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**Impact of the Anti-Tax Avoidance Directive on the OECD BEPS  
Action Package**

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## **ABSTRACT**

International taxation stands independent from national taxation and the regulation thereof is subsequently more difficult than the former. Taxation has remained one of the core sovereignties of States, therefore the cooperation necessary for the regulation of international taxation is relatively new. Purposeful tax avoidance by multinational corporations costs States an estimated millions of Euros in annual tax revenue, furthermore tax avoidance effects competition and the financial equality of foreign and domestic tax residents.

Subsequently, the OECD and the European Union have compiled legislation to alleviate the tax revenues of States, which are negatively impacted by aggressive tax avoidance. The EU relies on the implementation of the Anti-tax avoidance Directive, while the OECD applies the Beps package in regards to the same inherent issues. The EU enacts the provisions of the OECD BEPS package, when compiling the Anti-tax avoidance Directive, thus creating in addition to the shared goal, a shared basis. Furthermore, in specific situations they are interchangeable, while ATAD introduces only minor additions to the legislation then the OECD BEPS package shares a common base with the Directive and may theoretically collaborate with it. Cooperation between the two entities has been previously established, however, the compatibility of two individual legislations has not been previously discussed. Such a scenario may be possible, if facilitated through significant revisions to both documents.

Keywords: International corporate taxation, tax avoidance, OECD BEPS, ATAD

## Abbreviations

ATAD	Anti-Tax Avoidance Directive
BEPS	Base erosion and profit shifting
CCA	Cost contribution arrangement
CFC	Controlled foreign company
CUP	Comparable uncontrolled price
EBITDA	Earnings before interest, taxes, depreciation and amortisation
EU	European Union
GAAR	General anti-abuse rule IGO-intergovernmental organisation
IAEA	International Atomic Energy Agency
IP	Intellectual property
LOB	Limitation on benefits
OEEC	Organisation for European Economic Co-operation
OECD	Organisation for Economic Co-operation and Development
PE	Permanent establishments
PPT	Principal purpose test
R&D	Research and development
TFDE	Task Force on the Digital Economy
VAT	Value added tax

# INTRODUCTION

## 1.1. Brief overview

The reason international taxation is underdeveloped when compared to national taxation is simple. Historically taxation has been one of the fundamental competencies of a State and thus there has not been a necessity for international taxation regulations. However, globalisation has enabled businesses to expand at an exponential rate, allowing companies to form subsidiaries in multiple different tax jurisdictions. In a model world, these developments would not be used for profit shifting or base erosion strategies. In an attempt to regulate international taxation beyond the capacities of a singular State, intergovernmental organizations (IGO) were created. However, treaty shopping and intentional use of loopholes or inconsistency within tax treaties never the less cost States in the period of 2005 until 2014 an estimated 4% to 10% or 0.7-1.7 trillion Euros of the global corporate tax revenue.<sup>1</sup> Subsequently, there is a need for a uniform and comprehensive approach to the taxation of the profits of international corporations, with branches in multiple tax jurisdictions.

## 1.2. Response of the International Community

As one of its goals to combat the abuse of tax treaties and limit intentional tax avoidance by corporations an IGO the Organisation for Economic Co-operation and Development (OECD) was created. The mission statement of the IGO is to promulgate economic progress and trade, enabled by global cooperation. In 2015 the OECD initiated, along with the G20 countries, a program for the prevention of base erosion and profit shifting (BEPS).<sup>2</sup> The BEPS project has developed a 15 point Action Plan, which once implemented, provides States with the appropriate measures to limit tax avoidance thus ensuring that corporate profits are taxed in appropriate tax jurisdictions.<sup>3</sup>

However, as the OECD is a voluntary intergovernmental organisation then the OECD BEPS initiative has not been uniformly implemented in all tax jurisdictions. Furthermore, some EU

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<sup>1</sup> Johansson, A., Skeie, Ø., Sorbe, S., Menon, C. Tax Planning BY Multinational Firms: Firm-Level Evidence from a Cross-Country Database. Economic Departments Working Papers No. 1355, 2017, p8.

<sup>2</sup> About the Inclusive Framework on BEPS. OECD.  
[www.oecd.org/tax/tax-challenges-arising-from-digitalisation-more-than-110-countries-agree-to-work-towards-a-consensus-basedsolution.htm](http://www.oecd.org/tax/tax-challenges-arising-from-digitalisation-more-than-110-countries-agree-to-work-towards-a-consensus-basedsolution.htm) (20.01.19)

<sup>3</sup> BEPS Actions. OECD.  
[www.oecd.org/ctp/beps-actions.htm](http://www.oecd.org/ctp/beps-actions.htm) (20.01.19).

Member States such as Cyprus have been denied by the OECD, due to their classifications as non-compliant tax regimes, the former until as late as 2015.<sup>4</sup> Subsequently, the majority of the critique about the OECD in the past originated from the exclusivity of its' membership and the resulting dysfunctional and compartmentalised international taxation system.<sup>5</sup>

### **1.3. Response of the European Union**

In addition to the OECD, the European Union (EU) has also joined in addressing the issue. In January 2016 the EU proposed its own anti-tax avoidance initiative, the Anti-Tax Avoidance Package.<sup>6</sup> A part of that package was the Anti-Tax Avoidance Directive (ATAD). The ATAD and the OECD BEPS project are similar because they both contain anti-abuse measures, in fact out of the five measures presented by the ATAD, three are based on the fifteen Actions of the OECD BEPS project. The key differences between ATAD and BEPS are that ATAD has additional countermeasures in the form of the Exit taxation rule and the General anti-abuse rule (GAAR). Furthermore, for implementation ATAD may rely on the supremacy principle in EU law.

### **1.4. Motivation of study**

ATAD has introduced new countermeasure, not yet embodied in the OECD BEPS initiative, therefore there is a legal and economic necessity to review these additions. The existing tax legislation under the OECD's instructions has not eliminated the issues and due to the constant evolution of economy and business models, the OECD BEPS Action Plan should in the belief of this author also be subject to constant updates and review.

Furthermore, it is the view of this author that the myriad of issues international corporate tax avoidance poses must be resolved on a global scale. However, it should be noted that segregation resulting from exclusive Union membership might lead to further segregation within international taxation regimes. The major issue both ATAD and BEPS are trying to limit is base erosion and profit shifting. Therefore, the author of this thesis has concluded that further research must be

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<sup>4</sup> OECD Secretary-General Report to the G20 Finance Ministers and Central Bank Governors 2015. [www.oecd.org/tax/transparency/OECD-Secretary-General-report-to-G20-finmin-sep2015.pdf](http://www.oecd.org/tax/transparency/OECD-Secretary-General-report-to-G20-finmin-sep2015.pdf) (20.01.19).

<sup>5</sup> Julin, J. The OECD: Securing the future. *Oecdobserver*, 2003.

<sup>6</sup> Anti-Tax Avoidance Directive. European Union. [www.ec.europa.eu/taxation\\_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive\\_en](http://www.ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en) (20.01.19).



made into the applicability and intended effect of the European Union's Anti-Tax Avoidance Directive, focusing on the practical implementation of the additional countermeasures of ATAD, into the OECD BEPS initiative, to provide a uniform and comprehensive global offensive against intentional corporate tax avoidance.

The preliminary hypothesis of the thesis is that the additional measures provided by ATAD are dependent on the supremacy principle of the EU and, even though beneficial in the prevention of aggressive tax avoidance, would not be compatible with the core values or within the competences of the OECD, therefore would not be implementable into the OECD Action Plan. In the author's opinion, taxation is at the core of a countries' sovereignty and as the OECD is a voluntary intergovernmental organisation, it cannot infringe upon that sovereignty. Thus the implementation of the OECD principles must be more flexible and consequently not as uniform as those promulgated in the European Union. However due to the negative effect of tax avoidance in regards to the lost tax revenue, and the global scale of the issue, it must be analysed whether the OECD can benefit from the additional countermeasures of the ATAD without limiting the sovereignty of States. Hence, this is a current and fascinating issue, that is of relevance in both economic and legal practices, which has prompted the author to research further.

## **1.5. Research Question**

The research question of this thesis is constructed as follows:

“Do the European Union's Anti-Tax Avoidance Directive's anti-abuse measures provide additional remedies, to counter purposeful tax avoidance when compared to the OECD BEPS Action Plan? And if they do, what changes should be made to implement those measures into the OECD's BEPS initiative without infringing upon the OECD's core values?”

