Eva Ludvikova

The end of tax avoidance practices in the EU? The impact of the 4th Anti Money Laundering Directive and Anti-Tax Avoidance Directive on corporations

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The end of tax avoidance practices in the EU? The impact of the 4th Anti Money Laundering Directive and Anti-Tax Avoidance Directive on corporations

by

Eva Ludvikova

SCHOOL OF ADVANCED STUDY

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ABSTRACT

The thesis provides an analyses of tax avoidance in the EU after recent reforms of secondary EU law. The 4th Anti-Money Laundering Directive was adopted on 20th May 2015 and came into effect on 26th June 2017. The Anti-Tax Avoidance Directive was adopted on 20th June 2016 and will come into effect on 1st January 2019. The thesis author discusses new reforms focusing on both directives as a measures to tackle tax avoidance practices.

The first part describes the basic terms such as the definition and differences between tax evasion, tax avoidance and tax planning in relation to harmful tax competition. The causes of harmful tax competition in the EU are clarified and there is a brief description of the current practices of the corporations. The evolution of the corporate taxation provides a background to the recent developments of combating tax avoidance. The main part of the study focuses on the contribution of policy to prevent tax avoidance in the EU, and especially the impact of the recently adopted Anti-Tax Avoidance Directive and the 4th Anti-Money Laundering Directive.

Overall, the critical review assesses the impact and problems of the directives on the achievement of harmonised tax competition and steps which are necessary to accomplish the end of tax avoidance practices in the EU.

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1. INTRODUCTION

Recently the European Commission adopted two directives, the 4th Anti-Money Laundering Directive on 20th May 2015 and the Anti-Tax Avoidance Directive on 12th July 2016. The Directives aim for reforms to tackle tax avoidance practises that influence economic revenues not only in the EU but also in other countries around the world. The new reforms included in the directives should help to ensure sustainable revenues to provide a higher quality of society through education, health, security or public services and support a better business environment in the internal market.

The global and digital economy has brought new challenges to cross-border companies to increase their profits. Cross-border companies use legal mismatches and loopholes to reduce their tax liabilities. Because of these negative circumstances that affect the functioning of the internal market, the EU aims to combat tax avoidance and ensure fairer, simpler and more effective corporate taxation and ensure that companies pay tax wherever they make their profit in the EU.

The main substance of this thesis is the analysis of the new directives and to discuss how effective they can be in preventing tax avoidance and if they set up a new approach for fair and efficient corporate taxation. The Anti-Tax Avoidance Directive ensures harmonised implementation of the Base Erosion Profit Shifting (BEPS) Project within the EU and minimum level of protection against tax avoidance in all Member States. The Member States should apply rules against common form of aggressive tax planning. The 4th Anti-Money Laundering Directive has been adopted not only to tackle tax avoidance practices but it includes some measures that will be instrumental to combat aggressive tax planning such as transparency of beneficial ownership information and foundation of national registers of the beneficial ownerships.

The thesis includes six chapters. After the introduction, the second chapter explains terms of tax planning, tax avoidance and tax evasion and includes also methods of tax avoidance. The third chapter explains harmful tax competition in the EU and the evolution of corporate taxation in the Single Market. It also touches on low tax jurisdictions in the EU. The fourth chapter briefly describes big corporations and their tax avoidance practices. Chapter five is the main part of this theses and focuses on new measures adopted by the recent directives. The chapter is divided into the Tax-Avoidance Directive and its rules and the 4th Anti-Money Laundering Directive and its measures including combat tax avoidance. The last part of this chapter is the critical review and analyses if the Directives are effective against tax avoidance practices that directly affect the functioning of the internal market. The final chapter concludes the thesis.

2. TAX PLANNING, TAX AVOIDANCE AND TAX EVASION

2.1. What does tax avoidance mean?

Increasing globalisation makes it easier for transnational corporations ('TNCs') to reduce taxation. TNCs and their advisors have become more aggressive in how to escape tax through the international tax system. TNCs with multiple affiliates hold untaxed or hardly taxed profits in offshore tax havens.

The amount of offshore profits are growing fast. A large part of global trade is supposed to be among affiliates inside TNCs, across borders. It gives the opportunity to transfer TNCs profits around the world, for instance, from a high-tax jurisdiction to a low-tax jurisdiction and shift costs into high-tax jurisdictions to counterbalance them against tax. In the meantime, TNCs operate their logistics or consulting activities from subsidiaries in the tax havens and coincidently the tax haven entities own intellectual property rights, bonds or shares as a holding company over there.[1]

This chapter will explain the terms of tax avoidance, tax planning and tax evasion which are very often interchangeably.

2.2. Tax planning

Tax planning is a taxpayer's legal action to arrange his affairs in such a way as to pay less tax. This is acceptable to governments or tax authorities.[2] The general term as Carerro explains tax planning is that it

> "includes any legal operation, structure or formula for conducting legal business that includes a tax saving or advantage compared to the amount of tax that would be due if such acts or contracts were not undertaken."[3]

[1] Tax justice network, 'Taxing corporations' <www.taxjustice.net> accessed 1 July 2017.
[2] Paulus Merks, 'Tax Evasion, Tax Avoidance and Tax Planning' (2006) 34 INTERTAX 272.
[3] José Manuel Calderón Carrero and Alberto Quintas Seara, 'The Concept of 'Aggressive Tax Planning' Launched by the OECD and the EU Commission in the BEPS Era: Redefining the Border between Legitimate and Illegitimete Tax Planning' (2016) 44 INTERTAX 206.

Tax is considered a significant cost for companies and one of the ways to increase profitability is to treat tax liability as a manageable cost but the principles of how to minimise the corporate tax burden has to be legally and socially acceptable. The interest of the corporation is to admit the generally accepted principles.[4]

There is no contradiction that tax planning is a legal action, nevertheless, it has been distinguished between legitimate tax planning and aggressive tax planning[5] practices during the BEPS[6] era.

Legitimate tax planning means tax compliance in the spirit of tax law and regulations. Taxpayers' behaviour is lawful and legitimate in organising their activities and business in the most efficient way. The new concept of legitimate tax planning is to achieve fiscal consolidation with the requirement for tax practices of good corporate governance. The fair relationship between tax authorities and taxpayers can provide certainty, stability and predictability, avoiding abuse from both sides and higher level of voluntary compliance.[7]

Aggressive tax planning follows the changes of the international economic and financial environment and looks for ways of how to reduce tax liability. Firstly, it takes advantage of the technicalities of a tax system, secondly uses mismatches between two or more tax systems.[8] The last concept in the international tax system considers aggressive tax planning

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[4] Carlo Garbarino, 'Aggressive Tax Strategies and Corporate Tax Governace: an Institutional Approach' (2011) 8 European Company and Financial Law Revenue 277.
[5] The OECD and the EU Commission redefine the concept of legitimate tax planning by reshaping standards of international taxation and introducing this pseudo-category to refer a set of tax anomalies, for example, double deduction, double non- taxation or unusually low effective tax rates. See Calderón Carrero and Seara (n 3) 216.
[6] The Base erosion and profit shifting (BEPS) project was launched in October 2015. International taxation standards are resulting from the BEPS OECD Project. More then 100 countries and jurisdictions collaborate in the framework of BEPS Project to change tax planning strategies that undermines the fairness and integrity of tax systems across borders. This project supports voluntary compliance by all taxpayers and indicates unfairness of legally avoiding income tax by multinational corporations. *See* OECD, *About the Inclusive Framework on BEPS* <www.oecd.org> accessed 1 August 2017.
[7] Joao Dácio Rolim, 'The General Anti-Avoidance Rule: Its Expanding Role in International Taxation' (2016) 44 INTERTAX 815.
[8] Axel Cordewener, 'Anti-Abuse Measures in the Area of Direct Taxation: Towards Converging Standards under Treaty Freedoms and EU Directives' (2017) 26 EC Tax Review 60.

as unacceptable practices comparable to tax avoidance. The structure of this type is contrary to the purpose of tax regulations.[9]

The first interpretation of aggressive tax planning at the EU level was in December 2012 in the Recommendation on Aggressive Tax Planning by the Commission as "aggressive tax planning consists in taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability".[10] Aggressive tax planning is reducing taxation liability in an officially legal way, however, contrary to the spirit of the law. It takes tax advantages resulting from operations, businesses, structures or complex schemes of discrepancies between two or more tax systems in various forms, for instance, double deduction where the loss is deducted in the state of source and residence or double non-taxation where income which is not taxed in one state is exempt in another state.[11]

The concept of tax planning is a part of evolution in the international taxation system. It is necessary to keep in mind that profit maximisation in a legal way is the priority of corporations from their stakeholders' point of view and so, profit maximisation is ultimately in the interests of the company. The business point of view describes tax planning as a logical analysis of financial tax scheme combining financial goals including effective tax planning and other segments of the financial scheme in the most effective way. Tax planning is regarded by taxpayers as a part of their costs that can be decreased. The goal of tax planning is to achieve the highest possible profit.[12]

Another aspect is the promotion of economic activities by different countries which include tax allowances to attract investment. In an effort to promote political and economic interests, many countries have been competing in favour of global taxpayers. Many companies take advantage of incentives of attractive economic activity by domestic governments to operate

[9] Calderón Carrero and Seara (n 3) 217.
[10] European Commission, *Commission Recommendation of 6.12.2012 on aggressive tax planning* (2012) C8806 <www.ec.europa.eu> accessed 1 August 2017.
[11] Calderón Carrero and Seara (n 3) 214.
[12] Mirugia Richardson, 'Fighting Tax Fraud and Tax Evasion in the EU: The 2012 Action Plan' (2015) 4 EC Tax Review 220.

in certain jurisdictions. It brings benefits to the country through new job offers and income to the national budget from business activities.[13]

Tax planning can be interchangeable with tax optimisation that is based on economic and economical calculations. Tax optimisation is characterised as taxpayers' behaviour to maximise their after-tax income with the use of available exemptions and reliefs that are provided in all tax legislations. Taxpayers calculate the costs and benefits of tax optimisation to increase their profit.[14] Taxpayers use the possibilities of globalisation, tax competition between different countries and the international taxation system between countries, where cross-border cooperation and coordination have not been established.[15] The result is a combination of different taxpaying obligations and profitability.

2.3. Tax avoidance

In order to understand the term 'tax avoidance', a small part of the chapter is dedicated to the term 'tax evasion'. In this way, it will be easier to explain the whole matter of reducing tax liability.

