COMBATING ABUSIVE EU CORPORATE INCOME TAX PRACTICES

A thesis submitted for the Degree of Doctor of Philosophy

by

Neal Peter Beckett

Brunel Law School, Department of Politics, History and Law,

Brunel University, London

Abstract

This thesis examines the concept of EU corporate tax abuse in light of the tensions between the protection of EU Fundamental rights and the susceptibility of those rights to abuse.

Consideration is given to the major tax abuse practices and arrangements, accompanied by analyses of the responses of a selection of EU member states, and the role and impacts of judicial, state and commercial stakeholder interests. Consequent upon an examination of why past proposals have failed to attain either policy adoption or policy success, it is suggested that the legal concepts of abuse of rights, substance over form and proportionality may be of value in assessing and validating a corporate tax abuse proposal.

It will be argued that Member State tax rules and policy initiatives to date have been unsuccessful in eradicating the effects of corporate tax abuse deriving from the exploitation of Fundamental Freedoms and that this failure is attributable to reasons of poor transactional data lineage and disclosure, unresolved political and judicial conflicts between balancing Member State rights with the Internal Market ideal and from a corporate culture that is incentivised to circumvent tax rules with limited recourse.

Following an assessment of whether reform should focus on transactional based tax rules or on a broader legal framework to induce taxpayer behavioural changes, it is contended that EU corporate tax abuse can be addressed by rejecting the traditional ideals of tax harmonisation, formulary apportionment, and principles or rule-based tax law approaches as a complete solution. An effective scheme of reform should instead be based on Enhanced Disclosures and Attestation incorporating country-by-country reporting, additional reporting metrics and legal attestations, underpinned by civil and criminal penalties.

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List of Abbreviations

Abbreviation	Description
ACD	Administrative Cooperation Directive
ACT	Advanced Corporation tax
APA	Advanced Pricing Agreement
BEPS	Base Erosion and Profit Shifting
CCCTB	Common Consolidated Corporate Tax Base
CCTB	Common Corporate Tax Base
CCR	Country-by-Country Reporting
CEN	Capital Export Neutrality
CER	Cash Effective Rate
CFC	Controlled Foreign Company
CFO	Chief Financial Officer
CIN	Capital Import Neutrality
CJEU	Court of Justice of the European Union
CON	Capital Ownership Neutrality
CTB	Corporate Tax Base
CUP	Comparable Uncontrolled Price
CSR	Corporate Social Responsibility
DMV	Double Majority Voting
DPT	Diverted Profits Tax
DTT	Double Taxation Treaties
EBIT	Earnings Before Interest and Taxes
EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortisation
ECHR	European Court of Human Rights
ECOFIN	Economic and Financial Affairs Council
ED&A	Enhanced Disclosure & Attestation
EP	European Parliament
ETR	Effective Tax Rate
EU	European Union
FA	Formulary Apportionment
FDI	Foreign Direct Investment

FTA	French Tax Authority
FTC	French Tax Code
GAAP	Generally Accepted Accounting Principles
GAAR	General Anti-Avoidance Rule
GANTIP	General Anti-Avoidance Principle
HMRC	Her Majesty's Revenue and Customs
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
LOB	Limitation of Benefits
MNE	Multinational Enterprise
NACE	Classification of Economic Activities in the EU (Nomenclature des activities economiques dans la Communaute Europeenne
OECD	Organisation for Economic Cooperation and Development
PE	Permanent Establishment
QMV	Qualified Majority Voting
QPI	Qualitative Policy Indicators
TAAR	Targeted Anti-Avoidance Rule
THINCAP	Thin Capitalisation
TRPRICE	Transfer Pricing
TIWB	Tax Inspectors Without Borders
WHT	Withholding Tax

Chapter One: Introduction

1.1 Background

The European Union, hereafter referred to as 'the EU', has an unresolved problem relating to endemic tax avoidance practices exploited by multinational enterprises, hereafter referred to as 'MNEs', in consequence of the uncoordinated and fragmented direct tax environment implemented by Member States in an economic union underpinned by Fundamental Freedoms that provide opportunities for abusive tax mitigation. EU case law is becoming settled in many areas of direct tax law but the disparities between Member State anti-avoidance measures remain material and damaging to the efficiency of the Internal Market[1]. Traditional approaches to categorising tax conduct rarely sought to look beyond evasion or avoidance. Member States legislate tax laws and invoke penalty regimes to mitigate evasion and avoidance in their own jurisdictions, aiming to underpin both domestic policy objectives and EU law. Historical failures to address the issues necessitate a fresh assessment and approach to resolving what may be considered legal but abusive tax avoidance practices. The concept of abuse of law is pertinent to EU corporate tax abuse given that the EU construct is underpinned by EU law and Fundamental Freedoms.

An exposition of the conceptual phraseology used and referred to in the expression of tax conduct reveals some of the complexities inherent in addressing the issue of tax avoidance, planning, evasion, fraud, circumvention, misuse and abuse. For some time the significance of some of these references were not quite so clear as they more loosely referred to the boundaries of acceptability as defined by codified law, case law precedent or jurisprudence The complexities of the EU internal market and legal system and the evolution of more complex and creative commercial practices means that they are often used in an apparently interchangeable manner underpinned by a common set of objectives and effects i.e. a reduction in tax liabilities. There is neither a set of consistent criteria to characterise certain tax conduct nor is there a coherent understanding of what separates one expression of conduct

[1] Jacques Malherbe et al, The Impact of the Rulings of the European Court of Justice in the area of direct taxation, European Parliament (2010) 7

from another. For the purposes of this research, some broad assumptions shall be used with regard to such phraseology to ensure clarity and consistency.

‘Tax Avoidance’ shall be defined as bona fide tax planning arrangements executed by legal means within the permissible scope of Member State tax rules. This will be considered to be synonymous with ‘Tax Circumvention’ when specifically entered to exploit EU Fundamental Freedoms in order to escape from the scope of specific Member State tax legislation. Tax misuse is a form of circumvention contrary to the purpose of EU law on account of failure to act in good faith. ‘Profit or Loss Shifting’ shall be referred to as a technique of tax avoidance that represents the act of transferring taxable profits or losses to jurisdictions that would result in a reduced tax burden through the utilisation of preferential tax rates, tax relief or tax deductions. The concept of ‘Tax Abuse’ is a more interpretative and subjective conduct that is the primary focus of examination in this research. It shall be referred to as intentional tax circumvention engineered using wholly artificial arrangements to achieve a tax benefit in an excessive or disproportionate manner in relation to the purpose of the underlying legislation or EU Treaty right. ‘Tax Fraud’ is a derivative of abuse although limited to conduct which, by providing and relying upon false statements, is considered illegal. ‘Tax Evasion’ shall refer to the illegal practice of not reporting taxable income at all through the utilisation of shell companies or trusts in jurisdictions with no taxation. It remains out of scope of this research.

1.2 The European Direct Tax Law Problem

The issue of taxation remains at the top of the political agenda, with Member States airing ever more passionate public views on curbing tax abuse activities. Opinion remains divided between traditional rights to organise tax affairs in a legitimate and legal manner as notably promoted by Lord Tomlin[2], versus those who think that MNEs employing tax planning to reduce their tax burden are short-changing Member States. The new frontier to this debate relates to differentiating between unacceptable abusive tax avoidance and acceptable non-abusive tax mitigation. Courts have been open to the notion that “a taxpayer has always been

[2] *IRC v Duke of Westminster* [1936] AC 1 (HL)

free to mitigate his liability to tax"[3] in contrast to judicial resistance to unacceptable tax avoidance which "typically involves the creation of complex artificial structures….by which… the taxpayer conjures…a loss or a gain…which would have otherwise never have existed"[4]. The difference can often be difficult to define and various governments and the Court of Justice of the European Union, hereafter referred to as CJEU, rulings provide little consensus on how to measure or evaluate different circumstances. To assess more effectively the EU corporation tax avoidance issues and to promote an effective solution, this research will focus on examining a selection of Member States, namely Germany, France, UK, Netherlands and Italy.

Member States are obliged to create an internal market to ensure its efficient operation by removing any specific impediments that compromise cross-jurisdictional transactions relating to goods, resources, services and capital throughout the EU. EU Fundamental Freedoms provide tax-planning opportunities for MNEs, most notably through the Freedom of Establishment[5] and Free Movement of Capital[6]. Member State rules seeking to prevent tax avoidance must still reflect these entitlements. Corporate organisational complexity and globalisation infers that MNEs have the ability to generate income in multiple locations. Advancing early academic promotion of the primacy of shareholder value[7], various other academics[8] have found that competitive pressures regarding maximising shareholder value mean that MNEs view tax as a competitive lever in the marketplace. Balancing responsibilities between their shareholders, customers, employees and communities create a dilemma as they may encourage conflicting behaviours.

The response to the challenges of tax avoidance has been varied at both national and EU level. At national level, tax avoidance rules relating to specific practices such as transfer

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[3] *Commissioner of Inland Revenue v Challenge Corporation Ltd* [1987] 1 AC 155, 167

[4] *Ensign Tankers (Leasing) Ltd v Stokes* [1992] 1 AC 655, 681

[5] Consolidated version of the European Treaty [2010] art 49, OJ C83/13

[6] Ibid, art 63

[7] Milton Friedman, 'The Social Responsibility of Business is to Increase its Profits, *New York Times,* (New York, 13 September 1970)

[8] Sohnke Bartram, 'Corporate Risk Management as a Lever for Shareholder Value Creation', 9, Financial Markets, Institutions and Investments (2005) 5, 281; Amy Hillman and Gerald Keim. 'Shareholder Value, Stakeholder Management and Social Issues: What's the bottom line?' (2001) 22, 129

pricing continue to evolve across Member States in response to addressing loopholes, and tax authorities are becoming empowered to implement more aggressive auditing tactics for investigating and closing out those practices deemed in contravention to national anti-avoidance measures[9]. According to the United Nations, “Tax avoidance and the industry that drives it are increasingly an international phenomenon and it is vital that we have effective international cooperation to tackle it, as we do for tackling terrorism, organised crime, money laundering and fraud”[10]. The complexities and diversities of implementing a consensus driven solution have encouraged cooperation at an international level. Judicial authorities are becoming more empowered, through precedent rather than by treaty, to establish a set of settled case law[11] that may over time become a more powerful force but one that may neither close out all the gaps nor nurture the consensus necessary for a sustainable long-term solution.

It is not the primary objective of this research to hypothesise about the rather speculative measures attempting to quantify the specific levels of adverse corporate tax conduct but more to make lucid the scale of the issue in the EU as a precursor to the ensuing analysis. Quantitative assessments relating to the impact of EU tax avoidance are widely stated by various organisations but often difficult to consolidate into a consistent set of statistics. In the UK a study found that a third of FTSE 100 MNEs paid no corporation tax at all in the UK in 2005/6, and another third paid less than £10m in corporation tax[12]. The latest HMRC data for 2012/13 suggests a UK tax gap at £34bn, of which corporation tax avoidance is estimate to account in the region of £3.9bn.[13] This contrasts with earlier estimates from the Tax Justice

[9] PWC, ‘International Transfer Pricing 2011’ (2010) <http://pwc.com/pl_PL/pl/publikacje/itp_2011.pdf> accessed 25 August 2011

[10] Governance World Watch, ‘Public Policies and Globalisation’ (2004) <http://unpan1.un.org/intradoc/groups/public/documents/un/unpan016612.htm> accessed 22 July 2011

[11] Claudio Radaelli and Ulrike Kraemer, ‘Why Tax Cooperation? The Selection of Modes of Governance in EU Direct Taxation Policy’ in Tommel, Verun A eds, *Innovative governance in the European Union*, (Lynne Reinner Publishers, 2009)

[12] Tax Gap Reporting Team, ‘Firms’ secret tax avoidance schemes cost UK billions’, The Guardian (London, 2 February 2009)

13 HMRC, ‘Measuring Tax Gaps 2014’ (2014) <http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/364009/4382_Measuring_Tax_Gaps_2014_IW_v4B_accessible_20141014.pdf> accessible 2 January 2015

Network estimating a tax gap of £120bn, largely attributable to corporation tax avoidance.[14] In 2008 the UK Trades Union Congress publicised a corporation tax gap of £12bn[15]. Statistics confuse the exploitation of tax law loopholes with blatant evasion and late payment of taxes. Every metric is demonstrating increased tax avoidance whether it is by effective tax rate, or a falling percentage of tax revenues from corporate income tax. For example, in 1989, UK corporation tax accounted for 4.4% of GDP compared to 2.85% in 2009[16]. UK corporation tax revenues as a percentage of total tax revenues have remained reasonably constant despite evidence of cyclicality attributable to the volatile fortunes of financial services. The percentage has fallen from 10.4%[17]in 1989 to 8.0% in 2013/14[18].

This UK centric data if extrapolated to create a pan-EU view suggests a tax gap of €23.57bn for the Eurozone (or €20.98bn for the five sample EU countries) reflecting the EU equivalent of a UK ratio of 0.23% between the official UK tax gap and total GDP. An econometric perspective published in 2011[19] identified direct taxes in the five sample Member States contributing, on average, 33.2% of total tax revenues. In terms of corporate income taxes as a percentage of GDP, revenue from taxes on corporate income have increased over the last twenty years as a share of GDP, but has fallen as a share of total tax revenue[20]. For example, according to the Organisation for Economic Cooperation and Development, hereafter referred to as 'OECD'[21], in relation to the sample Member States, between 1990 and 2006, the percentage of corporate income tax as a percentage of GDP actually rose in France (from 2.2% to 3.0%), Germany (1.7% to 2.1%), UK (from 3.6% to 4.0%) and NL (from 3.2% to 3.4%). Only Italy witnessed a fall from 3.8% to 3.4%. As a share of total tax revenue,

[14]Richard Murphy, 'Tax Justice and Jobs: The business case for investing in staff at HM Revenue & Customs', (2010) Tax Research LLP, Tax Justice Network, 2

[15] Richard Murphy, *The Missing Billions*, (Trade Union Congress, 2008)

[16] Michael Devereux and Simon Loretz, 'Corporation Tax in the UK' (2011) Oxford University Centre for Business Taxation,13

[17] Michael Devereux et al, 'Why has the UK Corporation Tax Raised So Much Revenue' (2004) Institute of Fiscal Studies, WP04/04, 3

[18] HMRC, 'Tax and NIC Receipts' National Statistics (2015), 10

[19] Commission, *Taxation Trends in the European Union* (Publications Office of the European Union, 2011), 301

[20] Ibid

[21] OECD 'Centre for Tax Policy and Administration, Tax Database, Table B' (2008), <http://www.oecd.org/dataoecd/48/27/41498733.pdf> accessed 27 August 2011

corporate income taxes as a percentage of total tax revenue in the EU has fallen from 30% in 1985 to 25% in 2006 representing a general downward trend but distorted the changing constituency of the EU as a whole. This may reflect a downward trend in tax rates, broader corporate tax bases and more favourable corporate profitability.

1.3 Research Objectives

The objective of this research is to establish an effective corporate tax avoidance reform proposal for materially reducing tax arbitrage across the EU. This will be approached through an assessment of anti-tax avoidance legislative measures, judicial rulings and stakeholder influences in the sample set of representative Member States. This thesis will consider the merits of a tax law solution and alternative forms of reform, taking account of the inherent conflicts between respecting EU Fundamental Freedoms and the need to protect the Internal Market from tax abusive conduct that undermine the collective tax revenues within that market. This endeavour is motivated by a desire to challenge existing paradigms in the field of tax avoidance and address an unresolved area of EU law. A solution is sought that may be applied to a unique legal and economic unit such as the EU while being potentially extensible for global adoption. Corporate tax anti-avoidance measures offer the largest opportunity for reform in the area of direct taxation, as well as providing a thought process that will leave a mark in its field and open lines of further thought for future research as governments and global institutions pursue a long-term solution.

1.4 In Search of a Solution

Member States possess robust control over the formulation and implementation of their corporate tax policy, with tax policy considered a basic right associated with national sovereignty and beyond any EU competence. As economic integration evolves, there is a common view that national tax rules create impediments to attaining an efficient Internal Market. National tax rules nurture divergences in effective tax levels and rates encouraging complexity and conflicts between MNEs and tax authorities[22]. Therefore, tax-planning decisions are directly impacted by tax law parameters with the tax base distribution

[22] Michael Devereux and Clemens Fuest, *Corporate Income Tax Coordination in the European Union*, (Oxford University, 2009), 3

depending on the home jurisdiction of the parent company and the location of foreign entities. Statutory accounting increasingly reflects transactional reporting based on the lowest tax jurisdiction rather than the legitimate operating jurisdiction[23].

Member state tax systems are as widely heterogeneous as the MNEs serving their tax base. Historically EU policy proposals have been based around tax reform, either through tax rate tax policy harmonisation, or through legislative reform of Member State tax avoidance laws. The tax avoidance practices in operation, national anti-avoidance measures and the role of the European institutions and other stakeholders will all be reviewed as an input to a solution. Successful solutions are often engineered and implemented in times of crisis and the timing of the proposals in this thesis is opportune. Every angle will be examined including the merits of existing solution proposals as well as more fringe solutions based on ethical behaviour and the role of Corporate Social Responsibility, hereafter referred to as 'CSR'. Behavioural aspects of MNEs to tax avoidance will be factored in particularly in relation to the influence of the EU economic and political environment to propensity to engage in tax avoidance. Credible reform demands focus on the underlying governance and legal process with due consideration granted to the interests and concerns of all principal stakeholder issues including the sensitivity of national sovereignty protection and the corporate mentality.

1.5 Thesis Outline

This thesis is divided into nine chapters. Chapter One provides an outline of the corporate tax avoidance issues and background data. It identifies the research synopsis, challenges and thesis organisation. In Chapter Two the conceptual construct of principal tax avoidance practices and contemporary tax planning arrangements are set out. This forms the basis of understanding the nature of the core tax conduct issues and how they contribute to the concept of corporate tax abuse. To establish context, the key EU tax avoidance concepts, practices and national provisions associated with mitigating these practices in the sample set of Member State jurisdictions are identified. The national provisions are contrasted, factoring in recent changes in the law as well as underlying legal norms directing the approach adopted in each jurisdiction. Chapter Three examines the scholarly debate on the direct tax law

[23] Lisa De Simone, 'Does a Common Set of Accounting Standards Affect Tax-Motivated Income Shifting for Multi-National Firms' (2013) University of Texas, 11

matters relating to corporate taxation cross referenced against some legal models relevant to the subject of this research. In Chapter Four a stakeholder analysis extends the assessment to include influences outside of tax law that are relevant to the EU tax debate that will influence the direction and success of a reform proposal. The significance of the CJEU is reviewed and analysed in its role shaping EU direct taxation law to date. Other stakeholders such as MNEs themselves, national tax authorities and various international pressure group and organisations are assessed to understand how their influence can impact a policy change for mitigating corporate tax avoidance. The political dimension is considered whereby research is conducted into the various political orders in the sample jurisdictions to ascertain the appetite to accommodate legal changes associated with EU direct taxation. By treating the outcomes of our stakeholder analysis as an agenda for change dialogue it is possible to model a solution around their principles and behaviours. Chapter Five assesses the impact on national sovereignty is critically reviewed since consideration of this issue resides at the centre of implementing a successful direct taxation solution. The CJEU is mandated a role for ensuring oversight and authority over direct tax matters, particularly in relation to abuses relating to EU Fundamental Freedoms and this has had a marked impact on both current tax law and reform proposals. It follows in Chapter Six that over a number of years a proliferation of solutions have been proposed by academics, international organisations and national governments that cover a broad spectrum of change initiatives from harmonising the tax base, tax rates or tax rules to more extreme scenarios of centralising the direct taxation environment under central European control and governance akin to indirect taxation. These policy options are critically reviewed, particularly in the context of legal credibility and practical workability. Chapter Seven pulls together the analyses, observations and conclusions in the preceding chapters to formalise a reform proposal capable of addressing the tax conduct issues facing the EU. It sets out a clear and detailed assessment of country-by-country reporting, thresholds and attestations, and what part they would contribute in resolving corporate tax abuse issues. Chapter Eight assesses the legal reasoning of the reform proposal. A credible reform proposal will demand legal reasoning and to this point a detailed critique around each element of the proposal and how they align to the rule of law provides such substance to its legal positioning. Specific reference is made to the established legal doctrines of ‘substance over form’, ‘proportionality’ and ‘abuse of rights’, to not only underpin the reform proposal but also to establish how such an underpinning would be accommodated within the legal systems of the sample Member States. A set of criteria is also identified to measure success if such a proposal was to be adopted. The final chapter concludes with a specific set of observations and research findings. These observations and findings are correlated to the reform proposals so that there is a clear relationship between the research issues and a viable proposal for reform. This reform proposal is augmented with reasoning around why it addresses those points that have failed to achieve success in the past and how it is underpinned by leading scholarly research completed in related academic areas. As ever in a subject as broad and controversial as EU corporate tax abuse there will also be opportunities for further research and these are set out for consideration.

1.6 Research Hypothesis

Member States, through enacting and enforcing tax laws, and the EU, through the implementation of Directives and other policy initiatives, have been unable to establish an effective solution for the problems engendered by EU tax abusive behaviours. It is argued that a new approach is required to combat MNEs persistently leveraging EU Fundamental Freedoms as a shield to abuse the tax system by introducing a corporate behaviour changing initiative. If a corporate taxpayer evidences fraudulent or improper use of EU law rights then the assertion is that such behaviour may be classed as abusive. Historically, corporate tax abuse decisions have directly impacted statutory accounting disclosures. However, the flow of influence needs to reverse whereby accounting disclosures impact and steer the corporate tax planning decisions. This can be achieved by radical reform through exposing the transactional data responsible for tax abuse outcomes that enables Member State tax authorities to engender the desired behavioural changes. Reform focused on extended statutory accounting disclosures, threshold metrics and attestations would serve as an effective instrument for Member State tax laws in the struggle against tax abusive behaviours.

1.7 Methodology

This research has been conducted using both traditional doctrinal law research and law reform research methodologies[24]. In both instances, a careful use of critical and comparative analyses has been adopted. Chapters Two to Six adhere to the doctrinal law research

[24] Harry Arthurs 'Law and Learning: Report to the Social Sciences and Humanities Research Council of Canada by the Consultative Group on Research and Education in Law' (1983) Information Division, Social Sciences and Humanities Research Council of Canada, Ottawa

methodology, initially setting out an identification of legal tax rules relating to the particular tax avoidance practices in existence in the sample set of Member States. This provides a useful insight into the nature of the problem that the thesis seeks to resolve by providing an orderly exposition of the tax rules governing tax avoidance, analyses the relationship between these rules and between Member States and explains areas of difficulty. Tax avoidance practices are then critically assessed in relation to the measures that have either been adopted so far by the EU and the Member States as well as in relation to various schemes that have been proposed to date. Particular attention has been granted to ensure that the concept of tax abuse is carefully defined and understood and it's differentiation against more standard tax conduct concepts more widely debated to date.

The comparative analysis has been achieved through an assessment of the policies adopted by a selection of Member States in their attempts to protect their tax base and mitigate tax abusive activities by resident MNEs. This approach enables identification of preferred practices and dominant themes in policies. This is further extended to compare and contrast the relative influences of the various stakeholders that have a role to play in both the practicing of abusive tax avoidance practices and in the formation and agreement of reforms to resolve such abuses. These stakeholders include the European Commission, the Court of Justice of the European Union, Member State tax authorities and legislatures and the MNEs themselves. Further consideration has been given to the importance of legal sovereign rights in this debate and the constraints that sovereign rights offer in the EU corporate taxing powers debate. The comparative assessment is important for this research because any reform proposal needs to reflect the both the importance of relative stakeholder influence in the formation of a solution and on the alignment with the legal systems and context of Member States through the selected jurisdictions in the implementation of the proposed reforms.

Bringing together these analyses results in the development of a solution for abusive corporate tax avoidance. This utilises a law reform methodology in Chapters seven and eight including testing the reform proposition by assessing alignment to established doctrines such as the rule of law, abuse of rights, substance over form and proportionality. It transitions from the doctrinal approach of the earlier chapters to applied legal research[25] the purpose of which is to propose a future change in the law, including how it is administered. It utilises

[25] Richard Card, 'The Legal Scholar' (2002) The Reporter: Newsletter of the Society of Legal Scholars, 25, 5

traditional legal analysis of primary and secondary sources of data and is important because it "evaluates the adequacy of existing rules and recommends changes to rules found wanting"[26]. Through an understanding of the tax abuse practices, Member State tax law deficiencies and reform scheme failures, a proposition is promoted that is assessed in light of its alignment to legal doctrines.

The research data utilised to form these assessments has been derived from primary and secondary sources of law. Primary sources include the texts of EU Treaties and Directives and Member State statute law. Secondary sources have been principally based around judicial case law rulings derived from the CJEU and national courts, academic journals, academic working papers and similar published treatises, academic books, professional literature and material generated by special interest groups lobbying for reform in this domain. The primary and secondary sources have been accessed through academic libraries, e-library databases, e-journals, and various electronic databases such as LexisNexis, Kluwer and WestLaw.

[26] Dennis Pearce, Enid Campbell and Don Harding, *Australian Law Schools: A Discipline Assessment for the Commonwealth Tertiary Education Committee* (AGPS, Canberra, 1987) 307

Chapter Two: Tax Avoidance Practices and Provisions

2.1 Introduction

Corporate direct taxation in the Internal Market faces a number of challenges. Irrespective of the underlying drivers, lawful recognition of what constitutes a functional corporate group for tax purposes has become an increasingly complex issue and impacts both the structural organisation and accounting framework that MNE's enact in their commercial arrangements. The commercial impact of a MNE group entity structure may look very different when observing it for legal, tax or accounting perspective. MNEs, by nature, have large cross-border entity structures in which they are able to leverage EU Treaty rights in the context of both tangible and intangible transactions, using tax reliefs granted by Member States in an advantageous manner. These are often at odds with their original legislative intention to attract and retain investment and are aimed at reducing consolidated group tax liabilities. In response Member States have implemented a succession of anti-avoidance rules to protect their tax bases from specific types of transaction, or arrangements. Such anti-avoidance laws vary across Member States but have a commonality in form to the extent that they are typically aimed at identifying wholly artificial arrangements structured for the specific purpose of claiming a tax benefit in a way that is either inconsistent with or disproportionate to the underlying legislative intent. The manner in which such assessments are administered are a reflection of both Member State rules and the influence of CJEU rulings but the underlying objective being to ascertain the economic authenticity of an activity. In addition to these challenges there remains an ongoing tension generated by a requirement for these Member State anti-avoidance rules to be consistent with the exercise of EU Treaty rights supporting the Internal Market.

This chapter does not aim to provide a comparative technical assessment of Member State anti-avoidance tax rules but rather to provide an overview of contemporary tax practices and arrangements and a comparative review of differences in approach adopted by these Member States. In achieving an understanding of what arrangements have been popularised and the legislative provisions that have been enacted in response, it provides an insight into the relationship between corporate tax planning practices and the law as a basis for critically analysing the concept of anti-abuse law options in the formulation of an alternative reform proposal.

The aforementioned selection of Member States examined in this discussion represents a broad cross-section of economically important Member States with sufficient diversity in their tax laws providing substantial coverage across uncodified common law and codified *jus civile* jurisdictions. The nature and functioning of these different legal systems will permit a comparative assessment of differences in approach to corporate tax avoidance and likely adoption success in relation to a reform proposal. These sample Member States enable a comparative analysis of common law rules as well as civil law general principles raising distinct forms of differentiation in terms of how law is formed, enforced and interpreted. This may be exemplified in tax law litigation whereby in the UK case law not only sets out a tax rules for a given set of parties in a case but it also must be pursued in future similar tax cases evolving into what is deemed to be a common law. Conversely in civil jurisdictions such as Germany, France, Netherlands and Italy the judicial system relies on legislation as the most highly respected source of tax law. It is only when there are specific gaps in the written tax law then the Courts advance with an interpretation to enable an exercise of judgement ensuring new law is created to yield a decision despite the perils of such “mechanical jurisprudence”[1] that challenge “legal behaviourism”[2]. The EU has bought these legal systems closer together but nevertheless although the outcome in many areas of tax law is now converging, the methods adopted to attain those outcomes are rarely consistent across different legal systems. It would have been appealing to incorporate lower corporate tax rate jurisdictions into the sample but these jurisdictions are generally profit shifting benefactors and most do not have a substantial body of anti-avoidance tax law in place. For example, Cyprus and Ireland, both with legal system foundations structured on UK common law, and promoting the lowest corporation tax in the EU, have no basic anti-avoidance provisions such as controlled foreign companies or thin capitalisation rules. Furthermore Cyprus has no transfer pricing rules and Ireland has only recently introduced transfer pricing provisions

[1] Lee Epstein, *What's Law Got to Do with It? Judicial Behavioralists Test the Legal Model of Judicial Decision Making* (CUP, New York, 1999) 359

[2] Jeffrey Segal and Harold Spaeth, *The Supreme Court and the Attitudinal Model Revisited*, (CUP, Cambridge, 2002) 88

providing little substance for the basis of a comparative law assessment. The UK is the largest common law jurisdiction in the EU while Germany, France and Italy are the largest civil law jurisdictions. A discussion encompassing these jurisdictions provides extensive coverage across a substantial part of the EU.

2.2 Cross Border Taxation in the Internal Market

2.2.1 Controlled Foreign Companies

A Controlled Foreign Company, hereafter referred to as 'CFC', is a concept based around the legal and economic control of a non-resident company residing in a lower tax jurisdiction established for the purpose of reducing corporate tax. Unilateral rules are implemented as a means to limit the impact of these arrangements while protecting Fundamental Freedoms. However, the preponderance of CJEU case law suggests that Member States are being regularly challenged on the promotion of discriminatory legislation regarding direct taxation. CFC legislation is based on the doctrine of Capital Export Neutrality, hereafter referred to as 'CEN', which states that foreign income is treated in the same way as home income. According to the OECD[3] CFC legislation can regulate the distribution of taxable income, ensuring that corporate income is taxed equally irrespective of where it is owned. Judicial rulings have held that CFC rules were only relevant when applied to wholly artificial arrangements aimed at reducing national tax that otherwise would normally be payable[4]. Any judicial challenge to CFC arrangements typically necessitates distinguishing "between the use and abuse of Freedom of Establishment"[5]. A series of objective and subjective assessment criteria[6] is typically applied by the CJEU to ascertain whether an arrangement is deemed

[3] OECD, *Studies in Taxation of Foreign Source Income: Controlled Foreign Company Legislation*, (OECD Publishing, 1996) 90

[4] Case C-196/04 *Cadbury Schweppes Ltd v IRC* [2006] STC 1908

[5] Luca Cerioni, 'The abuse of right in EU company law and EU tax law: a re-reading of the CJEU case-law and the quest for a unitary notion', Brunel Law School Research Papers (2010), 4 <http://bura.brunel.ac.uk/handle/2438/4141> accessed 14 August 2011

[6] Dennis Weber, *Tax Avoidance and the EU Treaty Freedoms*, (1st edn, Kluwer, 2005) 182

wholly artificial[7] and restrictions applied. Even if an establishment in another State is made to avoid tax in the parent company's State, it is not necessarily an abuse of the Freedom of Establishment if the holding company is pursuing genuine economic activity. There appears to be no settled CJEU case law precedent regarding what constitutes genuine economic activity only the criteria that should be used in such an assessment[8].

The EU Treaty guarantees all companies in a Member State the right to set up an establishment in another Member State and to do so under the same conditions as the domestic companies of that Member State[9]. Furthermore, the home state may not impose any conditions regarding direct taxation that would make such an establishment less favourable compared to an establishment in the home state[10]. For CFC legislation to apply, a resident taxpayer in the home state must have a certain amount of de facto control of the overseas entity. Where a company holds only a minority interest in a foreign entity then it may be necessary to demonstrate control to support CFC status. In the UK, CFC rules set out clear tests to demonstrate the parameters between legal and economic control[11] whereas in Germany, France and Italy any minority shareholding would not be eligible for CFC status. For the prevention of abuse to be justified the legislation must have the sole purpose of preventing wholly artificial arrangements and the arrangement itself must be architected for purpose of tax abuse. In order to justify a restriction Member state CFC rules need to elucidate the characteristics, predictability and reasonableness of a genuine establishment, along with clear accountability for determining the burden of proof. Defining a genuine establishment may reflect carrying out some economic activity such as in France or represent an effective place of management of that activity such as in Germany. Member States generally approach assessing the genuineness of an establishment from the perspective of requiring an MNE to prove a CFC is based on economic reality and requires data by Member States to identify an element of doubt upfront regarding a CFC's authenticity.

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[7] Michael Lang and Frans Vanistendael, *Accounting and Taxation & Assessment of CJEU Case Law*, (EATLP Congress. Helsinki, 2008) 129

[8] Case C-196/04 *Cadbury Schweppes Overseas Limited v Commissioners of Inland Revenue* [2006] ECR I-7995, para 112-114

[9] Consolidated version of the European Treaty [2010] arts 54, 55, OJ C83/47

[10] Ibid art 65 (1b)

[11] Finance Act (UK), 2012, Schedule 20, part 9a

If the purpose of CFC legislation is to address elements of tax abuse it may be compromised by the presence of a tax treaty whose purpose is to prevent double or non-taxation. Tax treaties can introduce conflicts when implementing CFC rules although Member State rules may not override international obligations[12]. If a Member State wished to limit the scope of its bi-lateral obligations by CFC rules, it would only be able to do so if its tax treaty counterpart agrees. This principle stems from the point that a MNE that sets up a subsidiary in another Member State is entitled to receive national treatment. The national treatment principle could therefore encourage tax arbitrage as “the national treatment principle requires the Member State which is party to the treaty to grant to Permanent Establishments of non-resident companies the advantages provided for by that treaty on the same conditions as those which apply to resident companies”[13]. The home state of the CFC still has the right to taxation and Member States have adopted different approaches for achieving this such as the UK’s deemed dividend and the French approach in redefining the subsidiaries income as the parent entity income, both of which represent prospective treaty overrides.

Some technical differences exist between Member State CFC rules but in many respects they all use common evaluation criteria, with clear and consistent examples of utilisation of ownership thresholds[14], legal, economic or accounting control[15] and ascertaining either tax rate differentials[16] or an “effective tax rate test”[17]. This highlights both their credibility and importance of genuine activity tests and on thresholds for ascertaining a line of acceptance between acceptable and unacceptable ownership and control as a means of trying to identify what is tax abusive and what is not tax abusive. Once assessed, Member State rules have converged towards a common form of redress based on apportioning a foreign subsidiaries income to the parent company and applying current taxation in the parent company’s country. In theory these CFC anti-avoidance criteria should have the effect of limiting profit shifting

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[12] International Chamber of Commerce, ‘ICC Statement on Controlled Foreign Companies (CFC) Rules’ (2003) <http://www.iccwbo.org/policy/taxation/id537/index.html> accessed 25August 2011

[13] Ibid, 58

[14] Civil Code (France), art 209b

[15] Civil Code (Italy), art 2359, para 2

[16] Foreign Tax Act (Germany) 2010, s8, para 1

[17] Law Decree on Controlled Foreign Companies (Italy) no 78, art 167

activities as advocated by Ruf and Weichenrieder[18] who found that CFC rules were effectual in reducing the propensity to utilise passive investments through low-tax jurisdictions. However, when applying CFC rules, different approaches are evident in determining breaches. The transactional approach characterises the taxable income of residents based on income type, whereas the jurisdictional approach characterises taxable income based on total income earned by the CFC in a given jurisdiction. In an attempt to capture the merits of both approaches some Member States such as the UK[19] and Italy[20] introduced a transactional approach against a use a specific list of countries for determining CFC legislation, based on acceptable or harmful criteria respectively. Such an approach can be more complex and this is reflected in the Italian rules that demand more lengthy tax procedures to apply to its non-black list exclusions as a prerequisite to prove whether an arrangement is wholly artificial. Conversely, Germany[21] employs a comparative approach, whereby the CFC legislation will apply to certain items of income where the amount of taxes paid by the CFC is less than a specified rate or amount but this is only limited to EU jurisdictions.

UK CFC legislative provisions[22] have a novel two pronged approach. Consistent with France and Italy, a set of exemptions are set out but are more defined to include a low profits exemption, an exempt period exemption and a low profit margin exemption, with clear criteria for a CFC to determine any exemption from a UK tax charge. However, a CFC does not qualify for any exemption there is a further Gateway test, based on tax purpose, control and management of CFC assets and commercial effectiveness. If a CFC meets a gateway test then an arms-length pricing test is applied to compute chargeable profits to UK tax. Her Majesty's Revenue and Customs, hereafter referred to as 'HMRC' openly targets MNEs with subsidiaries earning material income from intangible assets where more contemporary criteria for determining whether income is genuine or not may fail[23]. German CFC rules[24] are

[18] Martin Ruf and Alfons Weichenreider, 'The Taxation of Passive Foreign Investment: Lessons from German Experience' (2012) 45, Canadian Journal of Economics, 1504

[19] Taxation (International and Other Provisions) Act, 2010, part 9a

[20] Law Decree on Controlled Foreign Companies (Italy) 432, 2001, modified by Law Decree on Controlled Foreign Companies, 344, 2003

[21] Foreign Transactions Tax Act (Germany), 1972, s42

[22] Finance Act (UK), 2012, Schedule 20, part 9a

[23] HMRC, 'Reform of the taxation of intellectual property goodwill and other intangible assets', <http://www.hmrc.gov.uk/consult/ct_reform.htm> accessed 9 September 2011

similarly based on ownership, control and tax rate differentials thresholds but differ in that the prescriptive application genuine activity tests are much more draconian than in other Member States and there is evidence of persistent judicial challenge[25]. The distinguishing factor regarding French and Italian rules is that CFC legislation extends to both non-cooperative jurisdictions as well as low tax jurisdictions. Italian CFC rules[26] accommodate three inter-related principal tests, namely the active business test, passive income test and commercial exception test based on the recommendations of a recent Italian Revenue Agency circular[27]. Rules apply to MNEs that are majority owned, and which demonstrate evidence of de facto control or dominant influence stressing the concept of business substance by requiring a link between the CFC and the relevant foreign market. These rules stand out as the only jurisdiction administering detailed substance links in the underlying activities between entities to trigger CFC rules rather than the genuine tests relating to the control or ownership of the establishment itself more pertinent in the other Member States. In contrast, there are no explicit CFC rules in Netherlands, but the subject-to-tax assessments in the participation regime[28] could be viewed as CFC rules because they have the same impact[29]. There is an obligation to annually revalue shareholdings whose assets breach a passive assets threshold. These Dutch assessments, however, do not advance any consideration of whether arrangements are wholly artificial and the concept of a genuine activity test is notably absent providing fertile opportunities to MNEs to exploit Netherlands based establishments for tax purposes.

2.2.2 Group Relief

Group Relief offers additional challenges to an ambiguous area of EU law. One consequence of the group relief regimes across the EU is the potential to consolidate profit and loss in a

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[24] Foreign Transactions Tax Act (Germany) 1972 ss7-14 (Aubensteuergesetz); Annual Tax Act (Germany), 2010

[25] Case C-298/05 *Columbus Container Services BVBA & Co v. Finanzamt Bielefeld* [2007] ECR I-10451; Case C-591/13 *Commission v Germany* [2015]

[26] Law Decree 78 (Italy) 2009

[27] Circular 51/E (Italy) 2009

[28] Other Tax Measures Act (Germany) 2010 (Wet overage fiscalemaatregelen)

[29] Johann Muller, *The Netherlands in International Tax Planning*, 2nd edn (IBFD, 2005) 13, 6

group encouraging the shifting of profits or losses for the purposes of tax liability mitigation. Group consolidation usually incorporates intra-group loss relief, deferred taxation of losses realised on intra-group transactions, exemption of dividends paid between group entities and avoidance of withholding taxes. As noted by Ting, "A consolidation regime is often one of the most complex regimes in an income tax system"[30]. In relation to intra-group losses, Member State tax rules usually provide some degree of tax relief to domestic firms that incur tax losses against their profits but these provisions do not always apply to non-resident subsidiary entities of resident PE's. These provisions may reflect differences in a loss carry back or carry forward rule, or simply represent a fundamental difference in the profitability of subsidiary entities within a group that incentivises the use of absolute loss offset provisions. The existence of both profits and losses can change the income shifting incentive. Group entities with loss making subsidiaries within the entity structure could benefit from loss consolidation to the extent that they may be offset by other profitable subsidiaries in other Member States. Losses can only be used once and so the MNE would be better positioned to use these losses if the immediate consolidation of those losses into the MNEs consolidated accounts were greater than carrying forward the loss to set against its own profits in a future accounting period. Relative tax rates are similarly important for assessing the decision to consolidate the losses or not. Over time reform proposals based on "deduction and recapture"[31] or part of the apportionment methodology inherent within the CCCTB detailed later in Chapter 6 have all been promoted but never gained enough support to be viable propositions.

It is not clear whether there must be symmetric treatment of profits and losses for the purposes of tax accounting consolidation. What appears to be a legitimate use of losses for reducing tax liabilities generally attracts less emotion than shifting profits for the same purpose. Any prohibition in the use of losses with a MNEs consolidated accounts appears to contradict the underlying ethos of the Internal Market particularly given the fact that such loss offsets are typically available to resident MNEs within a jurisdiction. However, the irony of group relief is that is it ordinarily an accounting standard that would be difficult to apply

[30] Antony Ting, *The Taxation of Corporate Groups under Consolidation: An International Comparison,* (CUP, Cambridge, 2013) 292

[31] Margaret Shulman, 'Treatment of Cross Border Losses in the European Union', (MSc thesis, Aarhus School of Business, 2010)

the standard tests of tax abuse against as the underlying purpose of the loss shifting is to reduce tax. The impact of loss shifting is not unlike some of the aforementioned practices and arrangements that are recognized as profit shifting, but profit shifting is not recognised as being an accounting treatment for the purposes of tax liability minimization.

The case of Marks and Spencer[32] provides the clearest example of the issues and has been subject to prolonged litigation for a number of years. The case initially focused on the legitimacy of the UK's position in prohibiting, as part of its group relief rules, the use of a parent entity to deduct the losses of its subsidiaries established abroad. Representing both a direct challenge to the conflict between taxing powers and the Internal Market, as well as proffering the case that loss shifting was in fact a means of tax avoidance, the initial case ruling found that these rules were incompatible with EU law despite the reasoning by Marks & Spencer that a tax jurisdiction should not accommodate loss relief from another jurisdiction if it has no competence to tax the profits in that other jurisdiction. Under such circumstances it provides for an accounting anomaly that will only encourage artificial movement of profits and losses consistent with the arrangements that provide for the same outcome but are more typically subject to justifications based on purposive reasoning. Subsequent litigation introduced the concept of both the principle of "effectiveness"[33] that set out time limits regarding loss relief claims, and most importantly a "no-possibilities"[34] test that essentially provided acceptance of loss shifting within the EU providing all reasonable means for utilising the losses made by its EU subsidiary in its country of residence had been exhausted. In practical terms, this means that the group relief claim cannot be reliably made until the subsidiary has been closed down with unused losses remaining, and there are no other local group companies that could utilise that remaining loss. Although this has now established a more coherent approach to evaluating and legitimizing loss shifting it nonetheless has reinforced the view that this is less tax abuse and more a tax accounting practice that the EU now feels more comfortable adopting in the context of the Internal Market.

[32] *HMRC v Marks and Spencer plc* [2013] UKSC 30

[33] Ibid, 45

[34] Case C-172/13 *Commission v United Kingdom* [2015]

For the sample set of Member States group taxation rules exist across all these jurisdictions. Based on IAS 27, MNEs compute tax liability on a consolidated basis with a common theme that uses shareholder voting rights as a basis for qualifying a group for consolidated taxation. These do vary widely though between 50% in Italy and 95% in France and the Netherlands reflecting consistently the variability inherent between the aforementioned CFC control thresholds in these two jurisdictions. Although the UK and Netherlands do not regulate the minimum periods of group taxation but Italy, France and Germany do. The marked differences between Member State regimes, however, come to the fore with regard to consolidation methodologies. The Netherlands utilises full tax consolidation under its consolidation regime placing great emphasis on the parent company to pay corporate taxes. Conversely in Germany, France and Italy consolidated tax results are pooled onto the parent company meaning that the individual tax results of each subsidiary are aggregated without consideration of intra-group transactions. Furthermore in Italy the group relief rules distinguishes its consolidation regime between those for Italian resident MNEs only as opposed to the broader worldwide consolidation regime available for all MNEs. Shareholder control thresholds are similarly important and to prevent abuse, tax losses realised before the election for tax consolidation can only be used by the company that incurred such losses. The Italian group relief system has been cited as "particularly favourable compared to the group tax regimes of other EU countries[35]. Only the UK offers consideration for intra-group loss transfers whereby tax integration is limited to surrendering losses on an entity-by-entity basis. Subsidiaries can transfer their losses to a group member which is profitable and immediately offset although loss relief is only available on a cross-border basis in France and Italy using the pooling method. The UK, however, does have certain exceptions in its group relief rules[36] supporting surrendering losses made by EU resident MNEs resident and again akin to its CFC rules is based around ownership threshold criteria. The Netherlands fiscal unity[37] regime has proved to be the most controversial in tax anti-avoidance terms reflected by a preponderance of challenges granted to the Netherlands by both the EU Commission[38] and most recently the

[35] Filippo Oropallo and Valentino Parisi, 'Will Italy's Tax Reform Reduce the Corporate Tax Burden? A Microsimulation Analysis', (2005) Societa Italiana di Economia Pubblica, Working Paper 403, 7

[36] Corporation Tax Act (UK), 2010, Part 5, chs 2, 3, 4, 5

[37] Corporate Income Tax Act (Netherlands), 1969, s15

[38] Commission, Reasoned Opinion, 'Taxation: Commission requests The Netherlands to amend discriminatory tax rules on fiscal unities' (2011) Case No 2008/4616

CJEU[39] to amend its tax legislation on fiscal unities to avoid conflicts with EU Treaty rights. For too long it was recognised that legislation not permitting two domestic subsidiaries held by a foreign parent company to form a fiscal unity between themselves implying that MNEs that have their parent company in another Member State may be denied the tax advantages associated with a fiscal unity arrangement.

2.2.3 Transfer Pricing

Transfer Pricing, hereafter referred to as 'TRPRICE', is a mechanism deployed by MNEs for the purposes of exporting income or capital to more tax favourable locations. Encouraging optimal allocation of revenues amongst subsidiaries within a group of related entities, it has become a common tool for avoiding corporate taxes as "it is largely invisible to the public and is difficult and expensive for regulatory authorities to detect[40]. Research has found a positive correlation between corporate profitability and international TRPRICE[41]. By manipulation of TRPRICE, tax liability may be reduced[42] and empirical studies have conclusively proven that MNEs strategically relocate income to low tax jurisdictions[43] and an increasingly significant proportion of this income is attributable to intangibles[44]. TRPRICE practices may be either formal rules or informal guidelines in nature, usually based around the OECD standard arm's-length principle[45]. The arm's-length principle is difficult to determine although the OECD's guidelines provide direction by providing for a comparison assessment of the conditions in a controlled transaction between related parties, with the

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[39] Case C-386/14 *Groupe Steria* [2015]

[40] Prem Sikka and Hugh Willmott**, '**The Dark Side of Transfer Pricing: Its Role in Tax Avoidance and Wealth Retentiveness [2010] Critical Perspectives on Accounting, 343

[41] Peter Oyelere and Clive Emmanuel, 'International Transfer Pricing and Income Shifting: Evidence from the UK' (1998) 4, 7, The European Accounting Review, 623-635

[42] Lee Radebaugh, Sidney Gray and Ervin Black, *International accounting and multinational enterprises*, (6th edn J. Wiley, 2006) 148

[43] Michael Devereux and Giorgia Maffini, 'The Impact of Taxation on the Location of Capital Firms and Profit A Survey of Empirical Evidence' (2007) Oxford University Centre for Business Taxation, WP 07/02

[44] Harry Grubert, 'Intangible income, intercompany transactions, income shifting, and the choice of location' (2003) 56, National Tax Journal, 221

[45] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, (1st edn, OECD Publishing), 33

conditions in an uncontrolled transaction between unrelated parties[46]. Various methodologies can be used to determine consistency with the arm's-length principle such as the Traditional Transaction Methods of Comparable Uncontrolled Price method, Resale Price Method and Cost-Plus Method, and Transactional Profit Methods such as the Profit Split Method and Transactional Net Margin Method[47] but differentially these are largely immaterial from a tax abuse perspective. The EU has provided leadership in resolving TRPRICE abuses, with the Commission focusing on mitigating not only the risk of a loss of tax through manipulation of transfer prices so that profits arise in Member States in a way that they would not under arm's-length conditions, but to also enable Member States to have transparent information on intra-group transactions in order for them to enforce national TRPRICE rules. Furthermore, the Pricing Forum[48] was created to promote EU-wide guidelines on Advance Pricing Agreements[49], hereafter referred to as 'APA's'. Other initiatives followed such as the Code of Conduct for the Effective Implementation of the Arbitration Convention[50] and a Summary Report on Penalties[51] aimed at enforcing TRPRICE rule compliance.

The effectiveness of Member State TRPRICE regulations can only be measured by its impact on reduced profit shifting, the most recent compelling evidence of which was offered by Lohse and Riedel who found that TRPRICE regulations "significantly reduced multinational income shifting as measured by the sensitivity of corporate pre-tax profits to changes in the corporate tax rate"[52]. Furthermore they concluded that "the implementation of transfer pricing

[46] Ibid 107-130

[47] United Nations, 'Practical Manual on Transfer Pricing for Developing Countries' (2011) Financing for Development Working Draft, 5, 37, <http://www.un.org/esa/ffd/tax/2011_TP/Oct2011_TP_Chapter5.pdf> accessed 14 July 2011

[48] Commission, 'Company Taxation in the Internal Market' (2001) COM(2001) 582 final

[49] Commission, 'The work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU '(Guidelines on Advanced Pricing Agreements) COM(2007) 71 final

[50] Council Code of Conduct of 30 December 2009 'Revised Code of Conduct for the effective implementation of the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises', OJ C322/01

[51] Commission, 'EU Joint Transfer Pricing Forum Summary Report on Penalties' COM(2009) 472 final

[52] Theresa Lohse and Nadine Riedel, 'Do Transfer Pricing Laws Limit International Income Shifting? Evidence from European Multinationals (2013) University of Honenheim, 3

documentation regimes is found to reduce profit shifting behaviour by around 50% on average"[53]. The drivers impacting the effectiveness of TRPRICE laws for stemming tax abusive behaviour are a factor of a Member State's TRPRICE documentation rules, its enforcement strategy of the regulations, and the role and emphasis on APA's. The UK TRPRICE rules[54] apply to an unusually wide range of transactions and are based on the arm's-length principle. It operates in a relatively loose fashion through self-assessment with no formal auditing of the returns. APA's prevail with encouraging growth of related Advanced Thin Capitalisation Agreements as well. Upon conclusion of an enquiry, if a TRPRICE adjustment is required only general rather than specific penalties are applied. Such a penalty is highly variable, however, based on the perceived culpability of the MNE. The German TRPRICE rules[55] vary little from the UK rules except the documentation requirements are more burdensome demanding detailed economic and legal context of a transaction to establish the arms-length price. This clearly increases the cost of TRPRICE for MNEs and in many instances represents a more threatening and transparent approach that discourages TRPRICE profit shifting arrangements than is prevalent in other jurisdictions. The penalty regime is broadly consistent with other jurisdictions based on the imposition of tax on the basis of an income estimate and additional penalties[56]. A succession of favourable rulings from the German Federal Fiscal Court[57] has prompted the tightening of the rules governing adjustments to the actual transfer prices. There is likewise evidence of more proactive circumstantial adjustment to the law, with recent legislation[58] providing for special rules relating to business restructuring.

Control features heavily in the French TRPRICE rules[59] which placed much greater emphasis on French MNEs that control, are controlled by or are under common control with entities established outside France to determine the level of TRPRICE scrutiny. In response to the

[53] Ibid

[54] Taxation (International and Other Provisions) Act 2010, part 4

[55] Corporation Income Tax Act (Germany), 1972, s8 3 *(Körperschaftsteuergesetz, KStG)*

[56] Foreign Tax Act (Germany), 1972, sch1 (*Außensteuergesetz)*

[57] Case IB 141/100 BFH/NV 2001 1169, Federal Fiscal Court [2001]; Case 17-k-894/05-E, Fiscal Court of Dusseldorf [2008]

[58] Enterprise Tax Reform Act (Germany), 2008 *(Funktionsverlagerungen)*

[59] Tax Code,1983 (France) s57 s238a (*Code General des Impots)*; Finance Amendment Act 2004, Procedural Tax Codes (France) L13B,sL80B, s188A (*Livre des Procedures Fiscales)*

recent OECD Base Erosion and Profit Shifting initiative, hereafter referred to as 'BEPS', larger capitalised French MNEs are now required, by French law[60], to prepare TRPRICE reports with a significantly enhanced set of details relating to product and business strategy, intangible assets and income flows, cross-border intercompany transactions and the functional profile of all legal entities. This represents a clear advancement in an anti-tax avoidance initiative prompted by the global OECD initiative and demonstrates the importance of data transparency and the behaviours it attempts to prompt in discouraging TRPRICE abuses. The French Tax Authority, hereafter referred to as 'FTA', is placing greater emphasis on delineation of actual transactions and conduct in their assessment of intra-group arrangements in an effort to clearly bring closer together accounting and tax reporting of cross-border passive intra-group transactions. In a similar fashion the Italian TRPRICE rules are similarly under scrutiny and review in light of OECD BEPS proposals. The Italian approach has been to target specific transactional types such as digital transactions reflected in Italian law[61] that has recently been amended to exclude the cost plus method for online advertising services unless accommodated in an APA. Historically Italy has had relatively loose TRPRICE regulations with a non-mandatory regime of publishing information on TRPRICE arrangements, the use of a more subjective fair market value concept rather than arms-length pricing and a non-specific penalty regime that does little to discourage opportunistic TRPRICE arrangements. The increased compliance burden that will stem from the BEPS initiative is likely to prompt a strengthening of TRPRICE regulations in jurisdictions such as Italy where proportionality concerns have prevailed to balance the burden on MNEs with the need to apply appropriate and reasonable TRPRICE rules. The Netherlands has similarly embarked on transformational changes in its approach to TRPRICE regulations in recent years[62]. It has embraced fully the ethos of increased TRPRICE transparency in its documentation requirements but now also requires data to be filed as part of a move towards country-by-country accounting. Interestingly in contrast to the French approach that now demands specific information relating to the underlying business arrangements, the Dutch approach has been to set out a more rigid structure around the reporting parameters and timeliness. Broadly consistent control thresholds, penalty regimes and enforcement procedures make the Dutch rules reasonably standard, although there is

[60] Tax Code, (France) art 223 Quinquies B, (*Code General des Impots)*

[61] Finance Act, 2014 (France) (Law No 147/2013)

[62] CITA, 1969, (Netherlands) s29e(2), s29g(5) (Regulation DB/2015/462M)

greater emphasis on the use of unilateral, bilateral and multilateral APAs[63], but its recent incorporation of country level reporting again underlines the growing realisation of the importance of data transparency and all the behaviours that this is likely to prompt in the future.

2.2.4 Thin Capitalisation

THINCAP is typically a subset of rules contained within a broader set of TRPRICE rules, and result from the fact that in a number of jurisdictions interest is a deductible expense for tax purposes, but dividends are not[64] It may therefore be advantageous from a tax perspective for a parent company to provide additional capital to its subsidiaries through debt than equity capital. The recipient subsidiary directs more of its operating profits to the parent in tax-deductible interest, leaving fewer profits subject to tax, thus representing a further dimension beyond profit and loss shifting, namely cross-border debt shifting. This is significant because governments "consider that there is nothing to stop groups of companies from capitalising subsidiaries with excessive levels of debt"[65]. Empirical research[66] has found a positive correlation between the tightness of THINCAP rules and debt shifting while others have found a robust link between THINCAP rules and the tax sensitivity of the capital structure of a MNE[67]. There is no better example of the challenge facing Member State's in their corporate tax avoidance rule making than in the improper use of intra-entity financial contracts engineered to take advantage of tax treaties and EU Treaty rights to reduce corporate tax. THINCAP rules must accommodate commercially and legally bona fide tax avoidance activities while putting in place mechanisms for mitigating possible abuse. To date this has been architected around applying threshold limitations to prevent subsidiaries from being capitalised with excessive debt, by denying interest deductions for interest on such debt

[63] Law Decree on Transfer Pricing (Netherlands) IFZ2004/680M

[64] Stuart Webber, 'Thin Capitalisation and Interest Deduction Regulations' (2010) Copenhagen Research Group on International Taxation, Discussion Paper 8/2010, 5

[65] Gareth Green, 'UK Thin Capitalisation: After the Renovations' (2004) 9, Tax Planning International Transfer Pricing, 5, <http://www.tpsolutions.co.uk/TPITP0904.pdf> accessed 12August12 August 2011

[66] Andreas Haufler and Marco Runkel, 'Firms' Financial Choices and Thin Capitalisation Rules under Corporate Tax Competition' (2008) CESIFO Working Paper 2429

[67] Buettner et al, 'The Impact of Thin Capitalisation Rules on the Capital Structure of Multinational Firms' (2012) Journal of Public Economics, 96, 930

rather than providing a broader set of data that would allow the Member States to identify abuse. Such an approach is reflective of the continued judicial challenges against THINCAP rules by placing a rather blunt form of relief limitation that may be considered a reasonably clear threat to Fundamental Freedoms. Such judicial challenges are further aggravated by their interaction with bilateral double taxation treaties. Avoiding a claim of discrimination by either offering preference THINCAP rule debt relief to resident entities as opposed to non-resident entities is to be avoided[68].

Across the EU there is no standard THINCAP rule that either standardises limitations on debt relief across Member States or a judicial precedent that sets out criteria to be used consistently on ascertaining the abusiveness of an arrangement containing THINCAP transactions. The former is, however, usually denoted by a debt to income threshold that is either subjective or fixed ratio in nature that, upon a breach, triggers a limitation on debt relief. This safe harbour rule, although common in principle, does offer variation in technical detail. For example, the debt may relate to total debt, as is the case in Germany[69] and Italy[70] or limited to parent company or related party debt as in France[71]. In some Member States such as Italy the THINCAP rules include non-resident related party debt[72], whereas in most others such as UK[73], Netherlands[74], Germany[75] and France[76] the rules relate to just related party debt. Upon a breach it may result in no debt relief above a threshold, as is the case with the German interest capping regime or is uncapped but based solely on a specific ratio such as in France[77]. Some jurisdictions do not rely so clearly on debt ratios but more of a subjective assessment of internal debt in respect to the arms-length price and indeed its outright authenticity as a loan as opposed to some other form of payment that would not necessarily be entitled to the same level or relief. Such technical variations do provide

[68] Case 524/04 *Thin Cap Group Litigation v Commissioners of Inland Revenue* [2007] ECR I-2107

[69] Income Tax Act (Germany) 2008, s4h

[70] Consolidated Text of the Income Tax Law (Italy) art 96

[71] Finance Law 2013 (France) art 23

[72] Consolidated Text of the Income Tax Law (Italy) art 96

[73] TIOPA (UK) 2010, part 7

[74] Corporate Income Tax Act (Netherlands), 2013, art13L

[75] Corporate Income Tax Act (Germany) 2007, s8c; Income Tax Act (Germany) 2008, s4h

[76] Finance Law 2013 (France) art 23

[77] Ibid

opportunities for exploitation by MNEs who may seek to architect their financial contracts between group entities in a manner that allows them to exploit favourable tax treatment consistent with the way in which such entities are funded and capitalised. Exploiting such differences through intra-group financial contracts is often difficult for the tax authorities to challenge even when such arrangements are made transparent. There is an element of commercial legitimacy to structuring the financial arrangements between entities under the current accounting system in a manner that supports the ability of "commercial enterprises the freedom to act and plan and make their plans secure by contracting with each other"[78]. In many ways THINCAP arrangements perfectly represent the conflict between what a MNE agrees as the financial contracts it agrees itself between its cross border entities, the *jus dispostivum*, and the Member State rules that apply in the event that an arrangement appears to have breached an accepted norm or ratio threshold, the *jus cogens*.

THINCAP laws to date have not attempted to impose specific terms on intra-group funding arrangements and there is little evidence of a move towards any harmonised form of THINCAP EU wide set of laws. There is a very mixed set of rules that attempt to either limit THINCAP excesses through ratio capping, enhance disclosures through documentation or pre-arranged agreements with the relevant tax authorities, or simply implemented the blunt tool of arms-length pricing once the arrangements are disclosed. The OECD has promoted the fact and circumstances approach of arms-length pricing[79] while, as outlined earlier in this chapter, the EU Member States have favoured applying debt / equity ratio thresholds and capping. The common issue at hand, however, is how to challenge the undercapitalisation of a MNE by determining the true nature of its financial contracts. As EU law is evolving this may no longer be as straightforward as simply applying rather subjective arms-length pricing rulings as the legal toolkit available to Member States is ever increasing with advances in TRPRICE laws and oversight, the progression towards ever increasing data transparency and the introduction of Member State GAAR's, all of which grant tax authorities with a plethora of means to assess the authenticity of THINCAP arrangements.

[78] Charles Bunn, 'Freedom of Contract under the Uniform Commercial Code' 2, Boston College Law Review, 1, 59

[79] OECD, 'Review of Comparability and of Profit Methods: Revisions of Chapters I-III of the Transfer Pricing Guidelines' (2010), 1, B2, 1.14, 7

2.2.5 Double Taxation Treaties

A double taxation treaty, hereafter referred to as 'DTT', exists to ensure that where a transaction creates a tax liability in one country, a MNE does not incur a similar tax charge arising in its country of incorporation or residency. The DTT is underpinned by the concept of a Permanent Establishment, hereafter referred to as ‘PE’, denoting a specific place of business that gives rise to a corporate tax liability in a particular Member State jurisdiction. The requirements of what constitutes a ‘PE’ within the scope of a particular DTT depends on what interpretation a particular Member State places on that term, in context of the text of that DTT.

The EU Treaty stated vaguely that “Member States shall facilitate the achievement of the Union’s tasks and refrain from any measure which could jeopardise the attainment of the Union’s objectives” [80]. The implied purpose of this provision is to ensure that cross-border activities are not compromised compared with national activities. According to the Commission, “discrimination and double-taxation resulting from the transnational character of an activity is inconsistent with the Internal Market”[81]. The principle issue is that DTT’s are designed to address double-taxation problems but in the case of divergent interpretations and similar problems no higher treaty forces them to find a solution. The existing network of bilateral tax treaties between Member States goes some way towards meeting these objectives although it is questionable whether these tax treaties sufficiently address the Internal Market requirements. Irrespective of the technical arrangements agreed between Member States in their DTT’s, a number of core principles of EU law provide the legal basis upon which treaties may be enacted, interpreted and enforced. These non-discrimination rules form part of long standing OECD Model Tax Convention[82] that provides specific grounds that cannot be relied upon by a state to discriminate for the purposes of corporate taxation. These range from discrimination on the grounds of nationality[83] to discrimination on the grounds of PE[84]. Specific provisions are now also outlined for ensuring accommodation of intangibles.

[80] Consolidated version of the European Treaty [2012] art 4, OJ C326/15

[81] Commission, ‘Company Taxation in the Internal Market’ COM(2001) 582 Final, 284

[82] OECD, Model Tax Convention on Income and Capital (2014)

[83] Ibid, art 4

[84] Ibid, art 5

DTT's offer MNEs a broad set of prospective tax reliefs that may include reduced withholding taxes on dividends, interest and royalties and foreign tax credits. Such relief is intended to benefit worthy MNEs who have a commercial arrangement that is consistent with the objectives of DTT's as set out by the Member States party to a DTT. The risks relating to improper usage, however, exist and Member States have enacted various means to ensure abuse is identified and addressed. Such policy initiatives reflect a myriad of complexities relating to the relationship between Member State anti-avoidance rules and a DTT, specific anti-abuse rules found in DTT's and the provisions for identifying and combating aggressive tax avoidance arrangements that leverage DTT's.

2.3 Aggressive Tax Planning Arrangements

The notion that MNEs in the EU can operate in a borderless environment fundamentally challenges many of the historical assumptions regarding territorial Member State tax systems. Taxing corporate income derived from activities within a Member State's boundary forms the basis of source system accounting but the combined factors of EU Internal Market integration, globalised trade and mobility of capital infers that the ability of Member State legislators to pursue domestic tax policies regardless of supranational considerations have significantly diminished. Technological advancements, the growth of digital trading and the use of sophisticated financial transaction structures have all provided dual challenges in protecting the EU tax base and Fundamental Freedoms.

The trend towards increased transactional significance of intangible assets and intellectual property is a reflection of the shift to a more knowledge based economies. Intangible assets include patents, know-how, trademarks, branding, licenses, contractual rights or royalties and are much more difficult assets to apply arms-length pricing assessments to in order to validate TRPRICE arrangements[85]. A growing reliance on intangible assets, and the absence of any theoretical valuation models for such assets means that the rights afforded to MNEs by Fundamental Freedoms incentivises TRPRICE based profit shifting to lower tax Member

[85] Tom Karkinsky and Nadine Riedel, 'Corporate Taxation and the Choice of Patent Location within Multinational Firms' (2009) CESIFO Working Paper 2879, 19

States. Similarly from a CFC perspective, Member State CFC rules generally consider intangibles to reflect passive income making them particularly susceptible to tax in their residence jurisdiction, so either encourages MNEs to shift intangibles to more tax friendly locations or relocate establishments where intangibles reside to low tax jurisdictions. Intangibles provide for specific challenges when assessing profit shifting. The identification of an intangible transaction is a different process to the one requiring price determination consistent with arms-length pricing, however both approaches may require a different approach based on the "facts and circumstances of a given case"[86]. These difficulties are compounded by the fact that intangibles evaluated for the purposes of TRPRICE may not necessarily be consistent with the application of accounting rules in MNE statutory returns. Likewise, the TRPRICE computation for an intangible may be different when evaluated singularly than when it is combined within an arrangement alongside other transactions, whether they are tangible, intangible or combined. It is also important to emphasis the connect between a more simplistic accounting or balance sheet entry relating to an intangible and the value created from it as it is the value creation that forms the basis of a proper assessment of its commercial legitimacy, in tax arrangement terms, between source and residence country. The enhancement to value of an intangible transaction is subjective and there is limited case law to provide direction in terms of evaluation criteria.

Member States have responded by tightening up the TRPRICE and CFC taxation rules relating to intangibles[87] but remain challenged by both the resources demanded by tax authorities to trace down and price up intangible transactions, as well as achieving consistency in a complex and diversified set of intangible-based transactions or arrangements. Proponents of unitary taxation[88] point out the benefit of a formulaic apportionment of income factors, including intangibles, to better identify and tax intangibles in the residence country. Similarly international initiatives have been at the forefront of initiatives to stem the impact of intangibles related profit sharing with the OECD leading the charge. Recognition of the issue was underpinned in action eight of the OECD BEPS proposal that focuses on revising

[86] OECD, 'OECD/G20 Base Erosion and Profit Shifting Project – Guidance on Transfer Pricing Aspects of Intangibles' (2014), Action 8: 2014 Deliverable, 30

[87] Jamal Hejazi 'Assessing the Risks of Intangibles Migration,' (2006) 15, Tax Management - Transfer Pricing, 10, 399

[88] Sol Picciotto, 'Towards Unitary Taxation of Transnational Corporations' (2012), Tax Justice Network

TRPRICE guidelines relating to "hard-to-value"[89] intangibles by establishing standards tools to "address the use of information asymmetry between taxpayers and tax authorities to undervalue intra-group transfers of intangibles"[90]. In response, the EU has proposed to instruct the Joint Transfer Pricing Forum to review and update TRPRICE to include more economic analysis, leveraging MNE systems and improving TRPRICE administration[91].

Digital transactions and the opportunities afforded to MNEs in profit shifting offer an additional dimension, reflecting a new internet mode of delivering services and products. It raises the prospect of introducing the concept of virtual PE's and there are both proponents[92] and critics[93] of a separate taxation regime to tackle tax avoidance for the digital economy. Identification of a taxable presence is challenging, with a particular reliance on geographically mobile intangibles and novel commercial models that means it is not always clear how and where MNEs create value. The EU Commission has responded in the establishment of a 'High Level Expert Group on Taxation of the Digital Economy'[94] but has yet to make any substantive proposals other than to express a view that there "should not be a special tax regime for digital companies"[95] and that "general rules should be adapted so that digital companies are treated in the same way"[96].

The term "stateless income"[97] has become a common term used in the context of EU direct tax and refers to "income derived by a multinational group from business activities in a

[89] OECD, 'OECD/G20 Base Erosion and Profit Shifting Project – Explanatory Statement, (2015), 8 final

[90] Ibid

[91] Commission, EU Joint Transfer Pricing Forum – JTPF Program of Work 2015 – 2019 (2015) JTPF/005/Final/2015

[92] James Ross and Matthew Herrington, 'A Call to Re-Write the Fundamentals of International Taxation: the OECD BEPS Action Plan' (2013), 39, International Tax Journal, 14

[93] Hosuk Lee-Makiyama and Bert Verschelde, 'OECD BEPS: Reconciling Global Trade, Taxation Principles and the Digital Economy' (2014) European Centre for International Political Economy Working Paper 04/2014

[94] Commission, Setting up the Commission Expert Group on Taxation of the Digital Economy COM (2013) 7082 final

[95] OECD, 'OECD/G20 Base Erosion and Profit Shifting Project – Addressing the Tax Challenges of the Digital Economy (2014), OECD Publishing, 41

[96] Ibid

[97] Edward Kleinbard, 'Stateless Income's Challenge to Tax Policy' (2011) USC Gould School of Law Research Paper C11-8

country other than the domicile (however defined) of the group's ultimate parent company, but which is subject to tax only in a jurisdiction that is neither the source of the factors of production through which the income was derived, nor the domicile of the group's parent company"[98] The "Double Irish Dutch Sandwich"[99] arrangement enacted by Google and Starbucks is an example of such stateless income tax planning. This is a classic 'treaty shopping'[100] concept, a term used to express a MNEs propensity to exploit inconsistencies in DTT's to avoid taxation by engineering conduit transactions between carefully chosen subsidiaries to receive dividends, interest or other investment income at low or zero withholding rates. This reflects numerous segments of the EU tax abuse challenge. It represents a scheme for US-based MNEs to avoid punitive corporation tax rates in EU markets by selling its products from an Irish subsidiary. To further reduce the low tax rate charged in Ireland, the firm transfers patents to a subsidiary in a haven economy with a zero rate, in the case of Google in Bermuda, and strips income out of Ireland through royalty and license payments. To avoid withholding taxes, the money is then channelled through a conduit in the Netherlands, exploiting the absence of withholding taxes under NL law. The US MNE then circumvents the application of US CFC rules by founding a second Irish affiliate managed by the Bermudian subsidiary, exploiting that the firm is tax resident in Ireland under US law and tax resident in Bermuda under Irish law. The scheme leverages both loose Dutch DTT's driven by FDI objectives, generally inattentive TRPRICE laws to commercial opportunities, and disconnect between US and EU legal provisions that have accommodated the arrangements. In the examination of this particular arrangement, Kahale[101] usefully differentiated the structuring from the re-structuring of arrangements to take usage of DTT's, the latter being friendlier towards identifying non-commercial purposive reasoning. Judicial challenge to these types of arrangements has historically centred on beneficial ownership of income or the application of anti-avoidance rules and principles relating to specific rules and Limitation of Benefits provisions, hereafter referred to as 'LOB', in DTT's. The OECD is expected, as part of the BEPS proposals, to be enacting a new US style LOB

[98] Ibid, 4

[99] Clemens Fuest et al 'Profit Shifting and Aggressive Tax Planning by Multinational firms: Issues and Options for Reform' (2013), Centre for Economic Research, Working Paper No 13-044 , <http://ub-madoc.bib.uni-mannheim.de/33946/1/Arbeitspapier_Spengel_Fuest_Finke_Heckemeyer_Nusser.pdf> accessed 12 July 2014

[100] Charles Kingston, "The Coherence of International Taxation" (1981) Columbia Tax Review, 81, 1153

[101] George Kahale, 'The new Dutch Sandwich: The Issue of Treaty Abuse' (2011) 48 Columbia FDI Perspectives, 2

rule as part of the proposal due in 2016 aimed at ensuring DTT benefits are for the sole use of the parties to the DTT and cannot be leveraged by third parties as part of a treaty shopping exercise.