## **1.6. Methodology**

The research method is qualitative and comparative with a *de lege ferenda* purpose for the OECD BEPS initiative. In the thesis, the author relies on OECD's Action Plan on Base Erosion and Profit Shifting and the accompanying Reports of the individual Actions to analyse the current strategy proposed by the global society. Furthermore, the author will use the Anti-Tax Avoidance Package and the Directive to analyse the countermeasures developed for the European Union. In addition

to the OECD and EU sources, the author will refer to scientific and legal academic literature and articles, as well as the opinions of legal experts in the field of international taxation. A holistic approach is applied to evaluate the compatibility of the additional ATAD measure and the OECD core values.

## **1.7. Limitations**

The scope of this thesis will be limited to the countermeasures proposed by the ATAD which yet are not covered by the OECD BEPS Action Plan or the additional Reports. Furthermore, as the ATAD is recent legislation, it is untested and does not have implementation reviews. Thus the thesis is limited to analysing only the theoretical impact of the anti-abuse measures proposed in ATAD. Additionally, under taxable entities, the thesis will be limited to international corporations. The implementation of the measures into the BEPS Action Plan will be limited to the boundaries of the OECD core values and the group's legislative capabilities.

## 2. THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

### 2.1. History and legal effect of the OECD

The Organisation for Economic Co-operation and Development, the OECD, is an intergovernmental organisation, an IGO, which was formed after World War II in Europe. The predecessor of the OECD the Organisation for European Economic Co-operation (OEEC) was formed in 1948 and its purpose was to administer state aid from Canada and the United States which was allocated to the then war-devastated Europe.<sup>7</sup> However, the Marshall Plan was not the primary cause of rapid growth in Europe after the war. When the Marshall Plan ended, the OEEC focused on economic issues inside the European Economic Community.<sup>8</sup> Until 1960, the OEEC concentrated its efforts on the European Free Trade Area. Nevertheless, it was held that due to the economic and social growth taking place in Europe in the late 1950s, the OEEC should be adapted to serve a global purpose instead of limiting itself to the boundaries of Europe.<sup>9</sup> Especially as during the period it was becoming obvious that the financial and economic stability of Europe is influenced by the global economy.<sup>10</sup> Consequently, it was decided that in addition to the European Economic Community, the United States of America and Canada, with Japan in the near future, should also be full members of the organisation.<sup>11</sup> This way the reach and co-operative mechanism of the IGO could be extended.

In 1957, following the signing of the Treaty establishing the European Economic Community, the first steps to reform and restructure the OEEC were taken.<sup>12</sup> The Convention on the Organisation for Economic Co-operation and Development was formulated and signed in 1960.<sup>13</sup> However, it was not until September of 1961 when the OECD finally replaced the OEEC. In 1961 the OECD

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<sup>7</sup> Christopher, W. In the stream of history: shaping foreign policy for a new era. Stanford, Stanford University Press 1998, p. 165.

<sup>8</sup> OECD. Explorations in OEEC History. Paris, OECD Publishing 2009, p 41.

<sup>9</sup> Ibid, p 236.

<sup>10</sup> Leimgruber, M., Schmelzer, M The OECD and the International Political Economy Since 1948. Cham, Springer Nature Publishing AG 2017, P 186.

<sup>11</sup> The Marshall Plan and the Establishment of the OEEC. The University of Luxembourg's research infrastructure CVCE.eu

[www.cvce.eu/en/education/unit-content/-/unit/55c09dcc-a9f2-45e9-b240-eaef64452cae/164c96b3-4d46-4c09-a177-2e6d35a832b2](http://www.cvce.eu/en/education/unit-content/-/unit/55c09dcc-a9f2-45e9-b240-eaef64452cae/164c96b3-4d46-4c09-a177-2e6d35a832b2) (14.02.19).

<sup>12</sup> OECD (2009), supra nota 8, p 224.

<sup>13</sup> Ibid, p 250.

consisted of 20 Member States, today there are 35. In addition to the Member States, the OECD also has a cooperative relationship with 29 non-Member States.<sup>14</sup>

## **2.2. Core values and goals of the OECD**

The OECD, similar to other intergovernmental organisations, was established on a voluntary basis and with funding from the Member States. Through global relations and open projects, the OECD promulgates fair trade and sustainable economic growth by providing independent and factual reports, recommendations and programs.<sup>15</sup>

The OECD focuses on the economy however, the reach of the OECD far surpasses mere economic policies or advisories. It propagates ideas of equality and social well-being, as well as supporting innovation and environmentally friendly growth in the industrial sector.<sup>16</sup> Therefore the OECD uses the uncertainty of economic development to concentrate attention on the underlying issues accompanying them, such as unemployment and taxation. Thus, the OECD aims to provide universal and inclusive economic growth and stability which is fostered by a global forum in which States have the ability to find common ground and compare experiences to find workable solutions to economic stagnation.<sup>17</sup> Consequently, the OECD can tackle multiple social and economic issues at the same time. Through active engagement, by all parties working both independently and in unison, the OECD is able to concentrate the efforts where they are most impactful.<sup>18</sup>

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<sup>14</sup> Regulation: Cooperation with non-member Countries. OECD.  
[www.oecd.org/gov/regulatory-policy/non-member-countries.htm](http://www.oecd.org/gov/regulatory-policy/non-member-countries.htm) (03.03.19).

<sup>15</sup> About the OECD.  
[www.oecd.org/about/](http://www.oecd.org/about/) (02.02.19).

<sup>16</sup> OECD 50<sup>th</sup> Anniversary Vision Statement.  
[www.oecd.org/mcm/48064973.pdf](http://www.oecd.org/mcm/48064973.pdf) (22.12.18).

<sup>17</sup> Global Forum on Responsible Business Conduct 26-27 June 2013 Summary Report. OECD.  
[www.mneguidelines.oecd.org/global-forum/2013GFRBC\\_SummaryReport.pdf](http://www.mneguidelines.oecd.org/global-forum/2013GFRBC_SummaryReport.pdf) (22.12.18).

<sup>18</sup> Boosting Jobs and Incomes- Policy Lessons from Reassessing the OECD Jobs Strategy. OECD.  
[www.oecd.org/els/emp/36889821.pdf](http://www.oecd.org/els/emp/36889821.pdf) (23.02.19).

### 3. THE OECD BEPS PACKAGE

In 2015 the OECD initiated, along with the G20 countries, a controversial program to overhaul the international taxation of corporations. The aim of the new package is to limit base erosion and profit shifting with special emphasis on the source taxation of profits in order to limit tax avoidance. The program is subsequently called the BEPS package.<sup>19</sup> The need for such a package is evident in the estimated annual loss of tax revenue ranging from 4% to 10% of the global corporate tax revenues.<sup>20</sup> This means that in the period of 2005 until 2014 there was an estimated loss of about 0.7-1.7 trillion Euros in tax revenue.<sup>21</sup>

Therefore, there was a genuine need for a re-structure and harmonisation of the global tax system. Subsequently, the Inclusive Framework on BEPS connects over 100 countries and jurisdictions to cooperate and implement the BEPS package in order to limit strategies which, even though not always illegal, utilize the discrepancies and mismatches in national tax systems to artificially transfer profits.<sup>22</sup> The BEPS package focuses on profits which are shifted into a State, where there is little or no economic activity for the company, with the intent of avoiding higher taxes in their original State.<sup>23</sup> The importance of the package is best illustrated in its regulation over cross-border companies, who may, through careful tax avoidance, be placed at a competitive advantage when compared to national companies who simply cannot afford to shift their profits and thus are more rigorously taxed.<sup>24</sup> Therefore the OECD BEPS package does not only aim to return the lost tax revenue to the States, instead following the OECD historical engagement in social and economic issues, the package aspires to harmonize taxation on a global scale and create an environment where all companies, regardless of their size and capital, are treated equally by the State. Furthermore, the OECD also promulgates that in addition to the fair taxation by the State, the corporations must also practise ethical taxation. Thus even though some aspects of tax avoidance are not illegal, they are inherently wrong and thus according to moral values should be avoided. Intentional tax avoidance by multinational corporations has an adverse effect on the population of

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<sup>19</sup> About the Inclusive Framework on BEPS. OECD.  
<http://www.oecd.org/ctp/beps-about.htm> (20.02.19).

