OECD / G20 BEPS Report on Action 1 of 2015 identifies the following areas of BASE erosion in the framework of direct taxation in the digital sector.

- Avoiding of PE status in the market country.
- Avoiding withholding tax.
- Eliminating tax in the intermediate country or in the country of residence.

When it comes to indirect taxation such as VAT, BEPS risks are due to remote digital supplies to exempt businesses and remote digital supplies in a multi-location enterprise.

As the Coordinator of the BEPS Monitoring Group Sol Picciotto explains it, tax challenges in the digital sector do not arise from a lack of definition of the digital sector but from 'general effects of digital technologies on business models'. A strict definition of the sector would apply to MNEs providing only digital services (i.e. Facebook, Google, Yahoo...). But many Small and medium-sized enterprises (SMEs) are also being affected due to their involvement in business to business services and consultancies.³¹

3.2. EU and Member States' Investigations on Digital Tech Giants

3.2.1. Legal Basis

The 11-million-file Panama Leaks, which led to the resignation of the Icelandic Prime Minister,³² Sigmundur Gunnlaugson, are alerting as even in the height of global action to end bank secrecy and to stop aggressive tax planning, complex mechanisms such as offshore companies, trusts and foundations still exist to soak billions of Euros out of our state's budgets.³³

Commentators say that this tremendous scandal is only the tip of the iceberg. Similarly, Swiss Leaks in 2015 exposed how global banking giant HSBC's Swiss branch helped wealthy individuals hide USD100 billion in secret offshore bank accounts.³⁴

²⁹ OECD (2014) Model Convention with Respect to Taxes on Income and on Capital (http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/model-tax-convention-on-income-and-on-capital-2015-full-version_9789264239081-en#page1).

³⁰ OECD Report to Working Party No. 1 of the OECD Committee on Fiscal Affairs (2001) Tax Treaty Characterisation Issues Arising from E-Commerce (<http://www.oecd.org/tax/consumption/1923396.pdf>).

³¹ BEPS Monitoring Group, Response to OECD Request for Input Regarding Tax Challenges of the Digital Economy.

³² EU Observer, Iceland PM defiant, EU weighs reaction to tax leaks, 4 April 2016.

³³ The Economist, The Panama papers: A torrential leak, 9 April 2016. (<http://www.economist.com/news/international/21696497-huge-trove-documents-has-revealed-secrets-offshore-business-presaging-tougher>).

³⁴ Oxfam, SwissLeaks Scandal one year on: political response to tax dodging is sluggish, says Oxfam, 5 February 2016 (<https://www.oxfam.org/en/pressroom/reactions/swissleaks-scandal-one-year-political-response-tax-dodging-sluggish-says-oxfam>).

Earlier, Lux Leaks had revealed sweetheart deals between Luxembourg and some 340 MNEs, allowing these companies to cut their tax bills to a very large extent all by maintaining almost no physical presence in the country.³⁵

Art. 107 TFEU provides the definition of state aid and lists the exceptions according to which it could be considered compatible with the internal market. The European Commission launched a number of investigations on tax rulings in Luxembourg, the Netherlands, Ireland and Belgium, which are potentially considered as illegal state aid.³⁶

Tax planning and avoidance may lead to a competitive disadvantage for companies, which lack the opportunity to engage in sophisticated planning schemes because of their size, their geographic focus or their business model.³⁷

An European Commission study³⁸ shows that MNEs benefit from tax rates that is 3,5 % lower than domestic companies and SMEs are especially disadvantaged as they pay relatively higher rates than MNEs.³⁹

Tax planning and avoidance has the potential effect of distorting competition by taking advantage of existing loopholes in different tax systems and shifting profits to zero tax or low-tax jurisdictions, where no economic activity takes place. As harmful tax competition leads a race to the bottom, tax base is eroded and profits are shifted. Whereas the winners are mobile factors, the losers are production factors such as labour as well as less companies with limited mobility.⁴⁰

Digital monopolies are harmful for competition and innovation, generating the risk to monopolise other markets and an incentive to lock-in customers. Moreover, gatekeeper positions of Internet Service Provider (ISP) can adversely affect market dynamics. State aid for broadband deployment can disturb markets.⁴¹

When geo-blocking, to give an example, harms the Digital Single Market, Article 101 and 102 TFEU can be used to eliminate restrictions imposed by dominant companies.⁴²

Abuse of dominant position (Article 102 TFEU) can be either exclusionary (foreclosure) or exploitative. In the former, access restrictions by a gatekeeper or leveraging of market (favouring own services, exploitation of third party content and data to the detriment of competitors and impeding supplier changes by customers) can constitute an abuse. In the

³⁵ The International Consortium of Investigative Journalists, Leaked Documents Expose Global Companies' Secret Deals in Luxembourg, 5 November 2014 (<https://www.icij.org/project/luxembourg-leaks/leaked-documents-expose-global-companies-secret-tax-deals-luxembourg>).

³⁶ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system', p.24.

³⁷ European Parliament Directorate-General For Internal Policies Policy Department A Economic and Scientific Policy. In-Depth Analysis for the TAXE Special Committee (2015) Intellectual Property Box Regimes, p. 5.

³⁸ VVA & ZEN (2015). SME Taxation in Europe-An empirical study of applied corporate income taxation for SMEs compared to large enterprises. European Commission CIP Programme, p.111.

³⁹ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system', p.8.

⁴⁰ European Parliament Directorate General for Internal Policies. Policy Department A. Economic and Scientific Policy In-depth Analysis for the ECON Committee (2015) Presentation: Challenges for Competition Policy in a Digitalised Economy, p.28.

⁴¹ European Parliament Directorate General for Internal Policies. Policy Department A. Economic and Scientific Policy In-depth Analysis for the ECON Committee (2015) Presentation: Challenges for Competition Policy in a Digitalised Economy, p.25.

⁴² European Parliament Directorate General for Internal Policies. Policy Department A. Economic and Scientific Policy In-depth Analysis for the ECON Committee (2015) Presentation: Challenges for Competition Policy in a Digitalised Economy, p.14.

latter, exploiting third party content or data or hindering customers from switching suppliers are examples of abuse.⁴³

3.2.2. EU and Member States Investigations

In addition to the investigations by the European Commission against big tech companies summarised in Box 1 below, in February 2015, the European Commission initiated an investigation on the Belgian excess profit tax scheme for allegedly distorting competition⁴⁴ by allowing companies to lower their taxes by 50 to 90% from excess profits resulting from a subsidiary of a multinational group. Hence, the Commission concluded that the tax regime was illegal and asked for a €700 million recovery of unpaid taxes from 35 MNEs.

Furthermore, Member States launched a number of similar probes:

- Google Inc. is currently investigated in Italy for tax evasion amounting to EUR 250 million in 2009-2013.⁴⁵
- Italy initiated a probe against Amazon on 9 March 2016. It reached an agreement with Apple in December 2015 and ended the dispute with a 350-million-dollar settlement.⁴⁶ Considering Apple Italy, Italian prosecutors prepared investigations in March 2015 that Apple saved EUR 879 million of taxes by channeling its investment through Ireland. As a result, a former court case was launched.
- Denmark took Seattle-based Microsoft to court for wrongdoing when the firm purchased a Danish company Navision in 2002 and thus allegedly avoided to pay 5.8 billion DKK in taxes. Microsoft Denmark had acquired the Danish firm and resold it to its US parent below the market value in order to avoid Danish transfer pricing requirements.⁴⁷ The European Commission asked Denmark to change its transfer pricing schemes.
- The German competition authority launched an anti-trust investigation on Facebook in March 2016 to verify whether Facebook misused its dominant position to collect people's digital information.
- In the beginning of this year, Google parent Alphabet and the UK reached a settlement, where Google accepted to pay GBP 130 million on a voluntary basis to compensate for tax losses since 2005.⁴⁸ This sum was deemed as 'disproportionately small' by the Public Accounts Committee.⁴⁹ Commissioner Margerathe Vestager said in January 2016 that she might look into this tax settlement.⁵⁰ France is currently seeking a compensation, which is ten times more.⁵¹ The Commission comments that such voluntary contributions are illegal as companies are obliged to ensure the best

⁴³ European Parliament Directorate General for Internal Policies. Policy Department A. Economic and Scientific Policy In-depth Analysis for the ECON Committee (2015) Presentation: Challenges for Competition Policy in a Digitalised Economy, p.19.

⁴⁴ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 47.

⁴⁵ Bloomberg, Google Probed in Italy for Unpaid Taxes Topping 250 million dollars, 28 January 2016.

⁴⁶ BidnessEtc, Italy Investigates Amazon for Alleged Tax Avoidance, 16 March 2016.

⁴⁷ The Free Library, Denmark: Microsoft faces a lawsuit from Denmark's tax agency, 11 March 2013.

⁴⁸ Fortune, 7 Corporate Giants Accused of Evading Billions in Taxes, 11 March 2016.

⁴⁹ Week, Google's back-tax bill for France is ten times what it paid in the UK, 25 February 2016.

⁵⁰ New York Times, How Europe is Going After Google, Amazon, and Other U.S. Tech Giants, 20 April 2016 (http://www.nytimes.com/interactive/2015/04/13/technology/How-Europe-Is-Going-After-U.S.-Tech-Giants.html?_r=0).

⁵¹ BBC, Google unpaid taxes: France seeks €1.6bn from search giant, 24 February 2016.

interest for their shareholders by law and their aim should not be pleasing taxpayers in the UK.⁵²

It is a positive sign that the EU and its Member States are investigating such cases but they are criticised to lack ambition, especially with regards to the amount of payback, which is being required. Moreover, they may not lead to desired outcomes in the Member States concerned.

The state aid cases launched by the EU against Luxembourg and the Netherlands may have led the two countries to lose 'a bit of a lustre as tax havens', yet countries such as Ireland and the Netherlands are likely to continue to operate as tax havens as the former is home to numerous offices and factories and the latter could use patent box benefits as well as its ports, airports and financial sector to lure MNEs into establishing their substantive operations in the country. There is a tendency towards opening more trusts and foundations and to multiply patent box regimes in these countries, which are loopholes easily exploitable by the MNEs. The phenomenon of Freeports in Luxembourg is another issue of concern, which shall be regarded with much vigilance.

While the Commission's investigations are a courageous step against largest tech companies, the Commission itself admits they only provide a rather temporary and small scale solution to the problem of taxation in the digital sector. Moreover, some complain about the lengthy investigation processes and suggest the introduction of deadlines.⁵³

Moreover, the US believes that EU state aid investigations create 'disturbing international tax policy precedents', criticising them for their retroactive nature, for disproportionately targeting U.S. companies and for undermining the U.S. rights under tax treaties with Member States (as the EU has not sign a tax treaty with the U.S. yet).⁵⁴

Acknowledging that some of these arguments may be justified, the European Commission shall be commended by its proactive approach on state aid investigations targeting the largest tech companies. As the investigations on state aid are done case by case, they have both their limitations and attractions. The Commission itself admits they only provide a rather temporary and small scale solution to the problem of taxation in the digital sector. Yet, Member States shall also assume responsibility in tackling this issue by adapting existing tax laws. For instance, as a result of The UK's new tax laws aimed at forcing companies to pay more tax on revenue generated in the UK, Facebook announced in March that it would soon alter how it paid tax in The UK. The changes will potentially lead to the company paying millions of dollars more on its operations in the country.

Box 1: EU Investigations against Tech Giants

Google

In April 2015, the Commission opened an anti-trust investigation on Google for alleged accusations that the tech giant abused its dominant position and hindered its competitors from growing or entering the market, when it created its Android operating system and applications for tablets and mobile phones. The Commission will investigate whether these practices constitute a breach of the Article 101 TFEU, prohibiting abuse of the dominant position. Google's investigation will focus on three areas: Its practices to drive

⁵² Interview with DG TAXUD.

⁵³ European Parliament Directorate-General for Internal Policies Policy Department A Economic and Scientific Policy In-depth Analysis for the ECON Committee (2015 'Presentation: Challenges for Competition Policy in a Digitalised Economy, p.22.

⁵⁴ U.S. Department of the Treasury (2025) Testimony of Robert B. Stack, Deputy Assistant Secretary (International Tax Affairs) Before the Senate Finance Committee.

manufacturers to only install Google applications while manufacturing devices with the open source Android system, stopping manufacturers from altering Android versions on other smartphones, bundling Google products and services distributed on Android devices with other Google applications.⁵⁵

Apple

The European Commission launched a state aid investigation in June 2014⁵⁶ to examine whether transfer pricing arrangements offered by Ireland to the multinational company in the form of tax rulings would violate the EU's state aid rules under the Article 102 TFEU. The problematic preferential treatment allegedly covers calculations of taxable profits of Apple Sales International and Apple Operations Europe to its Irish subsidiaries.⁵⁷ The investigation is taking longer than predicted due to large volumes of material.⁵⁸

Amazon

In October 2014, the European Commission opened a formal state aid investigation in relation to alleged aid to Amazon via a tax ruling. Preliminary findings in January 2015 confirm that a sweetheart deal between Luxembourg and Amazon permitted to the company to pay less taxes than it is due and breached the competition rules of the Union. In May 2015, Amazon decided to change its tax structure and began paying taxes in several EU countries instead of locating almost all of its sales in Luxembourg. This may be a direct result of pressures stemming from the EU investigations.⁵⁹ Separately, the European Commission opened a tax probe on Amazon for abuse of dominance, accusing the company of 'diverting traffic from its rivals to favour its own products and services, particularly websites for shopping.' The Commission examines a possible abuse of dominant position 'in the region's e-books market to make it harder for rivals to offer lower prices'.⁶⁰

The EU's tax probe on Fiat and Starbucks resulted in relatively small bills (EUR 30 million of repayment in taxes) but bigger bills may be expected for the investigations against Ireland and Luxembourg on Apple Inc. and Amazon.com, respectively. The question remains whether the UK and the US will change their transfer pricing rules, which is crucial for combatting stateless income.⁶¹

⁵⁵ European Commission Fact Sheet, Antitrust: Commission opens formal investigation against Google in relation to Android mobile operating system, 15 April 2015 (http://europa.eu/rapid/press-release_MEMO-15-4782_en.htm).

⁵⁶ European Commission Press Release, State aid : Commission investigates transfer pricing arrangements on corporate taxation of Apple (Ireland), Starbucks (Netherlands) and Fiat Finance and Trade (Luxembourg), 11 June 2014 (http://europa.eu/rapid/press-release_IP-14-663_en.htm).

⁵⁷ New York Times, How Europe is Going After Google, Amazon, and Other U.S. Tech Giants, 20 April 2016 (http://www.nytimes.com/interactive/2015/04/13/technology/How-Europe-Is-Going-After-U.S.-Tech-Giants.html?_r=0).

⁵⁸ Reuters, EU Apple Investigation to Take Longer Due to Amount of Material Involved; Hard to Predict When a Decision Will be Reached-Antitrust Chief, 4 April 2016 (<http://www.cnbc.com/2016/04/04/reuters-america-eu-apple-investigation-to-take-longer-due-to-large-amount-of-material-involved-hard-to-predict-when-a-decision-will-be.html>).

⁵⁹ New York Times, How Europe is Going After Google, Amazon, and Other U.S. Tech Giants, 20 April 2016 (http://www.nytimes.com/interactive/2015/04/13/technology/How-Europe-Is-Going-After-U.S.-Tech-Giants.html?_r=0).

⁶⁰ New York Times, How Europe is Going After Google, Amazon, and Other U.S. Tech Giants, 20 April 2016 New York Times, How Europe is Going After Google, Amazon, and Other U.S. Tech Giants, 20 April 2016 (http://www.nytimes.com/interactive/2015/04/13/technology/How-Europe-Is-Going-After-U.S.-Tech-Giants.html?_r=0).

⁶¹ Bloomberg Businessweek After Blow to Europe Tax Havens, Some Promise More Staying Power Bloomberg Business, 22 October 2015.

3.3. Common Tax Avoidance Practices

3.3.1. Avoiding Taxable Presence in the Market Country Due to the Difficulty to Determine Tax Jurisdiction or Nexus

Highly mobile intangibles and multi-sided business models make the digital sector elusive for national tax systems and 'may lie at the heart of any effective recalibration of how international taxation rules and guidance respond to changing patterns and characteristics of multinational and global businesses'.⁶²

Under current international rules, remote sales by an e-tailor do not create taxable presence but the presence of capital (such as a stand-alone server) is sufficient to establish tax jurisdiction. This situation may be aggravated by the widespread use of 3D printers at home and workplaces.⁶³

Hence, the concept of PE is not relevant for digital companies such as a web store as it does not necessitate a physical presence. Open markets, intangibles and the Internet make it possible for businesses to supply markets and to generate virtual profits without any need for legal or physical presence at the local level.⁶⁴

This so-called cyberisation of tax base can occur by conducting business in a country through a website without physical presence or replacing conventional sales outlets in the market with online licensing of software or specifications if the products can be produced through 3D printing, for instance.⁶⁵

The PE can be described as the country, where the source of income of a business is generated. According to the OECD, the source of income is 'the jurisdiction, in which value creation occurs'.⁶⁶

The country of residence, on the other hand, refers to the country, where effective management takes place. All bilateral income tax treaties are based on this concept and their aim is to prevent double taxation in the international economy. Accordingly, the source country has the primary right to tax income on a net income basis while imposing withholding tax on interest, dividends and royalties. The residence country may tax the income but is obliged to offset double taxation through a credit for source country tax or exemption of the income. According to the non-discrimination principle, the source country is bound to treat domestic and foreign business in an equal way.⁶⁷

While it is still debatable whether value creation occurs, where a platform is created, developed, managed or its services are provided, it is clear that it does not occur in tax havens, where the platform only owns a shell company.⁶⁸

3.3.2. Avoiding Withholding Tax

A non-resident company can be asked to pay taxes in a country, where it generates income via payments such as interest or royalties. This type of taxation is called withholding tax and

⁶² Ault, Schon and Shay, p. 278.

⁶³ De Wilde, p. 800.

⁶⁴ De Wilde, p. 797.

⁶⁵ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 31.

⁶⁶ OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing, (<http://dx.doi.org/10.1787/9789264202719-en>).

⁶⁷ Ault, Schon and Shay (2014), p. 276.

⁶⁸ OECD Tax Centre, (<http://www.bloomberg.com/news/articles/2016-04-06/the-sharing-economy-doesn-t-share-the-wealth>).

intends to tackle characterisation issues by imposing a tax on certain payments made by residents of a country for digital goods or services provided by a foreign provider.⁶⁹

Tax treaties between jurisdictions of the payer and recipient may be abused by treaty shopping to avoid the payment of withholding taxes in the high-tax jurisdiction by means of establishing shell companies in low tax jurisdictions.⁷⁰ MNEs often make use of tax havens or special tax regulations for this purpose. It has been revealed by the Consortium of Investigative Journalists that Luxembourg, for instance, has approved complex tax saving models, developed by PriceWaterHouseCoopers (PwC), with MNEs such as Amazon, allowing the companies to pay close to zero tax on profits.

Such cases, which are referred to as double non-taxation, involve a complex mechanism, which allows for the non-payment of withholding taxes in the source country and in the intermediary countries. As the ultimate tax collection occurs in a tax haven, it amounts almost to zero.

Separately, developing countries complain about a misbalance of tax rights in tax treaties including limitations to withholding taxes, which is also acknowledged by international bodies. NGOs addressing these issues recommend that development implications of tax treaties shall be taken into consideration.⁷¹

Box 2: The Double Irish Scheme: The Case of Google

While Google operates in countries with tax rates having an average of 20 %, it managed to keep its tax rate only at 2.4 % by using a complex model called the Double Irish scheme.

The license for the search and advertising technology of Google Ireland is issued at the Google headquarters in Mountain View, California, US, where most of the technology is developed. Yet, when companies in Europe, Middle East and Africa place a search ad at Google, they make the payment to Google's subsidiary in Ireland.

Thanks to a licensing agreement, it avoids paying withholding taxes at the source country and shuttles its overseas profits to an Irish subsidiary in Dublin at the arm's length price (the same price as an unrelated company would pay). As licensing fees from the Irish subsidiary are subject to 35 % withholding taxes in the US, the price is set at the lowest possible level. Relying on its subsidiary in Ireland and Irish local tax laws, Google manages to avoid both 35 % top rate in the US and 12,5 % income tax in Ireland.⁷²

This is made possible by payments of royalties to Google Ireland Holdings, which has its 'effective management centre' in Bermuda. The subsidiary in Bermuda is an unlimited liability company and is not required to disclose financial information, such as income statements and balance sheets, under Irish rules.⁷³

Since Ireland does not have a tax treaty with Bermuda and imposes a withholding tax, Google sends the payments to a shell company in the Netherlands (Google Netherlands Holdings), where there are tax exemptions for dividends and capital gains accrued overseas. Due to double taxation agreements between the Netherlands and tax havens,

⁶⁹ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 36.

⁷⁰ OECD Final Report (2015) Addressing the Tax Challenges of the Digital Economy, Action 1, p.81.

⁷¹ ActionAid 'Mistreated: The tax treaties that are depriving the world's poorest countries of vital revenue'.

⁷² Bloomberg Businessweek, 'The Tax Haven That's Saving Google Billions', 2010.

⁷³ Bloomberg Businessweek, 'Google 2.4 % rate shows how 60 dollars billion is lost to tax loopholes', 2010.

such as Bermuda, the subsidiary in the Netherlands sends the payments to another Irish subsidiary of Google based in Bermuda.