The term 'beneficial ownership'[102] is relevant to evaluating tax avoidance and relates to an entity that enjoys the benefits of income ownership but who has little title, control or custody over the income. The notion of beneficial ownership implies that the beneficial owner of a transaction such as a royalty payment can qualify for taxation at source exemption, but as is often the case regarding these sort of intangible transactions it is not always clear who the beneficial owner is for tax assessment purposes. It challenges the traditional boundaries between legal ownership and beneficial ownership inferring that there is a distinction between a transaction for the ultimate legal owners benefit as opposed to one which is for the benefit of an intermediary such as an entity in a more tax friendly Member State jurisdiction. The law is required to determine the difference between rightful recipient under Member State law and beneficial owner under a DTT. Ultimate legal owners therefore rely on DTT provisions and any assessment is less a technical one but more of a potential tax abuse one requiring a substance over form judgment to be formed in the context of the object and purposes of the DTT. At one level these become arms-length principle TRPRICE assessments and at another level they become more binary allocative decisions, but in either instance these may become easily challenged. It is entirely feasible that there is interchangeability between the beneficial ownership and anti-avoidance rules, each informing one of the other in different circumstances. A court is just as likely to conclude a ruling on beneficial ownership citing reliance on anti-avoidance provisions[103], as a ruling on anti-avoidance relying on the beneficial ownership principle[104]. Either way, the challenge for the EU is to achieve a position where the concept of beneficial ownership may be interpreted in a consistent manner to both ensure legal certainty and to ensure a robust check on potential MNE abuses within the context of Fundamental Freedoms.

One consequence of the use of DTT's is the widespread proliferation of exploiting differences in the tax treatment of an entity or instrument under the laws of different Member

[102] OECD, Model Tax Convention on Income and Capital (2014) arts 10, 11,12

[103] *Bank of Scotland* [2006] Case 283314, Conseil d'Etat, France

[104] *Indofood International Finance Ltd. v. JP Morgan Chase Bank NA London* [2006] B.T.C. 8003

States to achieve double non-taxation. These may relate to direct mismatches between two Member States or indirectly via a third party jurisdiction. Clearly in conflict with the notions of those attributes that underpin the EU Treaty such as competition and fairness, they represent a common abusive arrangement that has attracted the specific attention of the OECD in recent years[105]. 'Hybrid mismatches'[106] have the potential to arise under a number of different circumstances. They provide a more difficult issue for the EU as addressing abuses is most likely to require changes to relevant legislation in each Member State. Although this may be enacted through a Directive to eliminate payment hybridity through prohibiting deductible payment exemptions or elimination of deductible allowances in more than one Member State, there is an opportunity to supplement this through a more centralised approach persisted through changes to the OECD Model Tax Convention. This was reflected in the BEPS recommendations that would disallow hybridity when seeking to obtain the benefits of DTT's in a manner contrary to their original objective. It is similarly unclear through all the recent OECD publications as to whether the approach to mitigate hybrid mismatches is better tackled through the proactive neutralisation of mismatches through DTT changes or the centralised setting out of guidelines that would require the reversal of a tax benefit if challenged by a Member State, possibly with penalties. The inherent dispersed nature of this problem suggests that some of these reforms will require ongoing co-ordination of information between Member States, accommodation of specific measures to address dual resident entities as well as some element of motive or purpose test to ensure there is no adverse consequences to unintentional usage of DTT arrangements.

2.4 Abusive Tax Conduct

The study of EU corporate tax abuse is not just limited to the amalgamated outcome of the forms of tax arrangements highlighted in this chapter. It reflects a much deeper rooted form

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[105] OECD, 'Addressing Tax Risks Involving Bank Losses' (2010), OECD Publishing; OECD, 'Corporate Loss Utilisation through Aggressive Tax Planning' (2011) OECD Publishing; OECD, 'Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues' (2012) OECD Publishing; OECD, 'OECD/G20 'Base Erosion and Profit Shifting Project – Neutralising the Effects of Hybrid Mismatch Arrangements' (2014) OECD Publishing

[106] OECD, 'Base Erosion and Profit Shifting: Neutralising the Effects of Hybrid Mismatch Arrangements' (2015) Action 2 final report

of conduct that has become endemic in recent years as a consequence to many independent factors of influence established from commercial pressures and opportunity, political inertia and the institutional environment. Extending the notion of abusive behaviour to corporate taxpayer behaviour under EU tax law is far from simple. Historically, abusive behaviour as a legal form has its origins embedded in the widely adopted *fraus legis* principle that suggests "a person cannot rely on the recourse to the law when he in bad faith hopes to gain the benefit of his subjective right"[107]. This principle has been applied in different ways to limit tax liabilities, although Italy is the only known Member State in our sample Member States to not maintain the *fraus legis* principle in tax matters. Member State law provides a few further insights into abuse of rights when considered more generally. The most pertinent being French law, which is clearest in terms of its application to tax law. *Fraude a la loi* states that an abuse would occur if "a person performs a legal act or places himself in a specific legal situation with the intent to avoid or to circumvent otherwise applicable mandatory provisions"[108]. Broadly similar legal norms are evident in the German *Rechtswidrige* and in the Italian *Violazione di norme di legge*.

The abuse of rights doctrine is not yet universally considered to be a general principle of EU law. It is only likely to be applied in limited circumstances and its doctrinal characteristics mark it out as more of a hybrid moral-legal tool with all the ambiguous legal consequences that stem from such notions. A principle can only be considered to be a general principle of EU law if it can be consistently extracted out of Member State laws and achieve a normative constitutional significance at EU level. It needs to demonstrate universality with a minimum ascertainable legally binding content. Recognition of the doctrine in EU tax laws, CJEU case law and increasing codification in civil law codes supports the view that it is at least a general principle of EU tax law. However, the fact that there is little common agreement of the doctrine's boundaries and meaning in different contexts and its inapplicability across a range of more diverse EU law suggest there is some way to go before it is considered a more general principle of EU law.

[107] Tambet Grauberg, 'Anti-tax-avoidance Measures and their Compliance with Community Law' (2009) Judicia International ,142

[108] Pierre Schammo, 'Arbitrage and Abuse of Rights in the EC Legal System' [2008] 14 European Law Journal, 3, 358

The concept of tax abuse in the UK was advanced recently in a UK Supreme Court ruling[109] which found a VAT tax scheme abusive, noting that the abuse principle applied only if there is an element in the arrangement facilitating a tax advantage that has no independent "commercial rationale"[110], a description differing from the lack of "normal commercial operations"[111] or devoid of "economic reality"[112] or "economic links"[113] used in previous cases to differentiate substance from form. The importance of this UK case is not to be underestimated as this outcome was despite the fact that the principle of abuse of law, derived from civil law jurisprudence, is little known to UK Common Law. Lord Sumption laid out a two dimensional test to ascertain abuse, namely that an arrangement must result in a tax advantage that is contrary to VAT harmonisation[114], and furthermore must be considered objectively in that it must be clear that an "essential aim" of the transaction is the procurement of that tax advantage. The Supreme Court concluded that an arrangement designed to prevent double taxation had been exploited so as to prevent any taxation at all. On this occasion the Supreme Court ruled that the 'commercial objective'[115] was enough to explain the particular features of an arrangement, differentiating between an objective assessment of the aim of arrangement from the actual intention of the parties involved. Significantly greater emphasis was placed the aim of the arrangement rather than the actual intentions of the parties, the latter being more difficult to ascertain and open to challenge. Furthermore the scale of the tax advantage associated with the aim of the arrangement was deemed an important objective factor in the assessment of a potentially abusive tax arrangement.

[109] *CRC v Pendragon plc* [2015] UKSC 37

[110] Ibid, 7

[111] Case C-162/07 *Ampliscientifica Srl and Amplifin SpA v Ministero dell'Economia e delle Finanze and Agenzia delle Entrate* [2008] ECR I-4019, para 27

[112] Case C-653/11 *HMRC v Ocean Finance* [2013], para 52

[113] Case C-196/04 *Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I‑7995, para 61

[114] Council Directive (EC) 77/388/EEC

[115] *CRC v Pendragon plc* [2015] UKSC 37, s39

2.5 Conclusion

The analysis in this chapter demonstrates not only the diversity inherent within the common tax avoidance practices but also the considerable diversity in the approaches adopted by Member States in implementing anti-avoidance laws. Technical tax rules in a given jurisdiction have limited effect in the resolution of tax abuse either at Member State level or consistently across the EU particularly in light of the emerging trends in digital commerce and proliferation of intangible transactions that generate a different dimension to the same problem of EU corporate tax avoidance. In any disparate group of Member States with different political heritages, legal orders and tax base priorities a non-harmonised set of anti-avoidance laws are inevitable. The analysis highlights the challenge facing any reform in this field in the adoption of a common solution for materially mitigating such diverse tax avoidance practices. On a positive note, the highlighting of variability and inconsistencies in the application of such Member State laws suggests, beyond tax harmonisation, the issue may require reform above and beyond changes to individual Member State tax laws if a consistent and credible solution is to be formed. It also highlights the challenging complexity inherent in individual EU legislative provisions for closing out tax avoidance practices that reflect the local interpretation for protection of EU Fundamental Freedoms, jurisdictional legal norms and precedence, and experience in addressing specific tax avoidance cases presented to Member State authorities in the past.

Chapter Three: Tacking EU Tax Abuses - The Scholarly Debate

3.1 Introduction

The complex nature of EU direct tax anti-avoidance and its relationship with EU Fundamental Freedoms demands "generativity"[1] allowing a synthesis of the body of knowledge available and permitting a new perspective on the issues requiring redress. Tax avoidance has attracted hundreds of research papers but very few have incited successful legal reform in the arena of EU direct tax avoidance. The boundaries of this research subject cross accounting, tax law, public law, international law, economics and politics domains. Bearing this in mind, this analysis of the scholarly debate will focus on applying a set of relevant model ideals to a small number of notions relevant to understanding what is believed will be foundational concepts in understanding and defining EU direct tax anti-avoidance law reform. The first concept is reflected in Legal Origins Theory that suggest that from a neoclassical law and economics perspective law is a function of the "incentives it sets for welfare-maximising conduct"[2] inferring that law is principally directed towards social engineering. Generating a long-term social contract between corporate taxpayers and the communities they serve is fundamental to reform. The second concept also relates to Legal Origins Theory that suggests that legal rules are driven by economic, political and legal system context[3]. Legal institutions are a function of the legal and political system inferring that laws may shape economic behaviours, including tax conduct, the enforcement of which is more effective through the judicial system than by the blunt tools of EU or Member State regulation. The third concept connects the moral dimension to the issues at hand, and Legal Positioning Theory[4] that claims tax conduct may be linked closely to economic models of self-interest. Such self-interest infers that calculated behaviours, possibly emulated through game theory, encourages corporate tax planning decisions based on combinations of behavioural, normative and subjective beliefs as articulated in the Theory of Planned

[1] Lee Shulman, 'Professing educational scholarship' (1999) in Ellen Lagemann and Lee Shulman Issues in *Education Research: Problems and Possibilities* (San Francisco, Jossey Bass, 1999), 161

[2] Rafael La Porta et al, 'The economic consequences of legal origins' (2008) 46, 2, Journal of Economic Literature, 285

[3] Ibid, 288

[4] Rom Harre, *Positioning Theory*, (The Encyclopaedia of Peace Psychology, 2011)

Behaviours[5]. The relevance, importance and corollary of these models to the reform proposal shall be considered and underpinned by supporting scholarly material set out in this chapter. Through an understanding of the literature and its relationship with established models, it provides context regarding the issues requiring consideration in recommending a reform proposal to address the prevalence and challenges of tax abuse within EU law.

3.2 Research Evidencing Tax Avoidance Practices

There is considerable theoretical literature based around the concept of tax avoidance, most of which seems to be a derivative of tax evasion research, primarily attributable to the fact that the drivers of tax avoidance remain the same namely to minimise or eliminate tax liabilities. In fact "the conceptual distinction between tax evasion and tax avoidance hinges on the legality of the taxpayer's actions"[6]. Tax avoidance is a relatively aged concept[7] but political and academic interest in it, particularly in relation to the EU corporate taxation, did not evolve until the 1970s as a result of the formation of the EU and its handling of taxation matters. Such research by Kolm[8] and Richupan[9] are good examples of this early academic research. Genschel and Schwartz[10] identified rising corporate taxation and widening cross-border tax differences as primary reasons triggering material movements of taxpayers and bases across the EU. Hanlon argued that tax avoidance is usually "highly idiosyncratic and determined by a number of factors and interactions"[11], not all of which can be measured.

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[5] Icek Ajzen, *Attitudes, personality and behaviour* (Dorsey, Chicago, 1988), 117

[6] Agnar Sandmo, 'The theory of tax evasion: A retrospective view' (2004) Norwegian School of Economics and Business Administration Working Paper 31/04, <http://brage.bibsys.no/nhh/bitstream/URN:NBN:no-bibsys_brage_22475/1/dp2004-31.pdf> accessed 12 July 2011

[7] Frank Ramsey, 'A contribution to the theory of taxation' (1927) Economic Journal 37, 47; Carl Shoup, Roy Blough and Mabel Newcomer, *Facing the Tax Problem,* (Twentieth Century Fund, New York, 1937)

[8] Serge Christophe Kolm, 'A note on optimum tax evasion' (1973) Journal of Public Economics 2,3, 265

[9] Somdiai Richupan, 'Measuring tax evasion' (1984) 21, Finance and Development, 4, 38

[10] Phillip Genschel and Peter Schwarz, 'Tax Competition: a literature review' (2011), 9, Socio-Economic Review Publication , 339–370

[11] Michelle Hanlon**,** 'The Persistence and Pricing of Earnings, Accruals, and Cash Flows When Firms Have Large Book-Tax Differences', (2005) 80, 1, The Accounting Review, 137

Erle[12] placed more emphasis on more fundamental drivers stating that corporate taxpayers may have to support a multitude of tax strategies, depending on their tax philosophy.

One practical difficulty for the tax authorities across the EU has been to identify and quantify tax avoidance practices. Given the prospective materiality of corporate tax avoidance practices in the EU, some academics have made efforts to identify and assess those factors evidencing tax avoidance practices. In accounting terms, the term book-tax differences represent a cash effective tax rate, hereafter referred to as CER. Hanlon[13] identified such book-tax differences as being the prime reflector of tax avoidance or tax aggressive behaviour. Earlier research by Mills found that MNEs with large book-tax differences, measured on the tax return and using deferred tax expense from the financial statements, are more likely to be investigated by tax authorities[14]. Wilson found in a US study that book-tax differences are larger for MNEs accused of engaging in tax avoidance than for a matched sample of non-accused MNEs[15]. Other researchers such as Plesko[16], Manzon and Plesko[17], and Desai[18] all examined book-tax differences in the search for tax avoidance evidence. Further data was assessed by Mills et al[19] and Plesko[20] who used tax return data to reinforce

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[12] Bernd Erle and Wolfgang Schön, *Tax and Corporate Governance* (New York, Springer, 2008), 205-220

[13] Michelle Hanlon, 'Review of Tax Research' (2009) Massachusetts Institute of Technology Working Paper, 93, <http://econ-www.mit.edu/files/5417> accessed 17 August 2011

[14] Lillian Mills, 'Book-tax differences and Internal Revenue Service Adjustments' (1998) 36, Journal of Accounting Research, 2

[15] Ryan Wilson, 'An Examination of Corporate Tax Shelter Participants' (2009) 84, 3,The Accounting Review,<https://www.gsb.stanford.edu/facseminars/pdfs/Wilson_Examination_of_Corporate.pdf> accessed 17 August 2011

[16] George Plesko, 'Book-Tax Differences and the Measurement of Corporate Income' (2000) <http://web.mit.edu/gplesko/www/Plesko%20NTA%20Pro%201999%20Book%20Tax%20.pdf> accessed 17 August 2011

[17] Gil Manzon and George Plesko 'The Relation Between Financial and Tax Reporting Measures of Income' (2002) 55, Tax Law Review, 2, 175 <http://web.mit.edu/gplesko/www/Manzon%20Plesko%20TLR%202002a%20Relation%20Between%20Fin%20and%20Tax.pdf> accessed 21 August 2011

[18] Mihir Desai, 'The corporate profit base, tax sheltering activity, and the changing nature of employee compensation' (2003) NBER Working Paper 8866, <http://www.nber.org/papers/w8866.pdf> accessed 21 August 2011

[19] Lillian Mills, Kaye Newberry and William Trautman, 'Trends in Book-tax income and Balance Sheet Differences' (2002)Tax Notes <http://www.irs.gov/pub/irs-soi/bktxinbs.pdf > accessed 18 August 2011

the correlation. The evidence from all these studies suggests that book-tax differences capture some element of tax avoidance. It appears that there are no standard accounting practices for capturing such information and it is difficult to track and quantify across EU boundaries.

One could observe that the commonality in the aforementioned research by Mills et al and Plesko is that they focus on annual measures of avoidance. It is not clear whether the same MNEs are continually avoiding taxes or whether the tax avoidance is more of a transitory behaviour triggered by a specific set of circumstances. Research by Dyreng, Hanlon and Maydew[21] found that an event such as the disinvestment of a business may attract certain tax-favourable practices by MNEs not typically attracted to implementing regular tax avoidance practices. In any event, whatever the driver, Loretz and Moore stated "one of the perpetuating forces of tax competition is based on the desire of MNEs to reduce the burden of taxation on profits. This force is not only responsible for shifts of capital across borders, but also motivates the multitude of strategies that firms adopt to lower their CER" [22]. This illuminates not only the fundamental market forces driving optimal taxation planning but also the recognition that it drives capital movements to lower tax jurisdictions as well as other loophole exploitation associated with tax avoidance planning.

Robinson et al [23] highlighted two main factors accelerating the notable rise in book-tax differences in recent years. Firstly, MNEs tend to organise their tax departments as profit centres rather than cost centres. Secondly, the trend towards corporate tax functions focusing on planning rather than compliance. It was concluded that these two factors alone had a material impact on the propensity of a company to engage in corporate tax avoidances practices, placing emphasis on how a MNE is organised and what its priorities are will determine its appetite to practice tax avoidance. Whether these are a function of the longer-

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[20] George Plesko, 'Reconciling Corporation Book and Tax Net Income, Tax Years 1996-1998' (2002) SOI Bulletin 21, 4, <http://www.irs.gov/pub/irs-soi/98cobkin.pdf> accessed 10 August 2011

[21] Scott Dyreng, Michelle Hanlon, Edward Maydew, 'Long-Run Corporate Tax Avoidance' (2005) 1, University of North Carolina and University of Michigan <http://www.kellogg.northwestern.edu/accounting/papers/Hanlon.pdf> accessed 19 August 2011

[22] Simon Loretz and Padraig Moore, 'Corporate Tax Competition between Firms' (2009) 1, Oxford University Centre for Business Taxation, Working Paper 0912

[23] John Robinson, Stephanie Sikes, and Connie Weaver, 'Performance Measurement of Corporate Tax Departments' (2010) The Accounting Review, 85, 1035

term organisational culture with in a MNE or the short-term managerial direction they should be considered drivers of behaviour.

Consistent with Harre's Legal Positioning Model, Desai and Dharmapala[24] found that MNEs offering greater equity incentives to management engaged in more tax avoidance practices. Another angle to this research has been to look at the behaviours of certain industry groups. Loretz and Moore found that "firms' tax planning decisions, similar to their other operational decisions, are made in a competitive environment. Various stakeholders of the firm can observe tax payments and evaluate these against the relevant peer group, which creates interdependencies in the tax planning activities of firms"[25]. This introduces an interesting angle to the motivational forces behind tax avoidance, promoting the importance of peer pressure and recent examples include financial transactions purporting to avoid taxes across London based UK investment banks such as Barclays[26] and Goldman Sachs[27]. Frank et al.[28] introduced the concept of the "Simultaneous Equation Model" which positively correlated the tax aggressiveness of a company with the general financial aggressiveness of a company. The more aggressive a company is in pursuit of profit, the more likely it is to engage in corporate tax avoidance arrangements. Manzon and Plesko[29] focused more on investigating whether MNEs characteristics are associated with tax avoidance based on organisational, cultural, and geo-political or activity factors.

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[24] Mihir Desai and Dhammika Dharmapala 'Corporate tax avoidance and high-powered incentives' (2005), Journal of Financial Economics, 145

[25] Simon Loretz and Padraig Moore 'Corporate Tax Competition between Firms' (2009) Institute 'Economia de Barcelona, 2009/19 <http://eventosempresariales.com/aplicacio/fitxers/2009/11/Doc2009-19.pdf > accessed 16 August 2011

[26] Jill Treanor, 'How Barclays tax avoidance schemes worked' [2011] The Guardian <http://www.guardian.co.uk/business/2012/feb/28/barclays-how-tax-avoidance-schemes-worked> accessed 12 April 2012

[27] David Leigh, 'Goldman Sachs let off paying £10m interest on failed tax avoidance schemes' (2011) The Guardian <http://www.guardian.co.uk/business/2011/oct/11/goldman-sachs-interest-tax-avoidance> accessed 12 April 2012

[28] Mary Margaret Frank, Luann Lyunch and Sonja Olhoft Rego, 'Does Aggressive Financial Reporting Accompany Aggressive Tax Reporting (and Vice Versa)' (2004), University of Iowa Working Paper <http://tippie.uiowa.edu/accounting/mcgladrey/workingpapers/agg_reporting.pdf> accessed 10 July 2011

[29] Gil Manzon and George Plesko, 'The Relation Between Financial and Tax Reporting Measures of Income' 55, (2002) Tax Law Review, 2, 175

Rego[30] found that company size was an important determinant as large MNEs have more resources to optimize their tax planning, which would imply a lower CER. Furthermore, large MNEs are expected to be investigated more often by national tax authorities, creating higher political costs of tax planning for larger MNEs according to Zimmermann[31] and Omer, Molloy and Ziebert[32]. Larger organisations tend to be more profitable and Wilkie[33] discussed the importance of the profitability on the propensity to engage in tax avoidance practices. Graham and Tucker[34] analysed forty-four tax avoidance cases and identify firm size and profitability as determinants of MNEs which are using tax avoidance. A contrarian view has been expressed by Desai and Dharmapala[35] who found that tax avoidance has no association with firm value but rather on the level of institutional ownership.

The correlation between corporate governance and tax avoidance is well researched, but Desai and Dharmapala focused on how corporate governance affects the response of MNEs to changes in corporate tax rates noting that when governance is weak, an increase in a jurisdiction's tax rate results in more diversion lowering corporate tax revenues[36]. New forms of corporate governance have promoted internal controls and self-scrutiny. Owens[37] points out that these have not been tax focused, but the role of the board of directors has bought tax avoidance activities into the boardroom. Again, consistent with Harre's Legal Positioning

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[30] Sonja Rego, 'Tax Avoidance Activities of U.S. Multinational Corporations' (2003) 20, Contemporary Accounting Research, 4, 805

[31] Jerold Zimmerman, 'Taxes and Firm Size', (1983) Journal of Accounting and Economics, 5, 119

[32] Thomas Omer, Karen Molloy, David Ziebart, 'An investigation of the firm size - effective tax rate relation in the 1980s' (1993) 8, Journal of Accounting, Auditing, and Finance, 2, 167

[33] Patrick Wilkie, 'Corporate Average Effective Tax Rates and Inferences about Relative Tax Preferences' (1988) 10, The Journal of the American Taxation Association, 75

[34] John Graham and Alan Tucker. 'Tax Shelters and Corporate Debt Policy' (2006) Journal of Financial Economics, 81, 563

[35] Mihir Desai and Dhammika Dharmapala, 'Corporate tax avoidance and firm value', (2009), 91, Review of Economics and Statistics, 537

[36] Mihir Desai and Dhammika Dharmapala, 'Tax and Corporate Governance: An Economic Approach' in *Tax and Corporate Governance* (Wolfgang Schoen edn, Springer Press, Berlin, 2008)

[37] Jeffery Owens, 'Good Corporate Governance: The Tax Dimension', in "*Tax and Corporate Governance"* (Wolfgang Schoen edn, Springer Press, Berlin, 2008)

Model, Desai and Dharmapala[38] chose to extend the theories in Slemrod[39] and Desai et al[40] by correlating the effect of incentivised compensation and governance structures on tax avoidance, surmising that there was a negative correlation between equity-based compensation and tax avoidance.

The impact of ownership patterns on tax avoidance was researched by Desai and Dharmapala[41]. Concentrated ownership, examined in Chen et al[42], typically nurtures tax avoidance practices because a controlling owner benefits more financially. Conversely, these MNEs may avoid fewer taxes because these long-term concentrated holders have a longer horizon and may be more sensitive to the total costs of avoidance arising from reputation effects and suspicions of diversion from minority shareholders. Leblang argued that MNEs with more multinational activity generally have more tax planning opportunities[43]. Similarly, Rego reports evidence that suggests the scale of international operations leads to more tax avoidance opportunities resulting in lower effective tax rates[44]. A trend towards increasing intangible capital transfers has also had an impact despite the more traditional issue of tangible capital that has been most sensitive to differences in jurisdictional tax rates. Studies by Grubert and Mutti[45] and Altshuler, Grubert, and Newlon[46] found conclusive correlations between FDI and inter-country differences in tax rates. The ability to shield taxes on royalties

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[38] Mihir Desai and Dhammika Dharmapala, 'Corporate Tax Avoidance and High Powered Incentives' (2006a) 79, Journal of Financial Economics, 145

[39] Joel Slemrod, 'The Economics of Corporate Tax Selfishness' (2004), 57, National Tax Journal, 4, 877

[40] Mihir Desai and Dhammika Dharmapala, 'Corporate Tax Avoidance and Firm Value' (2009) 91, The Review of Economics and Statistics, 537

[41] Mihir Desai and Dhammika Dharmapala, 'Tax and Corporate Governance: An Economic Approach' in *Tax and Corporate Governance* (Wolfgang Schoen edn, Springer Press, Berlin, 2008)

[42] Shuping Chen, Cindy Cheng, and Terry Shevlin, 'Are Family Firms More or Less Tax Aggressive Than Non-Family Firms' (2010) 95, Journal of Financial Economics, 41

[43] Stuart Leblang, 'International double non taxation' (1998) 134, Tax Notes International, 10, 181

[44] Sonja Rego, 'Tax Avoidance Activities of U.S. Multinational Corporations' (2003) 20, Contemporary Accounting Research, 4, 805

[45] Harry Grubert, and John Mutti 'Taxes, Tariffs and Transfer Pricing in Multinational Corporate Decision Making' (1997) 68, Review of Economics and Statistics, 285

[46] Roseanne Altshuler, Harry Grubert, and Scott Newlon, 'Has U.S. Investment Abroad Become More Sensitive to Tax Rates?' (2001) University of Chicago Working Paper 6383, <http://www.nber.org/papers/w6383.pdf> accessed 14 June 2011

under the foreign tax credit system and income shifting opportunities create an incentive to exploit intangible assets developed by the parent company abroad. Even though part of the return on intangibles abroad is paid out in royalties to the parent, the evidence suggests that the foreign subsidiary retains a significant portion. This tax induced income shifting as initially identified by Grubert and Mutti[47] and further endorsed by Grubert suggests that the location of intangible income and the allocation of debt among high- and low-tax countries "account for all of the observed differences in profitability across high- and low-statutory tax countries" [48]. Such differences in declared profits may be attributable to various tax planning activities. A study by Altshuler and Grubert[49] indicated that income shifting relating to intangible capital has increased markedly in recent years, a fact confirmed by the EU Observatory on Infringements of IPR that found 40% of EU economic activity is generated by intellectual property right intensive industries[50].

The literature highlighted in this chapter has a particular significance for this thesis. There are themes inherent within much academic analysis of corporate tax abusive behaviours, namely the role of accounting, management incentivisation and behaviours, and the nature of cross-border trade, particularly in intangibles that nurture opportunities for tax abuse. When compared with the approaches more commonly adopted in recent years in mitigating tax avoidance practices, little consideration has been given to the influencing factors highlighted by the aforementioned academics. Chapter two demonstrated, for example, the limited Member State provisions attempting to directly influence behaviours or alter statutory accounting rules that have been identified by academics as core influencing factors. Despite the importance of the literature highlighted, it remains unclear how we can explain the variation in tax avoidance very well either across jurisdictions or across tax avoidance practice types. This affords a further research opportunity, as do exploiting research gaps relating to the role of the political economy and the influence of political ideology and culture

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[47] Harry Grubert, and John Mutti 'Taxes, Tariffs and Transfer Pricing in Multinational Corporate Decision Making' (1997) 68, Review of Economics and Statistics, 285

[48] Harry Grubert, 'Intangible income, intercompany transactions, income shifting, and the choice of location' (2003) 56, National Tax Journal, 221

[49] Rosanne Altshuler, and Harry Grubert, 'The Three Parties in the Race to the Bottom: Host Governments, Home Governments and Multinational Corporations, (2005) 7, Florida Tax Review, 3, 137

[50] Office for the Harmonisation of the Internal Market, 'Intellectual Property Rights Intensive Industries: Contribution to Economic Performance and Employment in the European Union (2013), 6

driving tax avoidance behaviours. Similar opportunities to research empirical evidence identifying why MNEs do not pursue tax benefits more aggressively than practicing tax avoidance would prove similarly useful.

3.3 EU Tax Avoidance Research

The research evident in the assessment of comparative direct taxation in the EU is notably limited. Even at a general level academic opinion differs widely. Sceptics such as McLure[51] stated “the grand illusion of a single European wide direct tax system illuminating all European inefficiencies and assist all Member States in maximising their relative advantages is commonly accepted as utopian”. Other academics such as Loukota[52] see the steps towards the harmonisation of EU corporate taxation as not only a logical idea but also the only realistic policy solution available that will evolve over time.

To appreciate the context of the EU necessitates an assessment of both the literature relating to both the theoretical background to the basic mechanics of the EU direct tax system as well as a more focused impact on tax policies in the sample set of Member States relevant to this thesis. Zodrow and Mieszkowski[53] developed a model to understand the background to EU corporate taxation avoidance issues. The model is rooted around a set of countries sharing an international mobile tax base. It necessarily implies that the tax policies of EU Member States are interdependent and so EU Member State’s tax revenue depends on the other EU Member States tax rates and enforcement procedures. Consistent with La Porta’s hypothesis that laws shape economic behaviours, the model predicts this interdependency to trigger a “race to the bottom”[54] in taxation as each country tries to attract mobile tax base from the other. This baseline model has subsequently been extended in various forms by Bucovetsky[55], Wilson[56],

[51] Charles McLure, ‘Tax Policies for the XX1st Century and Visions of the Tax Systems of the XX1st Century’ (1996) International Fiscal Association Congress Seminar, 21, Kluwer, 75

[52] Helmut Loukota, ‘Multilateral Tax Treaty versus Bilateral Treaty Network, and Multilateral Tax Treaties: New Developments’ (1998) 85, International Tax Law, 85

[53] George Zodrow and Peter Mieszkowski, ‘Pigou, Tiebout, Property Taxation, and the Under Provision of Local Public Goods’ (1986) 19, Journal of Urban Economics, 356

[54] Enrique Mendoza, ‘Why hasn’t tax competition triggered a race to the bottom? Some quantitative lessons from the EU (2004) 52, Journal of Monetary Economics, 1, 163

[55] Sam Bucovetsky, ‘Asymmetric Tax Competition’ (1991) 30, Journal of Urban Economics, 167

and Kanbur and Keen[57] all of whom focused on country size, implying that if all EU Member States were of equal size there would be balanced tax competition, whereas as jurisdictional sizes vary the smaller EU Member States have stronger incentives to cut tax rates than the larger EU Member State. Wilson references the advantage of smallness in EU tax competition[58], exemplified by the policies adopted by Member States such as Ireland and Cyprus. A further angle researched against this model relates to the domestic factors constraining individual EU Member States from approaching corporate taxation policies and avoidance mitigations in a consistent manner. While it is commonplace to assume EU tax competition is completely dominated by national tax rate choices, researchers such as Hallerberg and Basinger[59] and Hays[60] have noted that, in reality, Member States are contingent on constraints and countervailing pressures which, according to Swank and Steinmo[61], and Ganghof[62], prevent law changes due to competitive pressures.

Bankman[63] noted how a proliferation of tax avoidance increased tax risk for corporate taxpayers and tax authorities in Member States adding uncertainty about the application of tax law, particularly as there are many areas where the law is under-developed and where political consensus has not been attained. Consistent with La Porta's Legal Origins Theory theorising that legal institutions are driven by political systems, Bernauer and Achini[64] identified the principal actors involved in EU direct corporate taxation, notably the CJEU, the

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56 John Wilson, 'Tax Competition with Interregional Differences in Factor Endowments' (1991) 21, Regional Science and Urban Economics, 423

57 Ravi Kanbur, R. and Michael Keen, 'Jeux Sans Frontieres: Tax Competition and Tax Coordination When Countries Differ in Size' (1993) 83 American Economic Review, 877

58 John Wilson, 'Theories of Tax Competition' (1999) 52, National Tax Journal, 269

59 Mark Hallerberg and Scott Basinger 'Internationalization and Changes in Tax Policy in OECD Countries, The Importance of Domestic Veto Players' (1998) 31, Comparative Political Studies, 321

60 Jude Hays, *Globalization and the New Politics of Embedded Liberalism*, (OUP, Oxford, 2009)

61 Duane Swank and Sven Steinmo, 'The New Political Economy of Taxation in Advanced Capitalist Democracies' (2002) 46, American Journal of Political Science, 642

62 Steffan Ganghof, *The Politics of Income Taxation. A Comparative Analysis of Advanced Industrial Countries*, (ECPR Press, Colchester, 2006)

63 Joseph Bankman, 'The Tax Shelter Battle', in Henry Aaron and Joel Slemrod *The Crisis in Tax Administration*, (The Brookings Institution, Washington D.C, 2004)

64 Thomas Bernauer and Achini Christoph, 'From "real" to "virtual" states? Integration of the world economy and its effects on government activity' (2000) 6, European Journal of International Relations, 2, 223

European Parliament, hereafter referred to as ‘EP’, civil society organizations, Member States, the Commission and Business. Coherent corporate tax collaboration is made more difficult by the business community not being a unitary body of opinion, and their preferences for EU tax coordination may vary according to whether a MNE is exposed to significant cross border activity or the sector within which it operates. The forces of Member State *Casus Foederis* demonstrate how the EU is intrinsically pulled towards the concept of unitary action but is compromised by political divergence. The EU is a political system in which “actor constellations”[65], a concept developed further by Radaelli and Kraemer[66] who associated EU direct taxation with a territory of high political transaction costs.

According to The Centre for European Policy Studies it is clear that the Internal Market has highlighted the role of tax rule distortions making the need for corporate tax reforms more pressing[67]. It was research by Smith[68] that noted the corporate tax reform agenda witnessed more urgent visibility at EU level at the end of the 1990s. Economic integration within the EU has crystallised tax obstacles to genuine cross-border and MNE economic activity in several areas, such as TRPRICE, DTT’s, dividend taxation, and exit taxation according to Radaelli and Kraemer[69]. In the EU, cooperation in indirect taxation has been evident utilising Treaty provisions, but it was Majone that pointed out the fact that there are no specific Treaty provisions for direct taxation, therefore prompting Member State initiatives to combat tax avoidance and solutions for addressing tax problems suffered by MNEs doing business across jurisdictions either based on “general single market provisions in which unanimity applies or have to go off the beaten track of the Community method”[70].

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[65] Fritz Scharpf, *Games Real Actors Can Play: Actor-Centered Institutionalism in Policy Research*, (Westview Press, Colorado,1997)

[66] Claudio Radaelli and Ulrike Kraemer, ‘Why Tax Cooperation? The Selection of Modes of Governance in EU Direct Taxation Policy’ (2006) University of Reading, <http://www.psa.ac.uk/2006/pps/Radaelli.pdf> accessed 22 June 2011

[67] Alexander Klemm and Claudio Radaelli, ‘EU Corporate Tax Reform’ (2001) CEPS Task Force Report, 1

[68] Andy Smith, ‘Why European Commissioners matter’ (2003) 41, Journal of Common Market Studies, 137

[69] Claudio Radaelli and Ulrike Kraemer, ‘Why Tax Cooperation? The Selection of Modes of Governance in EU Direct Taxation Policy’ (2006) University of Reading, <http://www.psa.ac.uk/2006/pps/Radaelli.pdf> accessed 22 June 2011

[70] Giandomenico Majone, *Dilemmas of European Integration: The Ambiguities and Pitfalls of Integration by Stealth*, 1st edn (OUP, Oxford, 2005), 142

It is interesting to note that there is significant academic literature regarding EU tax competition but little on EU tax cooperation, similarly noted in more widely scoped research by Vito[71], and differentiation between the approaches to tax avoidance mitigation taken by various Member States. Further research by Eberlein and Kerwer[72] and Heritier[73] provided further evidence in the importance of cooperation in the area of direct EU corporate taxation, providing a set of comparisons between the classic Community method and the more contemporary modes of governance. Radaelli and Kramer[74] exemplified this further by observing the continuum of developments that had nurtured EU corporate tax reform through forums such as the Working Group on Common Consolidated Tax Base[75] and the Transfer Pricing Forum and the Arbitration Convention on Transfer Pricing Disputes[76].

Radaelli[77] similarly provided insight into the notion that the EU has pursued different goals over time initially focused on providing tax neutrality in the single market to fighting harmful tax competition, and, more recently, creating the pre-conditions for comprehensive corporate tax reform at the EU level. It was Tanzi[78] and Avi-Yonah Reuven[79] that both recognised that

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[71] Vito Tanzi, *Taxation in an Integrating World*, (Brookings Institution, Washington DC, 1995)

[72] Burkard Eberlein and Dieter Kerwer, 'New Governance in the European Union: A Theoretical Perspective' (2004) 42, Journal of Common Market Studies, 1, 121

[73] Adrienne Héritier, 'New Modes of Governance in Europe: Increasing Political Capacity and Policy Effectiveness' (2003) in Tanya Borzel and Rachel Cichowski in *The State of the European Union, 6 - Law, Politics, and Society* (OUP, Oxford, 2004), 105

[74] Claudio Radaelli and Ulrike Kraemer 'Why Tax Cooperation? The Selection of Modes of Governance in EU Direct Taxation Policy' (2006) University of Reading, <http://www.psa.ac.uk/2006/pps/Radaelli.pdf> accessed 22 June 2011

[75] Commission, 'Analysis and Coordination of tax policies' (2004) Common Consolidated Corporate Tax Base Working Group, CCTB/WP\003, <http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/cctbworkplanfinal_en.pdf> accessed 14 July 2011

[76] Council Convention 90/436/EEC of 1990 on the elimination of double taxation in connection with the adjustment of profits between associated undertakings, OJ L225, 10

[77] Claudio Radaelli, 'The Code of Conduct against Harmful Tax Competition Open Method of Coordination Disguise' (2003), Public Administration Journal, 81, 513

[78] Vito Tanzi, *Taxation in an Integrating World*, (Brookings Institution, Washington DC, 1995)

[79] Reuven Avi-Yonah, 'Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State' (2000) 113, Harvard Law Review, 7, 1573

globalisation was contributing to the degradation of domestic tax systems. The CJEU has widely been credited in academic literature as the driving force of change in harmonising corporate tax policies and behaviours across Member States. Radaelli and Kraemer noted that the CJEU focuses on tax regulations and entire taxes that provide either overt or covert discrimination in national tax systems with attacks on the exercise of Freedoms in the Internal Market[80]. Although exceptions are justifiable in accordance with protecting the public interest, Member States are under an obligation to prove that any tax policies implemented to protect such public interest are “appropriate, necessary, least onerous, and proportionate”[81]. All of these drivers support La Porta’s view that legal rules are driven by economic, political and legal system context.

Academic research relating to specific tax avoidance practices and their relevance to specific EU countries is limited. One key theme in the limited research available relates to not only technical difficulties in coordinating consistent policies to mitigate against avoidance practices but also diverging ideology. For example, Ruding[82] pointed out that France and Germany were unambiguous in their intention to look at tax base coordination only under the condition that it is discussed in the context of tax rate harmonisation. The UK, conversely, focuses more on the technical solution of common tax base coordination. These differences again appear largely political.

3.4 The Role of the CJEU and National Legislatures in Tax Avoidance Law making

Case law resulting from the challenge to corporate tax avoidance behaviour would suggest that the CJEU continues to play a pivotal role in providing direction and promoting consistency of application of direct taxation across EU Member States. As stated by Pistone “the CJEU is trying hard to remove cross-border direct tax obstacles, whenever they arise and whatever price we may have to pay in terms of the structure and consistency of our national

[80] Claudio Radaelli and Ulrike Kraemer (2006) ‘Why Tax Cooperation? The Selection of Modes of Governance in EU Direct Taxation Policy’, (2006), University of Reading, <http://www.psa.ac.uk/2006/pps/Radaelli.pdf> accessed 22 June 2011

[81] Malcolm Gammie ‘The Role of the CJEU in the Development of Direct Taxation in the European Union’, (2003) 57, Bulletin for International Fiscal Documentation, 3

[82] Onno Ruding, ‘The past and the future of EU Corporate Tax’ (2005) 14, 1 EC Tax Review, 2

tax systems" [83]. Further research by Pistone stated that the Commission lacks the actual support by the Member States to introduce effective measures of tax co-ordination or harmonization[84]. Others such as Sorensen[85] produce a more balanced view that reflects upon a situation that the impact of tax coordination or harmonisation would vary across EU Member States both in terms of national government revenues and the consequential tax behaviour by resident MNEs.

Legal scholars are finely divided about whether the CJEU has proactively pursued a discreet political agenda towards tax harmonisation or whether the CJEU's actions represent a more straightforward motive for protecting Fundamental Freedoms according to Graetz and Warren[86]. In contrast to La Porta, research by Pitsone[87] rejected the political dimension but acknowledged its role in creating a unique form of European international tax law. He concluded that the overarching objective of the CJEU is to ensure the tax treatment has achieved consistency aligned with the objectives of the Internal Market, as well as ensuring conflicts among EU Member States have been resolved. Radaelli and Kraemer stated that direct tax CJEU jurisprudence was too complex to form robust conclusions regarding an economic model or political orientation[88], noting the distinction between EU research that focuses on CJEU case rulings and alignment with the internal market, whilst most non-EU research concentrates more focus on jurisprudence that exhibits a much more distinct political orientation.

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[83] Pistone, Pasquale, 'Interaction between double taxation conventions and the rulings of the CJEU on the Fundamental Freedoms' (1990) Rivista di diritto tributario, 341

[84] Pasquale Pistone, 'European direct tax law: quo vadis?', (2007), EATLP Congress Paper, EATLP Helsinki, <http://www.eatlp.org/uploads/public/Pistone%20European%20direct%20tax%20law%20quo%20vadis%20-%20version%203.pdf> accessed 16 March 2011

[85] Peter Sørensen, 'The Case for International Tax Coordination Reconsidered' (2001) 31, Economic Policy, 431

[86] Michael Graetz, 'Taxing International Income: Inadequate Principles, Outdated Concepts and Unsatisfactory Policies', (2001) 54 Tax Law Review, 261, 277

[87] Pasquale Pistone, 'European direct tax law: quo vadis?' (2007) EATLP Congress Paper, EATLP Helsinki, <http://www.eatlp.org/uploads/public/Pistone%20European%20direct%20tax%20law%20quo%20vadis%20-%20version%203.pdf> accessed 16 March 2011

[88] Claudio Radaelli and Ulrike Kraemer, 'Why Tax Cooperation? (2006) The Selection of Modes of Governance in EU Direct Taxation Policy', University of Reading, <http://www.psa.ac.uk/2006/pps/Radaelli.pdf> accessed 22 June 2011

Between 1998 and 2008, over 100 individual tax provisions or tax laws in their totality were struck down by the CJEU[89]. The legal pressures of CJEU jurisprudence become more poignant when Member States or MNEs suffer large revenue losses as a consequence of a ruling. In addition, they are also capable of generating imbalances in the overall tax system according to Radaelli.[90] What can prove irksome to many observers is that the CJEU rules that a tax law is incompatible with EU law but fails to provide guidance on how such a tax law should be re-drafted. In this sense, the CJEU offers a negative influence, in that it can only rule against national provisions and cannot legislate substitute EU law according to Griffith and Klemm.[91] As a consequence to the rather ad hoc CJEU jurisprudence, and the resulting uncoordinated responses to their rulings by Member States, the role of the CJEU remains unpressured and the impact in its totality in the context of EU law could be described as erratic according to Gammie.[92]

It is common practice for both MNEs and Member State tax authorities to conduct risk assessment exercises to see whether current or proposed tax rules would survive a CJEU challenge according to Griffith and Klemm.[93] Various government initiatives have been set up in the past, both in the UK and in Germany in 2005 to reflect upon CJEU judgements and assess how CJEU decisions can be mitigated in the direct tax arena. Consistent with La Porta's model, Radaelli and Kraemer[94] suspect that there is more inter-governmental

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[89] Claudio Radaelli and Ulrike Kraemer, ' Governance arenas in EU direct tax policy' (2008) 46, Journal of Common Market Studies, 2, 326

[90] Ibid

[91] Rachel Griffith and Alexander Klemm, 'What Has Been the Tax Competition Experience of the Last 20 Years?' (2004), Institute for Fiscal Studies Working Paper 04/05 <http://www.ifs.org.uk/wps/wp0405.pdf> accessed 12 March 2011

[92] Malcolm Gammie, 'The Role of the CJEU in the Development of Direct Taxation in the European Union' (2003) Bulletin for International Fiscal Documentation, 57, 3

[93] Rachel Griffith and Alexander Klemm, 'What Has Been the Tax Competition Experience of the Last 20 Years?' (2004), Institute for Fiscal Studies Working Paper 04/05 <http://www.ifs.org.uk/wps/wp0405.pdf> accessed 12 March 2011

[94] Claudio Radaelli and Ulrike Kraemer 'Why Tax Cooperation? The Selection of Modes of Governance in EU Direct Taxation Policy', (2006),University of Reading, <http://www.psa.ac.uk/2006/pps/Radaelli.pdf> accessed 22 June 2011

coordination outside involvement of the Commission than is visible. Gammie[95] identified a number of areas in which CJEU rulings are likely to influence Member State tax policy. He highlighted various common arrangements that allowed MNEs to manipulate dividend policy, noting the general trend for Member States, such as UK and Germany, to outlaw imputation systems to avoid manipulation of dividend taxation that has historically been achieved through rules favouring investment in domestic equity that granted preferential treatment of domestic shareholders. An interesting angle of thought was similarly made by Gammie regarding EU trends in residence-based taxation noting how the concept is becoming increasingly obsolete for EU MNEs operating in an Internal Market. A rather bleak assessment was made by the researcher regarding the effectiveness of Member State tax laws, concluding that the discriminatory aspect of CFC means they will be outlawed over time, and that TRPRICE, despite the merits of various Member State tax rules, is unlikely to be enforceable while accounting practices promoting these practices are allowed to persist.

There is a vast commentary on the role of the CJEU in EU tax law, and the consensus view is that it has played a modest role, over a long period of time in normalising national rules through ruling against tax laws rather than promoting a common tax framework. This is inherent to its judicial role although the complexity involved in many of the cases has meant that it has been difficult to provide clear and concise messages that are commonly understood across Member States. History has demonstrated that following a particular ruling follows a similar case with a slightly different dimension that offers forth a slightly different interpretation. There is an overwhelming message in the literature available that the CJEU is a necessary check and balance but is unlikely to be the source of any solution to EU tax avoidance practices, perhaps only offering a policing role against ongoing national tax rule changes and challenges.

3.5 The Role of Tax Authorities

Literature relating to tax authorities response is largely theoretical and less focused on the specific or comparative assessment of EU Member State tax authority responses. Braithwaite

[95] Malcolm Gammie, ‘The Role of the CJEU in the Development of Direct Taxation in the European Union’, (2003) 57, Bulletin for International Fiscal Documentation, 3

and Ayres[96] promoted a theory based on the notion of an enforcement pyramid. This compliance pyramid reflects a taxpayer behavioural model and assumes that the majority of taxpayers willingly comply with the tax system and therefore can be managed through light-touch methods prompting cooperation and trust. Conversely, taxpayers at the top of the pyramid are those prompted to actively engage in tax evasion and is addressed through more punitive deterrence and criminal penalties. Taxpayers in the centre are generally compliant but may opportunistically exploit ambiguous areas in the law. To the tax authorities the tax evaders and those taxpayers in the centre area represent a risk and imply that that it will be efficient for the revenue authorities to focus efforts on improving the likelihood that taxpayers within these zones will comply with the revenue authority's view of the true intentions of the national law. The emphasis that Braithwaite and Ayers placed on the middle part of the pyramid suggests that it is data, and transparency to that data, that is required to resolve avoidance rather than intelligence which is more suited to addressing direct evasion. Attention to the middle part of the compliance pyramid is consistent with the influential research of Hasegawa who found that whenever taxpayers are offered opportunities for disclosure they will seize it[97]

Braithwaite noted that national law reform is the first "circuit-breaker needed to push those in the middle bulge down into the white base of the triangle" [98] but further actions are needed to manage this problem including the building of cooperative relationships between taxpayer and tax authority. This focus on an enhanced cooperation approach within a context of escalating regulatory options is an interesting hypothesis. Taxpayer profiling using risk ratings to decide where to focus resources to achieve maximum compliance with what is available is a concept pioneered by Braithwaite and Ayres[99]. Such risk centric regulation emphasizes analysis leading to targeting, as noted by Baldwin and Black.[100] If such a theory was applied EU wide to corporate income tax we could witness the use of assessments that

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[96] John Braithwaite and Ian Ayres, *Responsive Regulation: Transcending the Deregulation Debate,* (OUP, New York, 1992), 35

[97] Makoto Hasegawa et al, 'The effect of public disclosure on reported taxable income: evidence from individuals and corporations in Japan' 66 (2013) National Tax Journal, 3, 2

[98] John Braithwaite, 'Large Business and the Compliance Model', in Valerie Braithwaite *Taxing democracy: understanding tax avoidance and evasion,* (Ashgate Publishing, Aldershot, 2002), 177

[99] Ibid 205

[100] Robert Baldwin and Julie Black, 'Really Responsive Regulation' (2008) 71, Modern Law Review, 1, 66

would include taxpayer-reported information, data from other EU agencies and Member State tax authority intelligence to identify potential compliance risks. Braithwaite and Ayres noted that applying different approaches to different taxpayers according to certain predefined criteria enables tax authorities to use their limited resources efficiently but also creates a risk that different taxpayers are treated unfairly risking claims of inequitable tax authority behaviour.

Akin to more general models on tax, research by Reinganum and Wilde[101] applied the principal-agent theory further in the context of tax avoidance behaviours. The assumption was that the statistical likelihood of a tax investigation into MNEs arrangements is dependent on either levels of reported income or similar reported financial data in the statutory accounts, and that tax authorities are likely to work with investigation thresholds implying a form of evaluation against metrics indicating tax avoidance. Shleifer[102] took this theory further by implying that a degree of peer group comparison was factored into these tax authority thresholds. In both cases the inference was that there would be a correlation between either the tax authority's policies or procedures or their unofficial investigative behaviours and the MNEs inclination to shift profits. In the UK Freedman et al.[103] analysed similar theories and found that UK tax authorities are comparing the reported income of MNEs within a peer group in order to prioritise investigations, supporting the policy of introducing a risk rating for the biggest MNEs based on a combination of organisational features and past tax behaviour.

Research by Scharpf, however, offered an entirely different angle to interrelationships between actors engaged in co-ordinated negotiation through the use of so called "co-operation games"[104] inferring that tax conduct is driven less by the more traditional market or

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[101] Jennifer Reinganum and Louis Wilde 'Income tax compliance in a principal-agent framework' (1985) 26, Journal of Public Economics, 1

[102] Andrei Shleifer, 'A theory of yardstick competition' (1985) 16, 3, Rand Journal of Economics, 319

[103] Judith Freedman, Geoffrey Loomer, and John Vella, 'Alternative Approaches to Tax Risk and Tax Avoidance: Analysis of a face-to-face corporate survey' (2008) Oxford University Centre for Business Taxation Working Paper, 08, 14, <http://www.sbs.ox.ac.uk/centres/tax/Documents/working_papers/WP0814.pdf> accessed 28 May 2011

[104] Fritz Scharpf, *Games Real Actors Can Play: Actor-Centered Institutionalism in Policy Research*, (Colorado, Westview Press, 1997), 19

hierarchical co-ordination and governance but by more "self-organising networks"[105] of co-operative relationships between actors. In the context of this research it would relate to commercial or industry networks. This arguably conflicts with the findings of researchers such as James[106] who claim EU tax authorities regularly engage in negotiated tax settlements between tax authorities and MNEs, resulting in so called "sweat-heart deals"[107] but his research nevertheless does highlight the complexities of more informal actors interactions and behaviours when attempting to identify and rationalise corporate behaviours.

3.6 CFC Research

The location of a holding company and its impact on taxable income resides at the centre of much academic literature focusing on the challenges that exist between the conflicts between Member State sovereignty and respect for the principles underpinning the EU Treaty. Billgren[108] focused on a historical analysis of CFC legislation implemented initially in Germany in 1972. Research by Eden and Kudrle[109] analysed the behaviours of Member States who have enacted tax avoidance rules in isolation and noted that many of these jurisdictions have relied on supplementary exchange of information to ensure they are more workable.

Billgren identified the main objectives driving CFC legislation as the desire to prevent the erosion of national tax bases as MNEs increasingly benefit from tax competition across Member States[110]. Similarly, Lang identified the objective of CFC legislation as avoiding

[105] Ibid, 41

[106] Malcolm James, 'Cutting a good deal – UK Uncut, Goldman Sachs and the challenge to administrative discretion', Journal of Applied Accounting Research 14, (2013), 3, 248

[107] Ibid, 255

[108] Caroline Billgren, 'The Freedom of Establishment and Tax Treaties – A Comparative Study in the Light of the Cadbury Schweppes Judgement – CFC Legislation', (2008), University of Lund Working Paper, 7, <http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1556257&fileOId=1563929> accessed 22 May 2011

[109] Lorraine Eden and Robert Kudrle, 'Tax Havens: Renegade States in the International Tax Regime' (2005) Law and Policy, 100

[110] Carolyn Billgren, 'The Freedom of Establishment and Tax Treaties – A Comparative Study in the Light of the Cadbury Schweppes Judgement – CFC Legislation' (2008) University of Lund Working Paper, 7,

“the loss of tax revenue because of domestic MNEs allocating their profits to MNEs residing in tax havens” [111]. Gresik noted the importance of globalised trade and its impact on the ease upon which MNEs are able to transition activities form one jurisdiction to another, and claimed that “this flexibility not only helps transnationals minimize the cost of taxes and regulations imposed by national governments but it can also aid them in pitting one government against another”[112]. Breaking down barriers for transitioning physical activities as noted by Gresik supplemented with the ease upon which MNEs are able to create accounting entries favourable to a MNEs tax liability, in a combined manner, has resulted in accelerated tax abusive arrangements.

Examining drivers for CFC legislation, Bohm et al[113] stressed the importance of tax uncertainty and politics, suggesting the negative effect of tax uncertainty on investment is closely related to the market power of the firm. Using empirical evidence from German based MNEs they concluded that the effect is exacerbated if there is imperfect competition in the market. The political dimension was researched by Stasavage[114] as well as Bittlingmayer[115] who concluded that MNEs operating in an environment characterised by regulatory uncertainty and political focus are less likely to exploit tax avoidance practices than those MNEs operating in a low profile unregulated area of commerce. Sinn,[116] and Keen[117] both focused on the differences between source and residency based taxation. Mindful that

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<http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1556257&fileOId=1563929> accessed 22 May 2011

[111] Michael Lang, *CFC Legislation, Tax Treaties and EU law*, (Kluwer, The Hague, 2004), 39

[112] Thomas Gresik, ‘The taxing task of taxing transnationals’ (2001) XXXIX Journal of Economic Literature, 800

[113] Hjalmar Bohm, Michael Funk and Nikolaus Siegfried, ‘Discovering the Link between Uncertainty and Investment – Micro econometric Evidence from Germany’ (1999), Hamburg Universität Quantitative Macroeconomics Working Papers, 5 <http://fmwww.bc.edu/RePEc/es2000/0112.pdf> accessed 15 February 2011

[114] David Stasavage ‘Private Investment and Political Institutions’ (2002) 14, Economics and Politics, 41

[115] George Bittlingmayer ‘Regulatory Uncertainty and Investment: Evidence from Antitrust Enforcement’, (2001) 20, Cato Journal, 3

[116] Hans-Werner Sinn, ‘Tax Harmonization and Tax Competition in Europe’ (1990) 34, European Economic Review, 489

[117] Michael Keen ‘Preferential Regimes Can Make Tax Competition Less Harmful’ (2001) 54, National Tax Journal, 757

corporate tax is effectively accounted for on a source country basis, De Mooij and Ederveen[118] identified two options for implementing profit shifting, namely that they can shift profit generating activities to low-tax jurisdictions or shift book profits there. This seems obvious but the complexity arises when one considers that profit shifting is more sensitive to corporate taxation than FDI[119], diluting theories supporting the influence of investment over tax rates as a determinant of profit shifting. Billgren stated that "for the prevention of abuse to be a justified ground the legislation in question must have the sole purpose of preventing wholly artificial arrangements and the arrangement in question must have the sole purpose of tax abuse" [120]. A similar view was expressed by Lang who went further by proclaiming that "since not only wholly artificial arrangements but also economic structures are qualified as abusive by CFC legislations, anti-abuse does not seem to be a valid justification of CFC legislations" [121]. Similarly there is no evidence that a loss of revenue is a valid justification for a CFC restriction, and likewise, anti-abuse does not appear to offer a possible justification because most CFC legislations are also applicable to minority participations and minority shareholders do not have the influence to create wholly artificial arrangements.

Radaelli[122] and Kemmerling and Seils[123] highlighted the positive impact of implementing soft law interactions with hard law, and the associated impact on the shaping of the Code of Conduct for Business Taxation[124] as identified by Kowalczyk[125]. Other research in this area

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[118] Ruud de Mooij and Sjef Ederveen, 'Corporate Tax Elasticities: A Reader's Guide to Empirical Findings' (2004) 24, Oxford Review of Economic Policy, 68

[119] Ibid, 19

[120] Carolyn Billgren, 'The Freedom of Establishment and Tax Treaties – A Comparative Study in the Light of the Cadbury Schweppes Judgement – CFC Legislation' (2008) University of Lund Working Paper, <http://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=1556257&fileOId=1563929> accessed 22 May 2011

[121] Michael Lang, *CFC Legislation, Tax Treaties and EU law* (Kluwer, The Hague, 2004), 40

[122] Claudio Radaelli, 'The Code of Conduct against Harmful Tax Competition Open Method of Coordination Disguise' (2003) 81, Public Administration Journal, 513

[123] Achim Kemmerling and Eric Seils, 'The Regulation of Redistribution: Managing Conflict in Corporate Tax Competition' (2009) 32, West European Politics Paper, 756

[124] ECOFIN, 'Code of Conduct on Business Taxation' (1997)

[125] Mariola Kowalczyk, 'Hard and Soft Law Interactions in EU Corporate Tax Regulation: Exploration and Lessons for the Future' (2011) University of Edinburgh

referenced the impact of CFC legislation on national sovereignty, Avi-Yonah[126] argued that CFC rules do not offer any constraints on national sovereignty and do not imply double taxation since the taxable profits belongs to the residence country. This credible defence was further elaborated by Hartley who stated that Member States retain the right to "create and enforce anti-abuse provisions that prevent wholly artificial arrangements aimed at circumventing the national tax legislation an in line with the principle of proportionality" [127]. Sandler claimed that there is "an implicit consensus today that CFC rules are a legitimate instrument of "pushing the boundaries" of the territorial limits on residence taxation" [128].

Academic literature in this field has achieved coverage regarding the drivers of the CFC policies adopted by EU Member States as well the impact of tax planning behaviour by MNEs. Regarding drivers, case study evidence promoted by Rixen[129] and Ganghof[130] found that certain Member States have been reluctant to engage in unilateral implementation of anti-avoidance rules as they are concerned about becoming uncompetitive vis-à-vis jurisdictions with more tax friendly regimes. This has not prevented, however, some jurisdictions pursuing such unitary action, a point highlighted by Ganghof regarding Germany's unilateral measures to impose a penalty regime on capital income of German banks accused of assisting customers to avoid tax. Such an approach has been developed further in recent FATCA regulations[131] to impose withholding tax, hereafter referred to as 'WHT', penalties on banks facilitating potential tax avoidance. In terms of the impact of tax planning behaviour, research by Grubert and Mutti,[132] and Huizinga and Laeven,[133] both

[126] Reuven Avi-Yonah 'International Tax as International Law' (2004) 57, Tax Law Review, 483

[127] Trevor Hartley, 'The restrictive measure in question has to be of such nature as to ensure achievement of the aim in question and not go beyond what is necessary for that purpose' (2003) The Foundations of European Community Law, 151

[128] Daniel Sandler, 'Controlled Foreign Corporation Rules and Developing Economies', Bombay Management Association 10 International Tax Conference, Mumbai, 2004

[129] Thomas Rixen, *The Political Economy of International Taxation: Institutional Choice in the Global Tax Regime* (Palgrave Macmillan, Basingstoke, 2006), 49

[130] Steffan Ganghof, 'Adjusting National Tax Policy to Economic Internationalisation: Strategies and Outcomes', in Fritz Scharpf and Vivien Schmidt, *Welfare and Work in the Open Economy: Diverse Responses to Common Challenges,* (OUP, Oxford, 597, 2000)

[131] Foreign Account Tax Compliance Act (US) 2010, 26 U.S.C. 1471-74

[132] Harry Grubert and John Mutti, 'Taxes, Tariffs and Transfer Pricing in Multinational Corporate Decision Making' (1991) 73, Review of Economics and Statistics, 2, 285

provided the most compelling evidence that the taxable profits of subsidiaries in low-tax jurisdictions are generally considerably higher than in high-tax jurisdictions for large MNEs in the EU. Limited literature relating to the cross-EU Member State co-ordination of CFC mitigation is evident with only Rixen[134] and Palan et al[135] analysing CFC bilateral cooperation and concluded that such cooperation is entirely limited to information exchange. This work was taken further by Genschel[136] who concluded that "multilateral cooperation is most advanced where it encompasses both tax harmonization and information exchange" [137]. They noted that harmonization has been more common among other corporate taxes such as VAT where competitive pressure is low rather than where competitive pressure is high.

The complex relationship and interdependencies between tax abuse and tax competition has generated significant commentary. Keen[138] found that unilateral action by Member States for enacting tax avoidance laws reduces tax abuse and increases competitive pressure on FDI, encouraging MNEs in higher tax jurisdictions unable to shift profits by physically re-locating economic activity. Multilateral cooperation aimed at tackling targeted corporate tax competition was deemed to have a broadly similar effect according to Genschel and Swartz[139], who concluded that international tax arbitrage has prompted the both tax cooperation and tax competition depending on the circumstances. Little academic commentary targets the qualitative aspect of information exchanges or on the specific arrangements agreed between certain Member States when the exchange is either bi-lateral or at best limited to a selection of jurisdictions. The impact on mitigating tax abuse will be a

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[133] Harry Huizinga and Luc Laeven, 'International Profit Shifting Within Multinationals: A Multi-Country Perspective' (2008) 92, Journal of Public Economics, 1164

[134] Thomas Rixen, *The Political Economy of International Taxation: Institutional Choice in the Global Tax Regime* (Palgrave Macmillan, Basingstoke, 2006), 51

[135] Ronen Palan, Richard Murphy and Christian Chavagneux, *Tax Havens. How Globalization Really Works*, (Cornell University Press, New York, 2010)

[136] Philipp Genschel, 'Why No Mutual Recognition of VAT? Regulation, Taxation and the Integration of the EU's Internal Market for Goods' (2007) 14, Journal of European Public Policy, 743

[137] Philip Genschel, Achim Kemmerling and Eric Seils, 'Accelerating Downhill: How the EU Shapes Corporate Tax Competition in the Single Market' (2011) 49, Journal of Common Market Studies, 3, 585

[138] Michael Keen, 'Preferential Regimes Can Make Tax Competition Less Harmful' (2001) 54, National Tax Journal, 757

[139] Philipp Genschel and Peter Schwarz, 'State of the Art, Tax Competition: a literature review' (2011) 9, Socio Economic Review, 339

function of the "depth and automaticity of exchanges"[140] although other academics such as Gresik[141] rejected the impact of information exchanges concluding that MNEs control and manipulate the data they offer to tax authorities.

Academic CFC commentary is characterised by the proliferation of research in the field of CFC origins, causes and the influence of political inertia, typically focussing on administering the issue rather than attempting to level-set it within the context of direct tax avoidance law and a credible solution. There is little evidence of comparative analysis of EU CFC rules and their material impact across EU Member States offers disappointment. CFC rules are in abundance across Member States and they are no less significant than any other type of rule in attempting to address tax abuse conduct. Such rules do, however, attract the attention of lawmakers specifically in the context of EU Fundamental Freedoms and to this extent offers rewards for the academically ambitious in assessing the integrity and consistency by the CJEU relating to rulings in this regard.

3.7 Group Relief Research

An EU group entity was defined by Agundez-Garcia as "a group of related MNEs whose members are tax residents and operate in at least two different Member States of the EU" [142]. There are legal and economic interpretations regarding the meaning of a consolidated group, with legal approach offering simple and clear boundaries defined by the ownership test. Ownership thresholds for consolidation are particularly difficult. The concept of Group Relief is fully consistent with the economic principles underlying the internal Market in the consolidation of MNE group income and then allocating it by means of an agreed apportioning formula. The definition of a consolidated group was also studied by McLure[143],

[140] Ibid, 365

[141] Thomas Gresik, The taxing task of taxing transnationals. (2001), Journal of Economic Literature, XXXIX, 800

[142] Ana Agundez-Garcia, 'The Delineation and Apportionment of an EU Consolidated Tax Base for Multi-Jurisdictional Corporate Income Taxation: a Review of Issues and Options' (2006) European Commission Taxation Papers, 9

[143] Charles McLure 'Defining a Unitary Business: An Economist's View' (2004) The State Corporation Income Tax - Issues in Worldwide Unitary Combination, Standford, 89; Charles McLure, 'Replacing Separate Entity Accounting and the Arm's-length Principle with Formulary Apportionment' (2002) Bulletin for International

Hellerstein and McLure[144], Sørensen[145], Weiner[146] and Fox *et al*.[147] among others. Empirical studies have supported the impact of group relief. Grubert and Mutti,[148] Hines and Rice[149], Klassen and Schackelford[150], Mintz and Smart[151] and Altshuler and Grubert[152]all found empirical evidence supporting profit and loss shifting. Specific examples have been cited by Weichenrieder[153] who proved German MNEs shifting profits to Ireland's low-tax jurisdiction, and Blasch and Weichenrieder brought to light a relationship between the corporation tax in the home country and the associated net of tax profitability of its German subsidiary[154].

Fiscal Documentation, 56, 586; Charles McLure, 'The European Commission's Proposals for Corporate Tax Harmonization, (2005) ESifo Forum, 32

144 Walter Hellerstein and Charles McLure, 'The European Commission's Report on Company Income Taxation: What the EU can Learn from the Experience of the US States' (2004a) 11, International Tax and Public Finance, 199; Walter Hellerstein and Charles McLure, 'Lost in Translation: Contextual Considerations in Evaluating the Relevance of US Experience for the European Commission's Company Taxation Proposals' (2004b) 58, Bulletin for International Fiscal Documentation, 86

145 Peter Sørensen, 'Company Tax Reform in the European Union' (2004) 11, International Tax and Public Finance, 91

146 Joann Weiner, **'**Formulary Apportionment and Group Taxation in the European Union: Insights from the United States and Canada'' (2005) European Commission Taxation and Customs Union Working Paper, No. 8, <http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/economic_analysis/tax_papers/2004_2073_EN_web_final_version.pdf> accessed 30 December 2010

147 William Fox, LeAnn Luna and Matthew Murray, 'How Should a Subnational Corporate Income Tax on Multistate Businesses Be Structured?' (2005) 53, National Tax Journal, 139

148 Harry Grubert and John Mutti, 'Taxes, Tariffs and Transfer Pricing in Multinational Corporate Decision Making' (1991) 73, Review of Economics and Statistics, 2, 285

149 James Hines and Eric Rice, 'Fiscal Paradise: Foreign Tax Havens and American Business' (1994) 109 Quarterly Journal of Economics, 149

150 Martin Sullivan, 'Data show dramatic shift of profits to tax havens' (2004) Tax Notes, 1190

151 Jack Mintz and Michael Smart, 'Income shifting, investment, and tax competition: theory and evidence from provincial taxation in Canada' (2004), 88 Journal of Public Economics, 1149

152 Rosanne Altshuler and Harry Grubert, 'The Three Parties in the Race to the Bottom: Host Governments, Home Governments and Multinational Corporations' (2005) 7, Florida Tax Review, 3, 137

153 Alfons Weichenrieder, 'Fighting international tax avoidance: The case of Germany' (1996) 17, Fiscal Studies, 37

154 Frank Blasch and Alfons Weichenrieder, 'When Taxation Changes the Course of the Year - Fiscal Year Adjustments and the German Tax Reform 2000/2001' (2006), CESifo Working Paper Series 1861, <http://ssrn.com/abstract=949724> accessed 20 February 2011

Group Relief literature is dominated by focus on the FA concept. Various methodologies have been promoted representing different formulas and different factor weightings providing variations on FA outcomes and, as a consequence, on the MNE corporate tax liability. McLure,[155] and Anand and Sansing[156] experimented with different FA formulas and demonstrated the impact on MNE corporate tax liabilities. Agúndez-Garcia[157] and Weninger[158] analysed alternative FA systems and the different apportionment methodologies, concluding that each single FA results in distortions to the tax liabilities of MNEs. Oestreicher[159] compared and contrasted alternative methodologies for computing corporate income under separate accounting, FA and a process oriented system of income determination and found that each methodology exhibits benefits and challenge. Shackelford and Slemrod[160] discussed the US centric revenue effects of a unilateral introduction of FA but could easily be related to the EU context. They found that the tax liability of MNEs would increase. Fuest, Hemmelgarn and Ramb[161] discuss the revenue effects of introducing FA in the EU factoring in cross-border loss relief concluding that it nurtures a decrease in the overall tax revenues of the EU Member States concerned.

Despite the conceptual difficulty in evaluating the intra-EU rather than inter-EU impact of Group Relief rules as aggressive tax planning, there is little academic doubt about its role in profit shifting. Extensive analysis by Lang, Hellerstein and McLure, and Gordon and Wilson

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[155] Charles McLure, 'The State Corporate Income Tax: Lambs in Wolves' Clothing' (1980) The Economics of Taxation, 327

[156] Bharat Anand and Richard Sansing 'The Weighting Game: Formula Apportionment as an Instrument of Public Policy' (2000) 53, National Tax Journal, 2, 183

[157] Ana Agundez-Garcia, 'The Delineation and Apportionment of an EU Consolidated Tax Base for Multi-Jurisdictional Corporate Income Taxation: a Review of Issues and Options' (2006) European Commission Taxation Papers, 9

[158] Patrick Weninger, *Formulary Apportionment in the EU,* (Intersertia, Mertsel, 2009), 200

[159] Andreas Oestreicher**,** *Konzern-Gewinnabgrenzung* (Beck, München, 2009), 19

[160] Douglas Shackelford and Joel Slemrod, 'The revenue consequences of using formula apportionment to calculate U.S. and foreign-source income: a firm-level analysis' (1998) 5, International Tax and Public Finance, 41

[161] Clemens Fuest, Thomas Hemmelgarn and Fred Ramb, 'How would formula apportionment in the EU affect the distribution and the size of the corporate tax base? An analysis based on German multinationals' (2006) Working Paper, *Deutsche Bundesbank* Discussion Paper Series 1: Economic Studies, http://www.econstor.eu/bitstream/10419/19648/1/200620dkp.pdf > accessed 14 March 2011

offers comprehensive research into the FA concept. There is no consensus on what the right formula is and how a federated EU environment could possibly nurture a consistent set of group allocation rules to mitigate abusive practices. Omissions in research in this field relate to the impact of different forms of firm construction in the EU and the associated impact on FA, as well as the correlation, use and influence and relative materiality between Group Relief rules and other tax avoidance practices such as THINCAP and TRPRICE.

3.8 TRPRICE Research

There is a plethora of academic literature on TRPRICE, both theoretical and empirical. Theoretical work on TRPRICE by MNEs considers managerial and economic incentives in shifting profits. Bespoke CFC legislation and the development of TRPRICE regulations within the EU acknowledges the notion that Member States are reluctant to devolve their legislative rights, preferring to “act unilaterally, with some tacit coordination organized by the OECD, to meet the growing challenges of international double non-taxation”[162]. Member States are challenged with continuously amending their TRPRICE rules to respond to new schemes and behaviours evidenced by MNEs, and this is reflected in the diversification and frequency of changes across the EU. Tax avoidance rules relating to TRPRICE that have been implemented unilaterally attract legislative complexity in an attempt to cover all loopholes but in reality are rarely effective[163]. Langbein,[164] Bird and Wilkie[165] and Picciotto[166] all studied TRPRICE in detail, covering theoretical and empirical perspectives and found all concluded that in practice Member States are pursuing bespoke strategies of unitary model taxation rather than the more traditional arm’s-length pricing approach.