<sup>20</sup> Johansson, A., Skeie, Ø., Sorbe, S., Menon, C. (2017), *supra* nota 1.

<sup>21</sup> *Ibid.*

<sup>22</sup> About the Inclusive Framework on BEPS. OECD.  
<http://www.oecd.org/ctp/beps-about.htm> (20.02.19).

<sup>23</sup> *Ibid.*

<sup>24</sup> *Ibid.*

the State who, in an economically weaker status, are still more heavily taxed than multinational and multimillion conglomerates.<sup>25</sup>

### **3.1. The OECD BEPS Action Plan**

The BEPS package consists of 15 actions, which equips governments with both national and international tools to limit base erosion and profit shifting by corporations. These instruments ensure that the taxation of profits takes place where the services or sale has been performed and where the value is generated. Furthermore, these 15 actions will ensure businesses a greater level of certainty in regards to taxation as they will reduce disputes over the application of domestic and international tax laws and will harmonize compliance requirements across borders. Finally, the Plan calls for additional and improved transparency and subsequent certainty in taxation. The new BEPS package promulgates to alleviate the harm caused to three groups.<sup>26</sup> Firstly it will enable governments to be reimbursed and to avoid future tax avoidance schemes, thus allocating more tax revenue into States budgets. Secondly by limiting tax rules which allow certain businesses to reduce their share of the tax burden by shifting profits, thus imposing the remaining taxpayers in that area to excessive taxation and unfair competition. Thirdly, international corporations would not have to worry about scandals or harming their reputation because if everybody is taxed equally then no one's reputation can be harmed by the exposure of a scandalous tax avoidance scheme.

#### **3.1.1. Action 1: Tax challenges of the Digital Economy**

Action 1 of the OECD BEPS Action Plan concerns the tax issues arising in the Digital Economy.<sup>27</sup> The Action obligates to counter the tax challenges present in the Digital Economy by identifying the main issues in regards to applying existing international tax laws to the digital sphere and to produce detailed solutions for them.<sup>28</sup> Through this process and with the application of the holistic approach both direct and indirect taxation should be reviewed.<sup>29</sup> Action 1 also provides an inclusive list of situations that should be reviewed in regards to taxation.<sup>30</sup> It includes the

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<sup>25</sup> Teijeiro, G. International Taxation and the Moral Debate. Kluwer International Tax Blog. 2016. [www.kluwertaxblog.com/2016/05/23/international-taxation-moral-debate/](http://www.kluwertaxblog.com/2016/05/23/international-taxation-moral-debate/) (22.01.19).

<sup>26</sup> OECD. Action Plan on Base Erosion and Profit Shifting. Paris, OECD Publishing 2013, p 8.

<sup>27</sup> BEPS Actions. OECD.

<http://www.oecd.org/ctp/beps-actions.htm> (28.02.19).

<sup>28</sup> OECD (2013), *supra nota* 26, p 14-15.

<sup>29</sup> *Ibid.*

<sup>30</sup> *Ibid.*

possibility for a corporation to have a significant digital presence in a State without being liable for taxation due to the absence of regulatory harmony in existing international rules.

Due to the fluid cross-border transfer of digital good and services, it is difficult to separate the Digital Economy from the rest, in regards to taxation, while the sphere and its' business models do present features relevant to taxation.<sup>31</sup> In addition, the Digital Economy has also extended the speed and spread of international value chains, these are the routes which multinational corporations integrate their global operations into.<sup>32</sup> Subsequently, the new anti-fragmentation rule calls for the prohibition of artificial arrangements through which the right of conclusion of the contract is shifted between subsidiaries and the parent company with the intent of avoiding a PE.<sup>33</sup> Additionally, it was recommended that the definition of a controlled foreign company income, should include their Digital Economy earnings and be taxable in the jurisdiction of the parent company.<sup>34</sup> This type of Digital Economy income concerns the new developments in technology such as cryptocurrencies, unmanned robotics and 3D printing.<sup>35</sup> All of these sources are significantly profitable and largely unregulated.

### **3.1.2. Action 2: Neutralising Hybrid Mismatch arrangements**

Action 2 of the BEPS Action Plan develops model treaty provisions and recommendations in regards to the national legislation to neutralize the effect of hybrid mismatch instruments and entities.<sup>36</sup> These hybrid mismatch instruments take advantage of the differences between two tax jurisdictions to exploit double non-taxation or long-term tax deferral.<sup>37</sup> These loopholes are widespread and have an adverse effect on the taxable revenue of a State. Subsequently, multinational corporations can exploit these differences and employ them for limiting taxation by tax accounting rather than tax avoidance. Thus deteriorating competition, transparency and fairness in the market. As a part of the 2015 report on Action 2, the BEPS project called for recommendations for enhancing national and international legislation to eliminate hybrid mismatches.<sup>38</sup>

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<sup>31</sup> Ibid, p 54.

<sup>32</sup> Ibid, p 143.

<sup>33</sup> Ibid.

<sup>34</sup> Ibid, p 12.

<sup>35</sup> Ibid, p 43-45.

<sup>36</sup> BEPS Actions. OECD.

<http://www.oecd.org/ctp/beps-actions.htm> (22.12.18).

<sup>37</sup> OECD. Neutralising the Effects of Branch Mismatch Arrangements, Action 2: Inclusive Framework on BEPS. Paris, OECD Publishing 2015, p 89.

<sup>38</sup> Ibid.

The Primary rule proposed by the Report for national legal systems is the right for denial of a deduction for a payment which is not included in the declared taxable income of the recipient in the original State or if it was already deducted in the original State.<sup>39</sup> The Defence rule enables the State with the lower tax system to either obligate the deducted payment to be included in the taxable income or to deny the second deduction of tax, so-called double-deduction, from the corporation's taxable earnings.<sup>40</sup> The Action 2 Report issued in 2017 advises that mismatches will not appear if all States follow common practices in regards to determining the location of the taxable income or allocating income and expenditure to different parts of the same corporation.<sup>41</sup>

### **3.1.3. Action 3: Controlled Foreign Company rules**

Controlled foreign company (CFC) rules regulate the taxation of income of taxpayers, who hold a controlling share in a foreign subsidiary.<sup>42</sup> Generally, these shares are not taxed as apart of the corporate profits and not taxed at all until the distribution of dividends results in the accumulation of funds.<sup>43</sup> Through careful and intentional planning these CFC's can be used for profit shifting and long term tax deferrals. Therefore the OECD has set out recommendations to be implemented into national legislation, with the aim of modernising CFC rules in all jurisdictions.

The first recommendation by the group is to extend the definition of CFCs to non-corporate entities and their income, thus regulating them under CFC rules.<sup>44</sup> Subsequently, the OECD states that CFC rules should apply to companies whose tax rates are genuinely lower than those applicable to the in the parent State, and not to those who have artificially lowered their tax burden.<sup>45</sup> Due to the discrepancies in the definition of a CFC income, as in some States, all income which is allocated to the shareholders in the parent company is CFC income, then the report advises that the CFC rules should include a non-exhaustive list of approaches or practises by which the income could be defined.<sup>46</sup> Furthermore, in an attempt to limit partial ownership but majority profit sharing, the report advises that the attribution of income should be linked and proportional to the real ownership or influence. The final recommendation by the OECD is the prevention and

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<sup>39</sup> OECD (2009), *supra* nota 8, p 12.

<sup>40</sup> *Ibid.*

<sup>41</sup> OECD. *Neutralising the Effects of Branch Mismatch Arrangements, Action 2: Inclusive Framework on BEPS*. Paris, OECD Publishing 2017, p 19.

<sup>42</sup> OECD. *Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report*. Paris, OECD Publishing 2015, p 28.

<sup>43</sup> Eder, U. *OECD BEPS Base Erosion and Profit Shifting explained 1 (Actions 1-5)*. 2015.

[www.linkedin.com/pulse/oecd-beps-anti-base-erosion-profit-shifting-rules-explained-eder/](http://www.linkedin.com/pulse/oecd-beps-anti-base-erosion-profit-shifting-rules-explained-eder/) (20.12.18).

<sup>44</sup> OECD (2015), *supra* nota 42, p 46.

<sup>45</sup> *Ibid*, p 61-62.