Although the aim of these tax treaties are to avoid double non-taxation, they result in double non-taxation as Google escapes the 12.5 % Irish income tax at the place of its incorporation and it escapes the 35 % US tax at the place of its corporate management.

3.3.3. Eliminating or Reducing Tax in Various Jurisdictions

Commonly used methods by companies to eliminate or reduce tax in the country of residence or in the intermediate country may include preferential tax regimes, the use of hybrid mismatch arrangements or excessive deductible payments.⁷⁴ Some of these methods will be discussed in the next section.

3.4. Major BEPS Risks in the Area of Direct Taxation

The most commonly used methods for base erosion and profit shifting by MNEs are:

- Preferential tax regimes: MNEs use subsidiaries for marketing or technical support to enable faster customer access to digital products while the principle company bears the risks and claims ownership of intangibles. Thus, they locate Intellectual Property (IP) such as brands, copyrights, patents, licences etc. in low tax jurisdictions (or in jurisdictions where they are offered preferential tax regimes), where other subsidiaries pay royalties.⁷⁵
- Artificial internal trading of intangibles: The profit shifting may happen through artificial internal trading of intangibles, such as management fees or international property licensing.⁷⁶
- Thin capitalisation: A company may reduce risk at local company level by limiting capitalisation. A local subsidiary of a business selling online products may have a warehouse with limited earnings.
- Internal debt shifting: In cases where a subsidiary is heavily indebted to another one, the high interest rates decrease the tax base of one subsidiary while increasing the profits of the other.
- Transfer pricing: A company may sell goods and merchandise between subsidiaries at a very high price to make some subsidiaries richer or poorer artificially. It may sell services (i.e. management or consultancy) to its subsidiaries, which may be even imaginary services.
- Artificial contractual arrangements: Functions may be carried out by local contractual staff not having authority to conclude contracts on behalf of a non-resident enterprise.⁷⁷
- Circumvention of Controlled Foreign Company (CFC) rules: Complex hybrid arrangements (double non-taxation, double deduction, long-term deferral) may be designed to benefit from different tax systems and their dealings with financial instruments, asset transfers or entities with the aim of circumventing CFC rules.

⁷⁴ OECD Final Report (2015) Addressing the Tax Challenges of the Digital Economy, Action 1, p.81.

⁷⁵ Point Sud (2013), p.22.

⁷⁶ Global Tax Justice (2014) Tax and transparency fact-finding mission. Obstacles, solutions and Windows of opportunity for progress towards financial transparency and tax justice.

⁷⁷ OECD Public Discussion Draft. BEPS Action 1: Address the Tax Challenges of the Digital Economy. 24 March 2014 – 14 April 2014.

3.4.1. Preferential Tax Regimes

Patent Boxes

A patent box (Intellectual Property Box) is a tax advantage offered to companies for income earned from intellectual property. IP box tax rates are in general applied to IP profits and they allocate IP expenses (management expenses or financing costs) to IP income. Many MNEs misuse this tax break to reduce their tax base and to shift big amounts of profits to patents in low tax jurisdictions.

According to a report by the European Commission of 2015⁷⁸, patent boxes do not favour innovation but serve as a means for MNEs to shift their patents without necessarily increasing their research activities or the number of personnel involved in inventions.⁷⁹ Their effects are mainly of a 'tax nature'.

It is difficult for tax authorities to tax intangible assets and to prevent IP income from shifting abroad. It is also a major concern that companies are establishing their R&D and innovation activities, which have positive spill-over effects for other countries in fiscal terms.⁸⁰

The intellectual property such as patents, trademarks and copyrights constitute a challenge as they lack a fixed location (absence of nexus) and therefore can be easily relocated at non-tax costs.

In the UK, a tax incentive is given for returns on earnings from patents and other innovations, which reduces the tax rate to 10 %. The UK announced intentions to introduce limitations to align itself to the OECD's Modified Nexus Approach.⁸¹

Member States introducing patent boxes in the EU are multiplying and concerns are raised whether this would lead to a race to the bottom. Even the US announced that it was going to take the EU as an example to introduce its own patent boxes and a consensus was reached in the US Congress in 2015 to move in this direction.⁸²

France and Hungary, introduced such regimes in 2003, and the Netherlands and Luxembourg followed suit in 2007. In 2015, 11 EU Member States as well as Liechtenstein and the Swiss Canton of Nidwalden had an IP box regime in place. Whereas tax rates for such regimes are 0 % in Malta and 2,5 % in both Cyprus and Liechtenstein, they can go up to 15 % in France. The Netherlands, for instance, has a scheme of tax credits and enhanced allowance in addition to patent boxes, called Innovatiebox. The patent box brings down the tax rate to 5 % from 20-25 % on profits of which at least 30 % originate from patents.⁸³

The scope of eligible types of IP, IP income and treatment of expenses is varying across countries.⁸⁴ The widest range of eligible types of IP can be found in Switzerland, Cyprus, Hungary, Liechtenstein and Luxembourg, which apply to designs, models, trademarks, copyrights (software etc.) and other types of intangibles in addition to patents.

A study conducted by the European Parliament highlights that IP regimes in Belgium, the Netherlands, and the United Kingdom genuinely focus on R&D investment and innovation,

⁷⁸ European Commission (2015), Patent Boxes Design, Patents Location and Local R&D.

⁷⁹ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 20.

⁸⁰ European Parliament Directorate-General For Internal Policies Policy Department A Economic and Scientific Policy. In-Depth Analysis for the TAXE Special Committee (2015) Intellectual Property Box Regimes, p.5.

⁸¹ Arbeiterkammer, 'Tax Avoidance, Tax Evasion, Tax Havens', May 2015, p.23.

⁸² Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.20.

⁸³ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system', p. 83.

⁸⁴ European Parliament Directorate-General For Internal Policies Policy Department A Economic and Scientific Policy. In-Depth Analysis for the TAXE Special Committee (2015) Intellectual Property Box Regimes, p.5.

while other IP regimes are favourable to lure mobile IP income as is the case for Cyprus, France, Hungary, Malta and the Swiss canton of Nidwalden.⁸⁵

Especially, the patent boxes in Cyprus introduced in 2012 and in the United Kingdom in 2013 were very controversial as doubt was cast upon their being against the EU competition rules (constituting a state aid due to harmful tax competition). For instance, the Cypriot IP box regime 'applies to a wider range of income than any other European scheme' and does not impose limitations on benefits to income generated by 'patents and supplementary patent certificates'.⁸⁶ Although the patent box in Spain covers a large variety of IP patents, models, designs, formulae, plans and know how and 60 % of tax exemption for income is derived from transfers of intangible assets⁸⁷, the Spanish IP box was not classified as state aid by the European Commission.⁸⁸

Similar incentives can involve tax credits given for R&D, which can also be misappropriated. For instance, the French Senate in December 2014 launched an investigation on the CIR (Crédit d'Impôt Recherche), a tax credit granted for R&D, for allegedly misappropriating the incentive to siphon off money instead of recruiting researchers.

It is a major concern that the patent boxes are becoming more and more widespread as they are considered just after the necessary measures were taken to close the ones related to the Double Irish scheme. For instance, Ireland is set to introduce a patent box regime aiming to tax companies at a rate of 6.25 %.⁸⁹

Tax Rulings

In November and December 2014, the Lux Leaks shed light to secret tax rulings with hundreds of MNEs in Luxembourg. In 2015, Swiss Leaks revealed financial information about thousands of clients in a Swiss bank. These leaks clearly show how tax rulings are used to avoid large amounts of tax payments by MNEs.

These rulings also referred to 'sweetheart deals' include information by financial authorities that are legally binding. Although their aim is to give legal certainty and clarity to various tax questions that may arise, they are used to decide in advance how certain tax situations will be dealt with.⁹⁰

Tax rulings may include Advanced Price Arrangements (APA) to make the tax position of a company clear and to obtain a guarantee in advance that tax administrations will not challenge these practices. But sometimes they are used to 'legitimise tax avoidance' unless they are made public. Even in the aftermath of the Lux Leaks, the number of tax rulings and APAs are increasing, which is rather alarming. According to the European Commission APAs issued by Member States to MNEs increased by 50 % between 2013 and 2014.⁹¹

Denmark, for instance, modified its APA procedures, which allows to disregard a ruling if the value of transferred assets is significantly different from the value approved in the ruling, justifying this change by difficulties of pricing intellectual property correctly.⁹²

⁸⁵ European Parliament Directorate-General For Internal Policies Policy Department A Economic and Scientific Policy In-Depth Analysis for the TAXE Special Committee (2015) Intellectual Property Box Regimes, p. 7.

⁸⁶ Policy Directorate General for Internal Policies Department A: Economic and Scientific Policy TAXE2 Delegation to Cyprus 14-16 April 2016.

⁸⁷ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 93.

⁸⁸ European Parliament Directorate-General For Internal Policies Policy Department A Economic and Scientific Policy. In-Depth Analysis for the TAXE Special Committee (2015) Intellectual Property Box Regimes, p.9.

⁸⁹ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.71.

⁹⁰ Arbeiterkammer (2015), Tax Avoidance, Tax Evasion, Tax Havens, p. 24.

⁹¹ Interview with Eurodad.

⁹² Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 53.

3.4.2. Transfer Pricing

A transfer price is the price that is set for the exchange of goods and services between various subsidiaries of a corporate group. According to the OECD's arms-length principle, subsidiaries of a group are treated as if they were legally independent companies and their transactions are organised following standard transaction related methods and profit methods. The original aim of this principle was to ensure that all countries could share the profits as if they were made by a legally independent company.⁹³ Yet, it is criticised for having 'failed in its declared goal of creating markets inside multinational corporations where they do not really exist.' The OECD acknowledged in the 1960s that market based prices are often nowhere to find, allowing the use of formulary methods for calculation of the prices that corporations use in intra-firm trade.⁹⁴

MNEs can use transfer pricing to attribute income to tax havens by arbitrarily inflating prices for goods and services. This is a widespread practice in the digital sector where intangible assets such as patent rights, royalty rights or marketing rights can be established in low-tax jurisdictions or tax havens. Other subsidiaries based in high-tax jurisdictions then have to pay royalties for these intangible assets (company names, software licenses etc.), which can be deducted from their tax base as operating expenses.

3.4.3. Artificial Contractual Arrangements to Avoid PE

Under the current system, many companies are artificially avoiding the PE status while maintaining some form of physical presence in the market country by use of limited-function distributors or commissionaire arrangements, utilisation of toll manufacturing or contract manufacturing contracts, artificial fragmentation of activities to avoid temporal requirement of PE or to qualify for the exceptions to PE status for preparatory and ancillary activities under the Article 5(4) of the OECD Model.⁹⁵

For instance, the use of a fixed place of business to purchase, warehouse and deliver merchandise may be an activity of preparatory or auxiliary nature for traditional businesses while constituting a substantial or core activity for e-commerce. Similarly, online or Internet sale of digital goods and digital services is a core business of an enterprise requiring no physical stores, agencies or assets but could be defined as preparatory or ancillary activity according to these exceptions. Finally, it is difficult to talk about residence when it comes to cloud computing.⁹⁶

The exceptions under Article 5(4) of the OECD Model Tax Convention⁹⁷ can give rise to the following practices of MNEs to avoid PE status. Moreover, tax residence or physical location is disregarded by the customer and does not influence his/her choices.

- Migrating services that can be provided in person to cyberspace and keep in-person services at a minimum which gives no rise to PE.
- Converting royalties into services fees and avoid withholding tax by transforming technical services or provision of software etc. into services delivered online ; and

⁹³ Arbeiterkammer (2015) Tax Avoidance, Tax Evasion, Tax Havens, p.25.

⁹⁴ Tax Justice Network (2015) Taxing corporations: The Politics and Ideology of the Arm's Length Principle.

⁹⁵ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 28.

⁹⁶ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, pp.34-35.

⁹⁷ OECD (2014) Model Convention with Respect to Taxes on Income and on Capital (<https://www.oecd.org/ctp/treaties/2014-model-tax-convention-articles.pdf>).

- Monetising location relevant data created by local customers without any compensation.⁹⁸

3.4.5. Hybrid Mismatches to Avoid PE

Hybrid mismatches are arrangements designed to benefit from different tax systems and their dealings with financial instruments, asset transfers or entities with the aim of double non-taxation. For example, MNEs take advantage of differences in tax regulations by using a financial instrument, which can be regarded as equity (deductible) in one country but as dividend (tax-exempt) in another.

3.4.5. Issues Arising from Different Approaches to Corporate Tax

Some argue that corporate tax avoidance is immoral, especially in the wake of the financial crisis, where a big part of the population had to put up with austerity measures on the one hand, and multi-billion dollar companies could get away with paying no taxes, on the other.⁹⁹ At the same time, countries may be wary about taking defensive measures to combat tax avoidance as it should neither come at the expense of capital flights nor should it lead to fingerpointing by competitors as a country hostile to investors.

For countries such as Luxembourg, it is profitable to have a low tax system. At the same time, high-tax countries have a social system with higher needs for infrastructure. These countries may choose to protect their tax base even though it would make them less attractive for foreign investors. Therefore, achieving coordination with so many Member States having different interests in the area of taxation becomes a great challenge. Member States are furthermore constrained by the obligation stipulated by the Article 150 of the TFEU on the functioning of the Single Market to avoid the creation of tax obstacles.

There is a sense of injustice, especially considering that MNEs already pay generally less on tax than they used to pay 20 or 30 years ago, the new global average now being 23-24 % from 40 %. The UK's tax rate, for instance, has fallen from 30% to 22.6% in the last five years.¹⁰⁰

Yet, the MNEs are rather untroubled by their aggressive tax planning habits as they argue that there is no correlation between the recent rise of e-commerce as a sales platform and the corporate income tax base, attributing the falling share of taxation in the GDP to the debt crisis in the euro area.¹⁰¹ They disregard their share for the loss of taxable income in the digital economy, pretending that profit shifting and tax havens are problems, which existed before the Internet while arguing that issues related to transfer pricing and hybrid mismatches are a natural result of capital mobility and capital account liberalisation.¹⁰²

The fact that governments create incentives and mismatching opportunities in their fiscal policies is seen by some as 'healthy' tax competition by MNEs and they believe that only tax harmonisation would bring an end to it. As investors expect MNEs to maximise their post-tax

⁹⁸ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p.31.

⁹⁹ Tax-News (2016) Time to Kill Corporate Tax, p.3.

¹⁰⁰ Tax-News (2016) Time to Kill Corporate Tax.

¹⁰¹ ECIPE Occasional Paper No.4 (2014) OECD / G20 BEPS: Reconciling Global Trade, Taxation Principles and the Digital Economy, p.4.

¹⁰² ECIPE Occasional Paper No.4 (2014) OECD / G20 BEPS: Reconciling Global Trade, Taxation Principles and the Digital Economy, p.6.

earnings (and not pre-tax earnings), they find it natural that MNEs are responding to government's incentives.¹⁰³

MNEs further argue that the effective tax rates (income tax paid as a measure of pre-tax earnings) paid by US tech firms such as Facebook or Amazon are actually higher than those of most major European MNEs. They further compare Google and eBay's effective tax rates, at 19.91 % and 16.32 % respectively, to European industrial champions such as Volkswagen and Renault.¹⁰⁴

Some even take it a step further and advocate for the abolishment of corporate tax and its replacement by a revenue based tax while supporting the idea of taxing corporate sales.¹⁰⁵ But others such as Tax Justice Network opine that it curbs political and economic imbalances, protects democracy, boosts financial transparency and accountability, curbs criminal behaviour, underpins economic growth and raises revenues essential for public services.¹⁰⁶ A just balance shall be struck between these two fundamentally different approaches, which would allow for productivity and growth without harming public interests and draining public revenues.

3.5. Major BEPS Risks in the Area of Indirect Taxation

While income tax is a levy on our salaries, VAT is payable on items purchased. Traditional international sales were effectuated with customs collecting duties and filling forms with costs yet one cannot view the forms filled by a customs officer in the case of an online purchase as it is only sent from supplier to user. Hence, attaching VAT to online sales constitutes a big challenge, especially because there is no intermediary involved.¹⁰⁷ E-commerce can be carried out through emails, websites, distance selling, digital downloads etc. Whether e-commerce should be taxed has been a matter open to discussion as more and more transactions are carried out online.¹⁰⁸

There are three main challenges arising from the digital sector in the area of VAT. First, the rates are different in each country. Second, physical versions of digital goods are sometimes taxed at lower rates. Third, certain suppliers such as post service providers may obtain advantages to distribute online goods.¹⁰⁹

In the real world, we would tax auctions, sales of goods and services, distribution of music, films and television programmes, gambling websites and educational services but it is rather problematic to tax these online for the following reasons: Anonymity, difficulty to determine the amount of tax, lack of paper trail, tax havens, companies incurring liability in multiple countries, tax administration's lack of capacity to identify companies and to supervise and manage consumption taxes.¹¹⁰ For example, the US Internal Revenue Service had recourse to external consultants to help with the auditing on Microsoft, which cost USD 2 million.¹¹¹

¹⁰³ ECIPE Occasional Paper No.4 (2014) OECD / G20 BEPS: Reconciling Global Trade, Taxation Principles and the Digital Economy, pp.6-7.

¹⁰⁴ ECIPE Occasional Paper No.4 (2014) OECD / G20 BEPS: Reconciling Global Trade, Taxation Principles and the Digital Economy, p.5.

¹⁰⁵ Tax-News (2016) Time to kill corporate tax, p.7.

¹⁰⁶ Tax-News (2016) Time to kill corporate tax, p.7.

¹⁰⁷ Rogers (2011), p.88.

¹⁰⁸ Rogers (2011), p.86.

¹⁰⁹ European Parliament Directorate General for Internal Policies Policy Department A. Economic and Scientific Policy (2012) Simplifying and Modernising VAT in the Digital Single Market.

¹¹⁰ Rogers (2011), p.85.

¹¹¹ Tax Justice Network, So: What kinds of corporate tax schemes won't BEPS stop.

'The problem of cyberisation affects VAT collection. It is impossible in Business to Consumer (B2C) transactions if the foreign online vendor has no physical presence and does not register for VAT in the market country. In Business to Business (B2B) transactions, if the purchased goods or services qualify for input tax credit to the local business purchaser, the VAT revenue loss may be insignificant.'¹¹²

Cross border trade creates new challenges for VAT systems in the absence of an international framework to register and manage payments to a large number of tax authorities whereas managing tax liabilities by a high volume of low value transactions is administratively difficult.

There are two issues to be addressed regarding consumption tax or VAT: Exemptions for imports of low valued goods and remote digital supplies to consumers.

Critics highlight that the trend to introduce 'regressive, indirect taxes' is being 'complemented by a hollowing out of progressive direct taxes on high-income earners and capital as it can be testified by 'sharp personal income tax rates of almost 30 % on average since 1980'.¹¹³ Hence, a balanced policy approach should focus both on direct and indirect taxation and avoid the use of the latter to compensate for the lack of the former.

¹¹² United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p.31.

¹¹³ Christian Aid (2014) A Post-2015 Fiscal Revolution Human Rights Policy Brief Center for Economic and Social Rights, p.10.

4. ARE SPECIAL TAX MEASURES IN THE DIGITAL SECTOR NEEDED?

KEY FINDINGS

- There is a general consensus that ring-fencing the digital sector would be against the tax neutrality principle. The rapid digitalisation of all sectors in the economy as well as concerns about productivity losses also justify that isolation of the digital sector would not be the way forward.
- In its report of 2015 on taxation and digital sector, the OECD mentioned some far-reaching reforms such as the conception of a single firm, modification of source and residence and deemed PE, while providing several possibilities, including fractional apportionment, deemed profit methods, withholding tax on digital transactions and equalisation levy. In our view, immediate action is needed to advance this so called 'Beyond BEPS' strategy and to make it happen sooner than later as some of the reforms may take 5 or more years.
- EU Member States and some third countries experimenting with or flirting with the idea of the introduction of specific taxes on the digital economy. The European Commission raised doubts about these specific measures because of their impractical, irrational or temporary nature while not excluding the possibility for some out-of-the box thinking within the boundaries of the existing system.
- Within the existing system, it would be feasible to redefine the Permanent Establishment status for the digital sector according to a formula including amount of sales, customers, selling agents etc. which would enable to calculate profits.
- One should also ensure that digital companies such as Google and Amazon generating money by sales, content and auxiliary services and having Internet presence in one country constitute a deemed PE.
- Many economists and activists are arguing that it is time to change the existing system, starting with the OECD's arm's length principle.
- The US tax system is undergoing a major reform, which is worth keeping an eye on.
- To reform the tax system in the US, the Obama administration proposed a minimum tax of 19 % on global earnings of US companies, regardless of whether the income is repatriated to the US and imposed 'limits on deferral of overseas income and use of corporate structures that leave some income untaxed by any country.' The EU and the US have not reached an agreement on automatic exchange of information as the US didn't adopt the reciprocity principle. This makes the US a tax haven by choice.

Public comments on the OECD 2014 Discussion Draft¹¹⁴ underline that the digital economy cannot be ring-fenced; the Ottawa Convention is a good starting point for discussion; the digital economy does not create BEPS challenges exclusive to the sector; and broader tax

¹¹⁴ OECD (2014) Public Discussion Draft BEPS Action 1: Address the Tax Challenges of the Digital Economy.

challenges raised by the digital economy should be addressed after all the BEPS measures are developed.¹¹⁵

The OECD report of the Task Force on the Digital Economy (TFDE) under Action 1 of the BEPS project¹¹⁶ generally supports these ideas and does not recommend any specific action considering the digital sector.