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[162] Thomas Rixen, ‘Taxation and Cooperation: International Action Against Harmful Tax Competition’ in Stefan Schrim, *Globalization. State of the Art and Perspectives* (Routledge, London, 61, 2007)

[163] Richard Bird, ‘Shaping a New International Tax Order’ (1988) 42, Bulletin for International Fiscal Documentation, 7, 292

[164] Stanley Langbein, ‘The Unitary Method and the Myth of Arm’s-length’ (1986) Tax Notes, 625

[165] Richard Bird and Scott Wilkie, 'Source- vs. residence-based taxation in the European Union' in Sijbren Cnossen, *Taxing Capital Income in the European Union: Issues and Options for Reform*, (OUP, Oxford, 78, 2000)

[166] Sol Picciotto, *International Business Taxation. A Study in the Internationalization of Business Regulation*, (Quorum, New York, 1992), 190

The theoretical TRPRICE research focuses on the modelling of the impact on MNE tax liabilities when an MNE sets a single transfer price for inter-entity transfers. The empirical econometric studies on TRPRICE focus largely on the tax impact on the over- or under-invoicing of intra-firm cross-border transactions. This leans toward quantifying the incremental profitability of MNEs sited in low tax jurisdictions as opposed to high tax jurisdictions, and it is unsurprising to note that academics such as Clausing[167] confirm that cross-jurisdictional transfer prices are set by MNEs to achieve a declaration of lower declared profitability in high tax jurisdictions and disproportionately higher profits in low-tax countries. It is not, however, without peculiarities and inconsistencies as highlighted by Grubert[168], and Karkinsky and Riedel[169] who claimed certain transaction types relating to intangibles such as patents and brands are more aligned to TRPRICE than tangibles since accepted market prices do not exist for benchmarking purposes.

Research by Klassen, Lang and Wolfson,[170] Harris,[171] Swenson[172] and Gupta and Mills[173] regarding TRPRICE attack the characteristics of tax accounting, assessing how EU Member State tax rate differentials prompt TRPRICE manipulation and tax avoidance. A different emphasis was pursued by Emmanuel and Mehafdi[174], Cravens and Shearon[175] and Cravens[176]

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[167] Kimberly Clausing, 'Tax-motivated transfer pricing and US intra-firm trade prices' (2003), 87, Journal of Public Economics, 2207

[168] Harry Grubert, 'Intangible income, intercompany transactions, income shifting, and the choice of location' (2003) 56, National Tax Journal, 221

[169] Tom Karkinsky and Nadine Riedel, 'Corporate Taxation and the Choice of Patent Location within Multinational Firms' (2009) Oxford University Centre for Business Taxation Working Paper 0914, <http://www.sbs.ox.ac.uk/centres/tax/Documents/working_papers/WP0931.pdf> accessed 12 July 2011

[170] Kenneth Klassen, Mark Lang and Mark Wolfson, 'Geographic income shifting by multinational corporations in response to tax rate changes' (1993) Journal of Accounting Research, 141

[171] David Harris, Randall Morck, Joel Slemrod and Bernard Yeung 'Income Shifting in U.S. Multinational Corporations' in Alberto Giovannini, Glenn Hubbard and Joel Slemrod, *Studies in International Taxation* (University of Chicago Press, Chicago, 1993), 277

[172] Deborah Swenson, 'Tax reforms and evidence of transfer pricing' (2001) 54, National Tax Journal, 7

[173] Sanjay Gupta and Lillian Mills 'Corporate multistate tax planning: Benefits of multiple jurisdictions' (2002) 33, Journal of Accounting and Economics, 2, 117

[174] Clive Emmanuel and Messaoud Mehafdi, *Transfer Pricing*, (Academic Press Ltd, London, 172, 1994)

[175] Karen Cravens and Winston Shearon, 'An outcome-based Assessment of International Transfer Pricing Policy' (1996) 31, The International Journal of Accounting, 4, 419

whose efforts centred tax rules as but only one of the environmental factors impacting TRPRICE. Other research by Swenson,[177] Van Mens and Porquet[178] and Douvier[179] correlated TRPRICE practices to the fiscal policies in different Member States. There is also research defining the relationships between the types of MNE and the propensity to manipulate transfer prices. Conover and Nichols[180] identified company size as an important driver in the utilisation of TRPRICE to shift profits, confirming that large MNEs are more likely to shift profits through TRPRICE than smaller equivalents. Jacob[181] confirmed that MNEs with the highest number of intra-entity transfers had both the most compelling commercial incentive as well as the greatest number of practical opportunities to shift profits using TRPRICE. Corporate tax affects where a MNE steers FDI, how it sells its offerings, how to finance arrangements and the level of a transfer price according to Mueller et al[182] and as such these tax considerations collectively judged offer an hefty influence on the choice that MNEs adopt[183].

Academic opinion appears to be divided regarding whether minimizing corporate taxes through the use of TRPRICE should be considered abusive. Statistical research undertaken by Baker,[184] Dawson,[185] Hansen et al,[186] and Mehafdi[187] all concluded that the primary scope of

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[176] Karen Cravens, 'Examining the role of transfer pricing as a strategy for multinational firms' (1997) 6, 2, International Business Review, 127

[177] Deborah Swenson, 'Tax reforms and evidence of transfer pricing' (2001) 54, National Tax Journal, 7

[178] Harrie Van Mens and Fernando Porquet, 'Current European tax issues' (2011) European Taxation, 335

[179] Pierre-Jean Douvier, 'France: Current and future transfer pricing measures (2005) 12, International Transfer Pricing Journal, 2, 72

[180] Teresa Conover and Nancy Nichols, 'A Further Examination of Income Shifting Through Transfer Pricing Considering Firm Size and/or Distress' (2000) 35, The International Journal of Accounting, 189

[181] John Jacob, 'Taxes and Transfer Pricing: income shifting and the volume of intra-firm transfers' (1996) 34, Journal of Accounting Research Autumn, 2, 301

[182] Gerhard Mueller, Helen Gernon, and Gary Meek, *Accounting. An international perspective,* (4th edn, Richard D. Irwin, Inc, Chicago, 1997)

[183] James Hines, 'Lessons from Behavioural Responses to International Taxation' (1999) 52, National Tax Journal, 2, 305

[184] Raymond Baker, *Capitalism's Achilles heel: Dirty money and how to renew the free market system*, (John Wiley and Sons, Hoboken, 2005)

[185] Peter Dawson, 'Transfer price determination in a multinational corporation: Decentralized decision-making, agency costs, and strategic interaction' (2000) 60, Dissertation Abstracts International, 8

TRPRICE is to reduce taxation and should necessarily be considered abusive. On the contrary, professional research by Ernst and Young[188] in the UK found that MNEs use TRPRICE as a tax optimization strategy with no commercial inhibitions as they are widely considered to be legal and non-abusive.

Research by Vann outlined three key structural issues in TRPRICE rules incentivising tax avoidance, namely that the current rules for ascertaining whether the determinants defining whether a MNE is present in a country or not for tax purposes are unacceptably limited, the TRPRICE rules permit MNEs to structure intra-entity contracts speculatively based on an inappropriate market analogy, and lastly that the rules over-emphasis risk and not enough to resources and assets when apportioning tax revenues[189]. There is much debate regarding the merits of source versus residency tax. It has been argued that as the source tax will generally be low, the residence tax rate on the income will mean that investment choices of the MNE will be little influenced by the source tax rate according to Vann. The argument for residence based corporation taxation was made by Kaplow[190] and the argument for source based corporation taxation was made by Graetz[191]. PE rules provide direction on allocating profits between jurisdictions while the arm's-length principle defines the proper defendable and widely understood method to calculate jurisdictional profit. TRPRICE tends to imply that the tax base is heavily dependent on the jurisdiction in which income is allocated under the TRPRICE rules. When observed in the context of the influences of CFC and DTT's, Vann noted the close correlation between these concepts and TRPRICE concepts stating that "many countries adopt CFC rules to deal with deferral of tax by shifting income to MNEs with

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[186] Don Hansen, Rick Crosser, and Doug Laufer, 'Moral ethics v. tax ethics: The case of transfer pricing among multinational corporations' (1992) 11, Journal of Business Ethics, 9, 679

[187] Messaoud Mehafdi, 'The ethics of international transfer pricing' (2000) 28, Journal of Business ethics, 4, 365

[188] Ernst and Young, 'Transfer Pricing 2003 Global Survey' (2003) <http://www.ey.com/global/content.nsf/UK/IT_-_Library> accessed 12 February 2011.

[189] Richard Vann, 'Taxing International Business Income: Hard-Boiled Wonderland and the End of the World' (2010) 2, World Tax Journal, 3, 291

[190] Louis Kaplow, 'Optimal Income Transfers' (2007) 14, International Tax and Public Finance, 295

[191] Michael Graetz, 'Taxing International Income: Inadequate Principles, Outdated Concepts and Unsatisfactory Policies' (2001) 54, Tax Law Review, 261, 277

headquarters in low tax countries. The regimes are typically targeted at mobile passive income and TRPRICE" [192].

EU Member States have adopted different strategies for addressing TRPRICE practices in a number of ways. Gordon and MacKie-Mason[193] placed emphasis on the deferral justification suggesting that corporate tax should only be applied to retained profits attributable to shareholders in a Member State. This is not an accepted accounting practice and the norm is that income of MNEs is principally taxed in the Member State where economic activity gives rise to it occur. Whether the deferral justification could address TRPRICE practices has been discussed, such as by Clausing.[194] Studies by Grubert and Mutti,[195] Huizinga and Laeven[196] and Weichenrieder[197] all concluded a positive link between TRPRICE practices and increased reported profitability. As an example, Huizinga and Laeven analysed a sample of Europe MNEs and found that the German corporate tax base would have risen 14% if there had been no tax incentives to shift profits to other Member States through TRPRICE. The results of this study were similarly concluded by Harris et al[198] who found evidence of income shifting via TRPRICE between low tax and high tax countries by US MNEs and a consequential positive impact on the profitability reported by those US MNEs.

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[192] Richard Vann, 'Taxing International Business Income: Hard-Boiled Wonderland and the End of the World' (2010) 2, World Tax Journal, 3, 291

[193] Roger Gordon and Jeffrey MacKie-Mason, 'Why Is There Corporate Taxation in a Small Open Economy? The Role of Transfer Pricing and Income Shifting' (1995) NBER Working Paper No. 4690

[194] Karen Clausing, 'Tax-motivated transfer pricing and US intra-firm trade prices' (2003) 87, Journal of Public Economics, 2207

[195] Harry Grubert, and John Mutti 'Taxes, Tariffs and Transfer Pricing in Multinational Corporate Decision Making' (1997) 73, Review of Economics and Statistics, 2, 285

[196] Harry Huizinga and Luc Laeven, 'International Profit Shifting Within Multinationals: A Multi-Country Perspective' (2008) 92, Journal of Public Economics, 1164

[197] Alfons Weichenrieder, 'Profit Shifting in the EU: Evidence from Germany' (2009) 16, International Tax and Public Finance, 281

[198] David Harris, Randall Morck, Joel Slemrod and Bernard Yeung, 'Income Shifting in U.S. Multinational Corporations' in Alberto Giovannini, Glenn Hubbard, Joel Slemrod, *Studies in International Taxation. National Bureau of Economic Research Project Report*, (University of Chicago Press, Chicago, 1993), 277

The difficulties facing EU Member States is that, according to Tomkins and McAuley[199]there is “no clearly established theory…to indicate what an appropriate transfer price for enforcing goal congruence should be which is also practically satisfactory”. The problem was also highlighted by Vancil[200] who concluded “the issue [of TRPRICE] remains a perennial puzzle for academicians, while practitioners continue to cope”. Similarly, Vann stated that “TRPRICE is the dominant international issue as compared to company and shareholder or residence and source taxation” [201], suggesting that of all the corporate tax avoidance practices the TRPRICE remains the largest challenge to national governments. The size of the problem has witnessed widespread comment. Fuest and Riedel stated that “while the shifting of income out of developed countries is a widely debated issue, empirical evidence on the magnitude of the problem and on the factors driving income shifting is scarce. There are, however, a growing number of empirical studies on corporate profit shifting in OECD countries. Many of these studies use appropriate data and sophisticated econometric methods, and the results offer valuable insights into corporate profit shifting” [202]. Although there is plenty of evidence that international organisations such as OECD[203] and Commission[204] have developed provisions and guidelines on the formulation of transfer prices this is by no means the only approach.

The academic arguments promoted by a large proportion of the researchers conclude that TRPRICE forms part of a tax solution strategy that warrants merit. There are little academic conclusions to the contrary. The formation of the EU itself nurtures TRPRICE and offers little release from the conclusion that it is anything but abusive in the majority of

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[199] Cyril Tomkins and Laurie McAuley ‘A Review of the Contemporary Transfer Pricing Literature with Recommendations for Future Research’ (1992) 3, British Journal of Management, 2, 101

[200] Richard Vancil, *Decentralisation: Managerial Ambiguity by Design*, (Richard D. Irwin Press, Homewood,1979)

[201] Richard Vann, ‘Taxing International Business Income: Hard-Boiled Wonderland and the End of the World’, (2010) 2, World Tax Journal, 3, 291

[202] Clemens Fuest, and Nadine Riedel, ‘Tax Evasion and Tax Avoidance in Developing Countries: The Role of International Profit Shifting, (2010) Oxford University Centre for Business Taxation Working Paper 10/12, <http://www.sbs.ox.ac.uk/centres/tax/Documents/working_papers/WP1012.pdf> accessed 12 December 2010

221 OECD, ‘Transfer Pricing and Multinational Enterprises, (1979); OECD, ‘Transfer Pricing Guidelines for Tax Administrations and Multinational Enterprises (2009)

[204] Commission, ‘EU Joint Pricing Forum’, Publications Office of the European Union, COM (2004) 297 final

circumstances. Vann offers the strongest academic reasoning behind the motives and materiality of TRPRICE that impact Member State tax revenues and its links to legislation. The CFC research linking TRPRICE to deferral taxation by Vann, and Gordon and MacKie Mason, offers an interesting angle but little insight as to how this may contribute to a credible solution. Vann rightly concludes that successfully addressing TRPRICE offers the largest prize to Member States in terms of mitigating tax revenue losses, but although mitigating tax avoidance more generally now resides firmly on the agenda of the OECD no proposal yet has the academic credentials it will eventually demand.

3.9 THINCAP Research

The issue of THINCAP arises when "debt financing is excessive by reason of the relationship between the borrowing and lending MNEs, in which case interest payments are disallowed to the extent that they exceed the arm's-length arrangement" according to Devereux et al.[205] From a comparative perspective, von Brocke and Perez[206] pursued an empirical study comparing the growth of THINCAP rules in Germany and the UK. Repeatedly, both jurisdictions have been subject to challenge on the THINCAP rules and have had to amend rules in response to CJEU rulings. Further research by Brocke and Perez showed the knock on impact on rule changes in one Member State on the rules in another Member State, highlighting the influence German THINCAP rule changes had on Italian THINCAP laws.

Theoretical assessments of THINCAP are principally based around the notions of CEN and capital import neutrality, hereafter referred to as CIN. In respect to CEN, Doernberg[207] commented "a tax system meets the standard of CEN if a taxpayer's choice between investing capital at home or abroad is not affected by taxation". Schön stated that CEN "requires that, from the position of the investor, the tax burden for foreign and domestic investment is equal and therefore does not distort the decision of whether to invest here or

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205 Michael Devereux, Socrates Mokkas, James Pennock and Peter Wharrad, 'Interest Deductibility for UK Corporation Tax' (2006) Oxford University Centre for Business Taxation, <http://www.sbs.ox.ac.uk/centres/tax/Documents/reports/Interest_Deductibility.pdf> accessed 12 March 2011

206 Klaus von Brocke and Euginio Garcia Perez, 'Group financing: from thin capitalization to interest deduction limitation rules' (2009) 16, International Transfer Pricing Journal, 29

207 Richard Doernberg, *International Taxation in a Nutshell*, (8th edn, Thomson/West, St Paul, 2008), 19

there" [208]. International tax competition renders CEN as non-existent today. Schön argues that CEN would be "most easily achieved when the country of residence of the investor taxes his or her worldwide income while the country of source fully waives its jurisdiction over income connected with its territory"[209]. Source-based taxation is more widely adopted than residence-based taxation, and it would be reasonable to assume few jurisdictions appear willing to voluntarily sacrifice taxable profits through the adoption of a more punitive methodology. Gordon and Wilson[210] and Razin and Sadka[211] argued against source-based taxation although his argument seemed inconsistent when he went on to blame CIN for nurturing the development of THINCAP laws. Schön claimed CIN could be a useful tool for measuring profit shifting as "the concept of CIN starts from the perspective of the host country of an investment and compares the tax burden for domestic and foreign investors"[212]. Doernberg caveated this by stating "this standard is satisfied only when all firms doing business in a market are taxed at the same rate"[213].

Debt ratios are a useful barometer of THINCAP materiality. Research by Desai et al[214]and Schwarz[215] found in correlation studies a direct and near linear correlation between increases in the corporate tax rate in a source country and increases the debt ratio of subsidiaries in that country. In terms of reducing global tax liabilities, Desai et al[216] conclusively proved that

[208] Wolfgang Schön, 'International tax coordination for a second-best world (part I) (2009) 1, World Tax Journal, 1, 79

[209] Ibid

[210] Roger Gordon and John Wilson, 'An examination of multijurisdictional corporate income taxation under formula apportionment' (1986) 43, Econometrica, 1357

[211] Assaf Razin and Efraim Sadka, 'International tax competition and gains from tax harmonization' (1991) Working Paper 3152, National Bureau of Economic Research, <http://www.nber.org/papers/w3152.pdf> accessed 15 March 2011

[212] Wolfgang Schön, 'International tax coordination for a second-best world (part I) (2009) 1, World Tax Journal, 1, 80

[213] Richard Doernberg, *International Taxation in a Nutshell*, (8thEdn, Thomson/West, St Paul, 2008), 29

[214] Mihir Desai, Fritz Foley, and James Hines ,'A Multinational Perspective on Capital Structure Choice and Internal Capital Markets' (2004a) 59, Journal of Finance, 2451

[215] Peter Schwarz, 'Tax-Avoidance Strategies of American Multinationals: The Case of Profit Shifting' (2009) 30, Managerial and Decision Economics, 539

[216] Mihir Desai, Fritz Foley and James Hines, 'Economic effects of regional tax havens' (2004) NBER Working Paper No. 10806, <http://www.nber.org/papers/w10806.pdf> accessed 9 January 2011

MNEs leveraged subsidiaries in jurisdictions with high corporate tax rates with more debt than subsidiaries in jurisdictions levying low corporate tax rates. Interestingly, and perhaps not unsurprisingly, it was similarly proven that internal inter-entity debt was more responsive to high tax rates than external debt, inferring that there is a propensity for subsidiaries in high tax jurisdictions to be capitalised with external loans supporting the allegation of manufactured profit shifting. More focused research by Mintz and Weichenrieder on German-based MNEs made similar conclusions in that subsidiaries of German MNEs incurred more debt in high-tax jurisdictions than they did when reporting activity out of low-tax jurisdictions[217].

Beyond a trend, quantification regarding the materiality of profit shifting has generated mixed opinions. Desai et al concluded that only a small sub-section of MNEs shifted profits stating that "estimating the sensitivity of capital structure to tax incentives has proven remarkably difficult, due in part to measurement problems. Consequently, it is not surprising that several studies find no effect or unexpected relationships between tax incentives and the use of debt" [218]. Conversely, Haufler and Runkel opined that the evidence that high income tax rates motivate additional debt is "conclusive" and "widespread" [219]. Desai et al[220] studied the leverage of thousands of MNEs owning thousands of related MNEs during 1982, 1989 and 1994, focusing on corporate entities investing abroad, concluding that such MNEs increased debt in response to high tax rates in response to tax incentives.

It is generally accepted that THINCAP rules permits a Member State tax authority to evaluate a MNEs balance sheet to ascertain whether a CFC's structure is overly leveraged. According to Von Brocke and Perez, "the majority of these THINCAP rules established the existence of safe harbours in order to force related MNEs to apply normal market conditions in their intra-

[217] Jack Mintz and Alfons Weichenreider, 'Taxation and the Financial Structure of German Outbound FDI' (2005) CESifo Working Paper Series, 1612

[218] Mihir Desai, Fritz Foley and James Hines, 'A multinational perspective on capital structure choice and internal capital markets' (2004) 59, Journal of Finance, American Finance Association, 2451

[219] Andreas Haufler and Marco Runkel, 'Firms' financial choices and thin capitalization rules under corporate tax competition' (2008) Working Papers 0815, Oxford University Centre for Business Taxation, <http://www.sbs.ox.ac.uk/centres/tax/Documents/working_papers/WP0815.pdf> accessed 16 March 2011

[220] Mihir Desai, Fritz Foley and James Hines, 'Economic effects of regional tax havens' (2004) NBER Working Paper No. 10806, <http://www.nber.org/papers/w10806.pdf> accessed 9 January 2011

group transactions[221]". Lund et al agreed with this notion, stating "specific rules aimed to discourage thin capitalization often require that the debt-to-equity ratio meet a specific ratio in order for the MNE to be allowed to deduct interest expenses" [222]. Lund et al furthermore stated "in recent years, there has been a tendency for some countries to base their rules on a MNEs operations, and more and more countries are introducing so-called interest limitation rules and earnings stripping rules"[223]. In respect to our sample Member States, Germany and Italy have adopted this approach. Furthermore, it was claimed that debt-to-equity rules were rendered inadequate, stating "it was very simple for MNEs to circumvent the limit established by debt-to-equity ratio by increasing the equity of the financed subsidiary in a manner sufficient to push down as much debt as necessary"[224].

A number of other points may be raised regarding THINCAP rules. THINCAP policies although implemented nationally are very much formed in alignment with the legislation adopted in other Member States. Van Saparoea noted how a "Netherlands legislator has been investigating the possibility of introducing new legislation that is similar to that applying in Germany"[225], and how "the Italian parliament introduced new interest limitation rules inspired by the new German rules"[226]. Researchers to date have not differentiated between whether this is attributable to tax competition, alignment with CJEU rulings, and the pursuit of perfection in closing loopholes or a combination thereof. Irrespective of the driver, these alignments are not so significant so as to break down the different approaches adopted by different Member States.

[221] Klaus von Brocke and Euginio Garcia Perez, 'Group financing: from thin capitalization to interest deduction limitation rules, (2009) 16, International Transfer Pricing Journal, 29

[222] Henrik Lund, Carina Marie Korsgaard and Matthias Albertsen, 'Financing: A Global Survey of Thin Capitalization and Thin Capitalization Rules in 35 Selected Countries' (2008) International Transfer Pricing Journal, 283

[223] Ibid

[224] Ibid

[225] Anoucvan den Berg Saparoea, 'Optimizing the interest deduction rules—a never-ending story' (2009) European Taxation, 3

[226] Ibid

In Germany THINCAP rules were widely amended following *Lankhorst-Hohorst*[227] with the objective to apply to a wider set of transaction types. Research discovered that "Germany has attempted to create an attractive tax jurisdiction by widening its tax base in the Corporate Tax Reform Act of 2008"[228]. Becker et al [229] found that "the main goals of the German Tax Reform 2000 were to improve the competitiveness of MNEs in Germany, to foster investment, to increase Germany's attractiveness to foreign investors and to adapt the corporate tax system to the rules of the EC common market". With regard to debt-to-equity ratios, Germany has shifted attention to limiting interest expense deductions through the enactment of the General Interest Disallowance Rule. Such provisions have been widely welcomed with Bagel and Huning[230] stating that "the scope of the new rules is far broader than the former THINCAP rules, as any third-party debt financing is included".

The UK has legislated against highly leveraged financing structures for the last 25 years and in response to the *Thin Cap GLO*[231], the tax rules were modified several times. According the von Brocke and Perez "the CJEU concluded that even prior to 1995 and, in any case, between 1995 and 2004, when interest was paid by a resident MNE in respect of a loan granted by a related non-resident MNE, the tax position of the former MNE was less advantageous than that of a resident borrowing company which had been granted a loan by a related resident company"[232]. Historically, in cases whereby interest expenses were re-characterized as distributions, the UK rules differentiated it tax treatment based on whether the lender was a UK taxpayer or not. In response the CJEU determined "the UK thin capitalisation rules contravened the Freedom of Establishment clause in Article 43 of the EU Treaty"[233] From a definition perspective, tax authority guidance states that in tax terms "a UK MNE, which may

[227] Case C-324/00.*Lankhorst-Hohorst GmbH v. FinanzamtSteinfurt* [2002] All ER (D), para 169

[228] Anoucvan den Berg Saparoea, 'Optimizing the interest deduction rules—a never-ending story' (2009) 49, European Taxation, 6

[229] Johannes Becker, Clemens Fuest, Thomas Hemmelgarn, 'Corporate Tax Reform and Foreign Direct Investment in Germany — Evidence From Firm-Level Data' (2006) CESifo Working Paper No. 1722

[230] Friderike Bagel and Carsten Huning, 'Financing: Germany' (2008) 6, International Transfer Pricing Journal, 309

[231] Case HC03C04130, *Test Claimants in the Thin Cap Group Litigation v HMRC* [2009] EWHC 2908

[232] Klaus von Brocke and Eugenio Garcia Perez, 'Group financing: from thin capitalization to interest deduction limitation rules' (2009) 16, International Transfer Pricing Journal, 29

[233] Ibid, 31

be part of a group, may be said to be thinly capitalized when it has excessive debt in relation to its arm's-length borrowing capacity, leading to the possibility of excessive interest deductions"[234]. The UK regulations are much more simplified than was previously the case underpinned by standardised provisions that deny tax relief for interest expenses that exceed a MNEs arm's-length debt capacity.

Other academic assessments have focused on the interpretive metrics used by the CJEU in assessing THINCAP rules. The Commission stated that "Certainty is desirable to assist business planning, but also to provide a degree of revenue certainty for administration; for example, if the rules governing loss-offset are unclear then neither business nor government can predict tax payments and revenue"[235]. THINCAP rules suffer like many tax law provisions in that they offer uncertainty and are often implemented inequitably across industries and jurisdictions. Member States may cite the Rule of Law benefit principle to support THINCAP regulations, arguing that inter-entity loans are manufactured to shift profit from where it is actually earned, and where the state provides services, to low-tax jurisdictions that provide minimal state support. Likewise, academics are united in their belief that taxes should be neutral, avoiding discrimination in favour or against certain corporate taxpayers. For example, Musgrave and Musgrave[236] said "taxes should be chosen so as to minimize interference with economic decisions in otherwise efficient markets"[237]. This was also endorsed by Doernberg[238] who stated "the inspirational goal for a tax system in general is the implementation of a tax-neutral set of rules that neither discourage nor encourage particular activity"[239]. The weakness of THINCAP rules is that inter-entity loans are a common bona-fide commercial practice. It is very challenging to disprove the legitimacy of a

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[234] HMRC, INTM57101, <http://www.hmrc.gov.uk/manuals/intmanual/intm571015.htm> accessed 20 May 2011

[235] Commission, 'Analysis and Coordination of Tax Policies' (2005) CCCTB Working Paper, Joint Transfer Pricing Forum, Report on the Re-entry into force of the arbitration convention, <http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/transfer_pricing/arbitration_convention/report_jtpf_en.pdf> accessed 14 April 2011

[236] Richard Musgrave and Peggy Musgrave *Public Finance in Theory and Practice*, (1st edn, New York, McGraw-Hill, 235, 1973)

[237] Ibid, 210

[238] Richard Doernberg, *International Taxation in a Nutshell*, (8th edn, Thomson/West, St Paul, 2008), 29

[239] Ibid, 3,4

THINCAP transaction without reviewing the underlying details of the arrangement. Research by Webber reflected this stating an effective THINCAP law should constrain MNEs from incurring excessive inter-entity debt solely for the purpose of reducing taxation. However, it should allow MNEs to incur debt, and take a tax deduction, when such debt is a normal part of a MNEs business model[240].

The academic research evident relating to THINCAP may broadly be placed into three categories. First, the impact of tax rates and tax rules on THINCAP practices. Such commentary offers a largely consensus view that across the EU the higher the tax rates and the weaker the rules the higher the propensity to leverage debt ratios for tax optimisation purposes. Second, research by Lund and Van Brocke and Perez offer a unique EU centric view on how EU Member States have reacted to THINCAP practices, identifying how Member States such as UK, Italy and Germany have responded but the weakness in the research is its lack of follow through evidence to measure their success as it is observational rather than empirical in nature. The final element of the research offers the most valuable contribution to our search for a solution. Although academics are united in their opinion that the various measures enacted by Member States have had limited impact on THINCAP practices, the identification of such measures, specifically comprising debt to income ratios, debt to balance sheet ratios, and interest limitation rules such as arm's-length metrics have proved a useful measure for tax authorities to gauge abuse levels. Despite these efforts there is limited academic recognition of the inherent legal legitimacy of such financial restructuring.

3.10 DTT Research

In the EU, despite the fact that options exist for preventing double taxation on a unilateral basis there has been a proliferation of EU DTTs. The Avoir Fiscal decision usefully set out the CJEU's view on DTT instruments and has upheld the notion that the primacy of EU law may not be compromised by the specific provisions of DTT's and their inherent principle of reciprocity. The *Bouanich*[241] case established that DTT's were held to be part of Member

[240] Stuart Webber, 'Thin Capitalisation and Interest Deduction Rules, A Worldwide Survey' (2010) 60, Tax Notes International, 9, 15

[241] Case C-265/04 *Bouanich v Skatteverket* [2006] ECR I-923

States laws and therefore must comply with the primacy of EU law. Since DTT's are unlikely to provide comprehensive transactional coverage in the Internal Market it has not been possible to completely eliminate double taxation through DTT instruments. Furthermore the simplicity of such arrangements is often compromised when different internal transfer price mechanisms are applied between different Member States[242]. These points form the basis of much DTT literature.

There is considerable general literature in the field of EU DTT's. Toumi[243] claimed DTT's are not fit for purpose as a means of preventing harmful tax competition. Kofler and Mason[244] confirmed the notion that double taxation was inefficient and contrary to the principles of the Internal Market. The implementation of various formulas and provisions relating to double taxation exemption or credit reliefs based around source and residence based taxation methodologies complicates what should be a fairly vanilla concept. According to Terra and Wattel[245]Avi-Yonah[246] and Rixen[247] both concluded that such complexity was compounded by the multitude of implementation options, namely Member Static tax law, international DTT's and by EU law. Member State DTT's do not typically attract detailed tax rules but rather focuses on segmenting the tax bases of participant jurisdictions and assign accordingly so that domestic rules may be applied to secure an appropriate share of the tax base. Effectively, helping to "coordinate divergent national tax laws"[248], the legal constructs upon which a DTT is built rejects the tax base as a global concept, but instead implants a jurisdictional arrangement. Their popularity is predicated on the basis that DTT's secure

[242] Richard Doernberg, *International Taxation in a Nutshell*, (6 edn, Thomson/West, St Paul, 2004), 9

[243] Marika Toumi, 'Anti-Avoidance and Harmful Tax Competition: From Unilateral to Multilateral Strategies?' in Andrew Lymer and John Hasseldine, *The International Taxation System*, (Kluwer, Boston, 83, 2006)

[244] Georg Kofler and Ruth Mason, 'Double Taxation: A European Switch in Time' (2007) 14, Columbia Journal of European Law, 14

[245] Ben Terra and Peter Wattel, *European Tax Law*, (Kluwer, Deventer, 2005), 312

[246] Reuven Avi-Yonah, *International Tax as International Law: An Analysis of the International Tax Regime* (CUP, Cambridge, 2007), 111

[247] Thomas Rixen, *The Political Economy of International Tax Governance,* (Palgrave Macmillan, Basingstoke, 2008)

[248] Jinyan Li, *International Taxation in the Age of Electronic Commerce: A Comparative Study*, (Canadian Tax Foundation, Toronto, 2003), 33

Member State taxation rights of their share of the tax base, or what Vann termed "sovereignty-preserving cooperation"[249].

The Carroll Report[250] symbolised a watershed in DTT advances in the EU. Its reference to arms-length pricing was assessed by Langbein[251] who claimed the Carrol Report's assumption that arm's-length pricing was "the accepted norm" was misguided as it fails to recognise distributive conflicts. Picciotto viewed arm's-length pricing as a "natural solution capable of de-politicizing the distributive conflict inherent in the avoidance of double taxation"[252] even though FA and separate accounting offered qualified alternatives. Brauner claimed "the OECD Model treaty is practically the infrastructure of the current bilateral treaty-based system"[253] although its useful was highlighted by Avi-Yonah[254] who set out how the OECD Model Convention principles and rules restrict bi-lateral negotiations when forming DTT's to a common set of norms thus constraining unilateral tax rule making.

The significance off DTT's to this research is that MNEs often choose to use DTTs in accessing benefits associated with other tax planning practices such as CFC. Although variations in tax rules persist among Member States, DTT's are an effective tool for exploiting these. Cyprus or Ireland are examples of low-tax jurisdictions that choose to exercise their legal right not to impose punitive rates of high tax to reap their, arguably rightful, share of the EU tax base, but to increase their revenues from the "commercialization of their tax sovereignty"[255], giving up what we outlined in Chapter Five as their de facto sovereignty. Such behaviour by these "renegade states"[256] aimed at attracting economic

[249] Richard Vann, 'A Model Tax Treaty for the Asian-Pacific Region?' (1991) 45, Bulletin for International Fiscal Documentation, 99

[250] Mitchell Carroll, *Taxation of Foreign and National Enterprises: Methods of Allocating Taxable Income,* (Geneva, League of Nations, 1933) C-425

[251] Stanley Langbein, 'The Unitary Method and the Myth of Arm's-length' (1986) Tax Notes, 625

[252] Sol Picciotto, *International Business Taxation. A Study in the Internationalization of Business Regulation,* (Quorum, New York, 1992), 172

[253] Yariv Brauner, 'An International Tax Regime in Crystallization' (2003) 56, Tax Law Review,259

[254] Reuven Avi-Yonah, 'International Tax as International Law' (2004) 57, Tax Law Review, 483

[255] Ronen Palan, 'Tax Havens and the Commercialization of State Sovereignty' (2002) 56, 1 International Organization, 1, 151

[256] Lorraine Eden and Robert Kudrle, 'Tax Havens: Renegade States in the International Tax Regime' (2005) 27, 1 Law & Policy, 1,100

development restricts their flexibility to model their tax systems and can be seen to be entering into a strategy of "provocative dependence"[257]

3.11 Abuse of Rights Research

The term abuse of rights is enigmatic, attracting diversity of opinion with regard to its meaning and legal grounding. Despite this there is useful set of literature and evolving case law to assist observers in the appreciation of its importance in assessing abusive behaviour in the context of the law. It is from this that we may distil an established set of circumstances consistent with that defined as abuse[258]. According to Greggi[259] the notion of avoidance is strongly embedded to the concept of abuse of a right. An abuse, according to the Roman law tradition, represents the exercise of a right inconsistent with the "general principles of correctness, good faith or even with the basic rules of ethics". Therefore the definition of avoidance is not purely legal, but it depends also on other disciplines which influence it"[260]. Despite the authoritative attempts in tax literature to promote the concept, the view advocated by Vanistendael[261] is that the CJEU should formally acknowledge the notion of abuse in direct tax law so as to be consistent with the ruling in the *Halifax* VAT decision.

McCarthy noted that the body of EU case law dictating the circumstances in which abuse may be present is continually refining[262]. In the absence of a national abuse provision

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[257] Mark Hampton and John Christensen, 'A Provocative Dependence? The Global Financial System and Small Island Tax Havens' in Feargal Cochrane, Rosaleen Duffy and Jan Selby *Global Governance, Conflict and Resistance* (Palgrave Macmillan, Basingstoke, 2003), 194

[258] Hui Ling McCarthy, 'Abuse of Rights – Europe's Legal Elephant' (2007) GITC, <http://www.taxbar.com/documents/Abuse_of_Rights_Europes_Legal_Elephant_HLM.pdf> accessed 12 May 2011

[259] Marco Greggi, 'Avoidance and abus de droit: The European Approach in Tax Law' (2008) 6, eJournal of Tax Research, 1, 23

[260] Ibid , 30

[261] Frans Vanistendael, 'Halifax and Cadbury Schweppes: one single theory of abuse in European tax law?' (2004) EC Tax Review, 2006/4, 192

[262] Hui Ling McCarthy, 'Abuse of Rights – Europe's Legal Elephant' (2007) GITC, 48, <http://www.taxbar.com/documents/Abuse_of_Rights_Europes_Legal_Elephant_HLM.pdf> accessed 12 May 2011

prescribing those circumstances, he stated that the purpose of the doctrine is to catch cases where either a MNE is attempting to rely on a European legal right to circumvent or displace national law, or a MNE is looking to gain a financial or other advantage by way of an abusive use of EU law. The former situation is particularly relevant to direct tax, where taxpayers seek to rely on a fundamental EU freedom to influence the domestic tax treatment arising thereon.

McCarthy also noted how the Commission has sought to restrict the scope of the doctrine, to prevent excessive curtailment of traders' rights[263]. Harris[264] and Douma and Engelen[265] promoted a view regarding the French and Netherlands approach respectively regarding abuse of rights. Harris concluded that the French approach presumes that agreements are real and economically balanced and that the taxpayer does not have a legal right in a manner for which it has not been designed. In contrast the Netherlands view is that an abuse of rights is the ultimate prognosis and an interpretation can only be applied if all other methods of interpretation have been exhausted. In *EC Commission v Italy*[266] the Commission argued that, "… the principles of effectiveness would be observed only if cases of rejection of repayment claims were exceptional and maintains that the exercise of rights derived from the Treaty cannot be impeded by general measures based on a presumption of abuse of rights"[267].
According to McCarthy the key EU institutions responsible for formulating the doctrine show a shift from a subjective to objective interpretation[268]and Cerioni discussed the question of whether circumvention can arise without abuse[269]. He suggests that it can, and concludes that in the area of direct taxation, the direct access to benefits provided by EU law are generally

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[263] Ibid, 50

[264] Peter Harris, 'Abus de Droit in the field of Value Added Taxation' (2003) 2, BTR 131-152

[265] Sjoerd Douma and Frank Engelen, 'Halifax plc v Customs and Excise Commissioners: The CJEU applies the Abuse of Rights Doctrine in VAT Cases' (2006) 4, BTR, 429

[266] Case C-129/00 *Commission v. Italy* [2003] ECR I-14637

[267] Ibid, para 18

[268] Hui Ling McCarthy, 'Abuse of Rights – Europe's Legal Elephant' (2007) GITC, 51, <http://www.taxbar.com/documents/Abuse_of_Rights_Europes_Legal_Elephant_HLM.pdf> accessed 12 May 2011

[269] Luca Cerioni, 'The abuse of right in EU Company Law and EU Tax Law; a re-reading of the CJEU case-law and the quest for a unitary notion' (2010) 4, Brunel Law School Research Papers <http://bura.brunel.ac.uk/handle/2438/4141> accessed 14 August 2011

detrimental to Member States interests and so implementing abuse of rights into EU law may be best granted through national anti-abuse clauses. When exercising rights granted under Fundamental Freedoms, it is similarly considered detrimental to Member States and utilising abuse of rights as a justification for constraining the Freedom of Establishment requires proof based on a rule of reason approach. Academics such as Ceroni and Greggi infer that the notion of abuse is used instead of that of avoidance of a legal provision. Taken further this implies abuse of law could epitomise tax avoidance in those jurisdictions where abuse of law is an accepted principle. Despite the differences, the common ground of all these issues relies on interpretation. Dealing with tax avoidance or with 'abuse of law' still depends nowadays both on the interpretation of statutory law and on the constitution, where applicable, of a Member State. One final view expressed by Greggi was that in EU law qualifying avoidance is even more complex as EU law is deprived of any influence by other systems of values, the only general principles to rely on are the Fundamental Freedoms and the non-discrimination principle both enshrined in the Treaty. That is why when in recent cases the Court had to rule on the abuse of law it did its best to find principles or values to build the concept on.

The apparent lack of extended research in this field is arguably a representation of its perceived limitations in offering a credible contribution to a solution to corporate tax avoidance practices. Interestingly, public opinion in this sphere increasingly focuses on the abusive nature of tax avoidance and its adverse impact on stakeholder rights more generally, if not necessarily denoted so directly as such. A paucity of academic research in relation to the correlation between tax avoidance practices and abuse of rights is curious, therefore, particularly given the proliferation of references to such a concept in CJEU rulings. Abuse of rights is a theoretical and subjective concept but if over time a consensus emerges and it becomes a more accepted concept worthy of more rigorous scrutiny in the context of Fundamental Freedoms and EU direct tax law then a lack of commentary beyond that of Greggi, McCarthy and Cerioni will look like a weakness.

3.12 The Completeness and Influence of Scholarly Anti-Avoidance Tax Research

More generally, however, a number of observations may be made regarding research completeness in the field of corporate tax avoidance. Analysis demonstrates that avoidance literature generally is readily available, particularly in relation to the types of tax avoidance methods practiced by MNEs in a general sense, as well as the impact of tax factors such as tax rates and the tax base on FDI along with the factors driving MNEs to engage in tax avoidance at the outset. All of these are important as many tax factors reside at the centre of the proposals promoted to combat avoidance in the recent past. The mechanics of tax avoidances are well documented and CJEU jurisprudence is similarly well covered but there is little material on the wider impact on tax avoidance practices generally whereby CJEU case law that makes rulings in one area of the law could not be adopted, where similar characteristics persist, to cover broader practices in the field of direct tax law.

Areas of research that offer academic consensus relate to TRPRICE and CFC. The drivers and mechanics are well understood and there appears consensus that these two practices offer the greatest opportunity to the CJEU for effectively outlawing in terms of discriminatory abuse of EU Fundamental Freedoms. Most academic debate is witnessed in the area of abuse of rights. There are certainly divergences evident with respect to the interpretation and usage of the concept in the area of direct law, with stark differences between those who see no role for it in direct taxation matters and others who view it as central to the entire ethos of managing out tax avoidance practices. Similarly, the impact of CJEU rulings on national sovereignty seems to divide academic opinion too. Thoughts distinctly contrast between those who see a limited role for the CJEU who has no other agenda than to simply uphold Treaty freedoms, to those who see it as a European political instrument for harmonising direct tax matters under the guise of Treaty freedoms. In terms of tax avoidance concepts the academic literature relating to CFC is broadest and analysed in most depth in the context of Member States while the poorest coverage relates to DTT's.

Poor coverage is evidenced in the role of tax authorities in mitigating tax avoidance measures. Focus tends to be on the role of the national courts but the implementation of tax audits and their reach, frequency and effectiveness could play a larger role in tax avoidance mitigation particularly if co-ordinated across EU boundaries through intelligence sharing and consistency of enforcement practices. Corporate social responsibility in the area of direct taxation is covered but it is limited, and it surprising to see how ethical business practices that can be nurtured and encouraged over time feature so lightly in coverage terms both form a causal perspective or in solutions literature. Behavioural science, beyond that guided by corporate governance process, has also been absent from any literature, as it seems fair to conclude that MNEs behave in certain ways according to their environment, cultural norms, and incentives and disincentives available to them. There is similarly some commentary regarding the role of institutions such as the OECD and EC but little regarding how they can serve a purpose in defining a common way forward in the future.

It appears clear that there is an emphasis on traditional academic study in this field, attempting to look at the problems associated with tax avoidance practices in a particular location, usually with reference to national tax laws and associated CJEU cases impacting those laws. There is a notable dearth of academic material cross-referencing national law changes, CJEU rulings and MNE tax management practices across the EU as a whole and how commonality in issues and approaches could provide the necessary input into a workable solution for the EU as a whole. The solutions promoted in the research available appear to be either legislative in nature such as General Anti-Avoidance Rules, hereafter referred to as GAARs, or through long-term changes to the role of the EU in the domain of direct taxation generally. Mainstream ideas such as the national implementation of GAARs or the promotion of a common solution focusing on a harmonised outright outcome, such as a Common Consolidated Corporate Tax Base, hereafter referred to as 'CCCTB', rather than the addressing the root causes or processes that over time may nurture harmonisation in its own way, are proposed. Consideration needs to be made regarding the geo-political changes embracing the EU currently, as well as economic forces globally that will put pressure on EU economies, and therefore politicians, to ensure that EU business is efficient as possible in the battle for global competitiveness. The search for a common way forward through using both existing relevant scholarly research as well as plugging the gaps in those areas that are not only missing but material in finding such an answer present an opportunity and a challenge to develop solutions for the future.

Among the various research perspectives the most influential publications that relate to the foundational concepts introduced at the beginning of this Chapter emanate from the aforementioned works of De Simone, Hasegawa, Braithwaite and Scharpf. De Simone set out for the first time in detail an inferred relationship between accounting standards and profit shifting behaviours, highlighting how accounting is the primary driver towards profit shifting incentivisation and facilitation. Her research, with an empirical focus in the context of the EU advocated increased transparency as a means of reducing the impact of IFRS accounting standards on profit shifting outcomes. This correlates with the subjective norm behavioural element of Ajzen's theory that reflects the widespread perception of tax conduct acceptability resulting from accounting opportunities, and also La Porta's theory that links an established system such as accounting standards to economic behaviours. Hasegawa similarly conducted an empirical study on how public disclosure influences reported taxable income, noting how taxpayers will declare higher profits when they are required to disclose more data. He introduced an econometric means to analyse tax disclosure data and dismissed in full claims that loss of privacy and proprietary costs of tax disclosures are a commercial burden on MNEs. His study, although Asian centric, offers significant insights into the concept of how enhanced accounting disclosures may impact EU jurisdictional profit shifting, conclusions consistent with that promoted by Ajzen linking economic self-interest to commercial conduct and La Porta's premise that a law promoting enhanced disclosures is welfare enhancing as the commercial negativities commonly used to dismiss disclosures appear non-vexatious. Both Braithwaite and Scharpf offered theoretical perspectives. Braithwaite placed great emphasis on the influence of the judiciary system and as a consequence MNE decision-making is largely driven by a risk-reward assessment, consistent with La Porta's theory that links the legal system to economic behaviours. He hypothesised that law reform in the area of anti-tax avoidance rarely works top down as it generates exploitable loopholes, and so placing the emphasis on bottom up taxpayer disclosure and the compliance model it keeps the law dynamic. Scharpf's game theory hypothesises that individuals and institutions know all possible actions and how the actions combine to yield a particular outcome. By using basic game theory to understand public policy conflicts he suggests a number of important points if applied to the remit of this research. Tax outcomes are likely to stem from interactions of actors such as tax authorities, Member States and the judicial system, which are heavily influenced by the institutional setting, consistent with La Porta's Legal Origins theory. Such actor centred institutionalism is driven by the salience of the actors and their interactions, consistent with Ajzen's Theory of Planned Behaviour. Such a theoretical basis places much emphasis on normative behavioural intentions and control beliefs providing robust academic reasoning for proposing reform on the basis of nurturing behavioural changes.

Chapter Four: Institutional Stakeholders in the Tax Avoidance Debate

4.1 Introduction

Any reform of the EU tax system will demand the agreement and ongoing support of a wide range of institutional stakeholders. Evidence of lengthy battles has been seen between the advocates of tax planning competing against the defenders of the national tax bases' and EU Fundamental Freedoms, supplemented by the forces of political parties and special interest groups. MNEs in their pursuit of shareholder profits through placing emphasis on contractual or judicial interpretation of tax rules rather than fiduciary responsibilities of their Officers, sometimes referred to as the nexus of contracts approach[1], have been constantly challenging the boundaries. Such conflicts arise between the defenders of the national tax system, namely Member State legislatures and their tax authorities, and the CJEU as custodian of EU Fundamental Freedoms.

This chapter does not attempt to provide a normative stakeholder behavioural model but rather a practical foundation, based on observable behaviours, for the assessment of two specific dimensions to stakeholder impact on the EU tax avoidance debate. Such dimensions relate to the contributions and impact of these institutional entities on the EU tax avoidance landscape, specifically relating to policies, practices and behaviours, along with their contributions to the solution debate aimed at resolving the conflicts currently under review. The stakeholders under review promote differing interests, priorities and approaches in the EU tax avoidance debate and these need to be both identified, critiqued and balanced in the context of their likely impact and contribution to the debate going forward. This analysis provides the academic substance in the quest for a solution, the importance of which is underlined by the fact that any solution capable of a successful implementation needs to factor in the likely response from the relevant stakeholders who are likely to influence both the initial adoption and continued successful implementation of the proposal.

[1] Frank Easterbrook and Daniel Fischel, *The Economic Structure of Corporate Law*, (Harvard University Press, 1991)

4.2 The Role of the EU Judicial Institutions

4.2.1 The EU Institutional Framework

The propensity to forge a centralised role for the EU in direct taxation affairs has been largely shaped by the CJEU. In recent years the CJEU has focused its attention on reviewing and ruling on the compatibility of Member States tax laws with the EU Treaty's Fundamental Freedoms. Prima facie, the impact of the EU on the income tax systems of Member States appears significant, with some commentators such as Waele[2] suggesting its involvement in direct tax matters worthy of being called "unexpected"[3] and "underestimated"[4]. From a historical perspective, the EU construct promotes the dismantling of any tax obstacles that are contrary to the internal market ideal, because, according to Feldstein[5], taxes are an important determinant of economic behaviour. Research by Benassy-Quere[6] et al found that cross-border movements of capital are responsive to differences in the effective tax burden that may result from differing ways in which activities are taxed in two different countries exemplified by tax differentials between regulatory regimes, or from different tax treatment by one country of similar domestic and cross-border activities.

In the direct tax area there is neither an explicit prohibition of direct tax discrimination nor an explicit mandate the CJEU to act in this area. Unsurprisingly, the CJEU has been modest in removing direct tax disparities, in part because any EU action can be adopted only by

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[2] Henri de Waele, 'The role of the European Court of Justice in the Integration Process: A Contemporary and Normative Assessment (2010) Hansel Law Review Working Paper, <http://www.hanselawreview.org/pdf9/Vol6No01Art01.pdf> accessed 6 April 2012

[3] Ibid, 18

[4] Ibid, 8

[5] Martin Feldstein, 'Effects of Taxes on Economic Behaviour' (2008) 61, National Tax Journal, 131

[6] Agnes Bernassy-Quere, Lionel Fontagne and Amina Lahreche-Revil, 'How does FDI react to corporate taxation' (2004) CEPH <http://www.cepii.fr/anglaisgraph/communications/pdf/2004/161204/lahreche.pps#257,1,How Does FDI React to Corporate Taxation? Old and new results> accessed 12 November 2011

unanimity, creating a "legislative vacuum"[7]. Such a constraint is unlikely to be removed near-term because Member States consider corporate income taxes as one of the last sovereign policy opportunities at their disposal, despite some Member States advocating during the negotiations over the EU Constitution and its successor, Reform Treaties, the introduction of qualified majority voting, hereafter referred to as 'QMV', or more latterly double majority voting, hereafter referred to as DMV, in the tax area[8].

Direct corporate taxation and the laws governing its boundaries remains the sovereign prerogative right of Member States or by DTTs for cross border activities. When exercising their taxing powers, Member States rely on OECD principles which focus on allocating the tax jurisdiction between states and avoid double taxation, without necessarily including the free movement[9] and non-discrimination[10] guarantees embedded within the EU integration process. These guarantees potentially generate much space for misinterpretation. In the context of EU direct taxation, prospective discriminatory action, such as CFC legislation does not constitute discrimination of non-residents as the foreign CFC is not treated less favourably. It is the domestic shareholder that has a potential case for discrimination. The prevention of alleged abuses are achieved via a proportionality test that offers the CJEU a way of mitigating such tax avoidance practices. Interpretive consideration may be given to "imperative reason of public interest[11]" or the "rule of reason"[12].

The EU is mandated to rule on whether a Member State has failed to fulfil its obligations under EU law, and is empowered to bring an action against that Member State before the CJEU. The Commission has used its authority to sue Member States on tax matters in cases

[7] Lilian Faulhaber, 'Sovereignty, Integration and Tax Avoidance in the European Union: Striking the Proper Balance, (2009), Harvard Law School <http://www.law.harvard.edu/faculty/faculty-workshops/new-folder/faulhaber.pdf> accessed 1 May 2011

[8] Institute of Directors, EU Reform Treaty: a guide for IoD members, (2007), EU Policy Comment, <http://www.iod.com/MainWebSite/Resources/Document/policy_paper_EU_reform_treaty.pdf> accessed 22 January 2011

[9] Consolidated version of the European Treaty [2010] arts 28, 49, 43, 56, OJ C83/47

[10] Ibid, art18

[11] Case C-120/78 *Rewe-Zentrale AG v. BundesmonopolverwaltungfürBranntwein* [1979] ECR 649

[12] Cees Peters and Margaret Snellaars, 'Non-discrimination and tax law: structure and comparison of the various non-discriminatory clauses' (2001) 10, EC Tax Review, 13

such as *Avoir Fiscal*[13] and is influential through ruling on tax matters that demand Member States to change their domestic tax laws to the extent that they do not conform to the EU Treaty provisions. The historic context of the role of the Commission has been significant. In the early 1990s the Commission focused on matters relating to general tax practices in relation to the governing and efficiency of the Internal Market. Initial advances were made in reducing tax barriers through the Merger Directive[14], the Parent-Subsidiary Directive[15] and the Arbitration Convention on dispute resolution in TRPRICE[16]. Furthermore, tax competition deemed detrimental to the efficient workings of the tax system was assessed by the OECD Committee on Fiscal Affairs in a report[17] that recommended Council endorsement of the proposed guidelines for restraining such harmful tax practices and formed an institutional body for their effective implementation in Member and non-Member States. Following this the European Council focused on tax competition, the consequences of which led to a Commission report[18] advocating a Code of Conduct on harmful tax competition, tax harmonisation and elimination WHT on group inter-entity payments of interest and royalties. A further report[19] published by the Commission focused on corporate direct tax across the EU and concluded corporate taxation should remain a national matter and only on issues concerning cross-border activity impacting the Internal Market should the Commission attempt to provide direction. Such direction would take the form of targeted measures relating to such instruments as Directives on dividends and mergers[20], cross border loss relief[21] and TRPRICE[22].

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[13] Case C-270/83*Commission v France* [1986] ECR 0273

[14] Council Directive (EU) 2005/19/EC

[15] Council Directive (EU) 1990/435/EC

[16] Council Directive (EU) 1990/436/EC

[17] OECD, 'Progress in Identifying and Eliminating Harmful Tax Practices' (1998) Report to the 2000 Ministerial Council Meeting and recommendations by the Committee.

[18] Commission, 'Towards tax coordination in the European Union – a package to tackle harmful tax competition', COM(97) 495 final

[19] Commission, 'Towards an Internal Market without tax obstacles: a strategy for providing companies with a consolidated corporate tax base for their EU-wide activities', COM(2001) 582

[20] Council Directive (EC) 2011/96/EU

[21] Commission, 'Tax Treatment of Losses in Cross Border Situations' COM(2006) 824

[22] Commission, 'Company Taxation in the Internal Market', COM(2001) 582 final

The role of the CJEU is well established, if not contentious. Diligent control over the interpretation and application of EU law in the context of their enactment by Member State national courts remains a core competence. Disputes arise regularly that witness preliminary ruling requests so that national courts achieve direction on the interpretation or application of the relevant EU law[23]. The resultant EU law from such rulings is legally isomorphic to the EU Treaty itself. CJEU rulings are binding on Member States and their laws must be amended accordingly. Non-compliance with CJEU rulings is a violation of EU law. Beyond Member States, the CJEU also has the authority and validity to provide preliminary rulings on the interpretation of the EU Treaty, on the legitimacy of administrative actions taken by the other EU institutions and central bank, and on the EU law provisions enacted by the council[24].

4.2.2 CJEU Case Law

The corporate tax laws across Member States have historically been formulated in total isolation on the notion that EU law offered a sovereignty exception for income tax legislation. In the *Avoir Fiscal*[25] and *Schumaker*[26] cases, the CJEU asserted its authority in the domain of direct taxation in relation to the judicial oversight of direct taxation laws and their compliance with EU law. Such judicial oversight requires the Court to assess the compatibility of Member State tax laws with EU Fundamental Freedoms, namely the free movement of workers[27], the Freedom of Establishment[28], the free movement of capital[29], and the freedom of services[30].

This chapter will assess the impact of the CJEU rulings within the context of the specific tax avoidance practices outlined in this thesis so far. In doing so an analysis of the judgements and their impact on both national tax laws and on the behaviour of MNEs in response to the

[23] Consolidated version of the Treaty on the European Union [2010] art 267, OJ C83/164

[24] Ibid

[25] Case C-270/83 *Commission v France* [1986] ECR 0273

[26] Case 279/93 *Finanzamt Koln-Alstadt v Schumaker* [1995] ECR I-225

[27] Consolidated version of the European Treaty [2010] art 45, OJ C83/47

[28] Ibid art 49

[29] Ibid art 63

[30] Ibid art 56

judgements and legislative changes is conducted. The principal judgements shaping CFC practices in the EU have largely been based around two key rulings, namely *Vodafone*[31] and *Cadbury Schweppes*[32] (hereafter referred to as *'Cadbury'*). In *Cadbury*, the CJEU held that UK CFC legislation is only valid to the extent that it may be applied within the boundaries of EU law that prohibits MNEs entering into wholly artificial arrangements designed to circumvent national tax laws. Although the CJEU was clear that the decision to establish subsidiaries in Ireland for the sole purpose of leveraging a favourable tax rate did not represent an abuse of the right of establishment[33] it was not, nevertheless, relevant that the Irish tax policy was regarded as harmful under the EU Code of Conduct or that it may represent illegal state aid. State aid has a political dimension and is addressed through separate provisions[34], thus substantiating the view that the *Cadbury* decision to establish subsidiaries in Ireland to benefit from low tax rates was neither an abuse of Fundamental Freedoms nor an abuse of legitimate national tax provisions.

The second part of the judgement concluded that the UK CFC legislation did represent a blatant abuse against the Freedom of Establishment. This was based on the premise that the CFC regime only applied to a UK MNE owning an interest in a MNE that was a CFC under the UK rules and did not apply to circumstances where a UK MNE owned an interest in another UK MNE or in a foreign MNE that was not subject to a low level of taxation that brought it within the CFC legislation. The CJEU held that each Member State had a sovereign right to decide on tax rate levels, but Member States could not treat their resident MNEs differently depending on the tax rate in other Member States where they may establish subsidiaries[35]. The CJEU stated that EU law could not be used by EU nationals improperly to circumvent national legislation, but "profiting from tax advantages available in another

[31] *Vodafone 2 v The Commissioners of Her Majesty's Revenue and Customs* [2008] EWHC 1569, STC 1908

[32] Case C-196/04 *Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I‑7995

[33] Case C-196/04 *Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I‑7995, paras 37-38

[34] Consolidated Version of the Treaty on European Union [2010] art 107, OJ C83/47

[35] Case C-196/04 *Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I‑7995, para 56

Member State could not deprive a person of the right to rely on provisions of the EU Treaty"[36].

Of crucial importance is the *Cadbury* consideration of whether the restriction on the Freedom of Establishment applied with reference to UK CFC legislation could be justified under the EU Treaty as a means to defy tax liabilities. As such, the Court held that a Member State measure restricting the Freedom of Establishment may be justified in circumstances where it relies on wholly artificial arrangements, with the objective of minimising tax regularly due, and where it does not go beyond what is necessary to achieve that purpose[37]. In applying the motive test it concluded that the arrangements did not represent a wholly artificial arrangement. This case crystallises the dilemma facing the CJEU, with pressure to balance the rights of Member States to protect their tax base from manufactured and potentially abusive cross-border transactions with the rights of EU MNEs wishing to conduct their arrangements in the Member State of their choice.

The CJEU ruling has resulted in a legislative enhancement to national procedures across EU Member States. In Germany as a direct consequence of the *Cadbury* ruling, legislation amended CFC rules demanded evidence from MNEs that there is genuine commercial activities[38] and that any such cross-border activities were compliant with the anti-avoidance measures inherent within the Mutual Assistance Directive[39]. Further changes relating to amending the definition of a low tax jurisdiction were enacted, as were rules relating to ownership thresholds and income classifications. In Italy, CFC rules[40] were amended to apply to non-residents residing in a country not listed as a tax haven if the non-resident is subject to an ETR lower than 50% of the Italian rate and more than 50% of the non-resident's income is passive income. Additional effective tax tests are undertaken as are business test relating to source of income, both of which are aimed at avoiding wholly artificial arrangements.

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[36] Ibid paras 35-36

[37] Ibid para 55

[38] Annual Tax Act, 2010 (Germany)

[39] Annual Tax Act, 2013 (Germany)

[40] Tax Code, 2009 (Italy) ss167-168 *(TestoUnicodelleImposte sui Reditti)*

In the case of Germany and Italy, the changes, although complex and procedurally different in nature, were enacted to reflect the spirit of the *Cadbury* ruling by assuming that a MNE with a subsidiary in a low tax jurisdiction is innocent unless proven guilty rather than the other way around. Such a change necessitates a Member State proving a wholly artificial arrangement against a taxpayer rather than assuming it can tax profits with limited purposive testing. The UK spent considerably longer following the *Cadbury* ruling formulating new rules enacted in the Finance Act, 2012[41]. Unlike the direction followed by Germany and Italy, if a taxpayer, under UK rules, falls outside the prescribed exemptions they will need to provide evidence as to why any non-UK subsidiary is exempt from the charge[42].

The facts of the *Vodafone* case are similarly well documented. Vodafone has a subsidiary in Luxembourg and HMRC raised an enquiry into whether it was a CFC, an allegation objected to by Vodafone whom argued that the UK CFC legislation defied EU law and should be dismissed. The principal objection was based around what was believed to be an unlawful restriction on the Freedoms of Establishment and Movement of Capital. The UK court held that it was not possible to interpret the CFC rules in line with the opinions granted by the CJEU in *Cadbury* and suggested that a CFC charge would only arise where there was evidence of artificial arrangements akin to that seen in *Cadbury*.

Prior to changes enacted in response to this *Vodafone 2* judgement in the Finance Act 2012 treaty protection from the UK CFC regime for EU subsidiaries were considered on a case-by-case basis and each subsidiary had to be able to demonstrate that it is a genuine economic establishment and not a wholly artificial arrangement. A subsequent attempt to appeal by Vodafone to the Supreme Court[43] failed on the basis that the regulation under scrutiny had been interpreted by the CJEU in *SGI*[44] that "the correct application of Community law is obvious as to leave no scope for any reasonable doubt"[45]. The UK government acknowledged the material impact and relevance of the *Cadbury* judgement for justifying CFC tax law changes, and has referenced the significance of the *SGI* and *Thin Cap GLO* judgements on

[41] Finance Act (UK) 2012, Schedule 20, part 9a

[42] Ibid, chs 9-14

[43] *Vodafone 2 (Appellant) v Her Majesty's Revenue and Customs* [2010] UKSC 2009/0162

[44] Case C-311/08 *SGI* [2010] ECR I-0000

[45] *Vodafone 2 (Appellant) v Her Majesty's Revenue and Customs* [2010] UKSC 2009/0162

formalising the relevance of justification and proportionality in shaping the CFC legislative text[46].

The principal CJEU judgements shaping Group relief practices have largely been based around the *Marks and Spencer*[47] case outlined in Chapter Two and the *Autologic*[48] case. The former ruled that a MNE group relief system prohibits the use of a parent entity to deduct the losses of its subsidiaries established abroad under any circumstances is incompatible with EU law[49]. The *Autologic* case set out the procedure relating to making cross-border relief claims under EU law[50]. In *Marks and Spencer*, the CJEU held the rules to exhibit discrimination but deemed the provisions justifiable, placing emphasis on the importance of proportionality, concluding that non-compliance would be evidenced when the MNE had "exhausted the possibilities available in its state of residence of having the losses taken into account for the accounting period concerned….for previous accounting periods and that there was no possibility for those losses to be taken into account ….for future periods"[51]. An evaluation of CJEU decisions was made by Lang[52] where he identified a number of concepts that the CJEU were focusing on in these assessments, namely "Comparable Situation[53]", "Grounds of Justification[54]" such as fiscal cohesion, and "Proportionality[55]" in light of transferring the burden of proof[56], risk of tax avoidance[57] and less restrictive measures[58]. Comparability has become an important criterion for the CJEU in assessing compliance with rights associated

[46] UK Treasury, Consultation on Controlled Foreign Companies reform (2011) <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81304/consult_cfc_detailed_proposals.pdf> accessed 12 January 2013

[47] Case C-446/03 *Marks and Spencer v Halsey (HM Inspector of Taxes)* [2005] ECR I-10837

[48] *Autologic v IRC* [2005] UKHL para 54

[49] Ibid, para 56

[50] *Autologic v IRC* [2005] UKHL para 54

[51] Case C-446/03 *Marks and Spencer v Halsey (HM Inspector of Taxes)* [2005] ECR I-10837 para 59

[52] Michael Lang, 'Direct Taxation: Is the CJEU Heading in a New Direction?' (2006) 46, European Taxation, 421

[53] Ibid

[54] Ibid, 424

[55] Ibid, 427

[56] Ibid, 429

[57] Case C-446/03 *Marks and Spencer v Halsey (HM Inspector of Taxes)* [2005] ECR I-10837 para 43

[58] Michael Lang, 'Direct Taxation: Is the ECJ Heading in a New Direction?' (2006) 46, European Taxation, 427

with Fundamental Freedoms, stating that “not only must comparable situations be treated alike, but different situations must also be treated differently”[59]. Common terminology is beginning to pervade many CJEU rulings with respect to possible grounds of justification, namely the requirement to counter tax avoidance or the risk of tax avoidance[60].

The CJEU has taken a proactive approach to resolving other group relief cases, notably *Autologic*[61] which provided guidance on the procedure to be followed in making cross-border group relief claims under EU law. Representing a multitude of group structures, this case promoted consideration of various categories of consequential claims centred on the denial of relief in contravention of the Freedom of Establishment that the refusal of group relief[62]. The CJEU has provided a number of other less high profile rulings relating to the subject of cross-border losses. In *Futura*[63] the CJEU held that a source state may tax non-residents solely on income from domestic sources only in circumstances where resident taxpayers do not receive preferable treatment. It held that “The Court has repeatedly held that the effectiveness of fiscal supervision constitutes an overriding requirement of general interest capable of justifying a restriction …“[64]. In *Bosal Holding*[65] the CJEU, not unsurprisingly, held that a Netherlands provision that allowed gross interest incurred by a parent entity associated with the participation only to be deducted by the parent entity if the subsidiary had taxable profits in the Netherlands impeded the Freedom of Establishment. In *Oy AA*[66] the CJEU upheld Finnish tax law that permits the deduction of taxes relating to financial transfers within the same group on the basis that the two MNEs in question are established in Finland. It is justified by virtue of the provisions on Freedom of Establishment, particularly with reference

[59] Ibid, 422

[60] Case C-264/96, *Imperial Chemical Industries plc v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)* [1998] ECR I-4695; Case C-136/00 *Rolf Dieter Danner* [2002] ECR I-8147; Case C-436/00, *X, Y v. Riksskatteverk* [2002] ECR I-10829; Case C-334/02 *Commission of the European Communities v French Republic* [2004] ECR 0000; Joined cases C-397/98 *Metallgesellschaft Ltd and Others* and C-410/98, *Hoechst AG and Hoechst (UK) Ltd* [2001] ECR I-1727

[61] *Autologic v IRC* [2005] UKHL para 54

[62] Ibid, para 107

[63] Case C-250/95 *Futura* [1997] ECR I-2471

[64] Ibid, para 31

[65] Case C-168/01 *Bosal Holding BV v. Staatssecretaris van Financien* [2003] ECR I-9409

[66] Case C-231/05 *Oy AA* [2007] ECR I-6373

to the objective of not compromising the right of a Member State to exercise competence over tax matters and to prevent tax evasion.

In *Papillon*[67] the CJEU found further breaches of the Freedom of Establishment. The Court examined the French tax consolidation rules, which precluded a French parent entity from forming a group consolidation with multi-tiers of French subsidiaries established in another Member State. However, it was ruled that it could be justified by the need to ensure the coherence of the tax system[68], though that coherence could be achieved by less restrictive measures. In *X Holding BV*[69] the CJEU examined cross-jurisdictional conflicts when it ruled that a Netherlands tax rule that allowed a Netherlands parent to form a group with its domestic subsidiary but not with its Belgian subsidiary was tantamount to discrimination conflicting with the Freedom of Establishment. Emphasis was placed on the principle of proportionality and the need to secure a "balanced allocation of tax jurisdiction"[70].

The principal CJEU judgements relating to THINCAP are *Lankhorst-Hohorst*[71] and *Thin Cap GLO*[72]. The *Lankhorst-Hohorst* case similarly ruled against an MNE on grounds of infringing the Freedom of Establishment. The case found that a German entity had sustained gross interest entries relating to a Netherlands parent entity in excess of the German debt-to-equity ratios. Initial rejection by the German tax authorities was followed up by a broader CJEU ruling on whether the German THINCAP provisions were discriminating against foreign owned MNEs[73] since the rules treated subsidiary MNEs differently according to whether their parent MNEs were located in Germany or elsewhere. It stated that this "constituted an obstacle to the Freedom of Establishment which is, in principle, prohibited by Article 43"[74]. Further examination of whether the German rules formed a legitimate aim as being "justified

[67] Case C-418/07 *Société Papillo v Ministère du Budget, des Comptes publics et de la Fonctionpublique,* [2008] ECR I-8947

[68] Ibid, para 12

[69] Case C-337/08 *X Holding BV v Staatssecretaris van. Financiën* [2009] ECR I-1215

[70] Martin Poulson, 'Freedom of Establishment and the Balanced Allocation of Tax Jurisdiction' (2012) 40, Intertax, 3, 200

[71] Case C-324/00 *Lankhorst-Hohorst* [2002] ECR I-11779

[72] Case C-524/04 *Test Claimants in the Thin Cap Group Litigation v Commissioners* [2007] ECR I-02107

[73] Case C-324/00 *Lankhorst-Hohors*t [2002] ECR I-11779, para 21

[74] Ibid, para 32

by pressing reasons of public interest[75]", found that the rules could not be justified on the basis that they combated tax avoidance through THINCAP. The case was important for this research as it addressed the question of a national versus EU perspective on taxation. Andersson[76] stated that "CFC rules are perhaps the most extreme version of a nationalistic approach to taxation"[77] and it will be interesting to see in future whether the principles applied in a case relating to one tax avoidance practice may be applied to the others. The *Lankhorst-Hohorst* case reiterates the underlying ethos in EU law that a Member State tax system has to be formed in full accordance with EU law and consistent with the approach adopted by other Member States to ensure an efficient Internal Market.

A conclusion is drawn in relation to the rulings associated with many of the aforementioned cases that Member States have primarily been trying to counteract tax avoidance directly rather than on focusing strategic changes to the EU corporate direct tax system. The CJEU passes judgement on specific cases but, despite its constant cross-referencing to previous case law, rarely makes reference to how a judgment could be used as a basis for contributing towards a particular body of emerging case law to form a robust framework for Member States to enact legislative change. Over time, the Court may experiment with a more proactive direction aimed at achieving advances in Member State tax systems that supports the Internal Market more effectively. All of the aforementioned cases illustrate that there is a quantum of tax case law that has been developed over the last twenty years that forms an EU legal order provides strong direction to Member States. It may be concluded that the approach the CJEU has taken to reflect the conflicting tri-partite pressures to safeguard Member State sovereignty, promoting the protection of Fundamental Freedoms and advancing the EU mandate in direct tax matters to nurture the Internal Market. A broad cyclical pattern was identified by Terra and Wattel[78]who suggested the CJEU was reluctant to apply EU law in the 1980's only to see the period from early 1990s until 2005 evidencing a more proactive stance for applying internal market principles in the direct tax area. Since 2005 the Court seems to have returned to a more prudent phase, exemplified by cases such as

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75 Ibid, para 33

76 Krister Andersson, 'On the way to or Away from a European Tax Union (ETU)? (2010), The Swedish Network for European Studies, <http://www.snee.org/filer/papers/167.pdf> accessed 29 November 2010

77 Ibid, 8

78 Ben Terra and Peter Wattel, *European Tax Law*, 6 edn, (Kluwer, Netherlands, 2012)

D. v. Inspecteur case[79], *ACT Group Litigation*[80] and *FII Group Litigation*[81], all of which evidenced a much more measured, reasoned and balanced consideration between the competing national and European power bases.

Although Member States are competent in the direct taxation area, they must exercise that competence in accordance with Community law[82]. This rule endorsed in this *Schumacker* case has been repeatedly emphasised in the textual judgements of subsequent tax decisions such as *Asscher*[83], *Futura*[84], *ICI*[85] *and Compagnie de Saint Gobain*[86]. There is no specific reference that from a direct tax case law perspective, the EU Treaty does not promote a sovereignty exception for corporate income taxation. This implies that the way in which both the home and host Member State tax cross-border income flows between EU subjects must be constitutionally robust and that direct tax measures can be tested on their compatibility with EU law in general and the private sector rights to free movement and non-discrimination in particular. One area of interest relates to exit taxation. In light of the settled direct tax case law on prohibited exit and access restrictions[87], it is clear that any higher taxes imposed on cross border activity as compared to similar domestic activity constitute prohibited discrimination irrespective of whether imposed by the home state on taxpayers who want to be economically active in another Member State, or by the host state on those seeking access to that market. Incorporated into the aforementioned settled cases regarding prohibited exit taxes are cross-references to matters such as the definition of taxable income items, exemptions, deductible expenses, tax rates, tax credits, and tax procedures. The challenge for

[79] Case C-376/03 *D v. Inspecteur van de Belastingdienst* [2005] ECR I- 5821

[80] Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue* [2006] ECR I-11673

[81] Case C-446/04 *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue* [2006] ECR I-11753

[82] Case C-279/93 *Finanzamt Koln-Altstadt v Schumacker* [1995] ECR 1-225

[83] Case C-107/94 *Asscher* [1996] ECR I-3089, para 36

[84] Case C-250/95 *Futura* [1997] ECR 1-2471, para 19

[85] Case C-264/96 *ICI v Colmer* [1998] ECR I-4645, para 19

[86] Case C-307/97 *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt* [1999] ECR I-6161, para 57

[87] Case C-470/04, *N v Inspecteur van de BelastingdienstOost/kantoor Almelo* [2006] ECR I-7409; Case C-208/00, *Überseering BV v Nordic Construction Company Baumanagement GmbH* [2002] ECR I-9919; Case C-415/93, *Belge des Societes de Football ASBL v Jean-Marc Bosman* [1995] ECR I-4921

the CJEU is to remain consistent in how it uses taxation parameters into its decisions relating to different national taxation rules.