What is the difference between tax evasion and tax avoidance? Tax evasion[16] involves breaking the law – non-disclosure, concealment and fraud – it is an illegal activity that is punishable by criminal law. Tax avoidance[17] on the other hand, is a legal activity by the taxpayer to reduce a tax burden and at the same time does not constitute a criminal offence.

[13] Solange Devenish, 'Should Corporate Tax Avoidance Be Criminalised?' (2016) 6 Southampton Law Review 91.
[14] D.A. Albergtse, 'International Tax Avoidance: An Economic View' (1984) 12 INTERTAX 473.
[15] Calderón Carrero and Seara (n 3) 219.
[16] "The term is generally used to mean illegal arrangements where liability to tax is hidden or ignored, i.e. the taxpayer pays less tax than he is legally obligated to pay by hiding income or information from the tax authorities." See OECD 'Glossary of Tax Terms' <www.oecd.org> accessed 1 July 2017.
[17] "The term is generally used to describe the arrangement of taxpayer's affairs that is intended to reduce his tax liability and that although the arrangement could be strictly legal it is usually in contradiction with the intent of the law it purports to follow." See OECD 'Glossary of Tax Terms' <www.oecd.org> accessed 1 July 2017.

2.3.1. TAX EVASION

Tax evasion is generally defined by Garbarino as "behaviour involving a direct violation of tax law in order to escape payment of taxes".[18] An intention of escaping payment of tax through the failure to declare properly the appropriate income derived from legal transactions. The illegality, particularly the direct violation of a tax provision, is the taxpayer's act to avoid the payment of tax. It can involve different serious offences. On the one hand, it can be omission, for example, failure to submit complete returns of income. On the other hand, there are more serious offences[19], for instance, false declarations or fake invoices.[20] Tax evasion involves acts which can be investigated, prosecuted and sanctioned. Non-taxpayers face penalties or jail.

2.3.2. TAX AVOIDANCE

Even though tax avoidance is considered to be a legal action and explained by Merks as "a right of the taxpayer to arrange his affairs in such a way as to pay less tax"[21], it is not acceptable by governments because it covers only forms of tax minimisation and such practices which are contrary to fiscal equity, have serious budgetary effects and distort international competition and capital flows. Tax avoidance harms the economy as well as public interest as a whole - it relates to everybody without exception. Inherently, it affects each individual with a larger number of victims harmed from tax avoidance which is done on a large scale. The emerging tax gap may result in less money available for allocation to health care, education, security or any other developments for the society.[22]

There is no single legal definition of tax avoidance. A popular definition is "a behaviour aimed at reducing tax liability which does not violate letter of the law, but clearly violates its spirit".[23] On an international level, compliance with the spirit of the law means following the intention of the legislation and it includes, besides other things to provide relevant or required by law

[18] Garbarino (n 4) 283.
[19] Tax fraud is punishable under criminal law and it is classified as a form of deliberate evasion of tax. *See* Mirugia Richardson, 'Fighting Tax Fraud and Tax Evasion in the EU: The 2012 Action Plan' (2015) 4 EC Tax Review 220.
[20] Merks (n 2) 274.
[21] ibid 273.
[22] Devenish (n 13) 103.
[23] Garbarino (n 4) 283.

information to the authorities.[24] Spirit of law as a view of parliamentary intention is considered in the UK.

Different countries hold different views on what constitutes tax avoidance because there is no fixed legal meaning. In one country one issue of the transaction can be considered harmless tax planning, but in another country it can be harmful tax avoidance. The result can be decided by the courts but everyday occurrences do not come to the courts because it is not practical to pursue every case.[25]

One of the most important cases in the UK about artificial avoidance scheme was *Ramsay (WT) v IRC*[26]. The taxpaying company entered into a series of transactions to set against a large capital gain without commercial reality which caused an artificial capital loss on purpose to avoid capital gains tax. The case established the principle[27] to apply purposive interpretation in the case of tax law. Purposive interpretation is applied if the purpose of the statute needs to be interpreted by a court even if that sometimes needs a stretched interpretation of the language.[28]

Because of the legal insecurity a common definition of tax avoidance will provide more certainty in different jurisdictions and will be beneficial to governments to estimate their revenue and the national budget will become stable.[29] At an international level (OECD and EU) there has been an effort to develop new international taxation standards in the context of the BEPS OECD Project where 15 actions are addressed to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations.

Methods of tax avoidance are several and it is not possible to describe the whole range of activities because avoiders are developing new ways and practices. Among the main and

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[24] OECD, *OECD Guidelines for Multinational Enterprises* (edition 2011) <www.oecd.org> accessed 1 August 2017.
[25] Michael P. Devereux, Judith Freedman and John Vella, 'TAX AVOIDANCE' (Paper 1, Oxford University Centre for Business Taxation 2012) <www.sbs.ox.ac.uk> accessed 1 August 2017.
[26] *Ramsay (WT) v Inland Revenue Commissioners* [1982] ac 300 (HL).
[27] It is sometimes known as the Ramsay principle.
[28] Devereux, Freedman and Vella (n 25) 13.
[29] Merks (n 2) 281.

traditional methods is transfer pricing and allocation of debt and earnings stripping. There are many more methods of tax avoidance, but the thesis will focus on the main and the most common methods which are used by TNCs in the international taxation system.

Transfer pricing is the special alerted price charged by a company for goods, services or intangible property (particularly intellectual property) to a subsidiary or other related company (affiliated enterprises integrated under the same management). Inherently, income and expenses are improperly allocated for the purpose of reducing taxable income.[30] The expenses of the company are maximised in the high-tax jurisdiction and the income from a different part of the profit is shifted to the company in the low-tax jurisdiction.

One way of transfer pricing is selling for a low price by the parent or related company in the high-tax jurisdiction and raising the price of purchase in the low-tax jurisdiction. Inherently, prices for goods or services should be the same for both, the related companies and unrelated parties.

Another way of transfer pricing as arm's- length principle is the transfer of rights to intellectual property or of other similar intangible property. Intangibles, such as a new invention or new drugs, is licensed to related entities in a low tax country where the royalty or other payment is lower than the actual value of the license and consequently income is shifted. It is very difficult for authorities to estimate the real value of a royalty, for example, software or know-how. Intellectual property with cost sharing agreements where different subsidiaries contribute to the cost are even more complicated transfer pricing.[31]

Businesses establish dummy companies in jurisdictions with little or almost zero tax on the profits. Corporations have developed techniques to achieve productive operation while simultaneously shifting profits to the no-tax jurisdiction. The method "double Irish, Dutch sandwich"[32] is used by TNCs when intangible assets are transferred to a holding company in

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[30] OECD, *Glossary of Tax Terms* <www.oecd.org> accessed 1 July 2017.
[31] Jane G. Gravelle, 'Tax Havens: International Tax Avoidance and Evasion' (Congressional Research Service, 2015) <www.fas.org> accessed 9 August 2017.
[32] Mark Holtzblatt, Eva K. Jermakowicz and Barry J. Epstein, 'Tax Heavens: Methods and Tactics for Corporate Profit Shifting' [2015] INTERNATIONAL TAX JOURNAL 33.

Ireland. The sandwich means, for instance, a holding company has a subsidiary for selling advertising to Europe in Ireland. Between them operates a Dutch subsidiary gaining income from royalties (from the sales subsidiary) which are afterwards sent to the holding company in Ireland. The Irish holding company has management and its tax home in the third non-EU low tax rate country. The Dutch sandwich is used to avoid withholding taxes in Ireland and almost the whole profit of the Irish holding company can be transferred to a country with zero or low tax rate.

Another practise named check-the-box is connected with hybrid companies and their cooperation as a separate entity or partnership. If there is no possibility for the high-tax country to recognise, whether the related company is separate or not, there is an option to lend to the subsidiary in the high taxation regime and interest can be deducted for the company with the low-tax regime. Oppositely, if there is a partnership between companies, there would be no interest income to pay.[33]

Allocation of debt and earnings stripping is when borrowing is in a different jurisdiction with different taxation. The shifting of the debt can be achieved without changing the overall debt exposure of the company. Earnings stripping is a specific practice when one subsidiary in the low-tax jurisdiction lends funds to another subsidiary in the high-tax jurisdiction. The entity will be recognised as a separate company in the high-tax country and the interest will be deductible. The foreign borrower will not be subject to tax on interest income, although they are the same entity.[34]

General or specific anti-avoidance rules can contribute to the reasonable allocation of correct taxing among different states. One of that rules is the General Anti-Avoidance Rule ('GAAR') as a general statement of principle to combat tax avoidance which effects tax liability.[35] It was one of the first activities by the Commission related to tax avoidance and aggressive tax planning. GAAR gives right to national tax authorities to ignore non-genuine arrangements

[33] Gravelle (n 31) 14.
[34] ibid 11.
[35] Rolim (n 7) 815.

which are not implemented for valid commercial reasons to take account of the corporate tax liability.[36]

2.4. Difference between tax avoidance and aggressive tax planning

The similarity among aggressive tax planning, tax avoidance and tax evasion is that all of them have a negative influence on the national budget, either on the EU level or for each Members State.

Tax planning and tax avoidance involves the legal behaviour aimed to minimised tax burden.

Illegal behaviour is considered as tax evasion. Nevertheless, there are more distinctions between tax planning and tax avoidance which is necessary to consider.

Tax avoidance concludes artificial arrangement or an artificial series of arrangements whereas aggressive tax planning uses undesired overlapping of taxation measures and unforeseen loopholes. Typical for tax avoidance is the circumvention of domestic or international tax provisions of one jurisdiction. Aggressive tax planning diverts from the interaction of tax provisions of more jurisdictions.[37]

[36] Luca Cerioni, 'The Quest for a New Corporate Taxation Model and for an Effective Fight against International Tax Avoidance within the EU' [2016] 44 INTERTAX 463.
[37] Gianluigi Bizioli, 'Taking EU Fundamental Freedoms Seriously: Does the Anti-Tax Avoidance Directive Take Precedence over the Single Market?' (2017) 26 EC Tax Review 167.

3. HARMFUL TAX COMPETITION IN THE EU

3.1. Tax Competition and the Single Market in the EU

Taxes, as a part of the fiscal policy, which is an important component of the economic policy can influence many outcomes, for instance consolidation of public finance, stimulation of economic development or achievement of economic balance. On the EU level, the decision about fiscal issues from a member state can affect the national level of economic policy but it will also be on a community level. The settlement of national fiscal policies is essential for the Single Market to function effectively.[38]

The issue of tax harmonisation within the EU came about because the market ensures the free movement of goods, services, capital and labour and member states have created convenient conditions for investments and thus they are integral to tax competition but Member States have found it difficult to protect their national tax bases because of tax avoidance practices.