<sup>46</sup> *Ibid*, p 43.



elimination of double taxation, by the use of tax credits for genuine foreign taxes paid and the limitation of double taxation of dividends and profits from the sale of CFC shares.<sup>47</sup>

### **3.1.4. Action 4: Interest Deductions and Financial Payments**

Due to the mobility and fluid nature of capital, multinational companies can, through the allocation and inter-corporation transfer of debts and funds, achieve a beneficial tax treatment.<sup>48</sup> The 2015 report on Action 4 by the OECD identified 3 possible scenarios where BEPS risks may arise. Firstly, corporations may place the debt of third parties into branches which are situated in high tax States. Secondly, Groups who are using intragroup loans to generate interest deductions may do it disproportionately in comparison to the group's actual third-party interest costs. Thirdly corporations may use third party or intragroup financing to move funds from high tax zones to low or no-tax locations and thus effectively accumulating tax-free income. In an effort to combat these BEPS risks, the OECD report, recommends a fixed ratio based approach which will limit corporations net deductions for interest and payments to be equivalent to interest to a percentage of its earnings before interest, taxes, depreciation and amortisation (EBITDA).<sup>49</sup>

In 2016 the OECD issued an updated Report for Action 4. The report calls for the exclusion for interest paid to third parties on loans for public projects and the application of the *de minimis* threshold, to eliminate branches with a low level of interest expenses.<sup>50</sup> Lastly, it is recommended that the interests expenses or unused interest capacity should have the possibility to be carried forward. The carrying forward of interest expenses will enable companies, who incur interest on long-term investments and whose income is generated in a later phase, to offset the interest deductions when the profits occur.<sup>51</sup> The report also singles out the banking and insurance sector, because of their unique features and the specific BEPS risks they embody.

### **3.1.5. Action 5: Countering harmful tax practises through transparency and substance**

Action 5 of the BEPS Plan aims to identify and counteract the harmful tax practices through an extensive network for sharing information between States.<sup>52</sup> The Report on Action 5 issued in 2015 by the OECD focuses on preferential regimes which are at a greater risk for artificial profit

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<sup>47</sup> Ibid, p 66.

<sup>48</sup> OECD (2013), supra nota 26, p 17.

<sup>49</sup> Ibid, p 25-28.

<sup>50</sup> OECD. Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2016 Update: Inclusive Framework on BEPS. Paris, OECD Publishing 2016, p 39.

<sup>51</sup> Ibid, p 73.

<sup>52</sup> OECD (2013), supra nota 26, p 18.

transferring and the lack of transparency with connected rulings.<sup>53</sup> Therefore the new report's purpose is to promulgate transparency through a compulsory and spontaneous exchange of rulings in preferential regimes. In regards to information sharing, both future rulings, rulings issued after the 1 April 2016, and past rulings, issued after 1 January 2010 but which were still in effect from 1 January 2014, must be exchanged with all States involved.<sup>54</sup> Due to the private and introverted nature of these regimes, the BEPS package will also engage with non-OECD States to ensure widespread implementation of the Action.<sup>55</sup>

In regards to the substantial engagement by the preferential regimes, the Report outlines intellectual property (IP) regimes as having significant importance and recommends applying the nexus approach. The nexus approach uses the cost incurred by the corporation, for example in research and development (R&D) as the proxy for evaluating whether the corporation can benefit from the IP regime.<sup>56</sup> This means that a corporation can only take advantage of a preferential IP regime if they have a genuine and proportional expenditure in relation to the creation of that IP.<sup>57</sup> The Report adds that in addition to IP the nexus approach can also be applied to other preferential tax systems.

### **3.1.6. Action 6: Abuse of Treaty benefits**

The 2015 OECD Report on Action 6 targets treaty shopping, which impairs the tax sovereignty of States, by implementing anti-abuse provisions into tax treaties.<sup>58</sup> However, due to each State's unique approach to taxation and the *sui generis* nature of a bilateral convention's negotiations, the implementation process of a minimum standard of protection must be adaptable for multiple individual legislations.

The OECD Report on Action 6 states that the new anti-abuse rules for treaties will firstly counteract treaty shopping because they enable a non-resident to benefit from a tax treaty provisions reserved for the residents.<sup>59</sup> In an attempt to limit treaty shopping the OECD recommends introducing a declaration of intent and a specific anti-abuse rule, the limitation on

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<sup>53</sup> OECD. Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report. Paris, OECD Publishing 2015, p 11-12.

<sup>54</sup> Ibid, p 53-54.

<sup>55</sup> Ibid, p 25-26.

<sup>56</sup> Ibid, p 24-25.

<sup>57</sup> Avi-Yohan, Reuven S., edited by Schön, W., Corporate Responsibility and Strategic Tax Behaviour, Tax and Corporate Governance, Max Planc Institute for Intellectual Property, Competition and Tax Law, Munich, 2008.

<sup>58</sup> OECD. Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 - 2015 Final Report. Paris, OECD Publishing 2015, p 9.

<sup>59</sup> OECD (2013), supra nota 26, p 19.

benefits (LOB) rule to the OECD Model Tax Convention.<sup>60</sup> The LOB rule will ensure that treaty benefits are reserved for genuine tax residents by evaluating based on their general and economic activities, their legal status and the genuine location of the management.<sup>61</sup> In addition to LOB rules, the principal purposes test (PPT) rule will also be added to the OECD Model Tax Convention.<sup>62</sup> The PPT rule assesses whether or not one of the fundamental purposes of the transaction is to receive a benefit.<sup>63</sup> However, the minimum standard can be achieved either through implementing only the PPT rules or the LOB rule accompanied by a mechanism to counter conduit financing arrangements.<sup>64</sup> The Report also provides a non-exhaustive list of tax policy considerations regarding tax avoidance clauses.

### **3.1.7. Action 7: Artificial avoidance of Permanent Establishment status**

Action 7 is crucial to the BEPS Package because it counteracts concerns arising from tax treaties, by restoring taxation of previously untaxed cross-border income.<sup>65</sup> The 2015 OECD Report on Action 7 states that effective cross-border taxation of income must be coordinated with Action 6 due to the similarities between both actions. In order to limit abuse through artificial avoidance of PE status, Action 7 of the BEPS Action Plan demands the actual and factual classification of a PE.<sup>66</sup> The issue here arises from the regulation of the taxation of non-resident companies. Subsequently, multinational corporations have replaced subsidiaries, who previously acted as distributors and constituted PEs, with commissionaire arrangements.<sup>67</sup> Thus eliminating the status of a PE previously placed upon the distributors, while not making substantive changes in the business conducted in the State.

In addition to commissionaire arrangements, the PE definitions must also be updated to satisfy the conditions of the Digital Economy.<sup>68</sup> Therefore the updated OECD initiative has proposed an anti-fragmentation rule to bundle entities which perform complementary functions as a part of a cohesive corporate undertaking in order to re-introduce the status of PE and address BEPS issues<sup>69</sup> The Report also advises amending the OECD Model Tax Convention to counteract abuse practices

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<sup>60</sup> OECD (2015), *supra* nota 58, p 14-16.

<sup>61</sup> *Ibid*, p 18-19.

<sup>62</sup> *Ibid*, p 18.

<sup>63</sup> *Ibid*, p 43.

<sup>64</sup> *Ibid*, p 10.

<sup>65</sup> OECD (2013), *supra* nota 26, p 19-20.

<sup>66</sup> OECD. Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report. Paris, OECD Publishing 2015, p 19.

<sup>67</sup> *Ibid*, p 15.

<sup>68</sup> *Ibid*, p 10-11.

<sup>69</sup> *Ibid*, p 39-41.

in construction businesses.<sup>70</sup> The Report applies the PPT discussed in Action 6 to prevent tax abuse strategies regarding the splitting-up of contracts. However, Action 7 also enables States to opt out of implementing the PPT rule. States who do not choose the PPT, are provided with an automatic rule included in the Commentary.<sup>71</sup>

### **3.1.8. Actions 8-10: Transfer pricing and value creation**

Through transfer pricing, a parent company can transfer its earnings from a high tax zone to a more suitable tax jurisdiction by implementing controlled transactions between subsidiaries.<sup>72</sup> Actions 8 to 10 are grouped together as they share the common goal of linking the profits received from transfer pricing with the corporation who created them.<sup>73</sup> Action 8 concerns the capital created from inter-group sharing of intangibles. Action 9 expresses the necessity to create transfer pricing rules to counter the generation of profits by contractually transferring risk or superfluous capital between companies. Action 10 addresses the need to develop a comprehensive plan to counter possible high BEPS risk areas, such unusual transactions between third parties.