Researchers such as Isenbaert[88] broadly justify the role of the CJEU in direct taxation matters while others such as Prats[89] argue that the CJEU has gone beyond its constitutional role and a new process of reviewing taxation matters needs to be established. Azoulai[90] placed emphasis on political activism by interest groups such as The Bruges Group[91] who focus on the view that the CJEU is attempting to re-organise the tax base of Member States at the same time as attempting to remove their taxing authority. The notion that the CJEU can actually currently take away taxing powers[92] is not deemed to be a defendable argument. The complexity associated with differentiating between taxing powers specific to Member State sovereign rights with the ability to supervise all aspects of Member State tax rules which is a power granted to the EU as well as Member States is further compounded by the authority provided to the CJEU to assess and rule on the legal constitutionality on their legislative enactment by Member States. In this sense, the CJEU is not regulating the taxing powers of the Member States or initiating EU tax legislation. The point of contention arises when the CJEU treads across the boundaries of ruling on matters relating to protecting the internal market against the taxing sovereignty of the Member States. The proposition in some CJEU cases that there should be an agreeable equilibrium between the protecting the parameters of the Internal Market with the taxing revenues of the Member States has been deemed impractical[93] and conflicts with other cases that state that preventing of revenues could not be considered as a

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[88] Mathieu Isenbaert, *EU law and Sovereignty of the Member States in Direct Taxation*, 1st edn (The Netherlands, IBFD, 2010), 81

[89] Alfredo Garcia Prats, 'EU law and Direct Taxation: Towards a Coherent System of Taxation?' (2007) Universitat de Valencia Working Paper <http://www.eatlp.org/uploads/public/Garcia%20Prats%20Helsinki%2007.pdf> accessed 12 January 2012

[90] Loci Azoulai, 'The 'retained powers' formula in the case law of the European Court of Justice: EU law as total law? (2011) 2, European Journal of Legal Studies, 4, 194

[91] Robert Oulds, 'The Marks and Spencer Case: EU forces changes to British tax law' [2005] The Bruges Group < http://www.brugesgroup.com/eu/the-marks-and-spencer-case-eu-forces-changes-to-british-tax-law.htm?xp=media> accessed 3 January 2012

[92] Koen Lenaerts, 'Federalism and the Rule of Law: Perspectives from the European Court of Justice' (2010) 33, Fordham International Law Journal 1338; Koen Lenaerts, 'Constitutionalism and the many faces of federalism' (1990) 38, American Journal of Comparative Law 205, 220

[93] Case C-101/05, *Skatteverket v A*, [2007] ECR I-11531

bona fide reason justifying discrimination[94]. Unconstitutional behaviour can never be justified by the argument that complying with the law would be too expensive, particularly as the Member States have all the domestic and EC regulatory powers at their disposal to ensure that income tax legislation and tax treaties comply with EU law.

One criticism lodged against the CJEU is that the Court's rulings on direct tax case law are inconsistent[95] although this may be considered "inevitable for any supreme court that decides on a casuistic basis"[96] to maintain an internal market in which the equipoise forces of CIN and CEN need to prevail. The CJEU, however, does not rule directly on CIN and CEN in its income tax case law, instead more generally focusing on tax neutrality through ensuring the tax rules of one Member State do not discriminate against cross-jurisdiction transactions compared to domestic transactions. Other academic criticism of the CJEU has focused on its case law being unintelligibly complex[97]. Hellerstein et al criticised CJEU case law as being "woefully complex"[98]. In terms of the impact on Member States and their reactions to CJEU rulings a mixed set of responses are evident in terms of legislative responses. For example, in the *Daily Mail*[99] and *Werner*[100] cases, the CJEU has demonstrated a propensity to implement checks on Member State adoption of rulings even though these have often been shrouded in ambiguity in relation to previous case law ruling. The remit of the CJEU has similarly attracted criticism, as exemplified in the *Thin Cap Test Claimants* case[101], which supported limiting access to non-EU MNEs to EU legal benefits. Furthermore, the CJEU has, according to Van Thiel, limited itself to investigating whether "contested tax measures constitute discrimination….and has [therefore] consistently avoided applying an MFN view of the EU

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94 Case C-168/01, *Bosal Holding BV v Staatssecretaris van Financiën*, 2003 ECR I-9409

95 Michael Graetz, 'Dividend Taxation in Europe: When the ECJ Makes Tax Policy [2007] 44, Common Market Law Review, 1577

96 Servaas Van Thiel, 'Symposium on corporate tax policy in the European Union: the direct income tax case law of the European Court of Justice: past trends and future developments' (2008) 62, Tax Law Review, 143

97 Ibid

98 Walter Hellerstein, Georg Kofler and Ruth Mason 'Constitutional Restraints on Corporate Tax Integration' 62, (2008) Tax Law Review, 1, 14,<http://ssrn.com/abstract=1101560> accessed 19 January 2012

99 Case C-81/87 *The Queen v H M Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and. General Trust Plc* [1988] ECR 1-5483

100 Case C-112/91 *Werner v Finanzamt Aachen-Innenstadt* [1993] ECR 1-429

101 Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR 1- 2107

Treaty in its corporate income tax case law, therefore effectively placing tax treaties above the law"[102].

In order to assess the specific impact of the CJEU in relation to specific tax avoidance practices this research examines the case law precedents pertinent to key corporate tax avoidance practices in respect to the way in which Member States allocate tax jurisdiction between them by means of tax treaties. Leading cases such as *Gilly*[103] exemplify how the Court has been mindful not to go too far. In particular in its approach to tax treaties, decisions in cases such as '*D*'[104] demonstrate how the court, without any logical reasoning, appears to be replacing its traditional individual rights-based perspective with a broad acceptance of what Member States may wish to agree bilaterally. This seems to suggest that the CJEU is nurturing an unhealthy precedent in advocating disrespect for the basic concepts in EU law and potential distortions to the internal market. Other notable cases relating to the impact of EU law on DTT's between two Member States are *Amid*[105], *Commerzbank*[106], *Halliburton*[107], *ACT Group Litigation*[108] and *Elisa S.A*[109].

Further Freedom abuses have been investigated by the CJEU. In *Avoir Fiscal*[110] it was held that French tax law denying French entities of foreign company credits available to French MNEs[111], as well as the offsetting tax advantages to non-residents were deemed discriminatory[112]. There is evidence of other cases relating to the free movement of capital

[102] Servaas Van Thiel, 'Symposium on corporate tax policy in the European Union: the direct income tax case law of the European Court of Justice: past trends and future developments' (2008) 62, Tax Law Review, 190

[103] Case C-336-96 *Gilly v. Directeur des Services Fiscaux du Bas-Rhin* [1998] ECR 1-2793

[104] Case 376/03 *D v Inspecteur van de Belastingdienst/Particulieren/Ondernemingenbuitenlandte Heerlen* [2005] ECR I-5821

[105] Case C-141/99 *AMID v. Belgium* [2000] ECR I-11619

[106] Case C-330/91 *The Queen v. Inland. Revenue Commissioners, exp Commerzbank AG* [1993] ECR 1-4017

[107] Case C-1/93 *Halliburton Services BV vStaatssecretaris van Financiën* [1994] ECR I-1137

[108] Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation (BMW) v Commissioners of Inland Revenue* [2006] ECR I-11673

[109] Case C-451/05 *Societe Elisa* [2007] ECR 1-0000

[110] Case C-270/83 *Commission v. France (Avoir Fiscal)* [1986] ECR 273

[111] Ibid paras 27-28

[112] Ibid para 22

notably *Holböck*[113] and *OJ*[114]. Similarly there have been CJEU cases relating to establishment of commercial operations in the context of freedom of primary establishment notably *Daily Mail*[115], *Centros*[116], *Überseering BV*[117] and *Inspire Art Ltd*[118]. CJEU cases relating to freedom of secondary establishment include *Commerzbank*[119], *Halliburton*[120], *ICI*[121], *Amid*[122], *Baars*[123], *Keller Holding*[124] and *CLT-UFA S.A*[125].

The CJEU has repeatedly ruled[126], with reference to the Treaty freedoms, that the Member States should comply with EU law and accordingly adapt their laws. Experience shows that the Member States do not volunteer to take actions themselves, preferring to defer changes, and justify their approach by arguing that even if a breach of EU law was evidenced it should be allowed on grounds of general interest, such as "fiscal coherence" [127], "effectiveness of fiscal supervision"[128] and the "prevention of tax avoidance"[129] The general lag between CJEU rulings and national legislative change may, on occasion, be attributable to the lengthy legislative change process, but probably also due to an unhealthy apathy regarding some rulings.

[113] Case C-157/05 *Holböck* [2007] ECR I-4051

[114] Case C-143/26 *Official Journal of the European Union* [2005]

[115] Case C-81/87 *Daily Mail and General Trust PLC* [1988] ECR 5483

[116] Case C-212/97 *Centros* [1999] ECR 1-1459

[117] Case C-208/00 *Überseering* [2002] ECR I-9919

[118] Case C-167/01 *Inspire Art* [2003] ECR I-10155

[119] Case C-330/91*Commerzbank* [1993] ECR I-4017

[120] Case C-1/93 *Halliburton Services BV vStaatssecretaris van Financiën* [1994] ECR I-1137

[121] Case C-264/96 *ICI v Colmer* [1998] I-4695

[122] Case C-141/99 *AMID v. Belgium* [2000] ECR I-11619

[123] Case C-251/98 *Baars* [2000] ECR 1-2787

[124] Case C-471/04 *Keller Holding* [2006] ECRI-2107

[125] Case C-253/03 *CLT-UFA SA* [2006] ECR 1-1831

[126] Case C-279/93 *Schumacher* [1995] ECR I-225, para 21; Case C-264/96 *ICI* v *Colmer* [1998] ECR I-4695, para 19; Case C-35/98 *Staatssecretaris van Financiën* v *Verkooijen* [2000] ECR I-4071 para 32

[127] Case C-296/12 *Commission v Belgium* [2014] para 4

[128] Case C-120/78 *Rewe-Zentral* [1979] ECR 649, para 8

[129] Case C-196/04 *Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I‑7995, para 55

The CJEU has provided a number of rulings relating to the subject of dividend taxation. In *Lenz*[130] the CJEU ruled that the principle of cohesion could not be a justification for discriminatory taxation of dividends, as this principle is to be applied on a bespoke basis dependant on the level of the shareholder or the distributing company. This principle was held in this case irrespective of the circumstances whereby the distributing entity was resident in another Member State in which the corporate tax rate is lower compared to the home state. In *Manninen*[131] the CJEU upheld Treaty provisions establishing the right of the EU to preclude provisions whereby the right to a tax credit was excluded unless dividends were paid by a MNE incorporated in the same Member State as the beneficiary. In *ACT* the CJEU made a judgement on dividend relief, noting that if domestic dividends were "subject to an exemption system and non-domestic dividends were subject to the imputation system then there was no inherent conflict with the Freedom of Establishment and the free movement of capital" [132]. This distinction, however, was subject to two caveats, namely that the tax rate applied to non-domestic dividends should not be higher than the rate associated with domestic dividends, and the tax credit should be at least equal to the amount paid in the Member State of the entity making the distribution, up to the limit of the tax charged in the Member State of the company receiving the dividends[133]. Other notable CJEU cases relating to discriminatory taxation of dividend issues are *Baars*[134], *X and Y*[135], *Verkooijen*[136], *De Baeck*[137], *Bouanich*[138], *Denkavit*[139] and *Manninen*[140]in that they all ruled on how Member State tax laws infringed the free movement of capital.

[130] Case C-315/02 *Lenz* [2004] ECR I-7063

[131] Case C-319/02 *Manninen* [2004] ECR I-7477

[132] Case C-374/04 *Test Claimants in Class IV of the ACT* [2006] ECR I- 11673

[133] Ibid para 74

[134] Case C-251/98 *C. Baars v. Inspecteur der Belastingen* [2000] ECR I-2805

[135] Case C-200/98 *X AB, Y AB v. Riksskatteverket* [1999] ECR I-8261

[136] Case C-35/98 *Staatssecretaris van Financiën v Verkooijen* [2000] ECR I-4071

[137] Case C-268/03 *De Baeck v BelgischeStaat* [2004] ECR I-8.6.2004

[138] Case C-265/04 *Bouanich* [2006] ECR I-923

[139] Case C-170/05 *Denkavit v Ministre de l'Économie, des Finances et de l'Industrie*, 2006 ECR, I-11949

[140] Case C-319/02 *Manninen* [2004] ECR I-7477

In *Amurta*[141] the CJEU held that the differing Netherlands tax rules relating to the dividend WHT exemption in domestic and non-domestic circumstances was not consistent with the Freedom of Capital. This infringement could be justified only if it can be demonstrated that the provisions of an applicable tax treaty neutralize the taxation of dividends in the country of the recipient[142]. In *Netherlands*[143] the CJEU ruled that the Netherlands exemption for dividend WHT is contrary to EU Treaty provisions, and in *Italy*[144] the CJEU ruled that Italy's discriminatory tax treatment of dividends violated EU law and the EEA Agreement, but that the treatment was justified in the case of the EEA. In *Spain*[145] the CJEU held that Spain's rules on an exemption from WHT on dividend distributions, rules requiring non-resident MNEs to have a higher shareholding threshold than that imposed on resident MNEs to achieve tax relief on dividends, fail to satisfy Spain's obligations under Article 56 of the EU Treaty.

The CJEU has also provided a number of rulings relating to the subject of withholding taxes, hereafter referred to as WHT, and net taxation of services. In *Epson*[146] the CJEU ruled in favour of levying a WHT on profits distributed to parent MNEs in other Member States for a certain time period. In *Gerritse*[147] the CJEU ruled that tax deductions for costs should be consistent between resident and non-resident taxpayers. In *Scorpio Centro Equestre*[148] the CJEU decided that the Freedom to Provide Services does not impede a Member State tax provision that allows the deduction of expenses to be perpetrated by a non-resident entity as these expenses are directly linked to the income generated by those MNEs activities in Germany. The condition for deduction that such expenses must exceed half of that income is deemed as an unjustified restriction of that freedom.

[141] Case C-379/05 *Amurta*, [2007] ECR I-9569

[142] Ibid, para 84

[143] Case C-521/07 *Commission v Netherlands* [2009] ECR I- 0000

[144] Case C-540/07 *Commission v Italy* [2009] ECR I-0000

[145] Case C-487/08 *Commission v Spain* [2009] ECR I-2009

[146] Case C-375/98 *Epson Europe* [2000] ECR I-4243

[147] Case C-234/01 *Arnoud Gerritse v. FinanzamtNeukölln-Nord* [2003] ECR 1-5933

[148] Case C-345/04 *Centro Equestre da Leziria Grande Lda* [2007] ECR 1-1425

The CJEU has also provided a number of rulings relating to the subject of WHT on interest and interest deductibility. In *Truck Center*[149] the CJEU ruled that EU Fundamental Freedoms do not preclude a national WHT on interest payments towards non-resident MNEs, while exempting from that WHT interest payments towards resident MNEs, the income of which is taxed in the corporate income tax of those Belgian beneficiaries. In *Portugal*[150] the CJEU ruled against national WHT provisions that differentiated treatment relating to interest relief between non-resident and resident financial institutions. In relation to abuse of rights, in *Kofoed*[151] the CJEU held that it is not possible to rely on Danish legislation containing provisions prohibiting against abuse of rights or related tax avoidance practices if it conflicted with the provisions of the Mergers Directive[152]. In *Cartesio*[153] the CJEU concluded that without a common legal understanding regarding the terms upon which a MNE may benefit from exercising the Freedom of Establishment, it was a matter of national law to define which MNEs might rely upon the Freedom of Establishment in Article 43.

There have been some unusual CJEU cases in relation to the duty of the authorities to review decisions that turn out to rest on an interpretation of EU law, which has later been rejected by the CJEU. Examples of such cases are *Larsy*[154] and *Kühne & Heitz*[155]. Cases relating to claiming recompense for punitive taxes served for violating EU law include *Edis*[156] and *Weber's Wine World*[157]. Such cases provide a disruptive taxation environment for MNEs, reflecting an unsettled position in certain taxation matters between the CJEU rulings and its implementation at Member State level. Whether this uncertain environment caused by CJEU decision reversal serves as a general deterrent to MNE tax planning or a mere specific irritation in certain circumstances is difficult to ascertain.

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[149] Case C-282/07*Belgian State v Truck Center SA* [2008] ECR I-10767

[150] Case C-105/08 *Commission of the European Communities v. Portuguese Republic* [2010] ECR I-1609

[151] Case C-321/05 *Kofoed* [2007] ECR I-5795

[152] Council Directive (EC) 2005/56/EC

[153] Case C-210/06 *Cartesio Oktatóés Szolgáltatóbt* [2008] ECR I-9641

[154] Case C-118/00 *Larsy* [2001] ECR I-5063

[155] Case C-453/00 *Kühne & Heitz* [2004] ECR I-837

[156] Case C-231/96 *Edis* [1998] ECR 1- 4951

[157] Case C-147/01 *Weber's Wine World* [2003] ECR I-11365

The Court has acknowledged Member States' traditional approaches toward tax avoidance and towards their own preferences as to how to "shape inter-jurisdictional equity"[158]. This has effectively been developed through the aforementioned exceptions adopted in case law. An informal anti-avoidance doctrine now exists that allows Member States, on a case by case basis, to deny EC benefits to taxpayers who try to use "wholly artificial constructions"[159] without "economic link"[160] or "economic reality"[161] to obtain undue tax advantages, an approach that is broadly parallel to the basic anti-avoidance rules in all Member States. In doing so it has abandoned its own more principled decision based on justifications explicitly stated in the Treaty, evolving an approach whereby a European anti-avoidance concept has emerged that serves as a tool that may be enacted by Member States local courts without unduly burdening the internal market.

4.2.3 The Impact of CJEU Case Law

Two different views prevail on the impact the CJEU has had on direct taxation law. One view, represented by Mohamed[162], states there has been little material progress being made in adopting the EU tax harmonisation despite the empowerment for EC initiatives to advance "the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment and functioning of the common market"[163], an important element for ensuring the lawful legitimacy of Commission based directives relating to direct taxation. Conversely, a view promoted by Cseres[164], is that because the Member

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[158] Case C-307/97 *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt* [1999] ECR I-6161

[159] Servaas Van Thiel, 'Justifications in Community Law for Income Tax Restrictions on Free Movement: Acte Clair Rules That Can Be Readily Applied by National Courts' in *The Acte Clair in EC Direct Tax Law*, Ricardo da Palma Borges (IBFD, Amsterdam, 2008)

[160] Case C-341/04 *Eurofood IFSC* [2006] ECR I-0000, para 68

[161] Case C-196/04 *Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I‑7995, para 55

[162] Sideek Mohamed, 'Legislative Initiative in the Field of Direct Taxation in the EC (2003) 45 Scandinavian Studies in Law, 249

[163] Commission, 'Consolidated version of the Treaty on the Functioning of the European Union/Title VII: Common Rules on Competition, Taxation and Approximation of Laws' (2009), art 115

[164] Kati Cesares, 'Comparing Laws in the Enforcement of EU and National Competition Laws' [2010] 3, 1, European Journal of Legal Studies, 7

States affected by CJEU rulings have to incorporate the ruling in its legislation and all other Member States with similar provisions must check and, if necessary, adapt their legislation, the CJEU could be viewed as a champion of harmonisation. In this respect, the Commission has nurtured this through providing counsel to Member States on how to incorporate CJEU case law into their domestic tax laws[165].

The CJEU has evidenced consideration of 'proportionality', a principle grounded on the assumption that tax avoidance laws must consider the balance of different interests commensurate with the purpose of the legislation. It would be both inequitable and unworkable in an Internal Market for Member State tax authorities to be granted unlimited rights in resolving tax issues even though their tax base is within their sovereign jurisdiction. Public law cannot be compromised through unbalanced judgements that compromise the relationship between Member States and their tax subjects. In this sense MNEs require an element of certainty protecting them from excessive scrutiny. Judicial reasoning has correlated proportionality with other principles through case law, notably the construction of wholly artificial arrangements[166], the need for fiscal supervision[167], and fiscal coherence[168]. Some justifications have been rejected in the past. For example, a loss of tax revenue is not deemed an acceptable justification in relation to overarching public interest[169]. Similarly in *Bosal*[170] the CJEU rejected the Netherlands supposition that discriminatory action may be warranted by "erosion of the tax base going beyond mere diminution of tax revenue"[171]. Despite these ambiguities, the principle of proportionality has considerable weight in factual and normative assessments underpinning EU law case law judgements, although more recent case law[172] has placed firmer emphasis on the principle of wholly artificial arrangements.

[165] Commission, 'Co-ordinating Member States' direct tax systems in the Internal Market' COM(2001) 260 final

[166] Case C-264/96 *ICI v Colmer* [1998] ECR I-4645, para 26

[167] Case C-250/95 *Futura* [1997] ECR 1-2471, para 31

[168] Case C-80/94 *Wielockx v Inspecteur der Directe Belastingen* [1995] ECR 1-2493, paras 24-25

[169] Case C-446/03 *Marks and Spencer v Halsey (HM Inspector of Taxes)* [2005] ECR I-10837, paras 44-51

[170] Case C-168/01 *Bosal Holding BV v Staatssecretaris van Financiën* [2003] ECR I-9409

[171] Ibid para 20

[172] Case C- 376/03, *D. v. Rijksbelastingdienst* (NL), [2005] ECR I- 5821; Case C-403/03 *Egon Schempp v Finanzamt München V*. [2005] ECR I-06421; Case C-446/03 *Marks and Spencer v Halsey (HM Inspector of Taxes)* [2005] ECR I-10837; Case C-196/04 *Cadbury Schweppes Ltd v IRC* [2006], STC 1908; Case C-414/06

Proportionality requires that tax avoidance rules measures be “appropriate, necessary, and reasonable”[173]. Initial focus centred on false transactions in VAT cases such as Halifax[174], and then extended to direct corporate taxation such as *Scheuten Solar*[175]. The CJEU has also extended attention to the concept of sham transactions, when legal and economic relationships demonstrate that the principle aim of the transaction is to obtain tax advantages[176]. The responses by EU Member States to sham transactions have differed markedly. Only Germany and Italy have specific legislative provisions whilst France and, and more recently UK, rely more generally on GAAR provisions. In the Netherlands, a dedicated sham doctrine exists that has potential civil law and criminal law consequences. In the first instance, a repentance arrangement may be made in which the company taxpayer corrects the arrangements and tax due once under investigation. If not the Netherlands authorities may raise criminal sanctions under the category of tax evasion[177].

Tax avoidance measures must be rigidly tight for enabling it to meet and deliver against the purpose intended by the legislators but similarly must be accommodating enough to support CJEU scrutiny and interpretation in relation to its compliance with the EU Treaty. Furthermore, such adaptability needs to accommodate Member States periodic amendments to their laws to accommodate the diverse set of tax avoidance transactions enacted by MNEs. Legal integrity requires an established legal construct of EU law and practices and Member States have the best opportunity to shape local laws off clear and unambiguous CJEU case law judgements that relate to a type of behaviour rather than a specific transaction. In practice the CJEU is engaged for passing judgements not only on the permissible legality of Member State legislation in relation to EU Treaty by a MNE in dispute with local tax authorities in that Member State but also by the tax authorities themselves who wish to engage the CJEU in assessing the legality of a MNEs transactions in relation to local Member State tax laws.

Lidl Belgium GmbH & Co KG v Finanzamt Heilbronn [2008] ECR I-3601;Case C-67/08 Block [2009] ECR I-883

173 Tambet Grauberg, ‘Anti-avoidance Measures and Their Compliance with Community Law‘ [2009] 1 Juridica International, 141

174 Case C-255/02 *Halifax and Others* [2006] ECR I-1609 para 69

175 Case C-397/09 *Scheuten Solar Technology GmbH v Finanzamt Gelsenkirchen-Süd* [2011] STC 1622

176 Case C-436/00 *X and Y v. Riksskatteverket* [2002] ECR I-10829, Opinion of Advocate General Mischo

177 General Law State Tax (Netherlands) 2002, s69

Member State tax laws may, to an extent, be shaped around the limits established by the consistent approach taken by the CJEU in reviewing cases presented to them for a ruling. By understanding the assessment process, Member States can test their proposed tax avoidance measures in advance before adopting them in law. Initial analysis by the CJEU establishes a view on whether there is a reasonable possibility of tax avoidance in an arrangement. Once established, the CJEU may initiate a full interpretation of interpreting the MNEs arrangements in the context of applicable tax rules. In *Halifax*[178] the CJEU noted that a national court must set out what is actually meant by substance and the meaning of real transactions[179] before a referral to the CJEU. This approach is consistent irrespective of whether it is a special tax law instrument such as a decree, a general provision such as a GAAR, a tax law, or a civil law measure. In the case of conflicts between tax law and civil law, the Member States have a complex landscape for the CJEU to consider when deciding cases. In Italy, "civil law is the starting point for any assessment, followed by the legal form which prevails over the economic substance"[180]. Legal certainty promotes the prevalence of legal form in Italy implying there are elements of tax law that differ from their meaning in civil law. In France civil law concepts are significant, however in direct corporate income taxation the local courts are willing to look at the goal and purpose of a law in order to justify another meaning of a civil law term in a tax provision with taxpayers relying on a favourable administrative interpretation of tax statutes in contesting a tax matter, even if the interpretation is contrary to law[181]. In Germany, civil law is similarly the starting point of an assessment by local courts unless tax law explicitly or implicitly makes deviation possible. The legal basis of taxation resides with the constitutional provisions guaranteeing a legal basis for any act of administration[182]. The Court and tax administration are, furthermore, obliged to qualify the transaction rightfully.

[178] Case C-255/02, *Halifax plc v C&E Commissioners* [2006] ECR I-1609

[179] Ibid, para 81

[180] Garincha Pattinaja, 'Tax Matters! Limits to tax planning, minimizing taxes and corporate social responsibility' (2009) <http://arno.uvt.nl/show.cgi?fid=106361> accessed 3 August 2013

[181] Frans Vanistandael, 'Legal Framework for Taxation' (1996) 2, Tax Law Design and Drafting, International Monetary Fund, 1, 8

[182] Ibid, 3

One precedent set by the CJEU in many cases[183] in steering Member State behaviour in regard to initiating tax assessments is that tax avoidance rules cannot be applied simply because there is a speculative belief that tax avoidance has occurred or may occur, or there is a desire to restrict a MNE from exercising a tax beneficial arrangement. As a consequence, the CJEU now sets out a path of judicial reasoning with respect to how a Member State can implement its tax avoidance rules. Such reasoning is challenged to be both effective and appropriate for ascertaining the tax obligation, and most significantly, avoid degradation of other legal rights, a doctrine that can be evidenced through all CJEU judgements. One constraint of the CJEU is its lack of authority to force a Member State to introduce new legislation to remedy a breach of a fundamental freedom. It sets out in its judgments whether a tax rule is either compatible or incompatible with a fundamental freedom after which the Member State may change its tax regime to ensure that the particular freedom is not breached. Member States generally have a good track record in updating its legislation in such circumstances. In France, Italy and Netherlands exit tax rules were amended within a year in response to the *National Grid Indus*[184]case. Member State responses in other cases have not been so timely, such as the UK's response to *Cadbury* case[185] in enhancing CFC rules. The CJEU remains sensitive to the charge of usurping the role of national courts so it focuses on laying forth principles that would align a national law to EU law rather than assuming an authoritative corrective role in forcing changes in national law. This leaves scope for ambiguity, and although in some cases the principles laid down by the CJEU are clear, a principle may be defined so vaguely that the national court has little in the way of meaningful guidance.

A number of specific examples may be cited regarding CJEU case law that has widely impacted tax avoidance laws in most EU Member States but not provided an absolute level playing field. For example, in *Cadbury*[186] the resulting ruling in the UK Court has not evidenced CFC legislation enacted in some Member States or consistent adoption in those

[183] Case 270/83 *Commission v France* [1986] ECR 273, para 21; Case C-294/97 *Eurowings Luftverkehr* [1999] ECR I-7447, para 44; Case C-422/01 *Skandia and Ramstedt* [2003] ECR I-6817, para 52; Case C-136/00 *Danner* [2002] ECR I-8147, para 56; *Skandia and Ramstedt*, para 53

[184] Case- C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond* [2012] STC 114

[185] Case C-196/04 *Cadbury Schweppes Overseas Limited v Commissioners of Inland Revenue* [2006] ECR I-7995

[186] Ibid

jurisdictions with CFC rules. Similarly in the area of cross-border dividends, conflicting rulings are evident. In *Staatssecretaris*[187], *Anneliese Lenz*[188]and *Manninen*[189] little was achieved to promote consistency in associated tax rules.

Other examples may be cited regarding CJEU case law that have caused ongoing ambiguity in its interpretation by EU Member States and therefore have remained inconsistent in its application in national legislation. One such specific domain relates to exit charges. An exit charge arises when a MNE seeks to relocate an entity from one Member State jurisdiction to another. Favourable relief relating to unrealised gains is often provided by certain Member States in such situations and as a consequence most jurisdictions have established rules to prevent their abuse. The question of proportionality applies to exit charges, ensuring due balance and consideration is given to the MNE in providing economic justification of the arrangements. Few Member States, notably the UK, provide for such specific proportionality in their exit charge relief rules.

Although the CJEU has granted general favour for exit charges in “the preservation of a reasonable allocation of taxation rights amongst EU Member States although further EU level co-ordination to align national exit tax rules to be compatible with CJEU rulings is required”[190]. The contention has often been raised that such rules introduce a possible infringement to the Freedom of Establishment. In *Lasteyrie du Saillant*[191] and *N*[192] it was held that an exit charge on unrealised gains upon relocation to another Member State was contrary to the principle of Freedom of Establishment. Conversely in *National Grid*[193] it was held that, in relation to Netherlands exit charges that it is not contrary to EU law to charge tax on unrealised gains upon a MNE exiting its country of tax residence but that it is

187 Case C-35/98 *Staatssecretaris van Financiën v Verkooijen* [2000] ECR I-4071

188 Case C-315/02 *Anneliese Lenz v Finanzlandesdirektionfür* [2004] ECR I-7063

189 Case C-319/02 *Manninan* [2004] ECR I-7477

190 Commission, ‘Exit Taxation and the need for co-ordination of Member States’ tax policies’ COM(2006) 825 final

191 CaseC-9/02 *Hughes de Lasteyriedu Saillant v Ministère de l'Économie des Finances et de l'Industrie* [2004] ECR I-02409

192 CaseC-470/04 *N v. Inspecteur van de BelastingdienstOost/kantoor Almelo* [2006] ECR 1-7409

193 Case C-371/10 *National Grid Indus BV v Inspecteur van de Belasting* [2011] ECR 1-0000

disproportionate to require immediate payment of that tax at the time of such exit. There remains no settled case law in this area with national legislative provisions varying widely.

Another example of the CJEU presiding over contradictory rulings is in TRPRICE. In *Lankhorst-Hohorst*[194]the CJEU held that German TRPRICE rules regulating cross-border transactions between related parties were contrary to the principle of Freedom of Establishment. Since these tax regulations were not applied consistently between related German entities, they discriminated against forming an establishment in another Member State. In *Thin Cap GLO*[195], Advocate General Geelhoed suggested that UK pre-*Lankhorst-Hohorst* THINCAP rules were not, in principle, illegal. The CJEU opined that the intention of the legislation was to counter the opportunity for multinational groups to shift taxable profits by financing subsidiary entities with loans between jurisdictions depending on the relative tax rate. In principle, the CJEU considered that this was a perfectly acceptable anti-abuse measure accepting that the arm's-length principle is a bona-fide point for initiating any assessment regarding whether a transaction is abusive.

Further observations may be highlighted. Recent CJEU rulings evidence debate around the extent to which Member States can provide for anti-avoidance legislation without providing clear guidelines on what constitutes the behaviours associated with abusive tax avoidance versus economically justified arrangements. This was demonstrated in *SGI*[196]where the CJEU supported cross-border TRPRICE tax rules if they were more punitive than their domestic equivalents, but only where the legislative provisions specifically referenced and proved abuse through wholly artificial arrangements. It seems difficult to assess precisely whether the Member States' responses to CJEU judgements have contributed to the absolute uniform application of EC tax law in corporate taxation. A review of case law suggests increasingly aggressive and complex claims have tested the boundaries of the case law, and there is now a substantial body of case law that varies in its application regarding legislative outcome. There can be little doubt that a substantial number of corporate tax rules that had until recently been accepted by MNE taxpayers are liable to be impacted by the Fundamental Freedoms, particularly in relation to discrimination against inward-facing investment by non-residents,

[194] Case C-324/00 *Lankhorst-Hohorst GmbH v FinanzamtSteinfurt* [2002] ECR I-11779

[195] Case C-524/04 *Test Claimants in the Thin Cap Group Litigation v Commissioners* [2007] ECR I-02107

[196] Case C-311/08 *Société de GestionIndustrielle v Étatbelge* [2010] ECR I-0000

or obstacles hindering outward-facing investment activities of residents. A good number of the aforementioned cases suggest that the CJEU remains willing to consider a Member State's needs for fiscal supervision and look beyond the issue of discrimination to broader policy issues perhaps reflecting a discomfort within the CJEU regarding the reach of its decisions in international tax policy. The case-by-case assessment does little to promote the certainty required by Member States and MNE taxpayers, and what remains surprising is that whenever a judgement is made against a Member State's laws it rarely suggests an alternative solution.

The CJEU recognises that some restrictions are directly attributable to the presence of differing Member State tax systems, which are outside the competence of EU law. This is particularly relevant for matters relating to tax rate differentials and restrictions relating to allocation of taxing rights. These are best addressed by EU legislation and not by judicial intervention. In this sense, the CJEU's jurisdiction is well established and well placed to play a central role in the support for any future reforms, notwithstanding the ongoing conflict between Fundamental Freedoms and national tax sovereignty that infers a far from settled landscape.

4.3 The Role of Non-Judicial Institutions and Behaviours in Tackling Tax Avoidance

4.3.1 MNEs

A number of recent studies[197] have articulated the way in which efforts by MNEs to understand and manage tax risk can increase shareholder value and it is for this reason that MNEs go to strenuous efforts to re-arrange their tax affairs in the most optimal manner consistent with enhancing profitability. The primary goal of any MNE is to maximise return on capital and therefore MNE officers cannot dismiss the impact of taxes and tax planning. A

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[197] David Williams, 'Tax and Corporate Social Responsibility', (2007) KPMG Tax Business School Working Paper, <http://www.kpmg.co.uk/pubs/Tax_and_CSR_Final.pdf> accessed 14 May 2012; Henderson Global Investors, 'Responsible Tax' (2005), Henderson, <http://www.henderson.com/global_includes/pdf/corporate_governance/ResponsibleTax.pdf> accessed 12 March 2012

KPMG report[198] found that 72% of all MNE respondents in a survey considered reducing corporate tax as a key driver to increasing the value of a MNE. Despite public anger regarding such activities, investors rarely seem to generate similar agitation regarding MNEs tax planning approach, perhaps focusing more on stable financial returns than tax risk. This is even more surprising when one considers the strong interrelationship between the success of a MNE and its reputation. Paying corporate taxes on a source basis relating to the Member State within which it operates is considered to be part of corporate social responsibility. It is only once a MNE suffers public reputational damage or legal challenges that raise the issue's importance to shareholder attention. The Henderson report[199] considered corporate tax matters as the principal risk and uncertainties facing MNEs and has the potential to affect a MNEs future development, performance and position.

A moderation or, at best, elimination of tax avoidance activities to meet local and EU rules is generally accepted to give desirable social consequences, but if a MNE has a desire to go beyond compliance, it has to temper this with responsibilities to its shareholders, employees and customers. A MNE will typically always take compliance with the law as its starting point, and then build out a managerial case for whether they wish to reach out beyond the spirit of the law by developing its own code of tax planning conduct. Research by Slemrod[200] found that managerial styles are an important factor influencing levels of tax compliance. A broad range of managerial attitudes relating to subjects such as social responsibilities to personal tax avoidance all impacts the extent to which a senior manager directs tax planning within his MNE.

The economic psychology of how managers within MNEs decide whether to comply with tax regulations or whether to attempt to reduce their tax liability has been the subject of much research notably by Fischer, Wartick and Mark[201], Andreoni, Erard and Feinstein[202], Kirchler,

[198] Ibid

[199] Ibid

[200] Joel Slemrod, *The crisis in Tax Administration*, (Brookings Institute, Washington DC, 2004)

[201] Carol Fischer, Martha Wartick and Melvin Mark, 'Detection probability and taxpayer compliance: A review of the literature' (1992) 11, Journal of Accounting Literature, 1,1

[202] James Andreoni, Brian Erard, Jonathan Feinstein. 'Tax compliance' (1998) 36, 2 Journal of Economic Literature, 818

Holzl and Wahl[203] and Wenzel[204]. The conclusions of this research would provide a useful input for tax authorities to better understand corporate behaviours and would establish a more robust plan for ensuring that the relationship between corporate taxpayers and tax authorities nurtures the maximum voluntary compliance possible. Of note is the absence of any clear academic steer towards how these economic psychological assessments have impacted corporation behaviours to other corporate taxes and the extent to which managers think that it is appropriate to attempt to avoid these taxes. Similarly there appears to be little research on MNE decision paths to avoiding tax, most of which remains veiled in secrecy within large MNEs. The impact of corporate tax avoidance behaviour from a tax authority's approach, be it financial deterrence or persuasion, is also unclear across European jurisdictions, and whether a MNE reacts more positive to a legislative directive as opposed to a non-statutory directive also demands further research.

Continued judicial reference to legal vagary such as the 'boundaries of law'[205], and the 'spirit of the law'[206] remain problematic. Various stakeholders including most importantly the MNE taxpayer raise issues regarding their meaning, and it is of little assistance from a law perspective to assess corporate behaviours based on these ambiguous phrases. These vagaries are exposed well when one considers the way in which Freedman[207] identified tax-planning behaviour who proposed that MNEs might be judged to exhibit elements of behavioural risk as well as structural risk. The former relating to how a MNE uses the spirit of the law to defend actions and the latter relating to defence of actions based on best practice corporate governance and transparency. In this way, structural risk refers to a more institutionalised way of managing activities that have a positive tax outcome for the MNE that is well established and this should be distinguished from the more short-term decision making behaviours typically associated with abusive tax planning.

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[203] Erich Kirchler, Erik Hölzl Ingrid Wahl, 'Enforced versus voluntary tax compliance: The "slippery slope" framework' (2008) 29, Journal of Economic Psychology, 2, 210

[204] Michael Wenzel, ' An analysis of norm processes in tax compliance' (2004) 25, Journal of Economic Psychology, 2, 213

[205] Case 26/52 *Van Gend en Loos v Nederlandse Administratie der Belastingen* [1963], II, B

[206] *Barclays Mercantile Business Finance Limited v Mawson* [2004] UKHL 51

[207] Judith Freedman et al, 'Moving Beyond Avoidance' [2007] Oxford University Centre for Business Taxation, Report of a Preliminary Survey, 21

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4.3.2 National Tax Authorities

Member State tax authorities play a pivotal role in the exercise of identifying, investigating and punishing MNEs who abuse tax avoidance practices. They conduct their activities within the specific remit of the local legislature and are frequently party to local court judgements associated with cases that evidence attempted exploitation of tax avoidance loopholes. These local rulings may or may not reflect the outcomes of CJEU judgements.

The tax authorities have increasingly been subject to debates about their role in shaping corporate tax avoidance law through their influence in promoting cases for review by both local and CJEU judicial channels. The complex landscape demands consideration of the behavioural drivers of not only tax authorities but also the taxpayer response too. As such, if the views of society as to what is acceptable behaviour in the field of corporate tax are changing corporate taxpayers in particular may need to consider their actions more carefully in order to avoid the risk to their reputations and the risk of increased tax authority focus. The tax authorities similarly too need to consider their actions and policies carefully in light of the impact these can have on voluntary compliance.

One criticism levelled at Member State tax authorities is the limited amount of bi-lateral co-operation between themselves in the mitigation of tax avoidance practices. The absence of a common and established multilateral exchange of tax intelligence among Member States combined with a lack of capacity of tax authorities to even monitor pan-European MNEs effectively was noted by Sorsa[208]. Webb[209] promoted the improvement of information among Member State tax authorities as a key action for closing out tax avoidance practices. Research by Hanlon[210] suggested that what is missing is clear commitment and accountability of authorities, and a lack of co-operative skills, concluding that the mechanisms enabling large-scale tax avoidance also make commitment and co-operative skills of authorities difficult to

[208] Ville-Pekka Sorsa, 'Taxes! – Promoting Strategies for Global Taxation' (2005) Not Against the Windmills: Fighting Tax Avoidance, 96

[209] Michael Webb, 'Defining the boundaries of legitimate state practice: norms, transnational actors and the OECD's project on harmful tax competition' (2004) 11, Review of International Political Economy, 4

[210] Michelle Hanlon, 'The Persistence and Pricing of Earnings, Accruals, and Cash Flows When Firms Have Large Book-Tax Differences' (2005) 80, The Accounting Review, 1, 137

achieve. Pan-European tax avoidance schemes are likely to demand unparalleled consensus across Member States.

As this analysis of the role of the CJEU has highlighted, tax authorities across Member States have consistently seen their authority undermined by CJEU judgements, arguably weakening their resolve in challenging MNEs that are perceived as challenging the accepted frontiers of the law. The cost and manpower required to investigate innocuous MNE tax planning activities are high and it requires constant re-evaluation of the likelihood of a successful outcome for the tax authorities in light of CJEU judgements before embarking on such an investigation. This provides for an unsettled environment for the tax authorities to operate its tax avoidance investigation activities. A number of high profile MNEs operating across Member States are in receipt of particularly bad publicity relating to tax avoidance and this is raising additional public pressure on the tax authorities to initiate tax avoidance activity assessments. With a given amount of resource, a Member State tax authority is likely to allocate its resources to those areas of either highest risk or those areas in which it has the highest probability of success. In the UK, the disclosure regime[211] was introduced to identify in advance those tax avoidance schemes worthy of tax authority review and clearance. The disclosure regime does not attempt to set the boundaries of tax avoidance, but rather set out the characteristics of a scheme that are purportedly common of a tax avoidance arrangement. Bland[212] found that such disclosure schemes have impacted taxpayers behaviours but not to any underlying taxpayer intent. Given most manufactured schemes are common to certain industry types specific transactional loopholes they tend to have concentrated demand. To supplement this formal disclosure, a more general disclosure regime has been enacted by the UK so 'that companies put in place a formal tax policy that sets out their high level tax strategy, operating principles and guidelines and that this policy is approved by the board of directors'[213]. The significance of this is that it is the first known attempt to correlate the propensity to engage in tax avoidance and a MNEs governance system, a point that is

[211] Finance Act (UK) 2007, The Tax Avoidance Schemes, 'Prescribed Descriptions of Arrangements Regulations', 2006, SI 2006 No 1543

[212] Robert Bland, 'Hallmarks and the Direct Tax Disclosure Regime' (2006) BTR, 653

[213] HMRC, 'Tax in the Boardroom', <http://www.hmrc.gov.uk/lbo/tax-in-the-boardroom.htm> accessed 18 October 2012

important for this research solution and representative of a view supported by various lobbying groups such as the Tax Justice Network in the UK.

Across all EU Member States the increase in enforcement levels is involving heightened examination of large corporate taxpayers. Tax authorities are making particularly rapid gains in their understanding and challenges to cross-border structures[214].The growing sophistication of tax enforcement enabled by better communication and cooperation among tax authorities, enhanced in 2011 when several countries including Germany formally endorsed the OECD's Convention on Mutual Administrative Assistance in Tax Matters[215]. Mutual assistance agreements appear to be gaining even more international support providing as it does the multilateral information exchange vehicle that the G20 and OECD have struggled to develop in the last decade. Certain tax avoidance practices continue to attract the attention of all EU Member State tax authorities. TRPRICE will continue to be a core focus of every tax authority, as well as the abuse inherent in utilising certain international structures reflecting the increased pace of restructuring by MNEs as a reaction to the 2008 economic crisis. The use of losses similarly is witnessing tax authority focus particularly reflecting the large stock of losses hanging over from the economic crisis as highlighted by successive OECD Forum on Tax Administration reports.

In respect to the sample Member States of this research, the French tax authorities have stated their focus as being on PE issues and cross-border tax schemes particularly fighting against financial flows between a French company and a foreign entity deemed to have no substance. In Germany, key enforcement programmes include measures to address TRPRICE and intra-group financing, restructuring and transformation. In Italy key enforcement programmes focus on TRPRICE, CFCs, PEs, abuse of law and capital donations. In UK, the general approach of tax enforcement is based on a risk-based strategy to tax compliance and enforcement. It estimates the total tax gap and then breaks this total down by taxpayer

[214] Ernst and Young, 'Tax Policy and Controversy Outlook' (2012) 12 <http://www.ey.com/Publication/vwLUAssets/Tax_policy_and_controversy_outlooks_for_2012_-_EMEIA/$FILE/TPC%20Outlook_EMEIA.pdf> accessed 1 August 2013

[215] OECD, 'Convention on Mutual Administrative Assistance in Tax Matters' (2011)<http://www.oecd.org/ctp/exchangeofinformation/Amended_Convention_June2011_EN.pdf> accessed 14 August 2012

segment, specifically by tax, size and nature of the taxpayer and behaviour. It develops a tailored compliance and enforcement strategies for each segment. For large MNEs HMRC’s approach is based on building relationships with businesses to provide certainty on the tax outcome of significant issues, proportionate engagement, and clarity through effective consultation and dialogue. HMRC identifies large businesses it regards as low risk and implements a light touch approach, releasing resources to be directed to higher risk MNEs. The High Risk Corporate Programme[216] takes a collaborative approach to planning and board-level engagement with the largest MNEs, and has been used to resolve a significant number of material long-outstanding disputes, with settlements totalling more than GBP9 billion since 2006[217]. This is supported by an Anti-Avoidance Board[218] established for defining the delivery plan for HMRC’s anti-avoidance strategy. HMRC has been a leading proponent of the enhanced relationship approach. Core elements are a risk-rating system, which takes account of MNE systems for managing their own tax risk, support for MNEs regarded as low risk, including advance rulings and clearances on request, and targeting of HMRC resources on significant tax compliance risks.

4.3.3 Professional Organisations

Professional tax intermediaries have played a part in shaping the tri-partite relationship between MNEs, the local tax authorities and legislators. The “tax agents….represent a significant number of large companies”[219] and have long been associated as “key players in the rules avoidance industry”[220]. Their level of influence in respect to promoting, validating and formally auditing tax avoidance should not be underestimated. Most significantly, in the

[216] HMRC, ‘High Risk Corporates Programme (2012) <http://www.hmrc.gov.uk/large-businesses/prog-approach.htm> accessed 10 September 2012

[217] Ernst and Young, ‘Tax Risk and Controversy Outlook - EMEIA’ (2012) <http://www.ey.com/GL/en/Services/Tax/Tax-policy-and-controversy-outlooks-for-2012> accessed 27 August 2012, 130

[218] HMRC, ‘Resolving Tax Disputes – Commentary on the Litigation and Settlement Strategy’(2011) <http://www.hmrc.gov.uk/practitioners/lss-guidance-final.pdf> accessed 20 October 2012

[219] Donald Drysdale, ‘HMRC, business and the tax profession’ (2007) Tolley’s Practical Tax Newsletter, <http://www.taxautomation.co.uk/downloads/HMRC_Relationship_May_07.pdf> accessed 18 October 2012

[220] Prem Sikka and Hugh Willmott, ‘The Power of ‘Independence': Defending and Extending the Jurisdiction of Accounting in the UK’ (1995) 29, Accounting, Organizations and Society, 6, 547

sphere of public debate and political dogma surrounding corporate tax avoidance there is little evidence of hostility towards their undue influence. Such influences are typically enacted through the use of lobbyists and other influential stakeholders to shape tax avoidance rules consistent with their clients' tax planning requirements. This lobbying sometimes attempt to influence directly the EU tax laws, such as Deloitte lobbying changes to the UK's 2011 legislative proceedings on changes to corporate tax avoidance[221].

It has suggested that professional organisations are part of "the modern enterprise culture that persuades many to believe that bending the rules for corporate self-gain is a sign of commercial acumen"[222]. These organisations have no duty to disclose the advice provided to their clients on tax planning and are not held accountable for any such advice. The pursuit of profitability has an inherent prospective conflict with any public duty to avoid abusive tax planning. Such a conflict infers that for the large accounting MNEs the "emphasis is very firmly on being commercial and on performing a service for the customer rather than on being public spirited on behalf of either the public or the state"[223]. Even an association with the early high profile US based corporate tax abuse cases of *Worldcom*[224] and *Enron*[225] has not deterred continued involvement in this area of global tax planning from some of the major accounting and auditor organisations.

From an academic perspective the matter has been well represented. Broad condemnation of the approaches adopted by some of the professional organisations are well documented with academics such as Sikka claiming that "the involvement of accountancy firms in developing and selling tax avoidance schemes contrasts sharply with their expressed claims of ethical conduct and social responsibility"[226] In many respects this is tantamount to organised tax

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[221] House of Commons Treasury Committee, 'HC 1371 Closing the Tax Gap: HMRC's record at ensuring tax compliance', (2011)

[222] Gerard Hanlon, *The Commercialisation of Accountancy: Flexible Accumulation and the Transformation of the Service Class,* (St Martin's Press, London, 1994)

[223] Ibid

[224] *State v. WorldCom, Inc*. 293 BR 308 [2003]

[225] *Skilling v United States*, 561 US 358 [2010]

[226] Prem Sikka, 'The Role of Accountancy Firms in Tax Avoidance: Some Evidence and Issues' (2005) University of Essex Working Paper,

avoidance and raises serious questions about the CSR credentials of such organisations. Again, there is little correlation between CSR and accounting practices as highlighted by Christensen and Murphy[227]. Furthermore, there is little research correlating the taxing properties of a given Member State and the behaviours of the accountancy profession.

4.3.4 Political Influences

The socio-political context at any given time has the potential to be a powerful force in shaping of Member State tax policies and associated enforcement tactics adopted by their respective tax authorities. The EU tax law activities of the CJEU are relatively immune to such pressures as the role, in principle, should be limited to preliminary rulings in context of adherence to the EU Treaty irrespective of populist opinion of the EU population or its politicians. The rapidity associated with the impact of such socio-political factors on legislative changes at a national level can be such that they form one of the most potent forces for change.

As the global economy proceeds through a period of austerity following the fiscal crisis of 2008 EU Member States have adopted different strategies for propping up their public sector finances, with a particular emphasis on varied measures to increase corporate tax revenues through specific targeting of industries or through the closure of tax avoidance loopholes. The current environment is characterised by fragile financial systems, high public deficits and low or negative economic growth, providing fertile ground for self-perpetuating pessimism and propagation of populist anger condemning large MNEs avoiding corporation tax. Recent high profile publicity associated with Vodafone[228] and Starbucks[229], Amazon[230] and Google[231] in

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<http://www.mngt.waikato.ac.nz/ejrot/cmsconference/2005/proceedings/criticalaccounting/Sikka.pdf> accessed 10 October 2012

[227] John Christensen and Richard Murphy, 'The Social Responsibility of Corporate Tax Avoidance: Taking CSR to the Bottom Line' (2004) 47, 3, Palgrave Macmillan Development Journal, 37

[228] Tom Bergin, 'Insight: Vodafone in new 1 billion pounds tax scandal' (2012) Reuters, <http://uk.reuters.com/article/2012/06/26/uk-vodafone-tax-idUKBRE85P0GO20120626> accessed 1 November 2012

2012 are good examples. To date, politicians appease this public opinion by joining the chorus of disapproval but no actual changes in legislation have been proposed, opting instead to pressure MNEs to stay within the spirit of the law. This is less likely to reflect inertia and more a reflection on the known complexity of closing out tax avoidance practices tactically deployed by MNEs across the EU whilst remaining within the boundaries of the law.

The popular demand for decisive and timely action to curtail corporate tax avoidance practices has not been forthcoming even in those Member States advocating a political agenda most hostile to corporate behaviour such as France, but a number of distinct policy responses may be noted. In 2011, as a result of public and political pressure, a majority of the 'EP' came out in support of a Financial Transaction Tax at EU level, specifically targeting the tax revenues associated with EU financial institutions[232] although this remains a contentious policy pursuit among many Member States. Specific tax rules for combating tax avoidance at Member State level have, in recent years have focused on the aforementioned GAAR's. GAAR provisions have been enacted in the UK in 2013[233] and the HMRC GAAR guidance explicitly states carefully that "the GAAR is designed to counteract the tax advantage which the abusive arrangements would otherwise achieve"[234]. There is, however, no evidence yet of enacting such a policy at EU level endorsed through Treaty powers. A will by political stakeholders to bring closer fiscal union through the delivery of a more coordinated and harmonised tax policy is also evidenced by Germany and France announcing plans in 2011 for a common corporate tax base and ensuring better alignment of tax rules relating to tax treatment of losses[235]. In their own right, these differences between regional and peer-to-peer coordination of policy are increasingly creating friction between Member

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[229] Tom Bergin, 'UK lawmakers to grill Starbucks, Amazon and Google on tax' (2012) Reuters, <http://www.reuters.com/article/2012/10/31/us-britain-companies-tax-idUSBRE89U1HG20121031> accessed 1 November 2012

[230] Ibid

[231] Ibid

[232] Commission, 'Proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax' COM(2013) 71 final

[233] Finance Act (UK) 2013, part 5

[234] HRMC, 'HM Revenue and Customs General Anti-Abuse Rule Guidance' (2015), 7

[235] Bundesministerium der Finanzen, Ministère de l'Economie et des Finances, 'Green paper on business tax convergence between France and Germany' (2012)

States and uncertainty to MNEs. The political desire for singular or collaborative Member State responses to tax avoidance appears to be increasing at a time when the EU institutions are flexing their muscles too. From a political standpoint, countries throughout the region are striving to find the right balance between a tax system that attracts investment with one that generates the revenue needed to meet obligations and fund services consistent with the principles of the EU Treaty As stated by Hagen the challenges have mainly to do with "fiscal policy remains a national competence for EU member states, but under several constraints and subject to a variety of procedures….to achieve certain Community goals whilst safeguarding the sustainability of the member states' public finance"[236]

Pressure groups lobbying EU Member State legislators and tax authorities have played a role in corporate tax policy making. Historically focussed on lobbying at national level, but in recent years this has witnessed more energetic efforts directed towards EU institutions to reflect the gravity of influence[237]. The quantum of lobbying effort in evidence would suggest it forms a powerful voice in the corridors of EU institutions as the EU constitutes "a promising political opportunity structure for organized interests".[238]. The effectiveness of such pressure groups on shaping tax policy depends on a number of factors, particularly the accessibility to policy makers themselves and the number of policy-making stakeholders in a particular area of corporate tax law. The diversity of the EU policy-making process across the EU has nurtured differing approaches to be adopted by these lobbying organisations. Guéguen[239] divided lobbying strategies into positive, negative or reactive strategies. Negative strategies generally consist of direct opposition to Commission proposals, while positive strategies focused on active promotion of a change in policy or law delivered through a wider variety of EU institutions in a spirit of partnership and credibility. Reactive strategies, on the other hand, focus on specific initiatives to promote a particular course of actions. Member State responses to regulating these influences differ. In Germany there are formal rules

236 Jurgen von Hagen, 'Fiscal Policy Challenges for EU Acceding Countries' (2004) ECSA Conference, <http://www2.wu-wien.ac.at/ecsa/emu/papvonhagen.pdf> accessed 4 September 2012

237 Commission, 'Lobbying in the European Union: Current Rules and Practices' (2003) Working Paper <http://ec.europa.eu/civil_society/interest_groups/docs/workingdocparl.pdf> accessed 2 August 2013

238 Heike Kluver, *Lobbying in the European Union: Interest Groups, Lobbying Coalitions, and Policy Change* (OUP, Oxford, 2013)

239 Daniel Guéguen, 'European Lobbying' (2007) Europolitics, 117, <http://www.pacteurope.eu/pact/wp-content/uploads/2012/04/European-Lobbying-EN.pdf> accessed 9 August 2012

governing conduct, while in France there is a mandatory registration system only, and in Italy there are no rules at all

Whatever the drivers or influences, EU Member States, without exception, are taking a tougher stance on enforcing laws to help ensure that taxes owed are actually paid, as well as putting in place new legislation and processes to close off existing leakage of revenue. Reports by Ernst and Young[240] and PWC[241] in 2012 all claimed tax authorities are evidencing less tolerance and are becoming increasingly reactive to complaints by pressure groups or media publicity that allege corporate tax avoidance. It seems not unrealistic to expect this political dynamic to become more pronounced in the near-term and for tensions between corporate taxpayers and tax authorities to increase. In fact, 74% of senior management in the EU surveyed by Ernst & Young[242] agreed or strongly agreed that tax controversy will become more important to their MNE over the course of the next two years. This is perhaps unsurprising, as 97% of senior managers concurrently stated in the same survey that they expected to increase their focus on tax risk associated with their cross border activities, representing a concern regarding the ongoing threat to tax efficient structures afforded to them by the EU Treaty. In parallel tax policy makers were canvassed and it was found that nearly 81% expect some or significant growth in national anti-avoidance tax rule changes.

In the context of our sample EU Member States, France has been the most active. Typically characteristic of left-of-centre governments, the French agenda in recent times has targeted policy on increasing revenues rather than reducing expenses and this has illuminated the focus on tax avoidance mitigation. The worldwide tax consolidation regime has been abolished and a corporation tax surcharge increased the ETR to 36.15%. Political pressures in Europe has witnessed Germany moving to the fore in terms of negotiating packages for Greece, the Financial Stability Facility and European Stability Mechanism, illuminating the public perception of the need to protect tax revenues from corporate abuse. Initial high profile

[240] Ernst &Young, '2011-12 Tax Risk and Controversy Survey' (2012) <http://www.ey.com/GL/en/Services/Tax/2011-12-Tax-risk-and-controversy-survey> accessed 12 August 2013

[241] PwC, 'Total Tax Contribution Report' (2012) <http://www.pwc.co.uk/tax/publications/a-changing-tax-system.jhtml> accessed 12 August 2013

[242] Ernst and Young, 'Tax Risk and Controversy Outlook - EMEIA' (2012) <http://www.ey.com/GL/en/Services/Tax/Tax-policy-and-controversy-outlooks-for-2012> accessed 27 August 2012

support for the CCCTB evidenced Germany's appetite for change, as did its support for the Financial Transaction Tax. The German coalitions in recent times have been strong proponents of tax information clauses across the EU, and recent political manifestos have included advances in developing a guarantee of single rate corporate taxation above and beyond the more common DTT arrangements. Volatile political circumstances in Italy have not curtailed advances in promoting further anti-avoidance tax measures. A political desire to attack tax abuse at two levels has resulted in empowering tax authorities to target the most material tax abuse using prescriptive evaluation criteria alongside a desire for major change in the Italian tax system by abolishing the specific five-year restriction for tax losses and providing for a carry forward with no time limits[243]. The politics of Member States drive many of these changes, not only in tax anti-avoidance rules but also in relation to the tax base more generally. For example, Member States like France has targeted attacking MNEs more broadly through raising the corporate tax rate for all MNEs with revenues over €250m whilst Italy has been more targeted focusing on attacking those industries likely to reap most political capital alongside generating a healthy revenue stream.

In the Netherlands, the government published the Fiscal Agenda in 2011, largely targeting raising additional revenue through a financial institutions tax but also in enlarging the corporate tax base, aimed at resolving issues relating to the Bosal-gap in the corporate income tax. No other specific anti-avoidance measures are currently proposed akin to those in other EU Member States. In the UK, the political trend has been driven by a coalition government focusing specifically on reducing the corporation tax rate. This has been subsidised by increasing a bank levy despite the political desire to avoid participation in the FTT. There is continued refocusing of the CFC regime on artificial depletion of UK profits. Increased focus on international cooperation and information exchange between tax authorities, as well as improved funding for local HMRC enforcement, particularly relating to corporate tax avoidance.

The political desire to enact tax avoidance measures remains as strong as ever across all sample Member States. The magnitude of change is varying across jurisdictions but the direction of change appears to be broadly similar. The relative inertia witnessed in the last decade to EU institutions attempting to closeout loopholes have been met with improved

[243] Law Decree 98 (Italy) 2011

political rigour. Consistent with research by March and Olsen[244], one could suggest that long periods of political inertia common to EU coalition governments can often precipitate a crisis and sudden policy change. There remains a generally positive political appetite and acceptance to absorb and adapt to EU driven changes to tax avoidance mitigation whether through directives, initiatives, or CJEU judgements.

4.4 Conclusion

The analysis in this chapter has shown how the multiplicity of stakeholders and the strength of their interactions, influences and priorities can materially impact both the cause and effect of direct corporate tax abuse with the EU. The manner in which institutions such as the CJEU and EC operate and their interactions and influences with Member State courts and tax authorities have an impact on the direct tax environment. The interactions between Member State courts and tax authorities with MNEs, and the interactions between MNEs and their advisors have a similar impact on the level and nature of tax abusive practices evidenced in any jurisdiction. All these stakeholder interactions are somewhat fragmented, neither exhibiting complimentary nor necessarily cooperative interactions. The strength of influence afforded to the CJEU and EC is considerable and the significant impact on shaping the direction of Member State anti-avoidance laws is not underestimated. Recognition, however, is given to the prospective longevity of these stakeholder influences, accepting that the tax abuse issue is ripe for reform and that the relative strength of stakeholder influence over time may change. The EU is as much a political entity as an economic one and it is this crucial point that renders any controversial reform relying on political consensus difficult to attain. The multiplicity of stakeholders is not a unique complication but the outcome from the analysis in chapter shows that the design of any solution proposal will demand changes in institutional or taxpayer practices so any fragmentations in their interactions or influences are addressed to ensure effective adoption of any reform.

[244] James March and Johan Olsen, 'Elaborating the New Institutionalism' (2005) Arena, 11

Chapter Five: Limitations on Member State Sovereignty in Tackling Tax Abuses

5.1 Introduction

National sovereignty may be defined as the jurisdictional right to self-governance, representing "final and absolute authority"[1], uninhibited by any "rules, regulations or policies"[2] enforced by "an external authority"[3]. In the context of the EU this concept is particularly important and generates highly charged reactions to any political intrusions or threats to such sovereign authority. For the purposes of this research, it is relevant to examine the autonomy retained by Member States in their corporate taxing rights with the extent to which a broad and growing political community, developing a "legal community"[4] creates an interaction of law and politics forming an instrument of self-governance in a supranational entity. From the outset, the EU integration concept has threatened restrictions on national sovereignty through the systematic development of EU institutions being empowered to establish directives and regulate Member State laws via case law judgements under the premise of protecting EU Fundamental Freedoms. Since the outbreak of the EU debt crisis the region has taken unprecedented measures, including the implementation of a fiscal treaty[5] that may result in further pressure to centralise the command and control over direct taxation by EU institutions.

[1] Francis Hinsley, *Sovereignty* (2nd edn, CUP, Cambridge, 1966), 21

[2] David Held and Anthony McGrew, 'Globalisation and the Liberal Democratic State', (1993) 28, Government and Opposition, 265

[3] Rodney Hall, *National Collective Identity: Social Constructs and International System* (Columbia University Press, New York, 1993), 99

[4] Walter Hallstein, 'Constitutionalism in International Law: Comment on a Proposal from Germany' (2006) 47, Harvard International Law Journal, 1, 224

[5] Council Treaty, 'Treaty on Stability, Coordination and Governance in the Economic and Monetary Union' (2012)

5.2 Sovereignty Drivers

National sovereignty in the area of tax law has been diluted by a small number of key drivers. The increasing impact on domestic tax legislation of rulings of the CJEU has principally driven this erosion, interpreting directly applicable general principles included in the EU Treaty as previously detailed. In particular promoting non-discrimination and the right to establishment have led this charge of authority. Other EU institutions such as the Commission have been instrumental in directing changes in state rules which although not directly related to direct taxations has added further credibility to the role of the Commission in shaping the business environment beyond the powers of Member State legislators. The Commission has similarly claimed competence in some treaty negotiations with the aim of avoiding double taxation and this has been met with support and "a constructive attitude from Member States"[6]. Although this has not led to an EU Model Tax Treaty or positive harmonisation resulting from the eradication of double taxation its impact is important.

From an academic perspective, there is little contention that Member States have the legal right to tax corporate profits derived from domestic sources and the international profits of domestic MNEs although in practice different Member States frequently advocate different policies and approaches, often based on the political environment at a given time. Palan found that tax sovereignty is concerned with the autonomy of a Member State to tax its jurisdiction[7]. The researcher recognised two different styles of sovereignty, namely de jure sovereignty and de facto sovereignty. De jure tax sovereignty was denoted as the "legal freedom of action"[8] to impose taxes while De facto sovereignty represents the potential to achieve the Member State's tax policy objectives.

The EU legal order is based around a high dependency order of the Member States for both its existence and effective functioning. Historically there has been a strong unity ethos among

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[6] European Commission 'Double Taxation Conventions' (2005) Taxation and Customs Union <http://ec.europa.eu/taxation_customs/taxation/company_tax/double_taxation_conventions/index_en.htm> accessed> 14 August 12

[7] Ronen Palan, 'Trying to Have your Cake and Eating it: How and Why the State System has Created Offshore' (1998) 42, 4, International Studies Quarterly, 625

[8] Robert Keohane, *Sovereignty, Interdependence and International Institutions. Ideas and Ideals: Essays on Politics in Honour of Stanley Hoffmann* (Westview, Boulder, 1993)

most Member States[9], endorsed through national legislatures and judiciaries implicitly acknowledging the notion that EU law takes precedence over national law and it is specifically this point that underpins the transfer of constitutional power to the EU[10]. The effective operation of the EU internal market demands strong links between Member States in order to accomplish common objectives across a broad array of political and economic issues and this has encouraged this unity ethos to strengthen over time. Despite this collaboration, certain areas, such as taxation, remain formally excluded from the EU policy agenda[11] representing the conflicting forces shaping the legal order into what we see in place today.

Consideration to what is termed the direct applicability principle[12] represents an important concept that implies that MNEs have as much of a stake in terms of legal rights and legal obligations as other stakeholders such as Member States, the CJEU and the Commission. Despite the fact that the EU judicial system has supported and managed the direct applicability of EU law notwithstanding the issue that is faced is in situations whereby EU law generates a legal conflict between an MNE and Member State tax law. There is no formal judicial provision for promoting the primacy of EU law over Member State law and there seems little consensus on either the need or appropriateness of formalising this doctrine since the practical existence of EU law is premised on the basis that it is superior to Member State law. The impact on Member State sovereignty is broader than this suggests. Not only is EU law effective in changing Member State law in the immediate aftermath of a judgement, it also has the effect of limiting laws thereafter. It limits the effectiveness of current Member State law where deemed unlawful and by inference impacts the direction of any law or legal rule in that part of the law going forward. The legal significance of this rule of precedence is that Member State law which conflicts with EU law no longer applies. It has therefore been left to the CJEU to define more clearly the role of EU law in shaping the boundaries of Member State sovereignty in direct taxation law, a point that has generated much debate.

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9 Desmond Dinan, *Europe Recast: A History of the European Union*, (Colorado, Lynne Rienner, 2004), 14

10 Joseph Weiler, 'In Defence of the Status Quo: Europe's Constitutional Sonderweg', in Joseph Weiler and Marlene Wind, *European Constitutionalism Beyond the State* (CUP, Cambridge, 2003), 27

11 Andrew Moravcsik, 'In Defence of the 'Democratic Deficit': Reassessing Legitimacy in the European Union' (2002) 40, JCMS, 4, 607

12 Consolidated version of the European Treaty [2010] art 249, OJ C83/13

Lord Denning was a fierce proponent of the role of the CJEU in compromising sovereignty when he stated, "Our sovereignty has been taken away by the European Court of Justice. It has made many decisions impinging on our statute law and says that we are to obey its decisions instead of our own statue law…Our courts must no longer enforce our national laws. They must enforce Community law"[13]

The conclusion of the CJEU in many of the aforementioned cases relates to the non-compliance under EU law of a tax avoidance rule that is being enforced by a Member State. Such case law of the CJEU results in two substantial problems for the Member States with respect to sovereign powers. First, there is Member State obligation to reflect the conclusions of a judgement into its own legislation, although it is clear that the CJEU has not provided any substantive guidance to Member States about how to incorporate tax law into their national laws. Furthermore, all other Member States with comparable provisions are under an obligation to verify or align their provisions in accordance with the CJEU ruling. In this respect it has invoked a harmonisation process in the area of direct taxation, which, although not fully anticipated at the outset by Member States, has met with surprisingly little resistance in recent years. Second, there is an adverse impact on fiscal sovereignty too. As the EU assumes legislative primacy in the area of direct tax, the Member State control over national budgets diminish as tax avoidance rules protecting national tax revenues are outlawed by the CJEU as breaches of EU law.

Opinion remains divided about whether these shifting boundaries eroding national sovereignty in tax matters is a positive step forward. On the one hand it serves a positive purpose in levelling the tax landscape across jurisdictions in the interests of promoting EU harmonisation. On the other hand it can have the effect of creating a plethora of opportunity to MNEs for exploiting tax avoidance practices. Direct tax avoidance is an EU issue but there is no single EU institution entitled to solve tax avoidance issues, therefore supporting the case that taxation remains "firmly in the hands of national governments"[14]Although the EU has little formal control over taxation, Member States do not have complete autonomy over direct tax matters either. The concept of tax sovereignty may therefore be considered a rather ambiguous concept despite the fact that sovereignty appears to be relied upon with

[13] Lord Denning, House of Lords [1990]

[14] Kenneth Newton and Jan Van Deth, *Foundations of comparative politics* (CUP, Cambridge, 2005) 122

considerable frequency by Member States guarding against unwanted policy proposals intruding on such grounds. Sovereignty may be assed either in terms of what is raised by taxes, or "the functional role of the nation-state"[15], or in terms of how and on what terms it is raised, or "the governance values"[16]. As a concept sovereignty may be assessed in many different ways. From a regulatory perspective, the EU may be viewed as having developed a regulating command over Member State's taxing decisions even though it has no taxing power. From a political dimension, the EU is devoid of political responsibility to re-distribute taxable income among Member States but more aligned to promoting matters of internal market integration. From a judicial standpoint, the CJEU has a commanding oversight over what it considers to be EU law, or rather the compatibility between Member State law and EU law. There can be little doubt over the influence of the CJEU in recent years. Research has demonstrated that "a comprehensive dataset comprising all secondary tax legislation of the Commission and the Council of Ministers, and the entire tax jurisprudence of the [ECJ] from 1958 to 2007 shows a significant quantitative growth of EU tax legislation and jurisprudence"[17].

5.3 Sovereignty Constraints in Resolving EU Tax Abuses

EU tax law, akin to every other aspect to EU law, cannot be described as either a collection of EU treaties and directive, nor can it be considered an appendage to Member State legal systems. EU law resides as a fundamental concept within the EU construct as it remains the sole guarantee that EU law is not diluted by interaction with national law. Obvious conflicts arise when attempting to balance the demands of the internal market promoting consistent application of law across jurisdictions and the Member States desire to retain autonomy over the tax base, tax rates, tax allowances and other similar baseline activities in the area of direct taxation.

[15] Diana Ring, 'What's at Stake in the Sovereign Debate?: International Tax and the Nation State' (2008) Virginia Journal of International Law, 49, 57

[16] Ibid

[17] Phillipp Genschel and Markus Jachtenfuchs, 'How the European Union constrains the state: Multilevel governance of taxation' (2010) 50, 'European Journal of Political Research, 294

The role of the EU form as a platform for shaping the legal landscape for tax matters derives its authority from the EU Treaty, although not referencing any specific mandate to direct taxation itself. The EU Treaty focuses on the "Principle of Sincere Cooperation" that establishes the general relationship between the EU construct and its Member States[18]. It states, "Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties. The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the EU. The Member States shall facilitate the achievement of the EU's tasks and refrain from any measure which could jeopardise the attainment of the EU's objectives"[19].