Since the beginning of corporate income tax harmonisation there have been some significant achievements, for example, in legal instruments such as directives, in jurisprudence with the new doctrines of ECJ, in soft law with the Code of Conduct and proposals of the Commission, to make cooperation more effective. It is necessary to make many efforts (coordination of tax policies, harmonisation of tax law or action of the ECJ) on both sides, from the EU as a whole and each member state, to be able to guarantee efficient functioning of the Single Market.

Progress such as corporate income tax rates and differences among the corporate tax bases of member states, still has long way to be developed. Each member state has full autonomy to set its own system of direct taxation, which includes corporate income taxation, but the national taxes have to be compatible with EU law, in particular, the fundamental freedoms and fair competition and the establishment or functioning of the internal market laid down in

[38] Daniela Pirvu, *Corporate Income Tax Harmonization in the European Union* (PALGRAVE MACMILLAN 2012).

the Treaty of the Functioning of the European Union ('Treaty').[39] In fact, the full tax autonomy defends the proper functioning of the Single Market.[40] The solution is regulation of the national taxation system according to economic rules and measures and achieved common objectives stated in the Treaties but with the majority of member states, the area of direct tax keeps the sovereignty of national tax regimes.

The compliance of national taxes in accordance with EU law means in practice that national tax law should not make barriers for cross-border economic transactions. The progress of the Single Market requires more than ensuring cross-border economic transactions. There are many reasons why income tax harmonisation or income corporate tax coordination[41] is necessary; notably to provide better coordination of corporate tax policies in the EU.

The reasons are: 1) Twenty-eight members of the EU means the same number of national tax systems in the Single Market; 2) Conflict between national tax polices and EU law are often about incompatible national tax rules with EU law; 3) Compliance and administration fees are too expensive for companies operating in more Member States; 4) Differences in the tax systems and their dissimilar burdens distort economic activity in the EU; and, 5) Tax planning strategies of TNCs with their separate accounting methods makes the collection of corporate tax difficult.[42]

Harmful tax competition means that there are 28 different corporate taxes with different tax bases and rates in the EU with lack of harmonisation of corporate tax. To avoid the harmful tax competition it is necessary to think about the main obstacles to the harmonisation process which are: the legal basis of the Treaty is not straight for harmonising corporate tax, the principle of subsidiarity (all initiatives should be defined through a consultative process with

[39] In the case *Marks & Spencer* was stated "although direct taxation falls within their competence, Member State must none the less exercise that competence consistently with Community Law." *See* Case 446/03 *Marks & Spencer plc v David Halsey* [2005] ECR I-10837.
[40] Pirvu (n 38) 4.
[41] The European Commission used the term of *incorporate tax harmonisation* until 1980s as a process of approximating national regulations in the field of corporate income tax. Nowadays, the term *income tax coordination* is more specific for coordination of tax systems for entities engaged in cross-boarder activities in the EU. *See* Pirvu (n 38) 4.
[42] Michael P. Devereux and Clemens Fuest, 'Corporate income tax coordination in the European Union' (Oxford University Centre for Business Taxation 2009).

the Member States) and the rule of unanimity (tax provision about harmonisation of corporate income tax is very limited).[43]

Fundamental freedoms as a principle of non-discrimination do not allow tax discrimination by any measurements or activities made by Member States. In case of lack of income tax measures, incompatible national tax rules with EU law and any conflicts contrary to Community Law have to be resolved by ECJ. This is also called negative harmonisation.

There have been many important cases about locational efficiencies within groups of companies, cross border tax consolidation and deductibility by the parent company, costs or losses in relation to a subsidiary established in another Member State, or on the contrary. Locational efficiency of capital income is mainly cross-border corporate activities through complex corporate structures concerning the freedom of establishment and can be applied also to the taxation of cross-border dividends and profit shifting by multinational companies.[44]

Another form of cross-border tax consolidation is under controlled foreign companies. The parent company, within its group of affiliated companies can deduct costs or reflect losses in its tax accounts. Costs and losses can occur at the level of the controlled company.

In the important case about controlled foreign company (CFC) rules, *Cadbury Schweppes*[45], the parent company Cadbury Schweppes was established in the UK and consisted of other companies in the UK, other EU countries (two subsidiaries in Ireland) and non-EU countries. The UK tax authority believed that the reason for establishment of two subsidiaries in Ireland was to avoid tax provision on exchange transactions in the UK and benefit from the tax regime in Ireland.

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[43] María Teresa Soler Roch, 'Corporate tax in the EU: a never-ending story? (2005) 3 EC Tax Review 116.

[44] Carlo Garbarino, 'Harmonization and Coordination of Corporate Taxes in the European Union' (2016) 5-6 EC Tax Review 277.

[45] Case 196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-8031.

The main question to the ECJ was about abusing the freedoms introduced by the EC Treaty in case of establishing and capitalising companies in another Member State because of more favourable tax regime than in the UK. The ECJ decided that established subsidiaries in Ireland for the purpose of benefit from the favourable tax regime did not constitute abuse. ECJ found that the UK Controlled Foreign legislation in force at that time, restricted the freedom of establishment. ECJ made burdens between public interest of combating abuse and restrictions on cross-border activity within the EU.

ECJ concluded that freedom of establishment for companies which are formed in accordance with the law of a Member State, have their office, central administration and business place, means the same as natural persons who are nationals of the EU and the same measures are applied. Freedom of establishment includes not only the right to form a company or a firm, but also the right to form a subsidiary, a branch or an agency. A Member State cannot obstruct its national companies from establishing affiliated companies in another Member State. The freedom of establishment is applicable also on holding capital of a company established in another Member State. The objective is to allow a citizen of the EU to participate in the economic life not only in the state of his origin but also in another Member State and to profit therefrom.

The case *Cadbury Schweppes* established the term of the wholly artificial arrangement. ECJ explained that

> "the mere fact that a resident company established a secondary establishment, such as a subsidiary, in another Member State cannot set up a general presumption of tax evasion and justify a measure which compromises the exercise of a fundamental freedom guaranteed by the Treaty".[46]

The subjective circumstances in the intention to obtain a tax advantage has to be grounded by objective circumstances of non-genuine activities. The resident company has to satisfy a motive test where it is shown that there is no main purpose of the transactions between

[46] *Cadbury Schweppes* (n 45).

companies in the group to reduce taxes and it is not the main reason either. The resident parent company has to produce evidence about genuine activities. There are important objective circumstances, for example, incorporation has to be a real establishment in pursuit of an economic activity and physically exist (premises, staff and equipment) in the host Member State. If the objective circumstances do not come up, it is regarded as a wholly artificial arrangement, for instance, letter box or front subsidiary.

3.2. Evolution of corporate taxation in the EU

There are some interesting points in the evolution of corporate tax harmonisation. The international tax system and in parallel the EU tax system was based upon the principle of source and residence. These principles formed rules. Income is taxed where it arises and/or it is taxed where the entity earning the income resides; to identify which country is legitimate to a specific income and the ability to collect the income tax.

When the world became globalised and digitalised and the EU entered into the Single Market, distortions in international trade arose. Both governments and corporations have been demanding the best benefits in tax competition or tax avoidance and on the top of this, came the economic and budgetary crisis. The reaction to increasing harmful tax competition has introduced measures against tax avoidance to prevent aggressive tax planning and increase tax transparency.[47]

In the 1960s there were some unsuccessful initiatives[48] to achieve a limited degree of harmonisation of the corporate tax system in the EU. Many other proposals of directives were withdrawn because of the reluctance of most of the member states. The achievement as a consequence of economic integration was the Council Directive for mutual assistance between national tax authorities[49] to provide greater cooperation in the field of tax collection. In the 1990s the problems about distortions in the Internal Market because of differences in

[47] Rita de la Feria, 'Harmonizing Anti-Tax Avoidance Rules' (2017) 3 EC Tax Review 110.
[48] The Neumark Report of 1962 and Tempel Report of 1970.
[49] Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums [1977] OJ L336.

corporation tax were announced in the Ruding report. The Ruding report advanced recommendations, inter alia, to ensure effective taxation and prevent tax evasion that were rejected by the Council and the Commission. After this lack of success, the early 1990s saw significant progress by adopting the Mergers Directive[50] and the Parent/Subsidiary Directive[51]. The objective of the Merger Directive is to remove fiscal obstacles to cross-border reorganisations involving companies situated in two or more Member States. The Parent/Subsidiary Directive eliminated tax obstacles of profit distributions between groups of companies in the EU by preventing double taxation of parent companies on the profit of their subsidiaries. Although the directives were a step forward in the progress of corporate tax harmonisation, the issue of corporate taxation was not regulated completely and the problems between Member States and companies operating in several countries still continued.

In the mid-nineties, the OECD spoke about tax avoidance by TNCs that were able to reduce their tax bill through the provisions of national tax laws.

The first relevant initiative[52] against harmful tax competition was presented in the Code of Conduct for business taxation which was set out in the conclusions of the EU Council of Economics and Finance Ministers ('ECOFIN') in 1997. Even though it was not a legally binding document, the Member States undertook to reduce existing tax measures that constitute harmful tax competition and not to introduce any such measures in the future. In early 2000, a few directives or amendments[53] were approved without essential changes in corporate

[50] Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (the Merger Directive) [1990] OJ L225.

[51] Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (the Parent-Subsidiary Directive) [1990] OJ L225.

[52] There are many non-biding acts as a soft law, for instance conclusions, declarations, programmes, codes of conduct and communications, which do not create any rights and obligations for the EU law. However, they are integral part of interpretation, development and/or application of EU law. In the opposite case, the directives and regulations are the provision with binding force.

[53] Namely, *see* Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments [2003] OJ L157/38; Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States (the Interest-Royalty Directive) [2003] OJ L157/49; Council Directive 2003/123/EC of 22 December 2003 amending Directive 90/435/EEC on the common system of

taxation. For instance, the new legal entities and new types of transactions were amended in amending the Merger Directive. Because of the increasing fiscal problems and discovering that Member States could not fight individually against fiscal fraud, the Commission launched a debate about a strategy to combat fiscal fraud which was undermining the functioning of the Single Market and effected tax competition in a negative way.[54]

The key moment for the future evolution of corporate taxation in the EU was expected from the Common Consolidated Corporate Tax Base ('CCCTB') which was an ambitious project proposed by the EU Commission in 2011 but was never adopted. The single set of rules involved establishing a single tax base for companies with cross border activities and the establishment of the taxable profit should be made in one Member State (the country of the parent company). CCCTB could make the Single Market easier and cheaper for companies operating cross-border in the EU. It could also be an important instrument to combat tax avoidance.