Whereas many agree that ring-fencing the digital economy would not be the way forward as the digital sector affects the entire economy, some consider it appropriate to take sector-specific measures.¹¹⁷ Many argue if special taxes for the digital economy were introduced, it would be 'discriminatory taxation on productivity-improving activities'.¹¹⁸ Goolsbee believes that it is more beneficial to support economic growth of the digital sector instead of introducing specific taxes. Furthermore, he argues that taxation of e-commerce would be cumbersome not to mention the difficulties with regards to its enforcement. He stands against specific taxation of digital goods as they constitute 'a tiny fraction of online purchases and will continue to be small for many years'.¹¹⁹ This may not be a valid argument, as online purchases have become the norm in the past few years and continue to do so.

1998 Ottawa Principles regarding taxation are based on the principle of neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility.¹²⁰ There is a certain level of consensus to keep the Ottawa principles as a basis for tax reform underscoring that ring-fencing the digital economy would violate the tax neutrality principle.

At the same time, one cannot ignore the fact that the digital economy poses a challenge to the existing PE test and transfer pricing rules, which could be addressed in the long run. Falcao and Michel, for instance, perfectly illustrate how a digital company can provide a number of services to different countries without paying taxes where the revenue is generated.¹²¹

The OECD report on the Digital Economy touches upon the conception of a single firm, modification of residence and source, deemed PE etc.

The report identifies far-reaching reforms such as a taxable nexus based on significant economic presence, resulting in a greater allocation of taxable base to the country of sales. This relates to the concept of unitary approach and the revision of the rules regarding the attribution of profits. The report includes several possibilities such as fractional apportionment, deemed profit methods, a withholding tax on digital transactions and an equalisation levy.

But these reforms are seen as part of a 'Beyond BEPS' strategy, which could be realised within five years time or more. In our view, immediate action is needed to advance this strategy and to make it happen sooner than later.

According to BEPS Monitoring Group, these conclusions may be seen through a different lens in the future as the digital economy is continuously evolving in the areas of robotics, the

¹¹⁵ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p.37.

¹¹⁶ OECD Final Report (2015) Addressing the Tax Challenges of the Digital Economy, Action 1, p. 12.

¹¹⁷ Lehr and Pupillo (2009), p. 9.

¹¹⁸ ECIPE Occasional Paper No.4 (2014) OECD / G20 BEPS: Reconciling Global Trade, Taxation Principles and the Digital Economy, p.10.

¹¹⁹ Goolsbee (2009), p.147.

¹²⁰ OECD (2001) Taxation and Electronic Commerce Implementing The Ottawa Taxation Framework Conditions (<https://www.oecd.org/tax/consumption/Taxation%20and%20eCommerce%202001.pdf>).

¹²¹ Falcao and Michel (2014).

Internet of Things, 3D printing and the Sharing Economy.¹²² Cloud technology, big data, autonomous vehicles and automation of knowledge work are other technological trends that shall be closely followed as they have a potential impact on the future of the digital economy.¹²³

4.1. Unitary taxation with formulary apportionment system

According to BEPS Monitoring Group, an unresolved issue in the current international tax system remains the establishment of unitary taxation, which is referred to as the most effective system in highly integrated market, where firms have a right of establishment. The unitary taxation system already exists in confederal states such as Canada, the US and Switzerland. Accordingly, the profit split method would be used for transfer pricing. The MNE should be considered as a single firm and profit should be allocated according to economic activity in each country. Such reforms could take five years,¹²⁴ yet this is a relatively short period taking into account the fact that the existing taxation principles were put in place more than 100 years ago and are deemed by many as inefficient.

Many argue that the OECD's arm's length principle, lying at the heart of the transfer pricing issue remains untouched by the proposed BEPS measures. According to the arm's length principle, which is defined in Article 9 of the OECD Model Tax Convention, all cross border operations between subsidiaries of the same group shall be made at a market price and this price should be equal to the price applied to operations between independent companies. The objective of the principle is to avoid artificial delocalisation and to make every subsidiary declare its real profits in one given country. It is at the discretion of a tax administration to decide whether prices set by a company correspond to market prices and to correct anomalies. At times, it is difficult to define a market price as there may be no comparable prices if the product has no equivalent etc.¹²⁵ The OECD itself acknowledged this fact in the 1960s.¹²⁶

The recent decision on Fiat and Starbucks by the European Commission sent a strong message in a defial to the OECD's arm's length principle by underlining that transfer pricing arrangements were "artificial and extremely complex", 'economically unjustifiable' and 'not reflecting market reality'. Hence, the OECD's guidelines for transfer pricing may not be fit for calculations on transfer pricing.¹²⁷

Some scholars believe that it is absurd to assume that different subsidiaries of one group are independent economic entities all by imagining that they would act amongst each other in an independent manner. In addition, it is very difficulty and costly to generate databases, which serve to compare prices, to identify a market price, and to verify whether the subsidiaries respect the arm's length principle. This is especially relevant to the dematerialised goods such as intellectual property.

An alternative could be the formulary apportionment method, which helps calculating the global profit of an MNE by consolidating all profits in its subsidiaries, after which repartition

¹²² OECD (2001) Taxation and Electronic Commerce Implementing The Ottawa Taxation Framework Conditions (<https://www.oecd.org/tax/consumption/Taxation%20and%20eCommerce%202001.pdf>).

¹²³ European Commission Report on the Commission Expert Group on Taxation of the Digital Economy (2014), p.51.

¹²⁴ BEPS Monitoring Group, BEPS Project, End of the first phase.

¹²⁵ Interview with Antonio Gambini, CNCD.

¹²⁶ Tax Justice Network (2016) Taxing Corporations: The Politics and Ideology of the Arm's Length Principle.

¹²⁷ Interview with ActionAid.

is made among different countries following a formula based on sales, salaries, number of employees.¹²⁸

Today, there is an increasing trend in the world to attribute the tax base to market jurisdiction according to a formula. In Canada, for instance, the formulary allocation system is apportioned 50 % according to the sales factor and 50 % according to the payroll factor.

The EU should start taking the necessary measures for a timely shift to the formulary apportionment model and unitary taxation, which is seen as the only viable solution in the long-term to the main problems related to taxation in the digital sector.

4.2. Virtual PE

The OECD / G20 BEPS Discussion Draft of 24 March 2014¹²⁹ mentioned a new standard for nexus called 'significant digital presence' based on a test for the presence of a virtual permanent establishment (virtual fixed place of business PE, virtual agency PE and on-site business presence PE). The Discussion Draft suggests to define 'fully dematerialised digital activities' to have a Permanent Establishment if they maintain a 'significant digital presence' in the economy of another country.¹³⁰

Accordingly, a website could constitute a virtual PE. A foreign enterprise providing on-site services could be asked to have an onsite business presence PE. The Commission highlights that it is hard to decide how to categorise this kind of taxable presence (virtual, sales PE...). Moreover, the issue of registration is highly debatable as questions arise as to whether or not MNEs shall be registered in the country, where they have their customer base.¹³¹ According to ECIPE, a world-economy think tank based in Brussels, 'digital presence and virtual PE would in essence create a separate tax regime for the digital economy'.¹³² It would not only contradict the OECD's neutrality principle but also the free movement of services in the European single market. Moreover, requiring online services to register locally would not be in accordance with multi- and bilateral free trade agreements on cross border services trade. It could also curb productivity as ICT is the main driver of economic growth.¹³³

Solutions such as virtual Permanent Establishment and quantitative turnover thresholds to withholding taxes on outbound payments for inbound services were suggested in relation with the 'sales only formulary system' in the United States.¹³⁴ Already back in 1993, the Supreme Court of South Carolina had found it sufficient to tax a company which has an 'intangible presence', showing its customers as a real source of income.¹³⁵ Interestingly, a Spanish court in 2013 established taxed nexus by finding a virtual PE.¹³⁶

The OECD position is to characterise payments as services instead of royalties or technical fees. By contrast, the UN Model allows withholding tax on royalty, payment for ICT services, cloud computing and usage of data etc. and tends to characterise payments in the digital

¹²⁸ Point Sud (2013), p.22.

¹²⁹ OECD (2014) Public Discussion Draft BEPS Action 1: Address the Tax Challenges of the Digital Economy.

¹³⁰ OECD Public Discussion Draft. BEPS ACTION 1: ADDRESS THE TAX. CHALLENGES OF THE. DIGITAL ECONOMY. 24 March 2014 – 14 April 2014.

¹³¹ Interview with DG TAXUD.

¹³² ECIPE Occasional Paper No.4 (2014) OECD / G20 BEPS: Reconciling Global Trade, Taxation Principles and the Digital Economy.

¹³³ ECIPE Occasional Paper No.4 (2014) OECD / G20 BEPS: Reconciling Global Trade, Taxation Principles and the Digital Economy, p. 2.

¹³⁴ De Wilde, p.802.

¹³⁵ De Wilde (2015), p. 799.

¹³⁶ Bloomberg, Spanish Court Imposes Tax Nexus by Finding a 'Virtual PE', 9 January 2013 (<http://www.bna.com/spanish-court-imposes-n17179871765>).

sector as royalties.¹³⁷ As a consequence, some countries such as Saudi Arabia are establishing the concept of virtual Permanent Establishment based on the UN Tax Model.

Despite these examples, the concept of virtual PE was discarded in the OECD's BEPS framework. The discussions in the international organisation evolved towards the establishment of a 'deemed PE'. The Discussion Draft of May 2015 under BEPS Action 7¹³⁸ discloses what presumably will be close to the final recommendation of the OECD regarding proposed changes to Article 5(5) of the OECD's Model Tax Convention on Income and on Capital (OECD Model), which sets forth the dependent agent deemed permanent establishment (PE) rule. As such, taxpayers whose current sales entity structures may create deemed PEs under the new standards need to start considering what alternatives they may have.

4.3. Equalisation levy

Is there a need to equalise the losses incurred by digital companies to states by depriving them of advertising revenues?

The Commission highlights this problem by giving several examples: Facebook has around 2000 staff in New York and roughly 1 billion users all around the world. Its value is evaluated at USD 200 billion in the stock exchange. Given that profits per each user are estimated at around EUR 200 per year, the EU countries are being deprived of billions of Euros of tax revenues. Similarly, no advertisement revenue is generated for the country where Google operates without a physical presence through a local website.¹³⁹

On the same note, Amazon separates functions of sales, website operation, customer support, warehousing and order fulfilment. Although it is seen as a single firm from the customer point of view, it has several national websites and operates in a country-specific manner providing services in a given country's language. However, the booking of sales occurs in Luxembourg and it is therefore taxable in the Duchy.¹⁴⁰

To tackle these problems, countries such as India announced a specific measure called the equalisation levy, aiming to level the playing field. Instead of imposing a straight tax on digital advertising platforms, India will charge 6 % on the fees paid by advertisers.¹⁴¹

But the Commission is of the point of view that these challenges are valid not only for the digital economy but for all sectors of the economy. The French champagne, for instance, is sold in the US and Japan, using advertisement platforms in these countries. Following this logic, France should also pay taxes for its advertisements on champagne realised in these countries by means of the digital economy. But it is difficult to have this discussion as some countries want to maintain the status quo. Similar challenges are posed by highly mobile services.¹⁴²

4.4. Further Challenges Posed by the Sharing Economy

Unlike traditional businesses the sharing economy involves an additional player in

¹³⁷ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p.38.

¹³⁸ OECD (2015) Revised Discussion Draft BEPS Action 7: Preventing The Artificial Avoidance of PE Status (<http://www.oecd.org/tax/treaties/revised-discussion-draft-beps-action-7-pe-status.pdf>).

¹³⁹ Interview with DG TAXUD.

¹⁴⁰ BEPS Monitoring Group Response to OECD Request for Input Regarding Tax Challenges of the Digital Economy.

¹⁴¹ The Economic Times 'Equalisation levy of 6 % on digital ad: Government finds a way to tax companies like Google, Facebook, 2 March 2016 (http://economictimes.indiatimes.com/articleshow/51216310.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cpps).

¹⁴² Interview with DG TAXUD.

transactions, which is an online marketplace provider. These transactions are not necessarily treated the same way as traditional businesses are. The new business models of the sharing economy often do not comply with tax reporting standards and sometimes do not take into account business licence registration and insurance issues.¹⁴³

Airbnb and Uber are the most controversial new business models in the sharing or collective economy. Airbnb takes a 13 % commission for each rental of spare rooms advertised on its website. As Airbnb uses the complex tax systems in Ireland and offshore tax havens like Jersey, it avoids paying taxes in the US or elsewhere. It manages to do so by assigning its software IP to a subsidiary in Jersey and shifting profits to the tax haven by royalty payments from its Irish unit.

Uber manages its overseas operations in the Netherlands leaving a taxable base lower than 2 % in the US and shifts its profits to Bermuda through IP assignments in the tax haven.

According to PricewaterhouseCoopers (PwC), the sharing economy will generate USD 335 billion income in comparison to USD 15 billion it generated in 2014.¹⁴⁴

Recently, both companies called on the EU to help the growth of the sharing economy, asking for support for collaborative business models, which boost jobs and growth. Both firms argued that they make better use of resources by allowing for a better match between consumers and suppliers and benefiting households and local businesses while upholding innovation.

While the European Commission recognises the importance of the collective economy by including relevant proposals in the European single market strategy, Member States are taking measures to limit the activities of companies such as Uber.

In December 2015, Belgium asked the CJEU whether Uber services should be subject to regulation under the status of a taxi provider following the example of a similar lawsuit in the US.¹⁴⁵

Several EU Member States, including Belgium, Germany, France have banned the company's UberPOP service on the grounds of lack of professional taxi driver licenses or insurance.¹⁴⁶

Uber filed a complaint to the European Commission, arguing that these bans are against EU competition rules.

It remains to be seen in autumn 2016 whether the Court would decide on Uber's being a digital service or a transport company. If Uber is deemed a digital service, it could benefit from the four fundamental freedoms of the EU, including the free movement of services guaranteed by the TFEU.¹⁴⁷

¹⁴³ PwC (2015) Taxing the Sharing Economy Introduction to the tax issues that may arise from the new sharing economy (<http://www.pwc.com/us/en/industry/entertainment-media/publications/assets/pwc-taxing-the-sharing-economy.pdf>).

¹⁴⁴ Bloomberg Businessweek, The Sharing Economy Does not Share the Wealth, 6 April 2016 (<http://www.bloomberg.com/news/articles/2016-04-06/the-sharing-economy-doesn-t-share-the-wealth>).

¹⁴⁵ Bloomberg, Airbnb Leads Call for EU to Block Nation's Sharing Economy Laws, 11 February 2016.

¹⁴⁶ Euractiv, Uber ordered to shut Brussels service within 21 days, 24 September 2015 (<https://www.euractiv.com/section/digital/news/uber-ordered-to-shut-brussels-service-within-21-days/>).

¹⁴⁷ Outlaw.com, European court to rule on whether Uber a 'digital service' or transport company, 22 July 2015.

4.5. Existing or Potential Specific Measures in Member States

4.5.1 Diverted Tax Profit

On April 2015, the UK established the 'diverted profits tax' or the so-called Google tax at a rate of 25 to counter the artificial erosion of the UK tax base. It circumvents the PE principle and allows the UK to tax MNEs having significant economic activity in the UK, by establishing a nexus in the market jurisdiction. This measure, thus, decreases the possibility of profit shifting by avoiding the use of contractual arrangements aimed at avoiding taxable presence. Amazon took immediate measures to alter its tax structure in the EU following the introduction of this tax.¹⁴⁸

According to the Commission, Member States should go beyond the internationally accepted measures in the area of taxation as outcomes reached at the global level are often unsatisfactory.¹⁴⁹

BEPS Monitoring Group¹⁵⁰ defines the Google tax it as 'a short term palliative measure'. In fact, it fails to provide a clear criterion for attribution of profits but leaves it to the firm to satisfy the tax authority. Ironically, Google believes that the company is not subject to the so-called Google tax.

4.5.2 Bandwidth Tax

Some Member States such as France have come up with ideas to tax digital economy by the introduction of corporate taxes on income generated in the market country, the redefinition of the digital economy including the unpaid nature of work accomplished by Internet users and the identification of data generated by Internet users in a regular manner in the market country. In this context, 'the polluter pays' principle in the environmental area would be applied to the digital sector in the form of 'the predator pays' rule. Furthermore, suggestions have been made to adapt the definition of R&D activities to encompass key characteristics of the digital economy, to reform tax incentives concerning R&D activities and to finance the digital economy by market forces.¹⁵¹

France is considering to tax revenues of tech giants such as Google and Facebook based on their bandwidth rather than on the basis of their reported profits in France.¹⁵² French Minister Fleur Pellerin mentioned plans to introduce a new tax on 'the use of bandwidth', although exactly how this will be calculated is not clear.

Back in 2013, when she was the country's digital economy minister, Pellerin told the Financial Times that 'she was looking at data transfer, traffic and interconnection to work out where the big internet companies were making their money'.¹⁵³

France also suggested to attribute profits to jurisdictions, where users of social media services are located according to the destination principle instead of the origin principle. This

¹⁴⁸ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 98.

¹⁴⁹ Interview with DG TAXUD.

¹⁵⁰ APPG Responsible Tax (2016) Response from BEPS Monitoring Group (<http://www.appg-responsibletax.org.uk/beps-monitoring-group/>).

¹⁵¹ Collin and Colin (2013) Rapport au Ministre de l'économie et des finances, au Ministre du redressement productif, au Ministre délégué chargé du budget et à la Ministre déléguée chargée des petites et moyennes entreprises, de l'innovation et de l'économie numérique.

¹⁵² Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.58.

¹⁵³ The Register, French Minister : Hit Netflix, Google, Apple et al with bandwidth tax, 11 February 2015 (http://www.theregister.co.uk/2015/02/11/french_minister_hit_google_facebook_apple_netflix_et_al_with_bandwidth_tax).

could mean that corporate taxation could move towards the destination principle (from source jurisdiction to market jurisdiction) in a similar way as VAT does.

The two concepts were further discussed in a report published by France Stratégie in 2015¹⁵⁴, which recommended two specific digital taxes:

The first is an ad valorem tax based on revenues (sales or advertising). Accordingly, revenues generated by one-time access should be taxed less than revenue generated by data exploitation. (search data sold to third parties).

The second is a tax based on activity (number of users, flow of data or number of advertisers) concerning collection of data.

The Associations of Community Internet Services criticises these measures for ring-fencing the digital economy. Similarly, the EU Commission believes that it is absurd to create such taxation based on bits, which was actually suggested by the OECD's Discussion Draft in 2014. This would mean that Amazon would be able to sell its goods by only one-click and pay one unit of tax while Spotify would have to pay multiple thousand units of tax as HD quality needs several gigabytes to download.

While arguing that the use of Internet and toll of internet is not a practical idea for taxation matters, the Commission suggests to find solutions in the framework of existing rules.

Within the existing system, it would be feasible to redefine the Permanent Establishment status for the digital sector according to a formula including amount of sales, customers, selling agents etc. which would enable to calculate profits.

One should also ensure that digital companies such as Google and Amazon, generating money by sales, content and auxiliary services and having Internet presence in one country, constitute a deemed PE.

4.6. Reform Efforts in the US Tax System Relevant to the Digital Sector

The US has an outdated tax system with a high corporate tax rate and few tax breaks, which make it easy for profits to flow away from the country. Loopholes in the system make MNEs exempt from paying on their profits not earned in the US.¹⁵⁵ Therefore, they usually acquire their headquarters outside of the US by means of acquisition. The International Centre for Tax and Development estimates that 'the misalignment with economic activity of the profits of US-headquartered multinational groups amounts to more than 20 % of the total', and has been showing a generally increasing trend since the 1990s.¹⁵⁶ Companies outside the US avoid repatriation of their profits to the U.S parent firm as under current U.S. rules, the taxation of income is deferred until the income is repatriated.

The arm's length return to the so-called 'cash boxes' in tax havens, making subsidiaries eligible to no more than a risk-free return if they are mere funders of activities performed by other group members, is a great issue of concern as it causes losses amounting to USD 200 billion. Companies prefer to pay dividends to shareholders or to buy bonds or debt capital in order to avoid the 35 % of repatriated profits. A new U.S tax reform foresees to make amends to this situation by encouraging voluntary tax payments and deemed repatriation.¹⁵⁷

¹⁵⁴ France Stratégie (2015) Taxation and the digital economy. A survey of theoretical models (https://ec.europa.eu/futurium/en/system/files/ged/ficalite_du_numerique_9_mars_13_h.pdf).

¹⁵⁵ Citizens for Justice, The Hidden Entitlements(<http://www.ctj.org/pdf/hident.pdf>).

¹⁵⁶ International Center for Tax and Development (2015), p. 7.

¹⁵⁷ U.S. Department of the Treasury (2025) Testimony of Robert B. Stack, Deputy Assistant Secretary (International Tax Affairs) Before the Senate Finance Committee.