Debates in public law regarding sovereign rights introduce a number of issues pertinent to this thesis. Sovereignty is a concept that is as relevant to the Member States as it is to the EU institutions and the institutional authorities residing with them. At Member State level, the concept of sovereignty may be distinguished between that of the legislature as opposed to the Member State as a whole. Overarching legal authority for the provision of laws resides with the legislature rather than the state itself. If such an analogy is applied to the EU context of direct tax laws, the sovereign conflict is not in fact how it is commonly stated between the EU and its Member States but in fact between the EU institutions capable of having a law making role such as the EC and CJEU and the Member State legislatures. The EU construct relies on Member States voluntarily giving up some sovereign rights to the EU legal system. This is undisputed and forms the basis of the EU legal system and the fulfilment of many of the aims of the Internal Market. The practical limitation of this is that, notwithstanding the fact that any Member State reserves the theoretical right to exit the EU at any point, there is a grey area between accepting limitations in sovereign rights that are explicit and agreed upfront at point of joining with the subsequent loss of sovereign power in those areas that Member States had no intention or expectation of losing because of the EU's competence in enforcing the EU Fundamental Freedoms.

[18] Consolidated version of the European Treaty, [2010] art 4 (3), OJ C83/13

[19] Ibid

The conflict between the perceived surrender of sovereignty and the “democratic deficit”[20] that evolves is a longstanding and widely debated issue. The relevance to this thesis is its influence on differentiating what would or would not be an acceptable solution to Member States. Political ambitions to retain taxing powers must be offset against the interpretive autonomy granted to the CJEU in exercising judgement over compliance of national laws with EU Fundamental Freedoms. It would be futile to argue against such autonomy that is underpinned by Treaty provisions accepted by all Member States. Objections are typically based on a political basis or on grounds of jurisdictional infringement. Direct corporate taxation is implemented at Member State level to raise public funds for the public good yet the EU has an equally determined right to ensure consistent application of Member State laws for the good of the efficiency of the Internal Market.

5.4 Conclusion

Despite the intrusions into sovereignty by the CJEU, and irrespective of its different perspectives, it is argued that sovereignty has not been lost in an absolute sense but rather subjected to demarcation between institutions that all form part of a unified EU internal market. This reflects the transition from a collection of sovereign state to the European state as represented by the Internal Market. An alternative view was promoted by Wallace who stated “Sovereignty has not been transferred to a state-like federation…but sovereignty is increasingly held in common: pooled among governments, negotiated by thousands of officials through hundreds of multilateral committees, compromised through acceptance of regulations and court judgements which operate on a principle of mutual interference in each other’s domestic affairs”[21]. Furthermore he stated that, “European States can do little without the acquiescence and approval of their neighbours”[22]. This latter statement by Wallace probably represents a more fragmented but more accurate representation of the sovereignty impact of the EU in direct taxation. It is an inherently untidy and inefficient system “built on sustaining the illusion that governments can themselves provide their voters with benefits

[20] Wieler et al, ‘European Democratic and its Critique’ (1995), 18, West European Politics, 3, 4

[21] William Wallace, *The Sharing of Sovereignty: the European Paradox* (Political Studies Association, Blackwell,1999), 209

[22] Ibid

which can in practice only be won through common action with others"[23]. This perhaps provides a much more measured view on the sovereign impact of changes attributable to the EU construct, promoting a more complex relationship between an extended set of EU stakeholders beyond a more simplistic pull between the EU and Member States. Member State autonomy to shape their legal systems has been eroded and implies that future autonomy to integrate legal changes at national level will be limited unless there is broad consensus across the EU. This necessarily implies that any further progress in achieving national authority in this regard will require collaborative support, sustainable only on the basis that they are underpinned with support from a broad set of fellow Member States to challenge the authority of the EU institutions. This is an important observation in the formulation of a suitable solution proposal in this area of law.

[23] Ibid

Chapter Six: A Litany of Failed Schemes

6.1 Introduction

This chapter does not aim to review in detail all solution options previously promoted and debated. There is ample material on the subject so this analysis will focus on why they have failed and what may be learnt from their construct in proposing a more effective solution. The method adopted to assess compliance with the rule of law will take the form of a benchmark assessment against the widely stated rule of law definition advocated by Bingham[1]. The importance of this is such to ensure an assessment can be made against proposed reform proposals in light of its perceived alignment with the rule of law. Legal theory serves to validate or otherwise the usefulness of each solution. Until Bingham's advocacy the rule of law interpretation was dominated by Dworkin[2], Hayek[3] and Dicey[4]. Bingham's interpretation has been used because it has eight explicit sub-rules[5], all of which are relevant to the assessment of internationalist tax law reform.

Bingham stated "all persons and authorities within the state, whether public or private, should be bound by and entitled to the benefit of laws publicly made, taking effect in the future and publicly administered in the courts"[6]. Extending this further, Bingham noted that "law must be accessible and so far as possible intelligible, clear and predictable"[7] [Bingham Principle

[1] Lord Bingham, 'The Rule of Law', Centre for Public Law, University of Cambridge (2006) <http://www.cpl.law.cam.ac.uk/past_activities/the_rule_of_law_text_transcript.php> accessed 10 October 2013

[2] Ronald Dworkin, *Law's Empire*, (1st edn, Fontana Press, London, 1986)

[3] Frederick von Hayek, *The Road to Serfdom* (1st edn, University of Chicago Press, Chicago, 1944)

[4] Albert Dicey, *An Introduction to the Study of Law of the Constitution* (8th edn, Macmillan & Co, London, 1885)

[5] Lord Bingham, 'The Sixth Sir David Williams Lecture: The Rule of Law', University of Cambridge, Centre for Public Law <http://www.cpl.law.cam.ac.uk/sites/www.law.cam.ac.uk/files/images/www.cpl.law.cam.ac.uk/legacy/Media/THE%20RULE%20OF%20LAW%202006.pdf> accessed 12 March 2015

[6] Lord Bingham, 'The Rule of Law' (2007) 66, Cambridge Law Journal, 01, 69

[7] Ibid

One], ensuring that judicial authorities do not reshape the law in a radical manner beyond its original focus. Furthermore, “questions of legal right and ability should ordinarily be resolved by application of the law”[8] [Bingham Principle Two] to protect judicial rulings from arbitrary decisions, and the equality of law was fashioned through the principle that “the laws of the land should apply equally to all, save to the extent that objective differences justify differentiation”[9] [Bingham Principle Three]. Bingham promoted the good faith exercise of powers by public officers in a manner “consistent with the purposes in which the powers were conferred” [Bingham Principle Four], representing a fundamental principle of public law. Unlike any definition promoted by Dicey or Dworkin, protection of fundamental human rights featured in the sub-rules [Bingham Principle Five], as did the provision of state resolution of “civil disputes, which the parties themselves are unable to resolve”[10] [Bingham Principle Six]. Similarly, “adjudicative procedures provided by the state should be fair” [Bingham Principle Seven] and “the rule of law requires compliance by the state with its obligations in international law as in national law”[11] [Bingham Principle Eight].

Acknowledging that academics have historically offered a spectacularly divergent set of rule of law definitions and assessments, ranging from procedural and argumentative ideas[12], judicial and legislative accountability[13], political and individual morality[14], rights[15], substantive perspectives[16], to expressions of determinacy and certainty of outcome as guiding conduct[17], the scope of this thesis will initially be to limit the assessment to those specific rules advocated by Bingham as his synopsis summarised into eight principles is well suited to the notion of EU direct tax abuse law reform. The rule of law reflects the influence and authority of law and even though EU Member States represent nomocratic jurisdictions with a broadly common heritage of legal traditions and ideals, a rule of law assessment needs to reflect upon the demands of the formalist and substantive characteristics of the proposed

[8] Ibid, 72

[9] Ibid, 73

[10] Ibid, 77

[11] Ibid, 81

[12] Ronald Dworkin, *Law’s Empire* (1st edn, Fontana, 1986), 225

[13] Ronald Dworkin, *A Matter of Principle* (New ed edn, OUP, Oxford, 1985), 11

[14] Lon Fuller, *The Morality of Law*, (Revised edn, Yale University Press, London, 1964)

[15] Ronald Dworkin, *A Matter of Principle* (New ed edn, OUP, Oxford, 1985), 11

[16] Trevor Allan, *A Liberal Theory of the Rule of Law* (1st edn, OUP, Oxford, 2001)

[17] Joseph Raz, ‘The Rule of Law and its Virtue’ (1977) 93, Law Quarterly Review, 195

reforms. This is to ensure that, from a legal reform perspective, the reforms have lawful authority, are morally sound, passed and enforced in the correct manner, and the content of their provisions are good and just.

There are, of course, many alternative rule of law definitions ranging from those of Dworkin that focused on the moral dimension and interpretative aspects of laws rather than legal systems and legal discovery, and Dicey who focused on equality before the law and access to Courts[18]. Hayek focused predominantly on the predictability of law and superiority of law[19]. These are all sound bases for defining the rule of law but not as focused as Bingham for the purpose of addressing the specific challenges regarding the legal context of EU tax law reform. Bingham's rule of law principles combine a number of different aspects prevalent in other definitions promoted by other well-known legal philosophers. For example, Raz promoted the concept of legal positivism[20], so disliked by Fuller[21], emphasising the role of institutions and the importance of setting formal checks against the arbitrary use of institutional state power in order to promote principled adjudication. Raz[22] placed great strength to substantive legal norms such as accessibility to the law, akin to some of Bingham's principles, rather than notions of legality. Whereas Bingham's approach is to focus on traditional principles with an ethos of more substantive reasoning underpinning the rule of law, Raz insisted that the function of the rule of law is to facilitate legal rules, i.e. legislation, with the underlying doctrines of the legal system. Ultimately it provides harmony in its outcome that implies a law ceases to become enforceable, and therefore consistent with the rule of law, when it becomes unjust by selectively afflicting undue pressures on sections of its subjects. Rawls' theory of justice[23] is an interesting concept given the moral dimension to resolving MNE tax abuse. He perceived fairness as a basic fundamental right demanding protection and noted how the redress of social and economic inequality requires economic resources should be allocated to the greatest benefit of the least advantaged. Unfortunately

[18] Albert Dicey, *Introduction to the study of the Law of the Constitution*, (10th edn, Macmillan & Co, London, 1889), 198

[19] Friedrich Hayek, *Road to Serfdom* (New edn, University of Chicago Press, Chicago 1944), 72

[20] Wilfred Waluchow, *Inclusive Legal Positivsm*, (1st edn, Clarendon Press, Oxford 1994), 81

[21] William Wiecek, 'American Jurisprudence after the War: "Reason called Law' 37 (2001) Tulsa Law Review, 4, 2, 864

[22] Joseph Raz, *The Authority of Law: Essays on Law and Morality* (2nd edn, OUP, Oxford, 1997), 89

[23] John Rawls, *A Theory of Justice* (Revised edn, OUP, Oxford, 1999), 52

despite the merits of this approach it is not comprehensive enough to warrant application to reform proposals in this thesis.

There are features of this proposal that render Bingham's definition of the Rule of Law particularly relevant and stand to reason justifying its basis for the assessment and benchmarking of EU direct tax law reform proposals. First, the notions of fair exercise of powers and discretion are considered. Unlike Dicey who emphasised the curbing of discretionary governmental action and absolute restraint on arbitrary use of institutional state power in any area of the law, Bingham carefully balances the prescription of the fair exercise of power conferred in good faith for the purposes intended [Bingham Principle Four] reflecting the need for measured and consistent law making and enforcement across EU and Member State institutional offices, with a warning against outright discretion in the context of determining legal rights and liabilities [Bingham Principle Two]. He does not infer a challenge to the notion of reasoned opinions, based on the application of law, as being so necessary in the application of EU direct tax law abuse cases presented to the judiciary for resolution but rightly leaves the door open to subjective assessments of whether such legal rights and liabilities were exercised against a more substantive set of normative principles such as proportionality and substance over form. The nature of direct tax law and its interaction with Fundamental Freedoms creates a grey area of legal rights and liabilities outlined by Bingham that will require case-by-case assessment and a balance between the application of rules and discretion. To endorse a fair exercise of powers through the exercise of the law to achieve this is important. Second, the notion of fair state adjudication [Bingham Principle Seven] is important since "adjudication promotes purposive reasoning by inviting the decision to be justified by reference to a general rule, standard or principle"[24]. In the context of differentiating and determining unacceptable tax abuse from acceptable tax mitigation all judicial administrators of the law will rely on a degree of purposive reasoning to justify a ruling irrespective as to whether a reform proposal is rule-based such as targeted and specific anti-avoidance rules or formulary apportionment of income and tax, or an interpretative based reforms such as a legislative anti-avoidance principle. Bingham is not unique in highlighting the importance of this but he raises it to the fore. Third, the notion of equal application of the law pervades Bingham's literature [Bingham Principle Three] and

[24] Jeffrey Jowell, *The Rule of Law and its Underlying Values* (6th edn, OUP, Oxford, 2007), 20

has particular relevance to EU direct tax reform. In today's commercial world MNE's are formed in varying sizes, across different industry types exercising diverse operating models. Similarly from a Member State perspective there is a need to consider the establish doctrines of Most Favoured Nation[25] and National Treatment[26] that are intended to ensure equal treatment of taxpayers across EU jurisdictions consistent with the ethos of the Internal Market. In the absence of similarities in taxpayer behaviours, commercial trading patterns and Member State tax laws the protection of this principle is imperative to reform success. In contrast to Dworkin who promoted a more rights-based theoretical basis for the rule of law, Bingham's focus on more principle-based values in law. This approach is more suited to tax law reform in the EU internal market where subjectivity relating to legal taxing rights prevails as a consequence of MNE's abusing Fundamental Freedoms, often demanding judicial determination of commercial purpose that is easier to achieve through the application of principles than rules. Forth, the significance of dispute resolution is highlighted [Bingham Principle Six]. In an EU legal construct with non-homogenous Member States legal systems operating different anti-avoidance tax rules it will be important to have consistent, fair and accessible access to dispute resolution mechanisms. The EU direct tax abuse issue generates winners and losers generating high monetary stakes for both MNEs and Member States so an effective dispute resolution procedure is critical. Fifth, there is now universal agreement on the importance of human rights [Bingham Principle Five]. It was in the preamble of the EU Treaty that promoted the "principles of liberty, democracy and respect for human rights and fundamental freedoms and of the rule of law"[27], establishing that those areas of human rights, so notably absent from much legal philosophy literature, sit comfortably alongside the challenges facing EU law in the context of direct tax abuses. Similarly and uniquely the concept of alignment to international law is elevated to the fore [Bingham Principle Eight]. The inherent nature of the EU political and economic system systematically nurtures a heavy reliance not just on international law but on EU supranational law but in the context of direct tax law where the tensions relating to sovereignty become acute and a balance is required between public international law and supranational law in matters specific to tax abuse.

[25] World Trade Organisation, 'The General Agreement on Tariffs and Trades' (1947), 1, art 1

[26] Ibid, 2, art 3

[27] Consolidated version of the European Treaty [2012] OJ C326/01, 15

More generally, Bingham's promotion of more formal definitions of the rule of law based on core normative principles such as clarity and predictability, equality of application and procedural fairness are useful when assessing a wide range of dimensions to legal reform proposals in the areas of tax abuse. Bingham places great emphasis on the value of predictability, as did Dicey, Hewart and Hayek[28], but is a particular poignant topic in the unresolved conflicts between Fundamental Freedoms and EU direct tax avoidance. One of the most important aspects that corporate entities need from the law is predictability in the conduct of their businesses, and Bingham emphasises the importance of such predictability. However, what differentiates Bingham from all others is not only the universality of the principles he sought to underpin the rule of law but also the two principles relating to the protection of human rights, in relation to the potential liabilities against MNE officers responsible for disclosing corporate data, and compliance with international law obligations, in relation to the challenge of incorporating a direct law reform proposal into a developing supranational EU legal system heavily influenced by established international law and developing EU and Member State law.

The reason why it is so important to benchmark against the rule of law is a function of the legal indeterminacy resulting from variability in commercial circumstances and the developing law in the field of anti-abuse direct tax law abuse. The nature of the problem that needs to solved demands legal doctrines that permit both national judiciaries and the CJEU to justify a ruling within a given margin. A decision on an alleged corporate tax abuse can be achieved either side of an argument in many instances within the context of a body of legal rules. Only when doctrinal principles are applied can such discretion, so disliked by Bingham and Dicey, be applied in way that modern commercial reality demands. Overall, Bingham steers clear of the Dworkin approach by combining some selected formal procedural definitions, broadly consistent with the procedural goals set out by Fuller[29] that provide functional efficiency of the law, with a strong substantive set of principles, broadly consistent with some of those set out by Dworkin who focused on the values enshrined in the law that provides a universal set of definitions that could be widely seen as internationally accepted *jus cogens*. What works for the institutional EU and Member State administrators of the law is perhaps more aligned to the formal procedural aspects of the rule of law whereby this may

[28] Jeffrey Jowell, *The Rule of Law and its Underlying Values* (6th edn, OUP, Oxford, 2007), 16

[29] Lon Fuller, 'American Legal Realism' (1934) 82, University of Pennsylvania Law Review, 429

need to be balanced with the demands of the MNE taxpayer who relies more heavily on the substantive aspects of the law. Any reform proposal therefore needs to combine traits consistent with both aspects to the rule of law in order to reflect the demands of the EU direct tax issue under scrutiny. Bingham is best placed to do provide this.

6.2 Solutions under Formal Consideration

The policy challenge for formulating any solution involves balancing the multiplicity of conflicting targets and interests. An approach to defining the solution target is important, with opportunities for targeting constraints against the taxpayer directly as well as opportunities to provide enhanced enforcement powers to tax authorities. Such opportunities may focus on the underlying economic activities themselves, or from a legal perspective, the tax rules themselves. There are many commentators such as Hampton and Christensen[30] who promote the notion that tax avoidance can be resolved in a centralist EU framework whilst the more traditional view is that implementation of national measures that protect sovereign rights are more appropriate. There are no shortage of solution options being promoted by various stakeholders in the corporate tax avoidance debate – what is important is not to assess the economic merits of a solution but rather to assess their feasibility in the context of EU legal boundaries, precedents and the general socio-political environment.

Dual forces, not necessarily acting in unison or with common objectives, are driving the current solution agenda. On the one hand, Member States in response to public anger and economic necessity are attempting to patch up as many loopholes in their tax laws through the implementation of Targeted Anti-Avoidance Rules, hereafter referred to as 'TAARs' or through abuse of rights or similar GAAR-like provisions. These are typically implemented unilaterally but there is evidence of Member State collaboration in certain areas of direct tax law[31]. On the other hand, EU-wide initiatives are at various stages of maturity. Some

[30] Mark Hampton and John Christensen, 'A Provocative Dependence? The Global Financial System and Small Island Tax Havens', in F. Cochrane, R. Duffy and J. Selby (eds.) *Global Governance, Conflict and Resistance* (Palgrave Macmillan, Basingstoke, 2003)

[31] Bundesministerium der Finanzen, Ministère de l'Economieet des Finances**,** 'Green paper on business tax convergence between France and Germany' (2012)

proposals such as the consultation on non-double taxation[32] have not yet resulted in any formal proposals while others have been discussed and negotiated by Member States at length for some time such as the CCCTB and EU GAAR. The Commission has assumed a leading role in gathering support from Member States in the formulation of corporate tax avoidance policies or regulations for consideration, although none of these have been enacted into law in recent years consequential to the constraints associated with the consensus required inherent with DMV.

Legislative solution proposals, taking the form of either EC sponsored initiatives agreed by common consensus for implementation across all Member States or at individual Member State level to either introduce unitary or collaborative tax harmonisation rules to counteract tax avoidance or to strengthen existing national instruments by extending and harmonising the coverage and scope of existing laws. Legislation may explicitly provide for purposive interpretation or remain literal in form, targeting specific tax avoidance practices or being more general in its scope. It may police the form and substance of transactions or it may be directed towards an accounting based solution. The proliferation of non-legislative solutions include an improved environment encouraging CSR, nurturing behavioural changes by MNEs in response to the public anger challenging aggressive tax planning, the strengthening of corporate governance, information sharing and exchange of best practice and financial reporting and disclosure solutions. Structural solutions relate to fundamental shifts in the tax system such as changes in the EU tax base, new institutional powers in the command and control of the EU corporate tax system, changes to the EU direct tax law making process, changes to EU judicial powers of oversight and law making in corporate tax law, and implementation solutions challenging existing institutional channels of change into more novel routes for consideration.

6.2.1 Legislative Solutions

6.2.1.1 CCCTB

At the forefront of the EU's agenda for harmonising direct corporate taxation with the aim of addressing the most potent tax avoidance tactics is the CCCTB. Successfully implemented in

[32] Commission, 'Double Taxation in The Single Market' COM(2011) 712 final

the United States, the CCCTB now “represents one of the most fundamental changes in corporate taxation attempted within the EU”[33]. The CCCTB represents a consolidated set of accounting rules that MNEs operating across Member State jurisdictions would use to calculate their taxable profits, replacing the separate accounting of MNEs in each Member State of operation to a system of consolidated accounting. A centralised EU accounting model would be implemented under this system whereby a MNE would apply a common methodology for calculating corporate income tax as opposed to aligning with the differing rules associated with each Member State in which they have reported economic activity. Corporate taxation would then be apportioned to each Member State according to pre-defined apportionment formulas. A MNE would disclose a single set of statutory accounts to represent the group activities at an EU level and would be the responsibility of the group’s parent company forming the group with its subsidiaries or PE’s.

In 2011, the Commission finally published a Directive proposal[34] detailing the CCCTB, setting out a number of anti-abuse rules, largely centred on the anti-abuse principles set out in an earlier Commission communication[35]. It applies a two-pronged approach to combat perceived abuse through a GAAR[36], and specific anti-abuse rules to target identified problems[37]. The response of the selected countries has been mixed. The UK submitted a reasoned opinion to the Commission objecting to the proposal on the grounds that the CCCTB goes “beyond the means necessary to achieve the proper functioning of the internal market and so breached the subsidiarity principle”[38]. The Netherlands has submitted reasoned

[33] Chris Sanger, ‘Staying up to date with the European Commission's Common Consolidated Corporate Tax Base proposals’ Ernst & Young (2011), <http://www.ey.com/GL/en/Services/Tax/International-Tax/Staying-up-to-date-with-the-European-Commission-s-Common-Consolidated-Corporate-Tax-Base-proposals> accessed 2 January 2013

[34] Commission, ‘Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121 Final

[35] Communication from the Commission to the Council, COM(2007) 785

[36] Commission, ‘Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)’, COM(2011) 121 Final, art 80

[37] Ibid, arts 81-83

[38] UK Parliament, Commons Select Committee, ‘CCCTB - Reasoned Opinion of the House of Commons (2011) <http://www.parliament.uk/business/committees/committees-a-z/commons-select/european-scrutiny-committee/scrutiny-reserve-overrides/> accessed 20 December 2012

opinions expressing concerns over the subsidiarity aspect of the proposal although without substantiated evidence other than reference to the negative impact on GDP of the EU as a whole[39]. Its response raised concerns over the apportionment criteria ignoring key items such as intangibles and financial assets, and concerns about the proposed rule that the country of the EU group level holding is responsible for overseeing the enactment of the CCCTB. Italy has expressed no concerns about subsidiarity and is currently supporting the proposal[40]. In contrast, Germany has come out against the proposal favouring a mandatory common corporate tax base without consolidation[41]. Germany proposes a single mechanism for computing taxable profits from all MNEs in the EU where each Member State would retain its taxing rights at its own domestic corporate tax rate on the taxable profits declared of MNEs resident in its territory, calculated under new common rules. Germany rejects the consolidation part of the proposal since such a method would erode Germany's tax revenue, as it believes it would be a net loser in the apportionment of profits in a consolidated system[42]. France has been a vocal proponent of the CCCTB proposal as it stands to be a net tax revenue benefactor from the CCCTB[43]. In light of France and Germany mobilising efforts to harmonise their tax rates it is evident that France is in favour of moving towards a common tax base and rate and this has been acknowledged by the Commission[44].

It seems unlikely that the CCCTB can be implemented effectively based on the current proposals, particularly if implemented on an optional basis. A parallel system of CCCTB and

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[39] Gerdi Verbeet, 'Reasoned Opinion on the proposal for a Council Directive concerning a Common Consolidated Corporate Tax Base (2011) <http://ec.europa.eu/dgs/secretariat_general/relations/relations_other/npo/docs/netherlands/2011/com20110121/com20110121_tweedekamer_opinion_en.pdf> accessed 20 December 2012

[40] Michel Aujean, 'CCCTB - The Essentials and the Path Ahead' (2011) <http://www.deloitte.com/view/en_BE/be/insights/newsletters/tax-quarterly/issue44-june-2011/64eb16a6167b0310VgnVCM3000001c56f00aRCRD.htm> accessed 22 January 2013

[41] Feargal O'Rourke, 'CCCTB Dead or Alive' (2011) <http://download.pwc.com/ie/pubs/2011_ccctb_dead_or_alive_the_latest_developments.pdf> accessed 21 January 2013

[42] Ibid

[43] Matthew Gorman, 'The Common Consolidated Corporate Tax Base: what does the future hold?' (2012) CMS, 13

[44] Commission 'Report on the Proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB) COM(2011) 121

non-CCCTB Member States could not work efficiently, with potentially the same MNE operating different corporation tax modus operandi depending on whether it is based in or out of a CCCTB jurisdiction. Given the current optional nature of the proposal, MNEs would also be obliged to study in detail the various current systems and regularly review their decision whether to opt into the system or not. An all-encompassing corporate tax base involves a lot of detailed aspects that are unlikely to find much consensus across Member States. Many of these difficulties are not just technical, but also represent deeply rooted ideological tax policy divisions. This cultivates a view that it would be mightily difficult to envisage how Member States could reconcile many of the issues that this type of corporate base formulation raises in the near future. Moreover, the CCCTB requires a formulary allocation mechanism that is different from the arm's-length TRPRICE methodologies that Member States' currently employ[45]. The Commission regards the ability to consolidate losses as one of the CCCTB initiative's main benefits[46] but this loss consolidation is not possible without an allocation mechanism. Because the CCCTB would apply to almost all types of EU MNEs, the revenue impact of these decisions would be immense. Member States will find it difficult to reach agreements on these issues given the high economic stakes involved and MNEs will only support such a proposal if its cost for complying with the proposals is favourable in respect to the resulting cost of additional taxation resulting from closure of avoidance opportunities.

The principal objections to a CCCTB centre on its infringement on national sovereignty and subsidiarity[47]. Subsidiarity, in this context, advocates that any EU originated decisions should be consistent and as effective from a policy outcome perspective with decision options available to the individual Member States. To achieve subsidiarity such EU actions must be proportional to the steps required to achieve the objectives of the EU Treaty. Given the fact that a Member State rarely pursues a tax avoidance strategy on its own, such deadlock and non-participation is nurtured further at EU level by concerns regarding subsidiarity. The CCCTB faces severe political impediments. Advancing the ideals of the CCCTB has been from the EC resulting from pressure from the CJEU rather than from MNEs. The EC may struggle in itself to mobilise such a wide impacting change initiative. Despite the

[45] Iain Benshalom, 'A Comprehensive Solution for a Targeted Problem: A Critique of the EU's Home State Taxation and CCCTB Initiatives' (2008) North Western Law, Working Paper ,157

[46] Commission, 'Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)' COM(2011) 121/4

[47] Consolidated version of the European Treaty [2010] art 5, C83/13

collaborative formation of the CCCTB proposal with Member States, the involvement of the business community has been limited and may yet, despite subsidiarity objections from some Member States, still prove to be the source of its dilution or failure. The inequitable economic cost implications of implementing the CCCTB generally between different Member States presents a tangible risk to support irrespective of the rather unqualified gains in closing out certain tax avoidance practices. Despite its comprehensive scope, it could be a challenge for Member States to harmonise their own tax policies with the EC proposal, since so many aspects of these plans remain unclear, with expectations of materially different impacts on the Member States taxation revenues. While a number of objectives are repeatedly emphasized in all EC initiatives such as enhancing transparency, the EC has yet to state what the ultimate level of coordination should be, ensuring a clear path of reform for curtailing tax avoidance in the context of achieving all the other tax objectives inherent within its text. Until it is clear what the specific terms of a CCCTB would entail in respect to types of MNE income, and its relationship with other parts of the tax base there is clearly much work to do for it to become a credible proposal.

From a scholarly perspective the CCCTB has attracted widespread commentary. In relation to research relating to how the CCCTB would address TRPRICE or group relief issues, Spengel[48] concluded that a CCCTB can only assist in resolving group relief abuse if it is supported by an agreed minimum corporate tax rate. Panayi suggested that although the CCCTB would facilitate elimination of intra-group arrangements, TRPRICE would remain relevant under certain conditions and claimed that CCCTB objectives were too broad and needed to focus on a narrower scope to have any chance of success[49]. Confusion prevails around the underlying benefactor of the CCCTB with Panayi observing that it was unclear as to whether the CCCTB was favouring the taxpayer by reducing compliance costs and unifying the rules regarding pan-EU profit and loss consolidation basis or whether it was aimed at benefiting Member States through minimising TRPRICE and group relief [50]. Further

[48] Christopher Spengel, ‘Common corporate consolidated tax base – don’t forget the tax rates! (2007) EC Tax Review http://spengel.bwl.uni-mannheim.de/forschung/veroeffentlichungen/ec_tax_review_2007_118.pdf> accessed 30 July 2013

[49] Christiana Panayi, The Common Consolidated Corporate Tax Base and the UK Tax System (2011) IFS, TLRC Discussion Paper 9

[50] Christiana Panayi, ‘The Common Consolidated Corporate Tax Base’ in Christiana Panayi, *European Union Corporate Tax Law* (CUP, Cambridge, 2013), 81

research by Davies[51] concluded that the CCCTB would fail in its objective to eliminate TRPRICE to manipulate tax bases as this would result in additional distortions as MNEs manipulated the factors used in the formula to shift profits from low tax locations, a view more widely endorsed in earlier research by Hines[52] and Riedel[53]. This was further commented on by Andersson[54] who stated that the thresholds for consolidation come with the advantage of administrative simplicity but does not factor in the problem of commercial manipulation.

Nerudova opined that CCCTB will not fully address group relief abuse until rules are defined concerning dual thresholds, consolidation rules and the rules around moving in and out of a group. Tightly defined rules are important as Member States currently deploy “different group taxation schemes, and there are also states with no group taxation rules or methods of consolidation” [55]. Spengel and Wendt[56] found that some common rules would be required to resolve some the taxation abuse practices it seeks to mitigate. Intra-group losses would demand common rules regarding loss carry forward. Potential conflicts may arise from an accounting perspective. For example, source taxation, although aligned to the CCCTB, cannot be implemented with separate accounting. The need for harmonised accounting rules in some form of an Accounting Directive as a pre-requisite to implementing the CCCTB was also advocated by Lang et al[57]. On this point, further research by Neilsen, Raimondos-Mller

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[51] Ronald Davies, ‘CCCTB 4 EU? SA vs FA w/FTA’ (2012) Working Paper 12/24 <http://www.econstor.eu/bitstream/10419/72251/1/742688410.pdf> accessed 12 July 2013

[52] James Hines, ’ Income mis-attribution under formula apportionment’ (2010) 54, European Economic Review, 108

[53] Nadine Riedel, ‘The downside of formula apportionment: evidence on factor demand distortions’ (2010) 17, International Tax and Public Finance, 236

[54] Krister Andersson, ‘An Optional CCCTB for the European Union’ in Krister Andersson, Eva Eberhartinger and Lars Oxelheim, *National Tax Policy in Europe* (1st edn, Springer, 2007), 109

[55] Danuse Nerudova, ‘Group Taxation under the system of common consolidated corporate tax base’ (2009) Economics and Management, 14

[56] Christoph Spengel and Carsten Wendt, ‘A Common Consolidated Corporate Tax Base for Multinational Companies in the European Union: some issues and options’ (2007) Oxford University Centre for Business Taxation, Working Paper 07/17

[57] Michael Lang, Pasquale Pistone, Joseph Schuch and Claus Staringer, *Common Consolidated Tax Base* (Linde Verlag, Vienna, 2008), 69

and Schjeldrup[58]similarly placed strong emphasis on the effects of separate accounting and FA on asset allocation and TRPRICE when tax rates change. They found that a MNEs average tax rate decreases in many cases if they switched from separate accounting to FA.

Roeder[59] made a more fundamental critique of the notion regarding the consolidation element of the proposal, noting that consolidation would fail to address the problems associated with arm's-length pricing and that an enhanced Common Corporate Tax Base without consolidation is the optimal approach for reducing tax obstacles inherent within the internal market. Herzig and Kuhr[60] highlighted the lack of political feasibility and no linkage to financial accounting as being the principal factors behind its likely failure to mobilise policymakers, but they too referenced the suitability to pursuing a CCCTB to address some of the fierce political opposition evident in the debate to date. The political angle of CCCTB adoption was researched by Fuest who focused commentary around the efficiency and fairness of the tax system resulting from a CCCTB implementation, noting that "more evidence of significant economic benefits [from introducing a CCCTB] would be a pre-requisite to achieving widespread support" [61] for the proposal. A slightly different political perspective was offered by De Wilde[62]who concluded that based on the response to the CCCTB from the national governments, and the risk to substantial parts of the EU tax base becoming immobile, it could prompt Member States to respond by using the tax rate to protect their revenue interests and this would provide an additional dimension to complexity in understanding the material impact on mitigating the tax avoidance practices it seeks to address.

[58] Soren BoNielsen, Pascalis. Raimondos-Møller and Guttorm Schjelderup , 'Company taxation and tax spillovers: Separate accounting versus formula apportionment' (2010) 54, European Economic Review, 121

[59] Erik Roeder, 'Proposal for an Enhanced CCTB as Alternative to a CCTB with Formulary Apportionment' (2012) 4, World Tax Journal, 2, 125

[60] Norbert Herzig and Johannes Kuhr, 'Corporate Tax Base as the next sub-step towards harmonisation' (2012) Wroclaw Review <http://wrlae.prawo.uni.wroc.pl/index.php/wrlae/article/viewFile/13/26> accessed 17 July 2013

[61] Clemens Fuest, 'The European Commission's proposal for a common consolidated tax base' (2008) 24, Business Taxation in a Globalised World, Oxford Review of Economic Policy, 4, 720

[62] Marteen Floris De Wilde, 'Tax Competition within the European Union – Is the CCCTB Directive a Solution' (2013) 7, Erasmus Law Review, 1, 1

A concluding assessment of CCCTB scholarly commentary suggests the proliferation of earlier research focused on the general merits and challenges of the CCCTB in relation to how conceptually it would resolve general tax arbitrage concepts such as TRPRICE and group relief, particularly in a comparative context with other instruments such as GAAR's. More recent research, following more detailed consultations between the Commission and Member States and the publication of the EC Directive proposal[63] has attempted to address more detailed challenges around the how proposal would practically work in the context of specific tax system anomalies of individual Member States, in the context of various tax system externalities such as accounting rules, as well as in regard to alternative ways of trimming down the proposal to make it more manageable in the context making it more amenable to securing at least enhanced cooperation. Little scholarly research appears evident with regard to articulating a successful implementation proposal for the CCCTB, as arguably the biggest challenges are not centred on the merits of the tax proposals per se but rather the way in which it may be adopted transitionally rather than in its totality. The largest piece of prospective EU tax law change demands a defined implementation path possibly through transitional phasing that addresses the concerns that have been well researched and documented to date and this remains a clear gap in research commentary. Similarly, there is little research on the likely corporate behavioural impact of a CCCTB. Extending beyond the conceptual aspects of the CCCTB would suggest a need to understand how various stakeholders would react and the impact on its tax avoidance mitigation objectives. Without a view on this it becomes difficult to assess the merits of a solution and such a research gap suggests there is some way to go before we fully understand the likely feasibility of this as an instrument to curb EU tax arbitrage.

For the purposes of this research, the CCCTB offers a useful contribution in a number of ways. A harmonised tax base relies on a single set of accounting principles and a common approach for offsetting losses. This would deliver a fair and equitable system of computation but is complex and likely to impact the economic decision process of MNEs and so may be challenged as not being decision neutral. The concept of a common accounting system has strong merit and it seems difficult to explain what forces are in place preventing this from being implemented in its totality across all Member States. International Financial Reporting

[63] Commission, 'Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121 Final

Standards is the only recent example of success in this domain. The concept of consolidation cuts neatly across Member State boundaries to allow MNEs the ability to level out pan-European tax base inconsistencies and therefore reduces the incentive to shift profits across such boundaries. FA furthermore, introduces a novel way of allowing MNEs the means to apportion profits across Member States based on certain predefined apportionment criteria. The principle is entirely fair and equitable, relatively straightforward and addresses many of the drivers of tax avoidance practices and so this point alone merits further consideration.

It is submitted, however, that the CCCTB is not a viable solution. The method and scope of consolidation inherent within the CCCTB proposal presents a particular issue. One key element to resolving tax abuse in the EU is to eradicate intra-group transactional profit and loss. The principle whereby a resident MNE forms a group entity with all its qualifying subsidiaries located in a Member State will prove unworkable as it will nurture MNEs to manipulate the legal consolidation thresholds. A further fundamental issue relates to the effectiveness of the FA and the weighting factors. If the formulas and weighting are defined in a specific and complex manner there exists the possibility of abuse particularly as it would be unlikely to be equitably applied across all industry types. The FA mechanism furthermore may generate uncertainty for the MNE as it is likely to be subject to reduced tax avoidance resulting from TRPRICE but there is some reason to believe that it may not prevent the same tax avoidance effect through corporate manipulation of the apportionment formula, particularly if corporate tax rates continue to remain divergent. Political inertia is setting in for this proposal which is attributable to the perception that it compromises their fiscal sovereignty, evidenced by the fact that ten member states have objected based on compromising the principles of subsidiarity and proportionality. On this basis alone, and irrespective of the merits of its consolidation and apportionment model components, it will fail as a solution option. The optional nature of the CCCTB similarly presents problems in terms of implementation completeness and would provide Member States with the burden of having to manage a CCCTB computation as well as their own national tax computations.

In terms of its compliance with the Bingham rule of law definitions, the CCCTB relates poorly to the demands of being intelligible, clear and predictable. The consolidation and FA definitions may be well defined in a legal sense but offer MNEs too much scope for working around to make them robust. The CCCTB does provide a clear type of dispute resolution path and although one could reasonable expect proper adjudicative procedures to be in place by

Member States it remains unclear what the outcome of this would be on all parties involved. On the positive side, there are neither adverse implications on human rights nor any adverse prospects for Member States to affront international laws in the pursuit of a CCCTB solution. So from a rule of law point of view the CCCTB would only be partially compliant with the Bingham criteria.

One alternative but related policy option promoted by a subset of Member States in the form of the Eurozone Euro Plus Pact and one that is being fervently discussed in academic circles relates to a derivative form of the CCCTB and is known as the Consolidated Common Tax Base, hereafter referred to as 'CCTB'. The CCTB adheres to the basic model of ensuring consistency in the EU tax base but significantly omits the consolidation and allocation elements of the CCCTB. This substantially eliminates the concerns expressed by many Member States relating to the CCCTB and provides a harmonised tax base capable of addressing many of the tax avoidance activities that Member States seek to address. In effect, the current national tax codes calculating taxable income across Member States would be replaced by a single and common set of tax rules, embracing a set of tax base metrics for consideration such as depreciation rules, inventory valuations, production costs, double taxation and loss relief. The Centre for European Economic Research has promoted a model approach for calculating and comparing effective average tax burdens for MNEs located in different countries and a study by Oestrecher et al[64] concluded that for a "large company the effective tax burden increases in all countries except Cyprus and Estonia"[65]. Even for smaller MNEs the effective tax burden rose but to a lesser degree. The component contribution that each element of the tax base contributes to the increased tax burden is difficult to define but the depreciation rules drive the most material impact[66]. There are complex and time related interdependencies between components that make any generalised statements around tax rule component impact difficult to state.

A more favourable assessment may be concluded from the Bingham rule of law assessment in regards to the CCTB. The CCTB relates positively to the demands of being intelligible,

[64] Andreas Oestrelcher, Timo Relster and Christoph Spengel 'Common Corporate Tax Base (CCTB) and Effective Tax Burdens in the EU Member States' (2009) Centre for European Economic Research, 9, 26

[65] Ibid, 9

[66] Ibid, 17

clear and predictable. The CCTB similarly provides a clear type of dispute resolution path within the context of a mandatory EU implementation and one could reasonable expect proper adjudicative procedures to be in place by Member States. Any concerns regarding uncertainty of outcome from such procedures are much more limited in the absence of the consolidation and apportionment concepts inherent within the CCCTB. There are neither adverse implications on human rights nor any adverse prospects for Member States to affront international laws in the pursuit of a CCCTB solution. So from a rule of law point of view the CCTB would be fully compliant with the Bingham criteria based on the proposals currently under review by Member States.

Furthermore, there is evidence that many states are willing to embrace the concept of a CCTB policy with countries such as Germany publically supporting such a proposal[67]. Political viability is not to be underestimated and when combined with a solution that closes out economic distortions and tax planning abuses, it is not difficult to see why this is a compelling solution. Considering the constraints of QMV, this diluted version of the CCCTB merits consideration. The longevity associated with debating the CCCTB proposal suggests a healthy appetite to negotiate a feasible solution to corporate tax abuses but Member States participants have never really overcome the fears around uncertainty, equitable tax sharing and potential revenue losses associated with consolidation and FA of the CCCTB. The CCTB would unquestionably addresses income shifting with broader tax bases leading to an aggregated higher effective tax burden across the EU and mitigate these concerns. The only key challenge will be whether it can implemented consistently and quickly enough across Member States on its own merit and with broad support across sovereign powers and their corporate taxpayers.

6.2.1.2 GAAR

A GAAR is a complementary instrument to more specific anti-avoidance legislation that a Member State may utilise to ensure that economic transactions are not artificially or improperly generated for the purpose of avoiding tax. A GAAR would usually have embedded within its wording a sentiment that a jurisdiction is seeking to achieve relating to a

[67] Bundestags-Drucksache 17/5748 [2011] 2

philosophy or approach based on the terms substance over form[68], or abuse of law[69]. GAARs differ from anti-avoidance tax rules based on general legal principles as they are codified and stated in legislation but differ from specific anti-avoidance rules as they are not focussed on being applied to specific situations. In the absence of a GAAR, it is left to the judiciary in dealing with abusive practices to decide whether a form succeeds or fails by applying the normal principles of statutory interpretation to tax rules.

A GAAR does not represent a unified or customised set of concepts and presumed outcomes. In some instances a GAAR may simply serve to legitimise a discretion that the courts are already exercising[70] or it may be establishing a more robust legal basis for assisting judicial rulings in attempting to curb tax avoidance practices. If a GAAR does not cover other corporate taxes then it leaves the possibility to shift elsewhere so the most effective form would be wide ranging in reach and perhaps unspecific to allow the judiciary to establish rulings across a wide range of circumstances. In establishing the need for a GAAR any jurisdiction would need to form a clear perspective on what it would likely curtail and what the economic impact of that would be.

The measures set out in a GAAR are usually fairly consistent but what distinguishes a GAAR from other legal doctrines is the relative importance or emphasis they place on certain forms, such as contracts, legal entities or arrangements. For example, in Germany special importance is given to the abuse of the legal forms that lead to a certain arrangement while in the UK the GAAR places emphasis on a business purpose test[71]. One key challenge Member States would have in effectively implementing such a solution relates to addressing the questions about what legal form is considered inappropriate in the eyes of the GAAR. Introducing a subjective element to a tax avoidance provision arguably continues to create uncertainty, a view substantiated in research by Troup[72] who objected to the concept of a GAAR as shifting responsibility for determination of tax liability away from the legislature to

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[68] *Gregory v Helvering*, 293 US 465 [1935]

[69] Case 33/74, *Van Binsbergen* [1974] ECR 1299

[70] Helen Lethaby, 'Aaronson's GAAR' (2012) BTR, 1, 27

[71] HMRC, 'HMRC's GAAR Guidance'(2013), 3

[72] Edward Troup, 'City Lawyers Call on Government to Withdraw Proposals to Tackle Tax Avoidance' (1999) <http://www.simmons-simmons.com/en/News/1999/01-Jan/GAAR> accessed 2 January 2013

the judiciary, since it required a body other than the legislature to consider what the legislature would have intended. In his view a GAAR can never achieve certainty so must always be wrong in principle but accepted the principles must be viewed with an open-mind.[73]

Merely stating that a form is artificial or improper does not necessarily infer that it is illegal. Unless the GAAR establishes a firm comparison benchmark differentiating between an economic objective and the associated legal means it is likely to fail. One further problem relates to the potential continued conflict between a GAAR and EU law as shaped by the CJEU. The CJEU interprets anti-avoidance tax laws in Member States from the perspective of adherence to Fundamental Freedoms which may or may not conflict with the tax norms purported to be protected by a Member State's GAAR. Given the potential subjectivity in a GAAR the CJEU may be a powerful force in its interpretation as applied in the context of an EU specific tax avoidance case. This has the potential to undermine the effectiveness of a Member State's GAAR at any point in time.

Among the selected countries, only the Netherlands does not have any formalised GAAR set out in legislation. In France, wide ranging abuse of law provisions[74] prohibits fictitious transactions and legal structures aimed at avoiding, among other taxes, corporation tax. In German, similar wide-ranging anti-abuse provisions[75] exist akin to what a GAAR would regularly cover. The provisions provide for defining a tax abuse structure although it does not prohibit the use of fiscally advantageous structures if there is at least one economic reason for the structure. If an abuse of law, transactional structure is ignored for tax purposes, with the tax liability defined as if a regular transactional structure had been utilised. In Italy, a limited GAAR exists[76] to ensure tax authorities are empowered to ignore "acts, facts and transactions intended to circumvent obligations and limitations"[77] provided under Italian tax law. It only

[73] Edward Troup, 'The consultative document on a general anti-avoidance rule for the UK— a view from a practising lawyer' (1999) BTR, 5, 62

[74] Procedural Tax Code (France) sL64 (*Livre des Procedures Fiscales)*

[75] General Tax Code (Germany) s42

[76] Law Decree 600 (Italy) 1973, art 37

[77] Karen Brown, *A Comparative Look at Regulation of Corporate Tax Avoidance*, (Springer, New York, 2012), 202

applies if such acts, facts or transactions are included in limited list of transactions or events. It is not a true GAAR because it only constrained by a limited list of circumstances.

The Netherlands has no specific GAAR provisions at all but restrict its policy provisions to include the assessment of substance over form when assessing transactions. Artificial transactions may be ignored by the tax authority through a determination of the facts rather than the form. The abuse of law provisions relate to an interpretation method developed in case law where the spirit of the law is decisive, rather than the exact wording but can be used only as a last resort. The UK is the latest EU Member State to adopt a wide-ranging GAAR aimed at abusive transactions[78]. In the UK, a study was initiated to consider whether a GAAR could deter and counter corporation tax avoidance, mindful of the need to retain a certain tax regime that is attractive to businesses and keeping costs for businesses and HMRC to a minimum[79]. This demanded a complex analysis, factoring the UK judiciary's current approach to statutory interpretation of tax statutes, similar approaches and outcomes elsewhere around the world, academic commentary and guidance, and projected benefits in the event that such a principle was adopted. It concluded that a GAAR would not be effective means for the UK tax authorities to attack tax avoidance due to the fact that it would imply a risk of eroding stability and certainty but did acknowledge that it would benefit the tax authorities where it specifically targets abusive schemes, ensuring more clarity where currently the judicial risk of stretched interpretation results in ambiguous precedents being set out for businesses.

The European Commission is recommending a common unified GAAR across all Member States, recently stating that "Member States should adopt a common General Anti-Abuse Rule, under which they could ignore any artificial arrangement carried out for tax avoidance purposes and tax instead on the basis of actual economic substance"[80]. There are arguably two different approaches that policymakers could consider in the formulation of an EU

[78] Finance Act [UK] 2013, part 5

[79] HMRC, 'Study of a General Anti-Avoidance Rule' (2010) http://www.hmrc.gov.uk/budget-updates/gaar.pdf accessed 2 January 2013

[80]Commission, 'Clamping down on tax evasion and avoidance: Commission presents the way forward', IP/12/1325 (2012) <http://europa.eu/rapid/press-release_IP-12-1325_en.htm?locale=en> accessed 14 January 2013

GAAR. Either target the taxation of activities based on their economic substance and effects or test the arrangement as if it did not take place. In the former approach, it is necessary to apply a number of substance tests to ascertain the honest characteristics of an arrangement. The real economic substance doctrine provision provides for an assessment relating to a transaction that does not have any value other than to create tax losses in which case it would be disregarded. It embraces the concepts of sham transactions, substance over form and business purpose. On the basis that an MNE have an incentive to generate transactional labels to manufactured economic activities, and therefore concealing the real benefactor jurisdiction, courts will be challenged to determine the objective underlying suspicious truncations. Such suspicions may only materialise into proper tax investigations if the tax authorities have a meaningful way of assessing whether there are legitimate reasons for structuring a given set of transactions. Even once these challenges are addressed, the courts are faced with a further difficulty in ascertaining how a taxable profit should be computed for an arrangement once the invalid transactions are stripped out.

There will always be the risk that courts will wrongly declare a legitimate tax planning activity as an abusive transaction. Simply looking at the tax benefit to an arrangement provides limited insight as a more thorough assessment of the distinctions between subjective and real substance will be necessary. It is questionable whether CJEU interpretation of subjective and objective substance behaviours would be any less complex than the current set of case law originating out of national courts but a settled set of acceptable and non-acceptable behaviours could be formed in a short time-frame, backed up with an interest and penalty regime. The alternative way to regulate a GAAR would be to apply a series of tests as if they did not exist to ascertain the outcome. By understanding and measuring against the metrics that are being used to quantify the outcome, an adjustment can be made to the transaction route by eliminating those elements that are in dispute in order to identify their materiality. A number of different tests would likely to have been completed to represent the various metrics. A number of offensive transactions that generate a material impact in the tax liability of a MNE may be disregarded for tax purposes, therefore requiring a MNE to think carefully about embedding transactions with no substance into a transaction route.

There are some clear advantages that could be reaped from an EU GAAR. Mitigating aggressive forms of tax avoidance as a result of the ability of Courts to judge not only the authenticity of transactions but also to pass judgment in light of alignment to the spirit of the legislation would be a step forward. The challenge would be in relation to national legislation, which may differ in spirit and therefore present different results to the same tax questions across different jurisdictions. All aggressive and artificial forms of TRPRICE and CFC where clear breaches of reasonable behaviour are evidently breached would be tackled by a EU GAAR. Any transactions that are proven to have no substance under the aforementioned criteria would be candidates for exclusion and a reclassification of the transaction route granted, thereby enabling the scope for TRPRICE and CFC abuse to reduce substantially. Member State tax authorities would, in theory, retain a means to enable enforcement of both the letter and the spirit of the law. Since a General Anti-Avoidance Principle effectively outlaws transactions whose sole purpose is to reduce tax liabilities, this permits transactions to be reclassified from a legal arrangement of tax avoidance into the illegal activity of tax evasion, better defining the transition in legal form from civil to criminal law. In contrast, an EU wide GAAR would not address a number of tax avoidance issues. Mild and responsible tax planning, and general forms of tax avoidance consistent with a taxpayers right to "order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be"[81] would still prevail. It is similarly unlikely to address THINCAP abuses apart from the most aggressive forms, as well as Group Relief abuses that would similarly continue. Repeated attempts at challenging the GAAR would still likely to occur because if a GAAR is successfully imposed there is no penalty to the taxpayer other than paying the tax due, with little incentive to not taking a chance in creating further abusive transactions to circumvent the tax in a slightly different manner at a later date. An absence of any GAAR penalty regime offers the taxpayer continued opportunities with little downside financial risk beyond any tax due if a transaction or set of transactions are re-classified as abusive.

In its own right it is difficult to envisage how a GAAR could be anything other than a, perhaps useful, compliment to a tax avoidance solution rather than a solution in its own right. For the purposes of this thesis, GAARs offer a useful contribution in that they provide a framework for outlawing transactions that are deemed to be tax abusive. Their proliferation globally suggests they form a use in the battle against tax abuse but this may reflect the ease

[81] *IRC v Duke of Westminster* [1936] AC 1

upon which they may be formed an implemented rather than the benefit they reap. They short-circuit the ongoing dependency on detailed tax rule changes that are arguably so burdensome in some Member States that they are on the verge of destroying any remaining order in the corporate tax system. Inherent unease at any proposal attempting to mitigate tax avoidance through the judicial interpretation of what is or isn't consistent with the spirit of the law doesn't make for a robust and politically feasibly solution that could be relied upon for addressing a material number of tax avoidance practices.

In terms of its compliance with the Bingham rule of law definitions, the GAAR solution relates poorly to the demands of being clear and predictable due to its provision for judicial interpretation. The rule may be well defined in a legal sense but offers the judiciary substantial scope for interpretation to make it unpredictable when applied to different corporate transactions. The GAAR could in theory provide a clear dispute resolution path and although one could reasonable expect proper adjudicative procedures to be in place by Member States these are entirely at the discretion of Member States themselves with no oversight by the EU in these matters. On the positive side, there are no adverse implications on human rights as there are no known repercussions on the MNE directors themselves in the event of a disputed GAAR action, nor any adverse prospects for Member States to affront international laws in the pursuit of a GAAR solution since any GAAR statement is likely to be sufficiently vague to challenge any international laws. So from a rule of law point of view the GAAR would only be partially compliant with the Bingham criteria.

A GAAR is unlikely to succeed at EU level simply because of the complexities of having to apply the same principle to similar transactions against differing jurisdictional tax rules. The growth of anti-abuse rules across Member States exacerbates the complexity of this solution. It is difficult to envisage how the EU could agree to a common GAAR proposal even though there is a common set of anti-avoidance judicial doctrines emerging across the world. The tax ethos and tax bases are divergent in many respects and what may be considered avoidance in one jurisdiction may not be considered in another jurisdiction. Certainty would be replaced with subjectivity, and any MNE adversely impacted by a GAAR judgement that conflicts with a fundamental freedom is open to challenge through the CJEU. The differences between GAAR principles and numerous case law doctrines are remarkably immaterial but what is apparent is the importance or emphasis given to a particular element of those principles can differ materially. For example, the UK GAAR stresses the importance of a business purpose test while the German GAAR focuses on the abuse of law. The CJEU conversely focuses on the abuse of Fundamental Freedoms. In this respect the GAAR concept will not form a solution to this research solution as it provides for a problem of interpretation since a MNE would be challenged by interpreting a certain GAAR provision in a way that may conflict either with the intended purpose of a national law or by an CJEU case law judgment both of which are stressing differing objectives. This generates uncertainty and forms no credible basis for a comprehensive anti-avoidance solution across the EU.

6.2.1.3 General Anti Avoidance Principle

In spite of the concept of a GAAR taking shape in certain jurisdictions and increasingly active discussions emerging at national and EU level regarding the feasibility of a GAAR, it is quite clear that the judicial system in the EU has been unable to develop a coherent anti-avoidance rule or principle. Consequently, initial academic research promoted by Freedman[82] promoted the concept of a General Anti-Avoidance Principle, hereafter referred to as GANTIP, that would differ from a GAAR in that it would "create a legislative principles based framework to guide the actions of taxpayers and revenue authorities and give the courts authority to develop a legitimate principle through case law"[83] although there is no evidence that this has been adopted for even high level policy consideration across any of our sample EU member countries.The essence of GANTIP, which is a national solution based on a principle rather than a rule, is that national tax authorities "would be able to challenge and declare null and void any scheme where the primary purpose was an artificial contrivance to avoid tax rather than representing a genuine economic transaction"[84]. Taking the objectives of a GAAR to a next level, the GANTIP aims to assault only the most material cases of tax abuse ensuring that anything peripheral is deemed legitimate tax planning. Therefore the advantage of a GANTIP that is embedded in national law is that it does not require substantial volumes of legislation to tackle tax abuse through tax avoidance as and when it

[82] Judith Freedman, 'Tax and Corporate Responsibility' [2003] 695, Tax Journal, 2

[83] Ibid

[84] Left Futures, 'My bill to allow HMRC to strike down tax avoidance schemes' (2012) <http://www.leftfutures.org/2012/09/my-bill-to-allow-hmrc-to-strike-down-tax-avoidance-schemes/> accessed 12 December 2014

arises, retrospectively. It would highlight commonality in addressing tax avoidance across Member States through various national rulings perhaps encouraging harmonisation of tax legislation over time. It has the possibility to be adopted widely across numerous Member States with no identifiable objections even though its impact will vary according to national tax law and possible variations in national interpretation across national courts.

Such an instrument of law should be considered and judged as a legitimating and regulatory device for use by Member States and not an exercise in precise rule making. The primary driver is to ensure transactions represent substance in accordance with national legislation, which in itself has been shaped through not only national law making, but also supplementary amendments to conform to CJEU judgments ensuring adherence with EU Fundamental Freedoms. To this effect it is a smart secondary device aimed at regulating tax avoidance at national level appeasing any fears regarding surrender of national sovereignty and ensures the enforcement powers of the GANTIP remain at national level too. One of the major issues to be resolved with both the GAAR and the GANTIP is its relationship with the underlying law. That relationship would be made much simpler if all Member State legislation were to be principles based legislation as its implementation would be seamless, avoiding all the ambiguities regarding a mix of rules based and principles based legislation. Rules are capable of undermining the effectiveness of principles. Such a landscape across Member State tax law is unlikely to be evident for some time, if ever, so although the case for some time the argument for a GANTIP remains legitimate, it’s effective implementation remains questionable.

A principles based approach is not without its issues. Providing the baseline intentions and purposive statements could be made by the legislators in the text of legislation itself, or it could be assessed and settled through the judicial system. Thus it is not clear where the source of legislative intentions would be stated or defined. Complexity in the tax systems at Member State level means that it may not always be possible to state what the legislation intended, as well as the point that if enacted at national level it may not necessarily generate a uniform playing field as the drivers behind anti-avoidance laws in each jurisdiction may vary. One pertinent reason for its lack of adoption to date probably relates to the fact that legislation would need to be enhanced with clear objectives, without which the rule of law would depend on subjective interpretation by local judiciaries. On a similar note, its adoption has not been assessed at EU level as this is largely a national solution that would not be conducive towards being implemented across jurisdictions whilst anti-avoidance rules remain under the remit of individual Member States. Furthermore, conflicting dilemmas between the intention of a Member State anti-avoidance law and the Fundamental Freedoms would not be resolved by national GANTIP's.

The academic reasoning behind a GANTIP, and indeed all principles based legislation, is that by replacing rules based tax legislation it gives national tax authorities and judicial bodies the power to interpret legislation purpose. Opinions differ on the connection between principles-based legislation and purposive interpretation. Avery Jones[85] argued that principles and purposive interpretation are one of the same in that legislative purpose is implicitly embedded within a principle. Some national courts may be unfamiliar or apprehensive about ruling on principles based legislation but common law is based on exactly that and so there should be little reason why this should be problematic. The Renton Committee[86] argued that purposive statements added little value to legislation as they are too frequently qualified by subsequent rules that may be aligned or in conflict. Some Courts have similarly been known to be apprehensive in the use of purposive legislation such as the Privy Council in 1996 which stated "Quite often the benefits of a "purposive" approach are illusory, since the purpose which is used as a point of reference merely reflects the contention of one or other of the parties about what the words ought to mean"[87].

It is true that the legislative purpose may be found in a principle. It could be argued that many leading cases in EU tax law identified in Chapter Four have reflected a robust role of the judicial system in assuming considerable discretion in the interpretation of rules. A GANTIP implementation would allow further empowerment to be assumed by the legislature and judiciary in relation to the taxpaying MNE and although this may be appealing to the current wave of public opinion it could raise concerns about the fundamental alteration of the balance of power between the Member States and their taxpayers.

[85] John Avery Jones, 'Tax Law: Rules or Principles' (1996) 17, Fiscal Studies, 3

[86] Renton Committee, 'Making the Law: The Report of the Hansard Society Commission on the Legislative Process', HC (1993), 172

[87] *Chan Chi-hung v. R* [1996] 1 All ER 914, 922b

In terms of its compliance with the Bingham rule of law definitions, the GANTIP, assuming it takes the form of a solid statement of principle(s), relates satisfactory to the demands of being intelligible and clear but poor in its requirement to be predictable. A GANTIP offers too much scope for interpretation and its reach is far broader than that would be the case under a GAAR to make this anything but unpredictable. Akin to the GAAR, the GANTIP could be assumed to offer the opportunity for a Member State to implement a clear dispute resolution path and proper adjudicative procedures. On the positive side, there are no adverse implications on human rights and it is unlikely that a statement of principle would ever be drafted that would challenge international laws. So from a rule of law point of view the GANTIP again would only be partially compliant with the Bingham criteria

The GANTIP offers a useful contribution to the solution debate as it introduces a previously ill-defined distinction between the role of tax principles and tax rules. Sympathetic appraisal of the GANTIP stems from the view that many forms of mainstream tax avoidance would be subject to rigorous challenge by Member State tax authorities such as instances whereby income is shifted or reclassified. For the purposes of this research it is not seen as a viable solution for broadly similar reasons behind rejecting the GAAR. There is a certain irony in promoting a solution based on a statement of principle being identified in the legislation that aims to clarify a purpose. For the most part, legislation is generally fairly well understood in its purpose, with the only areas of uncertainty relating to those elements of legislation where it is highly technical. Even in these situations a GANTIP would be unlikely to assist. It is similarly only a narrowly focused solution that may be applied at national level with little prospect of a harmonious principle being adopted across all Member States. Any attempt at either achieving an agreed GANTIP for EU wide adoption let alone the prospect of understanding which judicial body, CJEU or Member State judicial functions, would be most authoritatively placed to assume responsibility for interpretation renders this solution as unworkable.

6.2.1.4 TAARs

A TAAR represents an anti-avoidance instrument deployed by Member States and may be defined as "a specific and very detailed rule… added… to tax legislation….that frustrates one kind of avoidance transaction or another"[88]. It "represents a middle route between the

[88] Rebecca Prebble and John Prebble, 'Does the use of general anti-avoidance rules to combat tax avoidance breach principles of the rule of law? A comparative study' (2010) 55, St Louis University Law Journal , 21, 25

applications of a general anti-avoidance rule, whether legislated or judicially created, and the use of detailed technical measures to counter every transaction that is considered unacceptable"[89].

The proliferation of TAARs across Member States suggests that these have been the simpler approach to attempting to resolve specific avoidance schemes in a particular jurisdiction at any one point in time. Varying degrees of coverage and complexity are evident across Member States in the deployment of TAARs in national law although the search for more general and comprehensive measures to counteract ongoing avoidance suggests that there is consensus on their limited value, providing support in only certain circumstances to tax authorities who have been instrumental in demanding detailed and specific tax avoidance rules as a tool for cracking down on offensive tax avoidance activities.

The concept of targeted rules implies that legislators can predict impending offensive transactions, otherwise a set of TAARs need to be substantiated with a GAAR provision. If legislators could foresee all varieties of tax avoidance, they would pass specifically targeted rules to frustrate those endeavours and not bother with any further efforts to resolve avoidance activities either individually or bi-laterally with other Member States or the EC. The most specific of rules will always have borderline cases. TAARs are typically very specific and detailed. Unfortunately the more specific and detailed a tax system's rules become, the more ways people find to circumvent those rules[90]. One failure of the TAAR provisions stems from the fact that a TAAR may end up being so specific that it results in the need for further detailed legislation to counteract consequential avoidance activity. This merry-go-round of continual catch up frustrates the tax authorities, whose discretion is impaired through the implementation of TAARs, and the cost of tax planning and resulting uncertainty is a burden on business. The value of certainty is placed highly on discussions in the corporate tax arena. Ironically, one could argue that TAARs increase certainty for MNEs in specific areas as they articulate the line of acceptable behaviour for a given transaction or scheme. On the other hand, the fact that a TAAR rarely closes all loopholes suggests that

[89] Judith Freedman, Geoffrey Loomer, John Vella, 'Corporate Tax Risk and Tax Avoidance: New Approaches', (2009) 1 BTR ,92

[90] Judith Freedman, 'Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle' (2004) 4 BTR, 346

there is a high degree of uncertainty associated with TAARs as MNEs constantly assess ways of circumventing the rules.

Again, a review of a TAAR in the context of the Bingham criteria provides interesting conclusions. In terms of its compliance with the Bingham rule of law definitions, the TAAR satisfies well the need to be clear, intelligible and predictable. By definition a more targeted rule is precise and limits scope for misinterpretation by either the corporate taxpayer or the judiciary. Assuming a TAAR is embraced within the context of regular tax legislation at Member State level there could be every reasonable expectation that it would benefit from a clear dispute resolution path and proper adjudicative procedures. There are no obvious adverse implications on human rights and it is unlikely that a targeted rule would ever be drafted that would challenge international laws. So from a rule of law point of view the TAAR, on the face of it, looks reasonably compliant. Where it potentially fails is in relation to some other legal interpretations regarding the rule of law. Some commentators have taken Bingham's criteria regarding clarity and predictability to the next level. Dicey speculated that the rule of law demands "the absolute supremacy or predominance of regular law as opposed to the influence of arbitrary power"[91] implying that the rule of law demands a clear, comprehensive and assertive legal statement rather than a series of "isolated commands[92]". This does not sit particularly comfortable with the concept of a TAAR but upon review perhaps this rule of law requirement is a little less relevant than first meets the eye. If a legal problem relates to specific and complex commercial transactions practiced across jurisdictional boundaries that are deemed to be inconsistent with a tax rule then surely a comprehensive legal statement is rendered meaningless. A targeted problem naturally favours a targeted solution but a more straightforward assessment may assume that its simple lack of broad coverage renders it as a partial solution and to that extent not worthy of full strategic tax policy consideration. One may view the promulgation of TAARs as part of a general tax policy whereby specific schemes are targeted with precision and those cases of abusive behaviour that might defeat a TAAR warrant the implementation of a GAAR as a back-up.

[91] Albert Dicey 'Introduction to the study of the law of the constitution (1965) 10, 4

[92] Rebecca Prebble and John Prebble, 'Does the use of general anti-avoidance rules to combat tax avoidance breach principles of the rule of law? A comparative study' (2010) 55, St Louis University Law Journal, 21, 22

One option open to Member States is to formulate more purpose-based TAARs with the focus on setting boundaries around the commercial intentions behind enacting a transaction rather than the boundaries around the specific details of such a transaction. There are clear examples of this in Member State law, such as the latest debt buyback anti avoidance rules in UK[93]. This legislation advanced earlier provisions that stated that the targeted anti-avoidance rule on debt release schemes apply "rules about impairment losses and release of debts in the case of companies connected with other companies"[94]. A similar example can be evidenced in France whereby a specific withholding tax of fifty per cent[95] is imposed on dividends and interest it can be demonstrated that the relevant transaction does not have the main purpose or effect of localizing such income in a non-cooperative country promoting a lower tax rate. It begs the question in the context of all these purposive TAARs whether a more rounded solution could not be more effectively deployed under the authority of a purpose-based GAAR that would cast a wider net and necessitate fewer legislative provisions in national law. In the absence of any purposive reasoning, a TAAR would demand notes accompanying the legislation detailing the framework for application of the provision by the taxing authority.

Despite these advancements towards purpose based TAARs, they are not generally considered to be the Member States weapon of choice in respect to tackling avoidance, and the consensus regarding their usefulness being limited to a complementary set of provisions only as such renders the analysis of their worth as a strategic solution necessarily short, notwithstanding the fact that consideration needs to be made of their current proliferation in the context of such a strategic solution. For this reason alone, and in spite of its favourable reflection in light of the rule of law assessment, this solution is rejected as a feasible solution either as part of a solution or in its totality. Consolidating TAARs into a harmonised set of targeted tax rules across all Member States would be difficult to achieve in a reasonable time period, if at all. Akin to the GAAR If a serial tax abuser was faced with a series of TAARs there would always be opportunities to circumvent the rules either discretely and indirectly, or directly in a challenge to the CJEU if they were felt to be inconsistent with any EU Fundamental Freedoms that sit at the heart of all tax abuse activities.

[93] Finance Act (UK) 2012, 23

[94] Corporation Tax Act (UK), 2009, 5, 6

[95] Finance Bill, (France) 2009

6.2.1.5 Other Legislative Proposals

Member States have, over time, advanced a comprehensive, if not fragmented, set of anti-avoidance legislation that attests to the difficulty in formulating a credible set of legislative provisions to address tax avoidance. Furthermore, various soft law initiatives from institutions such as Commission and OECD have added to that mix of legislative provisions, none of which is necessarily formulated with a view to resolving the entire problem or indeed necessarily have any objective appreciation as to how much of a given problem it will ultimately achieve or contribute towards a EU wide solution. Despite the colour that this mix of legislation offers, we can identify a few specific themes that are worthy of identification and analysis across our sample set of Member States. This is primarily looking at from the perspective of the source of legislation, the scope and content of the legislation and the target of the legislation. The source of legislation may be Member State or EU based although at present it remains firmly within the remit of the former. The scope and content of legislation varies from initiatives focusing on business transactions, corporate governance to accounting standards. The target of the legislation can similarly vary from MNEs, tax avoidance scheme promoters, accounting and audit MNEs to any other intermediary potentially considered a stakeholder in the tax avoidance process.

With regards to other key legislation at a national level, there is evidence of disclosure legislation as well as legislation aimed at curtailing specific promoted schemes. Aimed at combating pre-planned tax avoidance schemes, they are capable of capturing more broadly defined tax avoidance activity. Scheme disclosure regulations permit an upfront attack by providing tax authorities with relevant and timely data that ensures organised abuse may be addressed at the earliest stage feasible. The popularity of promoter penalty regimes similarly serves to act as an effective deterrent to organised abuse and come with significant financial penalties to deter such practices. The UK has been the pioneer of this legislation in the EU and its provisions enacted in 2006 were aimed at providing HMRC with an early warning system regarding potentially abusive corporation tax arrangements. The legislation[96] defines a tax arrangement as one where a tax advantage is sought, where that tax advantage is expected to be the main benefactor of the arrangement and comes into the description of a

[96] Finance Act (UK) 2004, 5, s30-32

hallmarked scheme. Reinforced with a penalty for scheme promoters this approach has been successfully implemented by HMRC, with 40 schemes being successfully challenged between 2010 and 2012 according to a report by the National Audit Office[97]. This report also raised concerns about a spectacular 41,000 unresolved scheme cases that have not been reviewed suggesting that although the legislation is conceptually sound the practicalities of enforcing it are burdensome, perhaps reflected in the "very long timescales involved in investigating, litigating and resolving avoidance cases, with the oldest cases dating back to the early 1990's"[98] It may also be a reason why no such similar scheme is existence across other EU jurisdictions.

There are other legislative solutions available to tax policymakers at a national level. Akin to all national legislation, of course, the effectiveness of such statutes is dependent on how many other Member States follow suit. Some Member States such as France and Germany are currently working closely together on harmonisation of rates and rules to present a heavyweight precedent for other Member States to follow in their stride. Research by Murphy[99]proposed promoting legislation for revising the source and residency principles. Obliging MNEs to file statutory accounts identifying the ownership of revenue generating assets ensures visibility to identify variations between the reporting jurisdiction and the jurisdiction in which they are physically located. It necessarily follows that the tax liability should correlate to the jurisdiction in which the entity is actually located to correctly compute a residence based tax liability. The other angle to Murphy's research proposed to simplify the tax system by "elimination of corporate allowances and reliefs"[100] available to be used either in their entirety, to MNEs operating in certain industries where abuses are more widespread, to MNEs who are using such allowances or reliefs with no obvious correlation to their underlying business or just to those MNEs that have the resources to avoid tax. A consensus may emerge to simplify, reduce or eliminate such ad hoc allowances and reliefs in statutes across all Member States and replace with direct intervention by the government in those

[97] National Audit Office, 'Tax avoidance: tackling market avoidance schemes', (2012) <http://www.nao.org.uk/publications/1213/tax_avoidance.aspx> accessed 29 January 2013

[98] Ibid, 31

[99] Richard Murphy, 'Closing the European Tax Gap', Tax Research LLP (2012) <http://www.socialistsanddemocrats.eu/gpes/media3/documents/3842_EN_richard_murphy_eu_tax_gap_en_120229.pdf> accessed 26 January 2013

[100] Richard Murphy, 'A Flat Tax for the UK? The Implications of Simplification' (2006), ACCA, 15

parts of the Member State economies that demand the pursuit of certain economic objectives. There are, however, many other forms of tax system reforms aimed at addressing reliefs and allowances. For example, research by Griffith, Hines and Sorensen[101] and Mooij and Devereux[102] advocated the Allowance for Corporate Equity (ACE) system whereby MNEs are allowed to deduct an imputed normal return on their equity from their corporate income tax base rather than interest deductions on their debts. Variations of this are reflected in the Allowance for Shareholder model advocated by Brys[103], as well as the Comprehensive Business Income Tax model advocated by Cnossen[104]. These have been implemented in part or in full by various countries over recent decades targeting principally the ill effects of THINCAP, neutralising double taxation and the mitigating distortions between new equity and retained earnings. However, the key constraint is that these reforms are less attractive when implemented unilaterally and require more substantial and broader adoption for them to be effective alternatives of sourced based corporation tax systems.