The lasting lack of a corporate taxation system in a globalised, digital and mobile business environment and published taxed schemes of TNCs as a negative effect of international tax avoidance and evasion, caused significant revenue losses for Member States. There was a need for fundamental reform of corporate taxation in the EU demanding to tackle tax avoidance, secure sustainable revenues and strengthen the Single Market.[55]

In 2012 the 'Action Plan to strengthen the fight against tax fraud and tax evasion' presented by the Commission included fighting tax avoidance and aggressive tax planning. The Action Plan incorporated two measures to protect the functioning of the Single Market and the

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taxation applicable in the case of parent companies and subsidiaries of different Member States [2003] OJ L7 41; Council Directive 2005/19/EC
of 17 February 2005 amending Directive 90/434/EEC 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [2005] OJ L58/19, *consolidated into* Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States [2009] OJ 301/34.

[54] Richardson (n 12) 221.

[55] Pierre Moscovici, 'Tough Measures Needed to Reform Tax on Corporate Profits' (2016) 1 EC Tax Review 2.

Member States' tax bases. The cooperation between Member States in the area of international tax law was necessary. The first recommendation concerned measures which intended to encourage third countries to apply minimum standards of good governance in tax matters, and the second was on aggressive tax planning regarding direct taxation. The development of the EU approach to corporate income taxation began by this recommendation which also included the definition aggressive tax planning.

Meanwhile, recent developments on the international level in corporate tax matters were made in the BEPS project. Its development has also been supported by the Commission and Member States and the implementation of the global BEPS measures should ensure more effective international corporate taxation in the EU.[56]

Another step forward was in 2015, when the Commission published the Tax Transparency Package[57] with proposals to automatically exchange information between Member States on their tax rulings. Furthermore, the Communication on External Strategy for Effective Taxation[58] presents a stronger and more coherent EU approach to working with third countries on tax good governance matters and the Communication on Action plan on corporate taxation[59]. The new approaches in the comprehensive Action Plan on Corporate Taxation by the Commission launched the new progress of how to achieve more efficient corporate taxation and to combat to tax avoidance with several objectives. Among the changes are competitive and advantageous corporate tax environment, protection of the Single Market, re-launch of CCCTB with some improvements, ensuring fair taxation where profits are generated and better coordination between Member States to tackle tax avoidance. The progress was linked with the BEPS measures which were actively supported by the Commission and Member States as they were essential to ensure corporate effective taxation worldwide and had to be implemented in Member States.

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[56] *See* (n 6).
[57] Communication on tax transparency to fight tax evasion and avoidance [2015] COM136.
[58] Communication Anti-Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU [2016] SWD6.
[59] Communication A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action [2015] SWD121.

In early 2016, the Anti-Tax Avoidance Package ('ATAP')[60] was published to make fairer, simpler and more effective corporate taxation in the EU. It includes measures aimed to tackle tax avoidance and abusive practices in the EU internal market. ATAP proposed a general Anti-Tax Avoidance Directive[61] ('ATAD') which includes new rules against tax avoidance and problem solving of aggressive tax planning strategies which have a negative effect on the internal market.

The area of tax transparency resulted from the new proposals to amend obsolete directives such as the Merger Directive and the Parent/Subsidiary Directive. Significant extension of the scope of the automatic information exchange to advance cross border tax rulings was adopted in the amended Directive of the Administrative Cooperation[62]. The new transparency requirements should ensure better cooperation and transparency between tax authorities for protection of tax bases and automatic exchange of information between Member States encompassing interest, dividends and gross from the sale or redemption of financial assets.

The Parent/Subsidiary Directive was amended several times, however there were many cases where companies avoided paying taxes in any Member State and loopholes used for hybrid loan arrangements needed to be closed. The mandatory anti-abuse rule as a minimum was amended in the Parent/Subsidiary Directive[63] in 2015. Member States were obliged to enact measures preventing abusive tax practices.

The new reforms should contribute to better revenue stability, a stronger Single Market and more efficient conditions of cross-border operations for businesses. The comprehensive proposals included in the Action Plan set out a range of soft law and hard law measures that could enhance the corporate tax environment in the EU and avert significant revenue losses

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[60] *See* (n 58).
[61] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market [2016] OJ L193 (ATAD).
[62] Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [2015] OJ L322.
[63] Council Directive (EU) 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States [2015] OJ L121.

for Member States, a heavier tax burden for citizens and competitive distortions for businesses.

There aree also some interesting proposals on how to solve the no longer suitable corporate tax systems. Garbarino suggests on the economical point of view to unite or approximate tax rates and taxable bases in Member States.[64]

Another proposal is called Destination-Based Corporation Tax where the country of the customers' base would be entitled to tax the company's profits. The last proposal is a Corporate Tax 2.0 which suggests taxing TNCs in the global market, on the concept of equal conditions for taxpayers within each state.[65] None of these were integrated in the new reforms by the Commission. The Commission's proposal to ensure taxation where the profit is generated remains in the traditional international tax law framework for corporate taxation.

3.3. Tax Havens and the EU

Tax havens are jurisdictions with low or zero corporate income tax rates. These countries are used by corporations or individuals to minimise their income taxes which otherwise should be payable in a high-tax country. There are three main characteristics, firstly, zero or only nominal taxes, another is non-effective exchange of information between other countries, the last is lack of transparency in the operation of the legislative, legal or administrative provisions.[66]

The result is that the biggest beneficiaries of low tax regimes or specific tax incentives are corporations and their wealthy shareholders and owners.

On the EU level there is tax competition that can be seen as harmful in some cases, however, there are some countries with some tax haven attributes such as low-tax jurisdiction or tax giveaways in countries across the Europe such as Cyprus, Ireland, Luxembourg, Malta or the

[64] Garbarino (n 44) 277.
[65] Cerioni (n 36) 468.
[66] OECD, Glossary of Tax Terms <www.oecd.org> accessed 1 July 2017.

Netherlands. Attracting investment is not only about low income tax rates, governments can also offer a variety of other tax incentives.

There were many cases about compliance with EU rules on state aid to TNCs, for instance, Apple in Ireland, Starbucks in the Netherlands and Amazon in Luxemburg. Several companies received important tax reductions by way of tax rulings issued by national authorities. Tax rulings used the companies about the issues of calculations or putting into the effect special tax provisions which are confirmed by tax authorities. They are used in particular to confirm transfer pricing agreements. The Commission investigated Ireland on the calculation of the taxable profit allocated to Irish incorporated companies of the Apple group and revealed that because of illegal state aid, rules which did not correspond to economic reality allowed Apple to pay substantially less tax than other businesses[67]. Apple avoided taxation on almost all profits generated by sales of Apple products in the EU because of the special tax treatment in Ireland.[68]

Low corporation tax is another attraction of these countries together with a territorial tax system that does not subject foreign source income to its income tax. For example, Ireland does not levy taxes on income coming from another subsidiary established in another state to the Irish company.[69] Ireland and the Netherlands with relatively low corporate tax rates and territorial tax system are interesting jurisdictions, not only for corporations from the EU, but also many U.S. TNCs have reincorporated overseas through corporate inversions in the last decades. A similar practice is possible in Luxemburg and Switzerland. These schemes have been popular among many TNCs, such as Amazon, Apple, Google, IBM, Microsoft and Starbucks.

Cyprus has one of the lowest corporate tax rates in Europe, which is 12.5%. There are tax incentives and 0% withholding tax. Ireland also has 12,5% on standard corporation tax rate on

[67] As a result of the tax rulings, Apple paid an effective corporate tax rate around 1% on the profits of its subsidiaries. The profit allocated to the head offices were no subject to tax in any country under specific provisions of the Irish law.
[68] European Commission, *State aid: Ireland gave illegal tax benefits to Apple worth up to €13 billion* (2016) <http://europa.eu> accessed 19 August 2017.
[69] Holtzblatt, Jermakowicz and Epstein (n 32) 35.

trading income, many tax incentives and there is evidence of large scale profit shifting. Luxembourg and the Netherlands offer many tax incentives, 0% withholding taxes and have evidence of large-scale profit shifting. As a comparison, the average corporation tax in the EU was 24,4% in 2016.[70]

A new dimension of tax competition is patent boxes for intangible investment across countries. It is important to mention countries with special tax rates on intangibles such as the Netherlands (5%), Ireland (6.25%) and Belgium (6.8%).[71]

[70] OXFAM, 'TAX BATTELS The dangerous global Race to the Bottom on Corporate Tax' [2016] Oxfam policy paper <www.oxfam.org> accessed 1 August 2017.

[71] Michael Devereux, Katarzyna Habu, Strahil Lepoev and Giorgina Maffini, 'G20 Corporation Tax Ranking' (Policy paper series, Oxford University Centre for Business Taxation 2016) <www.sbs.ox.ac.uk> accessed 1 August 2017.

4. BIG CORPORATIONS AND THEIR TAX AVOIDANCE PRACTICES

Economic globalisation brought independence between individuals and national economies, the interconnection and integration of financial markets and trade and internationalisation of production by multinational corporations. In addition, tax export[72] has been facilitated by moving the tax burden from one country to another where there are more favourable conditions to increase profit by low tax incentives.

In recent times, TNCs have gone far beyond the use of the incentives for avoiding tax. Many TNCs with high turnover either in the US, UK or other EU countries pay little and sometimes even no tax there. The reason is that in their tax strategy includes payments for interest, licenses and royalties in other jurisdictions.[73]

The integration of national markets has expanded tax competition in the EU. Every member state is obliged to ensure equal treatment, not merely for local investors but also for foreign investors, thereby enabling foreign investors to put into the practise tax advantage strategies.

The last few decades have seen the average of corporate income tax rate[74] fall. Some Member States, new members or countries trying to attract investment, have reduced or kept their corporate income tax rates low to encourage foreign investors. The tax rate is not the only reason why TNCs decide to relocate foreign capital. The decision is made by a combination of other factors such as other deductions, reductions, tax credits and exemptions which allow the new tax planning strategy to turn into many benefits.[75] There are many ways that can be used, for example, profit shifting intra EU (mobility of the companies or capital within the boundaries of the EU), removal of profits from the EU or income from external tax planning strategies into the EU.[76]

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[72] *Tax export* is an illegal expression used in the context of economic globalisation. *See* Pirvu (n 38) 15.
[73] Devenish (n 13) 94.
[74] The average of the corporate income tax rate was 22,5% in 2016.
[75] Pirvu (n 38) 5.
[76] Garbarino (n 44) 281.