The check the box rules are also problematic. It makes it easy for US companies and others to avoid tax payments. It is relatively common for groups to include hybrid entities, such as 'check the box' entities, especially if the groups are US-headed or have US investments. In comparison to the US, the EU does not face revenue losses stemming from such loopholes in its tax system.¹⁵⁸

To tackle the problem of tax avoidance, the US President Barack Obama proposed a business tax reform including a minimum tax on foreign earnings that represent excess returns, mostly arising from intangible assets. Furthermore, the thin capitalisation rules will be adjusted 'to ensure that groups would not be able to use related party loans to deduct interest expenses well in excess of the group's third party interest expense'. The issue of inverted companies is also being addressed by a proposal to limit the ability of 'U.S. subsidiaries of a foreign multinational to claim interest deductions in the United States that greatly exceed their proportionate share of the group's global interest expense'. To avoid hybrid arrangements, the reform intends to 'deny deductions for interest and royalty payments made to related parties under certain circumstances involving hybrid arrangements'. Finally, the reform proposal intends to modify the definition of intangible property to include 'goodwill and going concern value' while clarifying the valuation rules. Separately, the U.S. is planning to tax certain 'highly mobile income from digital goods and services'.¹⁵⁹

It is important to note that the Foreign Account Tax Compliance Act (FATCA) came into force in 2010 and saw a worldwide implementation under the Obama administration. Accordingly, foreign financial institutions and governments are required to provide information to the US authorities about American depositors of secret bank accounts and are threatened with penalties, including 30 % withholding tax on most transactions, freezing out of the US market and denial of access to US financial market in case of non-compliance. More than 100 nations signed up to the law and FATCA triggered the OECD's efforts on automatic exchange of information. But the US did not join in directly, as it announced that it would share data with other countries based on FATCA in a bilateral manner.¹⁶⁰

More worryingly, nowadays the US is referred to as the new Switzerland, as it continues to resist new global disclosure standards. Resources from former tax havens such as Bahamas and the British Virgin Islands are being moved to Nevada, Wyoming and South Dakota, which are exempt from disclosure.¹⁶¹

To reform the tax system in the US, the Obama administration proposed a minimum tax of 19 % on global earnings of US companies, regardless of whether the income is repatriated to the US. In addition, 'limits on deferral of overseas income and use of corporate structures that leave some income untaxed by any country' were imposed.¹⁶² Proposals for reform of the US international corporate income taxation have been formulated, which combine taxation of worldwide income through CFC rules with a lower tax rate. A political consensus in the Congress has not yet been reached on these proposals.

¹⁵⁸ Deloitte (2015) BEPS Action 2: Neutralizing the effects of hybrid mismatch arrangements (<http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-oecd-16-october-2015.pdf>).

¹⁵⁹ U.S. Department of the Treasury (2025) Testimony of Robert B. Stack, Deputy Assistant Secretary (International Tax Affairs) Before the Senate Finance Committee.

¹⁶⁰ Forbes, Panama Papers Expose Celebs, Politicians, Billionaires With Offshore Tax Havens Despite FATCA, 4 April 2016 (<http://www.forbes.com/sites/robertwood/2016/04/04/panama-papers-expose-celebs-politicians-billionaires-with-offshore-tax-havens-despite-fatca/#6b0f89119209>).

¹⁶¹ Bloomberg, The World's Favourite New Tax Haven Is the United States, 27 January 2016.

¹⁶² Bloomberg Businessweek, The Sharing Economy Does not Share the Wealth, 6 April 2016 (<http://www.bloomberg.com/news/articles/2016-04-06/the-sharing-economy-doesn-t-share-the-wealth>).

On December 18, 2015, the United States Treasury issued a proposal to regulate Country-By-Country Reporting for 'US persons that are the ultimate parent entity of a multinational enterprise group'.

The regulation foresees that 'the US may exchange CBCR information with countries where the US person operates, provided the US has reciprocity provisions in place with that jurisdiction'. The US also set the deadline for completion to 2018 and this rather flexible deadline could mean that the US companies would be not required to report their 2016 financial situation but could be asked to share this information with other countries. To counter this, the US intends to enter into bilateral agreements 'with appropriate countries that have also adopted Country-By-Country Reporting provisions, have appropriate safeguards and infrastructure in place, and with respect to which the US has an income tax treaty or tax information exchange agreement in effect'.

The implementation of the CBCR is questioned in the US by lawmakers due to privacy issues. In this regard, a legislation called the BEPS Act has been proposed, which could limit the amount of information exchanged and even stop the information flow on the grounds of abuse of confidentiality requirements.¹⁶³ Alarming, these legal uncertainties make the future of the automatic information exchange system unpredictable.

The US Congress did not approve the reciprocity principle of the automatic exchange of information. So, in practice the US will be sharing 'very little information with others', including with the EU. And this makes the US a tax haven by choice.

¹⁶³ Lexology (2016) Action 13: Country-By-Country Reporting; Are You Ready? (<http://www.lexology.com/library/detail.aspx?g=9ff88f91-872b-4784-a25d-5ee6102ab331>).

5. ANALYSIS OF BEPS MEASURES RELEVANT TO THE DIGITAL ECONOMY

KEY FINDINGS

The OECD Action 1: 2015 Final Report focusing on the digital economy identifies four solutions with regards to BEPS: Adapting PE status, modifying CFC rules, regulating transfer pricing and eliminating artificial arrangements or contracts. A number of BEPS measures address these issues.

Preventing the Artificial Status of PE: The OECD / G20 BEPS recommends the Modified Nexus Approach in order to adapt the list of exceptions to the definition of the PE.

Harmful Tax Practices: The OECD / G20 BEPS Action No.5 on harmful tax planning and BEPS Action No. 8 on transfer pricing regarding intangible assets are concerned with patent boxes. The Modified Nexus Approach also applies to patents and seeks to ensure that only companies involved in genuine R&D activities can benefit from such advantages. Thanks to a grandfathering rule, companies having obtained advantages under the existing IP regimes until June 2016, will be able to fully benefit from them until the end of June 2021.

Country-By-Country Reporting: The OECD / G20 BEPS calls on MNEs to report financial information, especially about their transfer pricing in relation to tax returns, in every country they operate. However, there is much criticism on the recommendation concerning the size of companies held accountable for reporting as a minimum threshold was set at USD 750 million. The OECD findings show that this would exclude more than 85 % of MNEs while limiting tax administrations' investigative powers.

Treaty Abuse: It is recommended to include General Anti- Abuse Rules in treaties, 'a statutory rule that empowers a revenue authority to deny taxpayers the benefit of an arrangement that they have entered into for an impermissible tax-related purpose.' The questions with regards to burden of proof falling on tax administrations, legal uncertainties and difficulties regarding implementation remain to be addressed.

Transfer Pricing: The OECD / G20 BEPS suggests revisions to its Transfer Pricing Guidelines, including risk, recharacterisation and other specific measures. The proposal does not go so far to discourage transfers taking advantage of ex ante pricing and problems arising from information asymmetry between tax authorities and companies.

CFC Rules: The OECD / G20 BEPS sets out recommendations on how to define CFC, threshold requirements to exclude low risk entities, definition of control, rules for computing income, rules for attributing income and rules to prevent or eliminate double taxation. Yet, these recommendations are lamented for excluding foreign affiliates of resident parent companies and for the lack of setting minimum standards.

Limiting Interest Deductions: The OECD / G20 BEPS suggests that corporate interest deductions imposed by Member States be limited between 10 and 30 % of earnings before interest, tax, depreciation, and amortization (EBITDA), or €1 million annually, the lower of the two options. Besides, an optional fixed cap is recommended, which is criticised for being a one-size-fits-all solution.

The overall analysis on BEPS measures shows that some measures fail to address the core of the problem. This may stem from the OECD's being a soft-law organisation and its efforts to reach a consensus on the basis of de minimis solutions and multiple options.

The G20 mandated the OECD to reform international tax rules in order to tax MNEs, where economic activity and value creation takes place.

The OECD Action 1: 2015 Final Report focusing on the digital economy identifies four solutions with regards to BEPS:

- Addressing the exceptions included in the definition of the Permanent Establishment (PE) status.
- Eliminating artificial arrangements or contracts allowing a subsidiary to exercise core activities such as selling goods and services in another country (online seller of tangible products or online provider of advertising services) without having a Permanent Establishment status.
- Regulating transfer pricing of intangibles, whose value is hardly determinable.
- Modifying the definition of Controlled Foreign Company (CFC) rules, which makes tax collection difficult.¹⁶⁴

However, it omits the proposal of the Discussion Draft to establish a nexus based on 'significant digital presence', to create a withholding tax on digital transactions, to introduce a bandwidth tax and to request non-resident suppliers to register for VAT in the market jurisdiction.

The BEPS Action Plan justifies action against base erosion and profit shifting, highlighting that it undermines the integrity of the tax system and harms fair competition. The momentum for it is an unprecedented one as a lot of attention is paid to the issue, public opinion, media and taxpayers finding it unfair that the big fortunes can get along with paying no taxes in the aftermath of the financial crisis and budgetary constraints in many EU states. MNEs also may encounter reputational risks if their effective tax payment is viewed as insufficient or low by the public at large.¹⁶⁵ This can be exemplified by the case of Starbucks, which ceded to public pressure by accepting voluntary tax payments and by moving its headquarters from the Netherlands to the UK.¹⁶⁶

5.1. Preventing the Artificial Avoidance on PE Status (OECD / G20 BEPS Action 7)

The OECD / G20 BEPS Discussion Draft of 24 March 2014 mentioned a new standard for nexus called 'significant digital presence' based on a test for the presence of a virtual permanent establishment (virtual fixed place of business PE, virtual agency PE and on-site business presence PE). However, the final OECD / G20 BEPS Report of 2015 on the digital economy discarded this option by coming up with a 'Modified Nexus Approach', according to which the list of exceptions to the definition of PE should be adapted to meet new challenges posed by the digital sector.¹⁶⁷

Under Article 5(4) of the OECD Model Tax Convention¹⁶⁸, the following constitute an exception to the PE status:

- the use of facilities for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise;

¹⁶⁴ OECD Final Report (2015) Addressing the Tax Challenges of the Digital Economy, Action 1, p. 12.

¹⁶⁵ Ault, Schon and Shay (2014).

¹⁶⁶ Ault, Schon and Shay (2014), p. 15.

¹⁶⁷ OECD Final Report (2015) Addressing the Tax Challenges of the Digital Economy, Action 1, p. 12.

¹⁶⁸ OECD (2014) Model Convention with Respect to Taxes on Income and on Capital (<https://www.oecd.org/ctp/treaties/2014-model-tax-convention-articles.pdf>).

- the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; and
- the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information for the enterprise.

To tackle the misuse of these exceptions with the aim of circumventing PE status through commissionaire arrangements and limited function distributorship with the subsidiary¹⁶⁹, a change to this Article is under discussion.

The BEPS Action 7 Discussion Draft of 15 May 2015¹⁷⁰ discloses hints about the final recommendation with regards to the amendments of the Article 5 (5), suggesting the 'dependent agent deemed Permanent Establishment' rule. The recommendations are expected to be finalised by the end of 2016 after Actions 8-10 are completed.¹⁷¹

The proposed changes to the Model Tax Convention include:

- Modifying the definition of agency PE rules, which only concerned contracts in the name of the non-resident entity, to cover contracts involving a transfer of the right to use property or to provide services by the non-resident, where the intermediary 'habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise'.
- Ensuring that agents being 'closely related' (depending on the right to vote and more than 50 % direct or indirect ownership of the company's shares or de facto control) as opposed to 'connected' to one or more enterprises are not considered as 'independent' agents.¹⁷²

Moreover, the OECD Model Convention will include an anti-fragmentation rule to offset the practices of fragmented units of a group working towards the common aim of fulfilling expectations of preparatory or auxiliary nature. The aim is to prevent exceptions such as '(a) an existing PE in the local country, or (b) the "overall activity resulting from the combination of the activities carried on...by the same enterprise or closely related enterprises is not of a preparatory or auxiliary character" (which includes activities of locally resident entities).'

¹⁶⁹ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 39.

¹⁷⁰ OECD (2015) Revised Discussion Draft BEPS Action 7: Preventing The Artificial Avoidance of PE Status (<http://www.oecd.org/tax/treaties/revised-discussion-draft-beps-action-7-pe-status.pdf>).

¹⁷¹ PwC (2013) Permanent Establishments 2.0 at the of the matter (<https://www.pwc.com/gx/en/tax/publications/assets/pwc-permanent-establishments-at-the-heart-of-the-matter-final.pdf>). For further information, see Bloomberg, Second Discussion Draft on Revisions to Deemed Permanent Establishment Rule of the OECD Model Article 5(5)-What Should Tax Payers Do Now?, 30 June 2015. <http://www.bna.com/second-discussion-draft-n17179928945/>.

¹⁷² Deloitte (2015) BEPS Action 7 : Preventing the artificial avoidance of PE status (<http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-oecd-7-october-2015.pdf>).

For these two cases, this rule can only apply if the activities constitute 'complementary functions that are part of a cohesive business operation'.¹⁷³ It is difficult to know at this stage what the final BEPS recommendations will be in concrete terms.

It is worth noting that some scholars proposed an alignment of the OECD Tax Model with the UN Tax Model by setting a minimum duration for the PE status and categorising all B2B services as royalties in order to solve the characterisation issue.¹⁷⁴ The aim here is to allocate profits according to value creation. The pros of such a system are that it is already in use and it would be administratively feasible.

The cons are that it would mean a shift in the source rule for services. The source rule would no longer mean the place of performance but would be similar to the UN Model Article 12(5) residence of payer or UN Model Article 12 (6) on base erosion. Second, it would signify a departure from the OECD position that e-commerce payments should be characterised as business profits exempt from withholding tax. Third, withholding tax is a poor proxy for a tax on net income and the tax burden would be shifted to resident companies, increasing the cost of business.¹⁷⁵

5.2. Addressing Harmful Tax Practices (OECD / G20 BEPS Action 5)

The BEPS Action No.5 on harmful tax planning regarding intangible assets are concerned with patent boxes. The Modified Nexus Approach also applies to patents and seeks to ensure that only companies involved in genuine R&D activities can benefit from such advantages.

The Action 5 focuses on the application of the Modified Nexus Approach to assess whether IP box regimes can be considered as harmful tax practices. Thanks to a grandfathering rule, companies having obtained advantages under the existing IP regimes until June 2016, will be able to fully benefit from them until the end of June 2021. The OECD Member States are expected to align their legislation with the Modified Nexus Approach until this deadline.

Although the OECD adopted guidelines on the design of patent boxes, there is no BEPS agreement to ban patent boxes. Hence, BEPS is seen as a system justifying the existence of patent boxes as even before the completion of the project, many countries made announcements that they would introduce such measures.¹⁷⁶

5.3. Addressing Transfer Pricing Documentation by Country-by-Country Reporting (OECD / G20 BEPS Action 13)

The OECD Action 13 on Country-by-Country Reporting calls on MNEs to report financial information, especially about their transfer pricing in relation to tax returns in every country they operate. Accordingly, information on pre-tax income, income tax paid and accrued, number of employees, stated capital, retained earnings and tangible assets in each jurisdiction, where the company operates, have to be put together in a master file enabling a global overview of their activities. The report for Action 13 includes a draft legislation and a model template, which countries are recommended to use.¹⁷⁷

¹⁷³ Deloitte (2015) BEPS Action 7: Preventing the artificial avoidance of PE status (<http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-oecd-7-october-2015.pdf>).

¹⁷⁴ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 40.

¹⁷⁵ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 4.

¹⁷⁶ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.11.

¹⁷⁷ Lexology (2016) Action 13: Country-By-Country Reporting; Are You Ready? (<http://www.lexology.com/library/detail.aspx?g=9ff88f91-872b-4784-a25d-5ee6102ab331>).

However, there is much criticism on the recommendation concerning the size of companies held accountable for reporting as a minimum threshold was set at USD 750 million. The OECD findings show that this would exclude more than 85 % of MNEs¹⁷⁸, while limiting tax administrations' investigative powers.¹⁷⁹

Furthermore, ensuring the automatic exchange of information under the Global Forum on Transparency and Exchange of Information for Tax Purposes in the area of the automatic exchange of information (which currently involves 131 countries), in particular with respect to the Common Reporting Standard, is an important tool to fight against tax havens. Previously, automatic exchange of information could be done at request. That meant that tax administrations had the need to know in advance that something was not in order and be of possession concrete evidence before being able to request this type of information. From 2017, tax havens will share data automatically. If correctly applied, it could eliminate future Panama leaks according to the Commission.¹⁸⁰

5.4. Restoring taxation of stateless income in the market jurisdiction (BEPS Action 6 on Treaty Abuse)

Tax treaties are designed to avoid double taxation but they often result in double non-taxation. Companies set up their subsidiaries in countries to benefit from such treaties, which is called treaty shopping. If it is proven that treaty shopping occurs for the purpose of avoiding withholding tax by use of methods such as transfer pricing or interest deductions, then one can speak of a certain abuse. In that case, the burden of proof falls on the tax administrations but they unfortunately do not have easily access to this type of information (as there is no public CBCR) and legal uncertainties further complicate this matter.

The BEPS recommendations involve model tax treaty provisions and modifications 'to address the inappropriate granting of treaty benefits and other potential treaty abuse scenarios'.¹⁸¹

Anti-abuse approaches may affect adversely costs of transition and reduce effects on existing business practices. Scholars stress that 'frequent and ongoing changes' are not preferable for anti-abuse rules but a 'comprehensive' change is needed instead. It is also highlighted that comprehensive change would be difficult to achieve with the current OECD timeline, therefore advising to strengthen anti-abuse rules in the short term with a view of implementing comprehensive changes in the future. Moreover, the implementation of anti-abuse clauses may prove to be very cumbersome.

Finally, preferential tax regimes should be also seriously addressed by the international tax community.¹⁸²

Also, see OECD Newroom (2016), A boost to transparency in international tax matters: 31 countries sign tax co-operation agreement to enable automatic sharing of country-by-country information (<https://www.oecd.org/newsroom/a-boost-to-transparency-in-international-tax-matters-31-countries-sign-tax-co-operation-agreement.htm>).

¹⁷⁸ Irish Times, Opinion: EU Commission falls short on corporate tax avoidance, 25 March 2016.

¹⁷⁹ Oxfam (2016) The European Commission's Anti-Tax Avoidance package. A brief Oxfam analysis of key points. (https://www.oxfam.org/sites/www.oxfam.org/files/oxfam_atap_analysis-final.pdf).

¹⁸⁰ Interview with DG TAXUD.

¹⁸¹ Ernst&Young(2015) OECD releases Final report under BEPS Action 6 on preventing treaty abuse (<http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--OECD-releases-final-report-under-BEPS-Action-6-on-preventing-treaty-abuse>).

¹⁸² Auth, Shaun and Shay, p. 277.

5.5. Regulating transfer pricing (OECD / G20 BEPS Actions 8-10)

The transfer of intangible property rights to related entities is one of the main techniques to avoid taxes. The OECD Discussion Draft under Action 8 suggests that the price of the asset transfer can be adjusted by tax authorities taking into account the income generated in reality.

The OECD / G20 BEPS further suggests revisions to its Transfer Pricing Guidelines, including risk, recharacterisation and other specific measures in 2015.

These measures include:

- A proper definition of transactions taking place within a group.
- Assessing transactions according to a split profit matter in the future.
- A delineation of transactions revolving around intangibles.
- A clear definition of commodity transactions.
- Intra-group services that create low value.
- Cost Contribution Agreements (CCAs).

Their aim is to ensure a precise delineation of intercompany transactions and to prioritise contractual agreements, where there is a misalignment between the two.

Furthermore, a six-step approach is recommended to facilitate the identification of the risk, allowing the returns to be allocated to the entity, which controls risk and bears its financial capacity.

Regarding intangibles, it is foreseen to allocate the returns to entities carrying out development, enhancement, maintenance and protection of the function rather than the legal owner of intangibles.

Guidance is provided to better apply comparable uncontrolled prices (CUPs) to commodity transactions.

Low-value services within a multinational group are recommended to be subject to a safe harbour of 5 %.

CCA participants are expected to have ability and capacity to manage risks arising from risk-bearing opportunities, valuing current contributions by cost but leaving prior contributions to be valued according to the OECD Transfer Pricing Guidelines.¹⁸³

It remains to be seen whether these new transfer pricing rules for intangible assets will be effective.¹⁸⁴ Some scholars argue that Brazil's transfer pricing system could be a 'viable alternative' to the current transfer pricing rules at the arm's length principle as it 'imposes fixed margins rather than relying on comparable transactions'.¹⁸⁵

The BEPS Monitoring Group believes that the BEPS proposal does not go so far to discourage transfers taking advantage of ex ante pricing. Second, there is an information asymmetry between tax authorities and companies. To address this, the reversal of the burden of proof is seen as a viable option. Accordingly, companies would be subject to pricing based on consideration of the actual income produced unless the taxpayer can show that the specified

¹⁸³ PwC (2015) Aligning transfer pricing outcomes with value creation-revised Chapters I, II, VI, and VII of the OECD Transfer Pricing Guidelines (<http://www.pwc.com/gx/en/tax/newsletters/tax-controversy-dispute-resolution/assets/pwc-aligning-transfer-pricing-outcomes-with-value-creation.pdf>).

¹⁸⁴ European Parliament Directorate-General for Internal Policies Policy Department A Economic and Scientific Policy In-depth Analysis for the TAXE Special Committee (2015) Intellectual Property Box Regimes, 2015, p.10.

¹⁸⁵ Falcao (2012), p. 1.

criteria were satisfied. Companies would be asked to prove that the transfer did not result in a significantly lower tax rate and to pass a purpose test requiring satisfactory evidence of the legal and commercial reasons of the transfer in order to provide more certainty to the APA-like ruling processes.