The OECD Beps Action Plan Action 8 has divided the strategy to counteract the intentional allocation of intangibles into 4.<sup>74</sup> The first is to implement a definitive list of intangibles. The next prescribes connecting the value created by the sharing of intangibles to the branch where it was generated. Additionally, specific transfer pricing regulations or supplementary measures must be developed for the transfer of intangibles and the instruction on arrangements by which companies form a cost contribution arrangement (CCA) must be revised. Action 9 relies on the applicability of transfer pricing rules to avoid the allocation of risk where no activities have genuinely been carried out. Additionally, the correct application of the pricing method is proposed to have an effect on the fair allocation of profits. For intangibles, legal ownership alone does not necessarily dismiss the risk of another party when those parties are conjoined or in cohesion.<sup>75</sup> Action 10 instructs the G20 and the OECD countries to cooperate on the development of transfer pricing rules. Collaborative action is called to provide protection from base eroding payments such as management and head office expenses.<sup>76</sup>

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<sup>70</sup> Ibid, p 42.

<sup>71</sup> Ibid.

<sup>72</sup> OECD. Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports. Paris, OECD Publishing 2015, p 15.

<sup>73</sup> OECD (2013), supra nota 26, p 20-21.

<sup>74</sup> OECD 2015, supra nota 72, p 163-164.

<sup>75</sup> OECD (2013), supra nota 26, p 20.

<sup>76</sup> OECD (2015), supra nota 72, p 55.

### **3.1.9. Action 11: Servicing and monitoring BEPS**

Action 11 establishes the methodology used to collect and analyse data on BEPS.<sup>77</sup> The analyses would take into account the scale and economic impact of BEPS in order to facilitate the creation of instruments for the evaluation of the effectiveness and economic impact of the BEPS actions.<sup>78</sup> Furthermore, the action introduces potential criteria for evaluating available data for BEPS research for future statistical work. The program divides the BEPS indicators into 6 for Action 11. The main BEPS indicators focus on the connection between financial and genuine economic activities, profit shifting through intangibles and profit shifting through interest.<sup>79</sup>

To combat tax avoidance proactively Action 11 has also proposed possible future BEPS indicators with new data which would use international consolidated financial statement information for both domestic and foreign operations to compare the profit rate differential between the two.<sup>80</sup> Subsequently, a negative correlation between domestic and foreign profit rates may indicate BEPS. Action 11 recognizes the impact of the OECD BEPS program currently and shows where it might be headed if cooperation is further developed and membership is more inclusive. However, currently, the revisions proposed by the Action are restrained by the same limitations which were responsible for the failure of the previous. The OECD can propose initiatives however without proactive implementation and uniform transparent reporting of issues it will never have the global effect it desires. Instead through the forced segregation by the member states and collaborative partners, the amended framework might have a counterproductive effect by further dividing the international tax sphere.

### **3.1.10. Action 12-15: Mandatory disclosure rules and dispute resolution mechanisms**

The Beps Action plan recognises that current, concrete and relevant information in regards to aggressive or abusive tax planning strategies is an elusive necessity. As such Action 12 focuses on the requirements of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures. In addition to the mandatory disclosure regime and initiatives, Action 12 examines international transactions and considers the circumstances favourable for their positioning into the disclosure regimes scope. Lastly, the Action reviews the exchange of information and its effect on international schemes and tax avoidance. The information required by Action 12 may be presented by multinational enterprises by the reports described in Action 13.

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<sup>77</sup> Ibid, p 21-22.

<sup>78</sup> OECD. Measuring and Monitoring BEPS, Action 11 - 2015 Final Report. Paris, OECD Publishing 2015, p 18-19.

<sup>79</sup> Ibid, p 46.

<sup>80</sup> Ibid, p 65.

As the consequences of non-compliance and future deterrence monetary penalties, non-monetary penalties and initiatives targeting promoters are applicable to abusers. However, the application of the penalties would be dependant on the appropriate implementation of such provisions into domestic law.<sup>81</sup> Furthermore, to counteract discriminative penalties Action 14 introduces revised mechanisms for dispute resolution.

Subsequently, Action 12 calls for a communication strategy between tax authorities to issue publications as a way of providing early warnings for taxpayers. Action 13 provides the forms for such documentation. The Actions bring as an example the United Kingdom with the 'Spotlight' initiative and Canada with their 'Tax Alert' product as well as the IRS in the United States of America with the 'listed transactions' solution to characterize the general system administrators should set up. This system shall enable the taxpayers to be knowledgeable of current issues as well as provide forms for reporting and dispute resolutions purposes. Action 14 relies on the transparency created by Action 12 and facilitated by the reports of Action 13 to upgrade dispute resolution mechanisms through peer review and monitoring. Action 15 provides the legal reasoning and necessity behind the OECD BEPS package and sets forth the measures for the countries to galvanize their implementation of the legislation.

## **2.4. Legal analysis**

The OECD BEPS program is the latest significant step by the intergovernmental entity to help promulgate the fair and appropriate taxation of both domestic and foreign gains by multinational corporations. However, due to the volatile and fast reactive nature of international taxation, the launched BEPS program has already in certain circumstances fallen behind the current practices. Thus creating what they set out to eliminate, unnecessary and confusing legislation. This legislation is a result of multiple factors beginning from discrepancies in the application of requirements and the lack of transparencies between State practises.<sup>82</sup> As the OECD is by nature a voluntary organization and pressuring unfavourable tax legislation goes against its core values then it cannot achieve coherency within its members through sheer force. Instead, the BEPS program must be open to interpretation of the methods while preserving the end goal. Subsequently it is apparent throughout the Actions that the legislators prefer taking the holistic approach within

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<sup>81</sup> Ibid, p 60.

<sup>82</sup> Leimgruber, M., Schmelzer, M The OECD and the International Political Economy Since 1948. Cham, Springer Nature Publishing AG 2017.

individual Actions as well as with the entire program. Therefore, the reports issued in regards to the Actions provide viable and necessary updates to the framework while simultaneously not exceeding the scope of the package or the powers of the OECD.

Furthermore, this author supports the connection of hybrid mismatch rules and branch mismatch rules together as a package. As a uniform practice, this will limit the ability of corporations to exchange hybrid mismatches for branch mismatches in more favourable situations. In addition, the exclusion of branch mismatches would in the opinion of this author defeat the purpose of the OECD BEPS Action Plan. If the plan envisions to level the playing field for international and national corporations, then the restriction of inclusion which allows only hybrid mismatches, will still have a favourable taxation scheme for the former. Additionally, eliminating the need for competition over headquarters for international corporations will deter States from employing inadequate and harmful tax systems to attract them. The key issue here is that these practices must be widespread and implemented in uniform in all jurisdictions, otherwise the package would be proactive. In addition to equal treatment by States and of States, the package also provides tools for tax residents for transparency and dispute resolution. Therefore, the OECD acknowledges that in addition to the governmental side in countering tax avoidance private companies must also be proactive in their conduct for limiting illegal and aggressive tax planning.<sup>83</sup> Thus the methods prescribed in Actions 12-14 provide transparency between the contracting States and thus informs the OECD of the effect of the Actions. Through these actions the OECD has a mechanism for oversight comparable to the European Union's cooperative legislative bodies.

Action 6 of the BEPS plan deals closely with reviewing and updating the legislative base of the BEPS initiative to better adhere to the core values of the OECD. While respecting the limitations of the intergovernmental organization in regards to the sovereignty of States. Action 7 relies on the instruments already mentioned in Action 6 as well as their cooperative application. The author believes the opt-out clause adheres to the limitations of the powers of the OECD but remain irrelevant due to the lack of a similar clause with Action 6 where the PPT rule is initially introduced. However special emphasis should be put on the possibility to disregard the PPT rule in Action 6, therefore working around the principle entirely. Therefore, the BEPS Actions should be revised to reduce possible inadequacies originating from unformed decisions. Furthermore, with Actions 6 and 7, the OECD also reveals their desire for rapid reform and updates for the BEPS program. Through addressing issues in the Digital market now the BEPS program may be

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<sup>83</sup> Littlewood, M. Tax Competition: Harmful to Whom? Michigan Journal of International Law, 2004, 26 (1), p 450-451.

able to avoid distress later. Furthermore, the OECD BEPS program is suitable for other States to join without relinquishing necessary sovereignty. Therefore, avoiding PE status through branches and agents acting in different States is unpractical due to the uniform appliance of regulations.