The essential landmark was the global financial crisis with slow economic growth and unsustainable debt levels. The governments had to find a way to increase revenue and one way was to combat aggressive tax avoidance strategies.

The tax affairs of large companies have been subjected to greater surveillance and public attention from governments, the public, international organisations and the media. Corporate social responsibility is growing as part of public interest and it has become important for companies to be socially responsible by paying taxes as required in the spirit of the law and not only in the letter of law.[77]

TNCs like Google, Apple, Amazon and Starbucks have been criticised for minimising their tax payments and they are the most visible corporations with efforts to minimise tax by shifting the territorial jurisdiction of their revenue.[78]

Apple is headquartered in the US and pays taxes there. Its tax minimisation strategy involves established subsidiaries in Ireland which are not registered as a tax resident of any country. These subsidiaries collect dividends from most of Apple's offshore affiliates. Apple claims in the US, that most of its profits are earned in other jurisdictions and does not regard these profits as taxable. Irish tax law asserts jurisdiction only over companies managed and controlled in Ireland. These arrangements and the gap between US and Irish jurisdictions allows Apple to escape both jurisdictions.

The American corporation Google also relies on profit shifting. Their Dublin offices conduct a great majority of European business including the right to sell advertisements. In respect of that, Google claim that 99% of its sales take place in Ireland. Google uses complex tax manoeuvres through Ireland and the Netherlands as tax centres and low tax jurisdictions to transfer money thought them to Bermuda, the offshore country.

[77] Garbarino (n 44) 286.
[78] John Mikler and Ainsley Elbra, 'Paying a 'Fair Share': Multinational Corporations' Perspectives on Taxation.' (Sheffield Political Economy Research Institute 2017) SPERI Global Political Economy Brief No. 8. <www.sheffield.ac.uk> accessed 1 August 2017.

All the strategies of the TNCs are lawful. As they are not breaking any laws, their strategies cannot be considered as tax evasion. According to the TNCs' statements, reducing tax liability is legal act in co-operation with states offering them opportunities for that.

5. POLICY TO PREVENT TAX AVOIDANCE IN THE EU

5.1. Two directives combatting tax avoidance

The taxation of TNCs and their aggressive tax planning strategies that affect the functioning of the internal market has come under scrutiny by the European Commission and European Parliament in recent years. Two directives were adopted as a result of this fight against tax avoidance.

The first is the 4th Anti-Money Laundering Directive ('4AMLD')[79] that improves transparency to prevent tax avoidance, especially transparency of beneficial ownership. The Directive specifies requirements regarding beneficial ownership of companies and the collection, maintaining and provision of this information. Furthermore, the establishment of national registers of the beneficial ownership facilitates the cooperation and exchange of information between authorities from different Member States.

The second is the Anti-Tax Avoidance Directive which determines rules against tax avoidance practices which have a negative influence for the functioning of the Single Market, such as taxpayers' actions against the purpose of the law, taking advantage of disparities between national tax systems and hybrid mismatches. Moreover, it includes cross-border activities involving third countries to preclude reducing tax liability by taxpayers in the EU.

In this chapter, attention is given firstly to the Anti-Tax Avoidance Directive, although it was adopted later, because of its direct focus on tax avoidance.

5.2. Anti-Tax Avoidance Directive

An appeal for reform in corporate tax as the reaction to globalisation and digitalisation of the economy was performed in the new Anti-Tax Avoidance Directive. The ATAD is directly related

[79] Council Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC, [2015] OJ L141/73.

to the establishment or functioning of the internal market in accordance to Article 115 of the Treaty. The base of the Directive is to provide a minimum level of protection and at the same time it enables national legislations to make provision with a higher level of protection.

The proposal of ATAD was a part of the Anti-Tax Avoidance Package that includes measures against tax avoidance and abusive practices in the internal market. The approval of the Directive did not take a long time and the reason was the necessity to apply BEPS rules among Member States and also provide anti-abuse measures against common forms of aggressive tax planning. The priority of BEBS included in ATAD is to ensure tax payments in the place where profits and value are generated. ATAD should ensure a fairer environment for business with measurements against tax avoidance within the EU. Concurrently, ATAD proves that the base of EU tax law is national tax sovereignty and cross-border tax competition. The minimum level of protection against aggressive tax planning and tax avoidance for national corporate tax systems is contained in ATAD which have to be implemented in 28 separate corporate tax systems.

The council adopted ADAT on 20th June 2016 and the Members States should apply the anti-abuse measures from 1st January 2019. The ATAD has to relate to the establishment or functioning of the internal market under Article 115 of the Treaty on the Functioning of the European Union[80].

ADAT includes the five main issues that are the interest limitation rule, exit taxation, GAAR, Controlled Foreign Companies rules, and rules to tackle hybrid mismatches.

5.2.1. INTEREST LIMITATAION RULE

“Limits on the deduction of cross-border expenses and losses are based on the assumption of tax competition among jurisdictions.”[81] Interest limitation rule, as a rule with an anti-avoidance purpose, provides harmonisation of the deductibility of interest via assigning taxing

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[80] The Treaty on the Functioning of the European Union [2007] OJ C326.

[81] Anna Paula Dorado, ‘The Interest Limitation Rule in the Anti-Tax Avoidance Directive (ADAT) and the Net Taxation Principle’ (2017) 26 EC Tax Review 112.

rights to the Member States and without changing rules on national corporate income tax bases and reinforcing the territoriality principle. The symmetry of the sovereign tax system is ensured by the deduction of costs and it leads to the taxation of income and the limitation of tax avoidance.[82]

The Interest Limitation Rule under Article 4 ATAD mitigates the difference on the tax treatment of debt to generate deductible payments. The limit for the deductibility of borrowing costs is established. It seems that there is no problem with the fundamental freedoms and that it is not a discriminatory rule because there is no discriminatory treatment between domestic and cross-border rules.

Explicitly under Article 4 ATAD, excess borrowing expense is deductible in the tax year up to the limit of borrowing costs, 30% of the taxpayer EBITDA[83] or up to EUR 3,000,000 – whichever is higher, for the entire group. The debt limit includes the whole group and the origin of the debt is not important. Fully deducting exceeding borrowing costs is possible for a standalone entity which is not part of the consolidated group for financial accounting purposes or any kind of subsidiary. Standalone companies which are out of the scope of the interest limitation could alternatively make a risk of tax avoidance.[84] Also excluded of interest are limitation rule loans used to fund long-term public infrastructure and the financial and insurance sectors. Member States can form even higher protection for their corporate tax bases than are established in ATAD as minimum standards of tax-avoidance measures.

The interest limitation rule was established at the national level in developed countries before ATAD, such as Germany and Austria and it has shown positive results in decreasing of deduction for group interest payments[85] but there is a question of whether it will be suitable to combat base erosion at the EU level. The interest limitation rule does not differentiate between industries or market sectors, although a comparison of each sector such as technology or the automobile industry has different leverage ratios and the real finance

[82] ibid 112.
[83] EBITDA includes taxpayer's income subject to corporate tax plus exceeding borrowing costs plus amount of depreciation and amortisation. It excludes tax exempt income. *See* Article 4.2 ATAD.
[84] Dourado (n 81) 118.
[85] Dourado (n 81) 114.

structure needs of taxpayers are remote. The same inequality is applied to both group and non-group companies. The interest limitation based on the fixed base parameters can give rise to double taxation when the interest earned is taxable at creditor level and the interest expense can not be fully deductible at borrower level.[86]

5.2.2. EXIT TAXATION

The exit taxation provision in ATAD is undoubtedly one of the main developments within EU tax law and was created on the base of the case law of ECJ. The exit tax provision consists of a tax on unrealised capital gains with conditional payment facilities and solves the problem on what conditions Member States can impose this tax. In simple terms, ATAD determines rules of when and where is the taxation of unrealised capital gains imposed in the case when a taxpayer relocates its residence, business or assets to another Member State or a third country and how the domestic state does not lose the power to tax certain capital gains on the relocated assets.

Fundamental freedoms protect the rights of the companies and their cross-border relocations. Exit taxes generally restrict fundamental freedoms, especially the freedom of establishment. Companies are restricted by exit tax rules to tax their latent capital gains at the moment of allocation which could never have happened if they did not relocate their business. On the other hand, in accordance to the principle of territoriality there is the right of the Member State to effectively tax capital gains and assets during the period when a company established a business on its territory and thereon fell under its taxing power.[87]

The new provision of ATAD is connected with two important judgements, *National Grid Indus*[88] and *DMC*[89]. In those cases exit taxes were concluded on latent capital gains with the restriction of the freedom of establishment because of the need to preserve the allocation of

[86] Aitor Navarro, Leopoldo Parada and Paloma Schwarz, 'The proposal for an EU Anti-Avoidance Directive: Some Preliminary Thoughts' (2016) 3 EC Tax Review 117.
[87] Steven Peeters, 'Exit Taxation: From an Internal Market Barrier to a Tax Avoidance Prevention Tool' (2017) 26 EC Tax Review 122.
[88] Case C-371/10 *National Grid Indus BV v Inspecteur van de Belastingdienst Rijnmond/kantoor Rotterdam* [2011] ECR I-12273.
[89] Case C-164/12 *DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte* [2014] ECR I-20.

powers of taxation between the Member States in accordance with the principle of financial territoriality linked to temporal component.[90]

National Grid Indus dealt with the taxation of the unrealised capital gains in relation to the assets of that company during the period of the transfer of place of effective management to the UK. National Grid Indus was a limited liability company incorporated under Netherlands law until 15th December 2000 when its place of effective management was transferred to the UK. The company had claimed in pound sterling from the company in the UK since 1996 and after a few years the value of the pound sterling against the Dutch guilder rose, causing a significant profit on latent capital gain on 15th December 2000 by the exchange rate gain.

It was clarified in *National Grid Indus* that a company "simply by reason of the transfer of its place of effective management, ceases to be subject to the tax law of its Member State of origin". From the date of relocation, the Member State of origin looses taxation power in respect of income from that company's activities. However, in accordance with principle of fiscal territoriality linked to a temporal component, the Member State can exercise its power of taxation in relation to the capital gains in its territory during the period of the company's residency. The Member State of origin does not have to abandon its right to tax capital gains which arose under its powers of taxation before the transfer because of the change of the place of effective management of the company to another Member State. The Member State of origin is entitled to charge tax on the capital gains until the moment when the assets are transferred because of the preservation of allocation of powers of taxation between the Member States. Unrealised capital gains are part of economic assets which are taxed in the Member State where they arose when there is an issue that the power of taxation of the Member State of origin does not exist anymore. The tax due on the unrealised capital gains is determined at the time of the transfer of the company's place of effective management to another Member State.