If fundamental reform of the tax system attracts limited enthusiasm then accounting reform is an alternative approach. Although the CCTB has harmonised accounting reform at its heart, there is a specific and separate candidate for legislative consideration at both Member State and EU level relating to rationalisation and improvement of the proliferation of accounting standards and disclosure rules that have been enacted at all levels of the EU economy. Interestingly the driver behind such changes have largely been the MNEs themselves who have sought common levels of principles, rules and disclosures across jurisdictions to enable them to operate on a more levelled basis, supported and recognised by governments, accounting bodies and audit firms. Although such diverse support has possible different driving forces, the impact of accounting standards have been to expose tax avoidance stakeholders to a potentially powerful weapon in their fight against aggressive tax planning by making it transparent how the correlation between accounting standards and potential tax avoidance practices are linked. The link, for example, between International Financial

[101] Adam Besley, *Dimensions of Tax Design: The Mirrlees Review* (OUP, Oxford, 2011), 10

[102] Ruud de Mooij and Michael Devereux, 'An Applied Analysis of ACE and CBIT reforms in the EU' (2010), 119

[103] Bert Brys, 'The Box System in the Netherlands', (2006), Reflets Perspectives de la vie Economique, 3, 39

[104] Sijbren Cnossen, 'Company Taxes in the European Union: Criteria and Options for Reform, 17, (1996), IFS, 4, 67

Reporting Standards, hereafter referred to as IFRS, accounting policies and TRPRICE is widely documented. For example, Fris and Gonnet[105] claiming that the adverse balance sheet impact of adopting IFRS accounting policies encourage TRPRICE. Disclosure is a useful corollary to accounting standards and adds an extra dimension to regulate MNEs standards by exposing them to public scrutiny.

When a Member State employs a separate accounting tax system, it, in effect, protects the income-producing activities taking place in its jurisdiction. There are implications when a MNE operating across the EU attempts to assign some of its income to a specific jurisdiction. Under the separate accounting system, the transactions are measured in accordance with the tax base and the tax accounting conventions of the jurisdiction to which it is attributed. Similarly, the activity is appraised separately from related transactions carried out by the same MNE in different Member States. Accordingly, every separate accounting system has its own TRPRICE rules for segregating integrated transactions occurring in more than one Member State. The harmonisation of tax accounting rules and associated reporting disclosures is one such way of mitigating these anomalies that encourage TRPRICE.

A proposal[106] promoting "country by country reporting, requiring all MNEs to report sales, profits, and taxes paid in all jurisdictions in their audited annual reports and tax returns"[107] has been advanced. Such information has traditionally been difficult to collate by the tax authorities, and would be resolved by country by country reporting identifying where corporations are located and what they do, how much business they do in each state as measured by an agreed financial metric, and how much tax they pay in each and every Member State that they have a presence. It would "hold companies to account and force them to change their behaviour under the glare of public, regulator and investor scrutiny"[108]. In the current environment MNEs typically "publish segmented information in their public accounts that breaks their business transactions down by product or business lines". There is no

[105] Pim Fris and Sebastien Gonnet, 'A European View on Transfer Pricing After Glaxo" (2006) Tax Planning International – Transfer Pricing, Bureau of National Affairs <http://www.nera.com/extImage/PUB_TP_after_Glaxo_TP1536.pdf> accessed 26 July 2013

[106] Task Force on Financial Integrity and Economic Development, (2012),<http://www.financialtaskforce.org/issues/country-by-country-reporting> accessed 28 January 2013

[107] Ibid

[108] Ibid

obligation or indeed any commercially motivated reason to publish data on a geographical country by country basis even though corporate entities are taxed in this way. Statutory reporting based on being a unified entity does not correlate with the way in which they are taxed. MNE subsidiaries constituting a group entity are taxed individually making it difficult to establish a view as to whether any abuses of law are taking place. Proposals being promoted by organisations such as The Global Reporting Initiative[109] and the Publish What You Pay campaign[110] seek to enhance transparency about the contribution made to different Member State jurisdictions. An existing EU directive[111]already provides a valid starting point for the EU to begin exercising some authority in these areas.

Similarly at EU level, the EP passed a resolution to urge the International Accounting Standards Board, hereafter referred to as 'IASB', to move beyond the current voluntary accounting guidelines and invoke a mandatory, more rigorous set of standards and reporting disclosures, including on a country by country basis[112]. Accounting reform has the prospect of exposing, and potentially addressing if implemented with rigour, TRPRICE and group trading relief. There are three possible solutions to consider. First, empower a body such as or EU to grant the IASB regulator status, with all the necessary funding, remit and enforcement powers mandating it with the regulation of audit and accounting firms to ensure such standards and disclosures are met. Such a regional or global mechanism was identified by Ville-Pekka who stated "national legislation insufficiency in economic globalisation makes room for some global mechanisms and their distribution, which is conducted by powerful anti-tax forces"[113]. Second, EU lobbying for ensuring Member State governments legislate for the mandatory implementation of accounting standards, tightened up to prevent

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[109] Transparency International, 'Transparency in Corporate Reporting: Assessing the World's Largest Companies' (2012) <http://issuu.com/transparencyinternational/docs/2012_transparencyincorporatereporting_en> accessed 27 January 2013

[110] Publish What You Pay, 'Country by Country Reporting' (2011) <http://www.publishwhatyoupay.org/about/advocacy/country-country-reporting> accessed 27 January 2013

[111]Council Directive (EC) 2004/109/EC

[112] European Parliament 'Promoting Good Governance in Tax Matters' (2010) (2009/2174)

[113] Ville-PekkaSorsa, 'Not Against the Windmills: Fighting Tax Avoidance - Promoting Strategies for Global Taxation' (2005)', in Penttinen, Sorsa and Ylonen, *More Taxes – Promoting Strategies for Global Taxation* (Attac, Helsinki, 2005) 104

TRPRICE, deferred taxation and other similar loopholes. Third, a solution promoted by Murphy suggests that in the absence of harmonised accounting standards, MNEs should be required to disclose "the consequence of differing accounting systems on the calculation of group taxation liabilities" [114], and supplemented with "disclosure of tax avoidance arrangements giving rise to tax deferral"[115] as part of any statutory disclosure. This latter softer solution approach assumes a behavioural change on behalf of MNEs as they respond to such public disclosures.

Any advancement in harmonised accounting standards and reporting disclosures needs to be unilaterally agreed at EU level or beyond rather than on a bilateral basis as is the case currently between a MNE and Member State. Large corporate organisations typically retain the sort of financial accounting data being requested so the cost of implementation would be minimal. Consistent adoption across the EU of a common standard means there can be no claims of unfair competitive disadvantage. As a note of caution, reformation of accounting rules and reporting does not solve all our corporate tax avoidance issues either directly or in their totality. It is the scale and volume of tax avoidance that it struggles to address rather than the complexity. For example, THINCAP would not be impacted by such reform in itself. Of course accounting standards can expose THINCAP, but it cannot be made effectively illegal without both challenging the validity and practice of the OECD arms-length principle and challenging MNE group debt arrangements, which is difficult without impacting the corporate rights and structures of modern business. Similarly for TRPRICE, accounting and disclosure reform can expose and highlight to the tax authorities TRPRICE arrangements but it still requires intervention and enforcement by the national tax authorities to pursue and resolve. Only a common legislated penalty regime aimed at MNEs pursuing aggressive TRPRICE arrangements across EU substantiated by a well-resourced set of tax authorities would be capable of reducing TRPRICE avoidance practices.

For the purposes of this research, the accounting angle to a solution proposal has strong merit. One could reasonably assume that any solution alluding to resolving tax avoidance

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[114] Richard Murphy, 'Closing the European Tax Gap', Tax Research LLP (2012) <http://www.socialistsanddemocrats.eu/gpes/media3/documents/3842_EN_richard_murphy_eu_tax_gap_en_120229.pdf> accessed 26 January 2013

[115] Ibid

through the use of tax law changes or changes to the tax system itself are fraught with complexity due to the unanimous and consensual nature of approval required and the time that it would take to achieve this if at all. Tax law solutions themselves, by nature, are focused on resolving the tax issue directly. An accounting solution attacks this from the perspective of exposing the avoidance. The challenge relates to whether exposing the avoidance is sufficient for other forms of resolution to then take hold such as triggering Member State tax investigations, adverse publicity resulting in moderating tax abusive behaviours, or perhaps enforcement via a GAAR or GANTIP executed at EU level.

Legal attestations offer an assurance that compliance has been attested to by an individual. There is evidence of successful implementation of such an approach in other jurisdictions, not necessarily in relation to tax abuse but in relation to financial controls and disclosure, [116]and in relation to regulatory compliance within the financial services industry[117]. In relation to our sample set of Member States Germany has legal attestation requirements associated with its German Corporate Governance Code[118] as does France with its Financial Security Law[119] and Netherlands with its Tabaksblat laws[120]. The pertinent text in Sarbanes Oxley states that the signing CEO and CFO must confirm that they are "responsible for establishing and maintaining internal controls and have designed such internal controls to ensure that material information relating to the MNE and its consolidated subsidiaries is made known to such Officers by others within those entities, particularly during the period in which the periodic reports are being prepared”[121]. In the Capital Requirements Regulation the pertinent wording states that an Officer of the MNE must make a disclosure when there is a “material breach of the laws, regulations or administrative provisions which lay down the conditions governing activities of institution”[122]

[116] Sarbanes-Oxley Act (US), 2002

[117] Capital Requirements Regulation (EU) No 575/2013, art 63

[118] Stock Corporation Act (Germany) 2002, art 161

[119] Loi de Securite Financiere, (France) 2003, 177

[120] Civil Code (Netherlands) 2004, s391

[121] Sarbanes-Oxley Act (US) 2002, s302

[122] Council Regulation (EC) 575/2013, art 63

In the case of Sarbanes Oxley there are civil[123] and criminal[124] provisions to the legislation and it is this point that provides the researcher with both the most compelling and potentially potent weapon against tax abuse behaviour but one that also provides the most difficult aspect to implement in the context of the EU Treaty. It has to be questioned whether a legal attestation is viable in the criminal context since how can a criminal charge be bought against an Officer of a MNE if an attestation contravenes a rule or principle but is consistent with a fundamental freedom promoted by the EU. The European Court of Human Rights would be the perfect judicial forum for such a challenge by a convicted Officer. Note from a Sarbanes-Oxley perspective such legal challenges have been made against the constitutionality of the legislation largely based on a lack of severability clauses but these to date have been unsuccessful[125].

Akin to many other solutions a legal attestation is not a solution in its own right but warrants further strong consideration as a useful enforcement point as part of a broader solution. From a corporate perspective, the prospect of a criminal conviction ensures that such legislation has the upmost attention of any responsible MNE Officer. In relation to the Bingham rule of law criteria the solution concept stands well placed. The legal statement outlining attestation requirements are likely to be entirely intelligible, clear, and predictable. Legal rights associated with a challenge would be accessible through the application of the law and any attestation requirement is unlikely to break any international legal obligations. The only area of uncertainty would relate to its protection to fundamental human rights. Irrespective of how the attestation requirement is worded it is always going to be open to potential challenge if the attestation challenges any aspect of EU Fundamental Freedoms. The nature and specific wording of the attestation is therefore of critical importance. If it pertains to a general statement around conformance with a purposive statement inherent within a GAAR it would arguably be set up to fail as it would be open up the attestation to a legal challenge based on subjective interpretation of the GAAR if such an interpretation was deemed to be inconsistent with a EU fundamental freedom. If it pertains to conformance to more specific rules associated with a TAAR or a specific tax rule again this provides a useful level of assurance to the Member State but again is open to legal challenge if a consequence of a TAAR or other

[123] Sarbanes-Oxley Act (US), 2002, s302

[124] Ibid, s906

[125] *Free Enterprise Fund v Public Company Accounting Oversight Board* [2006] 561 US

specific rule is deemed inconsistent with an EU fundamental freedom. In this case it could be argued that the TAAR or other tax rule under scrutiny is inconsistent with a EU fundamental freedom and not the legal attestation itself. As long as the tax rule is bona fide in terms of EU Fundamental Freedoms then so should the legal attestation associated with it. If the legal attestation provides the right level of attention to corporate compliance the barometer of success regarding its usefulness to deal with tax avoidance more generally is then placed on the effectiveness of the rule itself. If such a requirement for a corporate legal attestation was placed on an accounting rule or similar that was not a tax rule but indirectly had the effect of ensuring corporate behaviours were changed to have the effect of mitigating tax avoidance then this would be a useful tool for consideration. For example, thresholds could be set requiring explicit pre-clearance by either Member States or a EU institution for excessive tax avoidance baselined against specific criteria as identified through country-by-country reporting regulations. Such a concept warrants consideration in formal solution proposals. It relies on legal self-attestation against a rule, which in itself is not inconsistent with the EU Fundamental Freedoms as it relates to pre-clearance rather than adherence to a given threshold.

6.2.2 Non-Legislative Proposals

Alongside statutory measures a number of other policy directives that have a non-legislative basis are evident such as corporate governance codes and corporate social responsibility codes. Promoting good corporate governance remains at the centre of the debate for taxation and many other areas of corporate and governmental practice where behavioural and organisational factors are a material determinant of corporate tax planning and government policymaking respectively. Tax governance has two clear elements. First, it relates to the role, interaction, modes of governance and the framework in place to share and advance policy ideas between Member States and supranational organisations such as the EC and OECD when devising and regulating tax systems. Second, it relates to how corporate bodies, namely MNEs, conduct themselves in tax matters, specifically around controls and accountability. This distinction was further researched by Radaeilli and Kraemer[126] who

[126] Claudio Radaelli and Ulrike Kraemer, ‘Governance Arenas in EU Direct Corporate Taxation’, (2008), New Modes of Governance Project, Policy Brief 4, <http://www.eu-Newgov.org/database/PUBLIC/Policy_Briefs/NEWGOV_Policy_Brief_no04.pdf> accessed 31 January 2013

suggested that in respect to tax policy one had to consider “a set of governance arenas rather than a single entity”, identifying Member States, EC, tax authorities and MNEs as being the players in such a governance arena.

In regards to the EC, there have been various communications in recent times, some directly targeting tax governance[127], and others, amongst others, targeting specific tax avoidance issues such as TRPRICE[128], tax fraud[129], tax co-ordination[130] and double taxation[131], and others more general[132] in nature. There is little doubt that the EU is making assertive efforts to provide authoritative guidance to Member States and their tax authorities and resident MNEs in the domain of corporate tax. As they stated, “the EU and its partners have a strong common interest at this time in promoting tax cooperation and common standards on as wide a geographical basis as possible….to work together to encourage and support the move that has now started towards a broader acceptance of international standards of tax cooperation”[133]. Proactive initiatives emanating out of the Commission, notably the EU Code of Conduct Group codes of conduct, have gone some way towards enhancing the EU formal governance environment through promoting cooperation arrangements and implementing ECOFIN resolutions.

Through the evolution of corporate governance codes and various Member State legislation there is evidence of a movement towards a common definition of a harmonised view on what constitutes the accepted principles and practices of corporate governance. In light of a burdensome corporate governance framework across many jurisdictions, MNEs take account of the nature and standard of corporate governance when architecting schemes to shift profits.

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[127] Commission, ‘Final ‘Promoting Good Governance in Tax Matters’ COM(2009) 201

[128] Commission, ‘Work of the EU Joint Transfer Pricing Forum in the period March 2007 to March 2009 and a related proposal for a revised Code of Conduct for the effective implementation of the Arbitration Convention’ COM(2009) 472 Final

[129] Commission, ‘An Action Plan to Strengthen the Fight against Tax Fraud and Tax Evasion’ COM(2012) 722

[130] Commission ‘Growth-Friendly Tax Policies in Member States and Better Tax Co-ordination in the EU’ , COM(2011) 815 Final

[131] Commission, ‘Double Taxation in the Single Market’ COM(2011) 712 Final

[132] Commission ‘Company Taxation in the Internal Market’ COM(2001) 582 Final

[133] Commission, ‘Final ‘Promoting Good Governance in Tax Matters’ COM(2009) 201, 13

Only the UK[134] evidences any efforts to align corporate income tax laws with corporate governance legislation and policy guidance. It could be argued that Member States promoting corporate governance best-practice is attributable to differences in law rather than variations in recommendations that stem from the various governance codes across jurisdictions. Member State laws relating to corporate governance tend to reflect national attitudes and tolerances, whereas codes of conduct tend to express a common view on good practice.

All Member States have various codes of conduct that supplement the various regulations and laws governing corporate practice both in the MNE itself as well as in relation to its relationship with other bodies such as the State and its tax authorities. The EC has referred to the current EU corporate governance systems as a "patchwork of arrangements"[135]. Codes of conduct have a mixed review, with some critics such as Bratton and McCahery[136] arguing their worth is limited and "vulnerable to challenge"[137], while other such as Baccaro[138] pointing out the benefits, stating "international codes of conduct contribute to bring order to the unruly world of private codes of conduct"[139]. Others such as Painter-Morland[140] claim that MNE codes of conduct are "mere window dressing,,,[and that]… their western biases highlights the lack of stakeholder engagement in the code development processes" but that they can be made to work if integrated with a state guided ethics orientated programme of CSR.

[134] HMRC, 'Tax in the Boadroom' (2012) <http://www.hmrc.gov.uk/lbo/tax-in-the-boardroom.htm> accessed 1 February 2013

[135] Commission, 'Comparative study of corporate governance codes relevant to the European Union and its Member States', (European Commission Internal Market Directorate General, 2002) <http://ec.europa.eu/internal_market/company/docs/corpgov/corp-gov-codes-rpt-part1_en.pdf> accessed 27 January 2013

[136] William Bratton and Joseph McCahery, 'Tax co-ordination and tax competition in the European Union: Evaluating the code of conduct on business taxation' (2001) 38, Common Market Law Review, 677

[137] Ibid, 717

[138] Lucio Baccaro, 'Network Governance in International Organisations: The of Global Codes of Conduct' (2009) University of Geneva Working Paper, <http://www.unige.ch/ses/socio/luciobaccaro/workingpapers/bm.pdf> accessed 31 January 2013

[139] Ibid, 5

[140] Mollie Painter-Morland, 'Triple bottom-line reporting as social grammar: integrating corporate social responsibility and corporate codes of conduct' (2006) 15, Business Ethics: A European Review, 4, 352

For the purposes of this thesis, an enhanced EU wide corporate governance framework remains an interesting solution proposition. Arguably a robust set of corporate governance principles that are specifically focused on overseeing corporate tax or accounting practices that are established and monitored at EU level are a useful starting point. There is no specific institutional body in place that is well served currently to do this at EU level and it is hard to see how easily achievable it would be to attain consensus on these governance rules across such a diverse set of Member States operating in a complex tax and accounting environment. A light governance solution may incorporate the establishment of a single forum with representation from all Member States for discussing and managing consensual agreements regarding tax avoidance rule changes or responses to tax abusive practices. A more heavyweight governance solution may focus on responsibilities for incorporating matters such as nurturing formal tax and economic co-ordination and relationships between Member States, generation of tax rule Directives, tax recovery processes, managing political dialogue in levelling the tax avoidance rules across Member States or formulating a formal rule or principle akin to that described earlier in the chapter that is negotiated and implemented at an EU level. Some of these governance practices have formed part of the ECONFIN remit to date but could be further enhanced by either a more narrowly focused effort on promoting measures relating to specific tax avoidance practices or by folding into a separate institutional function under the same EU framework that has a higher profile and more robust mandate to deliver change proposals to the Commission for consideration in a Directive. Despite these options this research will not be taking this solution option any further. Tax avoidance is a complex matter in the EU and akin to other forms of non-legislative proposals the governance solution is useful and interesting but far too weak and open ended to be considered even a significant solution let alone a total solution. The magnitude of change required in a measured timescale against a backdrop of highly protected EU Fundamental Freedoms deems a governance solution as unfit for purpose.

To date Member States have not formally demonstrated a willingness to extend the boundaries of their corporate governance codes relating to tax matters from voluntary compliance to either civil or criminal sanctions. In accordance with the legality principle, it is common for Member State law retain a clear dividing line between these two laws for addressing tax offenses, broadly defined by the perceived boundaries between evasion and avoidance. A study by the Commission[141] identified all 35 corporate governance codes in place at that time across Member States had no civil and criminal sanctions relating to any matter. Some codes such as the UK Corporate Governance Code make no reference at all to tax[142]; others such as the German Corporate Governance Code[143]make reference indirectly, detailing specific procedures relating to corporate Supervisory Committees for compiling, auditing and authorising financial statements including all tax related transactions but have no formal civil or criminal sanctions. Arguably the EU and individual Member States have an opportunity to criminalise commonly agreed regulations relating to tax avoidance practices that don't necessarily impede the exercise of EU Treaty freedoms but are generally agreed to constitute tax planning abuses. Tax avoidance is not illegal and so what could be incorporated into a solution is a shifting in the boundary between what constitutes tax evasion and what constitutes tax avoidance. Tax planning arrangements reviewed by a judicial function can only be classed, upon failure, as ineffective for tax purposes, not illegal. Such arrangements and the law governing their legality can have a material impact on the commerciality of a business's relationship with its trading partners.

For the purposes of this research, CSR offers a useful contribution to the solution debate in that it leverages the dual powers of good corporate citizenship with public admiration, and all the commercial consequences of, a positive socially responsible corporate image. It denies any solution of the need to collate consensus around formal tax law changes and it sits at the heart of the arguments from proponents of the benefits attributable to corporate behaviours on tax avoidance practices. From an academic and practical perspective it cannot be considered to be anything more than an interesting complimentary element to a solution rather than a solution that is able to hold its ground in its own right. On this basis it is rejected as a formal policy approach but socio-political trends will likely retain life in this concept as a useful

141 Commission, 'Comparative Study Of Corporate Governance Codes Relevant to the European Union And Its Member States (2002) <http://ec.europa.eu/internal_market/company/docs/corpgov/corp-gov-codes-rpt-part1_en.pdf> accessed 26 July 2013

142 Financial Reporting Council, 'The UK Corporate Governance Code' (2012) <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.aspx> accessed 19 January 2013

143 Commission of the German Corporate Governance Code, 'German Corporate Governance Code' (2001) <http://www.corporate-governance-code.de/eng/kodex/7.html> accessed 19 January 2013

contributor to the wider behaviours associated with attempting to avoid the adverse impact of publicity associated with tax abuse behaviour.

We can distil useful conclusions from some aspects to these proposals and in particular review the likely impact from some of the components of the recent OECD BEPS proposal, identified in itself by Panayi[144] as the single most important advancement of a tax avoidance initiative for some time. This OECD report sets out a number of principles, the most pertinent of which to this research, promote an international tax system whereby the payment of tax payments are consistent with the jurisdiction in which the payments were made as well as the principle whereby taxable income is better aligned to income with activity through consideration of substance. Neither of these are particularly new solution concepts but it is the first time that these have been promoted as a formal policy proposal from the OECD. Challenges will ensue regarding transitioning such a policy proposal to a formal solution implemented by an institutional body with the authority to implement successfully across all Member States factoring in the scale and complexity of the undertaking as well as the need for generating consensus amongst all participating countries. Success will be dependent on Member State adoption of all the components promoted in the proposal within a similar timeframe. A failure to do so will mean there would be little incentive for individual Member States to enact the policy components in isolation as this will place domestic MNEs at an unfair competitive disadvantage to those located in Member States that haven't adopted the policy components. A review of literary commentary on the OECD proposal suggests there is strong public support for the measures, however it is unlikely that governments will act against the interests of their domestic MNEs should public favour wane in the future[145]. Historically governments have struggled to reach consensus on international tax measures. For example the aforementioned CCCTB first proposed in 2001, would address some of the issues that the BEPS Report identified, but has yet to be implemented due to lack of consensus among EU countries. Similarly the EU's plans to introduce a Financial Transaction

[144] Christiana Panayi, *Advanced Issues in International and European Tax Law* (Bloomsbury, London, 2015)

[145] Sullivan & Cromwell, 'International Tax Cooperation (2013) <http://www.sullcrom.com/files/Publication/daa218c9-a5a9-47fd-9424-74ec0d74971a/Presentation/PublicationAttachment/5d497f77-9a69-423c-9b8c-7df0b57f64c1/SC_Publication_International_Tax_Cooperation.pdf> accessed 19 November 2013

Tax which had strong public support in recent years was subsequently postponed due to lack of consensus among EU countries on its scope.

Elements of the OECD proposal are worthy for consideration in this research proposal. It highlights the necessity for an effective dispute mechanism[146], which is consistent with the rule of law notion defined by Bingham when related to the provision of a fair adjudication procedure and timely means to resolve disputes. It similarly highlights the need to address specific tax avoidance issues with specific measures implying that there is no one solution that addresses all avoidance issues in one hit. For example the proposal to address CFC via the harmonisation of Member State rules and limiting TRPRICE through enacting limitations on base erosion via interest deductions and other financial payments. Changes to the Model Tax Convention[147] are proposed to address the artificial avoidance of PE status as is the proposal to resolve TRPRICE through the alignment with a value creation concept.

6.3 Conclusion

The analysis has demonstrated that in recommending a reform proposal there are many considerations. At what level should a solution be pitched? Should the policy proposal seek to focus on leveraging commonality or addressing divergences? Upon which actor's shoulders should be given the responsibility of defining and eliciting consensus approval for a policy proposal? Which actor is best placed to implement such a solution proposal successfully? The lessons learnt for previous proposal failures provide a useful starting point since there are three common factors that pervade all these solution proposals and it on these point specifically that consideration needs to be made in our search for a solution.

First, there is a distinct lack of implementation authority underpinning all of these proposals. The distributed way in which the EU is organised from a political perspective and the sovereign protection afforded to and rightly protected by Member States with regards to direct tax makes defining and implementing an effective centralist solution no easy matter.

[146] OECD, 'Action Plan on Base Erosion and Profit Shifting (2013), 23 <Action Plan on Base Erosion and Profit Shifting by companies, the OECD> accessed 19 July 2013

[147] OECD, Model Tax Convention on Income and on Capital (2014)

The actual process of institutionalising the process of securing agreement and then empowering an authority to implement a proposal or set of proposals suggests such an approach is difficult to enact. The relationship between the key EU institutions themselves remains in a considerable state of uncertainty underpinning such institutional instability in the policy making process. In theory the EC could publish a treaty or code of conduct but such a process requires unanimous agreement before unified implementation across Member States can take place, suggesting a more discreet and indirect solution perhaps somewhat distant from direct reference to direct taxation itself may be more feasible. Alternatively, the EU institutions could overcome limitations in direct tax policy legitimacy by stimulating what Radaeilli calls "policy transfer by isomorphic process"[148]. Acknowledging constraints in implementing EU wide supra-national policies, Radaeilli advocates the use of policy transfer that relies on the advocacy of public policy in one jurisdiction and then centralised action to encourage the transfer of such public policy to a wider set of jurisdictions. Aside from the political and cultural constraints on making this effective we must acknowledge the absence of any centralised or hierarchical EU policy process. The EU gives the appearance of being more of an activist than a legitimate policy maker. All of the EC proposals appear to focus on resolving tax environment differences in Member States through harmonisation rather than identifying positive commonality in the tax environment that can be

Second, one senses that the solutions proposed to date are all rather one-sided. The derivation of solution proposals appear to target either the Member State legislators themselves or are sponsored by organisations pertaining to raise solution proposals with an emphasis on increasing corporate direct tax revenues or at least closing off specific tax avoidance practices rather than harmonising the tax base or tax rules. Such an approach may be interpreted as more confrontational towards the taxpayer seeking increased revenues rather than necessarily targeting a fairer harmonisation of direct tax rules that may ultimately have the same effect. Direct tax rule changes in the EU, whether sovereign states like it or not, need to secure, at a minimum, acceptance by corporate taxpayers. This is not formal approval but a general acceptance across the populous EU corporate taxpaying community that any changes are fair, clear, unambiguous and consistent with EU Fundamental Freedoms. Such a demand may on the face of it seem unusual but all of the formal proposals to date have not even secured

[148] Claudio Radaeilli, 'Policy Transfer in the European Union: Institutional Isomorphism as a Source of Legitimacy' (1997) <http://aei.pitt.edu/2710/1/002748.pdf> accessed 14 August 2013

unanimous support of the Member State community let alone clarity on the response by the taxpayers themselves. If a proposal does not secure taxpayer approval a given population of such a taxpayer is always likely to seek out gaps and anomalies to work around what may be considered penal.

Thirdly, the solutions promoted to date are generally competent at identifying the cause of issues and in some cases making policy proposals for addressing such issues but there is virtually no reference focus on the mechanics of actually overcoming the significant constraints regarding a decision making and practical implementation procedure. The decision making process in the EU regarding direct tax changes are far from clear. In the absence of addressing such complexities regarding enactment of direct tax changes into the EU the search for a workable solution will be fruitless. The EU is arguably one the most complex multi-tiered systems of government ever formulated, with a treaty empowered centre supplemented by sovereign systems of governments around the edge. From a direct tax avoidance perspective we need to understand whether a technocratic or political based solution is more appropriate. The EC may promote proposals but these are viewed as technocratic unless they are endorsed and agreed politically by all Member States. If the EC formulates proposals by non-political Officers then this may undermine the whole public policy formulation process from the outset. Formal direct tax rule initiatives embedded into an EU Treaty may be less effective politically than promoting informal norms and adopting the public policy transfer notion previously discussed. Policy making at EU level operates at what has been academically referred to as ‘super-systemic’, ‘systemic’ and ‘meso’ levels[149]. Adopting a direct tax policy at super-systemic or supranational EU level, encapsulating all the vital politically treaty-challenging concepts is challenging enough. Few public policy initiatives at this level are successful, and none at an EU direct corporate tax level aimed at curtailing tax avoidance. At the next level is systemic policy change, which places a reliance on institutionalised co-operation or intergovernmental bargaining. It is at this level that is dominated by the public policy proposals to date. The mechanics for policy proposals exist at this level but the policy enactment fails. At the policy shaping level, or ‘meso’ level, the EU institutions have been successful such as the previously discussed role of the CJEU advocating opinions in relation to direct tax rulings nurturing effective tax policy across the

[149] John Peterson and Elizabeth Bomberg, ‘Rationality, Structure and Power in EU Governance: A Process Dominant Approach’ (1997), 13 <http://aei.pitt.edu/2702/1/002754_1.PDF> accessed 12 August 2013

EU. What seemingly appears a simple analysis is quite telling in terms of public policy success in terms of direct tax policy solutions. Target a super-systemic public policy change and the force of resistance inherent within the multi-tiered system of government within the EU and it will probably fail.

The implementation of EU direct tax policy has a number of policy implementation options. Any solution may be instigated on a unilateral basis as a single Member State solution that gains tractions and as a policy is transferred over time more widely to larger parts of the EU. A solution may be instigated either bi-laterally or multi-laterally between two or more Member States with a long term objective to transitional adoption by a broader set of Member States. Conversely, a supranational EU initiative could be sanctioned at a super-systemic or systemic policy level in a unified manner but this has been the hardest challenge to date. The EU as a political system struggles to implement unified public policies in respect to direct tax for reasons already explained. It more generally lacks the monopolistic public policy powers that individual Member States have although it has public policy attributes, which any solution relating to this research will need to exploit. In the absence of a monopolistic force of advocating direct tax policy changes, the EU is to assume a compensatory role in a steering capacity in the sense of getting Member States to change their behaviours as suggested by Hix[150]. Further research by Laffan claims the EU can offer little more than a "challenge to the national political systems because they are confronted with the need to adapt to a normative and strategic environment that escapes total control"[151] suggesting that the cohabitation of two policy making systems at Member State and EU level make formal public policy in the direct tax domain difficult to instigate at EU level.

The other dimension to consider is the fundamental approach to the policy proposal. There remains a stark choice between advocating a policy starting from exploiting similarities versus closing out differences. Irrespective of where a solution proposal emanates, the policy maker has the choice as to whether to build out consensus from a set of common policy measures across the EU in the hope that over time these will be more broadly adopted and such consensus can be exploited to broaden out the reach to address other matters of tax

[150] Simon Hix, *The Political System of the European Union* (Macmillan, Basingstoke, 2005), 119

[151] Brigid Laffan, Rory O'Donnell, and Michael Smith, *Europe's Experimental Union: Rethinking Integration,* (Routledge, London, 2000)

avoidance. For example, the recent step change in tax transparency and exchange of information appears to be universally accepted as a means of exposing tax behaviours relating to tax avoidance by MNEs not just in the EU[152] but internationally[153]. Could this be exploited to across the EU to tax avoidance activities and could such as policy, over time, be extended down to the specific levels of tax avoidance activity? Formulating consensus within an EU institutionalised forum with the stated aim of nurturing agreement on addressing tax rule changes for mitigating tax avoidance issues is an approach with merit that acknowledges the limitations of EU level power over direct tax policy but would of course imply a lengthy and uncertain path to close out the most material gaps in tax policies across Member States. Alternatively, rather than building out consensus, the focus may be simply on identifying the largest tax policy gaps or at least those pertaining to being relevant to the most material tax avoidance activities and seek harmonisation and closure. The differences in tax policies represent differences in opinions, priorities and approaches from Member States and this in itself is a significant challenge in itself but of course would reap the biggest prizes in closing out tax avoidance. The contrast between these two approaches is subtle and represents a fundamental variation in the manner upon which the issue is being addressed.

The analysis in this chapter has demonstrated a number of key points. No scheme implemented to date at either Member State level or at EU level has been able to address materially either a single tax avoidance practice or tax avoidance practices in their totality. A number of schemes that have failed in their attempts to secure an agreed path to implementation demonstrate the level of challenge and complexity in securing reform, particularly given the effort demonstrated to date by both international and EU bodies in attempting to find such a credible solution. There is evidence of transitional thinking away from the focus on more bespoke Member State tax law reform or EU wide tax harmonisation to broader schemes such as the OECD BEPS proposal that embrace a much wider set of initiatives representative of the complexity inherent within the tax abuse issues prevalent in the EU. The litany of failed schemes may be a product of their disagreeable content or construct to the wide range of influential stakeholders whose support would be required; but

[152] Council Directive (EC) 2011/16/EU

[153] Global Forum On Transparency and Exchange of Information for Tax Purposes, ‘Tax Transparency (2013) OECD, <http://www.oecd.org/tax/transparency/draft%20annual%20report%202013%20%20for%20GF_2.pdf> accessed 12 December 2013

this chapter also demonstrates that the failures may well represent a more fundamental point regarding a lack of common agreement on the target of such schemes. Most schemes focus on invigorating the enforcement of Member State tax rules or to nurturing equitability in the outcome of the tax base distribution among Member States. Few schemes focus on regulating the source of the tax abuse, namely the corporate taxpayer and on changing behaviours that contribute towards decisions that are made resulting in tax abuses. In the assessment of these previously failed schemes we can infer from the above conclusions useful contributions in the formation a more credible solution proposal.

Chapter Seven: The Quest for an Effective Solution

7.1 Introduction

This thesis to date has established that the law relating to combating abusive corporate tax practices is in need of reform. There is a clear set of economic, political, moral and legal issues with the abusive conduct of MNEs relating to their tax abuse activities, often under the guise of exercising their right to EU Fundamental Freedoms. Solutions have been tried both nationally and internationally and these have not been effective, and others have been proposed but have not seen sufficient support to achieve implementation into law. On this basis alone, a fresh approach is required and such a change demands a change above and beyond the recent solutions adopted or proposed by Member States and other EU and international organisations. It is therefore proposed that EU law requires reform and the following two chapters establish a solution proposal substantiated by a critical analysis of its features against a set of legal conditions and metrics to endorse its credentials as a robust proposition.

This quest for an effective solution deviates from the approach more commonly adopted in mainstream tax avoidance proposals to date by providing for a hybrid scheme combining features of established legal doctrines and practices as well as new concepts. The underlying objective is to limit deductions capabilities in high tax Member States as well as reduce freedom to transfer income to lower tax Member States. Any successful solution needs to address the conflict between safeguarding the allocation of Member State taxing powers, with the need to protect EU Fundamental Freedoms. There are no relevant EU laws in place to address this conflict. Although there is a need to respect the conditions necessary to enforce EU Fundamental Freedoms and to reconcile with the conditions acceptable for a MNE to mitigate its tax liabilities, ultimately any design should support extensibility beyond EU borders. There is consensus on the need to better manage the conflicts within the internal market. This chapter aims to establish that it is possible to develop a solution that would prove effective and durable, and to propose a reform scheme that could implement that solution.

This solution proposal takes the form of a multi-dimensional scheme based around financial accounting disclosures and attestations implemented through an EU Financial Accounting Directive. Such a Directive would ensure consistent EU-wide disclosure requirements based around a set of specific reporting disclosures such as revenue by country and tax paid by country, more commonly referred to as country-by-country reporting, hereafter referred to as 'CCR'. The objective of CCR would be for MNEs to provide the relevant tax authorities, and the judicial system where referred, with a level of transparency that would assist them in understanding the economic structures of transactions and hence a better insight into whether any such structures could be considered anomalous and possibly abusive. CCR would be supplemented by a set of EU-wide metrics defining thresholds that form part of statutory financial reporting. The purpose of these thresholds is to provide parameters against which a tax authority would be interested in understanding the underlying economic activities contributing towards what would be considered an anomalous disclosure. The MNE would have to request pre-approval or provide explanations regarding any such anomalous breaches in order to satisfy the requisite tax authority that no further investigations regarding abusive behaviour is necessary. A threshold breach without pre-clearance would mandate an explanation in the annex to the financial accounts and if considered unsatisfactory would possibly trigger an investigation; but this decision would be at the discretion of the national tax authority. The Directive would set a target level of investigations for breaches to ensure lower tax jurisdictions benefitting from profit shifting are encouraged, but not necessarily mandated, to provide for a given level of investigations.

The final component underpinning the Directive would be an attestation requirement. An attestation, in this context, refers to a legally constituted sworn testimony in annual financial accounts, as mandated through an EU Directive, made by an Officer of a MNE affirming to the accuracy and integrity of supplementary statutory financial reporting data. The proposed legal attestations should be mandatory and made against the statutory financial accounts. Typically made by the CFO, the Officer would authenticate the accuracy and completeness of the submission in accordance with the Directive's requirements and to ensure that no data has been supplied to misstate real economic activity in a given country and to keep intentionally within the boundaries of the threshold reporting boundaries.

Attestation failures could be attributable to a number of outcomes, namely incomplete or misleading statements of affirmation of compliance, the absence of any explanation for threshold breaches that were not pre-cleared, and the disclosure of transactions that turn out to be wholly artificial in nature. Such attestations serve to ensure strong due diligence and governance over published data and to place legal accountability on an individual rather than a corporate entity, typically in the form of criminal liability. The legal liability construct definition would be important and would be set out in the Directive although these would be for guideline purposes only. Each Member State would be expected to establish its own penalties on the attesting Officer for an attestation breach. It would be expected that there would be a sliding scale penalty regime established to reflect both the severity of the breach and the frequency of breaches. Less material one-off breaches may attract a fine, but continued breaches may attract director disqualification. Only in the event of evidence of continued breaches that have a material impact on the tax revenues of a Member State would criminal liability be considered as a recommended course of action. This ensures that only in the most extreme violation circumstances that have been pursued repeatedly over time against the direction of the tax authorities or Courts would criminal liability be enacted.

Provision of criminal legislation as part of this reform proposal is intended to punish and deter violations of tax abuse, attracting narrow and precise boundaries to avoid ambiguity. Historically reform proposals have centred on civil actions to seek recompense for financial harm caused to the Member States' tax bases. At face value these tend to attract broader boundaries typically suited to case by case analysis of tax abuse. The primary objective of this reform proposal, however, is to advance a social consensus that over time will see the righteous majority conform to standardised non-abusive behaviour rather than to take the profit out of the crime. This Dworkinian link to morality better helps frame the permissible from the possible in relation to tax abuse and demonstrates to society that MNEs must take its basic moral code seriously. It is an indelicate legal tool but its power derives from such characterisation. The form of criminal liability as a last resort legal outcome would be at the discretion of each Member State jurisdiction but would likely take the recommended form of strict liability since this is an effective means to deter and penalise conduct which a State believes is wrong, and a conduct which cannot be excused for by personal reliance on third parties (reliance) or misinformation (causation). The political effect of the application of strict liability reinforces popular acceptance of the law and so the EU Directive would be expected to set out guidelines as such. Defences would typically be expected to be based around due diligence, reliance and constructive knowledge and such defences would be enunciated directly in the Member State legislation. Due diligence would enable a defence based on evidence of express oversight and control over the data published, and reliance would be based around access to data and formal internal controls to ensure adherence to the Directive's requirements . A defence of constructive knowledge would be based not around actual facts known by the Officer but rather the facts that he should reasonably know in the course of his duties as a MNE Officer. Recommended judicial proceedings would be based around summary trial with a penalty of director disqualification or financial fine in the event that a Court was able to prove misrepresentation liability.

Attestations do have legislative precedence in United States legislation[1], with a similar set of defence mechanisms identifiable in other legislation[2]. There is no expectation that this attestation requirement provides a guarantee against either identifying or mitigating breaches of lawful actions but is meant as a behaviour inducing provision that places responsibility and accountability on an Officer to certify the data submission relating to threshold metrics in the Directive. This in itself is a powerful tool for ensuring compliance given the criminal law provisions in place to address mis-statements of statutory financial data. The Directive should mandate the handling of attestation failures to be accommodated within the jurisdiction of the criminal law system of each Member State within a short period of time with safeguards against procedural abuse through the definition of formal guidelines set out in the EU Directive that would be expected to be followed by local legislation. An appeals process would reflect the standard judicial appeals process in each Member State, not necessitating any EU or independent appeals channel. An attestation would be expected to nurture improved internal controls and reliability of financial reports.

Despite the advocacy of criminal provisions in relation to non-technical violations of attestations, some constitutional perspective is required. There are limits to the EU's jurisdiction in relation to criminal law. The EU Treaty[3] explicitly reserves to Member States the right to administer criminal law and the associated administration of justice. Various cases[4] evidence support for this, confirming that criminal law resides outside the competences of the EU. It is submitted that such evidence does not preclude Directives from

[1] Sarbanes Oxley (US), 2002, s404

[2] Securities Act (US), 1933, s11-12

[3] Consolidated Version of the European Treaty [2012] art 82, OJ C326/49

[4] Case C-176/03 *Commission v Council* [2005] ECR I-5285

promoting criminal penalties to be legislated for by Member States as a necessary measure for countering serious wrongdoing. Case law does provide further direction in respect to the boundaries of EU criminal law jurisdiction. For example some cases[5] have upheld that the EU has no competence for establishing the nature of the penalty regime to be applied as this is the remit of the Member State themselves. The CJEU is in no position to impose specific criminal penalties but the proposed Directive may set out in quite clear terms a suggested criminal penalty regime for adoption. Case law[6] has suggested that violations of EU law should be punished in a manner akin to the legislative provisions in place for comparable violations of Member State law. By inference this eliminates the ability of the EU to harmonise criminal laws but again does not prohibit recommended courses of action in an EU Directive.

Collectively the thresholds and attestations locked into a CCR reporting solution shall be termed "Enhanced Disclosure and Attestation", hereafter referred to as 'ED&A''. None of these components are unique; but their collective usage to address this is novel. Central collation of 'ED&A' statistics by the Commission from Member States will serve as a measure of compliance and will provide useful analysis for ascertaining the impact on abusive tax behaviours that will form the basis of measuring success. This thesis rejects traditional tax law centric instruments to one that attempts to effectively address the underlying factors driving aggressive tax behaviours. The focus will not be on the root causes, namely tax rate differentials and loopholes in tax laws, both of which are legitimised through the EU Fundamental Freedoms, but rather the corporate tax strategizing behaviours that result from these root causes. The unique legal wrapper of the EU Fundamental Freedoms that legitimise many aggressive tax avoidance activities makes it a tough challenge. Just because the tax system is broken doesn't necessarily imply that it requires a solution targeting the tax system directly itself. Emphasising a solution on corporate taxpayer behaviours rather than the underlying direct tax system is a targeted response that avoids it being promoted as a direct tax system change, and so avoids all the resultant barriers to direct tax changes inherent within the EU as provided for by the EU Fundamental Freedoms.

[5] Case C-440/05 *Commission v Council* [2007] ECR I-9097

[6] Case 68/88 *Commission v Greece* [1989] ECR 2965

7.2 Solution Assumptions

Based on the lessons learnt from previous failed schemes or proposals, a number of fundamental assumptions are advocated to underpin the reasoning behind the features of the recommended solutions.

The first assumption is that it will be politically impossible to get all Member States to agree multilaterally to a direct taxation law proposal as there is no political consensus or EU wide regulatory obligation in place to facilitate such changes. If a proposal attempts to challenge the boundaries of existing tax law precedent as established by the CJEU, or attempts to harmonise the tax law rules or general tax law operating environment it will fail unless a paradigm shift occurs, closing out ideological differences of opinion across a substantial number of Member States. The likelihood of attaining political consensus for a broader proposal outside the immediate remit of direct taxation arguably has a better chance of success.

The second assumption is that any proposal must respect the concept of national sovereignty. Promoting a centralised EU solution will only become effective if the rights of Member States are acknowledged and provide a degree of autonomy for its enactment into law and law enforcement. National tax laws will remain and accounting disclosures must offer Member States interpretive flexibility within the context of their local rules.

The third assumption is that there is no obvious institutional entity or agreed process currently within the EU that is empowered to enact changes across Member States in the area of direct tax. On the face of it this may not represent such a material setback as such a mechanism is likely to demand a cycle of negotiation, consensual agreement, implementation governance and legal backing to ensure that it is agreeable to all Member States with practical foundations and robust legal authority.

The fourth and final assumption is that a proposal directed at addressing the issues identified in this thesis will need to exploit successful precedents identified with other, not necessarily directly related, laws and legal practices. On the one hand a unique problem could infer the need for a unique scheme, since experimenting with new legal doctrines or policies is unlikely to survive the challenges associated with implementing tax accounting law changes with the EU environment. On the other hand embellishing the existing tax system with changes or schemes that have failed to gain traction or work to date similarly does not bode well.

7.3 The Proposed EU Directive

The objectives to the proposed 'ED&A' Directive differ markedly from the existing Accounting Directives. EU Accounting Directives are primarily focused on protecting shareholders and third parties[7] whereas the objective of this 'ED&A' Directive would be to mandate disclosures for the protection of Member State tax revenues. The proposed 'ED&A' requirements should be applied to all listed and large non-listed MNEs across the majority of industry categories that are registered within the EU. Leveraging analysis of the European Classification of Economic Activities, referred to as 'NACE', by Beer and Loeprick[8], the focus would be on all industry groups except those that are characterised by a high proportion of assets attributable to intangibles and industry groups with a complex production process incorporating cross-industry activities. The proposal would be for only six of the forty industry groups to be excluded, namely health, entertainment, publishing, petroleum, legal and accounting and other services. Intangibles reduce the value of the profit shifting data because the allocation and pricing of assets offer a high degree of flexibility that grants opportunities for tax minimalisation. Industry groups considered complex would be included at a later stage only once the more vanilla industry groups had been included in the scope of the Directive. A large listed MNE would be defined in the proposed Directive as being one with gross revenues exceeding a monetary threshold, in the region of €50M or a balance sheet of more than €43m, thresholds consistent with threshold definitions of the EC[9]. It would also be applicable to listed and large non-listed MNEs registered outside the EU that have an operating interest and revenues in one or more Member States. In this latter instance, the international MNE registered outside the EU would be obliged to provide each Member State

[7] Council Directive 78/660/EEC, art 54(3)g

[8] Sebastian Beer and Jan Loeprick, 'Profit Shifting: Drivers and Potential Countermeasures' (2013) <https://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Events/conferences/doctoral_meeting/2013/beer.pdf> accessed 14 July 2014

[9] European Commission, Commission Recommendation 2003/361/EC, Official Journal of the European Union, 124, 36

tax authority in which it operates with the relevant 'ED&A' data and testimony relevant to the activities pertinent to each Member State for review and potential challenge.

Unlike most EU Directives, Member States will have little leeway regarding flexing details around specific rules and legislative procedures to be adopted. This Directive would demand consistent application across all Member States. Managed by the Commission, a preliminary timetable would be published outlining a consultation period followed by an implementation schedule. Since the 'ED&A' requirements will be provided by an EU Directive, Member States must transpose them into national law and this would need to be consistent across all jurisdictions. Practically, implementing the proposed Directive in its totality may be counter-productive in the first instance. Ensuring a robust case is delivered for CCR as a first necessary phase would be the preferred approach with a secondary phase extending the disclosures to threshold metrics and attestations. This proposal constitutes a completely new EU MNE transparency regime that will demand a timed phasing to secure success in a tough environment for implementing a new Directive. The objectives and wordings of the Directive would require specific attention. Existing tax laws are often indeterminate and judicial discretion over time has been necessary to clarify these laws and in effect created new laws. This proposed EU Directive aims to limit such judicial discretion by reference to specific wording that determines which legal principles are most consistent with existing laws and so best justify the laws already in place, a concept originally promoted by Dworkin[10]. Reference to its objectives should be limited to accounting best practice and the merits of CCR reporting rather than an attempt to emphasise addressing tax avoidance. Threshold metrics will be expressed as a means for Member State tax authorities to have visibility to information that infers abusive profit shifting behaviour to better prioritise local investigations rather than being a tool for seizing tax revenues per se. This Directive should be identifiable first and foremost as an accounting Directive akin to the EU Accounting Directive[11] rather than a Direct Tax Directive such as the Parent-Subsidiary Directive[12], Merger Directive[13] or Mutual Assistance Directive[14]. As a consequence the implementation path will be much less

[10] Ronald Dworkin, *Laws Empire* (Harvard University Press, Cambridge, 1986)

[11] Council Directive (EC) 2013/34/EU

[12] Council Directive (EC) 90/435/EEC

[13] Council Directive (EC) 90/434/EEC

[14] Council Directive (EC) 77/799/EEC

contentious, particularly if reinforced by a regularly structured and inclusive approach to drafting the Directive and subsequent consultation period. To support a phased implementation would be an upfront impact assessment for each phase, the content of which would be akin to that deployed as part of the most recent EU Accounting Directive[15] and would serve as a favourable approach for Member States and all other relevant stakeholders to attain enough information to offer considered opinions on the impact to their jurisdictions or interests. In addition a more all-encompassing impact assessment will be required up front prior to any consultation period to secure enough support upfront for the concept of ‘ED&A’ in an EU Directive. A credible political and economic case for such a proposal is vital and this may partially reflect tax avoidance mitigation but emphasis is to be made on the merits of nurturing a single market with a common set of more transparent accounting data and the strengthened governance around published financial data.

The reasoning behind this EU Directive proposal is that a EU centralized policy should be based upon the financial disclosure and consequential control of abusive tax avoidance activities rather than on corporate tax laws. National governments need the policy consensus and associated authority to monitor MNE accounts at a more granular level to ensure that they are applying taxation rights at the right income source. A coordinated EU policy has the effect of reducing fiscal competition between Member States and the policy implementation can be achieved across all Member States outside the constraints of unanimous consensual approval associated with direct tax initiatives. Acknowledging that no proposal to date has succeeded at EU level in addressing the problems identified in this thesis, it is submitted that a mainstream proposal such as CCR that is encased with other policy initiatives to underpin its credentials, namely thresholds and attestations, is a compelling policy option for consideration.

7.3.1 Country by Country Reporting

Presently no financial standards and only limited legal provisions for publication of geographic data exist, and there is no requirement to do so on a country-by-country basis. The only notable provisions relate to certain industry domains[16]. Despite statutory reporting

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[15] Council Directive (EC) 2013/34/EU

[16] Ibid

disclosure being based around the concept of a set of unified entities, MNEs are not necessarily taxed in this way. Each group entity is taxed separately ensuring that any outsider observer wishing to establish the economic integrity of an establishment will face a real challenge to understand the absolute economic activities underpinning the associated tax liabilities.

An economically integrated EU arguably favours an integrated financial accounting system. Such convergence to a common set of uniform accounting standards and reported on a country-by-country basis would progress forward with exposing irregularities in corporate financial statements of MNEs operating across Member State jurisdictions. Member States would be much better placed to start challenging MNEs on excessive tax abusive activities as revealed against a set of proposed threshold metrics that would form part of the Directive's financial reporting standards. Acknowledging listed EU MNEs have been obliged to submit financial statements in accordance with IFRS since 2005[17], this proposal simply aims to supplement IFRS accounting standards with a tax template addendum to the financial statement outlining specific country by country data, but fully reconcilable with consolidated legal entity accounts as per formal accounting submissions.

The objective of CCR is to enable Member States to have the requisite data to scrutinise corporate practices with regard to potential claims of tax abuse activities. This objective demands a political driven solution through an EU Directive rather than one promoted by a global or regional professional financial accounting body. Strategies relating to the closing of tax loopholes in national and international law have been fraught with having to address the inherent complexities of balancing economics, politics, ethics and administration[18] In the light of limited demonstrable progress over the last two decades in mitigating tax abuse an alternative approach is warranted. MNEs would be naturally encouraged to pay a tax level consistent with its economic activity within any jurisdiction although it is acknowledged that the materiality of this is both hard to predict at inception. Public disclosure would add pressure for MNEs to be more accountable and the administrative efficiency of tax collection would be enhanced.

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[17] Council Regulation 1606/2002 on the application of international accounting standards

[18] Guy Peters, *The Politics of Taxation – A Comparative Perspective*, (Blackwell Publishing, Oxford, 1991), 3

It would be expected that much of the financial information demanded by CCR would be readily available to most MNEs who engage large finance divisions to substantiate such data for internal management information purposes. A plethora of transparency initiatives in recent years have endorsed this approach even though their remit has to date been rather more limited than this solution proposes to advocate[19]. The concept of CCR and the likely impact on MNEs operating in the EU has been examined by the Commission[20] and the OECD has similarly considering country-by-country reporting as part of a tax transparency initiative[21]. Furthermore, as part of a consultation exercise in January 2014[22], the OECD set out a detailed and credible proposal for a CCR template for MNE population as part of its annual financial submission. All of these consultations and assessments demonstrated that CCR should be extended to financial reporting and tax reporting. CCR is not a tax policy measure or tax rule but a financial disclosure rule that circumvents the need for unanimous approval from Member States. This kind of disclosure serves to enhance the efficiency of the administration of tax collection and of detecting abusive tax arrangements. If CCR proves to be successful in limiting tax abuse at all, the expected benefits should exceed the related MNE compliance costs.

Designing a complete and credible CCR solution will rely on data to identify potentially aggressive tax activities. CCR would require a MNE to disclose data specific for each country. Firstly, a global overview of the MNEs legal entity structure and operating model demanding the name of each Member State in which it operates and the names of all its subsidiary entities in each Member State in which it has a subsidiary or branch of any legal entity, referred to as an 'establishment'[23]. Secondly, financial sales and expenses data for

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[19] Commission, Transparency Directive (2004/109/EC); Commission, Accounting Directive 2011/0684/Final; Commission, Extractive Industries Transparency Directive 2013/34/EU; Dodd Frank Act Wall Street Reform and Consumer Protection Act, (US), s1504; European Parliament Regulation 2013/34/EU

[20] Commission, 'Public Consultation on Country-by-Country Reporting by Multinational Companies' (2010)<http://ec.europa.eu/internal_market/consultations/docs/2010/financial-reporting/consultation_document_en.pdf> accessed 20 May 2014

[21] OECD, 'Memorandum on transfer pricing documentation and country by country reporting', (2013)

[22] OECD, 'Discussion Draft on Transfer Pricing Documentation and Country by Country Reporting' (2014) <http://www.oecd.org/ctp/transfer-pricing/discussion-draft-transfer-pricing-documentation.pdf> accessed 20 May 2014

[23] Council Regulation (EC) 575/2013

each establishment, represented by a breakdown of financial data differentiating group sales data and sales to other entities along with a breakout of profit and labour costs. Net income before tax for each legal entity in each country in the MNE group would be derived from individual legal entity statements. This data would be grouped according to the financial metric facilitating a legal entity view of all financial statistics, by a country breakdown hence providing the necessary information to easily calculate threshold metrics. A statement of tax on profit or loss per country would be derived from corporation tax receipts as per definition in Member State tax system, based on the actual cash figure paid with a footnote identifying and explaining any deferred tax. No other tax payments would need any reference, as they are not as material from a tax abuse perspective. Thirdly, country metrics would take the form of a series of statistics relating to value and maintenance costs for all tangible and intangible assets by country, number of employees by location, research expenditure by country, marketing expenditure by country, residence of senior management, and revenues by country residence of customers.

None of these three sets of data are particularly novel but form the generally accepted data requirements associated with CCR reporting[24]. To provide a country perspective on the global affairs of a MNE would be the ultimate aim but as an interim measure enforcing this at EU level is a highly credible first step. There would be clear transparency on the relative and absolute amounts of economic activity in a given jurisdiction along with the contribution made by the MNE to the Member State economy through corporation tax payments. A consistent set of standards for information disclosure will make MNEs accountable to their shareholders and to Member State tax authorities. Such standards are "surprisingly ignored in most corporate codes of conduct"[25] and would "establish a stronger basis of trust between tax authorities and business which would greatly improve tax compliance"[26]

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[24] Richard Murphy, 'A Proposed International Accounting Standard Reporting Turnover and Tax by Location', Association for Accountancy and Business Affairs (2003) <http://visar.csustan.edu/aaba/ProposedAccstd.pdf> accessed 9 June 2014>;Mabel van Oranje and Henry Parham, 'Publishing What We Learned', Publish What You Pay Coalition (2009), <http://www.publishwhatyoupay.org/sites/pwypdev.gn.apc.org/files/Publishing%20What%20We%20Learned%20-%20EN.pdf> accessed 9 June 2014

[25] Sol Picciotto, *Regulating Global Corporate Capitalism* (CUP, Cambridge, 2011), 6, 237

[26] Ibid

Numerous options exist for implementing CCR into financial reporting. Mindful of the technical limitations of formally amending financial accounting practices and standards, this proposal promotes utilisation of standardised tax templates as an addendum to financial statements. Neither consolidated accounting nor individual financial accounting standards are helpful in supporting the objectives of CCR. Consolidated accounting provides accounting data for a group of corporate entities as a single reporting entity and it is impossible to identify intra-group transactions. As such, this netting out of profits and costs within the group entity would be difficult to trace from source to destination, and challenging to reconcile in an accounting hierarchy. Furthermore apportioned deferred tax reporting would not accommodated on a country-by-country basis as it is based on future tax charges whose uncertainty is driven by different treatments across different countries. Individual financial statements present different issues. Local GAAP rules drive out financial reporting norms for Member States and so will offer little value for comparative purposes. But furthermore financial accounts do not properly reflect taxable or provide credible estimates for the true valuation of assets. Book-tax-differences between Member States reflect country-specific tax laws. Tax deductions relating to, for example, inter-company dividends, foreign source income and non-deductible expenses obscure the true taxable income.

Disclosure of CCR financial data in a separate annex to the financial statement avoids the complexities associates with amending common accounting standards. A standardized template with respect to data content and determinations is relevant to the viability of the solution. The disclosures should be both mandatory and public. Auditing of the annexed template should not be mandatory but recommended. It is acknowledge that there would both be some direct and indirect costs to MNEs complying with the requisite 'ED&A'. Existing financial accounting systems may need to be upgraded to conform to CCR reporting and these costs are neither predictable nor necessarily proportional to either the size of the organisation or industry domain. The more complex a business, the higher the probable cost. It is entirely plausible that larger MNEs can distil the required information from the data they routinely collate. Critics of such a solution may point to the more indirect costs associated with the competitive disadvantages of publicly disclosing commercially confidential information. To avoid MNEs hiding behind this weak argument presents the case for mandatory disclosure. It offers no competitive disadvantage to those MNEs disclosing CCR details since it is of only passing interest to a MNE how a competitor business is structuring its business. The reason for aggressive profit shifting is to minimize tax payments rather than conceal business transaction flows. The right of the tax authority to have transparency in financial accounts upon which it has responsibility for competently taxing is no less important than the right of a MNE to leverage Fundamental Freedoms to execute profit shifting for minimizing tax liabilities.

It is not unrealistic to expect CCR to provide the requisite data either demanded or of general interest to a broad set of stakeholder groups that will strengthen the aim to monitor abusive practices. This information is not limited to just financial reporting but will also provide insights to corporate governance and responsibility, actual tax payments, and cross-border transaction flows between Member States. Despite the fact CCR does not directly inform stakeholders about whether a MNE has or has not adopted an aggressive tax position it does provide transparency and a useful level of accountability to justify financial flows and transaction structures. Encouraging a behavioral change in respect to MNEs is a positive step and over time a financial accounting solution is much more likely to attract success than a direct tax solution proposal which requires unanimous approval. No tax secrecy laws exist within the EU although any eventual global rollout of this solution may encounter such issues. Public disclosure may seem excessive but a necessary part of the behaviour-inducing element of the solution strategy. One academic study[27] found that MNEs do not generally report higher profits once tax returns become confidential, although this was more common for larger MNEs than non-listed private equivalents. There is, of course, the danger that publicly disclosed CCR is misinterpreted and has a detrimental impact on a MNE but professional analysts will be always be able to interpret financial information in a measured manner to avoid malicious claims being made against MNEs.

Longer term adoption of CCR by the global financial accounting bodies would be a useful but need not in itself rely on endorsement by International Accounting Standards, hereafter referred to as IAS, and FASB. Conceptually CCR is a generally accepted financial accounting doctrine but the appetite for the size of such a project for these accounting bodies to formally adopt it as a standard is not yet evident and as this solution does not propose to embed this into financial accounting standards it remains non-critical. In time it could be

[27] Makoto Hasegawa et al, 'The effect of public disclosure on reported taxable income: evidence from individuals and corporations in Japan' 66 (2013) National Tax Journal, 3

expected to absorb such a project but it will probably require more localized regional adoption to provide the necessary impetus to initiate such a project by the accounting bodies. CCR is becoming an acceptable standard, and is consistent with the recent recommendations of the OECD BEPS report[28]. It delivers the OECD recommendations to require 'taxpayers to disclose their aggressive tax planning arrangements'[29], to 'make it harder to transfer profit streams with intangibles'[30], to 'counter harmful tax practices'[31], and to 'limiting base erosion through interest deductions'[32]. It also achieves the OECD BEPS objective of 'using a multilateral instrument to implement an international consensus more quickly'[33]. Acknowledging the inertia associated with consensual EU level changes on direct tax, and with embedding bi-lateral arrangements between countries, an EU adopted instrument would form an international standard that both other major economies and the financial accounting standards bodies may find increasingly difficult not to consider akin to the OECD aspirations when it architected multilateral standards such as IFRS for accounting and Basel II and Basel III banking prudential regulations.

7.3.2 The Thresholds

A set of threshold metrics would be detailed in the EU Directive and requiring mandatory adoption by each EU Member State. A voluntary proposal embedded within EU Contract Law would not have the necessary clout to ensure universal adoption and would deprive the proposal of the consistent application that is essential to its success. Thresholds require consistent application across all Member States. Defining thresholds at EU Member State level is unlikely to work because the ones with most to win may well set the most aggressive thresholds, whereas those with the most to lose would be likely to define only weak threshold limits. Thus, there would have to be a consistent application across Member States even though there may be economic reasons for threshold variations between Member States. The thresholds would apply directly to MNEs and any financial disclosure outside the threshold

[28] OECD, 'Action Plan on Base Erosion and Profit Shifting' (2013) <http://dx.doi.org/10.1787/9789264202719-en> accessed 18 February 2014

[29] Ibid, 22

[30] Ibid, 20

[31] Ibid, 18

[32] Ibid

[33] Ibid, 24

boundaries in annual financial reporting would infer a higher likelihood of aggressive tax planning and therefore contravene the CFO attestation unless pre-cleared. No MNE would have to fear threshold breaches attributable to genuine economic activity as such economic substance could be articulated to the relevant tax authority.

Thresholds disclosures to national tax authorities would nurture informed decisions as exemplified by Fuest and Riedel who stated that "attempts to assess whether and to what extent MNEs in developing countries engage in international tax evasion and tax avoidance activities have long been hampered by a lack of appropriate data"[34]. The underlying focus should be that the EU Directive targets transparency around controlled transactions, driving threshold breaches to transaction level reporting where required and its annexed incorporation into statutory financial reporting. Artificial transactions impact distribution of profits within a country but it is the combined set of transactions in their totality contributing to that distribution that need to be included within the threshold analysis. There are a number of threshold metrics that should form the basis of reporting obligations of a MNE operating in the EU. This proposal will set out three specific sets of thresholds that could be considered by the EC when drafting the EU Directive. Pre-clearance or explanations around breaches would be applied on a consolidated legal entity basis within a MNEs organisational financial reporting hierarchy at country level. This is required to avoid a single legal entity breach resulting in multiple pre-clearance assessments as the thresholds were breached higher up the MNEs reporting hierarchy. The threshold adoption would form part a secondary phase of implementing the Directive and would be mandatory along with the associated attestations. Pre-clearance of breaches would be encouraged but accepting that this is not always practical these could be explained as part of the CCR submission in the statutory accounts. Any local investigations into breaches would be discretional to the Member State, as would the criminal measures associated with an acute attestation breach.

Threshold variability to reflect different circumstances specific to a range of situations relating to economy size, MNE total capitalisation, industry category or MNE development stage is rejected. Apart from the unnecessary complexity there is little credibility in the

[34] Clemens Fuest and Nadine Riedel, 'Tax Evasion and Tax Avoidance in Developing Countries: The Role of International Profit Shifting' (2012) Working Paper WP1-/12, <http://eureka.bodleian.ox.ac.uk/3257/1/WP1012.pdf> accessed 25 February 2014

context of this proposal for such variations, particularly given the accommodation of pre-clearance explanations which are highly likely to roll over from one year to the next where appropriate, the non-excessive threshold levels, and to the fact that these statistical disclosures are primarily for transparency purposes to assess further any irregular behaviour that may be deemed as tax abusive. In most instances circumstances relating to varying the ratio thresholds against industry averages introduce a level of complexity and ambiguity that would render the threshold unworkable.

The thresholds make a bold step towards not only setting some realistic boundaries defining a benchmark level against which the concept of abuse with regard to conduct could be measured, but also uniquely leveraging the data provided in CCR reporting. Breaches would either relate to a genuine anomaly for good economic reason or in the pursuit of a tax advantage granted through the exercise of EU Fundamental Freedoms. Evidence of artificial conditions engineering a tax advantage would infer combined abusive intention and outcome implying an abuse of fundamental freedom rather than just tax abuse. Such a concept originally highlighted by Cerioni[35] warrants merit in particular reference to the form of this proposed solution. Rarely does CJEU case law reference abuse of Fundamental Freedoms directly but this solution approach leverages the rulings in the *Cadbury* and *Marks & Spencer* cases. Such a paradigm should be capitalized further in the examination of financial accounting threshold breaches applied to 'ED&A' particularly in light of its non-reliance on any form of direct tax law change necessitating unanimous Member State approval.

7.3.2.1 Threshold Set 1

A proposed set of 'Comparative Profits' threshold metrics, a derived concept from the Comparative Profits TRPRICE method evidenced in US[36] aimed at making the effects of TRPRICE, CFC and Group Relief somewhat more transparent, would involve utilising CCR data by assessing a MNEs country by country profitability in relation to a set of relevant real economic factors. These economic factors would be used to determine a formulary measure of reasonableness relating to a MNEs profit submission in relation to its real economic

[35] Luca Cerioni, 'The abuse of right in EU Company Law and EU Tax Law; a re-reading of the CJEU case-law and the quest for a unitary notion', Brunel Law School Research Papers (2010), 4, <http://bura.brunel.ac.uk/handle/2438/4141> accessed 21 May 2014

[36] CFR 1.482-5 (US)

activity. The desire for common comparability derives from the need to ensure a taxable profit level indicator accurately denotes the actual profitability of the underlying economic activities. Avoiding the complexities of transaction level TRPRICE analysis, this solution proposes that a MNEs profit should be consistent with a set of economic parameters relevant to the type of business undertaken by the MNE. The MNE would be required to apply economic parameters to its net profit in each country and explain any deviations from a set of pre-defined thresholds in the Directive. The profit threshold formula would be based on net profits of all controlled and uncontrolled tangible and intangible transactions in their totality. Accepting the computation of net profit is skewed for comparative purposes by Member State tax rules and reliefs, the country level net profits would be basis for this assessment.

The objective of these threshold metrics is intended to determine an acceptable range of profit levels that would satisfy the arm's-length requirement. Firstly a Profit / Sales threshold would be to set at 1:0.6 ratio of net profit to total value of sales to customers in a given country. If a MNE were making a net profit in a country with a value that exceeded 40% of the value of sales in that country it would exceed the threshold. If this was breached the MNE would be required to provide a detailed transaction level breakdown of controlled versus uncontrolled transactions, declared and expressed in net value. The 1:06 threshold is low enough to avoid routinely profitable business in a given country being caught in unnecessary disclosure but high enough to expose any unusually high profits that are not attributable to customers in a given country. The residency of a customer is routinely available data and statutory consolidated financial reporting would already have underlying transaction level data if required. With the emergence of the Internet economy facilitating web sales, it is realistic to surmise that an entity may be disproportionately involved in the economic activities in another Member State than the taxable liability suggests. These are deemed uncontrolled transactions and would therefore attract little attention from the tax authorities.

Secondly, a proposed Profit / Employee threshold metric would be proposed for understanding the relationship between the a MNEs net profit in a given jurisdiction as a percentage of its global profits versus the number of employees resident, permanent or interim and paid through that country expressed as a percentage of total global employees. Focus on ensuring this metric relates to the geographical location of an employee as well as the jurisdiction through which the employee is paid will prevent abuse. This again would be measurable at country level. A moderate threshold level of 40% is proposed so that a group that derives a significant portion of its income from a Member State that employs a disproportionately small number of group employees would breach the threshold. Setting the threshold at 40% will ensure that a MNE will breach if there is a differential between the two ratios of greater than 40%. The threshold level is not meant to be a scientific formula with deep-rooted statistical meaning but rather a measured metric that can be used broadly for identifying any significant profits generated in a Member State that has a disproportionately low level of employees. Many distributed business models that have an extended supply chain across many locations may exceed this threshold but such a breach would be explainable and acceptable if for good economic reason. For example, where there is a high concentration of product development or research employees that are in a different Member State from that in which income is generated. Again the objective is to expose unexplainable breaches that have no underlying economic substance that may represent tax abuse warranting investigation by the Member State tax authority.

Thirdly a Profit / Pass-Through Threshold would be applied. This would be a threshold that would require a declaration in the Member State where net profit is declared on any pre-sale controlled transactions within a controlled supply chain within the EU that has more than three pass-through transactions between Member States with a corporate income tax differential between the highest and lowest of more than 25%. It is of no interest to capture endless genuine pass-through transactions between Member States with immaterial tax differences. Acknowledging the desire to retain tax competition, the Member States would be offered a relatively straightforward tool to identify potentially abusive pass-throughs that have little economic purpose than to abuse such tax competition. Setting a threshold of three or more pass-throughs seems a relatively modest number on the basis of normal MNE economic behaviour in a community of 28 Member States, and a 25% tax rate differential between the relevant Member States represents a percentage that sensibly represents a differential below which would not regularly encourage a tax abusive pass-through.

These comparative profit thresholds will prove effective, as it does not require an exhaustive list of indicators to imply abusive practices. The threshold data will not itself expose whether there are insufficiently bona fide commercial reasons for the taxable profits but it will expose the data to imply economic anomalies that warrant tax authority investigation. This threshold data provides a mechanism for uncovering circumstances whereby incorporation is inconsistent with the physical establishment of the CFC and where genuine activities associated with financial reporting are being carried out. Furthermore, it exposes circumstances where there is an imbalanced correlation between the location of genuine economic activities and the physical location of its employees.

7.3.2.2 Threshold Set 2

The next metric demanded by the proposed Directive would be known as the 'Tax Dispersion' threshold, which is based around a simple statistical delta between tax expenses, and taxes paid in a given country. Leveraging some of the pioneering research by Kolay et al[37] in this field of consolidated tax spreads, this concept utilises the CCR reporting proposed in 'ED&A' and aims to capture the impact of a wide variety of tax deductions that are specific to a Member State such as depreciation, investment tax credits, foreign tax credits and stock option deductions that could be used by MNEs instead of debt to reduce their income in a given jurisdiction.

These are becoming a more common tool for tax avoidance as they do not require the use, and associated cost, of complex financial transactions to restructure the capital structure of a MNE to support debt leverage activities, they can be used to exploit the tax rules without impacting the underlying publicised income statement. Such a tax dispersion ratio would be implemented at country level and not at a consolidated entity level. A simple metric is not without issue, such as the possible anomalies generated by timing differences between tax accounting accelerators and deferrals, and those MNEs investing in early stage development that will rightly locate its investment in tax favourable locations. It is not the purpose of this metric to capture such lawful and bona fide activities. The purpose of the tax dispersion ratio is to expose the specific usage of tax reliefs in a given country and make the recipient accountable for any tax expenses that appear inconsistent with the underlying arrangements in the relevant Member State. In other words, the exam question is whether tax reliefs are being abused by a MNE solely for reducing tax liabilities that reflect no underlying economic substance.