Furthermore, it is eminent to this author that in between the different actions of the BEPS program there are clear indications of the core values of the OECD. The ancillary creation of improved employment growth again alludes to the OECD's ulterior motives of promulgating economic and social change on an individual level.<sup>84</sup> Additionally, the universal equal treatment of taxable entities and the due diligence expressed in fostering cooperation between the State and the public are obvious signs of the extended goals of the OECD. The OECD can propose initiatives however without proactive implementation and uniform transparent reporting of issues it will never have the global effect it desires. Instead through the forced segregation by the member states and collaboration partners, the amended framework might have a counterproductive effect by further dividing the international tax sphere. Therefore, the OECD and the EU are no vastly different in their methods for reaching a goal, however as the EU is limited in its influence mainly to its Member States, the OECD is subject to a wider audience and possible subsequent inclusion. Thus the BEPS program may have a greater impact in limiting cross-border tax avoidance with Action 8 than compared to the European Union. However, it must be noted that the OECD has been previously critiqued due to the exclusive membership traditions. Therefore, while the possibilities are positively significant the established practise of both entities does not create certainty in regards to the widespread and uniform implementation of the legislations.

It is the opinion of this author that the regulation will mostly impact companies with both a high amount of net interest expenses and a high net interest ratio, thus it will ensure that the corporation's net interest deduction is proportional to the taxable income generated by genuine economic activity.<sup>85</sup> Additionally, the approach should limit the deduction of interest in zones with little economic significance thus eliminating BEPS risks. The reduction of interest in the before mentioned zones will have a dual impact, significant both for the citizens of State as well as the international corporations conducting business therein. Furthermore, the holistic approach, which supports the core values and extended goals of the OECD, is evident in multiple instances throughout the BEPS package and supports the cooperation between the States and private enterprises in regards to fair and appropriate taxation.

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<sup>84</sup> Genschel, P. Globalization, Tax Competition, and the Welfare State, *Politics & Society* June 2002.

<sup>85</sup> Santos, António Carlos. What Is Substantial Economic Activity for Tax Purposes in the Context of the European Union and the OECD Initiatives against Harmful Tax Competition? *EC Tax Review*, 2015, 3.



## **4. THE ANTI-TAX AVOIDANCE DIRECTIVE**

### **4.1. Background of the Directive**

The European Union shares many similarities with the OECD in its formation and core values. However, the EU has a supranational governance structure allowing it to make decisions without the unanimous support of all its members.<sup>86</sup> Therefore, the European Union is better equipped to counter tax avoidance and promulgate an effective tax system across its borders. In its approach, the EU may rely on the principles of supremacy as embodied in case *Van Gend & Loos, C-26/62*.<sup>87</sup> As well as on the principle of direct effect as described in case *Costa v. ENEL, 6/64*.<sup>88</sup> Following the principles described in the Social Contract by Rousseau, the individual freedoms relinquished by the members should lead to widespread implementation of effective tax legislation.

The European Union has adopted the Anti-Tax Avoidance Directive (ATAD) which embodies most of the rules prescribed in the BEPS package, with additional measures relying on the impact of Union powers. Therefore the OECD's BEPS package is the foundation for the European Union's Anti-Tax Avoidance Directive, thus preventing the States, which are not a member to the OECD, from becoming tax heavens inside the Union. ATAD was drafted to counter the financial crises in the Single Market and to provide the necessary tools to prevent anti-avoidance in a complex multinational market.<sup>89</sup> Furthermore, aggressive tax planning and active tax avoidance erode at the fundamental freedoms of the EU by being detrimental to business and raising ethical questions.<sup>90</sup>

### **4.2. Core values embodied by the Directive**

The EU's Directive exhibits most of the core values of the OECD BEPS package resulting from the numerous members the two entities share. Subsequently, the OECD has stated that EU Member States party to the OECD BEPS package, who have not yet adopted the package may fulfill their obligations by implementing the ATAD. Thus the OECD acknowledges that while the implementation of the Directive is done on a national scale the impact will be on the international

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<sup>86</sup> Craig, P., De Búrca, G. *EU Law – Text, Cases and Materials*, Fifth Edition, Oxford University Press 2011.

<sup>87</sup> ECJ 1963 C-26/62 *Van Gend en Loos*.

<sup>88</sup> ECR 1964 6/64 *Costa v. ENEL*.

<sup>89</sup> Lyons, T., *The Financial crisis, tax avoidance and an EU GAAR*, *British Tax Review* 2013, p 1.

<sup>90</sup> Darcy, S., 'The Elephant in the Room': *Corporate Tax Avoidance & Business and Human Rights*, *Business and Human Rights Journal*, Volume 2, Issue 1, January p 8.

one. The aim of the Directive at its core is to combat aggressive tax planning and provide updated countermeasures to international tax avoidance.<sup>91</sup> Furthermore, ATAD aims to counter tax avoidance by international corporations to dissolve possible tax heavens within the Union. Additionally, tax harmonisation between the Member States fosters economic growth and strengthens the common market and monetary union.<sup>92</sup> However, due to the complexity and multitude of tax jurisdiction within the Union ATAD consists of general provisions put in place to guide the Member States.<sup>93</sup>

ATAD regulates all taxpayers that are liable for corporate tax in any EU Member State, thus affecting multinational conglomerates, which have previously enjoyed relatively preferable conditions in the Union. However, a distinction should be made between legal tax avoidance and illegal tax evasion, as one inhibits competition while the other a core financial freedom.<sup>94</sup> Globalisation has not made the separation of the previous easier and as informed tax avoidance may be profitable while illegal tax evasion gravely costly, specific criteria for evaluation tax liability has been created.<sup>95</sup> ATAD relies on the previously established instances on limiting tax liability; tax evasion, tax avoidance and tax mitigation.<sup>96</sup> Thus emphasising the importance of distinguishing between legal and illegal tax planning harmoniously on a multinational sphere.<sup>97</sup>

### **4.3. Brief overview of the structure and main contents of the Directive**

The Anti-Tax Avoidance Directive consists of 5 countermeasures to combat aggressive tax avoidance and to harmonise the legislation of Union Members. The legislation applies to Union corporate tax residents and to permanent establishments located within the Union but is a tax resident of a third country. A relief system has been put into place to provide alleviation in cases of double taxation. However special emphasis is put on the proper application of the arm's length principle to not be affected by the implementation of the ATAD. Furthermore, the preamble of the Directive prohibits from interfering with Member State's right to raise tax liability in accordance

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<sup>91</sup> Council Directive (EU) 2016/1164 of 12 July 2016.

<sup>92</sup> Terra, B., Wattell, P. *European Tax Law*, fifth edition, AH Alphen aan den Rijn: Kluwer Law International 2008, p. 5-6.

<sup>93</sup> EU (2016) supra nota 91.

<sup>94</sup> Merks, P., Ernst & Young and Vrije Universiteit, Amsterdam, *Tax Evasion, Tax Avoidance and Tax Planning*. *International Tax Review*, Intertax, Issue 1, January 2006, p 272.

<sup>95</sup> Mullineux, J., *The Distinction between Tax Avoidance and Tax Evasion*, *New Zealand Universities Law Review*, December 2014.

<sup>96</sup> Dixon, D., *Defining Tax Avoidance*, *King's Student Law Review*, Vol.5, Issue 2 (Winter 2014) p 20.

<sup>97</sup> Zodrow, G. *Tax Competition and Tax Coordination in the European Union*, *Springer Articles* November 2003.

with the arm's length principle as well as processing personal data without due care for Data protection. Additionally, ATAD is supposed to provide solutions to the issues of the internal market as a whole, while following the capabilities of the Member States and avoiding unnecessary intervention by the Union powers.

The Directive consists of three chapters, first of which lays down the scope and definitions. The second consists of the five anti-abuse measures and the third includes final provisions regarding the review and presentation of the implementation process. The five anti-avoidance principles described in chapter two of ATAD are Controlled foreign company (CFC) rule, Exit taxation, Interest limitation, Hybrid Mismatch rule and the General anti-abuse rule (GAAR).<sup>98</sup> Initially, a sixth countermeasure, the Switchover rule, was proposed however due to issues regarding the scope of the Directive and the limitation of EU powers the rule was disregarded. The Switchover rule would have surpassed the BEPS package and effectively given the EU direct control over national corporate tax rates.