The National Grid Indus case keeps in balance the freedom of establishment with the principle of financial territoriality linked to the temporal component. Freedom of establishment does

[90] Peeters (n 87) 123.

not guarantee tax neutrality of transfers of the place of effective management, however, the immediate recovery of the exit tax debt is restrictive of the fundamental freedoms.

The issue of an infringement of the freedom of establishment was also solved in the case *DMC*. The procedure was about the transfer of assets between a limited partnership and a capital company where a restriction on free movement of capital was considered. The substance of the case was the different treatment between investors who hold an interest in a limited partnership. The interest was converted into shares in a capital company and the investors were no longer liable to pay tax on the income that they made in that Member State. As a consequence of the exchange of interest and the unrealised capital gain on those interests could no longer be taxed by that Member State, the unrealised capital gains on that interest had to be disclosed and the business assets assessed at their value as part of a going concern. The taxation of unrealised assets arises because the Member State can not exercise its power at the moment when the gain is actually realised, as compared with investors with remaining tax liability in the Member State whom the collection of the tax takes place when the gain is actually realised. Because of the different treatment between investors with tax liability in different Member States there was a question about restriction on free movement of capital.

The ECJ clarifies in *DMC* the principle of territoriality and ensuring the balanced allocation of the power of imposing taxes between Member States. The conversion of an interest in a limited partnership into share in a capital company as it was solved in the case, does not mean that

> "the Member State in which those entities are established to relinquish its right to tax a capital gain that was generated in its territory and fell within its tax jurisdiction before the conversion, on the ground that the capital gain has not in fact been realised."[91]

In accordance with the principle of fiscal territoriality, connected with the temporal component, the former Member State has a right to tax the gains at the time the tax payer

[91] *DMC Beteiligungsgesellschaft mbH v Finanzamt Hamburg-Mitte* (n 89).

leaves the country. The former Member State has a right to tax lateral capital gain of its resident company during the period in which the capital gain arose. Inherently, the objective of preserving the balanced allocation of the power to impose taxes between Member States is to give rise to the taxation of the lateral capital gains relating to the assets generated in that territory, before they are actually realised, in case there is no chance for the former Member State to exercise its powers of taxation in the moment of realisation of the assets.

In the case *DMC* the ECJ also considered the proportionality of an exit tax between immediate payment of the exit tax or a payment spread over a period of five years. Because of the choice which was given to the taxpayer, the preservation of the balanced allocation of the power to impose taxes between Member States was reached. The ECJ clarified that the ability to spread payment of the unrealised gain tax over a period of five years is a satisfactory and proportionate measure in respect of the risk of non-recovery which increases with the passing of time.

ATAD adopted measures that companies tax their profits and value where they are generated. It establishes a minimum level of protection for the Member States when to impose unrealised capital gains in the case of relocation of companies to other Member States or to third countries.

Under ATAD Article 5, the Member State is obliged to impose an exit tax on cross-border transfers of assets[92] to another Member State or to third countries. The right to impose the exit tax is limited until the moment when the assets are transferred of tax residence to another Member State or third country. The rules do not apply for assets which remain effectively connected with a permanent establishment and the Member State of the original residence does not lose its taxing power over such assets. Transfer of assets between a group of companies is not included in the exit tax rule.

[92] The transfers of assets are from a head office to a permanent establishment abroad, from a permanent establishment to a head office abroad, from a permanent establishment to a permanent establishment of the same company abroad. *See* Article 5 (1) ATAD.

The taxable amount of the latent capital gain has to be determined at the time of exit, even thought the capital gain has been unrealised yet. The method pinpointed by ATAD of how to calculate the taxable amount, is the difference between the market value[93] of the transferred assets at the time of the exit and the value of the assets for tax purposes. The Member State of destination is obliged to accept the market value established by the Member State of origin. Taxable amount does not include any capital loses that might occur in the future.

Another subject is the tax due to pay. It could be contrary to the fundamental freedoms to pay tax at the moment of relocation without reaching profit. Due to the freedom of establishment, ATAD provides the right of the taxpayer to spread the payment of the exit tax over five years with a special condition that relocation is intra-EU or a third country where there is an agreement of the mutual assistance for the recovery of tax claims ('EEA')[94]. To ensure a Member State does not lose taxes, there are exceptions for some cases[95] when extension of payment facilities become immediately payable. Payment of the exit tax in instalments can include the charge of interest which depends on the domestic legislation or a guarantee if there is a risk of non-recovery.

Different treatment of transfers in the EU and third countries, when the transfers in third countries are recovered immediately, are justified by ensuring effective fiscal supervision which is not possible in third countries without agreement of the mutual assistance for the recovery of tax claims.

ATAD adjusts exit taxation in cases when companies relocate cross-border and ensures that Member States avoid loss of revenue of unrealised capital gains. A Member State of the new company residence can only tax the capital gains after the transfer when the company is in its power of taxation. To avoid double taxation, there is a rule that a Member State, where the

[93] The arm's length principle is used to determine the market value. Market value is the amount for which the asset can be exchanged in a direct transaction. See Recital no. 10 and Article 5 (6) ATAD.
[94] The third countries that are party to the EEA Agreement if they have concluded an agreement with the Member State of the taxpayer or with the Union on the mutual assistance for the recovery of tax claims, equivalent to the mutual assistance provided for in Council Directive 2010/24/EU. *See* Article 5 ATAD.
[95] E.g. when transferred assets are sold or transferred to a third country, tax payer goes bankrupt or is wound up or the obligation to pay was breach. *See* Article 4 ATAD.

unrealised capital gain is transferred, can not include assets which accrued prior to the transfer in its revenue.

5.2.3. GENERAL ANTI-ABUSE RULE ('GAAR')

GAAR was adopted as part of ATAD. Under Article 6, Member States have to enact measures against abusive corporate tax practices in their domestic law. GAAR was already imposed in several Member States, such as Germany, Ireland, Italy and the UK. This is the reason why ATAD does not have uniform GAAR and refers to national laws using their existing provisions or to adapt a concept of abuse in the field of direct taxation.

Inherently, anti-abuse measures were developed by the ECJ. The principle of prohibition of abuse law in corporate taxation in ATAD was the base of the abuse-concept by ECJ with stricter rules for taxpayers. GAAR reflects the artificiality test developed by ECJ in *Cadbury Schweppes*[96]. The first introduction of mandatory GAAR was included in the Parent-Subsidiary Directive in 2015. There, it was required by Member States to enact measures preventing abusive tax practises to prevent misuse and impose greater consistency when applying the Directive.[97]

The wide GAAR was adopted by ATAD to combat any abusive tax practices which are not covered by a specific anti-abuse rule in the scope of corporate tax liability. According to Article 6 ATAD, GAAR applies for a series of arrangements which have been put into place for the main purpose or one of the main purposes of obtaining a tax advantage. This measure is very wide for considering a taxpayer's behaviour as abusive. The main purpose is used for cases when the taxpayer fails and any other purposes of the arrangement are marginal. The measure provides complete harmonisation to both, domestic and the cross-border situations, including third countries where EU law is not applicable. Each Member State can provide stricter national measures when implementing GAAR.

[96] *Carbury Schweppes* (n 45).
[97] Luc De Broe and Dorien Beckers, 'The General Anti-Abuse Rule of the Anti-Tax Avoidance Directive: An Analysis Against the Wider Perspective of the European court of Justice's Case Law on Abuse of EU Law' (2017) 26 EC Tax Review 133.

GAAR can be applied to a situation only when obtaining tax advantage is contrary to the objective of the law. Another condition regards the non-genuine nature of transactions. All relevant facts and circumstances are not introduced for valid commercial reasons which reflect economic reality.[98]

5.2.4. CONTROLLED FOREIGN COMPANY RULES

Controlled Foreign Companies rules as a minimum standard is established under Article 7 and 8 ATAD. The CFC rule obliges the taxpayer to include the non-distributed income of related entities in its tax base.[99]

A controlled foreign company is an entity or permanent establishment with its income which is not subject to taxation in the Member State. There are two more conditions for treatment of CFCs. Firstly, the taxpayer holds more than 50% of a foreign company together with related parties and, secondly foreign taxation is considered unacceptably low which means that corporate tax is less then 50% of the domestic tax burden.[100]

ADAT allows to the Member State to include not-distributed income of CFC in the tax base. This provision is to prevent taxpayers from deferring domestic taxation.[101] There are two sources of non-distributed income. The first source is passive income which includes 1) interest and other income generated from financial assets as mobile sources of income which is very easy to shift to low-tax foreign jurisdictions. However, the CFC rules do not affect interest of income originated abroad; 2) license fees and other income from intellectual property; 3) dividend and capital gains which generally do not need to be considered as a passive income because they can be treated as active income; 4) insurance premium as income of insurance companies and banks which is also arguable because these activities are considered as active income, but on the other hand, it includes also intragroup insurers and banks; 5) intragroup services from invoicing companies for sales and services which completes the whole list. The passive income will not be included in the tax base of the Member State of

[98] ibid 143.
[99] Navarro, Parada and Schwarz (n 86) 125.
[100] Article 7(1) ATAD.
[101] Jens Schönfeld, 'CFC Rules and Anti-Tax Avoidance Directive' (2017) 26 EC Tax Review 145.

residence, if the CFC provides evidence about substantive economic activity (this is not possible to apply to third-country companies). The last provision is based on the case *Cadbury Schweppes*[102] with specification of economic activities as genuine instead of substantive. If there is some difference on the meaning, it will be resolved later on by the interpretation of the ECJ. The second source of non-distributed income of non-genuine arrangements is based on the principle purpose test to prove that they are not artificial arrangements.