5.6. Modifying CFC Rules (OECD / G20 BEPS Action 3)

The OECD sets out recommendations on how to define CFC, threshold requirements to exclude low risk entities, control mechanisms, rules for computing income, rules for attributing income, rules to prevent or eliminate double taxation. To better define CFC income, a categorical approach and an excess income approach are considered.¹⁸⁶

The G20/OECD agreed that CFC rules should be downgraded to a recommendation, the lower level of the BEPS proposals. The BEPS action 3 noted that there are 36 CFC regimes globally and that many countries did not need them, given the nature of their economies. Most EU Member States do not have CFC rules, although major countries such as France, Germany, Italy, Spain and the UK have these provisions in place.¹⁸⁷

Key problems highlighted by scholars regarding CFC rules include the treatment of payments received by the intermediary CFC in the source jurisdiction and the lack of coordination in the action related to CFC, corporate residence and anti-hybrid arrangements (double non-taxation, double deduction, long-term deferral).¹⁸⁸

The BEPS Monitoring Group believes that CFC rules 'should be on a full-inclusion basis, treating all foreign affiliates of EU-resident parent companies as CFCs so that the group consolidated profits are subject to tax in the resident country, with a full credit for all equivalent foreign taxes paid'. 'They should not be limited to income from transactions with the parent company, and there should be no exemptions based on criteria such as effective exchange of information, as profits may also be shifted into cooperative jurisdictions.' CFC rules on full-inclusion basis would be easily applicable without the need to identify whether the income is active or passive or having to use a threshold, which is a percentage of the effective tax rate paid by the taxpayer. The BEPS recommendations on CFC rules are furthermore criticised for failing to introduce minimum standards.

5.7. Limiting Interest Deductions and Other Financial Payments (OECD / G20 BEPS Action 4)

During OECD / G20 BEPS negotiations options discussed to limit interest deduction included the calculation of how much MNEs overall payment of interest to third parties should be and the application of the assumption that a corporation should not have higher interest payments internally than externally. However, the proposed final method included two alternative caps on interest deductions. The first is an optional group ratio rule (GRR) to limit interest deductions based on the consolidated net interest expense of the whole group to third parties, apportioned to each group member whose aim is to limit the amount of interest that the taxpayer is entitled to deduct in a tax year. The second dictates that corporate interest deductions imposed by Member States are limited to 30 % of earnings before interest, tax, depreciation, and amortization (EBITDA), or €1 million annually, the lower of the two options.

¹⁸⁶ PwC (2015) Aligning transfer pricing outcomes with value creation-revised Chapters I, II, VI, and VII of the OECD Transfer Pricing Guidelines (<http://www.pwc.com/gx/en/tax/newsletters/tax-controversy-dispute-resolution/assets/pwc-aligning-transfer-pricing-outcomes-with-value-creation.pdf>).

¹⁸⁷ Deloitte (2016) European Commission releases proposed anti-avoidance package (<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-28-january-2016.pdf>).

¹⁸⁸ Ault, Schon and Shay, p.278.

According to the BEPS Monitoring Group, the final report weakened the proposal by suggesting a fixed cap accompanied by an optional GRR as a fixed cap would not be desirable for it creates a one-size-fits-all solution. Furthermore, problems related to volatility of earnings and project life cycles necessitate flexible rules. It was also said that a de minimis threshold is not the appropriate solution to limit interest deductions.

The OECD's consultation document shed some doubts over the effectiveness of this tool. In addition, a PwC survey for BIAC Advisory Group of the OECD found that 55-61 % of MNEs had interest expenses below 10 % in 2009-2013 while 78-83 % had a ratio below 30 %.¹⁸⁹

According to Eurodad, this measure would fail to avoid the abuse stemming from the deductibility of interest rates and would not prevent companies from internal lending and borrowing to shift profits. One should also note that the U.S. law allows for a maximum of 50 %.

¹⁸⁹ OECD (2015) Comments Received on Public Discussion Draft BEPS Action 4: Interest Deductions and Other Financial Payments (<http://www.oecd.org/tax/aggressive/public-comments-action-4-interest-deductions-other-financial-payments-part1.pdf>).

6. LEGISLATION ADDRESSING TAX CHALLENGES IN THE DIGITAL ECONOMY AT THE EU LEVEL

KEY FINDINGS

The EU transposed most of the BEPS recommendations discussed above and even went beyond BEPS by introducing its own measures, which can be witnessed in the recent Anti-Tax Avoidance Package.

The Council held a first exchange of views on 12 February 2016. The Dutch presidency was planning to reach an agreement on 25 May 2016 on a proposal to tackle some of the most prevalent tax avoidance practices. Yet the agreement was blocked on three controversial issues: the switchover clause, CFC rules and provisions on hybrid mismatches.

The EU has been criticised for lack of ambition in some measures by choosing the highest range of 30 % as a minimum threshold for interest limitations.

The CFC rules proposing a nominal threshold are controversial, as tax administrations would not be able to tax foreign based subsidiaries if the tax rate paid there is lower than 40 % of the home country tax rate. Some Member States such as Luxembourg, Germany and the UK are opposed to the EU proposal for national leitmotifs.

The usefulness of the switch-over clause is also being questioned, as it might lead to double non-taxation if badly designed. Moreover, the 40 % relative threshold is may give rise to a race to the bottom and would not apply to low tax Member States.

Concerning the proposed CCCTB, the minimum threshold set at EUR 750 million would exclude 85 to 90 % of the MNEs. Moreover, it should be disaggregated for third countries all by providing for unconditional public access. The consolidation in two steps as well as the loss offset mechanism could be potential handicaps of the proposal in addition to the unanimity rule needed for its adoption.

Transparency measures to fight against the mushrooming of shell companies and Special Purpose Entities (SPEs) in the EU shall be quickly taken to avoid future Panama Leaks. There is an apparent need to tighten supervision over trusts and foundations but it would be difficult to achieve this at the EU level since the EU law is not concerned with persons but companies.

While some loopholes such as the Double Irish scheme are gradually being closed others are being opened by massive introduction of patent boxes in several Member States. In a situation where grandfathering clause imposes a serious break to tax administration's and the EU's investigative powers, there is need to look at the implementation of the Modified Nexus Approach with increased vigilance.

Since the European Commission announced its ambitions for a Digital Single Market to strengthen the Single European Market, the important role of taxation rules in this framework has been recognised, as taxation is the connecting point between key players in the market, be it Member States, business or consumers.¹⁹⁰

The European Commission Expert Group on Taxation of the Digital Economy highlights three priority areas in the context of BEPS: Harmful tax practices, transfer pricing rules and taxable nexus provisions.

¹⁹⁰ Centore and Sutich, p.784.

Harmful tax practices (Action 5) include hybrid mismatch arrangements, CFC provisions and circumvention of withholding tax on interest and royalties through treaty shopping.

Transfer pricing rules (Action 8,9,10) include profit allocation to intangibles, profit allocation to business risks, characterisation of transactions, base eroding payments and global value chain and profit splits.

Taxable nexus provisions (Action 7) may involve a new concept of digital taxable presence and the review of the PE concept (commissionaire agreements and exemptions).¹⁹¹

The EU's Commission Expert Group on Taxation of the Digital Economy reconsidered nexus and mentioned the possibility of applying a destination based cash flow tax, to allocate taxation to the demand side.¹⁹² Yet, there were no specific measures targeting the digital sector so far across the EU. According to the Commission, in order to keep the neutrality of the tax system and to avoid the ring-fencing of the digital economy, solutions have to be found within the existing rules by adapting EU standards to new realities. In January 2016, the EU reiterated this position by stating that 'the EU agrees that no special action is needed but will monitor the situation to see if general anti-avoidance measures are enough to address digital risks'.¹⁹³

The EU has committed itself to support the OECD / G20 BEPS Action Plan, beyond the patent box issue. The European Commission employs its own instruments, such as state aid and code of conduct, in order to tackle aggressive tax planning or fiscal administrative practices of Member States to attract Foreign Direct Investment (FDI).¹⁹⁴

The recent Anti-Tax Avoidance package testifies to this commitment while pushing the limits of BEPS action further. The package involves six legally binding anti-abuse measures to be incorporated in the Anti-Tax Avoidance Directive, a revision of the Administrative Cooperation Directive, a recommendation on tax treaties to include anti-abuse measures and an external strategy for effective taxation.

6.1. Anti-Tax Avoidance Directive

On 28 January 2016, the European Commission released an anti-tax avoidance package that contains proposed measures to prevent aggressive tax planning, boost tax transparency and create a level playing field for all businesses in the EU and establish a certain level of harmonisation in the field of direct taxation.¹⁹⁵

The package contains the following:

- a revision to the Administrative Cooperation Directive, which will introduce CBCR between tax authorities to facilitate information exchange on MNE activities;
- a draft Anti-Tax Avoidance Directive, which proposes legally binding anti-avoidance measures to combat aggressive tax planning;
- recommendations to EU Member States on reinforcement of tax treaties through the introduction of anti-abuse clauses; and

¹⁹¹ European Commission Report of the Commission Expert Group on Taxation of the Digital Economy. pp.41-49.

¹⁹² De Wilde, p. 801.

¹⁹³ European Commission (2016) Fact Sheet The Anti-Avoidance Package-Questions and Answers (http://europa.eu/rapid/press-release_MEMO-16-160_en.htm).

¹⁹⁴ Ault, Schon, Shay (2014), p. 276.

¹⁹⁵ European Commission-Fact Sheet (2016) Anti Tax Avoidance Package-Questions and Answers (http://europa.eu/rapid/press-release_MEMO-16-160_en.htm).

- a communication on an external strategy for effective taxation to deal with tax good governance matters with third countries in a coordinated manner.¹⁹⁶

The Directive suggests the following three actions, which were also recommended by the OECD / G20 BEPS project: Hybrid mismatches (Action 2), interest limitations (Action 4) and CFCs (Action 3). Moreover, the Commission proposes three additional actions, which were not covered by BEPS: GAAR, switch-over clauses where income and gains are regarded as taxable and not as tax-exempt, and exit taxation.

The Council held a first exchange of views on 12 February 2016. The Dutch presidency was planning to reach an agreement on 25 May 2016 on a proposal to tackle some of the most prevalent tax avoidance practices. However, the agreement was blocked on three controversial issues: the switchover clause, CFC rules and provisions on hybrid mismatches.¹⁹⁷

6.1.1. Interest Deductions

The Directive suggests a number of action points:

- 'a de minimis exemption for interest not exceeding EUR 1 million;
- a fallback to a group-wide test, based on the accounting ratio of third- party debt to assets, less 2 %; and
- the ability to carry forward excess EBITDA and disallowed interest.'

These measures are in line with BEPS recommendations but the group-wide ratio is delianated in a more restrictive manner, ignoring the 'public benefit exemption', which was proposed by the UK and received the green light from Germany. With this exemption, the financing of projects serving wider public interest, such as infrastructure, can be excluded from the general group limitations.¹⁹⁸

The fact that the Commission chose the lower side of the fork with regards to profit shifting shows the unambitious approach of the EU according to ActionAid.

According to a PwC survey for BIAC Advisory Group of the OECD only 55-61 % of MNEs had interest expenses below 10 % in 2009-2013 while 78-83 % had a ratio below 30 %.¹⁹⁹ This measure is likely to fall short to solve the problem of the deductibility of interest for a large number of companies.

6.1.2. Exit Taxation

The Directive provides a clarification for the PE status and introduces the rule of exit taxation.

¹⁹⁶Deloitte (2016) European Commission releases proposed anti-avoidance package (<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-28-january-2016.pdf>).

¹⁹⁷DLA Piper (2016) EU: ECOFIN approves implementation of Country-By-Country Reporting in the EU but fails to reach consensus on EU-Anti-Tax-Avoidance Directive (<https://www.dlapiper.com/en/us/insights/publications/2016/05/ecofin-approves-implementation/>).

¹⁹⁸Deloitte (2016) European Commission releases proposed anti-avoidance package (<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-28-january-2016.pdf>).

¹⁹⁹OECD (2015) Comments Received on Public Discussion Draft BEPS Action 4: Interest Deductions and Other Financial Payments (<http://www.oecd.org/tax/aggressive/public-comments-action-4-interest-deductions-other-financial-payments-part1.pdf>).

Exit taxation has as an objective to stop the transfer of assets with potential gains out of the taxable jurisdictions without a change of ownership. The provisions include cases on the transfer of residence while stipulating that taxes should be charged, where assets are transferred from a head office to a branch.

In accordance with the four fundamental freedoms and the EU case law, the Directive provides taxpayers with an option to defer tax payments over a period of time and enables tax payment in several instalments.

Deloitte comments that many Member States have long- standing exemptions or deferrals, and there is no clear reason why the European Commission considers that a new tax charge should be levied.²⁰⁰

According to Oxfam, while the objective of the Anti-Tax Avoidance Directive is to implement the G20 / OECD BEPS recommendations, the proposal concerning Permanent Establishment (Action 7 of the BEPS project) is only mentioned in a non-binding recommendation on tax treaty abuse. In December, discussions at the Council level actually referred to the 'artificial avoidance of Permanent Establishment status' but the issue was not dealt with in detail. A common definition of PE is urgently needed as without such strong definition, MNEs will continue to exercise artificial avoidance of PE by declaring a subsidiary and shifting their profits.²⁰¹

To render it more effective, the exit taxation rule could be complemented by anti-inversion rules. In a corporate inversion, a multinational company having its headquarters in one country, replaces its parent in that particular country with a foreign parent. For instance, the US announced rules designed to curtail the ability of an inverted company to access foreign subsidiaries' earnings without paying U.S. taxes.²⁰² Yet, the introduction of anti-inversion rules in the EU could be tricky as there a merger problem does not exist and only few EU companies have their headquarters overseas.

It has been a source of frustration to some Member States that the CJEU has ruled that states may not levy exit taxes when a company moves its tax residence to another EU or EEA country. The CJEU's rationale has been that payment of the tax should be deferred until ultimate disposal, although it has allowed the taxing state to levy interest.

6.1.3. Hybrid mismatches

Hybrid mismatches are the consequence of differences in the legal characterisation of payments (financial instruments) or entities when two legal systems interact. Such mismatches may often lead to double deductions. This problem has been explored by both the Group of the Code of Conduct on Business Taxation and the OECD.

The ATAD prescribes that the legal characterisation given to a hybrid instrument or entity by the Member State where a payment, expense or loss, as the case may be, originates shall be followed by the other Member State, which is involved in the mismatch.

The proposed hybrid mismatch rules stipulate legal characterisation of one hybrid instrument in one Member State, where a payment, expense or loss arises, shall be replicated by the other Member States involved in the mismatch. The rules are valid for hybrid mismatches

²⁰⁰ Deloitte (2016) European Commission releases proposed anti-avoidance package (<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-28-january-2016.pdf>).

²⁰¹ Oxfam (2016) The European Commission's Anti-Tax Avoidance package. A brief Oxfam analysis of key points. (https://www.oxfam.org/sites/www.oxfam.org/files/oxfam_atap_analysis-final.pdf).

²⁰² CGMA (2015), United States Issues New Corporate Anti-Inversion Rules (http://www.cgma.org/magazine/news/pages/newcorporate-anti-inversion_rules_201513431.aspx?TestCookiesEnabled=redirect).

within the EU. However, their scope should be larger, as many mismatches take place with third countries. This issue has yet to be addressed.²⁰³

Deloitte tends to discord with the ATAD provisions on hybrid mismatches, underscoring that they are ‘the opposite of the G20/OECD proposals’. Reminding that ‘the primary rule under BEPS Action 2 is that the deduction should be disallowed, with a secondary rule requiring that income be taxed (or a second deduction disallowed) where the primary rule is not adopted, the consultancy company further warns that adopting two different rules for EU and non-EU companies can actually lead to hybrid mismatches.’²⁰⁴

6.1.4. CFC rules

CFC rules re-attribute the income of a low-taxed controlled foreign subsidiary to its parent company. A parent company is hence prevented from shifting profit to low tax jurisdictions by making it possible for home countries to tax profits outside of their jurisdictions if these profits happen to be in a low tax jurisdiction.

According to the Directive, CFC rules ‘would impose a charge on undistributed profits of controlled non-listed entities that are subject to taxation at an effective rate lower than 40 % of the equivalent effective rate in the controlling Member State, where the entity principally receives financial income (e.g., interest), royalties, dividends, leasing income, certain real estate income, income from insurance, banking and other financial activities, and intra-group service income’.²⁰⁵

Subsidiaries in the EU/EEA would not be subject to CFC rules unless they are entirely artificial entities or are involved in non-genuine arrangements with the sole purpose of benefiting from a tax advantage. The CFC rules would not apply to subsidiaries having their shares listed in a major stock exchange.

If the CFC rules applied, profits would be apportioned to the parent company only where the CFC does not have the necessary significant people functions to manage its business and then only to the extent those functions are in the shareholder company.

The Commission defends its CFC proposals at the EU level by admitting that the OECD standard is weak as it offers a range of options to choose from and the minimum standard proposed by the OECD is higher than the average situation within the EU. It further acknowledges that given the need for a common approach to set more stringent rules in the EU and within legal constraints posed by the EU law, the Commission ‘has exploited the maximum ambitions of leeway the Court has given to it’.²⁰⁶

The draft Directive echoes the UK’s CFC rules, presumably with the aim of attracting the country’s support prior to the referendum on Brexit. However, some countries such as Ireland, Malta or the Netherlands may find CFC rules less desirable while others may lack the necessary resources to develop and manage such rules.²⁰⁷

²⁰³ MNE Tax (2016), Leaked EU anti-tax avoidance directive includes interest deduction limits, GAAR, exit tax (<http://mnetax.com/leaked-eu-anti-tax-avoidance-directive-includes-interest-deduction-limits-gaar-exit-tax-2-13110>).

²⁰⁴ Deloitte (2016) European Commission releases proposed anti-avoidance package (<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-28-january-2016.pdf>).

²⁰⁵ Ernst&Young (2016), ‘Report on recent US international tax developments’ (<http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--Report-on-recent-US-international-tax-developments---11-March-2016>).

²⁰⁶ Interview with DG TAXUD.

²⁰⁷ Deloitte (2016) European Commission releases proposed anti-avoidance package (<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-28-january-2016.pdf>).

The effectiveness of this tool is questionable as Luxembourg, the UK and Germany are against setting minimum standards to CFC rules. Luxembourg's rejection may be a legitimate one as it is dependent on FDIs but the position of Germany, in favour of adopting the already OECD rules already agreed upon rather than negotiating new ones, is less understandable, given that larger Member States have greater social security obligations and are, thus, in need of more tax revenues. Furthermore, the UK opposes the EU regulation on CFC, as it watered down its own rules recently and would not opt for something more ambitious.

Even though their aim is to eliminate tax avoidance, badly designed CFC rules can actually increase incentives for governments to lower tax rates and lead to a race to the bottom.

In addition, the 40 % threshold would mean that tax administrations would not be able to tax foreign based subsidiaries if the tax rate paid in those jurisdictions is lower than 40 % of the home country tax rate. If a company was subject to a 4 % tax rate in a tax haven, it would not have to pay taxes in Bulgaria, for instance, where the corporate income tax is 10 %, as the CFC rule would not apply.²⁰⁸ Moreover, nominal rates may create the incentive for the home country to lower its taxation. In that case, companies would gain a double benefit: First, they would be able to pay less tax in the home country. Second they could circumvent the CFC rules, as the threshold defining the low tax jurisdiction would drop in parallel with the tax decrease in the home country. Therefore, ActionAid recommends that a rate of 20 % would be more effective.²⁰⁹

Better alternatives for CFC rules could be found in Germany and France. For instance, in Germany a fixed rate cap of 25 % (absolute rate) is in place and it is not calculated as a relative rate. Yet, income covered by CFC rules is rather narrowly defined in Germany.

A long- term solution would be setting a fixed rate for minimum effective taxation but it rather seems unlikely because of the unanimity rule.

6.1.5. Switch-over clause

The EU goes beyond the BEPS recommendations by introducing the switch-over clause. The clause 'requires taxation of foreign income entering the EU, with a credit given for foreign tax paid, in cases where the income was subject to a rate of tax less than 40 %²¹⁰ of the corporate rate of the Member State'.²¹¹

The switch-over rule applies to income distributed or realised by a group as opposed to CFC rules applying to non-distributed income earned by separate legal entities.²¹²

Dividends and capital gains from low-taxed companies should not be exempt but taxable, with a tax credit granted for any overseas tax actually paid. The proposal sets the definition of low tax as a statutory tax rate that is lower than 40 % of the tax rate in the relevant Member State.

Many showed discontent at the proposed rate questioning its effectiveness and underscoring that this threshold is extremely high considering that some Member States have already very

²⁰⁸ Oxfam (2016) The European Commission's Anti-Tax Avoidance package. A brief Oxfam analysis of key points. (https://www.oxfam.org/sites/www.oxfam.org/files/oxfam_atap_analysis-final.pdf).

²⁰⁹ Interview with ActionAid.

²¹⁰ European Commission (2016) Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market (<https://ec.europa.eu/transparency/regdoc/rep/1/2016/EN/1-2016-26-EN-F1-1.PDF>).

²¹¹ MNE Tax (2016), Leaked EU anti-tax avoidance directive includes interest deduction limits, GAAR, exit tax (<http://mnetax.com/leaked-eu-anti-tax-avoidance-directive-includes-interest-deduction-limits-gaar-exit-tax-2-13110>).