#### **4.3.1. Identification of the updated anti-abuse rules**

Interest limitation rules deal with inter-corporate loans and the deductibility of interest payments in high-tax jurisdictions. ATAD limits the deductibility of taxpayers' exceeding borrowing costs by fixing a ratio for deductibility. The ratio refers to a taxpayer's taxable earnings before interest, tax, depreciation and amortisations. Therefore, Article 4 of the ATAD embodies the principle found in Action 4 of the BEPS package. Controlled foreign company rules regulate the re-tribution of income of low-taxed subsidiaries to its parent company, thus making it taxable for the State of residency. The goal of the Directive is to combat all forms of artificial agreements or profit shifting between parent companies and subsidiaries with the aim of taking advantage of preferential taxation. CFC rules are extensively covered in the BEPS package and due to the opting out of the package for EU Members, have also been precisely addressed in the ATAD. Hybrid mismatch rules aim to alleviate the complications arising from the interaction of multiple different legal systems in different tax jurisdictions. These mismatches may lead to double taxation or absent taxations, thus creating issues to both public and private bodies. The proposed hybrid mismatch rules are meant to relieve the existing mismatch arrangements and prevent additional

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<sup>98</sup> EU (2016) supra nota 91.

ones under the new Directive. Hybrid mismatch rules are also addressed in the OECD BEPS package, however, have been regulated in the Union since the 1998 Code of Conduct Group.<sup>99</sup>

In addition to the anti-avoidance measures listed above, ATAD contains two measures not covered by the OECD BEPS package, the Exit taxation rule and the General anti-abuse rule.

#### **4.3.2. Exit taxation rule**

The exit taxation rule ensures that in the case when a taxpayer moves assets or its entire tax residence out of tax jurisdiction, then that State may tax the economic value of any capital gains which have been created within its territory even if the gain has not yet been realised at the time of the exit. The market value for the transferred assets at the time of the exit is determined following the arm's length principle.<sup>100</sup> The rule is implemented in transfers of assets from one head office to a PE in another Member State or the reverse. Additionally, the rule applies to the transfer of a business to another Member State or to a third country. However, if the destination State for the transfer is a part of the Agreement on the European Economic Area then the owed tax may be paid in instalments over five years. The exit taxation rule is not applicable to the transfer of assets between parent companies and subsidiaries. Furthermore, the rule is not applied when the nature of the transfer is temporary and the transferor will return the aforementioned assets to the Member State or if the transfer is made to fulfil prudential capital requirements, liquidity management, securities' financial transactions or assets posted as collateral.

The exit tax rule is not included in the OECD BEPS package and is applicable to the transfer of assets, tax residency or business, dependant that they are appraised according to the real market value and not used to artificially transfer funds between subsidiaries. The rule provides multiple exemptions and a payment plan for easier compliance by corporations.

#### **4.3.3. General anti-abuse rule**

General anti-abuse rules counteract abusive practices still uncovered by other anti-tax avoidance rules.<sup>101</sup> GAAR consists of a broad rule based on general principles to prevent tax avoidance in unpredictable forms. These rules are commonly applied to arrangements which are not genuine

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<sup>99</sup> Kiegebeld, Ben, J. Harmful Tax Competition in the European Union - Code of Conduct, Countermeasures and EU Law. Foundation for European Fiscal Studies, Kluwer, 2004.

<sup>100</sup> Franze, R., et al, Transfer Pricing and Distribution Arrangements: From Arm's Length to Formality Apportionment of Income, Intertax, Vol. 33, Issues 6-7, June-July 2005.

<sup>101</sup> Heinemann, F, Overesch, M, Rincke, J, Rate-Cutting Tax Reforms and Corporate Tax Competition in Europe. Economic & Politics, Volume 22, November 2010.

and damage competition with abusive avoidance schemes. Similar to the OECD's requirements, GAAR is applied to arrangements only if their inherent goal is to unfairly reduce the tax burden. Therefore, the rules themselves are equally unpredictable and as a result, create uncertainty for businesses in regards to possible future taxation. As GAAR applies to multiple corporate taxes this uncertainty has proven to create a negative environment for domestic and foreign investments.<sup>102</sup> This would be counterproductive to the ATAD as it would have a negative impact on the economy of the single market. Additionally, GAAR counteracts unfair tax advantages arising from "pooling" arrangements.

#### **4.4. Legal analyses**

The EU's ATAD relies heavily on the legislation and tools already compiled by the OECD. The similarities become evident in the structure of the two texts. This is supported by the OECD's acknowledgement of the quality of the ATAD and the interchangeability of it, for members of both entities. Furthermore, three of the five countermeasures proposed in the Anti-tax avoidance Directive cover issues already addressed in the BEPS Package. Unlike the OECD, EU may rely on principles of supremacy and direct effect to obligate its Members to implement a coherent tax system across the Union. Therefore, the EU is better equipped from a legal standpoint, to provide a multinational approach to the regulation of corporate taxation. However, it should be noted that while the principle of supremacy has been established in previous casework it is the Union's previous practises that while the direct impact is enabled it is seldom applied. Instead with ATAD the Union drafted general guidelines which embody the values of both the EU and the OECD. Thus enabling the Member States to choose the best practises to achieve the goals prescribed by the legislation. Such an approach has been previously enacted by the Union and it is the view of this author that while the principles of supremacy and direct effect anoint powers to the Union, best course of action is the prescription of general guidelines. Subsequently, the Union can be assured that a comprehensive tax system has been implemented across the Union in harmony, while also not infringing upon the sovereignties of individual States.<sup>103</sup> The respect towards sovereignty in a supranational organization such as the EU is further supported by the exclusion of the proposed Switchover rule from the Directive. It is the view of this author that while the

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<sup>102</sup> Panayi, C., H., *European Union Corporate Tax Law*, Cambridge University Press, Cambridge, The Edinburgh Building, Cambridge 2013, p 109.

<sup>103</sup> *Sovereignty, Integration and Tax Avoidance in the European Union: Striking the Proper Balance*. Georgetown University Law Centre 2010.

ATAD has a more impactful scope in comparison to the BEPS package, neither desires to infringe upon the sovereign rights of Member's tax legislation. Subsequently, while the EU may rely on additional implementation guarantees, favouring the effective application of the Directive. It does not take advantage of its position and instead relies on the approach similar to the OECD, thus allowing the best practices to be determined by its Members.

Furthermore, in addition to the anti-avoidance tools proposed by the OECD and extended by the EU, the ATAD also consists of two additional measures. The proposed Exit taxation rule and General anti-abuse rules are original to the ATAD and regulate the specifics of the Single market and other general issues which may appear. The Exit taxation rule has been specifically designed to counter the abuse apparent in the transfer of assets, business or tax residency by corporations and their subsidiaries. Additionally, the Exit taxation rule regulates the transfer between the Member States as well as the transfer into a third State. Therefore, the scope of this rule surpasses national borders, which is supported by the previously established criteria for countering international tax avoidance. The General anti-abuse rules are additional provisions found in the ATAD, however not covered by the OECD. These rules are similar to Hybrid mismatch rules by their nature, as they are also meant to provide remedies for situations not yet fully regulated by legislation. However, a clear distinction must be made between the two, Hybrid mismatch rules aim to relieve challenges arising from the incompatibility of different national tax law and limit subsequent abuse by corporations. The General anti-abuse rules however are meant to provide remedies for additional challenges arising from inadequate tax law or unclear legal provision. It must be noted that Hybrid mismatch rules are also addressed by the ATAD, thus making the General anti-abuse rules additional tools for the Member States. However, special emphasis should be put on the observation and transparent administration of the GAAR, in order to avoid creating uncertainty within investors and therefore segregating the single market from the global one. The Exit taxation rule addresses specific challenges of the Single Market and the European Economic Area, while the General anti-abuse rules are similar to the principles established in both the ATAD and the BEPS package, they provide additional countermeasures for dealing with possible future problems. The additional measure introduced by the ATAD embody the key issues in close relation to the Union and it is the opinion of this author that the additional countermeasures introduced by the General anti-abuse rules acknowledge the complex and changing challenges relating to the taxation of international corporations thus it is beneficial to the implementation of the current Directive, while also laying a basis for possible future review. Furthermore, the uniform

application of GAAR throughout the EU may suffice in ensuring that the administration of the rules is transparent and subsequently favourable to investors.