The new measures of the CFC rules included in ATAD with elements of protectionism enable national legislation to shift income attributable shareholders from foreign low-tax jurisdictions to the jurisdictions with domestic rate of taxation. The new CFC framework enables each Member State or third countries to participate on the tax competition on a fair basis and favourable tax treatment.[103]

5.2.5. HYBRID MISMATCHES

Hybrid mismatches are caused by a different legal characterisation of financial instruments or entities between Member States where there is no proper reference on another Member State. Each Member State has full autonomy to enact its own tax system and so 28 diverse tax jurisdictions exist. Accordingly, hybrid mismatches arise, such as wholly or partly double deduction or deduction of the income on one side of the other country. Hybrid mismatches arrangements are one of the main practices of multinational entities to reduce their tax bills. They are considered a widespread aggressive tax planning technique which results from a substantial erosion of the taxable bases of Member States.[104]

The last part of ATAD belongs to hybrid mismatches and contains a very general description for actions against them. Specific provision under Article 9 addresses a few symptoms of hybrid mismatches within the internal market, namely situations of a double deduction or a deduction without a corresponding taxation and corporate structures.[105] The scope of the

[102] *Cadbury Schweppes* (n 45).
[103] Schönfeld (n 101) 146.
[104] European Commission, 'Proposal for a Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries' COM (2016) 687 final.
[105] Gijs Fibbe and Ton Stevens, 'Hybrid Mismatches Under the ATAD I and ATAD II' (2017) 26 EC Tax Review 151.

measure extends to hybrid entities and affiliated groups or associated enterprises. The mismatches to minority shareholders are not involved.

In order to avoid a double deduction it was necessary to establish the following measures. In the case of a hybrid entity as non-transparent is the deduction of interest expenses granted in a Member State where such payment has its source. The rule could be applied only for issues of uncoordinated qualification of a payment or company only within the EU. It affects EU investors who are obliged to counteract hybrid mismatches between Members States. On the contrary, investors from third countries are not directly affected and they can continue to enjoy some benefits such as the Check-the-box rules.[106]

Because of the limitation of hybrid mismatches rules within the internal market and the necessity to adjust mismatches measures with the OECD, BEPS report on Action 2[107], the Commission came up with a new proposal for a directive to amend ATAD as regards hybrid mismatches with third countries in a short time. The final version of the proposal was adopted in May 2017 and the new directive[108] to prevent corporate groups from exploiting the disparities among tax jurisdictions to reduce their overall tax liability has to be implemented into national laws by 31st December 2019 (reverse hybrid mismatches has to be implemented by 31 December 2021).

The amended ATAD extends the scope of the measures to third countries – including countries whose jurisdiction does not implement OECD recommendations and adds more rules on hybrid transfers, imported mismatches and dual inclusion income and reverse hybrid mismatches that were lacking in ATAD and introduces rules on permanent establishment mismatches and dual resident structures.

A Hybrid mismatch includes all possible mismatch cases concerning hybrid financial instruments such as payments between head office and/or permanent establishments that

[106] Navarro, Parada and Schwarz (n 86) 129.
[107] The OECD BEPS report on Action 2 sets out recommendations for domestic rules to neutralise the effect of hybrid mismatch arrangements.
[108] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries [2017] OJ L144.

have a link which is not recognised between countries, hybrid entities transactions and each situation with a double deduction outcome. The new scope of measures is aimed at hybrid entities and an affiliated group or associated enterprises where taxpayers are affiliated through 25% voting rights or capital ownership.

The use of mismatches which comes from differences in domestic tax legislations leads to a possible double deduction of payments. The domestic tax legislator is obliged to react against perceived abuse through two solutions based on a primary rule for one state. If there is no reaction from the first state, a defensive rule will be applied by the second state and the last imported mismatch rule will be applied by the other state as a reaction against the abuse of mismatches. The mismatch can be solved if one of the states reacts as proposed.[109]

The new rules oblige Member States to deny the deduction of a payment by a taxpayer or require the taxpayer to include a payment or a profit in its taxable income.[110]

The hybrid mismatches structures are generally oriented to TNCs that use tax planning strategies and operate through their legal or commercial offices not only within the EU but also abroad.

The impact of the new hybrid mismatches rules should have results soon. If the rules are effective and successful and TNCs abandon aggressive tax planning, the impact should be seen on the increased corporate income tax revenue soon after implementation by the Member States.

Whether it is measured in ATAD or the new adopted amendment, both measures deal with symptoms of hybrid mismatches. To tackle the essence of hybrid mismatches, it is necessary to remove the cause of the problem which is disparities between the tax systems of the Member States and the autonomous application of the tax classification methods by Member

[109] Bart Peeters, 'Hybrid mismatches: inspired coordination to mere anti-abuse' (2017) 4 Tax Magazine 187.
[110] European Commission (n 104) 6.

States. Unification of the tax classification methods in the internal market can solve the problem and eliminates the cause of mismatches in the internal market.

ATAD establishes minimum standards of anti-avoidance measures and Member States can also decide to require stricter measures in some issues.

5.3. The Fourth Anti-Money Laundering Directive (4AMLD)

The globalisation of international markets and the increasing mobility of capital has triggered organised crime to be international as well. As a negative consequence of globalisation, international organised crime, particularly money laundering and terrorist financing, has posed a threat to the financial sector and society. Under the given circumstances, it was necessary to develop anti-money laundering measures to support the stability, integrity and reputation of the financial markets. The effectiveness of the Anti-Money Laundering ('AML') measures was based on the cooperation between authorities and financial institutions which was widened for other involved persons over the years. The effectiveness depends on regular revisions and adaptability because of changes in the globalisation of financial markets, technological advances in payment systems and international organised crime being able to adapt.[111]

The fight against money laundering is an essential priority in the European Union to prevent not only the instability of the international financial market but also to ensure the integrity of the internal market and financial system in the EU. The effort in combatting international anti-money laundering involves Member States' governments, banking regulatory agencies and law enforcement agencies.[112]

A fundamental fact of the money laundering evolution is the extension of the list of established offences which becomes broader in relation to the evolving threat over time. The

[111] Indranil Ganguli, Olaf Achtelik, Lambert Köhling and Frederich M. Mauhs, 'The Third AML-Directive: Europe's Response to the Threat od Money Laundering and Terrorist Financing: Part I' (2009) 126 Banking Law Journal 579.
[112] ibid 584.

First Anti-Money Laundering Directive[113] *('1AMLD')* was adopted by the European Council in 1991 on prevention of the use of the financial system for the purpose of money laundering. It applied to credit and financial institutions to restrict drug trafficking and connected crimes.[114]

The Second Anti-Money Laundering Directive[115] *(2AMLD)* amended 1AMLD. The predicate offences were widened from proceeds from drug trafficking to organised and serious crime.[116]

In 2005, The Third Anti-Money Laundering Directive[117] (3AMLD) on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing was adopted with a wholly restructured and new complex set of rules. The extension had the following measures: Firstly, as an essential part and as a consequence of 9/11, money for financing terrorist activities was included as a further enhancement of the combat against international terrorism. Another scope, the customer due diligence (CDD) was adopted as the risk-based approach for low risk and high risk clients. Financial institutions in the EU are required to have the general CDD which includes identification of customers or beneficial owners, gathering information and monitoring obligation.[118] The CDD of high risk clients was considered in circumstances where there is no face to face contact between the institution and the customers, cross-border banking relationships and individuals who are regarded as politically exposed persons.[119] The third measure was the verification of the identity of the customer and beneficial owner to have appropriate information about the ownership and controlled structure of the customer. Anonymous accounts or passbooks has been strictly prohibited.

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[113] Council Directive 91/308/ECC on prevention of the use of the financial system for the purpose of money laundering [1991] OJ L166/77.
[114] Michael Levi, 'Efforts to Combat Money Laundering? The United Kingdom and the European Community' (1992) 18 Commonwealth Law Bulletin 1460.
[115] Council Directive 2001/97/EC amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering [2001] OJ L344/76.
[116] Louise Delahunty, 'Money Laundering Law in England and Wales and Switzerland and the Second EU Directive' (2002) 30 International Business Lawyer 157.
[117] Council Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing [2005] OJ L309/15.
[118] Ganguli, Achtelik, Köhling and Mauhs (n 113) 587.
[119] Colin Tyre, 'Anti-Money Laundering Legislation: Implementation of the FATF Forty Recommendations in the European Union' (2010) 69 Journal of the Professional Lawyer 71.

5.3.1. THE CURRENT AML MEASURES AND TAX AVOIDANCE

The intension of the EU is to take inevitable steps to stop the evolution and expansion the anti-money laundering and terrorist financing legal framework. Therefore, the 4AMLD has been adopted to update and improve measurements to strengthen the European Union's defence system against money laundering and terrorist financing and ensure confidence in the financial system as a whole with integrity and stability of credit and financial institutions. The 4AMLD was adopted on 20th May 2015. It came into effect on 26th June 2017 with expanding AML legal framework.

The fight against tax avoidance is part of the anti-money laundering measures in the EU. 4AMLD stresses transparency about who really owns a company and trusts and on the extinction of predicate offences with tax offences relating to direct and indirect taxes. The problem is that there is no harmonisation of the definition of tax crimes at the EU level. Each member state has to define tax offenses which should be included in the list of predicate offences to money laundering at national law.

In the 4AMLD, emphasis is increased on determining the beneficial ownership information. The obliged entities have to maintain basic information about the customer as well as accurate information on beneficial ownership which means the natural person who controls or holds the customer or on whose behalf a transaction or activity is being conducted.[120] The obliged entities have to determine the purpose and nature of the business relationship including ongoing monitoring of the relationship and updating all the information to ensure that the transaction is conducted in consistency with the obliged rules. To reduce or prevent the identified risks, the obliged entities have to request at least the purpose of an account or relationship, level of assets to be deposited by a customer or the size of the transaction undertaken and the regularity or duration of the business relationship.[121]

[120] Valsamis Mitsilegas and Niovi Vavouvla, 'The Evolving EU Anti-Money Laundering Regime: Challenges for Fundamental Rights and the Rule of Law' (2016) 23 Maastricht Journal of European and Comparative Law 279.
[121] Glenn Meyer, 'The fourth anti-money laundering and terrorist financing directive – Key aspects and changes' (Luxembourg newsflash 2015) <www.arendt.com> accessed 1 August 2017.