²¹² HJI Panayi (2013), p. 343.

low tax rates. (i.e. Ireland having a tax rate at 12,5 %). For instance, the European Public Service Union (EPSU) suggests a 25 % rate would be a better adjustment.²¹³

Furthermore, it is much debated whether or not it is necessary to introduce a switch-over rule across the EU. Clearly, countries that wish to adopt such a rule will need to include anti-conduit provisions to prevent income or gains being routed via a third country.²¹⁴

6.2. Recommendation on Tax Treaties

In compliance with the *acquis*, the proposed GAAR is designed to reflect the artificiality tests of the Court of Justice of the European Union (CJEU), where this is applied within the Union.

The GAAR provision calls for ignoring 'non-genuine arrangements or series thereof carried out for the essential purpose of obtaining a tax advantage that defeats the object or purpose of otherwise applicable tax provisions'.

The European Commission separately recommended the inclusion of a principal purpose test to double tax treaties. These provisions are almost identical to the BEPS Recommendations under Action 6.²¹⁵

ActionAid fears that GAAR may be not sufficient as reduced withholding tax rates can still have harmful effects.²¹⁶

According to some scholars GAAR cannot be effective unless they do not reflect the specificities of national law. Taking a negative stance towards a fixed definition of GAAR, they argue that it may cover a broader scope than the national law and may have a smaller impact on combatting artificial arrangements than provisions foreseen in national law. Furthermore, countries having GAAR in force would have a tendency to apply it to more areas than direct taxation and having different GAARs for different taxes would not be a viable solution.²¹⁷

For instance, the Danish Super GAAR is going beyond the requirements of the EU, which only covers the Parent Subsidiary Directive. Danish rules additionally apply to the Interest and Royalties Directive and the Merger Directive as well as the country's tax treaties.

Finally, it should be noted that 24 countries have been already sued by foreign investors in more than 40 separate tax related suits.²¹⁸ These cases, where MNEs question whether or not taxation is legitimate, may rise in the future. Even though some treaties include carve-outs for taxes, they can still be challenged in such courts. The Netherlands hosts many mailbox companies, which give access to Dutch investment treaties signed with more than 80 countries. Even Jersey, Guernsey and the Isle of Man were given access to the investor-state dispute settlement (ISDS) through the UK's tax treaties.

²¹³ EPSU (2016) European Parliament calls for tougher rules on tax avoidance but they 'll need to be tougher still to stop corporate tax dodging'.

²¹⁴ Deloitte (2016) European Commission releases proposed anti-avoidance package (<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-28-january-2016.pdf>). Also see for a comprehensive overview: <https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-european-commission-proposes-anti-tax-avoidance-package.pdf>.

²¹⁵ Deloitte (2016) European Commission releases proposed anti-avoidance package (<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-28-january-2016.pdf>).

²¹⁶ Eurodad (2015) 'Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system', p.22.

²¹⁷ Deloitte (2016) European Commission releases proposed anti-avoidance package (<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-28-january-2016.pdf>).

²¹⁸ Transnational Institute and Global Justice Now 'Taxes on Trial: How trade deals threaten tax justice', February 2016, pp.1-6. (<https://www.tni.org/files/publication-downloads/taxes-on-trial.pdf>).

6.3. Directive on Administrative Cooperation (DAC)

The Directive on Administrative Cooperation has been already amended several times to align itself to the OECD Requirements (DAC2, DAC3 and DAC4 under discussion now).

A European Commission proposal of March 2013 increased the scope of the DAC Directive to include dividends, capital gains and other financial income and account balances. The same proposal expanded the scope of the EU Savings Tax Directive to include investment funds, innovative financial instruments and life insurance products.

The Directive was recently extended the cooperation between tax authorities to automatic exchange of financial account information and cross-border tax rulings and advance pricing arrangements.²¹⁹

Eventually, the EU decided to introduce its own version of CBCR and deems it appropriate in addition to Member States' own CBCR regimes. It released a proposal on January 28, 2016 to amend a Directive to include 'mandatory automatic exchange of country-by-country reports between Member states' with some level of public disclosure.²²⁰ In this framework, Member States would have the freedom to legislate on their own penalty regimes, which should be 'effective, proportionate and dissuasive'.²²¹ The ECOFIN Council of May voted unanimously to adopt legislation on the implementation of the G20/OECD Country-By-Country Reporting.²²²

Separately, in March 2015, the tax transparency package of the EU announced to conduct an impact assessment on public CBCR in the EU, which was concluded on April 12, 2016 by DG FISMA. A previous impact assessment on banking sectors in 2014 had stated that public disclosure would not have a negative impact on the economy.²²³ In line with these outcomes, the EU Capital Requirements Directive IV²²⁴ already introduced the obligation for banks to disclose their CBCR publicly from 2015 onwards. Following the recent impact assessment for public CBCR for all sectors, the Commission introduced 'public reporting requirements for the largest companies operating in the EU'.²²⁵

The current proposal applies only to multinational groups with consolidated revenue of at least €750 million. The EU believes that 'whilst this would cover only 10-15 % of multinational enterprise groups, these groups hold 90 % of corporate revenues.'²²⁶ However, many criticise this threshold for it may limit the investigative powers of tax administrations.

²¹⁹ European Commission (2016) Enhanced administrative cooperation in the field of (direct) taxation (http://ec.europa.eu/taxation_customs/taxation/tax_cooperation/mutual_assistance/direct_tax_directive/index_en.htm).

²²⁰ Lexology (2016) Action 13: Country-By-Country Reporting: Are You Ready? (<http://www.lexology.com/library/detail.aspx?g=9ff88f91-872b-4784-a25d-5ee6102ab331>).

²²¹ Deloitte (2016) European Commission releases proposed anti-avoidance package (<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-28-january-2016.pdf>).

²²² DLA Piper (2016) EU Country-By-Country Reporting: Adopted (<https://www.dlapiper.com/en/us/insights/publications/2016/05/ecofin-approves-implementation/>).

²²³ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.44.

²²⁴ Eur-Lex (2013) Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Text with EEA relevance (<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013L0036>).

²²⁵ European Commission (2016) European Commission proposes public transparency rules for multinationals (http://europa.eu/rapid/press-release_IP-16-1349_en.htm).

²²⁶ European Council (2016) Corporate tax avoidance: Council agrees its stance on the exchange of tax-related information on multinationals (<http://www.consilium.europa.eu/en/press/press-releases/2016/03/08-corporate-tax-avoidance/>).

Moreover, most tax administrations of developing countries will be left in the dark because they need to apply reciprocity arrangements, which require high administrative capacity.²²⁷

Some scholars say that the benefits of Country-By-Country Reporting may outweigh the costs. Others believe that the reporting regime should be enhanced in parallel.²²⁸

Under the current Directive, CBCR has to be filed in the country where the MNE has its headquarters and the information is shared with other countries after using the mechanism of automatic exchange of information, which requires a certain degree of confidentiality.²²⁹ Many criticise the fact that Country-By-Country Reporting is being kept confidential and only a selected number of countries can access this information²³⁰ and call for 'an open data format that is machine readable and centralised in a public registry'. The OECD reporting template is sufficiently detailed but more companies should be covered. Eurodad suggests, for instance, that companies having a balance sheet of at least EUR 20 million, a minimum turnover of EUR 40 million and at least 250 employers on average should be subject to such reporting. Moreover, the Shareholders Rights Directive should also include public CBCR for all sectors.²³¹

As DAC is not a legislation on taxation, it does not have to be adopted by qualified majority, giving the European Parliament the possibility to suggest amendments in the secondary filing, including the automatic exchange on tax rulings and public CBCR. The European Parliament demanded for public CBCR in all sectors in its Annual Tax Report in 2015.²³² It furthermore suggested different thresholds for Member States to increase the number of companies eligible for CBCR.²³³

It is crucially important to achieve public CBCR for all sectors as it would be key to solve taxation problems in the digital and other sectors arising from transfer pricing. According to the BEPS Monitoring Group, public CBCR 'enables to conduct a risk analysis on BEPS', which is a pressing need.²³⁴

6.4. Communication on an external strategy for effective taxation regarding tax havens

On 6 December 2012, the European Commission launched an action plan²³⁵ to strengthen the fight against tax fraud and tax evasion, in which it encouraged Member States to constitute a blacklist of tax haven jurisdictions, to review their treaties with those jurisdictions and to establish a double non taxation (stateless income) clause as well as an anti abuse clause. However, it was at the Member States' discretion to accept or refuse these recommendations, as fiscal matters have to be voted unanimously.

In June 2015, the Commission issued a list of non-compliant countries with regards to taxation. The list included 30 tax haven jurisdictions, which do not cooperate with BEPS rules,

²²⁷ Oxfam (2016) The European Commission's Anti-Tax Avoidance package. A brief Oxfam analysis of key points. (https://www.oxfam.org/sites/www.oxfam.org/files/oxfam_atap_analysis-final.pdf).

²²⁸ Ault, Schön and Shay (2014), p. 278.

²²⁹ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.12.

²³⁰ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 11.

²³¹ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 38.

²³² European Parliament resolution of 25 March 2015 on the Annual Tax Report (2014/2144(INI)).

²³³ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 18.

²³⁴ BEPS Monitoring Group (2013), Response to OECD White Paper on Transfer Pricing Documentation (<https://www.oecd.org/ctp/transfer-pricing/BEPS-Monitoring-Group.pdf>).

²³⁵ European Commission (2012) Communication from the Commission to the European Parliament and the Council. An Action Plan to strengthen the fight against tax fraud and tax evasion (http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/com_2012_722_en.pdf).

keeping information on companies' secret. The list included non-EU jurisdictions blacklisted at least in 10 Member States, such as Switzerland and the United States. The listing, which included tax havens not appearing in the OECD list, resulted in an outrage, including from the OECD,²³⁶ which led to the eventual removal of the list.

The EP called for more action regarding tax havens, including better screening of countries, concrete lists and sanctions on non-cooperative countries. Moreover, the lack of specific counter-measures also raised much concern.²³⁷

Recently, the European Commission announced that it is willing to engage in new discussions with the Member States on building a common strategy to list and counter non-EU tax havens. The strategy will not apply to EU Member States although some of them are widely known as non-cooperative jurisdictions. To name a few, EU Member States such as the Netherlands, Ireland and Luxembourg could potentially qualify as tax havens.

Pan-EU lists constitute a big challenge, as they would involve screening and listing. Commentators say that it is difficult to decide on common criteria for tax havens. These criteria should include various elements such as openness to cooperation, secrecy, harmful tax practices, transparency and tax rates. The OECD Global Forum, for instance, does not take tax rates into account.

In addition, the proposed criteria should not only focus on secrecy jurisdictions but also on schemes allowing corporate tax avoidance.²³⁸

6.5. Action Plan for Fair and Efficient Corporate Taxation

The European Commission announced in June 2015 the adoption of the changes to the EU Parent Subsidiary Directive, a strategy to relaunch the Common Consolidated Corporate Tax Base (CCCTB) and an Action Plan for Fair and Efficient Corporate Taxation.

6.5.1. Parent Subsidiary Directive, and Interest and Royalty Directive

As the principle of free flow of capital is important according to the four fundamental freedoms of movement within the EU, The Parent Subsidiary Directive and Interest and Royalty Directive were the instruments which enabled the removal of withholding tax on cross-border flows within the EU. Since the free flow of capital bared a potential risk of being misused by MNEs, an anti-abuse clause was added to the Parent Subsidiary Directive in January 2015.

The Council is working towards amending the Interest and Royalties Directives by introducing a similar anti-abuse rule.²³⁹ Accordingly, Member States could refuse tax benefits offered to MNEs by governments if the set up of the company serves as the 'main purpose or one of the main purposes of obtaining a tax advantage'.²⁴⁰

²³⁶ OECD (2015) EU Commission's Announcement on Non-cooperative jurisdictions: Letter to Global Forum members (<https://www.oecd.org/tax/transparency/eucommissionsannouncementonnon-cooperative-jurisdictionslettertogloballforummembers.htm>).

²³⁷ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.43.

²³⁸ Oxfam (2016) The European Commission's Anti-Tax Avoidance package. A brief Oxfam analysis of key points. (https://www.oxfam.org/sites/www.oxfam.org/files/oxfam_atap_analysis-final.pdf).

²³⁹ Council of the European Union (2015). Outcome of the Council meeting – 3399th Council meeting – Economic and Financial Affairs, Luxembourg 19 June 2015, p.7. (https://www.google.be/search?client=safari&rls=en&q=http://www.+consilium.europa.eu/en/meetings/ecofin/2015/06/st10089_en15_pdf/&ie=UTF-8&oe=UTF-8&qfe_rd=cr&ei=IH9jV9VqOIRo2lms2AE).

²⁴⁰ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 42.

6.5.2 CCCTB

A leaked document published by the Financial Times²⁴¹ in January 2016 revealed the Commission's draft CCCTB proposal, which is planned to be introduced in two steps, the second step being the consolidation part.

In June 2015, the Commission announced its plans to relaunch the CCCTB based on two important changes: A compulsory CCCTB to combat BEPS risks, and a two-step approach to harmonise tax base across the EU and consolidation.²⁴²

The European Commission explained that 'the consolidation element in the CCCTB would also allow companies to offset losses in one Member State against profits in another'.²⁴³

Hence, when a subsidiary in one Member State suffers losses, the parent company in another Member State would be eligible for temporary tax relief. It is widely believed that the CCCTB would help expanding business activities and supporting start-up companies in the Single Market, by treating cross-border activities the same as national activities when it comes to loss offset.

At the moment the subsidiary starts making profits, the Member State hosting the parent company could recapture the taxes which were used for loss offset earlier. This would eliminate the risk in any Member State of carrying the burden of unprofitable companies in another Member State.

The first step involving cross-border loss offset would deliver many benefits for businesses yet the consolidation step is a much more vital issue that would drastically alter the way profits and losses are allocated between Member States with a real impact on Member States' revenues. Yet, it is a controversial issue among the Member States and therefore is expected to be achieved in a later phase. Action Aid supports the idea that the consolidation should take place immediately disapproving of the two-step-approach of the Commission. The NGO also calls for assurances that corporate income, which has already been subject to taxation in a country of source outside the EU, cannot benefit from tax deductions and exemptions in the EU.²⁴⁴

Some argue that this is the most promising EU legislation as it would make harmonisation of the corporate taxation possible. It would eliminate the issue of IP tax planning in the Union. As a result, companies would shift labour and tangible assets according to a formula the factors of which are labour, tangible assets and sales, to allocate a group's profits to its affiliates.

Many criticise the deal by saying that it is sweetened by the introduction of the loss offset mechanism, as it allows companies to shift losses across borders. It is doubtful whether allowing MNEs to move their losses without hindrance from one EU Member State to another would stop the problem of profit shifting and avoidance of tax payments.

The previous proposal of the Commission to establish a common corporate tax base faced a blockade in the Council for more than 10 years, as decisions regarding taxation are taken by unanimous rule in the EU and the European Parliament only plays an advisory role. Even the case law may fall short of shaping policies as judges are no economists or accountants.

²⁴¹ Financial Times (2016) Leaked proposal: Plugging up the LuxLeaks (<https://next.ft.com/content/683893a8-9d04-3276-856c-b1633627957a>).

²⁴² European Commission, Common Consolidated Corporate Tax Base (CCCTB) (http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm#practical).

²⁴³ European Commission (2015) Questions and Answers on the CCCTB relaunch (http://europa.eu/rapid/press-release_MEMO-15-5174_en.htm).

²⁴⁴ ActionAid's Input for EC Consultations on CCCTB.

The EC believes that moving towards a formulary apportionment model would be 'a holistic solution to profit shifting'.²⁴⁵ Consolidated tax base proposed in 2011 was based on a formula comprised of cost of labour, sales and assets. Although many believe that the formula was balanced and could be reused by the Commission for the new CCCTB proposal, clear information about the new formula was not revealed in the recent CCCTB consultations held by the European Commission.

Many Member States do not support a common tax base approach. Hence, in an attempt to reach consensus among its Member States, the OECD proposed a wide range of options, from which its Member States could choose. Unfortunately, the EU did not introduce measures in complete alignment with the OECD / G20 BEPS measures.

It would be preferable at the EU level to consolidate and apportion profits while evading future loopholes, which can be used by MNEs for tax avoidance, including 'mechanisms to offset cross-border losses without consolidation.'

In addition, leadership plays a big role in pushing for such legislation. The Netherlands, which will be presiding the EU until July 2016, declared that a harmonised approach will not be a priority during the Dutch Presidency. It remains to be seen what the intentions of future presidencies will be regarding the suggested Directive.²⁴⁶

6.6. Legislation in the Area of Transparency

Following the Panama Leaks, Transparency International called for 'mandatory public registers of companies' beneficial owners' to tackle the problem of secret companies and trusts.

It is a positive development that the European Parliament amended the Anti-Money Laundering Directive²⁴⁷ and the Shareholders' Right Directive in order to promote transparency measures. Yet, the fact that the Shareholders' Right Directive is under blockade in the Council raises major concerns.

The European Parliament completed negotiations on a directive on beneficial ownership transparency, which is equally of crucial importance. While France and Italy opposed to the idea of a public register for beneficial owners, the UK is introducing a register for beneficial owners of companies with the exception of trusts. Slovenia and Denmark are also on their way to establish public registers.

Concealing ownership seems to be common in Germany (treuhand funds) and Luxembourg.²⁴⁸ In Luxembourg, new elements such as Freeport and 'the patrimonial fund' are harmful for the transparency of beneficial ownership.²⁴⁹ Although the Commission believes that Freeports are not related to tax issues being only part of a portfolio investment

²⁴⁵ De Wilde, p. 799.

²⁴⁶ Deloitte (2016) European Commission releases proposed anti-avoidance package (<https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-european-union-28-january-2016.pdf>). Also see for a comprehensive overview: PwC (2015) European Commission proposes Anti-Tax Avoidance Package (<https://www.pwc.com/gx/en/tax/newsletters/tax-policy-bulletin/assets/pwc-european-commission-proposes-anti-tax-avoidance-package.pdf>).

²⁴⁷ Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (Text with EEA relevance). (<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32015L0849>).

²⁴⁸ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.28.

²⁴⁹ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.34.

strategy and serving for the main purpose of protection of wealth after taxation²⁵⁰, a careful eye should be kept on new elements such as Freeports and ‘the patrimonial fund’ in Luxembourg.

The EU adopted regulations on money laundering (Anti-Money Laundering Directive) in 2015 to address the problems posed by shell companies and trusts. Accordingly, companies in EU Member States are expected to declare the real owner of such entities but countries differ in their level of ambition when it comes to its implementation. At the same time, only persons having a ‘legitimate interest’ are granted access to the registers of real owners and it is not clearly defined who these real owners are.²⁵¹

Given that many EU countries such as Austria, Cyprus, Hungary and Spain enjoy SPE regimes²⁵², the EP Annual Tax Report 2015²⁵³ makes important recommendations on Special Purpose Entities (SPEs). The report asks Member States to disclose ‘data showing the flow of investments through such entities in their countries’. Such disaggregated data is available in a limited number of Member States. The EP called on Member States to ‘introduce sufficiently strong substance requirements for all such entities in order to ensure that they cannot be abused for tax purposes’. This was an attempt to eliminate shell companies or mailbox companies by testing the significance of the economic activity in the country of operation. The proper definition of relevant criteria and the establishment of common standards are also of crucial importance to that end.

Denmark is an exemplary case in the framework of transparency, as it encourages relevant stakeholders to establish a ‘Fair Tax Mark’, demanding companies to show their commitment to fair and transparent taxation by putting a label on their products. Denmark has also established an open tax payments list in 2012, where taxation information about companies, association and funds are disclosed publicly.²⁵⁴

In an anti-corruption conference²⁵⁵ on 12 May 2016, the UK announced measures to its Overseas Territories and Crown Dependencies to establish public registers of the beneficial ownership of companies while enhancing oversight over trusts and foundations.²⁵⁶

Additional attention should be paid to deliberate efforts to obstruct the real owner of assets in the corporate world. This is usually done for reasons of corporate secrecy. Interestingly, Apple created a shell company called SixtyEightResearch, which is believed to have been established to pursue Apple’s ambitions to enter the car industry, for instance.²⁵⁷

6.7. Legislation to Tackle Harmful Tax Practices

At the end of 2014, the EU Member States endorsed the Modified Nexus Approach, according to which a criterion of substantial activity with regards to IP Box regime was adopted. It

²⁵⁰ Interview with DG TAXUD.

²⁵¹ Eurodad (2015) Fifty Shades of Tax Dodging: The EU’s role in supporting an unjust global tax system, p.26.

²⁵² Eurodad (2015) Fifty Shades of Tax Dodging: The EU’s role in supporting an unjust global tax system, p.19.

²⁵³ European Parliament resolution of 25 March 2015 on the Annual Tax Report (2014/2144(INI))([http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2014/2144\(INI\)](http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2014/2144(INI)))

²⁵⁴ Eurodad (2015) Fifty Shades of Tax Dodging: The EU’s role in supporting an unjust global tax system, pp. 54-55.

²⁵⁵ Anti Corruption-Summit 2016 (<https://www.gov.uk/government/topical-events/anti-corruption-summit-london-2016/about>).

²⁵⁶ Financial Times (2016) Cameron: Britain’s offshore centres will lead transparency drive (<https://next.ft.com/content/6e9d4ffe-0009-11e6-ac98-3c15a1aa2e62>).