[37] Madhuparna Kolay, James Schallheim and Kyle Wells, 'A new measure for non-debt tax shields and the impact on debt policy' (2013) University of Utah Working Paper <http://glxy.swjtu.edu.cn/UpLoadFiles/files/2014-05-16/20142416112400.pdf> accessed 30 June 2014

A proposed tax dispersion ratio would in effect set out the effective difference between book and tax income. Expressed as a percentage, it should be set in the region of +20% so that if tax expenses exceed 80% of taxes paid in any Member State it would require explanatory notes in the 'ED&A' statement. This dispersion ration would need to be published annually in the 'ED&A' statement alongside a 5 year rolling history of the ratio for year-on-year comparisons. The basic premise is that the higher the threshold the lower the amount of tax paid and the higher the probability of tax expense abuse and although this may appear to be a rather blunt statistic no such data is published currently and it provides a useful insight into country level accounting not previously alluded to in any literature to date. It would expose any blatant artificial transactions aimed at abusive use of tax relief not relevant to the income generated in a country on which taxes have been paid.

7.3.2.3 Threshold Set 3

A proposed set of 'Debt Leverage' threshold metrics would have the objective of identifying abusive THINCAP through the use of interest deductions. Not directly leveraging CCR but more ensuring transparency at a non-consolidated entity based country level, it would be a mandated set of data requirements requiring any MNE registered in a Member State to publish data that would provide indications regarding the nature and extent of debt leverage. Identifying the extent to which every legal entity registered within a jurisdiction is balancing the benefits of debt against the costs of debt is an important metric. The benefits of debt far outweigh the estimated costs of debt[38] and so it is of significance to Member State tax authorities' transparency around the capital structure of MNEs registered within their boundaries. This threshold set should be based around an absolute annual disclosure of a long-term debt-to-total capitalisation ratio calculation, a comparative long-term debt-to-total capitalisation ratio over a 5-year period for comparison purposes, a legal entity to group entity equity ratio, and an interest to earnings ratio.

The **Long Term Debt to Total Capitalisation ratio** is an established metric derived from dividing total debt by shareholders equity. For the annual ratio disclosure it would be recommended to set this at a level of about 60% with a de minimis threshold of somewhere

[38] Merton Miller, 'Debt and Taxes' (1977) 32, Journal of Finance, 261; John Graham, 'How big are the tax benefits of debt' (2000) 55, Journal of Finance, 1901

between €1m and €2m. This proposed threshold level has been reached by careful consideration of two factors. Firstly a de minimis threshold ensures small interest payments that routinely form part of business activity would not be in scope. Debt payments above this level represent significant flows justifying transparency and, where necessary, explanation. The 60% threshold itself is derived from international data and averages based on empirical analysis by researchers that found for EU countries typical ratios vary between 28% in UK, 47% in France and 48% in Italy[39]. Less comprehensive but more contemporary analysis suggests the ratio has risen in recent years with many of the largest MNEs in EU evidencing a ratio of 50-75%. Historically higher ratios have been attributable to economic or industry specific factors[40] but as tax rules relating to interest deductions evolved it is suggested that high levels of debt in tax relief friendly jurisdictions have encouraged the use of debt to minimise tax payments.

There is no ‘right’ level of debt so to an extent it is a subjective metric but it could be inferred from a tax perspective that high debt in jurisdictions offering favourable interest deduction relief in tax law may reflect artificial transactions with no economic substance rather than genuine exploitation of such lawful tax reliefs. In instances where a breach of this threshold has not been explained and pre-cleared, an explanation in the ED& A template annex to the statutory financial accounts would be required. Circumstances that are not fully transparent or explained would likely encourage a more detailed probe by the relevant Member State tax authority.

Specific details to ensure practical implementation should be considered. For example, certain parameters such as debt tenure would mean that short-term debt below 3 months is not included. Specific industries such as entities operating in financial services should be excluded where their balance sheet activity can reflect substantial client activity rather than solely the MNEs own transactions. As is the case with all such debt ratios the definition of debt would need to be carefully crafted to ensure it captures the right debts, with optionality around the inclusion of deferred taxes as debt, preferred stock rather than capital and operating liabilities such as accounts payable and accrued liabilities, contractual obligations

[39] Raghuram Rajan and Luigi Zingales, ‘What do we know about capital structure? Some evidence from international data’ (1995) 1, Journal of Finance, 5, 1433

[40] Ibid, 1450

or other forms of financing that may not normally appear on the balance sheet. It is the recommendation of this proposal to not provide for any limitations to the definition of debt in the threshold calculation and to let the discretion lie with the MNE to calculate and subsequently explain if required.

The 5 Year Long Term Debt to Total Capitalisation ratio provides a view to the Member State tax authorities of the ratio trend that a given MNE is exhibiting over a longer time horizon, highlighting any specific sudden changes that may be attributable to certain debt leverage arrangements that are put in place, and to provide a mapping tool to some of the other CCR data such as income and expenses that may provide a more comprehensive view on corporate tax planning behaviours. A MNE evidencing a rising long term debt to total capitalisation ratio at the same time as a falling tax dispersion ration as set out above infers that a MNE was replacing the diminishing favourable impact of tax relief with substituted debt relief. Unlike the annual long-term debt to total capitalisation ratio no such threshold would be set against changes in the ratio on a year-by-year basis relating to the 5-year comparative computation.

The **Legal Entity to Group Entity Debt / Equity ratio** serves to identify the relative debt to equity that a given legal entity has in a given jurisdiction relative to that accounted for at group MNE level. The objective of this metric is to highlight those legal entities that are consuming the highest levels of debt in a group MNE structure in order to ascertain whether there is a loading of debt into those legal entities resident in jurisdictions that grant more favourable tax relief on debt. Such disclosures would offer the tax authorities the evidence to focus on those MNEs potentially abusing THINCAP rules for the purposes of tax minimisation rather than to reflect a purpose with economic substance. If the ratio between a legal entity's debt / equity ratio and the group level debt / equity ratio is above 1.5 then it would require pre-clearance or explanation in the disclosure. If a given legal entity has a debt-to-equity ratio that is 50% larger than the group debt-to-equity ratio then it will demand pre-clearance or explanation. Explanations inferring potential artificial transactions would likely prompt further investigation.

The **Net Interest to Earnings ratio** indicates the ability of a MNE to pay interest on outstanding debt relative to earnings. Published at a consolidated accounting level the objective would be to provide more granular disclosures at country level. The ratio is calculated by dividing a MNEs EBITDA in a given year by the MNEs interest expenses in the same period. The lower the ratio, the more a MNE is burdened by its debt expense relative to earnings. THINCAP practices relating to the financing of debt for wholly artificial means implies that the Net Interest to Earnings ratio will be lower in jurisdictions offering favourable tax treatment for interest deductions than others. Certain THINCAP practices regarding utilising tax efficient financing transaction types for raising finance will be acceptable but those practices involving artificial transactions for which, upon investigation, there is no obvious economic reason relating to the underlying business may be considered abusive. This ratio will be required for disclosure relating to every legal entity registered in each Member State. If the ratio is likely to be below 1.0 for any legal entity it will require explanation and pre-clearance. Non-pre-cleared ratios below 1.0 will be subject to prospective scrutiny by Member States.

A ratio disclosure indicates an excessive level of debt to equity implies potential tax abuse worthy of investigation or explanation on a case-by-case basis. Furthermore a comparison between the equity percentages of any MNE subsidiary entity to that of the MNE group worldwide would similarly evidence possible excessive debt. Where the metric indicates the amount of net interest paid by the MNE goes beyond a certain threshold of the earnings before interest and taxes, hereafter referred to as 'EBIT', or of EBITDA then it similarly implies potential tax abuse worthy of investigation or explanation.

7.3.3 Attestations

In the context of this proposal attestations refer to a requirement for a MNE Officer to formally testify as part of the MNEs annual financial statement that the accounting results and supporting data comply with the requirements of the proposed Directive. A short statement with specific attestation assertions serves to affirm that the financial disclosures are complete and accurate, that operational and financial controls are in place to support the integrity of the data provided, and that there has been sufficient due diligence to support the data submission. A supporting narrative statement of observations, exceptions and conclusions resulting from the due diligence would also be submitted. The EU Directive would promote a common language approach to convey consistent and mandatory elements of the attestation. The MNE should be accountable for the submission of the attestation, and the attesting Officer personably accountable for the content and outcome of the attestation. Fines or penalties would prevail over MNEs who fail to provide attestations, as enacted through Member State legislation in the adoption of the Directive's provisions. Failure by the attesting Officer to provide a complete or accurate attestation would entail potential criminal law liability, again to reflect the provisions in Member State legislation.

The common language would cover two key points. Firstly, the accuracy of the financial statements being submitted as to the completeness and integrity of a MNEs financial statement with respect to country by country reporting and associated declaration of threshold ratios data in its operating Member States. It would include a carefully phrased text confirming that the 'contents of the statement are materially correct and complete', and contain no 'false or misleading material statements' Secondly that the 'ED&A' data has been compiled in 'good faith' and include no cross boundary transactions that may be considered 'wholly artificial' utilised for the 'sole' purpose of mitigating corporate income tax payments. These words are carefully chosen as established legal terminology. The term 'false or misleading' material statement has successfully applied to the disclosure filing attestations in US legislation[41]. In the case of the Dodd Frank legislation the attestation is made on behalf of the MNE and the civil law penalty is revoking MNE registration if persistent misstatements are evident, although criminal provisions are available to prosecutors against the individual attesting Officers. This solution proposal is to make the attestation liability a criminal one that is placed on the MNE Officer rather than the MNE. The Directive would be expected to set out guidelines on what would constitute materiality. Layering accounting standards onto Member State tax laws provide a degree of uncertainty and inconsistency about how a MNE would be minded to represent a transaction that implies a level of subjectivity in statutory disclosures. In the context of this proposed scheme, there are two components of materiality. On the one hand, any accounting disclosure would be considered material if it would have an impact on a decision by the Member State tax authority in which it has made the disclosure. On the other hand, materiality refers to the assessment of accounting judgements made by the

[41] Dodd Frank Act Wall Street Reform and Consumer Protection Act, (US), 2002, 13q1, s1504; Securities Act (US), 1933 s24; Securities Exchange Act (US), 1934, s32

MNE Officer. Clear evidence of an intention to mislead the Member State tax authorities, whatever its magnitude, should be considered material. The onus is on a qualitative disclosure rather than the setting of any quantitative tolerance level. On this point, degrees of tolerance are EU provisions are not typically embedded into EU Directives, other than the First Directive that states that in situations where there is evidence of "a failure to disclose"[42] appropriate penalties or sanctions may be enforced.

Clarity is required to ascertain whether misleading or false accounting disclosures equate to non-disclosure of accounting data. False accounting disclosure implies an element of fraud whereas non-disclosure is an act of defiance and so this proposed scheme aims to address both potential delinquencies. Ascertaining whether an accounting disclosure is false or not demands reference to specific Member State rules as well as EU case law. The CJEU has stated without ambiguity that Member States should ensure disclosure violations are dealt with in an "effective, proportionate and dissuasive"[43] manner. 'False' claims that contain facts that are found to be untruthful will likely be held to be misleading. A statement that does not contain untrue facts but is incomplete because of the omission of certain facts that are relevant to the Directive's requirements would typically be considered to be misleading too. Truthful claims that are likely to lead to a false impression may be held to be misleading. In such circumstances, given its relevance to tax law, it will likely to require an assessment of the financial data on the grounds of whether it represents a "wholly artificial arrangements which do not reflect economic reality" as demonstrated in *Cadbury*[44]. Under such circumstances the burden of proof will lie on the attesting Officer. Once the MNE has submitted a financial statement in which the facts are stated, an assessment by the tax authority may oblige the CFO to prove its assertions, as well as providing evidence on which the CCR financial data and associated thresholds were based. This is likely to be accounting based evidence. Once provided the tax authority then takes the burden of proof and cannot pass it back to the MNE unless it can demonstrate sufficient doubt on the evidence presented by the MNE to suggest false or misleading disclosures. The distinguishing feature of these attestation requirements is that there is specific text in the attestation wording that will provide better clarity around exactly what they are attesting to and to reference to case law

[42] Council Directive (EC) 20103/58/EC, art 6

[43] Case C-167/01 *Kamer v Inspire Art Ltd* [2003] ECR I-10155, para 62

[44] Case C-196/04 *Cadbury Schweppes Ltd v IRC* [2006] STC 1908, para 55

precedent in the evaluation of cases under judicial review. Introducing criminal liability to such attestations provides for a powerful instrument of behavioural change.

Non-cleared threshold breaches would demand a detailed causal explanation. In the event of a threshold breach the MNE Officer who has attested to the disclosures would be held to account for this explanation. If under further scrutiny the reasons given explaining such a breach were found to be false, either by the tax authority in the first instance, or by the further judicial referral or appeal then the attesting Officer would be potentially held to account for the submission in the criminal courts. The higher the personal criminal liability, the higher the likely impact on corporate conduct[45]. Such cases would be rare but the threat itself of such a liability is the driver for changes in behaviour. It would be unnecessary to extend this legal attestation requirement to a MNEs auditor but the underlying MNEs attestation may encourage such back-to-back attestations in order to satisfy the attesting Officer that sufficient third party due-diligence has taken place over the commitments being declared in the financial statements. Given it would be part of the statutory financial accounts this annex should be included at least within the scope of the auditors opinion. It remains a thought provoking concept that a MNE would be encouraged to ask an auditor to attest that its accounts do not reflect any of the activities regularly promoted by such auditors in the first place that may threaten a MNEs compliance with CCR and the new threshold metrics.

Evidence in the recent usage of attestations across a broader range of law and procedures suggests that it is more usual for their application relating to specific legal compliance to internal controls[46] or against being party to illegal acts[47]. Other attestations may have no legal determination[48]. There is no reason why this concept cannot be extended to attesting to enhanced disclosure and reporting, a breach of which may suggest but not necessarily confirm illegality. An attestation may be used as a pre-judicial tool to regulate corporate taxpayer behaviours and not necessarily as one which specifically formalises conformity to legal activities. As a tool for encouraging compliance rather than as an instrument to

[45] Jennifer Arlen, 'The potentially perverse effects of corporate criminal liability' (1994) 23, The Journal of Legal Studies, 3, 834

[46] Sarbanes–Oxley Act, (US), 2002, s107–204, 116 Stat. 745, s404

[47] The Private Securities Litigation Reform Act, 1995, Pub Law104- 67, s10a

[48] ISAs 100–999 'International Standards on Auditing', IAASB, 2008

differentiate legal and illegal behaviours, the attestation is made for the purposes of confirming accurate and complete disclosure. Any threshold breach without pre-approval is of secondary consideration. In such a scenario the MNE Officer may disclose and attest to a threshold breach without pre-clearance in confidence if it was conducted with justifiable economic substance with no evidence of attempting to escape "tax normally due on the profits generated by activities carried out on national territory"[49]. If upon further investigation it were found that the threshold breach was indeed executed for reasons other than a valid economic purpose then the MNE Officer would have to justify the breach to the satisfaction of the local tax authority to avoid a judicial challenge. The reasoning is that such a judicial threat in itself would encourage every MNE Officer other than the bold and reckless to keep within the boundaries of acceptable economic reasoning. Clearly the *SGI*[50] and *Thin Cap GLO*[51] judgments provide a sound basis for articulating the importance of the concepts of justification and proportionality, supporting the reasoning for this approach as well. Any judicial challenge would be able to utilise these established concepts in ascertaining the legitimacy in using economic structures for the purposes of avoiding tax that resulted in a threshold breach.

The concept of economic purpose and abuse of tax law through wholly artificial arrangements has been demonstrated to be well established in CJEU case law. This proposal extends the concept from an abuse of tax law to an abuse of Fundamental Freedoms. Accepting that EU law cannot be relied upon for addressing abusive tax avoidance behaviour, the case of *Emsland-Starke*[52] is useful for more generally determining the objective and subjective criteria for assessing such abusive conduct in respect to this proposed solution. From an objective perspective, it ruled that conduct under scrutiny should not conflict with the original intention of the provisions, and there should be no evidence of an intention to achieve an improper advantage from such provisions. Therefore it necessarily follows that if a MNE Officer attests to the completeness and accuracy of a financial statement and an investigation resulting from the breach of a non-cleared threshold relating to CCR reporting

[49] Case C-196/04 *Cadbury Schweppes Ltd v IRC* [2006] STC 1908, para 55

[50] Case C-311/08 *Société de GestionIndustrielle v Belgian State ("SGI*") [2010] ECR I-487

[51] Case C-524/04 *Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue ("Thin Cap GLO*"*)* [2007] ECR I-2107

[52] Case C-1100/99 *Emsland-Starke GmbH V Hauptzollant Hamburg-Jonas* [2000] ECR I-1569

is found to expose abuse then such an Officer would be criminally liable in accordance with the Directive's attestation requirements.

The concept of EU mandated corporate criminal liability is well established. It has been introduced in most Member States facilitating judicial sanctions on corporate entities for criminal acts or the criminal acts of its Officers. An exception to this would be in Germany where imposing corporate criminal liability would conflict with the basic principles of the German Criminal Code. This hasn't prevented Germany from instigating regulatory action against German MNEs resulting from criminal conduct through the imposition of fines that produces the same criminal liability. The EU Treaty sets out specific provisions relating to how a Directive may define criminal offences, common rules on the definition of criminal offences and sanctions[53] particularly when there is "a cross-border dimension resulting from the nature or impact of such offences or from a special need to combat them on a common basis"[54]. A recent EU Directive on criminal sanctions for market abuse[55] extends the concept of criminal sanctions to corporate individuals rather than the corporate entity.

In the context of our sample Member States, France was the first jurisdiction to introduce the concept of corporate criminal liability in 1994 but recently updated in 2005[56]. The law states that the criminal liability of a corporate entity does not preclude any individual who may be a perpetrator in the corporate entity from being held criminally liable, although a corporate entity's liability does not automatically result in liability for any of its directors or Officers. Penalties in France on corporate Officers include imprisonment, fines and prohibition of office. Italy enacted its corporate criminal liability in 2001[57] replacing tort law with criminal provisions. Under this law, a corporate can be criminally liable for false financial statements. The liability of its Officers is completely independent of the corporate entity's liability and would have to be separately defined under Italian law. Punishments include fines, disgorgement of profits and business activity prohibitions. In the Netherlands, there is a long-standing legal provision relating to fiscal criminal offences relating to corporate entities

[53] Consolidated version of the European Treaty [2010] art 69, b, 2, OJ C83/47

[54] Ibid

[55] Council Directive (EC) 2014/57/EU

[56] Penal Code, Law No 2004-204 (France) 2004

[57] Decreto Legistativo no 231(Italy) 2001

and their Officers. The UK and Netherlands has a long-standing acceptance of corporate criminal liability. Since 2009 these criminal laws[58] have provided for fines applicable to both the entity and its Officers. Any Officers can be prosecuted who can be shown to be perpetrators of an offense if held accountable for neglecting to take proper measures to prevent misconduct or misstatements. The judiciary has the power to implement fines on Officers and on the corporate entity as well as prohibiting business activities or placing it into temporary administration. In the UK, recent legislation[59] establishes a clear mandate on the judiciary to hold corporate entities criminally liable for inciting criminal acts or breach of duty, but there is also legislation[60] providing for Officer criminal liability where neglect is proven. In the latter case, fines, disqualifications from office and imprisonment penalties are available. Finally in Germany, the position of corporate criminal liability is less clear. German criminal law only applies to natural persons implying a corporate entity cannot commit a criminal offense. Forfeiture orders and regulatory fines may be applied to corporate entities in the event of proven wrongdoing but for the Officers themselves can be held criminally liable for breach of duty. One feature evidenced in this analysis of different jurisdictions is that there is legal provision in EU law for corporate and Officer criminal liability. Defences provisions around having proper systems and controls are commonplace, although penalty regimes do differ markedly. EU mandated criminal liability is consistent with the principles of the EU Treaty but also consistent with the principles underpinning this proposed proposal.

The wholly artificial arrangements doctrine is well established, supporting the notion that "nationals of a Member State cannot attempt, under cover of the rights created by the Treaty, improperly to circumvent their national legislation. They must not improperly or fraudulently take advantage of provisions of Community law"[61]. As stated in *Thin Cap* case, "In order for a restriction on the Freedom of Establishment to be justified on the ground of prevention of abusive practices, the specific objective…must be to prevent….the creation of wholly artificial arrangements"[62] The principles governing when an abuse of law can be deemed to

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[58] Criminal Code (Netherlands) 2009

[59] Bribery Act (UK) 2010; CMCHA Act (UK) 2007

[60] Financial Services and Markets Act (UK) 2000, s400

[61] Case C-196/04 *Cadbury Schweppes Ltd v IRC* [2006] STC 1908, para 35

[62] Case C-572/04, *Test Claimants in Thin Cap Group Litigation* [2007] ECR I-2107, para 77

have occurred and the benefit of that right withdrawn is not entirely clear. The French Civil Code is best placed to provide insight by placing emphasis on actions executed in an excessive manner which causes harm to a third party. Equally applicable to an abuse of secondary legislation as well as an abuse of Fundamental Freedoms, the teleological aspect to the abuse of rights doctrine is based on the hypothesis that for an abuse to apply the legal act in question has to be contrary to the legal purpose of the legislative provision. The conflict arises as a result of the somewhat potential different purposes associated with secondary EU legislation and Fundamental Freedoms, the former generally focusing on minimising tax avoidance and the latter on promoting economic integration. Therefore, the linguistics used in CJEU rulings is probably the most helpful domain for defining a minimum threshold for tax abuse. The earliest case in *Van Brinsbergen* stated that an abuse occurred when arrangements were enacted "entirely or principally"[63] for purposes of circumventing tax. In *Halifax* abuse was defined as occurring when such an arrangement was "essentially"[64] for the purposes of circumventing tax (corresponding to "principally" in *Van Binsbergen*), and in *Koefed* abuse was only deemed present where the "sole"[65] purpose was to circumvent tax (corresponding to "entirely" in *Van Binsbergen*). It was only once the ruling in *Emsland-Starke* was in place that a more methodical test was identified to assess abusive behaviour, advocating an initial objective element assessing alignment with the purpose of the rules against a subjective assessment of demonstrable intentions to yield a benefit through artificial arrangements. Such an assessment is a structured proposition but gives little insight into the extent to which an intention deviates from the purpose to justify an abuse of rights to have occurred.

The challenge for any scheme proposing to exploit the correlative relationship between proportionality and abuse of rights doctrines should consider a number of complicating factors. First, *Van Brinsbergen*[66] introduced the concepts of public interest and proportionality. Constraining EU Fundamental Freedoms may be justified on the grounds of protecting the general public interest and is proportionate to attain those requirements. Circumvention can occur without abuse with the differentiation being defined by what the *Van Brinsbergen* case highlighted as the artificial use of EU Fundamental Freedoms when the

[63] Case 33/74 *Van Binsbergen v BedrijfsverenigingMetaalnijverheid* (1974) ECR 1299,13

[64] Case C-255/02 *Halifax and Others* [2006] ECR I 1609, para 81

[65] Case C-321/05 *Koefed* [2007] ECR I 5795, para 36

[66] Case 33/74 *Van Binsbergen* [1974] ECR 1299

outcome was the circumvention of Member State rules without an impact on the public interest. Any public interest claim associated with circumventing tax payments should offer adverse public interest and therefore align more closely to an abusive categorisation. The challenge will be reconciling a national ruling based on an EU collective public interest. Secondly, the *Cadbury* ruling stated that for a wholly artificial arrangement to exist there must be a demonstration of not only a tax advantage but also a clear failure to achieve economic interpenetration through a genuine economic activity. A tax advantage on its own, of course, will be insufficient. Wholly artificial arrangements is a carefully worded phase synonymous with abusive behaviour which makes it particularly suitable for this proposed scheme but MNE and national tax authorities need to be mindful of exactly how the *Vin Brinsbergen* and *Cadbury* cases articulated their thought process in determining abuse.

In leveraging the wholly artificial arrangement as a basis for defining a prospective abuse of a fundamental freedom is a credible and powerful concept to regulate behaviour, although untested when supplemented with corporate entity and Officer strict liabilities. If a financial statement is found to contain a false or misleading statement based on a wholly artificial arrangement the liability will rest firmly on the attesting Officer. To make this a practical proposal, although all transactions would constitute the CCR disclosure, a *de minimis* transaction threshold would be specified in absolute € terms in the EU Directive regarding the minimum transaction level subject to review on the grounds of a wholly artificial arrangement. Such a *de minimis* threshold would be uniform across all Member States, MNEs and Industry categories, and subject to periodic review. There are judicial precedents in tax case law, mostly commonly in the context of VAT cases[67] that suggest a common line of defence is frequently based around acting in good faith. If the attesting Officer took every step which could reasonably be required of him to satisfy himself that the financial statements were correct and complete. This could relate to reliance on internal controls or external advice. Considering the principle of *null poena sine culpa* (no punishment without fault), if the attesting Officer has acted without fault by undertaking all possible and reasonable steps to avoid an infringement of the proposed Directive 'ED&A' requirements then this would be

[67] Case C-587/10 *VogtländischeStraßen-, Tief- und Rohrleitungsbau GmbH Rodewisch (VSTR)* [2010]; Case C-273/11, *Mecsek-GabonaKft. v. NemzetiAdó- és Vámhivatal Dél-dunántúli Regionális Adó Főigazgatósága* [2011]; Case C-409/04 *Teleos and Others* [2007] ECR I-7797

expected to be considered in a favourable light by a Court, as specified in the defence available set out in the relevant Member State legislation

"Good faith" is a vague notion that, although well defined in contract law, is difficult to give a precise and unequivocal legal meaning in a wider context. The concept in legal terms has different connotations when expressed in terms of intention and defence demanding elucidation. Good faith is synonymous with honourable intentions and it is this wording that is relevant for the proposed attestation text. Conversely good faith has particular relevance in terms of legal interpretation or legal defence. It has merit with legal grounding in international law such as the Vienna Convention of the Law of Treaties[68] that noted how legal interpretation should be conducted with good faith in accordance with context, objectives and legislative intent. Similar provisioning is evidenced in the Declaration on Principles of International Law concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations[69]. Although the use of the term 'good faith' as an instrument of interpretation is inconsistent between different Member State jurisdictions the impact depends on the context. The Netherlands does not reference the notion of good faith directly in its Netherlands Civil Code, but does provide provision for "determining what reasonableness involves….reference must be able to generally accepted principles of law…and to interests involved"[70].but in Italy it is directly codified[71]. Case law in Germany[72] and the UK[73] are also supportive of the use of subjective and objective interpretation. In France case law the concept of good faith has been challenged as a point of legal obligation[74], but "may be used to limit the exercise by a state of discretion within the context of legal obligations to which it is subject" [75]. This provides a difficulty for MNEs to use this line of defence consistently until a constant is agreed by the CJEU on this point specifically relating to the Directive in due course. In the jurisdictions that recognise the

68 Vienna Convention on the Law of Treaties, 1969, art 31

69 United Nations, 'Declaration on Principles of International Law concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations', 25/2625

70 Civil Code (Netherlands) art 3:12

71 Civil Code (Italy) art 1175

72 *Entscheindungendes Rechtsgericht* [1911] 78, 239

73 *Yam Seng Pte v International Trade Corporation Ltd* [2013]

74 Jan Klabbers, *The Concept of Treaty in International Law,* (1st edn, Kluwer, The Hague, 1996), 94

75 *Dijibouti v France* [2008]

legitimacy of subjective interpretation by searching for the parties intentions there should be an expectation the attesting Officer that relies on the notion of good faith would complement the other proposed lines of defence based around due diligence reliance and constructive knowledge.

An attesting Officer may seek to use and rely on third party advice as part of any ‘good faith’ defence against a breach of the proposed Directive. To this point, recent opinion offered by the CJEU[76] suggested the need for a number of criteria fulfilled for reliance on third party professional advice to be considered a legitimate defence. Although not a tax related Advocate General’s Opinion it nevertheless set out some general principles. First, the MNE must have relied on the professional advice in good faith. If it can be proven that they relied on the opinion against its better judgement or the advice was specifically tailored to the MNEs business activities the professional advice should be considered irrelevant for the assessment of fault. Second, the professional advice must come from an independent external specialist who must regularly work in a domain relevant to the tasks required. Third, the professional advice must have been provided on the basis of a full and accurate description of the facts by the MNE involved. Fourth, the professional advice must not be manifestly incorrect, and the plausibility of the advice must be assessed by the MNE concerned. If the advice indicated that the legal situation is unclear, the MNE concerned is deemed to act at its own risk. This important opinion is highly relevant to the credibility of this proposal as it defines the boundaries of acceptability in the eyes of the CJEU as to how a MNE can or cannot rely on the advice of a third party professional to defend against attestation breaches.

One of the challenges that could be levied against the attestation part of the proposal is its position in regard to the rule of law and its unsettled place with regards to human rights. There is a need to finely balance fundamental rights, such as the human rights[77] of an attesting MNE Officer, as enforced through the European Court of Human Rights, with the rights of an economic entity such as a MNE to exercise Fundamental Freedoms, as enforced through the CJEU[78]. Contemporary political and economic life has an emerging sense of

[76] Case C-681/11 *Bundeswettbewerbsbehörde and Bundeskartellanwalt v Schenker & Co. AG and Others* [2013] ECR 00000

[77] European Convention of Human Rights, 1970, s1 arts 6, 7,13, 17; Protocol 7, arts 2, 6

[78] Consolidated version of the European Treaty [2010] arts 1, 2, 3, 4, OJ C83/47

justice associated with a social contract that this reform proposal aims to create and this arguably stems from human rights.

To address such a challenge the legal doctrines of proportionality and legal certainty are important. The concept of legal proportionality, first recognised formally by the CJEU in 1954[79] and, in the context of this proposal, suggests that the legal legitimacy of the Directive would be a function of whether it is considered appropriate and proportional to achieve the objectives as enacted in the Member State legislation. Is the kind of attestation being proposed a suitable measure for achieving the legitimate aims of the proposed Directive, is the attestation necessary to meet that aim, and does the attestation have an excessive impact on the attesting Officer's interests? This proposal promotes an attestation as a suitable component to nurture and enforce maximum due diligence over the completeness and integrity of the Directive's financial threshold reporting requirements. By placing personal accountability on a serving Officer of the MNE it will not get lost in the common malaise of corporate processes. Pre-clearance of breaches will likely filter out the most acute forms of abuse with MNEs unlikely to want to face adverse publicity. The highest level of personal criminal liability of MNE Officers is an extreme outcome and the purpose of this attestation is not to award penal sentences to large numbers of serving Officers but rather disclosures are complete and that there are no wholly artificial arrangements in such disclosures. The ability to pre-clear breaches or explain with confidence the circumstances of genuine economic reason for what may appear tax abusive activities offers ample capacity to avoid the worst possible consequence of a threshold breach. There is a risk that Member State judiciary bodies make inconsistent rulings in the first instance but like many other areas of EU public law, despite the lack of appetite to engage in what may be deemed political decisions, there will likely be a body of settled case law in this domain within a reasonably short period of time.

The other challenge around attestations could stem from the concept of legal certainty. Referring to a well-established principle in public case law[80], legal certainty infers that any law must be clear and precise and its legal impact foreseeable. In this sense, the proposed 'ED&A' would be laid out with no potential for material mis-interpretation. There is no

[79] Case C8/55 *Federation Charbonniere de Belgique v High Authority* [1954] ECR 245

[80] Case 105/75 *Giuffrida v Council* [1976] ECR 1395

danger of the Directives 'ED&A' being used for anything other than its original purpose and this is important given the burden of criminal liability being placed on the MNE Officer. Member States may use the disclosures as a reason for pursuing some MNEs more aggressively than others but this is no different to the autonomy given to national tax authorities currently, and any personal criminal liability is based not on the underlying activities but expressed in terms of data completeness and integrity. In this respect the MNE Officer is entitled to exercise the right to legitimate expectations. The doctrine of legitimate expectations is "undeniably part of Community law"[81] although some commentators surmise that it is "rather intangible" [in EU law]….and "very few cases succeed on the legitimate expectations argument"[82]. The doctrine comes from public law and applies to the principles of fairness and reasonableness to a situation where a person has an expectation of a public entity retaining a long standing practice or keeping a promise. It demands consistency and proportionality from such public entities.

In the context of this 'ED&A' proposal there are several aspects to a MNE Officer's legitimate expectations. On the one hand it relates to a legitimate expectation around the procedures for executing the 'ED&A' Directive's rules, and the measured and relatively consistent implementation of Member State rules for meeting the proposed Directive's rules. On the other hand, it relates to providing for sufficient *locus standi* for judicial review in the event of an 'ED&A' conflict. A MNE Officer has a legitimate expectation of being treated in accordance with a fair and structured administrative process for resolving 'ED&A' conflicts. Any evidence of Member State procedural impropriety would justify judicial review. There is also an internalised angle on this doctrine too. A MNE Officer could be expected to have legitimate expectations that the controls and procedures put in place internally within the MNE to ensure integrity and completeness of data would be sufficient to rely on in making an attestation. Only a failure to ensure such controls are put in place or to oversee a level of due diligence over such controls would leave the Officer at risk. The external dimension to relates to having a legitimate expectation that the Member State tax authorities and judicial system would treat him fairly in any investigation either as consistent with the policies and

[81] Case C147/84 *Finsider v Commission* [1985] ECR 131

[82] Eleanor Shapston, 'European Community Law and the Doctrine of Legitimate Expectations: How Legitimate, and for Whom' (1990) 1,1 Northwestern Journal of International Law and Business, 87

procedures inherent within the Directive or from consistent past practice[83]. In accordance with the findings of Srivastava, the legitimate expectation of a MNE Officer "may not by itself be a distinct enforceable right, but failure to give due weight to it may render any outcome as arbitrary. This is how the requirement of due consideration of a legitimate expectation forms part of the principle of non-arbitrariness, a necessary part of the rule of law" [84]. Reference to these legitimate expectations referenced in this section constitutes the reasoning relevant to an equitable decision-making process relating to 'ED&A' investigations.

The application of the doctrine of legitimate expectations to taxation is not a new concept. It has been well documented in scholarly literature and has been evidenced in administrative laws for some time. Legitimate expectations can be considered a procedural right although this has been extended to the enforcement of more individual expectations, something that has been termed substantive protection of legitimate expectations[85]. Of relevance to this research are the findings of Barak-Erez[86] who highlighted the difference between expectations and reliance with most EU case law focusing on the latter point. Further research by Freedman and Vella[87] focused on the correlation between legitimate expectations and fairness as a basis of the rule of law, setting out the "careful balance to be struck between certainty and fairness for the individual on the one hand, and flexibility and public interest on the other"[88]. Similarly, case law reference has been made to such a doctrine in a number of tax cases. In *Unilever*[89] it was ruled that in the absence of reliance, legitimate expectations would not be enforced unless a taxpayer relied on a tax authority's actions and as a

[83] Hardinge Halsbury, *Halsbury's Laws of England,* (Butterworth's, 2007), 151

[84] Arun Kumar Srivastava, 'Doctrine of Legitimate Expectation', Institute of Judicial Training (1995) <http://www.ijtr.nic.in/articles/art13.pdf> accessed 10 May 2014

[85] Christopher Forsyth, 'The Provenance and Protection of Legitimate Expectations' (1988) 47 Cambridge Law Journal, 238; Clive Lewis, 'Fairness, Legitimate Expectations and Estoppel' (1986) 49, Modern Law Review, 251; Ross Cranston, 'Legitimate Expectations: A Conceptual Analysis' (1992) 108, Law Quarterly Review, 79

[86] Daphne Barak-Erez, 'The Doctrine of Legitimate Expectations and the Distinction between the Reliance and Expectation Interests' (2005) 11, European Public Law, 4, 583

[87] Judith Freedman and John Vella, 'HMRC's Management of the UK Tax System: The Boundaries of Legitimate Discretion', Oxford University Centre for Business Taxation WP10/22, (2010) Oxford University Centre for Business Taxation, 21

[88] Ibid, 21

[89] *R v IRC, ex p Unilever* [1996] STC 681

consequence witnessed change for the worse. As such, the judiciary will need to take note of any documented guidance, historical clearances, statements of interpretation, previous agreements and any other relationship form between the MNE and tax authority in respect to an attestation challenge as it may legitimately be relied upon. It seems realistic to argue that even where a MNE has enjoyed a favourable tax treatment for a number of years there should be no legitimate expectation to continue to enjoy such a benefit if an abuse of Fundamental Freedoms has been proven. In the event that an 'ED&A' disclosure prompts a tax investigation that results in a punitive tax charge being applied to a MNE on a set of circumstances previously approved or accepted by a tax authority, there is an argument that the MNE may have a legitimate expectation of such a favourable tax treatment continuing but there is no statutory provision for any EU tax authority for open ended assurances. A tax authority armed with more granular information could be expected to exercise their right to review and, where necessary, pursue abusive transactions irrespective of their previous actions. Ultimate responsibility, however, resides with the MNE. Reliance on an auditor's certification of compliance may not be relied upon. In *Newham*[90] it was held that an ultra vires bi-lateral assurance by a tax authority with a MNE cannot give rise to a legitimate expectation, although this becomes potentially complicated when public statements are made by the tax authorities and no such case law exists that has ruled on this matter.[91].

The final consideration is the adherence of the 'ED&A' solution proposal to human rights legislation. Ensuring the tenets of this solution proposal align with the rule of law is imperative but there is a necessary alignment with the European Convention on Human Rights too, hereafter referred to as 'ECHR'. Any solution proposal, and the associated procedures and actions adopted by Member States and their tax authorities will likely attract a degree of reliance by MNEs and its Officers on the ECHR to challenge 'ED&A'. There is limited academic literature relating to the correlation between accounting disclosures or attestations with criminal liability and its impact on the legislative provision of human rights protection. Considerable case law[92] on corporate tax cases has made reference to the ECHR although "there have not been many successful challenges of tax provisions under the

[90] *R (Bibi) v Newham London Borough Council* [2002] 1 WLR 237, 249, 46

[91] Lord Woolf et al, *De Smith's Judicial Review*, (Sweet & Maxwell, 6, 627, 2009)

[92] Case 44759/98 , *Ferrazzini v Italy* [2001] STC 1314; *R (on the application of Federation of Technological Industries and others) v CCE* [2004] EWHC 254

ECHR"[93]. The ECHR articles and protocols set out specific rights, acknowledging the fact that some are more relevant than others and that different Member State jurisdictions have differing human rights legislation to accommodate the provisions of the ECHR.

First, article 1[94] of Protocol 1 provides for respecting protection of property. There have been a number of EU cases on this matter, the most pertinent of which is *Hentrich v France*[95] whereby a French court ruled, in relation to article 1 of Protocol No 1, that "there must be a reasonable relationship of proportionality between the means employed and the aim sought to be released". If such proportionality is violated then there would be a case under the ECHR. This would be relevant if a Member State tax authority took disproportionate efforts in relation to the perceived abuses to investigate a MNEs transactions based on the accounting disclosures.

Second, article 6[96] provides for a right to a fair trial, providing the taxpayer with an independent and impartial trial within reasonable time. In the UK there have been some cases relevant to this research synopsis. *King v Walden (Inspector of Taxes)*[97] ruled that in the case of a taxpayer being negligent in his tax return and was subject to criminal liability there was no defence around a right to a free trial. A right to a fair trial may be possible if there is a delinquency in proceedings and the same could be applied to any judicial proceedings. A more interesting challenge may arise where investigation procedures used by a Member State tax authority based off the enhanced disclosures demand the disclosure of incriminating information that may be used against them. In some jurisdictions such as the UK if a MNE cooperates with the tax authority they will not usually prosecute but rather settle out of Court. Reconciling this approach with a more formal rigid penalty regime could introduce some difficulties as a right to a fair trial, as a human right, may be infringed if he was enticed under threat of more penal liability to provide incriminating evidence. The case of *R v Allen*[98] ruled

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[93] Victor Thuronyi, *Comparative Tax Law*, (1st edn, Kluwer, 2003), 110

[94] Convention for the Protection of Human Rights and Fundamental Freedoms (European Convention on Human Rights, as amended) (ECHR) art 1

[95] *Hentrich v France* [1995] 21, EHRR 277

[96] Ibid, art 6

[97] *King v Walden* [2001] STC 822

[98] *R v Allen* [2001] UKHL 45

that disclosure of information cannot constitute a violation of the right against self-incrimination.

Third, article 7 upholds that "no one shall be guilty of a criminal offence on account of any act or omission which did not constitute a criminal offence under national or international law at the time it was committed" [99]. The impact of this is that the implementation of any 'ED&A' requirements in the proposed EU Directive could not incur criminal penalty for retrospective violations as they would only become effective after Member State transposition. This does not preclude using enhanced accounting disclosures that shed light on retrospective tax abuses in evidence against a MNE when examining wholly artificial arrangements.

Fourth, article 8[100] provides for right to privacy. There is case law[101] evidence of when taxpayers have alleged tax legislation unreasonably impinges on confidentiality and the right of privacy. There is a risk that a MNE or its Officer may refuse, on the grounds of privacy, to supply information for specific reasons. This may not necessarily relate to the statutory disclosure itself but rather information demanded in any subsequent investigation by a Member State tax authority or Court. This remains a weak argument, substantiated by case law such as *Guyer v Walton*[102] whereby the taxpayer unsuccessfully argued that disclosure of information infringed the right to privacy of his clients. Data protection is a fundamental right enshrined within Article 8 of the EU Charter of Fundamental Rights and the processing of all data by law enforcement agencies must comply with the principles of "necessity, proportionality and legality"[103].

Fifth, article 14[104] contains a prohibition on discrimination and although it does not provide an exhaustive list of discrimination types, the right could correctly be applied to any potential discrimination suffered by a MNE if it could demonstrate that it was being singled out for

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[99] Ibid, art 7

[100] Ibid, art 8

[101] *R V Hillsdown Holdings plc v Inland Revenue Commissioners* [1999] STC 561

[102] *Guyer v Walton (Inspector of Taxes)* [2001] STC 75

[103] Commission, 'EU Data Protection Reform Proposal' (2015)

[104] Convention for the Protection of Human Rights and Fundamental Freedoms (European Convention on Human Rights, as amended) (ECHR) art 14

undue or disproportionate pursuit of tax abuse activities. There is an element of ambiguity with regards to this right that is only aggravated by its absence in case law precedent relating to taxation and corporate rights. Not all differential treatment is discrimination. Discrimination occurs when differential treatment cannot be reasonably justified. A Member State tax authority may assess a MNE more closely than another MNE but is infringing no rights in doing so. It is legitimate to treat MNEs differently. If a MNE has a track record of tax avoidance or is publicly exposed as deployed such practices there is no discrimination evidenced if a Member State tax authority elects to assess that MNE with an extra level of scrutiny above and beyond another MNE who does not have such a record.

Sixth, article 17[105] provides that no one may use ECHR rights to seek the abolition or limitation of rights guaranteed in the Convention. In *Oxhey v Raynham*[106] it was ruled that Member State legislation must intend to act consistently with the Member State's obligations under International Law. Legislation must be consistent with the ECHR but also international laws such as the EU Treaty. If there is any ambiguity around Member State laws in relation to provisioning the proposed EU Directive in this solution proposal then there is always the possibility of a referral for a judgement in relation to its compliance with ECHR. There is no known case law precedence that suggests ambiguity in a tax or accounting law has been relied upon in relation to its compliance with ECHR as an aid to judicial interpretation.

The doctrine of human rights provides this research with some important elements regarding the reform proposal. It serves to constrain Member States in creating penalty laws to support the proposed Directive within the expectations of the ECHR and it establishes behavioural goals to the extent that they can be influenced by external EU institutional actors. Although there appears little evidence of any material risks to the proposed solution on the grounds of a successful claim under ECHR there are two further points warranting consideration. In some non-corporate tax law cases[107], Courts have made a recurring reference, in relation to human rights, of parties being subject to an "individual and excessive burden". Does it necessarily follow that the 'ED&A' provisions mean that a MNE Officer could extend the concept relating to having to bear an "individual and excessive burden" through the proposed

[105] Ibid, art 17

[106] *Oxhey (Inspector of Taxes) v Raynham* [1983] 54 TC 779

[107] *Sporrong and Lonnroth v Sweden* (1982) ECHR 7151/75; *Hentrich v France* [1995] 21 EHRR 277

extended disclosures and attestation requirements? If so would an Officer subject to potentially excessive and burdensome tax authority investigative scrutiny as a result of 'ED&A' have a case under ECHR article 1 of Protocol No. 1? It remains a possibility and therefore a risk but there is no such case precedence to support this on the grounds of either a substantive interpretation of this right or from a procedural interpretation perspective. Finally, there is the challenging question regarding the balancing potential conflicts between human rights and abuse of rights. The manner in which the legal system addresses the potentially inherent conflicts of balancing the interests and rights of the EU in the protection of an Internal Market as set out in EU Fundamental Freedoms with individual ECHR rights of EU subjects when there is evidence of abuses of the former is the key challenge. There would be no credible argument that an individual surrenders ECHR rights if there is evidence of an abuse of EU Fundamental Freedoms but it may, in the eyes of the judicial system, weaken any case that a MNE or its Officer may bring when attempting to defeat an 'ED&A' violation by utilising the ECHR. Under such circumstances, if a Court is to consider a permissible interference with ECHR rights then it must be in accordance with the law and have a legitimate aim[108]. Any assessment on the reasonableness of such a restriction would be based around the principle of proportionality. The extent of any interference is important but Courts tend to assess any case by assessing whether a particular course of action such as a tax investigation consequential to the proposed 'ED&A' could be attained by a less intrusive mode. This has been recognised through judicial reference to the "margin of appreciation" doctrine[109] outlining the flexibility offered to Member States and their institutions in fulfilling their ECHR obligations, acknowledging that a uniform standard of human rights protections is difficult to achieve. Margin of appreciation is a context dependent assessment which is easier to apply to qualified rights rather than absolute rights[110] and there are examples of conceptually relevant human rights case law outside tax or accounting cases referencing margin of appreciation in relation to article 8 which ruled on the fair balance between the economic interests of a country and individual rights[111], in relation to article 14 and a case

[108] Mark Janis et al, "*European Human Rights Law. Texts and materials",* (3rd edn, OUP, Oxford, 2008), 19

[109] Steven Greer, *The Margin of Appreciation: Interpretation and Discretion under the European Convention on Human Rights*, (Strasbourg, Council of Europe Publishing, 2000), 39

[110] Kathleen Kavanaugh, 'Policing The Margins: Rights Protection And The European Court Of Human Rights' (2006) 4, European Human Rights Law Review, 422

[111] *Hatton v The UK* [2003] ECHR 36022/97

ruling on a fair balance between protecting the interests of the community and respecting fundamental rights[112], and in relation to article 1 of Protocol 1 that ruled on the proportionality between a legal penalty and the legitimate aim underpinning the legislation[113]. All of these have relevance and potentially provide the basis for any challenges regarding potential interferences with ECHR rights raised in the context of the solution proposal.

[112] *Belgium Linguistics v. Belgium* [1968] ECHR 1474/62

[113] *Sarukhanyan v. Armenia* [2008] ECHR 38978/03

Chapter Eight: Rationalising the Proposed Solution

8.1 Introduction

Although the path to reform is a challenging one, the ED&A solution detailed in Chapter Seven offers a credible strategy for reducing tax avoidance practices. Succeeding in implementing such a legal solution proposal will be a challenge, very much determined by the underlying alignment to established legal doctrines both in absolute terms and in accordance with the legal order inherent within the adopting Member States. The solution components are subjected to a critical assessment of its absolute compliance with the fundamental concepts underpinning the Rule of Law since laws are rarely adopted successfully or sustainably if they infringe on such concepts. Reliance on the doctrinal concepts of abuse of rights, substance over form and proportionality direct the analysis towards how these are relevant not just in relation to the solution in principle but to their alignment with the legal order in each of the sample set of Member States.

8.2 Alignment to Rule of Law

The rule of law remains a contested concept. In its most basic form it refers to what Hayek termed “rules fixed and announced beforehand…which make it possible to foresee with fair certainty how the authority will use its coercive powers in given circumstances, and to plan one’s individual affairs on the basis of this knowledge”[1]. The credibility of any proposed solution would demand alignment with the rule of law. In Chapter Six an assessment was conducted of the mainstream solution options against the basic concepts generally understood to form part of the rule of law. For the solution proposal we will apply the component parts against the more detailed definition in accordance with a UN report[2] definition stating the rule of law as;

[1] Friedrich Hayek, *The Road to Serfdom*, (50th Anv edn, University of Chicago Press, Chicago, 1994), 80

[2] United Nations, ‘The rule of law and transitional justice in conflict and post-conflict societies: Report of the Secretary General’ (2004) <http://www.unrol.org/files/2004%20report.pdf> accessed 22 February 2014

“A principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards. It requires, as well, measures to ensure adherence to the principles of supremacy of law, equality before the law, accountability to the law, fairness in the application of the law, separation of powers, participation in decision-making, legal certainty, avoidance of arbitrariness and procedural and legal transparency."[3]

This particular definition of the rule of law has been selected as it has a number of additional component parts to its content that Bingham omitted that have direct relevance to this reform proposal. Reference to accountability to the law refers to the processes, norms and structures that hold MNEs and EU institutions legally responsible for their actions and who may impose sanctions if they violate the law, a potent issue for a reform proposal that delivers tax compliance through the targeting of MNEs directly rather than the Member States. Reference to equality before the law reflects legal egalitarianism that is important given the diversity of the MNE population in the EU, and reference to accountability to the law reflects the strength of a law to ensure that the legal rule being proposed underpins the claim of being held culpable of the breach of a law. Reference to the separation of powers is a political doctrine reflecting the diversity of power inherent in the ordinary legislative process of implementing a Directive, and participation in decision-making is an important element given the diversity of stakeholders influencing the EU tax reform process. The emphasis placed on legal certainty is similarly significant as a component of international law to enable MNEs to regulate their conduct with security and protecting the taxpayer from arbitrary use of state power which reforms often offer ample opportunity to exploit. The rule of law aspect is important because of the competing forces of law making and judicial oversight roles and responsibilities. This tension resides at tax administration, tax legislation and judicial tax ruling levels across EU and Member State domains. It refers to a set of set of principles and ethical standards that are analogous with the concept of legality. Disparate national provisions relating to tax laws have posed little issue from a rule of law perspective while operating in tandem, but efforts to promote a centralised pluralistic direct tax law or related initiative through the EU raises challenges.

[3] Ibid, 4

Compliance with the rule of law would provide credibility to the proposal. In Chapter Three it was shown how the Common Law *Legal Origins* legal doctrine[4] is a useful starting point whereby the integration of legal norms through a common law system in each Member State impacts economic behaviours. The link between market or economic behaviour correlated to its legal system, suggests that in the context of this research changes to EU law reform are likely to impact on the economic behaviours of its constituents, both sovereign and corporate. La Porta[5] endorsed the earlier historical versions of legal origins theory by suggesting how legal rules are propagated by particular economic contexts. Legal rules at Member State change frequently in response to local needs and substantive rules of law are flexible to this local environment whereby it requires a more essential change in 'legal infrastructure'[6] that embraces more deeply rooted legal rules and practices that determine the role of the legal system in shaping economic behaviour. Member States cannot do this singularly as it requires a more fundamental force to enact change. La Porta also highlighted how this fundamental force is more likely to be effective through common law means than civil law[7], supporting the distinction implied by Hayek's analysis of the differences between common law and civil law[8]. The legal philosopher Hayek promoted the notion that the bulk of knowledge in a society is local in character and dispersed, implying that no individual could master enough information to anticipate the effects of a planned change in laws. Research by Armour[9] et al suggested that legal origins theory defines the 'quality of law' by ensuring legal rules shape economic decisions and outcomes according to how far they support market based economic activities. This theory is important to this proposed scheme as it recognises the importance of EU Fundamental Freedoms driving Internal Market MNE behaviours, as well as how it signifies the importance of Member State tax laws residing along more broadly based EU provisions for resolving complex issues such as EU tax abuse. Each has their part to play and

[4] Rafael La Porta et al, 'The economic consequences of legal origins' (2008) 46, Journal of Economic Literature, 2, 285

[5] Ibid

[6] Ibid

[7] Ibid

[8] Friedrich Hayek, *The Constitution of Liberty*, (1st edn, University of Chicago Press, Chicago, 1960), 109

[9] John Armour et al, 'Shareholder protection and stock market development: an empirical test of the legal origins hypothesis' (2007) Centre for Business Research, University of Cambridge, Working Paper 358, 2

it is these provisions working in parallel that need to be assessed from a rule of law perspective.

When considering the proposed scheme in the context of the rule of law, its content may be viewed “as a means rather than an end”[10]. Conventionally, law starts with an act of illegality and the judicial system uses evidence of the illegality to pursue prosecution. In the context of corporate tax avoidance we start looking at the evidence to see if a crime has been committed. It requires a different line of reasoning than many other aspects to law making. The EU would be empowered with the legal authority to mandate corporate disclosure through the EU Directive and the Member States would be empowered to implement law to regulate the process of review, challenge and penalty of the corporate disclosure.

There is no such concept as the EU rule of law although there has been reference to the more general concepts of an international rule of law[11] and academic reference to “supranational rule of law”[12]. In the context of this research, the rule of law needs to be applied to Member States and the MNE and its Officers. For Member States there is an obligation to exercise its powers based on legislative authority utilising channels that make such public rules limited to their absolute statement, limiting subjective interpretation by officials and abiding by due process of law. For the MNE and its Officers, there is a responsibility to obey these laws, be cognisant to changes in the laws, have controls in place to ensure abidance and do not act in any way that compromises the operation of the legal process. Given a MNE must obey the law where it exists but does not have any obligation where it does not is an important point. They have no obligation to behave in accordance with the morality, purpose or spirit of the law.

Whether it is possible to curtail the abusive attack on Fundamental Freedoms without adversely impacting the rule of law is a debatable point. There is an element of discretion offered to Member States in how they implement locally into law and how, whether and to

[10] Simon Chesterton, ‘An International Rule of Law?’ (2008) 8, New York University Public Law and Legal Theory Working Paper, 1

[11] Jeremy Waldron, ‘The Rule of International Law’ (2006) 30, Harvard Journal of Law & Public Policy, 26

[12] Karen Alter, *Establishing the Supremacy of European Law: The Making of an International Rule of Law in Europe*, (New ed edn, OUP, Oxford, 2003), 44

what extent national tax authorities wish to pursue a potentially abusive disclosure. Such discretion warrants a more prescriptive process to nurture a homogenous implementation of the Directive. The EU Treaty represents formalised constitutional arrangements accommodating both rules on establishment and movement as well as defining the competencies and inter-relationships between EU institutions and Member States. It grants and restricts powers, provides for judicial review through the CJEU, and ensures legal protection of EU law for Member States and its subjects, including MNEs. Administratively 'ED&A' is predictable in its application and is subject to a straightforward judicial enforcement process. Subjectively, the predictability of the outcome of extended disclosures and the extent to which a Member State tax authority decides to enforce a prospective abuse is far from certain and to this extent could be considered to offer a negative impact on the rule of law. Intuitively, this dilemma could be extended to virtually every solution that has been promoted to date to curb EU tax abuse and the deep-rooted complexity of the problem challenges such conformity to the rule of law.

Introducing an element of criminal liability into disclosure violations is a material point. Illegal behaviour is but only one element of law. Law forecasts illegal behaviour and accommodates violations in its provisions. To shape such illegality within the law it is necessary to understand what would drive violations. Behavioural Law and Economics Theory advocated by Thaler[13] identified three primary drivers, namely bounded rationality, bounded willpower and bounded self-interest. Such drivers necessitate a change in corporate thinking when architecting avoidance schemes for this proposed scheme to become effective in the long term. The disclosures, attestation and its liabilities need to ensure that there is an "unthinking obedience to them"[14] rather than the nurturing of an ongoing "calculation of the costs or benefits of abiding by them"[15].

[13] Richard Thaler, 'A Behavioural Approach to Law and Economics' (1998), Coase-Sandor Working Paper 55, University of Chicago Law School <http://chicagounbound.uchicago.edu/cgi/viewcontent.cgi?article=1003&context=law_and_economics> accessed 11 December 2014

[14] Gerard Lynch, 'The Role of Criminal Law in Policing Corporate Misconduct' (1997) 60, Law and Contemporary Probs, 23, 46

[15] Ibid

To understand better how the proposed new law potentially impacts compliance it is necessary to look at how such an 'ED&A' scheme would empower legal authorities such as Member State tax authorities and judicial institutions to establish and maintain a corporate taxation order by regulating corporate behaviour. Securing such compliance through the threat of criminal liability is a new concept to EU law but not to international law. Feld and Frey[16] promoted the concept of a "psychological tax contract" to explain how the way in which a tax authority treats a taxpayer influences their tax morale. If a Member State implements punitive tax laws or implements an unconstructive and threatening approach it can result in higher tax avoidance. Tax compliance requires a deterrence as well as responsive regulation. The measured way in which this proposed scheme is being promoted would be consistent with this point, notwithstanding a level of frustration from those MNEs that do not currently have an ability to generate CCR data in an automated and robust manner. There is little that 'ED&A' itself could be considered to be unfair or threatening, although the manner upon which Member State tax authorities follow up on prospective abusive conduct would impact the relationship outcome between MNE and tax authority.

Opinion is divided about whether introducing criminal law provisions impacts behaviours. Mill[17] advocates criminality in terms of the harm principle. Research by Slemrod and Tyitzhaki[18] as well as Andreoni, Erard and Feinstein[19] all noted a positive correlation between a legal deterrent and tax compliance. Lord Delvin similarly promoted the view that introducing an element of criminal law into legislation is to enforce a moral principle[20]. Conversely Robinson and Darley argued that "having a criminal justice system that imposes sanctions no doubt does deter criminal conduct but manipulating criminal laws within that system to achieve heightened deterrence effects will be ineffective"[21]. Furthermore Robinson and Darley stated that criminal law rarely influences behaviour despite the assumption by

[16] Lars Feld and Bruno Frey, 'Tax Compliance as the Result of a Psychological Tax Contract: The Role of Incentives and Responsive Regulation' (2007) 29, Law and Policy Journal, 102

[17] John Mill, *On Liberty* (1st edn, OUP, Oxford, 1859), 9

[18] Joel Slemrod and Shlomo Yitzhaki, 'Tax Avoidance, Evasion and Administration' (2001) Handbook of Public Economics, 3

[19] James Andreoni et al, 'Tax Compliance' (1998) 36, Journal of Economic Literature, 818

[20] Patrick Devlin, *The Enforcement of Morals*, (OUP, Oxford, 1965), 14

[21] Paul Robinson and John Darley, 'Does criminal law deter? A behavioural science investigation" (2004) 24, Oxford Journal of Legal Studies, 2, 173

policy makers that application of criminal law always influences conduct[22]. More recent research by Parker[23] assessed the regulatory-compliance relationship and the propensity of businesses to adopt legislation with criminal provisions, concluding that there were a number of drivers, most significantly the enforcement strategy, the internal characteristics of a MNE and the manner in which a MNE interacts with the economic and political environment. To better understand whether the proposed scheme's criminal law provisions would assist its objectives, research[24] has found that certain personal characteristics of individuals typically respond badly to the threats of legal action, namely repeat offenders, risk seekers and those with lack of self-control although none of these behaviours are typically evident at senior management targeted by the proposed scheme. If the 'ED&A' rules were dismissed for whatever reason by the MNE then it may similarly encourage dismissal by the Officer although the different liabilities implied in the Directive may render this observation as meaningless.

Economic models of self-interest typically drive out behavioural patterns regarding tax avoidance. The punishment for tax avoidance discounted by the possibility of prosecution and conviction is commonly rather small relative to the gain. The personal punishment for tax avoidance relative to the corporate gain in the context of this proposed scheme to resolve corporate tax avoidance is rather large. This may generate a rather unpredictable set of behaviours relative to that documented in academic literature to date. Legal positioning theory[25] has been shown to advocate an understanding of behaviours in the legal system to the processes by which the permissible is extracted from the possible. One may determine the moral order in ascertaining what is done versus what can be done. Such a moral order is a loose and complex system of rules, conventions and principles that impact behavioural patterns. In the context of this research these may be a function of the individual Officer, the MNE corporate culture, national culture in which the Officer and / or MNE resides and the group behaviours enacted by those individuals and entities around the attesting Officer and MNE. The relevance of corporate governance is also significant in that behaviours will also

[22] Ibid

[23] Christine Parker, 'Criminalisation and Compliance: The Gap between Rhetoric and Reality' (2009) University of Oxford Centre for Competition Law on Policy on Criminalising Cartels

[24] Michael Gottfredson and Travis Hirschi, *A general theory of crime*, (Stanford University Press, 1990)

[25] Rom Harre, *Positioning Theory*, (The Encyclopaedia of Peace Psychology, 2011)

be a function of how a MNE sharpens up its governance in response to the 'ED&A' disclosure requirements of the proposed Directive. Greenfield[26] turned to behavioural economics to advocate how changes to corporate governance are beneficial to a MNE as well as socially beneficial, an important point given the assumed strengthened governance that a MNE Officer would be expected to put in place to assure oneself of corporate compliance.

For a criminal law provision to be effective in this proposed scheme the MNE Officer would need to acknowledge the personal repercussions of the criminal sanctions inherent within the Directive. Such an acknowledgment would need to include an appreciation of the disclosure reporting and attestation actions required and the lines of defence available to excuse any actions which may be considered criminal in nature. This understanding would be expected to be reflected in his business decision-making conduct. Although more commonly relevant to private forms of corporate entities, MNE Officers may be incentivised to make decisions that conflict with the proposed Directive and in such cases it is for the MNE Officer to decide whether the perceived costs of non-compliance outweighs the personal benefits of a prospective criminal action. In such cases, if a senior MNE Officer is likely to personally benefit in terms of compensation from tax abuse activities there may be a different risk / reward assessment than a MNE Officer who is unlikely to derive any direct benefit. Such an assessment is likely to factor in the probability of being discovered, the total amount of the potential punishment, and the delay in which a penalty typically follows the law violation.

Analysis of jurisprudence in providing an approach to understanding how law is granted its authority to enforce behaviours provides a useful insight. It has been claimed that what makes a rule a legal rule is not determined by its content but by its source. Austin expressed this in his "command theory of law"[27] whereby command lies at the heart of the legal system surmising that every law needs its own legal personality. In the UK, law is the prerogative of the Sovereign and is enforced by punishment in the event of non-compliance. As an EU

[26] Kent Greenfield, 'Using behavioural economics to show the power and efficiency of corporate law as regulatory tool' (2001) University of California, L Rev 35, 581, <http://lawreview.law.ucdavis.edu/issues/35/3/symposium-corp-theory-governance-law-memoriam-daniel-j-dykstra/DavisVol35No3_Greenfield.pdf?bcsi_scan_dd0fad490e5fad80=0&bcsi_scan_filename=DavisVol35No3_Greenfield.pdf> accessed 2 December 2014

[27] John Austin, *The Province of Jurisprudence Determined* (W Rumble ed, CUP, Cambridge, 1995), 111

Directive has the authority of EU law this provides sufficient command to enact subjects to obey the law, Hart[28] on the other hand observed that there are primary and secondary rules of obligation. In the context of the proposed scheme, the proposed EU Directive would be the primary rule and the Member State rules and judicial process for interpretation and enforcement of those rules would be the secondary rules. Other researchers offer useful literature such as Dworkin who claimed that every legal rule has a moral dimension[29] although there is plenty of resistance to such an ideal from other researchers such as Hart who claims no such linkage and that the acceptance and compatibility of a law with moral values served as a criteria for the validity of a law[30]. Dworkin's theory suggests that if legal positivism is invalid and individuals or MNEs do have rights above and beyond those expressly set out in law then the view that an action that inflicts economic harm on a Member State through profit shifting could be considered rightly abusive on moral grounds even if it is not implicitly set out as such in law. A Member State, the argument would go, has a legal right for its tax subjects to act in certain ways beyond that set out in law and the judicial system has a right to defend such rights.

There are a number of observations that may be made that, in advance of a more detailed analysis in respect to the proposed 'ED&A' components, relating to its consistency with the Rule of Law. 'ED&A' is neither strictly a rule based nor principles based solution. While the concepts of rules and principles have traditionally been useful to classify specific provisions in tax law they have a slightly different purpose for this proposed scheme in the sense that they serve to underpin a set of enforceable provisions targeting behavioural changes through legally binding disclosures. There is no debate around the notion that this proposed scheme deals with facts, with factual disclosures mandated through the Directive. The discretion around whether a Member State tax authority pursues threshold breaches inferring tax abuse introduces an element of threat and uncertainty that is useful for encouraging behavioural change. An observer may conclude that the potential inequitable way in which potential tax abuse evidenced is investigated is unfair but this would be a fallacious conclusion. A rule that mandates inconsistent procedures or actions is one matter and not constituted within this proposal. There is an element of discretion in the manner upon which national tax authorities

[28] Herbert Hart, *The Concept of Law* (Clarendon Press, Oxford, 1994)

[29] Ronald Dworkin, *Taking Rights Seriously* (Duckworth & Co, London 1978)

[30] Herbert Hart, *The Concept of Law* (Clarendon Press, Oxford,1994)

may pursue potential anomalies but this is because it is seeking evidence of illegality rather than responding directly to it. It is the threat that nurtures behavioural change that is consistently provided for not the potential consequences of off-limit disclosures that would be subject to Member State investigation under any proposed scheme and does not differ from the situation MNEs find themselves in already today. Any adverse impact on a MNE or its Officers would be based upon violations of disclosures and control requirements to validate their authenticity. If the rule of law is based around equality before the law, legal certainty, transparency and accountability then given a MNE taxpayer will continue to be able to act freely, plan their tax affairs and make decisions based on the law then 'ED&A' conformance to key aspects to the rule of law is secure. Perversely, it is EU Fundamental Freedoms that arguably compromise certainty by providing for an environment that contradicts Member State tax laws and offers opportunity for exploiting loopholes and ambiguities. By mandating more extensive disclosure it exposes a broader set of such loopholes and ambiguities and makes for a stronger case of more extensive case law over time in ruling out opportunities to practice profit shifting.

There is an argument that curtailing Fundamental Freedoms for the purposes of mitigating tax abuse within an internal market is also a force for social good since the curbing of abusive practices against such Fundamental Freedoms do not compromise the internal market's workings. The merits of redistributing taxable payments in order to maximise profits that benefit corporate stakeholders such as employees and shareholders hold no more merit than the benefits to the citizens of Member States in being rewarded with its rightful taxable income. There is no disagreement about whether a law offers a common social good implying consistency with the rule of law. A social good may well be served by maximising profits to stakeholders but a common social good can only be served through the common public purse which in its totality is bereft of its maximum potential as a result of tax abuse.

The proposed ED&A scheme also safeguards political rights through the protection of Member State sovereignty in the formation and enforcement of the rules compliant with the proposed Directive. From a MNE Officer perspective civil liberties are protected through the clear definition of the attestation requirements and formal procedures for appeal. Mechanisms for accountability affirm the political equality of all Member States and commercial equality of all in scope MNEs and constrain potential abuses of Member State power and corporate power. Proponents of the proposed scheme would also rightly point out the merits of how the legal procedures advocated in the Directive both to enact rules in to national law and the procedures inherent in enforcing such rules, the legal reasoning underpinning the legitimacy of the Directive's requirements, and the legal consequences determined by the outcome of implementing the Directive's rules are clear and well defined.

In respect to independent adjudication of laws, if MNEs operating across the EU are bound by a common Directive and set of thresholds, it necessarily follows that the process for investigating exceptions or anomalies is equally consistent. Initial investigations would be the responsibility of the tax authority in the relevant reporting Member State and not necessarily the country where the MNE is domiciled, closely followed by judicial appeal in circumstances where a ruling by the tax authority is deemed to be unacceptable to one of the counterparties, initially in the Member State judicial system and upon appeal to the CJEU. Over time judicial rulings on matters of conflict need to form a settled set of case law responses to threshold breach scenarios so that there is a common set of defendable acceptable exceptions to the thresholds. The rate at which Member State tax authorities pursue prospective abuse evidence will be important. Maintained this rate at a high level will ensure the criminal liabilities associated with 'ED&A' violations act as a deterrent. Such a level is hard to define but would probably be at least 20 – 25% with a lower pursuit rate possibly prompting the opposite effect and encouraging even more tax abuses.

In its purest form, the rule of law ethos promotes due process of law and equality before the law. The federated multi-tiered nature of the EU and its institutions ensure the institutional mechanisms for implementing the rule of law are complex and dispersed. Moreover, against this background of complexity, what may appear to align with the rule of law for one stakeholder may not be viewed in the same light for a different stakeholder with different perspectives. In theory such ambiguity should not exist but in the case of EU law it is relevant as how the rule of law may be interpreted by a MNE may be different from a Member State or EU institution. This proposal also advocates a legal order that supports improved governance standards and stronger multilateral cooperation to fight the battle of corporate tax avoidance abuses. The CJEU has a role to play in this process, scrutinising not just the Directive's alignment and legal conformity with the general principles of EU law but also the Member State measures implemented as a consequence of the Directive ensuring adequate respect for the EU Treaty and general principles of law which include human rights in any judgements consequential to its implementation. In this respect the CJEU would play a crucial role in guiding direction over the proposed Directive's influence and enforcement.

Consistent application of the law could infer that the judicial adjudication of the proposed Directive's legal rules should be consistent across equivalent case law, and is made without taking into account the status, commercial domination or influence of any of the parties involved. Publicity around several high profile MNEs such as Google and Starbucks avoiding tax could arguably attract the attention tax authorities in Member States suffering most from the profit shifting activities of these MNEs suggesting a less than fair application and enforcement of the law. But this is the case now irrespective of whether a new 'ED&A' Directive is adopted and 'ED&A' only emphasises more credibly the need for more detailed disclosure to either vindicate or suppress any claims of tax abusive. The Directive would adhere to pre-established transparent procedures and allow a fair claim to the opinions and interests relevant to a given case. This proposal offers a fundamental direction away from centralised rule making that characterises other areas of EU law. This proposal promotes an EU solution transitioning away from a more traditional role of being a donor of tax avoidance change via CJEU rulings to one of co-ordinator of a mandated policy to mitigate the adverse consequences of EU Fundamental Freedoms abuses through an accounting Directive. Once the Directive is implemented the EU would act as a compliance manager rather than an enforcement manager, collating information from Member States to review and share for the purposes of further iterative enhancement while leaving enforcement to the Member States themselves.

Irrespective of the merits presented in support of the proposed scheme's alignment to the Rule of Law, there remain a number of points that will be grasped by critics resisting the proposed changes. "Fairness in the application of law"[31] forms the basis of the rule of law, and there could be a challenge around whether the enhanced disclosures would provide a sufficient level of information that will allow objective judicial reasoning. Every MNE will proclaim a unique reason or set of circumstances that justify a given course of action. The larger the potential benefit to the MNE from profit shifting, the higher the MNE investment that could be justified in engineering a complex web of transactions to mask the abusive

[31] United Nations, 'The Rule of Law and Transactional Justice in Conflict and Post Conflict Societies' (2004) Report of the Secretary-General, 4

transactions. If Member State tax authorities pursue just the largest potential abuses this is not necessarily a fair application of the law if similar tactics by less material MNEs are not pursued with same energy. Any arbitrariness that results from such a law is likewise an unhelpful effect. Research by Shane[32] is particularly relevant in this respect, advocating two principal problems facing EU law making. First is the tendency for "public officials, even if conscientiously attentive to law, will often find the written law applicable to their particular problems or opportunities to be genuinely vague." implying that any 'ED&A' Directive would always be susceptible to variable interpretation to reflect both the complexity of underlying transactions and the propensity to enact a disclosure probe based on the subjective assessment by the Member State tax authorities on such complexity. If the Directives 'ED&A' procedures are clear in text but ambiguous in terms of how they are interpreted and implemented at Member State level then MNEs will retain a degree of incentivisation to shift profits and reduce taxation. Second, there is evidence that "the chances are remote that law can and will be enforced against nonconforming behaviour"[33] suggesting that even where an opportunity arises to probe prospective abuse there is an unhealthy reluctance to do so. This may not necessarily be as negative as it may suggest. Shane stated that the rule of law must have "an operational consequence even when the actual prospects of sanction for illegality are remote"[34]. This suggests that written rules need to be supported by societal norms, conventional expectations and behaviours that ensure Member State tax authorities behave as if they are accountable to the public interest. This promotes a sense of legal authority that is important resulting in a public policy to reduce corporate tax abuse based less on the actual outcome but more about whether it has been "conscientiously and systematically pursued"[35]. Such enforcement should be expected to drive changes in behaviours rather than propagate a high number of judicial rulings of alleged abuses. In the end an evaluation is required concerning how the tax and accounting system operates in response to the proposed Directive as much as the formal rules contained herein.