Transparency has been increased through the creation of beneficial owners' national central registers. It should enable greater transparency in financial transactions.[122] National registers of beneficial owners of companies and some trusts have to be put in place by each Member State.[123] Because of the protection of fundamental rights of the beneficial ownership information, the 4AML demands data protection safeguards by Member States. The member states have to guarantee current ownership information in a central register with ensured unrestricted access, but full public access is not expected. According to Article 30(1) of 4AMLD the central register should be accessible to competent authorities and financial intelligence units without any restrictions. Because of the direct interconnection of the registers to facilitate co-operation between Member States, it should be easier to identify businesses in illicit activities for regulators and prosecutors.[124] This rule extends to the existing disclosure obligation relating to beneficial ownership. These measurements promise to create the new disclosure obligations among the highest levels of transparency in the world.[125]

Generally, the data protection rules are set down in the 4AMLD, however, there is leeway to the member states to regulate their data protection. Nevertheless, there are also important personal and financial data which are contained in suspicious reports issued by obliged entities. All the suspicious reports have to be reported to independent financial intelligence units which have been established at national levels to be suitable to each legal and financial system in accordance with Recital 37 of the 4AMLD. The new FIU's powers and cooperation helps to match anonymous data and clarify circumstances to achieve clarity and the effectiveness of the combat against money laundering and financing terrorism.[126]

A new instrument is imposing sanctions for non-compliance with the money laundering preventive duties upon the private sector. There are suggested sanctions with a list of minimum penalties which have to be applied in certain cases of serious, repetitive, systematic

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[122] Barry Vitou, Michael Ruck and Elena Elia, 'Anti-money laundering: Can money laundering really be prevented?' (2016) 5 Compliance and Risk Journal 4.
[123] EU Focus, 'Commission strengthens transparency rules to tackle terrorism financing, tax avoidance and money laundering' (2016) <www.europa.eu> accessed 1 August 2017.
[124] Vitou, Ruck and Elia (n 124) 4.
[125] Gibson Dunn, 'Have sympathy for the devils' (2016) 34 International Financial Law Review 42.
[126] Mitsilegas and Vavoula (n 122) 283.

breaches such as customer due diligence, suspicious transaction reporting, record-keeping or internal controls.

Prevention was also strengthened by focussing on risk assessment and the risk based approach. There are the European, national and private levels of the risk-based approach.[127] The risk assessment on each level is necessary to be documented, kept up-to date and made available to the relevant competent authorities.

Furthermore, the enhancement of CDD is required before work is carried out for a client. The 4AMLD has included the CDD for all types of politically exposed persons ('PEPs') because they are considered as high-risk individuals and it is prevention of the domestic and international level of lobbying for prominent status by money launderers.[128] There is an extension of scope to the whole gambling sector that the whole gambling services has been involved in the system and customer due diligence has to be applied as well. Virtual currencies are brought within the AML system and includes CDD waiver for certain e-money products.

5.4. Critical review

The sudden changes in the global and digital economic environment including the global financial crisis forced the EU to reform corporate tax policy. The EU corporate tax policy was mainly to reduce the gaps between the taxation of cross-border and internal transactions and eliminate double taxation within the internal market.

Nowadays the EU corporate tax policy balances between supranational and domestic interests. Corporate income tax in the EU is a conflict between two interests established in the Treaty. On one side is the establishment and the functioning of the Single Market, the fundamental freedoms and their fair competition, on the other side is the protection of domestic tax systems and their revenues.[129]

[127] ibid 276.
[128] Mitsilegas and Vavoula (n 122) 279.
[129] Bizioli (n 37) 168.

Until now there was not a lot of progress to unify corporate income tax rates. That remains in national tax sovereignty. The EU does not have a direct role in setting tax rates, it depends on national tax systems and inherently creates tax competition on internal markets which is considered harmful and is used for aggressive tax planning strategies. The new reforms have established new rules in the directives to tackle practices used by corporate taxpayers to get tax advantages from distinctions between different domestic tax systems in the Member States.

The Anti-Tax Avoidance Directive provides transposition of the BEPS measures within the EU addresses five main rules to harmonise corporate tax in the EU. The new legally binding rules should combat aggressive tax planning used by TNCs.

Interest limitation rules limit the amount of interest that a can company deduct which should increase the amount of tax it pays. The tax avoidance rule contains fixed parameters such as 30% EBITDA or EUR 3,000,000 for both, individual or group companies included all business sectors. The fixed parameters provide disproportions of the rule. Furthermore, it does not prevent borrowers to provide loans in low tax jurisdictions but only limits the amount. The rule does not solve the problem when the interest earned is taxable creditor level, the rule may cause double taxation.

The exit tax rule ensures Member States the right to impose exit tax on the value of the unrealised gains before it was transferred cross-border from the Member State. The normal practise in some industries by companies based in the EU is to develop a new product and move it to the low tax country before it gets finalised. Exit taxation rule treats different transfers intra EU/EEA and to third States. The payment of transfers intra EU/EEA can be deferred by paying the instalments over five years. On the contrary, the payment of the transfers to third countries on unrealised gains has to be recovered immediately. The discrimination of third countries is because of the need to ensure effective fiscal supervision which is higher risk in third states. Exit taxation was justified in judgements, for example *National Grid Indus* and *DMC*. ATAD established the exit tax rules on the base of these cases with more clarified measures for transfers intra EU/EEA and to third countries.

A General Anti-Abuse Rule gives Member States the power to tackle artificial arrangements instead of applying other specific rules. The calculation of corporate tax liability has to reflect economic reality. The TNCs have to use arrangements with valid commercial reason as a main or one of the main purposes to be able to grant GAAR and obtain a tax advantage. This obligation should fight abusive tax practices and hinder finding ways of circumventing rules and finding loopholes in tax laws. There are many cases of artificial agreements which benefit taxpayers. GAAR allows Member States to refuse those arrangements.

Controlled Foreign Companies Rule still enables companies to shift their profits but it has to be taxable in the EU. The taxpayer is obliged to include the non-distributed income of related entities in its tax base. This rule facilitates Member States to prevent erosion of the domestic tax base. Resident companies are discouraged to shift income to third countries. This rule will affect entities without effective business activity with passive income.

The final measure, Hybrid mismatches are considered as a consequence of a different legal characterisation of payments or entities by two legal systems. Accordingly, the cause of mismatches lies in disparities between national tax systems. Hybrid mismatches rules, including the new amendment with the extended scope to third countries and implementing the defensive rule do not close many of the existing loopholes where hybrid mismatches are used. The reason is that ATAD is not addressing the cause of hybrid mismatches but only a few of the symptoms of hybrid mismatches, especially situations of a double deduction or a deduction without corresponding structures. The right solution to eliminate hybrid mismatches in the internal market should be in uniform classification tax systems between Member States by mutually recognising the tax classification in the third country.[130] The specified rule of ATAD cannot solve the whole problem of mismatches created by tax avoidance.

ATAD aims to close the loopholes and discrepancies of cross-border situations created by the interaction between different tax jurisdictions. Adopted rules affect the main matters created by tax avoidance practices. Without substantial reform in national tax systems and unification

[130] Fibbe and Stevens (n 105) 166.

of corporate tax and tax rates, there is no certainty of positive results in revenue on national levels.

The 4AMLD does not contain measures which are precisely against avoidance practices. New measures could significantly help to combat tax avoidance. The obliged entities, for instance, credit institutions, banks and other financial institutions, professionals such as lawyers, accountants and financial advisers have to maintain basic information about the customer as well as accurate information on beneficial ownership. Ultimately, each company has to cooperate with the obliged entities that have to be provided with genuine information. Furthermore, transparency has been increased through the creation of beneficial owners' national central registers. These measures enable greater transparency in the financial sector and facilitate to clarify structures of TNCs which are necessary for the tax authorities to impose the correct tax. The 4AMLD contributes through its measures to avert tax avoidance because of effective transparency of information which is substantial for tax authorities to impose real tax of the TNCs.

The implementation of directives will complicate the way TNCs reduce tax liability but corporate tax avoidance is caused by tax competition between states.[131] The solution lies with the EU to provide tax reforms that affect tax avoidance or aggressive tax planning used by TNCs and Members States must implement them. The power to regulate direct taxation remains largely with the Member States, however, there is an effort by the EU to harmonise standards ensuring the smooth operation of the internal market.[132]

The latest evolution of the EU approach in the field of corporate income taxation has been done to diminish existing distortion in assuring that taxes should be paid where the economic activity takes places and in eliminating profit shifting. Inherently, the Directives will contribute to prevent further tax avoidance by corporations, however, they are just the beginning of the long way of how to reach a fair share of taxation from the TNCs.

[131] Mikler and Elbra (n 78) 7 - 8.
[132] De Broe and Beckers (n 97) 136.

The problem on the whole Commission's ambitious agenda is that all measures solve consequences of tax competition between Member States but do not solve the cause, being, 28 different corporate taxes with different tax bases and rates in the EU.

Until it is decided to tackle substantial corporate tax reform on a legal basis of the Treaty and system of direct taxation is integrated and which will correspond to the fundamental freedoms and fair competition and the establishment or functioning of the internal market, the tax competition in the EU will continue to allow tax avoidance by TNCs. The many efforts to harmonise corporate taxation will reduce impacts made by TNCs in the scope of tax avoidance.

Insofar as the directive shows big progress in combatting tax avoidance it does not end tax avoidance practices in the EU.

6. CONCLUSION

Tax avoidance is a profitable practice of reducing the tax burden of TNCs. The EU Member States have become part of their strategies because of the existing tax competition and because of ensuring fundamental freedoms and achievement of tax neutrality between cross-border transactions.

The recent reforms which were implemented in the new directives, ATAD and 4AMLD were analysed in the main part of the thesis. The study establishes that ATAD provides essential changes to combat tax avoidance, for example, the interest limitation rule, exit taxation, GAAR etc. The 4AML is rather essential in the anti-money laundering field, but measures are included which are essential for prevention of tax avoidance.

In conclusion, ATAD and 4AMLD are good steps forward. It was essential to develop new measures to combat tax avoidance practices not only because of significant revenue losses but also for society which is negatively affected by a heavier tax burden in the end. Both directives signify changes in corporate taxation and approach the fair share of tax. On the other hand, if there is no reform in the fundamentals of the international corporate tax system to approach paying fair share of tax, in other words, the unification of corporate taxes and tax rates at least at European level, tax avoidance will continue to some extent.

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7.2. Abbreviations

AML	the Anti-Money Laundering
ATAD	Anti-Tax Avoidance Directive
ATAP	Anti-Tax Avoidance Package
CDD	the customer due diligence
CFC	Controlled Foreign Company
Commission	the European Commission of the European Union
ECJ	the European Court of Justice
EEA	a third country where there is an agreement of the mutual assistance for the recovery of tax claims
GAAR	general anti-abuse rule
TNCs	Transnational Corporations
Treaty	Treaty of the Functioning of the European Union
4AMLD	4th Anti-Money Laundering Directive

7.3. Table of Cases

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7.4. Table of Legislation

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