²⁵⁷ Vox (2016) Panama Papers: a massive document leak reveals a global web of corruption and tax avoidance (<http://www.cnn.com/2016/04/04/panama-papers-a-massive-document-leak-reveals-a-global-web-of-corruption-and-tax-avoidance.html>).

stipulates that the amount of eligible income is going to be constrained to in-house R&D activity and R&D activities outsourced to third parties. At the same time, IP income will be associated with intra-group contracts and acquired IP needs will be excluded. Furthermore, the nexus approach will limit the scope of eligible IP to patents and comparable intangibles while rendering IP Box relevant to net instead of gross income.²⁵⁸

Although there are no sanctions for non-compliance with the Modified Nexus Approach, the legislation should be withdrawn or adapted if it is not compliant. But there is a state aid angle to some of these tax regimes that can be illegal, in which case the taxes owed should be paid back.

According to the Commission, the Modified Nexus Approach decreases the temptation of a race to the bottom and adds substance to R&D activities, while allowing companies to attract more investment and to grow.²⁵⁹ Hence, 'the tax-sensitivity of patent location is reduced when such specific conditionality is imposed'. This implies that this approach could potentially stop the 'dominant tax competition dimension of patent boxes'.²⁶⁰

The EP addressed the issue in its 2015 Annual Tax Report demanding 'urgent action and binding measures to counter the harmful aspects of tax incentives offered on the income generated by intellectual property or 'patent boxes'.

To give an example, the Hungarian patent box can reduce the tax rate to 10 % (the same rate as the UK). In exceptional cases, the rate can go as low as 3 % or 5 % and covers a wide range of IPs, exempting the income IP sales from capital gains taxation.²⁶¹

A study published by the European Commission in November 2014²⁶² questioned the effectiveness of patent boxes. Although the Commission started an investigation on the patent box regime in the UK, following an agreement reached between Germany and the UK on the future use of patent boxes in the EU, the investigation was called off in February 2015.

Back in 2014 the UK, Luxembourg and the Netherlands were the only countries to defend patent boxes but following the UK-Germany deal, introducing complex guidelines to design patent boxes, they gained support in more and more Member States. Out of 28 EU Member States, 12 already introduced patent boxes, half of which were introduced in the last five years. Ireland is preparing to adopt legislation on patent box; Italy is adopting a similar regime ; and Germany is considering such a possibility.²⁶³

In the corporate tax package in June 2015, the Commission called for the alignment of Member States with BEPS measures considering patent boxes. 12 Member States were warned of non-alignment and the Commission threatened to put forward a legislative proposal in order to ensure that the necessary changes are made in these Member States. This would be an appropriate step, as the OECD measures are not considered to suffice to eliminate BEPS resulting from use of patent boxes.²⁶⁴

In their joint statement, the UK and Germany proposed three specific measures:

²⁵⁸ European Parliament Directorate-General For Internal Policies Policy Department A Economic and Scientific Policy. In-Depth Analysis for the TAXE Special Committee (2015) Intellectual Property Box Regimes, p. 9.

²⁵⁹ Interview with DG TAXUD.

²⁶⁰ Interview with Eurodad.

²⁶¹ European Parliament Directorate-General For Internal Policies Policy Department A Economic and Scientific Policy. In-Depth Analysis for the TAXE Special Committee (2015) Intellectual Property Box Regimes.

²⁶² European Commission (2014) A Study on R&D Tax Incentives Final report (https://ec.europa.eu/futurium/en/system/files/ged/28-taxud-study_on_rnd_tax_incentives_-_2014.pdf).

²⁶³ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.28.

²⁶⁴ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.43.

- Raising qualifying expenditure, which determines whether or not a companies could obtain a maximum of 30 % uplift for their qualifying expenditure for R&D activities.
- Eliminating patent boxes by 2021.
- Providing for a transition period in order to adopt the Modified Nexus Approach.²⁶⁵

However, these measures fall short of reflecting whether real R&D activity is taking place in a given company. Furthermore, there are legal uncertainties with regards to how research related activities are defined.

The Code of Conduct Group has a significant impact on IP Box regimes and is being heavily criticised for its opaqueness.

In camera meetings of the Conduct Group on Business Taxation in the Council is a worrying development. The EP already asked that its mandate should be reviewed in 2015 'in order to improve its effectiveness and provide ambitious results, for example, by introducing the obligation to publish tax breaks and subsidies for corporations' and to increase its transparency by publishing 'an oversight of the extent to which countries meet the recommendations set out by the group in its six-monthly progress report to the finance ministers'. The Group is also criticised for being 'largely ineffective' by Eurodad.²⁶⁶

Long-term solutions to avoid harmful tax practices could be in the form of tightening transfer pricing or introducing targeted anti-avoidance provisions.²⁶⁷ For instance, Germany introduced rules to supervise the transfer of business functions such as intangible assets in 2008.²⁶⁸

Another solution for the IP tax in the case of source countries could be the introduction of withholding taxes on royalties and royalty deduction limitations. In R&D countries, the principle of retroactive price adjustment in relation to the intra-group disposal of IP applies. The profit split method is used to calculate contract R&D fees. In residence countries of the parent of MNEs Controlled Foreign Company rules may be introduced. Yet, there is a risk, in case of its unilateral application, that it may lead to double taxation. In any event, a coordinated approach would be more than necessary to reach comprehensive and lasting solutions.²⁶⁹

Regarding tax rulings, a clear and narrow definition should be conceived and public access to these rulings shall be ensured.

Finally, one should note that the EU-wide guidelines on Advance Pricing Agreements, which were approved in 2007, were subject to much criticism for failure to tackle aggressive tax planning issues and for lack of objectivity, as they were written by experts composed of MNEs and consultancy firms. Only three NGOs were included in the process. To avoid such cases in the future, the Ombudsman launched an investigation in 2015 to make expert groups more balanced, which is a step in the right direction.²⁷⁰

²⁶⁵ Germany-UK Joint Statement (2014) Proposals for New Rules for Preferential IP Regimes (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/373135/GERMANY_UK_STATEMENT.pdf).

²⁶⁶ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.41.

²⁶⁷ European Parliament Directorate-General For Internal Policies Policy Department A Economic and Scientific Policy. In-Depth Analysis for the TAXE Special Committee 'Intellectual Property Box Regimes', 2015, p.5.

²⁶⁸ European Parliament Directorate-General For Internal Policies Policy Department A Economic and Scientific Policy. In-Depth Analysis for the TAXE Special Committee 'Intellectual Property Box Regimes', 2015, p.5

²⁶⁹ European Parliament Directorate-General For Internal Policies Policy Department A Economic and Scientific Policy. In-Depth Analysis for the TAXE Special Committee 'Intellectual Property Box Regimes', 2015, p.9.

²⁷⁰ Interview with Eurodad.

Table 1: Comparison between OECD and EU Actions on BEPS

	OECD / G20 BEPS	EU ACTION
Action 1: Digital Economy	The digital economy is the whole economy and ring fenced solutions are not appropriate. OECD / G20 BEPS actions in general should address risks posed by digital economy.	The EU agrees that no special action needed but will monitor the situation to see if general anti-avoidance measures are enough to address digital risks.
Action 2: Hybrid Arrangements	Specific recommendations to link the tax treatment of an instrument or entity in one country with the tax treatment in another, to prevent mismatches.	The proposed Anti Tax Avoidance (ATA) Directive includes a provision to address hybrid mismatches.
Action 3: Controlled Foreign Companies	Best practice recommendations for implementing CFC rules.	The ATA Directive includes CFC rules.
Action 4: Interest Limitation	Best practice recommendations on limiting a company's or group's net interest deductions.	The ATA Directive includes provisions to limit interest deductions, within the EU and externally.
Action 5: Harmful Tax Practices	Tax rulings: Mandatory spontaneous exchange of relevant information. Patent Boxes: Agreement on "Nexus Approach" to link tax benefits from preferential regimes for IP to the underlying economic activity.	Tax rulings: Mandatory automatic exchange of information on all cross-border rulings from 2017. Patent Boxes: Member States agreed to ensure that their Patent Boxes are in line with the nexus approach (Code of Conduct Group, 2014).
Action 6: Treaty Abuse	Anti-abuse provisions, including a minimum standard against treaty shopping, to be included in tax treaties.	The Recommendation on Tax Treaties suggests that Member States introduce a general anti-abuse rule in their treaties in an EU-compliant way.
Action 7: Permanent Establishment	Definition of Permanent Establishment (PE) is adapted in Model Tax Convention, to prevent companies from artificially avoiding having a taxable presence.	ATA Recommendation encourages MSs to use the amended OECD approach for Permanent Establishment.

	OECD / G20 BEPS	EU ACTION
Actions 8 -10: Transfer Pricing Intangibles Risk and Capital High Risk Transactions	Arm's Length Principle and Comparability Analysis confirmed as pillars of Transfer Pricing. More robust framework for implementing this standard.	Joint Transfer Pricing Forum (JTPF) working on EU approach to review and update transfer pricing. Work includes looking at more economic analysis in TP, better use of companies' internal systems, and improving TP administration.
Action 11: Data	The OECD aims to publish statistics on corporate taxation and its impact.	EU study underway on the impact of some types of aggressive tax planning on Member States' effective tax rates.
Action 12: Disclosure of Aggressive Tax Planning	Recommendation to introduce rules requiring mandatory disclosure of aggressive or abusive transactions, structures or arrangements.	The Commission will keep the issue under review, as part of its tax transparency agenda.
Action 13: Country-By-Country Reporting	Country-By-Country Reporting (CbCR) between tax administrations on key financial data from multinationals. Information for tax authorities only – not public CbCR.	ATA Package proposes legally binding requirement for Member States to implement CbCR between tax authorities. Work ongoing on feasibility of public CbCR in the EU.
Action 14: Dispute Resolution	G20/OECD countries agreed to measures to reduce uncertainty and unintended double taxation for businesses, along with a timely and effective resolution of disputes in this area. A number of countries have committed to a mandatory binding arbitration process.	In 2016, the Commission will propose measures to improve dispute resolution within the EU.
Action 15: Multilateral Instrument to modify tax treaties	Interested countries have agreed to use a multilateral instrument to amend their tax treaties, in order to integrate BEPS related measures where necessary.	ATA Recommendation sets out the Commission's views on Treaty related issues, which MSs should consider in negotiations on the Multilateral Instrument.

Source: European Commission.

7. ADDRESSING VAT CHALLENGES IN THE DIGITAL ECONOMY

KEY FINDINGS

As the current international tax system dates back to the 1920s and is seen by many as obsolete, consensus is growing that the concept of source and residence should be replaced by origin and destination.

This is becoming a pressing issue due to challenges posed by e-commerce such as the absence of a physical presence or a taxable nexus.

One can observe a gradual trend towards changing the VAT system by increasingly using the destination principle, that is to apply VAT in the market country.

This can be clearly seen in the EU since last year, as VAT on all telecommunications, broadcasting and electronic services has been levied, where the customer is based.

In order to address problems arising from the localisation of businesses and conceptualisation of taxable person, new rules regarding the destination principle and the Mini One Stop Shop (MOSS) entered into force in January 2015.

As the VAT GAP was estimated at circa €170 billion in 2013, there was a need for such a legislative proposal to modernise and simplify VAT for cross-border e-commerce as part of the Single Digital Market.

Under a new law to be proposed by the Commission next year, supply and acquisition would be submitted to VAT so that companies would have to pay the VAT at all stages of the cross-border supply chain.

The new system will provide more autonomy and flexibility for Member States to set their VAT rates and would rectify the tax differences between e-books and physical books.

A positive effect of the new rules is the reduction of harmful tax competition between Member States, as taxing at consumption stage would prevent businesses from picking and choosing their place of establishment according to tax rates. It would also improve distributional equity as Member States could collect VAT on the supplies consumed on their territory and share the cost of taxation amongst individuals.

The European Parliament is expected to provide guidance on whether the EU shall do away with an updated list of goods and products, which can be taxed at a minimum of 15 % rate or rather keep a regularly updated version of the list.

Traditional fiscal policy is based on geographically defined jurisdictional boundaries. The collection of sales or value added taxes proves quite difficult when it comes to online activities.²⁷¹ These transactions can take place without any physical presence, which makes the concept of nexus obsolete.

Only when the online seller has nexus in the consumer's state is the sales tax automatically added to the transaction price by the firm. Hence, online consumers enjoy the advantage of the absence of sales tax when shopping online as opposed to a physical store. Even in the US, although citizens are obliged to pay their state's sales or use taxes on their online

²⁷¹ Lehr and Pupillo (2009), p. 9.

purchases, taxation rarely occurs in practice as it is left at the consumer's discretion to report and pay.²⁷²

The current international tax system dates back to the 1920s and is seen by many as outdated²⁷³. To address the challenges posed by the current tax system, consensus is growing that the concept of source and residence should be replaced by origin and destination to determine tax jurisdictions.²⁷⁴

One can observe a gradual trend towards changing the VAT system by increasingly using the destination principle, that is to apply VAT in the market country. The OECD also enhances the use of the destination principle but underlines that its diverse implementation in different jurisdictions can actually lead to double-taxation.²⁷⁵

Whereas there is common consensus that the adoption of the destination principle as opposed to the origin principle would render the tax system more neutral, opinions differ on the need for registration in the market country. According to Centore and Sutich, if taxes were collected in the place of consumption, there would be no need to identify and localise businesses or to register them.²⁷⁶

A report by the United Nations suggests that 'the most appropriate way to ensure VAT collection on cross-border B2C services is to require the non-resident supplier to register and account for the VAT on these supplies in the jurisdiction of the consumer'. To force compliance, one should use simplified registration regimes and registration thresholds to minimise the potential compliance burden on businesses. The report further highlights that technical issues in setting the threshold and identifying non-resident vendors and resident customs may arise yet the Amazon tax or Google tax may offer insights about feasible amounts.²⁷⁷

The EU is also increasingly leaning towards the destination principle and overhauling its VAT system. The following section will analyse the latest developments in the field of indirect taxation, which largely concerns the digital sector.

7.1. VAT Measures in the EU

Already in 2002, the Commission stated that 'it is desirable for the good of the internal market to have a harmonised set of rules relating to the applicability of VAT to electronically supplied services and to tax website supply, web hosting, distance maintenance of programmes, supply of software, updating supply of information, databases, supply of music purchased online in the country of consumption'.²⁷⁸

The 6th VAT Directive²⁷⁹ and Directive/2002/38/C²⁸⁰ on the VAT arrangements applicable to radio and television broadcasting services and certain electronically supplied services alter

²⁷² Lieber and Syverson (2012), p. 206.

²⁷³ De Wilde (2015), p.801.

²⁷⁴ De Wilde (2015), p.796.

²⁷⁵ OECD Final Report (2015) Addressing the Tax Challenges of the Digital Economy, Action 1, p. 30.

²⁷⁶ Centore and Sutich, p. 786.

²⁷⁷ United Nations Department of Economic and Social Affairs (2014) Protecting the Tax Base in the Digital Economy, p. 2.

²⁷⁸ Rogers, p. 89.

²⁷⁹ Eur-Lex (2007) Sixth VAT Directive: uniform basis of assessment (<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=URISERV:I31006>).

²⁸⁰ Eur-Lex (2002) Proposal for a Council Directive amending Council Directive 2002/38/EC as regards the period of application of the value added tax arrangements applicable to radio and television broadcasting services and certain electronically supplied services (<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52006PC0739>).

rules of applicability of VAT on purchases to the place of consumption instead of place of sale, thus protecting EU suppliers.²⁸¹

In order to address problems arising from the localisation of business and the conceptualisation of taxable person and new rules regarding the destination principle were introduced in January 2015. In addition, the Mini One Stop Shop (MOSS), an electronic registration and payment system, also entered into force to facilitate administration, which is planned to be extended to tangible goods ordered online both within and outside the EU.

One of the aims of the new system is to simplify the rules, which can encompass the automation and dematerialisation of economic activity.²⁸² A positive effect of these rules is the reduction of harmful tax competition between Member States, as taxing all telecommunications, broadcasting and electronic services at consumption stage would prevent businesses from picking and choosing their place of establishment according to tax rates. It would also improve distributional equity, as Member States could collect VAT on the supplies consumed on their territory and share the cost of taxation amongst individuals.²⁸³

The previous VAT rules imposed a levy on imported goods from non-EU countries to be collected at the customs but a threshold was set in each Member State, below which imports were exempt from taxation. For goods originating within the EU, VAT was paid at each stage of production.²⁸⁴ Since this created a distortion and put EU companies at a disadvantage, it was recommended to lift this scheme.²⁸⁵

Under the new rules, different schemes are foreseen for EU and non-EU taxable persons. While EU citizens register in the Member State of establishment, non-EU Member States are free to choose their Member State of identification. The documentation and return supplies have been standardised on a website. An exchange of information between tax administrations will be put in place to give them access to registered taxable persons in other states. The audit will be carried out by the Member State of consumption. Finally, 'the payment of tax will be made by state of identification at a domestic rate (reducing refunding procedures), which will compensate the tax collected with the other Member States, withholding a quota for the collection carried out on behalf of the other state'.²⁸⁶

'Although the implementation of the destination principle is limited to the digital economy, it is possible to extend this system to other categories of supplies of cross-border services with a relevant simplification of the current tax system and a broader application of VAT, allowing non-EU taxable persons to trade within the EU'.²⁸⁷

The effects of the new legislation are not clear yet. First, MOSS is at a very early stage. Hence, it remains to be seen whether the destination principle could be implemented with MOSS in an efficient way and a broader extension of the new rules of territoriality could be extended to all supplies of services, transforming the MOSS into an OSS (One Stop Shop).²⁸⁸

Second, the Member States' reaction to such legislation, whose primary aim is to ensure the closure of loopholes, may not necessarily be the most desirable outcome, as exemplified by

²⁸¹ Rogers, p.90.

²⁸² Centore and Sutich, p. 786.

²⁸³ Centore and Sutich, p.785.

²⁸⁴ Lieber and Syverson (2012), p. 206.

²⁸⁵ Centore and Sutich, p. 786.

²⁸⁶ Centore and Sutich, p. 787.

²⁸⁷ Centore and Sutich, p. 787.

²⁸⁸ Centore and Sutich, p. 787.

Luxembourg's VAT tax increase from 3% to 5% following the introduction of the new legislation on e-commerce.²⁸⁹

Third, opinions differ on whether or not the destination principle is the optimum means for VAT collection. Whereas some believe that VAT as a consumption tax is one of the most growth-friendly forms of taxation, critics reject the idea that companies should pay taxes on sales rather than income, arguing that it would give them more opportunities to shift profits away and pointing out the existing EU VAT gap as a testament to it.²⁹⁰

Last, major challenges concerning the differences in VAT treatment between physical and online goods have yet to be addressed. The European Court of Justice highlighted this problem by challenging the low VAT rate on e-books in March 2015.²⁹¹ As a consequence, A VAT Action Plan was recently put on the table to address these type of challenges.

7.1.1. The VAT Action Plan

The VAT Action Plan Agenda, proposed under the Better Regulation Agenda by the Commission on 7 April 2016, is the first step towards a single EU VAT area, which is equipped to tackle fraud, to support business and to help the digital economy and e-commerce. It aims to make the current VAT system 'simpler, more fraud-proof and business friendly.' The Action Plan on VAT goes towards more harmonisation and control of cross-border trade and more autonomy for Member States to fix taxation rates.

In the long term, the EU aims to establish a single VAT system for cross-border transactions in order to avoid fraud and will come up with a proposal in 2017. Under this new law to be proposed by the Commission next year, supply and acquisition would be submitted to VAT, so that companies would have to pay the VAT at all stages of the cross-border supply chain. Moreover, e-publications will benefit from the same reduced rates as physical publications.

The 'VAT gap', which is the difference between the expected VAT revenue and VAT actually collected in Member States, was almost EUR 170 billion in 2013. In reality, many companies buy goods benefiting from VAT exemptions and sell them after adding VAT. The difference is not captured by tax administrations. While VAT revenues equal to €1,000 billion annually for the year from VAT – corresponding to 7 % of the bloc's wealth, €50 billion is lost due to cross-border fraud.

The current VAT system, dating back to 1993, was adopted as a temporary measure. It imposes administrative burdens on businesses and proved to be very complex and costly for companies and Member States. Moreover, EU companies are put at a competitive disadvantage as third country traders can import VAT-free goods to the EU. The lack of a compliance mechanism further complicates the system.

Under the current rules, Member States have to comply with a list of goods and services to which they can apply zero or reduced VAT rates. Current rules oblige Member States to apply a minimum 15 % rate on all goods and services. A limited list of products is taxable at a minimum 5 % rate, and some Member States under derogations can apply a rate ranging from 5 % to zero.

The Commission proposes two options in order to modernise the current framework and to give Member States more autonomy and flexibility: one option would be to keep the minimum threshold of 15 % while having consultations with Member States to update the list of goods and services, which can benefit from reduced rates on a regular basis. The second option

²⁸⁹ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 78.

²⁹⁰ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p.8.

²⁹¹ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, pp. 78-79.

would be to abandon the list of goods and services that can benefit from reduced rates. The European Parliament and the Council will be asked to provide guidance on the current recommendations.²⁹²

It is believed that the second option was proposed to please Member States such as the UK, which voiced anger at EU rules in the eve of its referendum on Brexit, that restrict the ability to change Value Added Tax rates.²⁹³

²⁹² European Commission (2016) VAT Action Plan: Commission presents measures to modernize VAT in the EU (http://europa.eu/rapid/press-release_IP-16-1022_en.htm).

²⁹³ EU Observer (2016) EU Commission takes on VAT fraud (<https://euobserver.com/economic/132969>).