## **5. COMPARATIVE ANALYSIS OF ATAD AND THE OECD BEPS ACTION PLAN**

### **5.1 Analysis of the OECD and the EU**

The OECD's desire for a uniform and equal taxation process facilitated by the BEPS package is realised through the holistic approach, such as described in the initial Actions of the package. Similarly, the EU has an established use of the holistic approach in regards to security.<sup>104</sup> Therefore, the collaboration between the two programs regarding international taxation of corporations should also be possible, without regard to the superior implementation powers of the EU. Even though the EU may rely on the principle of supremacy, if both parties apply the holistic approach then superior tools may reduce the challenges in implementation but the end result should remain similar in general characteristics and core values.<sup>105</sup> Furthermore, collaboration is supported by the multiple shared provisions between ATAD and the BEPS package, as well as the small difference between only two anti-abuse measures in ATAD. Additionally, the OECD has stated that the implementation of ATAD substitutes the BEPS package for its members.

While the OECD may share many of its intentions with the EU, it nevertheless is restricted by the powers prescribed in its charter. Therefore, the key issue in regards to the effect and reach of the BEPS package is that the described practices must be uniform and widespread in all jurisdictions. The previous without the support of the principles of supremacy or direct effect, thus relying on the acknowledgement of the possible positive impact by States and voluntary implementation of the provisions. Furthermore, the OECD lacks a central legislative body such as the Council of the European Union. Subsequently, it is unable to produce legislation with a superior scope and more comprehensive implementation than the EU. Furthermore, the OECD is unable to provide the assurances in regards to the transparency necessary for the adequate application of GAAR. This also due to the lack of confidential implementation on a large scale. Therefore, while OECD and the EU may align on core values the latter is much better positioned to provide a systematic and harmonious approach to international taxation of corporations. While the former is better suited to

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<sup>104</sup> Zwolski, Kamil. (2012). The EU and a Holistic Security Approach after Lisbon: Competing Norms and the Power of the Dominant Discourse. *Journal of European Public Policy*. 19. 988-1005.

<sup>105</sup> Cerioni, L. The Introduction of Comprehensive Approaches to Business Taxation, *European Taxation* December 2005 and January 2006.



compile legislation, which may be implemented by States regardless of their Union Membership. Thus reaching a wider audience and countering tax avoidance on a global scale.

## **5.2 Implementation of the Exit taxation and General anti-abuse rule into the OECD BEPS package**

The General anti-abuse rule is not difficult to implement into the BEPS packages, because it is not dependant on any of the unique principles of EU law. Therefore, no amendments would be restricting the implementation, however, perhaps it would not be beneficial. This is due to two variables. Firstly, GAAR is inherently similar to many Actions of the BEPS package as it evaluates the true meaning of a transaction on a singular basis. The rules embodied in GAAR follow the similar methodology as the Principal purpose test and therefore are in the form already covered by the package. However, as previously described, while implementing the BEPS package States have the possibility to disregard the PPT, thus creating a situation where a State may not have the protection provided by GAAR. The existence of the option for completely disabling the PPT illustrates the possible negative impact of GAAR. Therefore, due to the possibility of the incorrect application of GAAR, it is advised against implementing such rules to legislation by an entity such as the OECD. GAAR remains to be tested on a controlled setting such as the EU before being considered to have applications within a relatively unsupervised organization. Nevertheless, the PPT should provide the necessary protection against avoidance arrangements and other similar schemes, therefore it is recommended that the implementation of it is not an additional voluntary option within the BEPS package. Instead, it should be an instrumental part of Action 6 as well as 7 and subsequently mandatory.

The exit taxation rule regulates the relocation of assets, tax residence and business between the Member States and third countries. The OECD BEPS package does not regulate such transfers equally specifically, therefore additions and revisions to the package would be beneficial. Furthermore, the inclusion of third countries into the ATAD provisions illustrates the possibility for cooperation between an extended network, more suitable to the OECD. However, in addition to the issues relating to the collection of the tax by the appropriate State, the implementation of the exit taxation rules requires equal collaboration by multiple parties. Partial regulation will segregate tax jurisdictions and lead to the creation of additional tax havens and irregular taxation. This will negatively impact both public and private parties, therefore the implementation, while positive in nature, presents significant risks to the entire BEPS package and the core values of the

OECD. Regardless the exit taxation rule may be implemented by taking the approach already applied throughout the package. The holistic approach will relieve the OECD from the restrictions posed by the principles of supremacy and direct effect while enabling it to provide a solution to the core challenge. The exit taxation rule is partially covered by Action 1 in the digital sphere. In Action 2 by relieving mismatches between international taxation arrangements and in Action 3 by regulating the taxation of shareholder profits of companies located in foreign States. Actions 7 to 10 provide countermeasures to artificial permanent establishments and profit transfer through transfer pricing. The last Actions provide the majority of the basis for the adoption of the principles of the exit taxation rule into the OECD BEPS package. These make up the regulations for the transfer of capital and business and in collaboration with the previously described Actions limit the unfair relocation of tax obligations. The implementation of the methods would be facilitated by transparency as prescribed in Action 5 and proactive cooperation by the public and private sectors in the form of reports as in Action 14. However, it must be emphasised that while applying the holistic approach is theoretically successful and utilises the tools already established by the package, with minor revisions for compatibility, it relies on the active implementation of voluntary legislation, by a myriad of jurisdictions. Therefore, while the collaboration between the EU and the OECD is likely possible and in regards to the legislative provisions seemingly realistic, it is still dependent of the acknowledgement of the legitimacy of the OECD and the necessity as well as subsequent supremacy of the BEPS package. Thus the effect and necessary amendments to the packages are dependent on its popularity.

## CONCLUSION

The taxation of profits of international corporations is an issue which affects most States on the global market.<sup>106</sup> Precisely the countering of intentional aggressive tax avoidance schemes has presented issues which have forced the global community to produce two complementing legislative writings. The OECD has the advantage of a long history in the field of international taxation of corporate gains, however, the EU has the use of legal principles such as supremacy and direct effect.<sup>107</sup> Furthermore, both organisations have been criticised in the past due to the exclusivity of their memberships and the subsequent limitation of their scope. Additionally, the two legislations are similar in effect and share many countermeasures between themselves. Therefore, the revision of the BEPS package, which has the possibility for a wider scope, in comparison with the ATAD, which may rely on bolder regulatory provisions, may provide to be beneficial for the regulation of the taxation of international corporations.

Following an extensive review of the BEPS package and the ATAD two additional countermeasure not present in the OECD were identified to counter purposeful tax avoidance in the European Union's Anti-Tax Avoidance Directive. The GAAR and exit taxation rule covered areas of international corporate tax avoidance unregulated by the package and presented possible updates for it. The review of possible implementation and subsequently necessary amendments to the BEPS package, aligning with the core values and capacity of the OECD resulted in the following observations. Careful review and analysis of the GAAR resulted in the elimination of the provision from the selection. This is due to the fact that the intended effect of GAAR can be achieved by the mandatory adoption of the PPT in any of the Actions in the BEPS package. Therefore, the additional adoption of GAAR would be redundant as well as due to the unpredictable nature of it may present significant risks. Thus the addition of GAAR coverage can be achieved by amendments relating to the mandatory adoption of the PPT. The exit taxation rule is specific to the EU and the single market subsequently the updates necessary for the BEPS package are more significant than those regarding GAAR. Due to the challenges created by the limitations of the OECD's powers, the provisions of the exit taxation rule must be implemented by taking the holistic approach. Furthermore, it is dependant on the acknowledgement of the positive impact and widespread voluntary adoption of the package. The goal of the exit taxation rule is possibly achieved by the uniform implementation of the Actions described in the package

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<sup>106</sup> Rohatgi, R., *Principles of International Taxation, Volume One*. Richmond: Richmond Law & Tax Ltd 2005.

<sup>107</sup> Terra, Ben, J.M.et al. *European Tax Law, Fifth Edition*, Kluwer Law edition, The Netherlands 2008.

by the majority of States. While the challenges of the taxation of international corporations remain an issue as long as there are different tax jurisdictions, then extending the scope and updating the countermeasures of the OECD BEPS package may provide the most effective tool in limiting aggressive tax avoidance. The impact of the package is dependent on the inclusion of numerous States as well as the proper application of the holistic approach.

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