8.2.1 Country-by-Country Reporting and the Rule of Law

[32] Peter Shane, 'The Rule of Law and the Inevitability of Discretion' (2013) 36, Harvard Journal of Law and Public Policy, 23

[33] Ibid, 23

[34] Ibid

[35] Felix Frankfurter, 'John Marshall and the Judicial Function' (1955) 69, Harvard Law Review, 217

CCR does not compromise any rule of law definition, in fact it positively promotes many aspects of the doctrine. Propagating CCR disclosures through an EU Directive ensures that all Member States and their corporate tax subjects are accountable to the additional disclosures. Consistent application to all Member States irrespective of economic size or other economic metric and consistent application to MNEs irrespective of industrial segment or any other commercial metric is an important point. It has no adverse impact on human rights, and offers equality, fairness and accountability in relation to the law. From an accounting point of view, CCR is a fairly standard and established accounting practice even if it is not widely adopted in statutory accounting. Reconciliation with consolidated accounts is straightforward and there are no specific complexities around the accounting segmentation required. The CCR procedure is transparent and straightforward, and as an annex to statutory reporting offers no legal uncertainty. There is sensitivity regarding legal protection offered to private sector business investments[36]. Confidentiality from public scrutiny could be sighted as a reason to refrain from disclosure but this has no credibility in terms of the rule of law. No MNE conducting and reporting business transactions with economic substance have anything to fear from ‘ED&A’. Claims that mandating the publishing of CCR data compromises competitive advantage is considered a weak argument and has been rejected by the CJEU[37]. For larger MNEs transparency is already largely in place as data is comprehensively scrutinised by market analysts and there is no empirical evidence to suggest any linkage between financial transparency and MNEs competitive advantage at any level across industry size or types.

From a fairness perspective, the Directives proposals are entirely equitable in terms of what is being asked in relation to CCR but offer a degree of discrimination against smaller MNEs in terms of their implementation as the costs associated with CCR are likely to be higher as data is likely to be less readily accessible or available for computation from the outset and disproportionately larger and burdensome for MNEs at early stage development where investment in financial accounting systems are likely to be less of a priority than developing a business proposition itself.

[36] Simon Johnson et al, ‘Regulatory Discretion and the Unofficial Economy’ (1998) 89, American Economic Review, 982

[37] Case C-182/00, *Lutz GmbH and Others* [2002] ECR I-547

8.2.2 Threshold Disclosures and the Rule of Law

Akin to CCR reporting the implementation of threshold disclosures offers a similar profile of alignment to the rule of law. As an additional disclosure it offers additional complexity in its compilation specifically for MNEs operating in industries that have an operating model that makes distinguishing activities attributable to different Member States as being difficult to quantify. Although these are small in number the accounting standards associated with compiling the thresholds will be less established and to that extent a set of guidelines will need to be issued by the EU as part of the Directive aimed at avoidance any conflict or inconsistency. These will likely be updated on an ongoing basis to reflect specific case examples as they are raised in the 'ED&A' process.

Procedural certainty is set out in the clear 'ED&A' procedures and prospective review paths offered to national tax authorities with regard to investigations and Member State judiciaries in terms of MNE appeals. The legal certainty relating to the outcome could be criticised as being less clear but the Directive's provisions are designed to ensure complete and accurate data for the purposes of encouraging pre-clearance, explanation or investigation rather than for the purposes of creating an ambiguous set of data liable to subjective interpretation. The objective is to mandate the disclosure of data for the purposes of an assessment by the relevant tax authority rather than providing for a defined path of prospective certainty regarding the outcome of such a disclosure. For any breaches of the 'ED&A' disclosures the concept of consistent application may be challenged on the basis of the autonomy offered to national tax authorities in deciding whether to investigate MNEs on the basis of their data published. This is a function of its implementation rather than legal integrity. Both national Courts and the CJEU have political accountability that in itself implies the granting of rights to enforce the measures in the proposed Directive. The importance of enforcement should not be underestimated. Research by Laux and Stocken[38] concluded that 'raising accounting standards without improving enforcement can backfire and reduce reporting quality[39]'.

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[38] Volker Laux and Phillip Stocken, 'Accounting Standards, Regulatory Enforcement and Investment Decisions' (2013) University of Michigan Working Paper, <http://faculty.chicagobooth.edu/appliedtheory/workshop/autumn2013/stockenaccountingaut2013.pdf> accessed 14 August 2014

[39] Ibid, 1

Similar conclusions were drawn by Hope[40] and Holtausen[41]. Empowering national tax authorities to investigate potential abuses and the availability of a judicial escalation path at national and European level addresses this point. Depending on whether a country is a general economic benefactor of profit shifting in terms of tax revenue as opposed to a general loser may skew national judicial rulings relating to 'ED&A' that will require normalisation through more independent CJEU rulings. Such a need for judicial normalisation can only be mitigated through a levelling of economic conditions across Member States, which is entirely unfeasible, or through the EU centralisation of a taxation taskforce responsible for pan-European enforcement of 'ED&A' but this is not deemed a near-term aspiration of the solution proposal.

From a judicial perspective, if a MNE raises a dispute regarding threshold interpretation by the tax authority, the Courts have demonstrated in the past that they follow no single and consistent set of rules in deciding when to accept or disregard on a form of conduct. This is unhelpful and in itself provides uncertainty to the legal outcome but this is endemic across most forms of legal systems and it could be expected that within a reasonable short period a set of established assessment criteria would be set akin to similar judicial reviews by the CJEU that would be adopted by national Courts in order to avoid protracted disputes through arbitrary differences in rulings between different Member State judiciaries. For example it has been shown that the basic notion of substance and form is well established cross the EU and there is no reason why such a doctrine cannot be capitalized further by tax authorities once furnished with more detailed disclosures. In circumstances when declining to accept a MNEs choice of form in the interpretation of a threshold breach there is no obvious reason why Courts would not be able to assert as a matter of principle that substance over form would take precedence. Adherence to established legal norms of assessment will avoid any temptation to diverge from acceptable means of interpretation – in such a case, if a form is accepted then the appropriate conclusion would be that "nobody owes any public duty to pay more [taxes] than the taw demands"[42]. So despite the fact that this solution does not have

[40] Ole-Kristian Hope, 'Disclosure Practices, Enforcement of Accounting Standards, and Analysts Forecast Accuracy: An International Study' (2003) 41, Journal of Accounting Research, 2

[41] Robert Holthausen, 'Accounting Standards, Financial Reporting Outcomes and Enforcement' (2009) 47, Journal of Accounting Research, 2, 447

[42] *Commissioners v Newman*, 159 F.2 848, 850-51 (1947)

clear *stare decis* (to stand by things decided), as previously referenced there are established legal '"bedrock precedents"[43] that underwrite the legitimacy of concepts such as form and substance that will enable MNEs to better understand the consequences of entertaining abusive practices.

8.2.3 Attestations and the Rule of Law

The attestations offer any prospective critics of this reform proposal some potential fuel for challenging its credentials in respect to the rule of law. Despite its merits relating to promoting accountability in relation the law, a principle residing at the heart of the schemes objectives, and the transparent and straightforward nature of the attestation, challenges remain. Such clarification relates to the challenges of fairness, certainty and adverse impact on human rights. Critics of such an approach will proclaim that a MNE Officer should not have to suffer from the potential threats of personal liability relating to the completeness and integrity of 'ED&A' that reside within the legal boundaries set out in EU Treaty. Such criticism would be fair but this proposal asks the MNE Officer simply to attest to the completeness and integrity of the data, adherence to the threshold guidelines and to the absence of any wholly artificial arrangements.

Attestations nurture a control system of the accounting disclosures through the establishment of processes and practices that ensures disclosure integrity. This is achieved through strengthening the incentives for MNE and its Officers to improve controls and have better management accounting visibility and accountability in their statutory disclosures. The Directive in no way mandates such a control system but the obligation and liabilities for incomplete or inaccurate disclosure would likely encourage internal control reviews to avoid such omissions or errors. Attestations utilised in the context of this proposed Directive likely create a new direction for corporate responsibility. The challenge is to construct a Directive that accommodates a mix of corporate and individual responsibility blended in a way that develops a comprehensive set of rules and working practices that provide incidental benefit to a collective Member State objective in minimising abusive tax minimisation strategies. Modelling liability for abusive practices from the MNE to the individual Officer reflects the actual operational decision making in an organisation. The non-prescriptive manner of the

[43] Daniel Farber, 'The Rule of Law and the Law of Precedents' (2005) 90, Minnesota Law Review, 1173

governance controls required for attesting to the disclosures is intentional but may attract criticism, and may at worse incentivise conditional statements within the attestation identifying control weaknesses beyond the attesting Officers control. Disclosures, combined with liabilities, create a powerful incentive to fix control weaknesses in accounting disclosures but if they are cost prohibitive, particularly for smaller MNEs, then a weakness will persist in the context of equality and equitability before the law.

Whether the purpose and intent of the legislation is clear enough is similarly a fair challenge. In this case the purpose and intent of the legislation is for MNEs to provide enhanced accounting disclosure to enable tax authorities to have a clearer view of where abusive tax minimisation practices are being enacted that reflect an abuse of EC Fundamental Freedoms. Enforceability is a key principle underpinning the legitimacy of a law and as it stands there would appear to be little issue of enforceability in 'ED&A' proposals as long as any escalated judicial dispute process is well defined and rulings are consistent and fair. The rule of law suggests that a taxpayer should know with certainty what his legal position is and it is this point that critics will focus on when challenging this reform proposal. If this were a tax law reform proposal then an assessment of its relative ambiguity would be reasonably straightforward. As an accounting directive it combines the toxic combination of accounting disclosures as a certain input and a tax liability as a possible outcome. The legal position is clear as the attestation wording sets out a clear requirement and the guidelines for penalties and liabilities for an attestation failure that would be expected to be adopted set out a clear liability construct. For an attestation failure, the liability is clear for the Officer and for the MNE the consequential liability will be nothing other than a near certain direction to improve disclosure controls, improve disclosure governance and to cease any offending artificial transactions depending on the nature of the attestation failure.

Thus in conclusion, a common Directive homogenously implemented across all Member States grants consistency and coherence to accounting disclosures and hence to the underlying principles inherent within the rule of law. The purpose of the rule of law is to "enhance human rights, protect persons from fear and want, address property disputes, encourage economic development, promote accountable governance and peacefully resolve conflict"[44]. This proposal promotes accountable corporate governance through the 'ED&A'

[44] Ibid, 5

attestations. No other form of legally binding testimony would encourage a form of corporate behaviour more consistent with mitigating, if not eliminating, tax abuse behaviours. Aside from some legitimate challenges to the rule of law relating to the attestations, the reform proposal is sound in the context of the rule of law. Conversely, there is a meaningful challenge to the rule of law if EU Fundamental Freedoms continue to be interpreted in a way that promotes a legal system that perpetuates abusive behaviour. In changing a behavioural order within the EU those abuses may be curtailed and a closer alignment of the operational tax system to the rule of law restored.

8.2.4 The Impact of the Rule of Law in Member States on 'ED&A'

The concept of whether an EU supranational concept of the rule of law may exist is strongly contested. As it stands, the confidence of all EU citizens and national authorities resides in the legal order associated with each Member States. For the EU to succeed there must be a shared respect among all Member States for the rule of law. For the purposes of reviewing the compatibility of the proposed solution within the context of the rule of law in our sample set of Member States, all such jurisdictions offer well defined, respected and stable constitutional legal provisions that are applied equitably and impartially. The challenge regarding how the proposed 'ED&A' Directive can be lodged in a complex EU political framework requires an assessment of whether a material addition to public policy relating to commercial accounting and disclosures adversely impacts expectations about commercial rights. In this sense commercial rights relate to transparency, legal certainty, fairness and confidentiality. If there is a perception across MNEs in Member States that their commercial rights have been exploited then the rule of law is compromised. Beyond the judicial system, this solution has a complex *quadru* of relationships to consider, namely the EU body of institutions, Member States, national tax authorities and the MNEs themselves. The effective embodiment of the rule of law demands that there is no transgression of rights, that the proposal has the broad support of all such stakeholders and that the legitimate boundaries of the relationships between these stakeholders are understood and not compromised. To this extent the proposed 'ED&A' solution would become largely self-enforcing although it is important to understand the provisions within the EU for supporting some of the 'ED&A' concepts such as the judicial review of threshold breaches and attestation failures relating to allegations of abuses. Despite historical challenges from Germany[45] and Italy[46], the supremacy of the CJEU and the principle of primacy remain and this is as relevant to a Directive as to any other form of legal provision.

The precise content of the principles and standards stemming from the rule of law may vary at national level, depending on each Member State's constitutional system. CJEU case law provides limited guidance as to what it considers this list of principles are in their totality, and hence has little option to revert to considering the rule of law as a common value enshrined as part of the EU Treaty. Different Member States have different perspectives on the value of the rule of law. In Italy**,** the *Stato di diritto* is a well-established doctrine although Italy attracts most commentary about rule of law issues. In 2013 the OECD published a report[47] highlighting how policy measures intended by the Italian government exhibited adverse uncertainty of policy measures, procrastination in the judicial system and lack of transparency that nurtured corruption. Similarly, the World Justice Project[48] found Italy had worst record of monocracy abuses, highlighting issues with regard to access to justice and evidences of corruption with uncertain variability relating to judicial independence and fundamental rights. Such a backdrop is unhelpful in the execution of our solution proposals but not an inhibitor as the Italian government would be obliged to implement the Directive's rules and MNEs would be subject to the Directive's measures. Italy has a commendable track record in combating tax avoidance with specific methodologies such as *redditometro* implemented for personal tax avoidance and the aggressive role of *Equitalia* in nurturing collaboration between public bodies in the assessment of corporate tax avoidance and debt collecting. In France the established *Etat de droit* embodies the principle of constitutional decision making and legal order ensuring that the notion that state must act in a legal manner in accordance with the law. It provides for "judicial review of statutory law in accordance

[45] BVerfGE 37, 271 2 BvL 52/71, *Solange* [1974]

[46] Case 183/73 *Frontini v Ministeriodelle Finance* [1973]

[47] Paul O'Brien, 'Policy Implementation in Italy, Public Administration and the Rule of Law' (2013) OECD Economics Department Working Papers 1064,<http://www.oecd-ilibrary.org/docserver/download/5k44sssdmgzs.pdf?expires=1408349008&id=id&accname=guest&checksum=DFACBC7562F1DF742172E97D30662084> accessed 18 August 2014

[48] Alejandro Ponce, 'Rule of Law Index, 2014' (2014) World Justice Project, <http://worldjusticeproject.org/sites/default/files/files/wjp_rule_of_law_index_2014_report.pdf?bcsi_scan_dd0fad490e5fad80=0&bcsi_scan_filename=wjp_rule_of_law_index_2014_report.pdf> accessed 18 August 2014

with formal and substantive rules laid down in the Constitution, which is placed at the top of the hierarchy of norms"[49]. The rule of law is now "regularly relied on by parties in judicial proceedings to convince the courts to strictly apply well-recognized standards which the courts impose by way of judicial review"[50]. Such a credible inherent legal order promotes a solid set of rule of law principles that provide no issues for the 'ED&A' solution. In the UK, the rule of law differs from Germany and France in that there is no written constitution, no bill of rights or judicial review of legislation, although in respect to the latter the creation of the Supreme Court has now provided for a constitutional separation of legislative and judicial powers. Despite this it is accepted that the UK has legal protection of its subjects against unlawful official conduct by a separate administrative court[51] supplemented by English law incorporating the provisions of the European Convention on Human Rights and its First and Sixth Protocols[52]. There is clear legal form relating to actions taken outside taxation law, known as *ultra vires*[53], and provision for substantive interpretation of taxation law exist to prevent unreasonable legislative encroachment of laws on rights[54]. In Germany, the rule of law, or *Rechtsstaat*, is well established, incorporating both formal[55] and substantive[56] concepts in law. This constitutional order embraces the principles across federal and state level of the German government hierarchy. The *Rechtsstaat* has provisions[57] for promoting the principles of legality, fair procedure, legal certainty and proportionality, all of which are important for the sustainability of the 'ED&A' solution. In the Netherlands, again the basic concepts of the rule of law are observed, with clear provision across the constitution and the *BurgerlijkWetboek*, most recently updated into the Netherlands Civil Code[58] and provides for access to justice, implementation and enforcement of legislation, European procurement and

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[49] Louis Favoreu, 'Légalité et constitutionalité' (1997) Les Cahiers du Conseil Constitutionnel, 3

[50] Laurent Pech, 'The Rule of Law as a Constitutional Principle of the European Union' (2009) NYU School of Law, Jean Monnet Working Paper 04/09, 47

[51] Queen's Bench Division, High Court of Justice

[52] Human Rights Act (UK), 1998

[53] *R. v Inland Revenue Commissioners Ex p. MKF Underwriting Agents Ltd* [1990] 1 W.L.R. 1545

[54] *Al Fayed v Advocate General for Scotland* [2004] STC 1703

[55] Grundgesetz, <https://www.btg-bestellservice.de/pdf/80201000.pdf> accessed 10 November 2014

[56] Rechtsstaatlichkeit, Robert von Mohl's, *Die deutsche Polizeiwissenschaftnach den Grundsätzen des Rechtsstaates*, (1844, Tubingen, Auflage,1,2)

[57] Grundgesetz, 1949, art 28

[58] Civil Code (Netherlands) 1992, 10:1-9

administration of justice. Of particular relevance to this proposal is the law relating to "commercial contracts"[59] and its reference to "abuse of circumstances"[60] that endorses a good moral conduct by criminalising behaviours in situations where a person knows that another is being induced to execute a wrongful act and fails to prevent it from happening.

The rule of law representation in any form of EU policy or initiative relating to a supranational tax policy raises practical issues as there is no EU rule of law but more a set of shared features that have commonality in the heritage of Member States. But even where EU rule of law principles are evident there is no meaningful distinction between the EU and Member State meanings and emphasis of the rule of law. The EU Treaty places no reliance on Member State constitutions or constitutional as a basis for interpreting the principle of the rule of law. There are some subtle differences as one would expect between Member States in constitutional mechanisms relating to due process of law and protection of rights and these are reflected in the different expressions of the rule of law in those jurisdictions. This is as applicable for the application of EU Law into the civil law provisions as well as the criminal provisions relating to abusive tax avoidance practices as initially exposed through the Directive's 'ED&A'. The philosophical assumptions behind any Member State diversities at a detailed level should be considered immaterial in the accommodation of the measures proposed in the 'ED&A' proposal. Theoretically any variations in the extent and method adopted for defining how the rule of law is enacted in different jurisdictions could present a challenge. The EU judicial system should be able to enforce equitably across the EU without incurring the wrath of MNEs suffering from inconsistent rulings but this is difficult to predict. This is just as relevant for this solution though as for any other tax rules based solutions that have previously been either implemented or proposed, and highlights the importance of the CJEU in adjudicating such matters. The CJEU's authority to review 'ED&A' decisions made by national tax authorities of Member State Courts is relevant to the rule of law that infers guaranteeing the Treaty's legal order and securing confidence in the legal integrity of the proposal.

[59] Ibid, book 6, 119, a

[60] Ibid, art 44, 4

8.3 Legal Conditions Underpinning the Credibility of the Proposal

There are three established legal norms that may be relied upon to underpin this proposal, namely substance over form, proportionality and abuse of rights. As established legal principles they provide the necessary legal order for ensuring the proposal is workable and enforceable, and ultimately becomes an effective EU tool for mitigating tax avoidance practices. These legal conditions are general principles and although unspecific to tax law are fully evidenced and adaptable to the requirements for this proposal. These doctrines in EU tax law provide us with a framework of orientation, creating an identity in this body of law that nurtures a common understanding.

8.3.1 **Substance over Form**

From a substance over form perspective, there is a proliferation of evidence supporting judicial examination at both Member State and CJEU level regarding the authenticity of activities controlling levels of corporate taxation. In situations warranting investigation, the tax authorities will assess MNEs statutory reporting based on an interpretation of transactional substance. In this sense, substance is defined as the economic characteristics and outcomes of an economic transaction, which may or may not differ from legal form of the transaction. A somewhat backward looking doctrine looking at the factual situation of a tax outcome once it has happened rather than one that focuses on searching for some reasoning for prompting the tax behaviour at origination, it is a well-established principle utilised for analysing taxpayer behaviour. It is a useful tool to be used by tax authorities and judicial institutions for establishing whether there has been an abuse of rights. In the case of the 'ED&A' proposal such an analysis would focus largely on whether a MNE has abused any EU Fundamental Freedoms for the purpose of tax avoidance by being party to transactions that have no economic substance. The objective is for Member States to examine and evidence what may initially be considered a legitimate transaction or set of transactions but upon scrutiny are engineered for no other purpose than to exploit EU Fundamental Freedoms in some capacity for the purpose of reducing tax obligations. National tax authorities are under an obligation to deal with taxpayers in an equitable manner in similar circumstances. A business purpose test is initiated to assess the outcome of a course of transactional activities, the basis upon which interpretation may ensue alongside GAAR assessment precedents in a given jurisdiction and an abuse assessment in relation to EU Fundamental Freedoms.

Once the business purpose is assessed the tax authority contrasts the outcome against legislative intentions. This sets out an analysis of the transaction against the spirit of a particular tax law where or if relevant. If a set of economic activities demonstrates no business purpose it is not unrealistic to assume that form alleged to be associated with it is not defendable and that characterises abuse of the law. In tax terms this would represent a prohibited transaction exercised with improper intent particularly where a MNE has choices and has decided on a course of statutory reporting associated with a lower tax liability. Early case law set out guiding principles in this domain. In *Weiss v Stearn*[61] it was held that "questions of taxation must be determined by viewing what was actually done rather than the declared purpose of the participants….when applying income tax laws……we must regard matters of substance and not mere form". *Gregory v Helvering*[62] first noted the business purpose test and *Higgins v Smith*[63] first promoted the requirement that an element of economic reality must reside within the transaction to give substance to the transaction beyond its tax treatment. In more recent times specifically in relation to EU tax cases, the case of *Ocean Finance*[64] ruled that national courts should look beyond contractual arrangements if such contractual arrangements are economically groundless and indefensible but constitute a purely artificial arrangement that had been established with the sole aim of generating a favourable tax benefit.

The interpretive aspect to converting 'ED&A' data into a potential abuse action requires careful consideration. If the 'ED&A' data suggests tax avoidance the usual course of action should be to analyse the civil form of the transaction in the first instance. Once this is established the outcome of the economic activity and the economic substance of the arrangement are assessed. In UK and France the interpretation is normally based around the substance of the arrangement whereas in Italy and Germany and Netherlands the civil law form takes precedent where the intent of the MNE is assessed. Ultimately the emphasis of

[61] *Weiss v Stearn*, 265, US, 242 [1924]

[62] *Gregory v. Helvering*, 293, US, 465, 470 [1935]

[63] *Higgins v Smith*, 308, US, 473 [1940]

[64] Case C-653/11, *Ocean Finance v HMRC* [2013] ECR I-4019

interpretation in the first instance resides with the Member State tax authority and, given no form of interpretation prevails over another, any conflict or inconsistency that arises between Member States may be escalated for CJEU interpretation. Establishing whether MNEs transactions are abusive or not should be assessed on individual case merits and this is consistent with current practices. Although it is impossible to find a universally acceptable rule to differentiate abusive from non-abusive activities, the judicial process of interpretation itself offers a suitable mechanism for case-by-case assessment. With every case likely to exhibit unique characteristics and circumstances such a process mitigates any criticism that an identical set of circumstances could possible generate differing interpretations that may have a criminal law liability under the attestation provisions.

Member State tax laws do provide some insight into how various jurisdictions will address judicial interpretation. In Germany the law states that "The tax statute shall not be avoided by an abuse of the arrangement opportunities of the law. If there is an abuse, the tax claim originates as it does from a legal arrangement that adequately reflects the economic substance of the transaction"[65]. The German Supreme Tax Court has set out the position in various rulings[66] that an abuse of legal form shall be found if a legal structure is found that is inappropriate to reach the pursued goal, serves to reduce tax and cannot be justified by non-tax factors. Acknowledging the right of a MNE to minimise corporate income tax, the German Court typically regard "artificial, unusual or uncommon transactions as abusive[67]. In another case[68] the Supreme Tax Court ruled that in tax cases the general abuse of legal form provisions should be assessed in the context of special abuse provisions in German tax law on the basis of their purpose. In another relevant case[69], the Supreme Court found that tax arbitrage could not be considered abusive even when a structured transaction had been established with a tax friendly construct if the MNE was able to establish credible business substance around employees and physical assets in the country concerned. In all these cases consideration is evidenced of legal and economic substance where the Court made an

[65] General Tax Act (Germany) 2014 s42

[66] German Supreme Tax Court, docket no VIII R 173/83, Federal Tax Gazette 1984, 2, 428; German Supreme Tax Court, docket no VIII R 36/98, Federal Tax Gazette 1999, 2, 770

[67] German Supreme Tax Court, docket no. I R 35/96, Federal Tax Gazette, 1998, 2, 235

[68] German Supreme Tax Court, docket no. IR 94/97, Federal Tax Gazette, 2001, 2, 182

[69] German Supreme Tax Court, docket no. I R 63/99, Federal Tax Gazette, 2003, 2, 50

interpretation based on the legal form, the chosen form in terms of tax impact, and justification of form and intent of the MNE taxpayer.

In the UK, similar supportive conclusions are also evident. Notwithstanding the fact there has been no formal accommodation of a substance over form provision in UK tax law since *Ramsay*[70] there is plenty of more contemporary case law in corporate tax law[71] evidencing an assessment of the legal manner in which a transaction is structured in respect to defining tax liability. The sham doctrine is well established in various cases[72] but hasn't been referenced to date in relation to freedom abuses. Interestingly there is judicial reference to abuse of rights doctrine in UK direct corporate taxation case law[73], focusing largely not on illegal acts but improper acts that do not exercise rights in an acceptable manner. The acknowledgment that a right can be abused is of high significance. Unlike the UK, France has an abuse of law procedure and an established substance over form assessment methodology. Such a provision relating to a substance over form interpretation relating to corporate tax was enacted in France in 2004[74] and sets out the conditions necessary to successfully apply the substance over form interpretation. Cases such as *Janfin*[75] and *Clement Bayard*[76] both exemplified how an abuse of law as a legal concept under French civil law denies benefits associated with utilising a right when the use of that right exceeds the limits of its reasonable use and enforcement. Established criteria set out how the court is able to define such excessive behaviours. In recent years the French Supreme Administrative Court has introduced references to the term 'fraud to the law' facilitating the French tax authorities specifically to restore the true nature of transactions that reside outside the scope of sL64 of the French Tax Code Procedures. There is also a social angle to judicial interpretation in France. Under French law the abuse of rights provisions limit the scope of rights that have been granted to a MNE but can also be used by the courts to adjust the law to reflect the needs of society as it

[70] *W T Ramsay Ltd v Inland Revenue Commissioners; Eilbeck (Inspector of Taxes) v Rawling* [1981] STC 174

[71] *Commissioners for HMRC v Tower M Cashback LLP 1 and another* [2011] UKSC 19

[72] *IRC V McGuckian* [1997] STC 908; *Hitch v Stone* [2001] STC 214

[73] *Blackqueen Ltd. v. C&E Commissioners* (LON/00/1178) VTD 17680*; BUPA Hospitals Ltd. v. C&E Commissioners* [2002] BVC 2,155

[74] Livre de Procédure Fiscale (France), sL64

[75] *Societe Janfin* [2006] No 260050

[76] *Clément Bayard* [1917] 1, 79, [1920] 1, 300

evolves. Numerous cases[77] in France have referenced simulation as an abusive practice that denies legal effect to transactions that are artificial or simulated. In the Netherlands, legislators have been reluctant to formally reference substance over form as a doctrinal concept in respect to tax avoidance but there is evidence in Netherlands case law[78] of a willingness to take into account fact and circumstances in relation to potentially abusive transactions, specifically around the use of intermediary entities and TRPRICE. This is enacted through either a legislative provision or procedure called the *richtigeheffing*, or levying position, under which a legal transaction in dispute may be ignored for tax purposes, or through judicial implementation of *fraus legis* whereby the spirit of the law in question is decisive rather than the exact wording. There is no explicit criteria for assessing whether there is sufficient substance to transactions although, consistent with the other aforementioned Member States, there is ample evidence that courts are increasingly willing to identify and rule against abuses of law in the domain of corporate taxation even though the boundaries within the Netherlands are not so universally challenged and quite as closely defined as elsewhere.

Beyond these contributions of Member State judicial rulings, the CJEU's jurisprudence in clarifying the interpretive aspects to tax avoidance in the context of abuse of EU freedoms is important. For the purposes of this proposal EU law is involved and as such the CJEU will ultimately provide rulings around conflicts to shape the boundaries from an EU law perspective. In the case of *Segers*[79] the CJEU held that the need to eradicate abuse for public interest reasons established the reasoning for the different treatments enacted by tax laws in Netherlands and that the need to address such abuses justifies different treatments in some circumstances. In *Centros*[80], the highly significant ruling stated that Member States could, subject to case by case analysis and in the context of EU law objectives, take measures to prevent taxpayers "attempting, undercover of the rights created by the Treaty, improperly to

[77] Administrative Tribunal of Versailles [2005] No 0404909; CE, [2005] No 267087; CE [2006], No. 283314; *Bank of Scotland* RJF 3/07,No. 321, 248

[78] *HR* [2008] 42954

[79] Case 79/85, *D. H. M. Segers v Bestuur van de Bedrijfsverenigingvoor Bank- en Verzekeringswezen, Groothandelen Vrije Beroepen* [1986] ECR 2375

[80] Case C-212/97,*Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459

circumvent their national legislation or to prevent [taxpayers] from improperly or fraudulently taking advantage of provisions of Community law"[81]

There are a considerable number of further case law precedents underpinning this proposal's ethos that an abuse of EU freedoms is a legitimate claim to challenge the legal form given to a set of suspected abusive transactions. Such cases include *Leclerc*[82] and *Van Binsbergen*[83]. In the former case the CJEU held that courts should differentiate between those transactions executed for normal commercial reasons differentiated from those executed for the sole purpose of achieving improper advantage. Member States can pursue freedom restrictions if they can justify them for public interest reasons and meet the requirements of the proportionality principle. Arguably much of this case law is based on mitigating improper advantage gained from exercising Fundamental Freedoms rather than examining the detailed structuring of transactions that may lack economic substance and therefore imply a tax advantage. In theory there is little difference but in practice it requires a different level of assessment. There is no single approach in place yet for necessarily utilising 'ED&A' data for the purposes of local interpretation but there is a clear and common theme that enables tax authorities to try and counter any kind of outcome that lacks economic substance and abuses a fundamental freedom. As these CJEU cases highlight, there is no inhibitor for the Member States, or indeed the CJEU where required, to assume such an assessment role to provide a more common and dominant approach to protecting the taxing rights of Member States.

8.3.2 Proportionality

Proportionality is granted considerable strength and influence in EU law and virtually every law has relevant provision for a proportionality assessment. It bridges the gap between tax avoidance and tax abuse, and is relevant in its application for this reform proposal in the context of economic substance[84], tax investigation[85] and legal redress[86]. In this sense any

[81] Ibid, 24

[82] Case 229/83, *Association des Centres distributeurs Édouard Leclerc and others v SARL "Au blévert" and others* [1985] ECR 229

[83] Case 33/74, *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsverenigingvoor de Metaalnijverheid* [1974] ECR 1299

[84] Case 33/74, *Van Binsbergen* [1974] ECR 1299

'ED&A' reporting that results in a tax investigation would require proportionality to be applied to an allegation of substance over form in order to determine whether an abuse of rights has occurred. Member State tax authorities are not able to attain unlimited rights in addressing tax abuses as consideration needs to be given to formal constitutional rights provisions as granted through national laws. This may or may not conflict with direction from the CJEU regarding the principles attained through case law for assessing when tax avoidance measures are deemed proportional. Proportionality is granted considerable strength and influence in EU law and as such would be expected to add a credible check against excessive and adverse interpretation of 'ED&A' data.

In the context of the 'ED&A' proposal the objective would be to ensure Member States courts invest a proportional amount of time investigating a MNEs transactions in relation to the prospective level of tax abuse. Loss of Member State tax revenue is the consequential result of abusing Fundamental Freedoms and so assessing the right level of proportionality in relation to applying measures required to assess such abuses are less clearly defined. Case law provides unhelpful conflicts in this regard, noting the difference between the ruling in *Leur- Bloem*[87] that held that tax investigations should be limited to exactly that and not reach beyond tax avoidance breaches. In *Part Service*[88] it was clear that the authorities had every desire to look beyond tax avoidance activities to the underlying legal breaches that constituted an abuse of rights. 'ED&A' data is a proportional measure as it advocates specific granularity around transaction reporting and threshold disclosures, both of which could expose pre-determined behaviours. 'ED&A' is a general accounting provision relevant to all Member State and MNE industry types. There is a tripartite challenge to balance the commercial interests of the MNE with the public civil obligations of the Member States with the personal interests and human rights of the attesting Officer. It constitutes an appropriate and reasonable, set of disclosures and attestation to be used for the purposes of making data transparent in the pursuit of mitigating tax avoidance. The proposed Directive would offer a firm basis for 'ED&A' through an established EU legal framework but permit flexible

[85] *Hentrich v France* [1995] 21 EHRR 277

[86] Case C-311/08 *SGI* [2010] ECR I-0000

[87] Case C-28/95 *Leur-Bloem v Inspecteur Der Belasingdienst/Ondernemingen Amsterdam 2* [1997] ECR I-4161

[88] Case C-425/06 *Part Service* [2008] ECR I-897

interpretation by Member States under the auspices of their sovereign doctrinal forms of interpretation against their tax laws.

The ‘ED&A’ solution is a means of determining, through data transparency, whether, in the view of a Member State tax authority, tax avoidance may have occurred. Upon adoption of this proposed reform, it will be the interpretation that ensues that will be the basis of evaluating the specific transactional circumstances under relevant tax law. Once a court has ascertained the substance of the offending transactions it may rule that they go against the relevant tax norms in that Member State, or be considered abusive in respect to Fundamental Freedoms, or both. In accordance with the aforementioned Part Service case, the interpretation pursued as a result of the ‘ED&A’ must be consistent with EU principles and relevant to the aim of tackling tax avoidance. Similarly, it should not be presumed that the exposing of MNE tax abuse is necessarily correlated to the abuse of Fundamental Freedoms even though such reasoning is commonplace. The measures inherent within ‘ED&A’ are certainly an effective and suitable tool for triggering investigations into prospective tax irregularities, but the manner in which the measures should be framed would avoid diminution of other legal rights, including human rights of the MNE Officers in the execution of attestations. Indeed, the Fundamental Rights Agency is the EU’s own expert human rights body that screens proposals and ensure the reform proposal for a new Directive are checked against the EU Charter of Fundamental Rights. There are enough checks and balances in this process to protect their legitimate interests, with clear boundaries set to encourage data completeness and integrity that is proportional to the objectives of the Directive, but not too punitive to compromise their human rights through making them personally liable for activities outside their control. All these points ensure a balanced and proportional treatment of taxable and human rights.

8.3.3 Abuse of Rights

From an abuse of rights perspective we have to be clear on what rights are being challenged. A MNE may proclaim that the right to choose the most tax efficient transaction model is no lesser of a right than the right of a Member State to raise revenues consistent with their tax laws. Does a MNE, given all its competing interests and stakeholders, have any less responsibility to Member State tax revenues than to its own shareholders? What is relevant though is the tension and dysfunction between the conflicts of the EU rights embedded within EU Fundamental Freedoms and the government of the issues relating to tax avoidance. These conflicts are fuelled further when one considers the dual political authorities of the CJEU and Member States giving rise to an inherent system of checks and balances, with evidence of the CJEU allowing, to a limited degree, Member States to enact measures to mitigate abuses. Enabling Member States to mitigate the adverse consequences of EU law is not unreasonable if it undermines its tax laws and denies it rightful tax revenues. However it is limited to the extent that it must not undermine EU Fundamental Freedoms. Providing for the right balance is a challenge and as yet ill-defined as what is considered abusive in one Member State must endure a likewise consideration in other Member States if consistency of application is to be achieved. The balance is best explained by Lasok who stated "the concept of abuse of right is concerned with the exercise of a right either for ends different from the legal purpose served by the right or in an excessive or disproportionate way"[89].

An abuse requires a form to abuse and in this case relates to the Fundamental Freedoms granted through the EU Treaty. An abuse of these Freedoms is, under law, challengeable. There are many angles to this though. On the one hand, the most prolific abuse has been related to the free movement principles, and on the other hand we need to consider the notion that is only becomes relevant when there is harm imposed on a third party as result of the abuse. The legal purpose of Freedom of Movement provisions is to "eliminate discrimination on the grounds of nationality"[90] in a single "internal market"[91] rather than facilitate the minimisation of tax liabilities. In theory therefore, a transaction used for minimising tax that grants no advantage to the objectives that were set out in the EU Treaty could be considered abusive. Conversely, if the underlying objective of the EU Treaty is economic integration is an abuse of rights relevant when it outlaws the use of EU law where the result is not economic integration? In other words, the question arises whether an MNE cannot take advantage of EU law if it doesn't fulfil EU Treaty objectives of economic integration. What

[89] Paul Lasok, 'Abuse of Rights in EU law – Origins and History' (2006) <http://www.euroblawg.com/eu-law-2/the-eu-law-doctrine-of-abuse-of-rights-should-it-be-a-general-principle-of-eu-law-and-is-it/#note-44178-12> accessed 1 December 2014

[90] European Parliament, 'Fact Sheets on the European Union' <http://www.europarl.europa.eu/aboutparliament/en/displayFtu.html?ftuId=FTU_3.1.4.html> accessed 19 November 2014

[91] Ibid

is abusive to a Member State may not necessarily look quite so abusive under all conditions when looked at the context of the Internal Market. In order to examine this conflict, one may apply the principle of proportionality. Abusive behaviour must be "entirely or principally"[92] based on circumventing national law. *Centros* took the matter further by insisting that any alleged abuse had to be considered in light of being proportionate to any public interest aims. Given the fact that abusive behaviour relating to profit shifting would incur an adverse economic impact on the Internal Market itself in its totality, the public interest is not well served by artificial shifting of economic activity to reduce the overall tax liability in the Internal Market. In this sense from a tax perspective this serves as a useful case law precedent.

The clearest reference by the CJEU to abuse of EU Fundamental Freedoms in a corporate income tax case was in *Cadbury*[93] although this has not resulted in abuse of rights legislation being clearly denoted in the legislative provisions of Member States. Other rulings have referenced abuse in other types of tax case such as *Daily Mail*[94] in a Capital Gains Tax ruling. Other rulings in areas of non-taxation are evident such as *Van Binsbergen*[95] regarding the free movement of services and *Emsland-Starke*[96] regarding the free movement of goods, and it could be expected that these cases would be used as a reference point in building out the principle further. For example in *Emsland-Starke* the CJEU has found favour in the view that a generalised abuse of rights legal principle is evidenced in Member States law and has no apprehension in reflecting such points in CJEU case law. Despite this contradictions are evidenced in the provision of a coherent approach to defining what constitutes and abuse or not and although this provides a challenge to a tax authority pursuing an abuse case as a result of enhanced disclosure it can only be a matter of time under such an EU Directive that a body of settled case law emerges. This proposal can rely entirely on the CJEU test advocated in *Emsland-Starke* but over time would be reinforced further if this evolved from

[92] Case 33/74 *Van Binsbergen v BedrijfsverenigingMetaalnijverheid* [1974] ECR 1299, 27

[93] Case C-196/04 *Cadbury Schweppes Ltd v IRC* [2006] STC 1908

[94] Case 81/87 *The Queen v HM Treasury and Commissioners, ex oarte Daily Mail and General Trust plc,* [1988] ECR 5483

[95] Case C-33/74, *Johannes Henricus Maria van Binsbergen v Bestuur van de Bedriifsverenigingvvor de Metaalnijverheid* [1974] ECR 1299

[96] Case C-1100/99, *Emsland-Starke GmbH V Hauptzollant Hamburg-Jonas,* [2000] ECR I-1569

being a general test of attempting to mitigate abuse of Fundamental Freedoms to a more ambiguous but focused outlawing of abuse of law. Such a condition of a common EU legal principle in this regard would be useful.

Previous case law[97] has focused on establishing the objective of transactions and applying criteria to ascertain whether they indicated abusive conduct. Given EU "law cannot be relied on for abusive or fraudulent ends"[98] it is useful to have case law direction in this respect, as it is "by no means easy to define the precise scope of that principle"[99]. The problem to resolve is identifying the prospective abuse in the first place. In this sense the low level of disclosure mandated on MNEs as part of its statutory reporting is disabling Member States from even attaining the point of challenge at the outset. Resolving this matter relies on resolving the challenge in identifying abuse rather than in the legal challenge of that abuse. One unanswered question in case law is whether abuse relates to the absolute act of circumvention of Member State tax laws or whether it relies on utilisation of EU Fundamental Freedoms for invoking such circumvention. Member State tax law targets the former whereas the latter has no clear tool for redress. Furthermore, there is no clear case law distinction, however, between fraud and abuse. Can an abuse take place without it being fraudulent? If abuse relies on a Member State being denied of its rightful tax revenues through the use of artificial transactions with no economic substance then by definition it is fraudulent. The CJEU has notably avoided the use of the word fraud in many of its judgements suggesting the terms association with criminal law being contentious and unsuitable as it stands.

To crystallise what an Abuse of Rights in the context of this research means requires a multi-dimensional perspective. A Member State could bring a case against a MNE regarding abuse of EU Fundamental Freedoms but there is little reason to doubt why a MNE couldn't bring a case against another MNE on the basis that it should not be allowed to exercise specific rights. Early case law provided clear direction. The CJEU ruled in *Van Binsbergen* that a Member State could take action in situations whereby an entity is exercised EU Fundamental Freedoms solely for the purpose of circumventing national law. Noting the proliferation of

[97] Case C-110/99, *Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas* [2000] ECR I-1569

[98] Case C-367/96 *Alexandros Kefalas and Others v Elliniko Dimosio (Greek State) and Organismos Oikonomikis Anasygkrotisis Epicheiriseon AE (OAE)* [1998] ECR I-02843

[99] Case C-212/97, *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I-01459, para 20.

cases covering abuses of all EU Fundamental Freedoms suggests general application, specifically referencing the use of the term “improper advantage”[100] that suggests not only application to specific EU Fundamental Freedoms but also aimed at stemming abuses that attempt to circumvent the objectives of EU laws. The prevailing headwind of Member State sovereignty protectionism has for a long time sought to mitigate the non-legislative enlargement of EU competencies engineered through the development of general principles of EU law. Comfort may be drawn from this research that the leveraging of an Abuse of Rights doctrine has the opposite effect in that it returns to the Member States an interpretative opportunity in which abusive EU law may be curtailed.

8.3.4 An ED&A Directive: A Compelling Instrument for Reform

This proposal advocates the use of a Directive rather than EU regulations, a multilateral convention or Member State rules and regulations to deliver an ED&A solution. Member States levy taxes and there has been significant quantitative growth in Member States legislation and judicial rulings to preserve the politically salient issue of taxation. A Directive enables the EU, in the absence of conventional taxing powers, to exert considerable regulatory power over a matter such as accounting disclosures and taxation matters more generally. Given the “fiscal impotence”[101] of the EU it can utilise Directives to good effect by seizing control of technical and broadly apolitical issues of corporate regulation and governance. The EU is, in a sense, a regulatory body in that it is not a political state capable of dealing with matters such as taxation directly even though such EU regulation in the form of a Directive can impose considerable regulatory influence on Member State tax policies and taxpayer behaviours.

The EU Directive remains the most powerful instrument of secondary legislation. It is binding only with regard to the stated ends set out in the text, but leaves an element of discretion to the Member States as to the means by which to achieve them. It remains the most effective legal instrument for imposing unity on somewhat diverse Member State legal orders. In contrast an EU regulation, despite rising in number in recent years, would be

[100] Case C-425/06 *Ministero del l’Economia v Part Service* [2008] ECR I-897, para 44

[101] Giandomenico Majone, ‘The European Community as a regulatory state’ (1996) Collected Courses of the Academy of European Law 5, 410

effective so far as implementing provisions for other secondary tax law but not anything more substantial in form. Similarly, detailed tax legislation derived from the European Council or Commission is likely to have constrained legal standing for substantial reform as the scope of legislative powers remains limited and would likely attract more public scrutiny. Such public scrutiny usually focuses on the equity and legitimacy of the impact of a EU regulation or legislation on the Member State whereas the challenges administered to Directives is often focused on the methods of Member State adjustment to it.

Historically other legal instruments have occasionally been used such as multilateral conventions that represent a multilateral undertaking, the most pertinent example being the Arbitration Convention. The Arbitration Convention was adopted to provide MNEs facing double taxation due to adjustments in their profits a remedy that obliged Member States to resolve the double taxation issue. This intergovernmental convention provides for no CJEU interpretative jurisdictional competence and there is no international or supranational body with the competence to interpret or apply the Convention's provisions in an unintended manner. The instrument is widely acknowledged to be narrow in its scope, only focusing on addressing transfer pricing related double taxation. Lacking precision in its provisions it also provides for uncertain interpretations in relation to DTT's where possible conflicts may arise both in legal substance and precedence. The omission of any provision to independently adjudicate the application of the Convention breaches fundamental features of legal certainty and fair adjudicative procedures previously identified as principle tents of the rule of law.

The cornerstone of ED&A centres on accounting transparency and specific disclosures and attestations. If it were to take the form of a more direct tax instrument then it would require unanimity in policy decision-making. Such unanimity is not only extremely difficult to attain but at a minimum would likely demand high policy and enforcement autonomy for Member States, not something easily supported by the objectives of the proposed reform. Unanimity to create direct tax reform is only matched by the unanimity that would similarly be required to change any aspect of the instrument once transposed into Member State law. As an accounting Directive such unanimity is not required but rather a more measured DMV approach to policy approval. As ED&A is a more novel reform proposal it seems more appropriate to adopt the latter approach in implementing a new standalone accounting directive.

As the desire for reform intensifies, the agenda for proposing new schemes is becoming more prolific and imaginative with previously dismissed notions pertaining to addressing tax abuse being reassessed. The clearest recent evidence of a Member State attempting to incorporate the concept of mitigating tax abuse into its legislation without actually using the phraseology is the UK's Diverted Profits tax[102] (hereafter referred to as 'DPT'), representing a new tax on profits artificially diverted from the UK. The basis of the charge applies to tests relating to avoidance of a PE and to insufficient substance tests, both of which the CJEU considers abusive. For the tax to apply there would need to be a "main purpose"[103] to avoid tax, or the "tax mismatch" conditions[104] would need to be met, resulting in a more complex and subjective assessment of tax charge based on the difference between actual profits and those that would have arisen absent of the mismatch. Mismatch arrangements are defined as transactions that increase the expenses or reduce the income of one related party when the tax paid by the other related party as a result of those transactions is less than 80% of the that reduction of tax liability. The insufficient substance tests are interesting too in that they apply certain thresholds. For example, where a single transaction between related parties produces a tax reduction greater than any other financial benefit, where the transaction is part of a series, and where mismatch arrangements contribute economic value to the transaction that is less than the tax benefit.

The DPT aims to define formulaic metrics and threshold principles akin to the solution proposed in this reform proposal, and similarly requires pre-notification to the tax authorities, but with some subtle differences in legal form, namely it is a standalone tax intending to enforce penalties on abusive behaviour as opposed to legislating for anti-avoidance rules, akin to much of Member State anti-avoidance law, or transparency initiatives aimed at promoting changes in behaviours, akin to the reform proposal in this research. There are a number of potential areas of challenge, not least in regard to its compatibility as a tax with EU law. Applying a penalty rate in excess of the standard UK corporation tax rate infers discriminatory treatment contrary to EU law between those non-UK companies incorporated in another Member State trading in the UK than a UK entity if it carried out the same activities. Additionally the inability to use group, consortium and loss reliefs as offsetting

[102] Finance Act (UK) 2015, part 3

[103] Ibid, 80d

[104] Ibid, 86f

factors further challenges the notion that it could be justified by an overriding reason of public interest and proportionate to the underlying objectives of the legislation. Others have argued that the "limited grounds for taxpayers to dispute initial assessments and the requirement for the tax to be paid upfront mean [the tax] is contrary to Article 6 of the [ECHR]"[105]. As suggested in Chapter Seven assertions by taxpayers to raise human rights objections in tax cases have generally proven to be ineffective although this does not diminish the view of this research that this approach adopted by the UK to tackle abuse of rights although politically astute is not likely to stand the test of legal challenge likely to ensue from MNEs in the judicial system.

The ED&A proposal is much more likely, in EU legal terms, to be future friendly in the sense that it reacts with immediacy to today's tax abuse conduct and builds longer term legal sustainability through its rule of law alignment and adherence to the aforementioned doctrine of principles. It has a number of unique features worthy of note. This research has demonstrated that reform demands a multi-faceted proposal akin to the BEPS proposal but in conflict with those such as the CCCTB and GAAR proposals. Reforms targeting specific issues such as TRPRICE individually have a track record of very limited success. BEPS is a step forward as it is similarly multi-faceted but does not address directly the elements of thresholds and attestation accountability so important for nurturing MNE behavioural change. No known published law reform proposal to date promotes a tripartite solution of CCR, Thresholds and Attestations. Historically EU corporate tax avoidance reforms have targeted applied reform of the legal system rather than the ED&A proposal that targets the MNE with a broader econometric solution embedded within the legal framework in which they operate. Targeting the MNE rather than burdening an intermediary agent such as the Member State legal system or the CJEU with addressing profit shifting is a unique proposal and infers that behaviours rather than transaction structures form the basis of reform. In elevating behavioural science to the fore of resolving tax abuse, specifically those elements of behavioural science relating to judgment and decision-making, models developed by Braithwaite and Ayers, Harre, and Thaler assist in underpinning the targeting of end agent MNEs. It also explains the importance of the 'substantive' element to tax abuse decision making so prevalent now in the judicial evaluation process.

[105] Dan Neidle, 'The Diverted Profits Tax; Flawed by Design' (2015) 2, BTR, 165

This reform proposal admittedly has some areas of vulnerability most notably in relation to data privacy of legal entity structure disclosures, the inertia or capacity issues sometimes evident in the resourcing of tax investigations by Member State tax authorities and the rather limited criminal jurisprudence supporting criminal enforcement of sustained ED&A breaches. The sensitivity relating to data privacy concerns are reflected by the differences in approach as proposed by the OECD for limited mandatory disclosure of data to tax authorities via "Competent Authority Agreements"[106] as opposed to public statutory disclosures As tax authorities are obliged to collate more granular data in statutory reporting this will provide a much more comprehensive set of data that will require resources to assess and action against prospective abuses. It is not unrealistic to assume that those jurisdictions likely to benefit from such data in the pursuit of suppressing abuses are more likely to invest in tax compliance resources than those countries that are likely to be tax-losers. On the criminal jurisprudence point, the advancement from a simple civil law reform proposal to one that incorporates criminal law provisions is a step beyond previous reform proposals but its specificity in the ED&A proposal is based on examples of successful precedents implemented in civil legal systems within our selected EU jurisdictions[107] as well as in various statutes within the UK common law legal system[108]. These provisions provide the necessary foundation for MNE behavioural change.

This reform proposal utilises precedential reasoning as a basis for assisting the judiciary in resolving contentious disputes. This is recognized by identifying the established doctrines that can be relied upon more effectively with enhanced data. These doctrines combine historical, legal and narrative context for negotiation a resolution of tensions between a specific case and an abstract set of rules placing heavy emphasis on precedential reasoning. This is important for the reform proposal as the EU has an evolving orthodoxy of civil and common law and it will be important to establish a settled set of principles and norms for resolving case-by-case issues. For example, in relation to tax avoidance, if an abuse of rights is evidenced through enhanced accounting disclosures as advocated in ED&A then it necessarily follows that such an abuse can be proven when we apply established concepts

[106] OECD, Base Erosion and Profit Shifting, 'Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 - 2015 Final Report', 37

[107] Code of Criminal Procedure (Germany) s154; Criminal Code (Netherlands) s9-63

[108] Bribery Act (UK) 2010, s11; Financial Services Act (UK) 2012, s92; Fraud Act (UK) 2006, s12

such as substance over form and proportionality. Such a legal order can evolve that has clear boundaries defining tax abuse and corporate entities will start to nurture different behaviours in their tax planning activities. In the promotion of specific and established doctrinal norms for the purposes of tax abuse assessments by the judicial system it will be a necessary input to understanding how increased data transparency once utilized can be interpreted in a consistent manner where required by Member States and the CJEU.

This reform proposal is uniquely underpinned by a blend of both doctrinal and comparative analysis. In avoiding overtly theoretical or empirical perspectives on reform the focus has been on ensuring reform is closely aligned to the levels of legal acceptability in the sample Member State legal constructs. The comparative analysis has embraced comparing the influence and authority of various stakeholders, the bedrock of civil codes where relevant, and the nature of conflicts between Member State and EU law and jurisprudence. The application of a comparative impact assessment on the sample Member State constructs reinforces the credibility of the proposal so lacking in many reform proposals advocated to date.

8.4 Legal Metrics for Measuring Success

Adopting measures to quantify the success or otherwise of adopting an EU Directive to mitigate a known but largely unquantifiable level of tax abusive behavior will be a difficult but not insurmountable challenge. Complying with the provisions of the Directive ultimately rests on the MNE taxpayers themselves but the secondary provisioning of Member State responsibilities regarding embedding attestation requirements into national law and empowering national tax authorities with the powers and resources to investigate prospective abusive activities resulting from more data transparency will be just as critical. Ensuring more accounting data transparency but doing little about it from a tax enforcement perspective will fail the cause.

Adoption of the ‘ED&A’ proposal in its totality is likely to take a number of years to implement. The eight success measures identified in this thesis will reflect this phased approach, with some initial measures of success required to ensure a measure of progress up to transposition, others to reflect disclosure compliance, and others to reflect target measures for assessing the success of the outcome. Certain metrics are required to measure the success or otherwise of meeting the objective of reducing tax abusive behaviours that result in profit shifting activities to lower tax jurisdictions. It is proposed that as part of the EU Directive, provision is made for the Commission to compel both national legislatures and national tax authorities to provide information not only to the Commission itself but to share information and specific data mandated by the 'ED&A' provisions between the relevant tax authorities on an annual basis. The information and data derived from the directive over time should provide both quantitative and qualitative policy indicators, hereafter referred to as 'QPIs', all of which will provide coverage across all components of the Directive's footprint. Such transparency regarding the policy indicators should facilitate better federated management of policy implementation, enhance accountability of Member State governments and provide valuable data to the Commission in its efforts to reduce tax avoidance practices.

QPI 1: Transposition of CCR into Member State Law

The EU Directive process would follow an Ordinary Legislative Procedure[109] with initial proposals formed by the Accounting Directive Committee of the Commission followed by joint adoption by the EP and European Council, the former adopting its position by a simple majority and the latter by DMV. Once adopted, the Directive will specific a date, ideally within two years, that will ensure Member States have accomplished transposition of the Directive's provisions into Member State law to ensure CCR compliance. This would be sufficient time for the laws to be adopted to reflect local situations but also enable a timetable to be set for MNEs to realistically be given the time to properly implement CCR reporting. A Commission review of these laws to ensure absolute consistency and compliance will be required and any material deficiencies likely to adversely impact the integrity of the future phases are to be identified and addressed well in advance of the CCR live date. There should be no open infringements of the Directive by the point of transposition, and therefore no pre-litigation notices issued to any Member States.

QPI 2: Transposition of Thresholds and Attestations into Member State Law

[109] Consolidated version of the European Treaty [2008] art 294, OJ C115/13

The Directive will specify a date, ideally within two years of the CCR live date that will ensure Member States will have enacted national laws locally to meet the threshold and attestation requirements of the Directive. This would be sufficient time for the laws to be adopted to reflect local situations and ensure sufficient resources and processes are in place for monitoring and enforcing this enhanced disclosure and attestation. Member States should be obliged to provide periodic updates to the Commission regarding progress during the transposition period. This will ensure absolute consistency and compliance, and any material deficiencies likely to adversely impact the integrity of the final phases would be identified and addressed well in advance of the threshold metric reporting and attestations transposition date. There should be no open infringements of the Directive by the point of transposition, and therefore no pre-litigation notices issued to any Member States.

QPI 3: CCR Disclosure Metrics

A realistic measure of success would be a compliance target for CCR disclosure set at 90% within 12 months of the transposition date for CCR reporting and 100% at the transposition point that puts into effect threshold disclosures and attestations. It is imperative that CCR compliance is complete for the attestations to become workable. These are aggressive targets to reflect the compulsory nature of disclosure, but acknowledging there will be an element of delinquency at the beginning prior to attestation to reflect possible disputes around in-scope compliance. Where a MNE is operating close to a *de minimis* threshold there may be disputes around whether it needs to effect disclosure or not. Similarly there will be an element of delinquency to reflect either logistical problem within the MNEs reporting systems regarding programmatic generation of disclosure data or indeed a short period to resolve technical accounting queries around disclosures. Both of these would be expected to be resolved within the above timeframe.

QPI 4: Threshold Disclosure Metrics

The measure of success associated with the threshold metrics would be trend based rather than quantitative in nature. To this extent, a cumulative trend analysis compiled over a 10-year period consisting of aggregated data from all Member States would be considered necessary to identify a positive trend towards reduced abusive practices. Deducing abusive behavior from the thresholds themselves is not a straightforward task but a collation of various trends will provide substance to the argument that progress is being made in reducing the propensity to enact artificial debt transactions to facilitate tax relief. With regard to the Threshold Set One it would be expected to witness evidence of both a closer correlation over time between the Member State jurisdiction that sees declared profits and tax paid with the jurisdiction in which the customer revenues are generated, as well as an absolute reduction in the overall number of controlled transactions passing through two or more Member State borders. For Threshold Set Two it would be expected to see an absolute reduction over time in the number of tax relief rules available through changes in Member State tax laws. As it becomes transparent that certain tax rules are being exploited as a result of either data transparency or through the results of tax investigations then rules may be amended accordingly. Similarly a rising dispersion ratio, particularly in those Member State jurisdictions that witness high dispersion at inception, would be a commendable measure of success. For Threshold Set Three, the key measure of success will be to identify reductions in the Legal Entity to Group Entity Debt to Equity ratio, particularly for those highly leveraged legal entities at inception, A similarly useful measure would be, once again, a settled number of case law precedents for challenging and unwinding what are found to be abusive debt or funding transactions that are structured in a way for no other purpose other than to avoid corporate taxation.

QPI 5: Attestation Metrics

Accepting the reality of an initial level of delinquency associated with the adoption of any new regulations on such a broad scale, the implications of MNEs not submitting an attestation statement by an Officer of the MNE past the transposition date would be a breach of the Directive's provisions and merit the relevant Member State sanctions accordingly .A combination of such sanctions and auditor oversight of publication of statutory financial accounts will ensure adherence to the attestation requirement. Anything other than achieving 98%-100% compliance across all in-scope MNEs across every jurisdiction of the attestation requirement at point of attestation transposition would constitute a failure in the implementation of the Directive's provisions.

QPI 6: Investigating Tax Breaches

A provision in the Directive will mandate Member States to empower their tax authorities to both pre-approve and investigate breaches of thresholds through the provision of meaningful data as indicators of potential tax abuse activities. The concept of Tax Inspectors without Borders[110], hereafter referred to as 'TIWBs', as promoted by the OECD has been rejected in this proposal. The TIWB concept has merit in investigating pan-European tax abuse as result of these disclosures but the public availability of data and likely resistance by Member States in losing autonomy over the investigation of the tax affairs of its corporate subjects suggests this is far from a suitable option. At Member State level it is impossible to ascertain in advance the level of likely breaches that require pre-clearance or investigation. A low level of investigation will undermine the concept of the thresholds, and given the thresholds have been carefully set to capture moderate to high levels of potential abuse it will be important that Member States use the disclosures for the purposes intended, namely to probe further into MNE data. The higher the threat of tax investigations, the more effective the deterrent against abusive behavior, not only in terms of the prospective financial cost for the MNE but from a personal liability perspective for the attesting Officer. As a more general measure it is proposed that the number of threshold breaches pre-cleared in proportion to the absolute level of breaches disclosed increases over the first 10-year period of legislative enactment although this should be measured as a trend rather than in specific statistical terms. This would signal heightened awareness of the significance of the thresholds and more diligent control over threshold disclosures and the underlying activities driving the threshold data.

QPI 7: Inclusion of CCR in IFRS or IAS protocols

Ultimate adoption of CCR into global accounting standards would be a long-term measure of success. The path to complete adoption has begun for certain industries in certain jurisdictions, and this Directive proposal suggests an extension to complete industrial coverage for all EU jurisdictions. Broader assimilation into a global accounting standard will demand not only European success as part of this initiative but also recognition into US accounting protocol and by other similar large trading entities across the world. A positive recognition and proposal by the Commission in 2018 is expected to mark the beginning of that journey towards incorporation into an accounting standard, and IASB will likely to

[110] OECD, 'Final Report on the Feasibility Study into the Tax Inspectors Without Borders Initiative' (2013) <http://www.oecd.org/ctp/tax-global/TIWB_feasibility_study.pdf> accessed 21 July 2014

respond more expeditiously if the OECD promotes more formal proposals to act on its original BEPS recommendations for CCR accounting adoption.

QPI 8: Long-Term Profit Shifting Trends

A more quantitative based assessment organized by the Commission over a 10 year period from the Directive's transposition point for the complete 'ED&A' initiative would serve to provide a broader view of the success of this initiative. The Commission should collate statistical trend analysis for the purposes of identifying pan-Member State trends in CCR disclosures and thresholds. Such trends will crystallize a view on the relative merits of whether there are determinable improvements in behaviours that are mitigating tax abuse. Aggregated data in its totality will be a much more beneficial statistical base to work off rather than the data derived from individual MNEs. The materiality of tax abuse mitigation attributable to individual CCR or threshold disclosures may still prove difficult to quantify but for a large proportion of MNEs it may be possible to see the impact on consolidated financial accounts resulting from 'ED&A'. It is impossible at this stage to speculate about the collective data that will be generated by 'ED&A' and made available to the Commission, but we may rightly assume that such data will confirm a correlation between the introduction of 'ED&A' and the overall corporate tax revenues earned by Member States resulting from reduced tax avoidance practices.

Chapter Nine: Conclusion

This thesis has sought to address a two-dimensional conflict. On the one hand the EU Fundamental Freedoms have arguably cultivated an environment for opportunistic MNEs to adopt common avoidance practices. On the other hand, such opportunities have been cultivated further by Member States providing a complex set of tax rules that provide for arbitrage that is reflected in additional artificial transactions that enable the manipulation of statutory financial accounting disclosures.

The preceding discussion has established the following. There is evidence of corporate tax abuse which has resulted in the implementation of tax law rules at Member State level[1]. Despite extensive academic debate, no effective solution has been successfully enacted[2]. A radical reform proposal above and beyond anything that has been proposed to date is required[3]. Tax accounting, rather than tax laws, provides the basis for change[4] Resolving tax avoidance requires the use of accounting data to spotlight on tax abuse rather than tax circumvention and the concept of abuse of rights is becoming a more powerful and more frequently referenced concept both academically and in CJEU judicial rulings[5]. Technical accounting reform achieved through accounting standards is a positive approach for resolving tax abuse[6]. Enhanced disclosures of accounting data, supported by attestations, are one way in which behavioural changes may be nurtured[7]. Criminalising behaviours via legislation has a managerial behavioural impact[8]. The most effective judicial custodian of overseeing the mitigation of direct tax abuses evidenced through the transparent disclosures across Member States promoted by the proposed solution is the CJEU[9].

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[1] Chapter 2.0

[2] Chapter 6.0

[3] Chapter 7.0

[4] Chapter 7.2

[5] Chapter 7.3.3

[6] Chapter 8.3.3

[7] Chapter 8.3.4

[8] Chapter 8.2

[9] Chapter 8.2

It is therefore submitted that, despite the failures to date of various initiatives and measures aimed at combating abusive EU corporate income tax practices, this problem can effectively be resolved. Such resolution can be implemented through a scheme of reform based on enhanced statutory reporting mandated through an EU Directive. The issue of tax abuse cannot be resolved effectively by directly attacking the tax avoidance practices themselves, such as TRPRICE or THINCAP, as tax laws attempt to achieve. The issue may be resolved by attacking the underlying corporate behaviours behind utilising such practices as an accounting tool, and to ascertain whether they are legitimate or abusive in relation to the rights granted by the EU Treaty. This reform proposal has the benefit of residing as a stand-alone financial accounting disclosure solution as a complimentary measure to the current tax rules enacted by individual Member States. This mitigates concerns regarding loss of sovereign power over tax matters and does not adversely impact any accounting standards that are set out as standard protocols across the EU. Complimentary disclosures nurturing transparency offer little reason for resistance, other than from MNEs who have reasons to remain non-transparent about their country by country accounting and various metric disclosures.

The objective of the proposed reform is the promotion of corporate accountability and transparency through this enhanced disclosure and attestation. A change in MNE tax avoidance behaviour would be prompted through mandatory disclosure of statutory financial data that will make artificial transactions transparent to Member State tax authorities that are empowered to pursue those conditions that are considered to be demonstrably abusive. The need to offer a credible balance between a mandatory centralised EU solution offering a consistent set of rules with Member State autonomy over legislative provision, judicial review and tax enforcement of such rules is recognised and reflected in the reform proposal. It is unlikely to attract any meaningful level of political resistance and the Member State tax authorities will over time establish a more robust set of criteria based on the disclosures to pursue those abuses deemed most material to the Member State. Abuse will be easier to detect and investigations more targeted. Any potential discrepancies in what different Member State tax authorities deem abusive and non-abusive may, over time, become settled through CJEU case rulings.

The credibility and sustainability of the reform proposal demands utilisation of established legal principles such as wholly artificial arrangements, abuse of rights and proportionality.

These doctrines offer academically credible doctrinal substance and judicial case law support to the prescribed approach and 'ED&A' policy content. Successful judicial challenges to date have largely been based on clear abuse of Member State rules. Abuse of Fundamental Freedoms is evident but limited in its transparency, warranting leveraging these established principles such as 'wholly artificial arrangements' to rule against abusive transactions that lack economic substance. CJEU case law precedent in this respect has further scope for assisting resolution of tax abuse issues once more transparent accounting disclosures are in place. This thesis has explored tax avoidance in terms of tax abuse and its importance in understanding what is demanded from a credible reform proposal to, at best, eliminate and, at worst, materially to limit tax abuse issues. A successful enactment of a tax abuse doctrine has ample scope for extending its reach to other non-tax treaty abuses as well in the future.

The CJEU has established a credible set of relatively consistent evaluation criteria and principles in many aspects of tax avoidance practices. There is ample judicial precedent in the use of doctrines that support this research hypothesis relating to wholly artificial arrangement, abuse of rights and proportionality, ensuring that there is an established view regarding the CJEU's interpretation of acceptable corporate taxpayer behaviour. There are two striking observations. First, there is a lack of authority to force a Member State to remedy an abusive breach of EU Fundamental Freedoms. This effectively ensures that Member States benefitting from profit shifting can continue to ignore the issue. Secondly, those Member States that do suffer detriments from profit shifting simply do not have the accounting evidence in place to raise the requisite investigations that, in likelihood, would be supported by the CJEU in the event of it being pursued. With respect to the wider question of how the conflicts between Member State entitlement to tax policies reconcile with the EU tax directions and the case law of the CJEU, the outcome has been less tense than many would have predicted. Clear breaches of EU Fundamental Freedoms have been addressed where necessary by the CJEU, and as such, although Member State autonomy over its legal system has reduced, it is only one angle in a complex set of influences and compromises between a wider set of stakeholders. These stakeholders include the MNEs themselves and the Member State tax authorities. Modelling management behaviours and claims of ignorance around the boundaries of the law have been set out to explain or, at worse, justify abuses. EU Fundamental Freedoms provide an accounting capability to abuse the Internal Market and those with the most to gain continue to exploit such strategies while Member State tax authorities are starved of the information required to enable a more effective investigation or prosecution. Member State tax authorities remain ineffective through a combination of weak co-ordination across jurisdictions, divergent focus on what is pursued between jurisdictions and a lack of confidence in the judicial system that have generally demanded a much more robust case substantiated with more detailed accounting and legal substance if it has any chance of winning tax abuse cases against MNEs.

With respect to the need for common enforceability as a benchmark rule of law paradigm, the burden of challenging MNEs on their 'ED&A' is likely to reside primarily on those Member States that are net tax revenue losers of EU tax abuses. There is likely to be much more tax conflict raised as a result of 'ED&A' between various high and low tax Member States as it becomes obvious how MNEs have shifted profits between jurisdictions. Such conflicts potentially have economic and political impact and it will be important that broad consensus and consistent enforceability is achieved through CJEU case law. It could be reasonable to evidence MNE behavioural changes driven by 'ED&A' in a short period of time following transposition, as demonstrated by the successful legislative provisions of Sarbanes Oxley in the US. The effect will take time to materialise, as a period of operational bedding-in within MNEs along with judicial challenges to specific transactional circumstances will over time provide for a more established statutory reporting disclosure operating environment.

The reform proposal is satisfactorily aligned with the principal tenets of the rule of law, legitimising its credentials and underpinning the proposal with a backbone of legal best practice principles associated with successful laws. Each component of the proposal has been assessed and the proposed disclosures are facilitating measures towards greater transparency that breach no material rule of law principles, even though its resulting enforcement may be inconsistent and uncertain. This is no different from any tax law enforcement measure and is not specific to this reform proposal. The attestations offer few concerns regarding rule of law alignment other than a degree of uncertainty regarding its alignment to human rights principles, which has been mitigated through a measured approach to penalty enforcement.

Limitations are acknowledged. Enhanced disclosures could impose a financial burden on many MNEs. In particular, the reform proposal's thresholds may be considered to be a somewhat blunt instrument for identifying prospective abusive transactions that may require significant and therefore costly efforts by MNEs for capturing, and explaining where necessary, the required disclosures. Conflicts may arise between interpretations and outcomes of threshold disclosures resulting in inconsistencies between Member States for similar disclosures. It is submitted that this is a small price to pay for maintaining sovereign Member State power as a constituent part of the reform proposal and would have no tangible legal consequences for the attesting MNE Officer. It may raise calls for separate accounting courts set up as dedicated chambers to adjudicate disputes between MNEs and Member State tax authorities although at present it is arguable that the existing judicial system provisions are sufficient for resolving any challenges. Beyond the EU borders, punitive measures aimed at reducing tax abuse in the EU presents a risk that such abusive tax transactions may be pushed outside the boundaries of the EU. This does not prevent the country-by-country data from exposing such corporate tactics but identifying the taxable destination of such transactions outside the EU may provide enforcement issues in many instances. Once implemented there could also be an expectation of extending the reform proposal beyond the boundaries of the EU. Enabling tax authorities to examine the end-to-end translation trail of a set of MNE transactions that result in taxable charge avoids pushing the problem beyond EU borders but global adoption must be achievable in principle and desirable over the long-term to ensure enforcement is achievable across all jurisdictions.

It is submitted that the time is right to implement this 'ED&A' proposal, given the challenges confronting Member States that face decades of public revenue deficiencies, the failure of previous policy initiatives and the political and societal consensus at resolving corporate abusive behaviours. It is time to move to a reform solution based on transparency and enforceable tax boundaries rather than tax compromises. These reasons provide substance to the timing and nature of the reform being proposed. CCR is now gathering support and momentum by both the OECD and EU Commission and will undoubtedly broaden its appeal over the next few years. The complexity of corporate tax abuse is aggravated by the competing forces of a continued commitment at EU level to enact changes to the EU tax system against an uncompromising desire at Member State level to retain legislative autonomy over direct tax affairs. Furthermore, the command and control process, structure and authority for the legislative, judicial, and enforcement functions of EU and Member State institutions for all direct tax matters remain unsettled, inconsistent and in places ill-defined. All these parties have a stake in tax abuse reform but this will be difficult to achieve while a common operating tax environment based on common tax or accounting principles is out of sight.

This thesis reveals further areas of prospective research. A particular area of relevance relates to the extent to which profit shifting incentives and initiatives impact real economic decisions rather than artificial economic decisions. In Chapter One it was stated how one may hypothesise about the collective level of EU tax loss associated with profit shifting but it is rarely extended to attempt to understand the real economic cost in relation to actual commercial decisions that result from the disharmony among Member State tax rules and rates. The nature of this reform proposal prompts further questions regarding the scope to develop a new model approach tax avoidance based on commercial behaviours resulting from enhanced disclosures, a deeper understanding of the correlation between the actions and inactions of Member State tax authorities and resolving tax abuses, and similarly to a more empirical centric based study of the impact of the threat of criminal liability on commercial tax planning. All these areas remain fertile areas of prospective future research. Beyond tax law, reference in Chapter Two to Abuse of Rights and its place in EU law offer further research potential to examine the potential advancement of the concept from a principle of EU Tax Law to a more general principle of EU law.

Left unattended, this area of law is likely to become increasingly controversial in the future. Tax abusive practices have caused the practices of MNEs and their accounting and auditor partners to come under closer scrutiny. The widespread dissatisfaction with the MNEs' attempts to regulate their own affairs liberally under the cover of EU Fundamental Freedoms and free from proper governance or scrutiny has resulted in a need to find an alternative way forward. This thesis provides such a reform proposal, demanding much greater legal involvement in the process of standard setting by the EU regarding certified mandatory accounting disclosures in a manner that may finally offer hope in addressing one of the more vexed unresolved areas of EU tax law.

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