8. CONCLUSIONS AND RECOMMENDATIONS

- Action 1: Digital Economy

Although specific measures for the digital sector are not desirable, some out-of-the-box thinking might be needed to shape tax policies. In the short term, priority should be given to the question of the Permanent Establishment status mentioned below. In the long-term far-reaching reforms such as the conception of a single firm, modification of source and residence and deemed PE should be considered. Fractional apportionment, withholding tax on digital transactions and equalisation levy, which was already introduced in India, could be evaluated as possible measures in this area. In our view, immediate action is needed to advance the so called 'Beyond BEPS' strategy and to make it happen sooner than later, as some of the reforms may take 5 or more years. By doing so, one shall keep a careful eye on measures on taxation introduced in other countries such as the reform process in the US. The current EU investigations against digital tech giants are commendable but they are temporary and a time-costly step in addition to being limited to the four fundamental freedoms and the EU case law. Hence, Member States shall also assume responsibility in tackling this issue by adapting existing tax laws. For instance, as a result of the UK's new tax laws aimed at forcing companies to pay more tax on revenue generated in the UK, Facebook changed its tax structure. One shall consider the possibility of the introduction of deadlines to make the investigation processes more efficient.²⁹⁴

While the current legislative process in the EU on the VAT marks a shift towards the destination principle, some EU Member States such as the UK make it a propaganda by complaining about the omni-present EU. Having a say on VAT matters is important for the EU as its budget is mainly supplied by those payments. In our opinion, the VAT Action Plan Agenda, proposed under the Better Regulation Agenda by the Commission on 7 April 2016, is a significant step towards a single EU VAT area. The EU shall address the problem of its VAT gap but this should not come at the expense of giving up the right to have an influence over VAT rates of goods and products circulating to ensure the good functioning of its Single Market in order to please one or more Member State(s).

- Action 2: Hybrid Arrangements

The EU Anti-Tax Directive largely addresses this issue but the usefulness of some measures such as the switch-over clause is being questioned, as it might lead to double non-taxation if badly designed. The 40 % relative threshold is also seen as meaningless, as it may give rise to a race to the bottom in the Member States and would not apply to low tax Member States.

US-type check-the-box rules are not desirable in the EU, as they make it easy for companies to avoid tax payments by include hybrid entities.²⁹⁵

²⁹⁴ European Parliament Directorate-General for Internal Policies Policy Department A Economic and Scientific Policy In-depth Analysis for the ECON Committee (2015) 'Presentation: Challenges for Competition Policy in a Digitalised Economy', p.22.

²⁹⁵ Deloitte (2015) BEPS Action 2: Neutralizing the effects of hybrid mismatch arrangements (<http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-oecd-16-october-2015.pdf>).

- Action 3: Controlled Foreign Companies (CFCs)

In residence countries of the parent of the MNE, Controlled Foreign Company rules may be introduced. Yet, there is a risk in case of its unilateral application, which may lead to double non-taxation. In any event, a coordinated approach would be more than necessary to reach comprehensive and lasting solutions.

The CFC rules proposing a nominal threshold would not be an effective measure for the EU, as it would limit tax administrations' ability to tax foreign-based subsidiaries if the tax rate paid in those foreign countries is lower than 40 % of the home country tax rate. Some Member States such as Luxembourg, Germany and the UK are opposing to the EU proposal for national leitmotifs.

Wrong policies such as setting a relative threshold to CFC rules could increase double non-taxation while triggering a race to the bottom among Member States. To quote the head of the IMF Christine Lagarde, in a race to the bottom, everyone ends up in the bottom. The UK has already announced that it would introduce a tax rate of 17 %.

Finally, CFC rules shall be addressed in parallel with transfer pricing rules as 'they act as a backstop to transfer pricing and other rules'²⁹⁶.

- Action 4: Interest Limitation

The OECD recommendations for interest deductions include a benchmark net interest/EBITDA ratio, which is in the range of 10%-30%. The fact that the EU has been opted for the highest range of 30 % as a minimum threshold for interest limitations, does not illustrate an ambitious approach.

- Action 5: Harmful Tax Practices

Urgent actions to be taken involve the elimination of the existing loopholes such as patent boxes in the international tax system. Although some adjustments took place to address such aggressive tax planning practices, tightening one loophole does not preclude from the opening of another, thus, perpetuating the problem of tax avoidance. Therefore, ensuring that the Modified Nexus Approach is applied properly and successfully eliminating patent boxes from 2021 onwards is crucial.

Another solution for the IP tax in the case of source countries could be the introduction of withholding taxes on royalties and royalty deduction limitations. In R&D countries, the principle of retroactive price adjustment in relation to the disposal of intra-group disposal of IP applies. The profit split method based on objective criteria should be used to calculate R&D fees.

- Action 6: Treaty Abuse

It is recommended to include General Anti- Abuse Rules in treaties, 'a statutory rule that empowers a revenue authority to deny taxpayers the benefit of an arrangement that they have entered into for an impermissible tax-related purpose.' Some fear that GAAR may not be a sufficient measure, as reduced withholding tax rates can still have harmful effects.

More than ever shall the European Parliament call upon Member States for cooperation and unity. For example, the EU draft report from July 2015 recommended 'a common EU framework for bilateral tax treaties' and 'the progressive substitution of the huge number of bilateral

²⁹⁶ OECD, Top 10 FAQs About BEPS (<http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm>).

individual tax treaties by EU/third jurisdiction treaties'.²⁹⁷ Cooperation of such kind shall be increased in the 28 to tackle common challenges with regards to taxation.

- Action 7: Permanent Establishment

The OECD Tax Model Convention are under revision, as its exceptions are allowing many companies to avoid taxation. Within the existing system, it would be feasible to redefine the Permanent Establishment status for the digital sector according to a formula including amount of sales, customers, selling agents etc., which would enable to calculate profit and to allow for tax payments in countries, where value is created.

The discussions in the OECD evolved towards the establishment of a 'deemed PE'. The Discussion Draft of May 2015 under BEPS Action 7²⁹⁸ discloses what presumably will be close to the final recommendation of the OECD regarding proposed changes to Article 5(5) of the OECD's Model Tax Convention, which sets forth the dependent agent deemed permanent establishment (PE) rule. As such, taxpayers whose current sales entity structures may create deemed PEs under the new standards need to start considering what alternatives they may have.

One should ensure in this crucial process that digital companies such as Google and Amazon generating money by sales, content and auxiliary services and having Internet presence in one country constitute a deemed PE.

- Actions 8-10: Transfer Pricing (Intangibles, Risk and Capital, High Risk Transactions)

To solve the issue of transfer pricing thoroughly, the OECD's arm's length principle shall be adapted in the long-term. According to BEPS Monitoring Group, an unresolved issue in the current international tax system remains the establishment of unitary taxation. It suggests that the MNE should be considered as a single firm and profits should be allocated by use of the formulary apportionment method, according to which all subsidiaries shall make independent declarations on their economic activity, profits and taxation in each country they operate. Such reforms necessitate a lengthy period of time and could take up to five years.

However, even if these measures were in place, one would face the problem of easily manipulatable data. Hence, a 'conceptual revolution' should be achieved by declaring the entirety of profits (which are less difficult to manipulate including information on shareholders, investments, bank accounts) made by a group according to an objective formula, which would appropriate profits to countries according to number of employees, mobilised capital, volume of sales etc.²⁹⁹ The Commission highlights the difficulty of calculating profits while underscoring the fact that one should be careful when establishing formulary criteria. (Creation of income, number of social media accounts, number of sales agents...)³⁰⁰

In one of its rulings, the CJEU asked Denmark to adjust its transfer prices but the EU cannot count on the Court to solve these crucial issues in the long run. One of the inherent problems

²⁹⁷ Allen & Overy (2016) EU Anti-Tax Avoidance Directive published: implications for United Kingdom corporate taxpayers (<http://www.allenoverly.com/publications/en-gb/Pages/EU-Anti-Tax-Avoidance-Directive-published-implications-for-United-Kingdom-corporate-taxpayers.aspx>).

²⁹⁸ OECD (2015) Revised Discussion Draft BEPS Action 7: Preventing The Artificial Avoidance of PE Status (<http://www.oecd.org/tax/treaties/revised-discussion-draft-beps-action-7-pe-status.pdf>).

²⁹⁹ Interview with Antonio Gambini, CNCD.

³⁰⁰ Interview with DG TAXUD.

with the CJEU cases stems from the fact that judges are not economists and may find it hard to decide on complex transfer pricing arrangements.

- Action 13: Country-By-Country Reporting

In this context, public CBCR is essential to provide more transparency and scrutiny over MNEs' activities in every country they operate. To address these hurdles, one shall think out of the box in order to realise two major reforms: First, to increase transparency and to give public access to tax rulings. This can be achieved by public Country-By-Country Reporting, where MNEs provide detailed information about their income, profits and tax payments in each country they operate.

Second, priority should be given to find technical solutions to strengthen tax administrations, as if they were victims of these manœuvres. We tend to forget that they have deliberately collaborated with MNEs and therefore cannot be trusted to verify MNE reports. The questions with regards to the burden of proof falling on tax administrations, legal uncertainties and difficulties regarding implementation remain to be addressed. Tax incentives should allow for the development of ICTs all by avoiding potential abuse or fraud. To achieve this, a neutral tax system is needed, which does not encumber tax administrations to control activities and to collect taxes.³⁰¹ In this context, data showing the flow of investments through SPEs could be made public.

- Action 14: Dispute Resolution

MNEs are increasingly having recourse to arbitration courts where the level of uncertainty is high.³⁰² A particular attention should be paid to trade deals signed with third countries as they can give way to a dispute settlement mechanism such as ISDS. In fact, '24 countries have been already sued by foreign investors in more than 40 separate tax related suits.'³⁰³ These cases, where MNEs question whether or not taxation is legitimate, may rise in the future. Even though some treaties include carve-outs for taxes, they can still be challenged in such courts. The Netherlands hosts many mailbox companies, which give access to Dutch investment treaties signed with more than 80 countries. Even Jersey, Guernsey and the Isle of Man were given access to the ISDS through the UK's tax treaties. The US government and companies repeatedly underline their 'strong interest in access to robust dispute resolution mechanisms around the world.'³⁰⁴ 24 countries were taken to court by foreign investment companies in around 40 tax-related cases and these kind of trials are likely to rise in the future. As the very legitimacy of taxation is put in question, the issue needs particular vigilance.³⁰⁵

- Action 15: Multilateral Instrument to modify tax treaties

'Many schemes described in the Panama papers involve anonymous shell companies, whose real owners hide behind hired 'nominees'. Governments could start by making it a criminal offence to enable tax evasion by others.'³⁰⁶ At the EU level, the Savings Directive as well as other tax-related legislation concerns physical persons not moral persons. It still makes it

³⁰¹ Centore and Sutich, p.784.

³⁰² Interview with Antonio Gambini, CNCD.

³⁰³ Transnational Institute and Global Justice Now 'Taxes on Trial: How trade deals threaten tax justice', February 2016, pp.1-6. (<https://www.tni.org/files/publication-downloads/taxes-on-trial.pdf>).

³⁰⁴ Testimony of Robert B.Stack, Deputy Assistant Secretary (International Tax Affairs) U.S. Department of the Treasury Before the Senate Finance Committee, 1 December 2015.

³⁰⁵ Transnational Institute and Global Justice Now 'Taxes on Trial: How trade deals threaten tax justice', February 2016 (<https://www.tni.org/files/publication-downloads/taxes-on-trial.pdf>).

³⁰⁶ Economist, The lesson of the Panama papers, 9 April 2016 (<http://www.economist.com/news/leaders/21696532-more-should-be-done-make-offshore-tax-havens-less-murky-lesson-panama-papers>).

possible to create an artificial company (whose actual owner is simulated by a physical person) and to escape these measures.³⁰⁷

Swiss Leaks and Panama Leaks showed that taking measures in the EU is not sufficient and there should be an effort to increase global cooperation even more. As the automatic information exchange on bank account information became prevalent and bank secrecy is becoming less of a problem, anonymous structures such as shell companies, trusts, holdings and foundations are being increasingly used in association with nominal assets.³⁰⁸ Following the Panama Leaks, Transparency International called for mandatory public registers of companies' beneficial owners to make it harder to hide stolen assets in secret companies and trusts. To deal with the problem of tax havens, an internationally legally binding agreement instead of OECD soft law would be a better solution. Therefore, multinational cooperation and participation is key in this process and sanctions should be put in place for non-compliance. Following the G20 in Washington, many EU governments showed their support for a European FATCA and adhered to global standards. Yet, the US being initially behind these initiatives, lowered its ambitions. Major players such as the US and Switzerland should be taken on board for any international taxation reform without being allowed to adopt a pick and choose attitude. The EU 'should summon the courage to impose a withholding tax on payments originating in the Union to non-compliant jurisdictions such as the US, copying FATCA's big stick', which could 'unblock arguably the most powerful guardian of financial secrecy in the system'.³⁰⁹ The cooperation with the UN Expert Committee on Tax could be increased, which equipped with more capacity and staff, could help shaping and ensuring compliance with global standards.

- Beyond BEPS

BEPS is an important project aiming to avoid base erosion and profit shifting in all sectors, including the digital one. The US pretends that the failure of BEPS project would result 'in countries taking unilateral, inconsistent actions, thereby increasing double taxation'.³¹⁰

In addition to the recommendations tabled above, which more or less correspond to the BEPS agenda, one shall think beyond BEPS.

One should keep in mind that, due to the mechanism for consensus building at the OECD, the Organisation tends to set minimum standards in a form of recommendations and guidelines, which was the case for BEPS measures. The OECD is only a soft-law organisation and its recommendations are adopted in different countries with different timetables, different implementations, different model templates, different conditionality and varying thresholds. However, at the EU level, these recommendations are transposed into hard law. The Single Market in the EU operates in a different context than the OECD. Hence, there are restraints such as fundamental freedoms, corporate laws, tax priorities and different interests.

Moreover, BEPS measures may have less than the desired outcomes in the end of the day, as it is believed that few businesses change their behaviour as a result of BEPS measures.³¹¹

Most of tax evasion such as company's aggressive tax planning activities are realised with the help of consultancy companies due to Member States' weariness to avoid capital flight,

³⁰⁷ Point Sud (2013), p. 21.

³⁰⁸ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 27.

³⁰⁹ Financial Times, Panama is only one head of the tax haven Hydra, 5 April 2016 (<https://next.ft.com/content/d01062a0-fa71-11e5-8f41-df5bda8beb40>).

³¹⁰ Testimony of Robert B. Stack, Deputy Assistant Secretary (International Tax Affairs) U.S. Department of the Treasury Before the Senate Finance Committee, 1 December 2015.

³¹¹ Interview with Eurodad.

which leads to fiscal dumping.³¹² Accounting firms, offshore company formation agents, trust companies and banks are tasked to find loopholes and enable tax evasion.³¹³ Accounting and consultancy firms known as the Big Four (KPMG, PwC, Deloitte, Ernst Young), having played a big role in the Lux Leaks scandal, admit that they often probe the boundaries of law and create complex and legally doubtful models, which have only a 25 % chance of success.³¹⁴

The problem of the consultancy companies is that they lead to conflict of interest with reoccurring practices of revolving doors, as one day these consultants work for companies; the other day they are employed by the state. Or they are closely interlinked with the state as the case of Patrick O'Rourke, a tax consultant seen as playing a key role in the Double Irish scheme, shows.³¹⁵ This points out to the danger of revolving doors aiming at perpetuating ideas that represent corporate interests.

It is the private sector that is mostly involved in public BEPS consultations providing input with the help of consultancy firms and most importantly, having the capacity to do so.

This is why the civil society should be included more in public consultations and be trusted to represent public interest, especially so given that tax authorities supposedly have 'neither the resources nor the political will to take on wealthy tax dodgers or the powerful accounting firms that set up these schemes for them'.³¹⁶ It is therefore an excellent initiative that the Ombudsman recently suggested a quota system to ensure the inclusion of the civil society in public consultations.

Following Lux Leaks, PwC (the company brokering most tax rulings), was accused in the UK's Public Accounts Committee for planning tax avoidance in an industrial scale. Such accountancy mechanisms shall be established on a routine basis. The EP hearings with the Dutch government, for instance, constitute another good accountability mechanism since it raises awareness and goes on public record through web streaming etc., with companies describing their tax systems. Similarly, the US Tax Committee has been arm-twisting and mobilising companies.

When asked about his moral obligations to pay taxes, Google's CEO Eric Schmidt had answered that he was proud of the aggressive tax planning strategies of the company, as they are legal and any company is obliged to maximise the gains of their shareholders. A number of NGOs are currently working on the concept of corporate tax responsibility suggesting exemplary behaviours to MNEs in the area of tax planning practices, public transparency and reporting, non-public disclosure, relationships with tax authorities, tax function management and governance, impact evaluation of tax policy and practice, tax lobbying and advocacy and tax incentives. While they argue that these measures are necessary to accompany any international tax reform, they acknowledge that a change of corporate culture may take time.³¹⁷

In this context, businesses could incorporate tax ethics more into their Corporate Social Responsibility policies. The link between Corporate Social Responsibility and aggressive tax

³¹² Interview with Antonio Gambini, CNCD.

³¹³ Financial Times, Panama is only one head of the tax haven Hydra, 5 April 2016 (<https://next.ft.com/content/d01062a0-fa71-11e5-8f41-df5bda8beb40>).

³¹⁴ Arbeiterkammer (2015) Tax Avoidance, Tax Evasion, Tax Havens, p. 22.

³¹⁵ Irish Times, Scion of prominent political dynasty who gave his vote to accountancy, 8 May 2015 (<http://www.irishtimes.com/business/financial-services/scion-of-a-prominent-political-dynasty-who-gave-his-vote-to-accountancy-1.2203820>) Also see Bloomberg, Man Making Ireland Tax Avoidance Hub Proves Local Hero, 28 October 2013 (<http://www.bloomberg.com/news/articles/2013-10-28/man-making-ireland-tax-avoidance-hub-globally-proves-local-hero>).

³¹⁶ Canadians for Tax Fairness 'You're A Rich Tax Dodger? No Problem, Says CRA'. 2013.

³¹⁷ Christian Aid, Oxfam and ActionAid (2015) Getting to Good-Towards Responsible Corporate Tax Behaviour.

planning has been much debated and the importance of its implications has been acknowledged in light of several parliamentary hearings and investigations on aggressive tax planning practices of MNEs. In the UK, several multinationals were recently accused of being immoral in the Public Accounts Committee and fear of public boycott encouraged companies such as Starbucks to pay GBP 20 million in the form of 'voluntary charitable donations'. The Committee has further recommended a code of conduct for tax advisors.³¹⁸ Similarly, ethical charters, special training or courses could be designed for accountants.

Another issue which is worth mentioning is the protection of whistle-blowers. Let us recall that Antoine Deltour which disclosed the Lux Leaks, is facing a possibility of 5-year prison sentence. Similarly, the Swiss Leaks whistle-blower may also be prosecuted.³¹⁹ Ironically, the European Commission President Jean-Claude Juncker, who was the then Prime Minister of Luxembourg when the scandal erupted, was 'spared' from an eventual removal by a compromise among EP political groups.³²⁰

Finally, one should bear in mind that Governments should 'take steps individually and through international assistance and cooperation, especially economic and technical, to the maximum of (...) available resources' in order to ensure human rights,³²¹ which implies that they should ensure efficient tax collection and to provide public services for their citizens.

It may also imply that they act in a moral way by avoiding sweetheart deals with MNEs and to take into consideration the harmful effects of tax competition when they design tax policies. To echo IMF, even the healthiest tax competition could have harmful effects. Therefore, the quest for setting a minimum effective rate should not be abandoned.³²² It could be even considered to introduce an anti-abuse clause to effective taxation although the feasibility of this ambitious pursuit could be seriously undermined by the unanimity vote in the Council. Even the US has not managed to introduce a common tax since 250 years as individual states still compete on income and sales taxes and on attracting corporate headquarters (Delaware, for example) and voters seem to value this freedom.³²³

The existence of national tax policies also allows economies like Ireland to lure businesses to offer themselves as an attractive place to do business. Although competition in tax matters is crucial to keep tax rates down, it gives multinational companies and investors incentives to arrange their affairs so as to minimise their tax charge. So, Member States face the dilemma between introducing tax breaks to convince companies to remain in the country and designing regulations to eliminate loopholes, which are known to be exploited by MNEs.³²⁴

³¹⁸ HJI Panayi (2015), pp.544-555.

³¹⁹ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 9.

³²⁰ Eurodad (2015) Fifty Shades of Tax Dodging: The EU's role in supporting an unjust global tax system, p. 39.

³²¹ International Covenant on Economic, Social and Cultural Rights (ICESCR) Article 2(1).

³²² European Parliament (2016) 2016 : Year of corporate tax reform and fiscal transparency, Moscovici tells MEPs (<http://www.europarl.europa.eu/news/en/news-room/20160111IPR09424/2016-year-of-corporate-tax-reform-and-fiscal-transparency-Moscovici-tells-MEPs>).

³²³ Economist, Simple, independent and multinational; another trilemma, 6 April 2016 (<http://www.economist.com/blogs/buttonwood/2016/04/international-tax-avoidance>).

³²⁴ Economist, Simple, independent and multinational; another trilemma, 6 April 2016 (<http://www.economist.com/blogs/buttonwood/2016/04/international-tax-avoidance>).

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NOTES

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ISBN 978-92-823-9476-2 (paper)
ISBN 978-92-823-9475-5 (pdf)

doi: 10.2861/756899 (paper)
doi: 10.2861/799984 (pdf)

